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THE CORPORATE DIRECTOR: QUESTIONS AND ANSWERS

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with the collaboration of

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THE CORPORATE DIRECTOR'S Q & A
by André Laurin
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INTRODUCTION

Individuals who think about becoming directors of a legal person or those who already are wonder or should be wondering about several issues. We attempted to provide practical and concrete answers within the applicable legal framework. However, this bulletin is not intended to be nor is it a law treatise or a legal opinion. Readers seeking a legal opinion should consult their legal advisors.

Each question is preceded by a number. Where an answer to a question refers to another question, the number of this other question is indicated at the bottom of the page. Other bulletins dealing with corporate governance have also been published and are available on Lavery's website (Lavery→ Publications → André Laurin).

1. Is a director required to be a shareholder or member of the legal person?

Subject to the following, the **answer** to this question is **no**.

However, the governing statute, articles of incorporation, internal or administrative by-law or unanimous shareholder agreement may stipulate specific eligibility conditions.

For instance, as a non-exhaustive list of examples,

- the incorporating statute or the by-law of a not-for-profit organization (NFPO), professional corporation or some other legal persons may stipulate requirements as to membership, residence, citizenship, etc.;

- the articles of incorporation of a corporation or a unanimous shareholder agreement may confer on a shareholder the authority to appoint one or several directors or provide that a director must also be a shareholder.

2. Who is eligible to become a director?

The eligibility conditions are mainly found either in the *Civil Code of Québec*[1] for legal persons governed by it or in the incorporating statute of the legal person, as completed in both cases by the internal or administrative by-law duly adopted by the legal person or a unanimous shareholder agreement.

Under all relevant statutes, a **director** must be a **natural person**. A legal person cannot be a member of the board of directors of another legal person.

[1] *Civil Code of Québec*, L.R.Q., c. C-1991

Article 327 of the *Civil Code of Québec*[2] stipulates that "Minors, persons of full age under tutorship or curatorship, bankrupts and persons prohibited by the court from holding such office" are disqualified for office as directors. Exclusions which are similar in whole or in part are to be found in most incorporating statutes of legal persons.

Most incorporating statutes do **not** require directors to be **shareholders** or, in the case of a NFPO, a **member** of the legal person.

Moreover, **some incorporating statutes** prescribe eligibility conditions, such as **citizenship** or **residence**.

Some statutes other than the incorporating statutes or some regulations or decisions of regulatory authorities establish **prohibitions** from acting as a director generally or, in other circumstances, from acting as a director of specific legal persons.

In another publication entitled "May a director be removed by the board of directors during his term of office?" [3] we discussed **some additional eligibility conditions which may be prescribed by the internal or administrative by-law**. Some legal person may, for example, wish to impose as an eligibility condition the absence of criminal record to avoid having to file an application with the court under article 329 of the *Civil Code of Québec*[4] to obtain the removal of a director who has been found guilty of an offence pursuant to the *Criminal Code*.

Failure to meet the conditions of eligibility and **the loss of eligibility** should, in our opinion, result in most cases and for most purposes, in the automatic **disqualification** of a natural person as a director.

Any person who is invited to become a director of a legal person and the legal person itself must therefore **verify** that the applicable eligibility conditions are met.

3. What precautions should a proposed director take prior to accepting to act as a corporate director?

A person who is invited or wishes to become a director should clearly make some **prior verifications**, **including**:

- His interest for the organization and its objectives;
- the requirements of the position as to time and efforts and his availability in that respect;
- the actual possibility to make a significant contribution, therefore resulting in added value for the legal person;
- the quality of incumbent directors, who will be his colleagues if he accepts to act as a director;

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2 *Civil Code of Québec*, L.R.Q., c. C-1991

3 Lavery website → Publications → André Laurin → "The Corporate Director's Q & A" - "20. May a director be removed by the board during his term of office?"

4 *Civil Code of Québec*, L.R.Q., c. C-1991

- the receptivity of management respecting sound governance and the help provided by management to directors to enable them to discharge their duties and play their full role;
- the quality of the existing corporate governance;
- the financial health of the legal person;
- the existence of actual or threatened significant proceedings against the legal person;
- the compliance by the organization with laws and contracts;
- the existence of adequate directors' and officers' liability insurance coverage;
- the availability of an indemnification undertaking by the legal person in favour of the director;
- the existence of recent director resignations and the reason thereof;
- the proportionality of compensation relative to the liability risks (mainly in the case of reporting issuers).

Preliminary discussions with the chief executive officer, the chairman of the board and some current and former directors may be helpful in obtaining adequate confirmations in respect of many of these items. However, these discussions **should be completed by reviewing documents** such as the financial statements, court records, minutes...).

A person who is an officer, director or employee of a corporation must also ensure that the new **office** as director is **acceptable** to the first corporation. The new office may in fact contravene a policy of the corporation, the contract between the individual and the corporation or the interest of the corporation.

The **risks to reputation related to accepting to act as director with some legal persons are** not to be neglected either. We have recently seen that the reputation of high quality persons who had accepted on a *pro bono* basis to act as directors of not-for-profit organizations suffered as a result. The media, politicians and even auditors general sometimes draw quick, ill-founded conclusions as to the proper discharge of their duties by directors.

4. What are the duties of a member of a board of directors?

Incorporating statutes, particularly the *Canada Business Corporations Act*[5] and the *Business Corporations Act*[6] (Quebec), as well as the *Civil Code of Québec*[7] all stipulate **two general duties** which directors are subject to, that is, the duty of **care** and the duty of **loyalty**. The *Canada Business Corporations Act* stipulates these duties as follows:

> ***"122**. (1) **[Duty of care of directors and officers]** Every director and officer of a corporation in exercising their powers and discharging their duties shall*
> *(a) act honestly and in good faith with a view to the best interests of the corporation; and*
> *(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances."*

5 Canada Business Corporations Act, R.S.C. 1985, c. C-44
6 *Business Corporations Act*, C.Q.L.R., c. S-31.1 art. 119
7 *Civil Code of Québec*, L.R.Q., c. C-1991, articles 321 and following

In addition to these general duties, a director is **also** subject to many **statutory obligations or presumptions of liability or guilt** under various statutes, particularly for unpaid salaries and remittance of deductions at source and GST/QST. It is important for directors to be aware of **all the** statutory **obligations** and presumptions and know how to recognize them, ensure that the legal person takes appropriate measures in this respect and that the board supervises such measures.

5. What does the duty of care involve?

The duty of care means that a director has to attend the meetings of the board and its committees which he is a member of, prepare for such meetings, inquire about the legal person, its activities and its market, supervise the management of the legal person and provide a positive and active contribution to the best of his knowledge and competence. This contribution also includes the **communication of information** he collects **which may help the legal person**.

Directors must be **well informed, proactive and have the courage to act**. The **courage to act** means that he must not hesitate to express his actual thoughts and propose what appears to him to have to be done in the best interest of the corporation, even if this may displease management or colleagues or affect his own personal ambitions and interests.

The Supreme Court of Canada interpreted the duty of diligence as follows in the *Peoples* Case[8]:

> *"[67] Directors and officers will not be held to be in breach of the duty of care under s. 122(1)(b) of the CBCA if they act prudently and on a reasonably informed basis. The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known. In determining whether directors have acted in a manner that breached the duty of care, it is worth repeating that perfection is not demanded. Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making, but they are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made."*
>
> (emplasis added)

Both the **process** leading to the decision and the **decision** itself must comply with the **criteria of care and reasonability** in the circumstances. The courts compare the process which was followed with the practices of other legal persons in the same area of activity but take into account particular circumstances. The process implies that the director must adequately **inform himself** and, in some instances, obtain opinions from **independent experts**.

When the board delegates part of its duties to a committee or to management, it must ensure that such delegation is made to **competent persons** who, according to the reasonable judgment of the board, will themselves act with care and loyalty.

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[8] Peoples Department Stores Inc. (Trustee of) v. Wise, 2004 SCC 68

In the context of a legal recourse, various circumstances and **elements** may be taken into consideration by the courts **in determining whether reasonable care was exercised** by the legal person and its directors in the circumstances. Let us mention some elements which have been considered by the courts according to the circumstances:

- the nature and **seriousness** of the harm;
- the **investigation** and detection systems implemented, and more generally, the risks management system (assessment and treatment);
- the **quality of the verifications** made on a regular and on a one-time basis;
- the **culture** of the enterprise;
- the **policies** adopted by the enterprise in the relevant area and the follow-up on these policies.
- the **training** and assistance provided to employees respecting the **prevention** of the type of risk which materialized;
- the **foreseeability** of the loss, problem or event;
- the prior **knowledge** of the problem or **indications** of a potential problem;
- the **time** it took **to react** and the measures taken to rectify the problem once it is known;
- the record or **history** of the enterprise in that respect;
- the **degree of tolerance** to risk or past breaches;
- the **availability of measures** to prevent harm or reduce the impact thereof;
- the **competence** of the responsible persons.

6. What does the duty of loyalty involve?

The duty of loyalty **is comprised of three elements**: **act honestly and in good faith, with integrity and** a view to the **best interests** of the legal person which he is a director of.

Good faith is mainly a **standard of conduct**. It supposes a positive attitude and step. In the *Civil Code of Québec*, it is **mainly defined by the expression of some parameters in the context of the exercise of rights**:

> "Art. 7. No right may be exercised with the intent of injuring another or in an excessive and unreasonable manner which is contrary to the requirements of good faith." [9]
>
> (emphasis added)

[9] *Civil Code of Québec*, L.R.Q., c. C-1991

Honesty or integrity is a **moral value**. It is also synonymous with probity. It **involves** not to alter the facts or reality in relationships or communications with third parties and to **avoid misleading**. This value is therefore close to the standard of good faith, which we just discussed.

Let us now review the **third component** of the duty of loyalty. The search for the best interest of the legal person must obviously be conducted in compliance with the **legal and contractual obligations** of the legal person. The Supreme Court of Canada, in the case of BCE,[10] provided us with some parameters which should or could incorporate the pursuit of the best interest of the legal person:

- this interest of the legal person must be interpreted as that of a legal person acting **"as a good corporate citizen"**;

- this interest, or more precisely the obligations of directors in this respect **"is not confined to short-term profit or share value"** and **" Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation."**;

- in so doing, it may be **appropriate – without being mandatory** – for the directors in all cases to **take into account the effect of the decisions on the stakeholders** (i.e., employees, clients, suppliers, community, government,...);

- however, in such a case, **if the interest of interested parties** or stakeholders **cannot be reconciled with that of the legal person**, the interest of the legal person must prevail.

Accordingly, complying with the duty of loyalty implies that directors must act honestly and in good faith, comply with the **law and contracts** which the corporation is a party to, **avoid abusing rights** and promote as much as possible **fair treatment of stakeholders**.

This third element of the **duty of loyalty** includes:

- the obligation of **confidentiality**, which must be complied with even with respect to the person who had the director elected or appointed;

- the obligation to **disclose** the interests other than those of the legal person which a director may have;

- the obligation to **abstain from voting** in case of a conflict of interests;

- the obligation to **maintain solidarity** before third parties (except in some situations before shareholders or members) in respect of the decisions which have been made;

- the obligation **to abstain from using the property and information** of the legal person for personal purposes or for the purposes of persons other than the legal person.

[10] BCE Inc. v. 1976 Debentureholders, 2008 SCC 69

Section 120 of the *Canada Business Corporations Act*[11] describes in the following manner the **conflicts of interests** of directors:

> ***"120**. ... a material contract or material transaction, whether made or proposed, with the corporation, if the director or officer*
>
> *a) is a party to the contract or transaction;*
>
> *b) is a director or an officer, or an individual acting in a similar capacity, of a party to the contract or transaction; or*
>
> *c) has a material interest in a party to the contract or transaction."*

The *Business Corporations Act* (Quebec) [12] uses a somewhat different wording at sections 122 and 123:

> *122. ...For the purposes of this subdivision, "interest" means any financial stake in a contract or transaction that may reasonably be considered likely to influence decision-making. Furthermore, a proposed contract or a proposed transaction, including related negotiations, is considered a contract or transaction.*
>
> *123. ...any contract or transaction to which the corporation and any of the following are a party:*
>
> *1° an associate of the director or officer;*
>
> *2°a group of which the director or officer is a director or officer;*
>
> *3°a group in which the director or officer or an associate of the director or officer has an interest."*

These cases of conflicts identified by the above statutes are **not exhaustive**. Potential conflictual interests **are not only of a financial nature**.

The **obligation** to comply with this part of the duty of loyalty **is not modified** by the fact that the legal person is a **wholly-owned subsidiary of a parent corporation** or that it is a **Crown corporation**, the whole partly subject to the stipulations of the incorporating statute or a unanimous shareholder agreement.

We recommend that directors indicate in writing to the board their external offices and relations in an **annual statement** and ensure that they promptly update such statement in case of a change of facts or circumstances. The statement should be complete and, in case of doubt, directors should choose disclosure.

We discussed some specific conflicts in a **separate bulletin** entitled "*The Nominee director and conflicting loyalties*". Readers can access it on the Lavery website[13].

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[11] Canada Business Corporations Act, R.S.C. 1985, c. C-44

[12] Business Corporations Act, C.Q.L.R., c. S-31.1

[13] Lavery wbsite → Publications → André Laurin → "The Nominee director and conflicting loyalties"

7. Are a director's duties limited to their "fiduciary" aspect?

The answer is **no**.

In common law, the general duties of directors, namely, the duties of care and loyalty, are often referred to as "fiduciary duties". **The concept of "fiducie" (trust) in the context of Quebec civil law is different** and cannot be correctly used to refer to these duties. However, the *Civil Code of Quebec* has incorporated the components of the common law fiduciary duties at articles 321 and following.[14]

The **"fiduciary" approach** is essential and assumes, as we have seen, some components, most of which borrow characteristics which takes the form of supervision and respect of **a certain mode of operation**.

At least in Quebec law, but most probably also in common law, these "fiduciary duties" assume, as noted by professors Allaire and Firsirotu[15], playing an active role in **creating value** for the legal person. In other words, **directors must assist the corporation in fulfilling its mission and reaching its objectives** by contributing their competence and knowledge.

It is easy to concentrate on supervision and deal with objective and verifiable subjects. However, and without denying in any way the importance of the supervisory duty, directors **must not lose sight of what is important** for the legal person and devote to the creation of value the required time, efforts and energy.

8. Are the duties of SME or NFPO directors different from those of the directors of a large corporation

The general duties of directors are **the same**, irrespective of the type of legal person. Although the general duties (i.e., care and loyalty) are the same for all directors, various **characteristics**, including the nature of the legal person and its activities, its purpose and objectives, its incorporating statute and the other laws and regulations which govern it, as well as its human and financial resources **will have an effect on the way in which directors should discharge their duties**.

For instance, the **purpose or the raison d'être of a not-for-profit corporation**, such as private not-for-profit organizations, professional corporations and most of the Crown and parapublic corporations do not allow in most cases these corporations to conduct as diversified activities as for-profit corporations can. Most, if not all the time, the purpose, the raison d'être or the mission of the NFPO is expressly defined in its incorporating statute or letters patent. For instance, the fundamental mission of a professional corporation is the protection of the public in the context of the exercise of the profession it governs. Any other activity can only be subordinate to or incidental to such mission. We are of the view that **such an incidental activity may not hinder the pursuit of the main mission** or dilute the effects thereof.

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[14] *Civil Code of Québec*, L.R.Q., c. C-1991

[15] Gouvernance créatrice de valeurs, Allaire et Firsirotu, 2003, 2005. (see the IGOPP website)

Directors of such a NFPO therefore **must ensure that the mission of the NFPO is fulfilled** by protecting its pursuit and **taking appropriate measures to avoid distractions** or diversification of activities which are not consistent with the mission of purposes of the NFOP. We have dealt with NFPO in another bulletin.[16]

In our bulletin entitled *"The External Directors of a SME"* [17], which is available on Lavery's website, we discussed various formal and informal contextual measures which may or should be implemented to adapt to the reality of SMEs. Most of these measures are **as relevant in the case of a NFPO**. It is clear that the number of shareholders and its material and human resources, which are more limited than those of large reporting issuers or Crown corporations, have an impact on the means available to its directors. In such a context, the **governance practices must be simpler and often informal**.

As to the **obligations and responsibilities originating from the law**, some of them are **common** to all legal persons (example: unpaid salaries, GST, QST, deductions at source, etc.), while **others are specific** to the type of legal person or the nature of its activities (for example, reporting issuers).

9. Do directors, taken individually, have rights and authority separate from those of the board of directors?

Subject to the powers that may have been conferred upon him by the board, a director has **no separate rights or authority** other than to ask questions, provide his opinions and suggestions to the board and exercise his right to vote as a member of the board. **A director is not the board**.

The board ensures the management of the legal person. **However**, the board may give a **specific mandate** to a director or **delegate** to him the exercise of a power of the board.

10. May a director give a power of attorney?

The office of director is entrusted on someone **on a personal basis** and **no power of attorney is valid except pursuant to explicit exceptions set out in incorporating statutes**.

Incorporating statutes which stipulate exceptions are very **rare**. The *Act respecting the Barreau du Québec*[18], which governs this professional corporation, stipulates such an exception at section 10(4°) by providing for the **possibility of appointing substitutes** to regular directors. No incorporating statute governing business corporations having their head office in Quebec contains a provisions allowing for such substitution.

However, in the absence of such an exception, nothing would prevent the board of directors to allow, upon the suggestion of the absent director or the initiative of the board, the

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16 Lavery website → Publications → André Laurin → "Directors of Quebec non-profit organizations (NPOs)"

17 Lavery website →Publications → André Laurin → *"The External Directors of a SME"*

18 An Act respecting the Barreau du Québec, C.Q.L.R. c B-1

presence of a person (a "**guest**") at a meeting of the board and even grant him the right to address the board. However, the board would not be allowed to grant to such person the right to vote and it should take come **precautions** before allowing the guest to attend the meeting, such as the signature of a confidentiality undertaking.

Moreover, the guest should be aware of the fact that in certain circumstances, (i.e., if he is considered to be a "*de facto*" director), **he may have to assume the same risks** of being found liable or guilty as the properly appointed or elected directors.

11. Does a director have any legal duty to the person who had him elected or appointed to the board of directors?

In the performance of his duties, a director must act **in the best interests of the legal person, which have priority over those of the person who had him elected or appointed to the board**. In Quebec law, directors have the status of **mandataries** of the legal person.

A director may also wear other hats. He may be the employee or supplier of a shareholder or another person who had him appointed or elected to the board of directors of the legal person. **As an employee or supplier**, he also assumes duties of care and loyalty similar to those of a director, but in those cases these duties are discharged in favour of the employer or the client.

However, **when he acts as a director, his loyalty must be only to the legal person of which he is a director**. This duty particularly includes the obligation to keep confidential the information which he accesses in his capacity as a director, even with respect to the person who had him elected or appointed to the board, unless an explicit authorization of the board, an explicit provision of the by-laws, unanimous shareholder agreement or other valid agreement to which the legal person is a party relieves him of such confidentiality obligation. Rules applicable to insider transactions, where applicable, must also be complied with.

12. Are the duties and potential liability of an observer, a member of an advisory or consultative committee the same as those of a director?

Neither an observer nor a member of an advisory or consultative committee assumes **the same liability as a director**, except in the cases described in the following paragraphs.

A member of an advisory or consultative committee may be subject to the **duties and obligations of a supplier of services**. In such capacity, he may be held liable if he does not adequately discharge his duties, at least, to the corporation who retained his services.

However, there are **some exceptions** to the general answer in the first paragraph. Persons who act as directors in the case of a mass resignation and removal of all the directors, when they are not replaced, are deemed to be directors under several statutes. These exceptions also have their own exceptions. For example, paragraph 109(4) of the *Canada Business Corporations Act*[19] reads as follows:

[19] Canada Business Corporations Act, R.S.C. 1985, c. C-44

> *"(4) If all of the directors have resigned or have been removed without replacement, a person who manages or supervises the management of the business and affairs of the corporation is deemed to be a director for the purposes of this Act."*

(N.B.: exceptions similar to those of this paragraph 4 are also found in the provisions referred to in the following paragraph.)

Both the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*[20] contain provisions similar to that of the *Canada Business Corporations Act*.

Moreover, **case law broadened these specific presumptions**. Mtre Paul Martel summarized that case law trend as follows:

> [TRANSLATION]
>
> *"As the name implies, a* de facto *director will be deemed to be a director if in fact he usurps this office by taking actions normally reserved to directors: for instance, participating to the meetings of the board of directors, signing resolutions of the board, making or participating in management or divesture decisions, giving instructions on behalf of the corporation, presenting himself/herself to third parties as a director, etc".*[21]
>
> (emphasis added)

Observers and members of a consultative or advisory committee should therefore be prudent and limit their role and interventions. In so doing, they should **avoid** playing **any decision-making role whatsoever** respecting the management of the legal person.

13. Are shareholders exercising certain powers usually reserved to the board of directors bound by the "fiduciary duties" of directors?

Where pursuant to a unanimous shareholder agreement, shareholders exercise **powers which are usually reserved to the board**, they may be considered as ***de facto* directors** in the precise context of doing so. In such cases, the liability of the shareholders could be the same as that of directors. However, if a decision must be submitted to the shareholders for approval under the incorporating statute of the legal person, the shareholders thus called upon to approve this decision are not, on that basis, bound to a duty of loyalty to the legal person and therefore, in compliance with the laws and contracts, they may exercise their right to vote to the best of their own interests.

Both under section 214 of the *Business Corporations Act*[22] and section 146(5) of the *Canada Business Corporations Act*[23], **the rights, powers, duties and liabilities of the directors** which

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20 *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3, art. 5.1, *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. C-36, art. 50(18) and art. 5.1(4) et 11.03(3)

21 Paul MARTEL, La Société par actions au Québec, Volume 1, Le aspects juridiques, Wilson & Lafleur, 2012, 21-68

22 Business Corporations Act, C.Q.L.R., c. S-31.1

23 Canada Business Corporations Act, R.S.C. 1985, c. C-44

have been withdrawn from directors through a unanimous shareholder agreement are then **given to the shareholders** who are parties to the agreement and directors are relieved therefrom to the same extent. In such a case, the shareholders are also entitled to the same **means of defence** available to the directors.

14. What are the main elements of the board of directors' mandate?

The Canadian Securities Administrators (CSA) [24], the *Act respecting the governance of state-owned enterprises* (Quebec)[25] and other written materials have proposed various items which the mandate of the board (directly or through its committees) should contain. These items are applicable, with the necessary adaptations, to nearly all types of legal persons.

Here is our **summary of the main elements** of the mandate of a board:

- **supervise the management of the legal person;**
- satisfy itself as to the **integrity** of the legal person (and its executive officers), particularly financial integrity, by particularly promoting the implementation of a culture of integrity throughout the legal person;
- supervise the compliance by the legal person of the **laws and contracts** which are applicable to it or bind it;
- develop an approach to **governance**, including a description of the duties and mandates of the various corporate bodies and a statement of the expectations;
- adopt a **strategic planning process** and participate in this planning;
- identify the main risks and ensure that a **risk management process** is implemented;
- **succession** planning;
- ensure that **internal controls and management information systems** are implemented;
- in the case of reporting issuers, adopt a communication policy and develop measures for receiving shareholders' comments;
- develop a policy and a procedure respecting the receipt and management of **complaints and whistle-blower information**;
- adopt the **financial statements and the budget**;

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[24] *Policy Statement 58-201 to Corporate Governance Guidelines*, issued by the Canadian Securities Administrators, including the l'Autorité des marchés financiers (mainly at section 3.4) as completed by *Policy Statement to Regulation 52-110 Respecting Audit Committees*.

[25] An Act respecting the governance of state-owned enterprises, C.Q.L.R., c. G-1.02 (mainly see sections 14 and 15)

- review and approve the **compensation policy**, review and approve the objectives of the chief executive officer, assess his performance and determine the level and terms of his compensation**;**

- recommend the choice of the **external auditors**, fix their remuneration, ensure that they are independent and supervise their work;

- adopt a **business code of conduct** and supervise compliance therewith;

- adopt criteria for the **composition** of the board and regularly **assess** the composition of the board and its operation.

This **mandate must** obviously **be influenced** by the **creation of value** (as recommended by professors Yvan Allaire and Mihaela Firsirotu[26]) and promote the fulfilment of the mission of the legal person and the achievement of its objectives while respecting the interested parties and stakeholders.

15. What should be the level of intervention of a board of directors in managing the legal person?

Under the laws governing corporations, the board of directors is responsible for managing the legal person. The board usually **delegates** the **day-to-day administration** to **management**. However, the board establishes the orientations and objectives and supervises their implementation by management as well as the day-to-day management. It must also ensure that the practices of the legal person are adequately supervised through the adoption of policies and rules of conduct and supervise compliance therewith.

Some have identified this approach by the NIFO ("***nose in, fingers out***") acronym. **However**, this acronym or more precisely, this approach, may have the effect of unduly reducing the role of the board. The expression "fingers out" mainly refers to the execution of the decisions of the board and the implementation of the orientations it adopts. The role of the board **is not only to approve or reject** what management submits to it. It must also **assess the business strategy** and the means taken to execute it **and propose**, as needed, correctives and different ways or means.

We discuss the contents of the mandate of the board in response to another question [27].

The board is not there simply for the sake of appearances. It must at all times play an active role.

This role must be **more intense**,

- respecting the **strategic plan** and its implementation;

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[26] Gouvernance créatrice de valeurs, Allaire and Firsirotu, 2003, 2005

[27] Lavery website → Publications → André Laurin → "The Corporate Director's Q & A" – "14. What are the main elements of the board of directors' mandate?"

- in the case of a **significant operation**;

- in the case of a **difficult financial situation**;

- when **serious problems** occur or are expected;

- when complaints respecting **illegal, fraudulent or inappropriate behaviour** are made against management; and

- when **conflicts occur between the interests** of management or board members and those of the corporation.

The separation of powers between the board and management **causes some difficulties for several not-for-profit organizations (NFPO).** Some officers tend to transform into petty dictators or ambitious future politicians while in other cases the members of the board, and more particularly some chairmen of the board, find it hard to resist meddling with day-to-day management and treating the executive director as a mere agent for implementing their decisions. **Acting in such a way is not indicative of sound governance practices**. To each his own. The accountability of each corporate body is achieved through a clear distinction between the duties and expectations and abiding by the respective responsibility zones of each corporate body.

16. May the powers of the board of directors be restricted or withdrawn?

The usual **powers** of the board of directors **may be restricted or withdrawn** by the incorporating or another statute. They may also be restricted or withdrawn under most incorporating statutes for business corporations which are not reporting issuers through a **unanimous shareholder agreement**.

Incorporating statutes usually reserve some powers to shareholders or members. In other words, shareholders or members must rule on some issues. For instance, **shareholder approval** must be obtained **in respect of the following**:

- appointment of external auditors;
- number, election and removal of directors;
- approval of the internal or administrative by-law;
- winding-up the corporation;
- merger or arrangement;
- sale, rental or exchange of all or nearly all the property of the corporation which does not occur in the normal course of the corporation;
- changes to the share capital;
- some other operations, depending on the incorporating statute;
- ...

Unanimous shareholder agreements are only possible in the case of corporations whose securities are not listed on an exchange (i.e., reporting issuers). These agreement generally restrict the powers of the directors by listing a series of decisions respecting the corporation or its activities which shareholders – not the board of directors – will be responsible for. Such

decisions will be adopted by the shareholders according to majorities as provided under the agreement before becoming binding on the corporation. The following operations or subjects are generally included in the decisions that must be submitted to the shareholders under such agreements:

- borrowing over a minimum stated amount;
- some transactions respecting the sale, acquisition or other forms of alienation of certain assets in excess of a stated amount otherwise than in the normal course of business;
- changes in the share capital and issuance of new shares;
- replacement of a resigning or removed director;
- certain contracts;
- business plan;
- choice, termination and compensation of high executives;
- grant of options;
- change of head office;
- establishment of a place of business outside the country;
- new areas of activity or elimination of current areas of activity;
- transfer of intellectual property;
- winding-up or dissolution of the corporation;
- …

It must be noted however that **certain liabilities of the directors under the law will not necessarily be eliminated** by a limitation of their powers pursuant to a unanimous shareholder agreement, particularly those pertaining to deductions at source and the remittance of GST/QST if the directors fail to demonstrate reasonable care in that respect. Furthermore, **if** the persons who were acting as directors **continue in fact** to manage the legal person, they may be considered as actual or *de facto* directors and despite the withdrawal of their powers as set out in the unanimous shareholder agreement, be faced with the same risks and liability as before.

We must also add that the internal or administrative by-law of the legal person may stipulate **a proportion of director votes in excess of an ordinary majority** in respect of certain decisions. Such provisions thus limit the powers of the board without withdrawing them or reduce them directly.

Lastly, it is important to mention that withdrawing certain powers from the board in favour of the shareholders results in some **liabilities and obligations for these shareholders**. We discuss this in response to **another question**[28].

[28] Lavery website → Publications → André Laurin → "The Corporate Director's Q & A" → « 13. Are shareholders exercising certain powers usually reserved to the board of directors bound by the "fiduciary duties" of directors?"

17. What are the information and documents of the legal person which the board of directors is entitled to access?

Subject to possible, very limited exceptions, the board is entitled to obtain from management all the information and documents concerning the legal person and all the elements of its activities.

This right is inherent to the powers conferred on the board of directors pursuant to the incorporating statutes. In fact, the **board manages the legal person** and **management only exercises delegated powers**. Management therefore **cannot refuse** to provide the board with the requested information and documents.

Certain incorporating statutes also contain precise provisions which require the corporation to maintain registers, as well as certain specific documents and information which the board is entitled to access. These documents and information concern the corporation itself (articles, by-laws, securities) or are of a financial nature (accounting books). Section 20.4 of the *Canada Business Corporations Act* [29]and sections 31 to 39 of the *Business Corporations Act* (Quebec) [30] constitute examples of this type of provisions.

Furthermore**, directors have, on an individual basis, no powers separate from those of the board**. It is the board that has the power to manage the legal person.

Certain foreign incorporating statutes expressly stipulate that **individual directors** have a **right to access information**. U.S. case law confirmed that right while however recognizing some exceptions mainly related to conflicts of interests of the director. The above mentioned *Canada Business Corporations Act* and *Business Corporations Act* (Quebec) are silent on the subject. However, the internal or administrative by-law of the legal person may provide for such a right and thus remedy this silence. However, even in the absence of such a provision, management could not refuse to a director access to information without having first had its refusal validated by a **majority of the board**. Indeed, the right of a director to obtain information and tools constitute a legitimate and logical counterpart to his legal obligations as a director.

The fact that the director who makes the request is in a situation of conflict of interests may constitute a legitimate reason for refusal by the board. In case of a refusal by the majority of the board to support his request, the director will be left with no choice but to **ask the courts to decide**. In such a case, the **director in question** should wonder whether it would be proper for him **to resign**, taking into account the fact that he is refused the means to discharge his duties in an appropriate manner.

Management must respect the authority of the board, be transparent and assist the board in the discharge of its duties. It should facilitate the task of each individual director, **comply with the reasonable requests of each of them and not systematically wait for a formal request of the board**. In other words, it must facilitate for each director the discharge of his duties.

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[29] Canada Business Corporations Act, R.S.C. 1985, c. C-44

[30] Business Corporations Act, C.Q.L.R., c. S-31.1

18. Must or may a director abstain from voting in respect of certain issues?

A director **must** abstain from voting on an issue when his own interests are in conflict with those of the legal person. The main incorporating statutes however provide for some exceptions particularly related to the compensation and indemnification of directors.

In all **other** cases, a director **should not abstain from voting**. The general duties of directors (loyalty and care) require that he makes a decision. Directors are not elected to stand on the fence. However, nothing prevents him from suggesting that the vote be postponed so he can obtain additional information or confirmations or, more generally, to form a clearer opinion.

19. May a director be relieved of his duty of confidentiality?

Unless he obtained the consent of the board or is automatically relieved pursuant to the rules adopted by the legal person or is compelled by a public authority, a director is **never relieved** of his obligation of confidentiality and must therefore ensure the confidentiality of the information which he accesses in his capacity as a director and which is communicated to him by the legal person.

In practice some **items of information** are **publicly known** or accessible to the public. However, even in such circumstances, a director should in all cases **demonstrate prudence and restraint** and **have the legal person validate in advance** any disclosure he intends to make. He should also notify in advance the legal person of any request for disclosure made by a public authority.

20. May a director be removed by the board during his term of office?

The answer is no.

A **director may not be removed** or have his mandate revoked **by the board of directors**. Under the general rule, only the person who appoints may revoke, subject to certain nuances.

A director may be removed:

- by the **meeting of the members or shareholders** convened specifically for these purposes and, in the case of a government corporation, by the government which has appointed him;

- by a **court** competent to do so or by the regulatory authority having jurisdiction in some very special and limited circumstances (criminal conviction, violation of certain rules pertaining to securities...), as, for instance, provided under article 329 of the *Civil Code of Quebec*:

> ***"329**. The court, on the application of an interested person, may prohibit a person from holding office as a director of a legal person if the person has been found guilty of an indictable offence involving fraud or dishonesty in a matter related to legal persons, or who has*

repeatedly violated the Acts relating to legal persons or failed to fulfil his obligations as a director."[31]

(emphasis added)

In the case of not-for-profit organizations incorporated under Part III or the *Companies Act* (Quebec), the **letters patent** should ideally include the power of the members to remove a director.

Moreover, a director may be **automatically terminated if he ceases to meet the eligibility conditions** specifically prescribed by the law, for instance, a director who becomes bankrupt or is adjudicated by a court as incompetent within the meaning of the *Civil Code of Quebec* (i.e. mental health) [32].

A director may **probably also** be automatically terminated if he no longer meet the **eligibility conditions** set out in the **internal or administrative by-law** of the legal person duly adopted by the meeting of shareholders or members before the election of the director. However, the **eligibility conditions must then be objective** and not leave room for a **subjective assessment or determination** by the board of directors or the discretion of the board and must be clearly stated in the by-law adopted by the shareholders or members. We can add that according to such an approach, the concept of termination should preferably be accompanied by a stipulation of deemed resignation by the relevant director in the same circumstances as the *Professional Code* has done in its section 61[33]. The choice and wording of the eligibility conditions require significant attention, thoroughness and prudence, so to avoid judicial invalidation to the legal person.

As **non-exhaustive examples of eligibility conditions**, let us mention:

- in the case of a **NFPO**, the loss of member status, failure to pay dues when due, the loss of specific characteristics (ex.: member of an organization, change of residence) and the fact of being found guilty of a criminal offence by a court having jurisdiction;

- in the case of a **business corporation**, the loss or citizenship, the termination of the appointment by a shareholder pursuant to a unanimous shareholder agreement, the loss of shareholder status and the fact of being found guilty of a criminal offence by a court having jurisdiction.

21. What are the most frequent cases of conflict between the interests of the legal person and those of a director?

It is **impossible** to make an exhaustive inventory of all the possible cases of conflicts of interests. The following presents **some examples**.

Let us first deal with a case that we forget too often: that of the director who, to ensure that he will remain in office, get other directorships or preserve or obtain mandates or contracts is unduly **complacent** and fails to make the contribution expected of a director. For instance,

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31 *Civil Code of Québec*, L.R.Q., c. C-1991
32 Article 327 of the *Code civil du Québec*, L.R.Q., c. C-199
33 *Professional Code*, C.Q.L.R., c. C-26

we have seen in the past certain cases of "entrenchment" in which directors would reject an operation which would have resulted in the loss of their directorships.

Here are some other examples:

- promoting the **grant of a contract** to a person related to the director or the hiring of such a person;

- **using property or information** of the legal person for the benefit of a person other than the legal person, particularly through disclosing confidential information (ex.: client list, intellectual property, ...);

- **promoting an operation** which will benefit more the director than all the shareholders, all things being equal;

- especially in the case of NFPOs, **using the legal person's platform** to score political points or move forward matters which have nothing to do with the main objectives of the NFPO;

- promoting the interest of the person who proposed the nomination of the director to the board;

- protecting the interests of one or several shareholders or members against the best interest of the legal person, including voting according to the indications of such a person.

22. What training and information should directors receive and obtain?

One cannot expect a **director** who is not adequately **informed** on the legal person, its activities, environment and challenges to make an optimal contribution.

At the beginning of his mandate

Any new director should **receive from the management of the legal person**, **at the beginning of his/he mandate**, verbal and written presentations on the following subjects:

- the balance sheet, financial statements and budget;

- the financing (loans, capitalization, internally generated funds);

- the strategic plan and the status of it implementation as well as the main challenges and risks;

- the industry in which the legal person conducts its activities and the positioning of the legal person in such industry; and on

- the governance process and systems (who is responsible for what and what are the assessment and control procedures).

During the mandate

Management should provide all directors with all the information it possesses and **which may have an effect on the decisions** which the board is called upon to make or **may determine the degree of intervention of the board**. Management or, in other words, the employees of the legal person also have duties of care and loyalty to the legal person and therefore, in practice, to the corporate body responsible for managing the legal person, that is, the board of directors.

Continuing education opportunities should also be offered to members of the board, particularly on market trends (needs and outlooks) and other subjects which may improve their relevant knowledge respecting the exercise of their duties as directors of the legal person.

Moreover, **directors themselves have a duty to keep informed**. Today, an incredible body of information is available on the **Internet**. Directors may, as we just noted, expect that management will inform them adequately and provide them with training sessions. However, they must themselves **take initiatives and spend time on research and consultations**. They cannot act as passive newborns. As athletes or artists, they must train to provide high-level performance. Most of these efforts will be made outside the context of formal meetings.

Let us remind the words of the Supreme Court in the *Peoples'* case with respect to the duty of care:

> *"[67] ...The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known. ..."*[34]
>
> (emplasis added)

23. To what risks of liability or being found guilty are directors exposed?

Directors are subject to the **legal liability regime provided in the incorporating statute of the legal person and possibly to that of its registered office** and, **in some respects, to the regimes in place in jurisdictions where the legal person carries out its activities**. It is therefore important to have a **good knowledge of the laws** that apply to the legal person and directors. In the context of Quebec law, directors face two major types of potential liability, namely:

- **contractual** liability to the legal person of which they are directors or, by way of derivative action, to the persons who may step into the shoes of the legal person in certain circumstances (shareholders or creditors of the legal person); and

- **extracontractual liability** (delictual, quasi-delictual and penal) to third parties, but also to the legal person.

[34] Peoples Department Stores Inc. (Trustee of) v. Wise, 2004 SCC 68

Contractual liability

Civil contractual liability stems from the nature of the link between the legal person and its directors. Under Quebec law, directors are mandataries of the legal person. They may incur liability to the legal person if they do not discharge their duties (care and loyalty) to the legal person or if they exceed the limits of their mandate.

Extracontractual liability

Extracontractual liability may be civil or penal in nature.

A person seeking a civil liability judgement, whether of a delictual or quasi-delictual nature, against a corporate director, is required to prove that the director, in the course of discharging its duties, committed a **fault which caused damages to such person**. However, the person may in some circumstances rely on **legal liability presumptions** against the director. Such presumptions impose the burden of proof on the director. The court will assess the elements put before it according to the rule of preponderance of evidence.

For instance, a director who would knowingly support the decision of the board to authorize the marketing of a product which he knows is hazardous or non-compliant with the regulatory standards of the industry and may cause damages to third parties may be ordered to pay damages to the victims who suffer such damages. In the same way, a director who votes in favour of a recommendation to the shareholders to approve a merger or accept a takeover bid which he knows or should have known that they are not fair or not in the interest of the legal person and its shareholders may be held liable to the shareholders.

Failure by a director to exercise its duty of care or duty of loyalty to the legal person may en certain circumstances be considered by the courts as being a **civil fault** in the context of proceedings against the director by the legal person itself or third parties.

Specific statutes identify certain behaviours as constituting penal or criminal offences. Some statutes also create **presumptions of guilt**. Here are two examples, the first of which is taken from the *Act Respecting Occupational Health and Safety*[35]:

> *"241. Where a legal person has committed an offence, every director, officer, employee or agent of that legal person who has prescribed or authorized the action or the omission that constitutes the offence or who has consented thereto is deemed to have participated in the offence and is liable to the same penalty as a natural person, whether or not the legal person has been prosecuted or found guilty."*
>
> (emphasis added)

and the second one in the *Environment Quality Act*[36].

> ***"115.40*** *If a legal person or an agent, mandatary or employee of a legal person, partnership or association without legal personality commits an offence under this Act or the regulations, its director or*

[35] Act Respecting Occupational Health and Safety, C.Q.L.R. c. S-2.1
[36] Environment Quality Act, C.Q.L.R. c. Q-2

> *officer is presumed to have committed the offence unless it is established that the director or officer exercised due diligence and took all necessary precautions to prevent the offence.*
>
> *For the purposes of this section, in the case of a partnership, all partners, except special partners, are deemed to be directors of the partnership unless there is evidence to the contrary appointing one or more of them, or a third person, to manage the affairs of the partnership."*
>
> (emphasis added)

Furthermore, the *Criminal Code* (Canada)[37], mainly in section 21, opens the door to the concept of **complicity** to **or participation in** a criminal or penal offence. A director who is found guilty may, according to the case and the nature of the offence, be ordered to pay a fine, be imposed a limitation of his rights and even imprisonment.

The evidence will be assessed on the basis of the "beyond a reasonable doubt" criterion.

In most cases, a defence of due diligence may be made, even against a presumption, if the director has been in fact diligent. Furthermore, it is to be noted that the more the determination of the fault is objective, the less accessible becomes the defence of due diligence.

Solidary liability

Each director who commits a fault which causes the same damage to a third party has a **solidary obligation** with the other persons who also committed a fault against the victim or claimant. The claimant may thus claim from any of the directors, several of them or all of them the entire payment of the damages which may have been awarded to him. The directors who pay may however claim from the other directors who committed the fault their proportional shares of the damages.

It is to be noted that a director who had his dissent registered may be exempt from any liability if, in fact, he voted against the decision made by the board. We discuss dissidence in response to question # 25[38].

In the same way, certain directors who approved a decision or action may in certain cases offer a **defence of due diligence** which is not available to all directors and thus avoid a finding of solidary liability. Such may be the case, under some conditions, of a director who did not access the same information or did not have the same competence as his colleagues.

Other remedies and comments

The **oppression remedy** and the **application for an injunction** complete the arsenal of means or remedies which may be brought against directors.

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[37] Criminal Code (Canada) R.S.C. (1985), c. C-46

[38] Lavery website → Publications → André Laurin → "The Corporate Director's Q & A" → "25. Should a director have his dissent recorded in respect of some decisions of the board of directors?"

In practice, **suits** against directors **are rare in Quebec**. The greatest risks are related to unpaid salaries (up to six (6) months), failure to make remittances of deductions at source, GST and PST not paid to tax authorities and other contributions to regimes established by specific legislation. However, the willingness of plaintiffs' attorneys and the tendency of government to use presumptions or other means to impose liabilities on persons managing legal persons should result in an increase of legal proceedings.

24. What can directors do to protect themselves against the potential risks of being found liable or guilty?

The simplest answer is to **adequately discharge their general duties and the obligations imposed on them by law.**

To do so, **three steps are necessary**:

- understanding the legal environment;
- ensuring an adequate governance framework;
- being proactive and acting with courage and forethought to the best of the interests of the legal person.

Directors must therefore know and understand their duties and obligations. As those duties and obligations must be assumed in the context of the obligations of the legal person and the laws and regulations it must comply with, it is important to be well aware of **what governs the legal person**. Is it necessary to stress that ignorance of the law is no excuse?

The Supreme Court of Canada clearly indicated in the *Peoples'* case[39] that **governance can constitute a shield which may protect directors against their potential liability**.

Directors should therefore **ensure** that various **measures** are **implemented** or maintained to create a suitable framework for the discharge of their duties. Among these **measures**, we can mention:

- access to relevant information, including on the reasons which motivated the adoption of a proposal recommended by management;
- obtaining reports and certificates;
- clarity of drafting respecting duties and responsibilities of the various corporate bodies and related expectations;
- proper meetings with a standard agenda which includes a heading entitled "*Matters from previous meetings*";
- minutes which are not personalized, but demonstrate a diligent process of the directors.

We are discussing in another bulletin of the various measures which we recommend that external directors take ("The External Directors of a SME")[40]).

[39] Peoples Department Stores Inc. (Trustee of) v. Wise, 2004 SCC 68 at paragraph 32

[40] Available on the Lavery website →Publications → André Laurin → " The External Directors of a SME"

Directors should also obtain a **contractual indemnity undertaking** from the **legal person** and ensure that a "Directors' and Officers'" liability policy has been purchased by the legal person and adequately covers them. Furthermore when a director is called upon to sit on a board of directors at the request of a **shareholder**, **member**, **investor** or **lender**, it would be appropriate for him to obtain an indemnity undertaking from that person and also to be covered by the Directors' and Officers' liability policy of that person.

Several incorporating statutes are silent on indemnity while others include some stipulations. In the first case (i.e. silent statutes), the contractual indemnity undertaking of the legal person to the director is necessary. **It is useful in all cases** as it **clarifies** and **completes the protection** which some **incorporating statutes** give or remedies the legislative silence. In addition, by promoting the contractual approach, **directors protect themselves against the unilateral modification** by the legal person of the indemnity measures. A by-law or resolution should be adopted by the board of directors to grant to the board the authority to enter into such undertakings according the terms and conditions it deems appropriate while complying with the parameters imposed by law. In the case of a NFPO incorporated under Part III of the *Companies Law* (Quebec) [41], the meeting of the members must authorize the board to do so occasionally or through the internal or administrative by-law or an administrative resolution.

Among the clarifications that can be made through an indemnification undertaking from the legal person to a director we can mention the presumption of compliance with the duties and the law, the terms governing advances, the right for each director to choose his own attorney and other experts and the survival of the undertaking for a minimum number of years after the end of the director's mandate.

As to the insurance coverage, it is important to note that **all the policies are not the same**. It is therefore essential for the director to ask the insurance broker to indicate what is covered, what is excluded and the insurer's rights of termination and the conditions which must be complied with by the legal person to maintain the insurance coverage in force. The prior identification of all the obligations and liabilities imposed on the director by law and the related risks and the comparison of these risks with the coverage offered should offer a basis for assessing what coverage should be obtained, to the extent it is available. The insurance broker should be a specialist recognized in this type of insurance contracts. However, not all brokers are specialized in this area. It should be noted that in Quebec, the defence costs must be assumed by the insurer in addition to the monetary limit of coverage. Such is not necessarily the case for insurance contracts issued in other jurisdictions.

It is to be noted that **directors of certain legal persons** (for example, certain Crown corporations) benefit from **immunity** from legal proceedings to the extent that they acted in good faith and in the performance of their duties.

25. Should a director have his dissent recorded in respect of some decisions of the board of directors?

In practice, dissent **should be only resorted to in the case of significant issues or decisions** and at no time as a tactic for a director.

[41] *Companies Act*, C.Q.L.R. c. C-38

Under corporate laws which deal with **dissent** (some do not), the purpose of dissent is to **give to directors the opportunity to avoid the potential liability in respect of a decision made by the board**. However, dissenting does not constitute a total guarantee that liability will be avoided to the extent that circumstances do not justify it. For instance, a director cannot dissent in respect of a decision he or she approved.

A dissent must be **expressed** at the meeting and be **noted** in the minutes or be **expressed in writing** and sent by registered mail to the head office of the legal person in accordance with the procedure described in the incorporating statute, **forthwith** after the meeting.

It is to be noted that under the *Canadian Business Corporations Act*[42] and the Business Corporations Act (Quebec) [43], a **director who was absent from a meeting is presumed to have consented** to the decisions made by the board. A director who was absent from a meeting and wants to register his dissent **must do so in writing and immediately** after becoming aware of the decision as the statutes generally stipulate that this must be done in a very short time.

Furthermore, the **relative value** of a dissent will be rather low if the director continues to sit on the board and approves several related measures aimed at implementing the decision in respect of which he dissented. In such circumstances, a director should ponder whether he should resign from his directorship with the legal person in question.

26. How important should integrity be to directors?

Integrity is a moral value by itself. It is included in ethics, which is synonymous with morality or moral values.

The expression **code of ethics** is often used to describe **what is in fact a code of conduct**. As previously mentioned, ethics is about morality or moral values. Deontology is about rules of behaviour or conduct. **These rules are part of the compliance domain**. **Compliance** must therefore **distinguished from integrity**.

Compliance may facilitate reaching integrity. However, a legal person may be compliant and respect rules without necessarily showing integrity, as illustrated by the Enron saga.

The word **culture** is often used in our society to discuss, among other things, the values of a society or a business. When discussing the concept of **culture of integrity**, we refer to a system of values which influences the behaviour of people who are included in a given group. The word "value", in this context, does not have the same meaning as in the concept of "creation of value" in which directors are supposed to participate.

Ronald R. Sims, an author, had this to say about the culture of integrity:

> "*A culture is a system of shared beliefs and responses that conditions people how to behave in the organizational environment.*

[42] *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, section 123(3)
[43] *Business Corporations Act*, C.Q.L.R., c. S-31.1, section 139

> *The ethical culture of an organization is defined by those things it rewards, and an employee's ethical behaviour is dependent on both his or her values and the ethical climate within the organization. Further, both the content and the strength of an organization's culture have an influence on the ethical behaviour of its managers and employees."*[44]
>
> (emphasis added)

As noted in our answer to question "14. What are the main elements of the board of directors' mandate?" [45], the **mandate of a board of directors** should include the responsibility to "satisfy itself as to the **integrity** of the legal person (and its executive officers), particularly financial integrity, by promoting, among other things, the implementation of a culture of integrity throughout the legal person".

In the BCE case[46], the Supreme Court of Canada noted that in the analysis of the duty of directors to act in the best interests of the legal person, the interests of the legal person must be those of a "**good corporate citizen**".

Ronald R. Sims, whom we previously cited, was confirming in 2003 the **inherent importance of integrity** and socially responsible behaviour as follows:

> *"Being socially responsible, ethical and a good corporate citizen is important to meeting and exceeding the expectations of any organization's stakeholders. Unless today's organizations recognize the importance of developing and sustaining a reputation that is built on « doing the right things » and « doing things right » as viewed by their key stakeholders, they will not survive or thrive, as has been the case with several organizations over the last few decades."*[47]
>
> (emphasis added)

In the past few years, the **news shed some light on serious breaches of integrity**, particularly in the Quebec society, as more fully illustrated by the media, the Charbonneau Commission and the work of UPAC. Collusion, bribery, illegal political contributions, breaches of the laws are some of the forms which those violations of integrity have taken. Those who committed these violations have suffered or will likely suffer the consequences thereof. These consequences are not only civil suits and criminal charges but also the loss of accreditation and reputation. For a number of legal persons thus charged, these consequences already include the loss of significant contracts and may jeopardize their very survival. The **clients** and **suppliers** of these businesses will also suffer negative effects, despite the fact that they did not participate in the violations.

In short, integrity and socially responsible behaviour:

- are **values** to which everybody should adhere;

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44 Ethics and Corporate Social Responsibility: Why Giants Fall, Ronald R. Sims, Praeger, 2003, p. 214

45 Lavery website → Publications → André Laurin → "The Corporate Director's Q & A" → "14. What are the main elements of the board of directors' mandate?"

46 BCE Inc. v. 1976 Debentureholders, 2008 SCC 69

47 Ethics and Corporate Social Responsibility : Why Giants Fall, Ronald R. Sims, Praeger, 2003, p. 8

- their implementation and related supervising form part of the **mandate** of a board;

- constitute essential elements of the **expectations of interested parties** or stakeholders and the courts;

- are, and will even more so in the future, **be the subject of rules and frameworks**, as those already present in many statutes[48].

Directors must therefore promote the integrity of the legal person through **policies**, **verifications**, and ongoing **supervising** and **taking remedial measures and imposing the necessary sanctions**. The legal person's risk management process must include this element. For a director, neglecting to ensure integrity would constitute a breach of his duty of care. Directors will not be able to rely on a due diligence defence if they fail to take the means to achieve integrity.

In a presentation made in Davos, on January 27, 2010, at the World Economic Forum, Professor Yvan Allaire, Executive Chairman of the Board of the Institute for private and public organizations ("IGOPP") described ethics as being "**the resistance of values under pressure**". He added the following "This resistance to the pressures of individual interest is not unlimited. Individuals, except saints and heroes, all have a breaking point, a tipping point between integrity and greed. The board must be vigilant to ensure that the nature and level of **compensation** and the **performance metrics adopted to set compensation** do not create an undue pressure on the ethical values of its executives and managers".

The members of Lavery's Corporate and Business Integrity team can assist legal persons in implementing prevention and integrity management mechanisms. They also can help in managing crisis situations. [49]

27. How important should risk management be to directors?

As we already noted in answering another question, risk management **must form part of the mandate of the board of directors** and directors must consider it as being very important.

The **materialisation of certain risks** may indeed **jeopardize** the very existence of the legal person or at least materially and negatively affect the legal person, the continuation of its activities according to the strategic plan, its financial health, its financial capacity, its reputation or several of the foregoing aspects.

A new competitor or competing product entering the market, the obsolescence of a product, an investigation, the filing of a complaint against the legal person, the destruction of a manufacturing plant, the loss of a major client or supplier, a loss such as a flood, an earthquake, fire or other loss only constitute **examples of risks** which may have a negative impact on a business.

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[48] For example: *The Integrity in Public Contracts Act; An Act Respecting Contracting by Public Bodies;* Anti-Corruption Act, C.Q.L.R. c. L-6.11; Corruption of Foreign Public Officials Act, S.C. 1998, c. 34, which have been modified by the *Fighting Foreign Corruption Act*.

[49] Lavery website → Corporate and Business Integrity

Let us add that the materialization of risks for a **supplier** or **client** of the legal person also constitutes a risk for the legal person in question due to the potential domino effect.

Risk management is an ongoing process, although it may have to be intensified upon the occurrence of a specific event. It involves the **assessment of the risks** and **dealing with the risks** so assessed.

We already published a detailed bulletin on that issue, entitled "Directors and Risk Management" [50] and invite the reader to consult it on the Lavery website for more information on the subject.

28. How important should the assessment of the performance of the various corporate bodies be to the board of directors?

The regular assessment of the performance of the various corporate bodies of a legal person is essential. It is impossible to adjust, improve and progress without conducting such an assessment.

A board must ensure that an assessment is conducted not only on management but also on **the board itself**. Such assessments are part of an **ongoing optimisation process of the resources and ongoing improvement of the functioning of the board**.

In view of the relative importance of such assessments for the legal person and the fact that they are part of the governance recognized good practices, all the boards of directors should conduct such assessments. By so doing, directors improve the quality of their compliance with their **duty of care**.

The **assessment methods may vary** and **must be adapted** to the reality and financial means of the legal person.

In the case of the assessment of the board, we promote an **approach** which:

- adequately safeguards **confidentiality**;
- encourages comments by using **open questions** rather than an assessment of the "objective examination" type**;** and which
- makes room for directors to express comments on the issues they wish to discuss at board meetings, on items which should be added on or removed from the **strategic plan** and the directors' **concerns**.

In our opinion, the approaches proposed by several organizations, which we find on the Internet, fail to yield adequate results and are more of the nature of compliance assessments than assessments of performance and issues.

Many legal persons may receive **access to information requests**. Most of them would undoubtedly be reluctant to disclose the results of the assessments. The grant by the board of a **specific** contract to a legal firm may offer such a protection to the legal person in view of

[50] Lavery website → Publications → André Laurin → "Directors and Risk Management"

the recognized right of the client to the lawyer's **professional secrecy** and the obligation of the lawyer to protect such right.

Lavery's corporate governance law team offers such a service for assessing the operation of the board. The members of the team have many years of experience in the field of governance and acquired relevant experience as directors and managers.

29. What should the board do in the event of a proposed transaction involving a member of management or another director as a co-contracting party?

As this is a case of conflict of interests of the management member or the director, the board should take **specific precautions**.

In the case of a simple **supply contract or contract for the sale of products or services or a hiring contract**, the conflict should obviously be disclosed. The person in conflict should not receive confidential information and should also abstain from participating in the discussions and voting. **If the person in conflict does not do so on his own initiative**, the board should take measures to protect the interests of the corporation, such as meeting informally without the presence of that person, not giving confidential information to him and, when doing so does not hurt the legal person, avoiding giving him the responsibility of negotiating the specific matter on behalf of the corporation. However, some of these practical measures may be legally contested, at least when they concern a director. If the director in question contests the use of these practical measures, the board may be forced to go to court.

In the case of a material operation of the nature of an **arrangement**, a merger, a favourable recommendation of the board to the shareholders respecting the acceptance of a share purchase offer or the **sale of the business** or a significant part thereof:

- involving another party in which the person in conflict has an actual or potential interest, or
- which may confer a significant benefit to the person in conflict exceeding that of all shareholders,

the board should also **establish a special committee** of the board comprised of at least a majority of independent directors to coordinate and supervise the negotiations and ensure the protection of the best interests of the corporation and all shareholders.

In the case of **reporting issuers**, the Canadian Securities Administrators ("CSA") have established **certain rules** regarding these operations by adopting *Regulation 61-101 respecting protection of minority security holders in special transactions*[51]. However, the measures and precautions taken by the board should not be limited to those prescribed under this regulation.

[51] Regulation 61-101 respecting protection of minority security holders in special transactions, C.Q.L.R. c. V-1.1, s. 331.1

30. Why and how to resign from one's directorship?

A director ceases to hold office **at the expiry of the period fixed** in his mandate or immediately before being replaced. However, he should cease to hold such office or resign before the date of expiry of his mandate if he no longer meets the eligibility conditions (see the question: "20. *May a director be removed by the board during his term of office?*" [52]).

A director should also ponder **whether he should resign** in the following cases:

- if he **no longer has the interest**, the time or the capacity to discharge his duties and positively contribute to the mission of the legal person;
- if his contribution is **very weak** in practice;
- if the legal person **does not provide him with the means to adequately discharge** his duties;
- if he **disagrees** with the values, orientations or material decisions of the legal person and does not foresee a serious and reasonable possibility of bringing changes in those respects;
- **in case of a difficult financial situation** or insolvency of the legal person, if he cannot obtain guarantees respecting indemnity or adequate protection against the risks of personal liability;
- if the **legal person** does not adequately comply with the **law** and its contractual **obligations** and does not act as a good corporate citizen should; or
- if he systematically and **regularly finds himself/herself in a situation where his own interests conflict** with those of the legal person or if he no longer has the capacity, according to reasonable criteria, to exercise independent judgment in the best interests of the legal person.

A resignation must be made in compliance with the duty of loyalty of the director to the legal person. This means that the resignation must be made with dignity, in such a way as to reduce as much as possible the negative effects of this resignation for the legal person. Readers should read the more detailed bulletin on the issue, published by the author, and entitled *"When Should a Director Resign?"*[53]

A resigning director **must ensure that the public registers** are immediately **corrected** in such a way as his name no longer appears as a director. For as long as the registers are not corrected, a *bona fide* third party may in certain circumstances rely on the information found therein. He must also cease to act in practice as a director if he does not want to incur the risk of being considered as a ***de facto* director**.

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[52] Lavery website → Publications → André Laurin → "The Corporate Director's Q & A" → " 20. May a director be removed by the board during his term of office?"

[53] Lavery website → Publications → André Laurin → "When Should a Director Resign?"

31. Does resigning discharge a director from his obligations?

Subject to what is mentioned in the following paragraphs, the resignation of a director **and** the **correction of the public registers discharge** the director in question of his obligations **in respect of the management of the legal person** from the latest of the effective date of his resignation and the date the registers are corrected.

However, the resigning director **is not discharged from the obligations** resulting from him holding office as a director of the legal person for the period **prior to his resignation**. He may therefore by sued for failing to discharge these obligations and for any other civil fault having caused damages to others and any violation of an applicable law or regulation or any criminal offence which occurred during the time he was holding office.

Thus, as an **example**, he will not be discharged from his liability for unpaid salaries prior to the date of his resignation and for the remittance of deductions at source and GST/QST which should have been done prior to the date of his resignation, subject, of course, to the due diligence defence he could offer.

However, it should be noted that if, despite his resignation, a director continues to act in fact as a director, he will likely be considered to be a ***de facto* director** and will therefore assume the same obligations and risks of liability as a director.

32. Is a resigning director who is not replaced always deemed to be in office or is he discharged from his obligations?

The fact that a resigning director is not replaced **has no effect on the discharging effect of his resignation and changes nothing to reality**. A resigning director is not deemed to have remained in office and is discharged from his obligations subject to what we mentioned in response to another question[54] including the modification of the public registers. In fact, section 98 of the *Act Respecting the Legal Publicity of Enterprises*[55] provides that certain items of information which are included in the register (including the name and domicile of each director) are proof of their content for the benefit of third persons in good faith. **It is therefore in a resigning director's interest to make sure that an amending declaration is promptly filed to remove his name from the register.**

A resignation is different from the end of the expected term of a mandate. Some incorporating statutes such as the *Canada Business Corporations Act*[56], at section 106(6) and the *Business Corporations Act* (Quebec)[57], at section 143, provide that notwithstanding the expected expiry of their mandate, directors remain in office until they are re-elected or replaced. This provision is called **"holding over"**. A director who does not want to remain in office beyond the expected expiry date of his mandate must therefore resign.

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54 Lavery website → Publications →André Laurin → "The Corporate Director's Q & A" → "31. Does resigning discharge a director from his obligations?"

55 An Act Respecting the Legal Publicity of Enterprises, C.Q.L.R. c. P-44.1

56 Canada Business Corporations Act, R.S.C. 1985, c. C-44

57 Business Corporations Act, C.Q.L.R., c. S-31.1

33. What does entail the offices of chairman of the board of directors or chair of a committee?

In the case of numerous legal persons, the duties and expectations related to these offices are described in writing.

The main duties of a chairman of the board and a chairman of a committee is to allow the members of the board or the committee, according to the case, to adequately discharge their duties and act as an intermediary between management and the board or the committee, as applicable.

This entails, among other things:

- **preparing the meetings**, particularly the **agendas**, with management;
- obtaining from management or external experts the **tools, information**, documents and **opinions** which he deems necessary or useful to enable the board or the committee, according to the case, to fulfill its mandate;
- inquiring about the **subjects which the members** of the board or committee **want to discuss** and follow-up on the assistance requests of these members;
- **effectively and respectfully conducting the meetings** by ensuring that the most part of these meetings is devoted to the questions and comments of directors;
- **following-up on the decisions** made by the board or the committee with the management;
- **passing along to management** the comments and suggestions of the members and passing along to the members of the board the comments of management on the improvement of the directors' performance; and
- more generally, **coordinating the pursuit of the most complete fulfillment possible of the board's mandate**.

The director who performs the duties of chairman of the board or chairman of a committee is subject, in such capacity, to the **same duties** as the other directors. However, in case of a liability suit, the courts will take into account in their analyzes the way in which the chairman fulfilled his specific duties in the circumstances. In that sense, the courts will have **higher expectations** respecting him.

A more detailed analysis of the duties of chairman of the board has been made in another bulletin published by the author and entitled "*The Role of the Chair of the Board of Directors*" [58], which readers may access on the Lavery website.

[58] Lavery website → Publications → André Laurin → "The Role of the Chair of the Board of Directors"

34. What is the purpose of minutes and what should they contain?

Minutes of meetings are extremely useful. They make it possible to:

- **better understand the decisions** made and the intended objectives thereof;
- **demonstrate the process followed by management**, which led to recommending the decision and the reasons for making it;
- **demonstrate the due diligence process followed by directors** prior to adopting the decision; and
- **facilitate the supervising** of the implementation of the measures which were the subject of the discussions of the directors and the fulfilment of the objectives sought to justify adopting the decision.

The minutes **should not be personalized** except in case of specific and special request of a director. They should **not open the door to** of provide a foundation for **suits**.

Furthermore, these minutes should, **in the case of any material decision**, and provided it can be made without risks, briefly:

- refer to the presentation (including the documents provided) by management and experts;
- describe the reasons for the recommendation and the verifications made;
- describe the other assumptions considered and discarded and indicate that they were unavailable or not of an equal quality;
- mention the most important questions asked by the directors and their satisfaction in respect of the answers they received by describing the answers to the most important questions; and
- indicate that there were exchanges and a discussion at the meeting of the board.

Furthermore, minutes should **refer to the confirmations and certificates** of management.

When the **chairman of a committee reports** to the board on the work of the committee he chairs, the minutes of the board of directors should mention the subjects discussed by the committee (i.e. a simple list) and note that the report of the chairman of the committee corresponds in all respects to the minutes of the meeting of the committee. In cases where the committee recommends to the board to adopt a given decision, the minutes should report it in the same way as previously suggested in the case of a material decision recommended by management.

Except in special circumstances, the minutes should only indicate that the resolution was duly passed **without referring to the concepts of unanimity or majority**.

35. What types of certificates should be obtained by directors from management and what is their purpose?

Three types of certificates should be obtained from management. These three types of certificates **may be consolidated** in one or two certificates except in the case of reporting issuers who must comply with the rules under *Regulation 52-109 respecting certification of disclosure in issuers' annual and interim filings*[59].

A **first** certificate should confirm that the legal person fulfilled, up to the date of the certificate, of all its **obligations** under the various statutes prescribing obligations which directors must comply with or may bring about **any liability or guilty verdict of the directors in respect of their statutory liabilities**. Such a certificate should precisely refer to each of the statutes in question. It should also confirm that the Directors and Officers insurance contract is in effect, that the **related premiums** have been paid, that the conditions of the policy have been complied with and that the legal person has received no notice of termination or questions from the insurer.

A **second** certificate should be obtained from management, describing the same items as those covered by the certificates imposed on reporting issuers under the above mentioned Regulation 52-109, **in respect of the accuracy of the financial information, the existence of controls and of an internal audit and the effectiveness of the control measures and internal audit**. In the case of reporting issuers, this certificate should comply in all respects with the provisions of the above mentioned Regulation 52-109.

A **third, more general**, certificate should be obtained from the chief executive officer, confirming, among other things, that:

(a) **all the material information and documents** in the possession of management, which were or are those which may influence the decisions of the members of the board of directors have been provided by management to the members of the board;

(b) management **is not aware** of any **fact** or **circumstances** which **may materially and adversely affect the legal person** and the pursuit of its activities according to the budget and strategic plan adopted by the board of directors which would not have been disclosed to the board; and

(c) management is not aware of any **suit, actual or threatened** or circumstances which may bring about legal proceedings against the legal person which would not have been disclosed to the board of directors and may **materially and adversely affect** the financial results, balance sheet or the reputation of the legal person.

Obtaining such certificates may appear at first glance to be a cumbersome process. However, they offer the following **benefits**:

- they **reduce the time reserved for questions** at the meetings since the information they contain already answers questions which directors should ask;

[59] Regulation 52-109 respecting certification of disclosure in issuers' annual and interim filings, C.Q.L.R., c. V-1.1, r. 27

- they **offer some protection to directors** by enabling them to demonstrate the exercise of due diligence; and

- they also **protect the chief executive officer**, who will have to obtain himself appropriate written confirmations from persons who report to him according to their respective responsibilities (pyramidal operation).

The expression « **to the best of my knowledge"** of the person who signs **should not be used in certificates**. Furthermore, the use of the expression "after verification" should be included.

It is to be noted that the fact, for an officer to **have to** sign a certificate often **makes him more careful** and causes him to make more stringent and thorough verifications.

36. <u>What is the purpose of the reports or external expert opinions and when should a director require them?</u>

Both the *Business Corporations Act* (Quebec) [60] at section 121 and the *Canada Business Corporations Act*[61] at section 123(4) establish a **presumption of the exercise of due diligence** by directors when they rely on reports or opinions of certain external experts (ex. lawyer, CPA, ...). **Even in the absence of an express provision** of the incorporating statutes, such reports or external opinions are useful to demonstrate the exercise of due diligence by directors.

It is to be noted however that this **presumption may be rebutted** if the report or the opinion is not serious or if other elements should be taken into account and have not been in the exercise of due diligence.

These reports or opinions which allow for relying on the due diligence presumption include not only those directly requested by the board **but also those provided by management**. In case of a possible conflict of interests between management and the legal person, the board should retain its own experts as, for example, in the case of the choice of auditors and compensation advisors as the regulations and guidelines applicable to reporting issuers stipulate.

Directors should obtain such reports or opinions only in the context of material or sensitive decisions or in the case of conflict of interests of management or directors with those of the legal person.

Unfortunately, directors are not competent in everything, despite the training and information that they may have received. Furthermore, some activities are sophisticated or very technical in nature or are conducted in remote countries. In such circumstances, directors are not always in a position to adequately assess the projects submitted by management, the measures taken by management and the risks involved. Lastly, the report of the external auditor, who is responsible for financial certification, does not necessarily raise the problems of resources optimization and the difficulties for implementing decisions in the

[60] *Business Corporations Act*, C.Q.L.R., c. S-31.1, sec. 121
[61] *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, sec. 123(4)

field. These facts and circumstances, among others, may also justify the use of external experts by the board.

Many written **mandates** ("charters") of board of directors stipulate the right and power of the board to retain the services of experts when the board deems it appropriate, at the expense of the legal person.

Thus, the board should:

- identify the confirmation of experts which it needs and retain the services of such experts as, for instance, in respect of the strategic plan; and

- from time to time, have an audit conducted respecting the practices of the legal person and the material projects and have these practices and projects validated by external experts.

37. Should the board establish committees of the board of directors and who should sit on these committees?

Unless there are explicit provisions in the incorporating statute or the regulations to which the legal person is subject, the board has **no obligation** to establish committees.

Furthermore, the **board**, as we have seen in answers to other questions **may delegate**, including to committees but must ultimately remain accountable for the actions taken and decisions made by those committees.

Here are **two (2) examples of explicit provisions** concerning committees of the board:

- the *Act respecting the governance of state-owned enterprises* (Quebec) [62] imposes to state-owned enterprises to establish the following committees: an audit committee, a governance and ethics committee and a human resources committee **composed entirely of independent directors**; and

- the regulations applicable to reporting issuers[63]require them to establish an audit committee composed solely of board members who are independent directors and recommends, without however imposing it, the establishment of a compensation committee and a nominating committee composed entirely of independent members of the board.

In these two examples, we also find **mandatory or recommended charter contents**, according to the case, for each of these committees.

Where the **composition** of the committee is **prescribed** by law or regulations as is the case of the two (2) preceding examples, it is clear that only independent members of the board

[62] Act respecting the governance of state-owned enterprises, C.Q.L.R. c. G-1.02

[63] Regulation 52-110 respecting audit committees, C.Q.L.R. c. V-1.1, r 28; Policy Statement 58-201 to Corporate Governance Guidelines

appointed to the committees in questions are entitled to vote. However, other persons may be invited to participate to the discussions of the committee **without having the right to vote**.

Even without legislative or regulatory provisions, it would be better for the board to distinguish between the **advisory** or consultative committees and the so-called **decision-making** committees, to which the board truly delegates powers it must retain under its charter. In the first case, other persons than members of the board may have the right to vote while in the second case, only members of the board should be entitled to vote.

There is no doubt as to the **usefulness** of establishing committees of the board where the board comprises a rather great number of directors. Committees can spend more time to review some important subjects. They therefore ensure greater effectiveness and better productivity of the board. **However, if the board comprises less than seven (7) persons**, the use of committees can make unnecessarily cumbersome the performance of the directors' duties and deprive them of the possibility to play an active role.

Even in the case of committees whose establishment is required under laws or regulations, the **charter** of a committee may be **grouped** with that of another committee, provided that the other applicable legislative or regulatory requirements are complied with (independence of all or a majority of the members).

Many board of directors have established an **executive committee**. **We generally do not favour** such an approach as it often results in relegating the directors who are not members of that committee to an accessory and secondary role. However, we understand that such an executive committee may prove useful when the board comprises a great number of directors (ex.: more than 15). In such a case, it would be probably preferable to reduce the size of the board and create an honorary board of governors or another body of the same type.

38. Can an unanimous written resolution of all the directors replace a formal meeting of the board of directors?

Yes. A **unanimous** written resolution of all the directors can replace a duly convened formal meeting of the board where there is a quorum.

To be valid, the resolution **must be signed by all** the directors without exception. Such a resolution should indicate a date and **truly reflect the will of the directors as of the indicated date** or, at least near such date. Attempting to retroactively correct a situation without expressly mentioning it in the resolution could constitute a suspicious operation and open the door to a contestation of the validity of the resolution.

A **resolution signed by all the directors**, without exception, expressing their consent to this course of action and a waiver of a duly convened formal meeting should be valid and bind the board **even if a minority of directors express their disagreement with the position of the majority**. It is however to be noted that the decision of the board expressed through a written resolution must be a **business decision which is reasonable** in the circumstances and thus have been adequately thought through as the decisions adopted at formal meetings in order to avoid these decisions not complying the standards established by case law and being declared invalid or modified by the courts.

39. What is the recipe for an effective and respectful meeting of the board of directors or a committee?

The recipe includes **many ingredients and techniques**, the main one being listed below:

- the prior identification of the **purpose of the meeting** and the establishment of a **priority order** for the subjects to be discussed;
- everyone (leader, participants and management) being prepared for the meeting;
- the **quality of the leader** of chairman of the meeting;
- clear and respectful **operating rules**, disclosed in advance by the leader, which should not be too technical and procedural;
- the **quality of listening** to the points of view expressed and the open-mindedness to the opinions of others;
- the **concentration on the objectives and respect of the others** (i.e. no personalization);
- the **conciseness** in the interventions and **non-repetition** of what has been already expressed by others; and
- the **respect of alloted time** and allocation of time to questions and discussions (and not to what has been submitted in writing prior to the meeting and what can be dealt with outside the meeting).

The role of the **chairman** of the meeting **or** the **moderator** is fundamental. Ideally, this **moderator** should be a **director who is not a member of management**.

The **chairman** or **moderator of the meeting** should:

- be **aware**, prior to the meeting, of the **stakes and constraints** related to the subjects, the personalities of the members and the approaches which may be adopted;
- **have prepared the meeting** with the executives and ensured that the members of the board or committee, according to the case, receive the information, documents and presentations they required or that he deems to be useful for them to hold enlightened discussions;
- be extremely **respectful of the members and their points of view**;
- **have unclear points of view clarified;**
- **encourage the participation of everybody;**

- **summarize** the state of evolution of the meeting (« sense of the meeting");

- **encourage** those who disagree with a proposal to propose **other solutions or measures**;

- **make the discussions advance** with solutions or arrangements (i.e., be creative) which may attract a majority of, if not all the members;

- immediately **stop repetitions and personal attacks** or motive attributions, thus managing the meeting smoothly, dynamically, proactively, respectfully and in a disciplined manner;

- **refrain from constantly intervening with one's own point of view** and giving oneself a priority right to speak;

- respectfully tell those favouring the minority opinion that their point of view is not ready to be accepted and that it serves nothing to press the issue; and

- ensure **adequate follow-up**.

It is important to note that **human beings** have a tendency to be **intuitive** and **emotive.** As noted by some authors, more often than not, they find rational arguments to justify their intuition[64]. Truly listening to others and keep one's mind open may bring someone to put his intuition aside or modify it.

If the chief executive officer cannot be convinced to let another director chair the meetings, he should at least **adopt an operating mode** which promotes directors' questions and comments and respects the priority of intervention of the other directors and act as an independent leader or chairman of the meeting would.

40. What is the corporate veil and what is its relevance for directors?

The **incorporation** of an entity into a business corporation or, in the case of NFPO, into a not-for-profit corporation (Canada Not-for-profit Corporation Act) or Part III company (Companies Act (Québec)) results in giving the juridical personality to that corporation or company and therefore to confer it a status and powers, rights and obligations separate from those of the applicants, shareholders or members. Section 309 of the *Civil Code of Quebec*[65] reads as follows:

> "309. Legal persons are distinct from their members. *Their acts bind none but themselves, except as provided by law*".
>
> *(emphasis added)*

[64] Daniel Kahneman, *Thinking fast and slow*, Toronto, Doubleday Canada, 2011; Jonathan Haidt, *The righteous mind: why good people are divided by politics and religion*, New York, Pantheon Books, 2012

[65] *Civil Code of Québec*, L.R.Q., c. C-1991

This is called the corporate veil.

Article 317 of *Civil Code of Québec*[66] further provides that this separate juridical personality cannot be invoked in certain circumstances.

> *"317.* In no case may *a legal person set up juridical personality against a person in good faith if it is set up to dissemble fraud, abuse of right or contravention of a rule of public order."*
>
> *(emphasis added)*

Raising the corporate veil is not relevant in itself for directors. It has only an effect on shareholders and members of the legal person who lose the benefit, in such circumstances, of the separate juridical personality of the legal person and results in these shareholders or members being held accountable to third parties for the actions or omissions of the legal person.

However, **if a director participates in the wrongful action or omission, he may incur extracontractual liability**. In fact, a court may conclude that the director's fault caused damages to a third party. As we noted in the answer to another question, non-compliance by a director with his duties to the legal person makes him liable to pay damages following a suit instituted by the victim of such fault.

A director must therefor be wary of the requests of shareholders or members which may constitute actions or omissions of the nature of those described in article 317 of the *Civil Code of Québec*, which may result in the corporate veil being lifted.

41. What are the risks associated with the eligibility criteria of members of a NFPO?

The development and adoption of eligibility criteria for becoming a member of a NFPO are extremely important and **must be given very special attention**.

In the case of NFPOs of the "representative association" type, these eligibility criteria pose less of a problem. They include either a basic characteristics requirement or voluntary enrollment by paying dues or not or a combination of these two elements. The basic characteristics of such legal persons may include:

- the exercise of a professional, artisanal, cultural or sports activity;
- the past attendance at an educational establishment; or
- residence in a given jurisdiction.

As to **non-representative NFPOs** (for example, a social or sports club, a charitable organization, etc.) the purposes of the NFPO are mainly related to its mission and the activities it intends to have, organize or produce. In such cases, the eligibility criteria are often based on the interest of the persons for the mission of the NFPO or their actual or

[66] *Civil Code of Québec*, L.R.Q., c. C-1991

potential contribution to this mission and membership in the NFPO may be subject to validation by the board.

While in representative associations, **objective criteria** usually determine whether someone may become a member, **such is not always the case for the other NFPOs**.

The legal person **being taken over** by "undesirable" elements and **the absence of a date of expiry** or lapsing of member status constitute the two main risks facing NFPOs in general and more particularly a NFPO whose members do not share a common characteristic with all other members.

For instance, when a NFPO has **significant liquidities** from its activities or donations, it may be very tempting for some persons to take control of the NFPO for the purposes of using it, and more particularly its liquidities, **for purposes other than those of the NFPO or the reasons for which donors had contributed financially to the NFPO**.

Maintaining member status without an expiry date may cause sclerosis or inappropriate conservatism of a NFPO.

The **founders or the board of directors** should therefore give some thought to these risks and develop related protective measures by stipulating **adequate eligibility criteria** for the admission as a member of a person and the loss of such status, the whole in the best interest of the NFPO.

42. What meaning should be given to the words or expressions "importance", "reasonable", "independence" and "fiduciary out?"

While discharging their duties, directors will often come across the adjectives "**important**/ **material**", "**independent**", "**reasonable**" and may, especially if they sit at the board of a reporting issuer, be confronted to the expression "**fiduciary out**".

Here is some interpretation guidance respecting these words and expressions.

"Important/material"

These adjectives are often found in the securities legislation and accounting standards as well as at least 16 times in the *Civil Code of Quebec*[67].

Dictionaries associate these adjectives with the characteristic of what they qualify **by giving to what is qualified a significant value, interest or rol**e.

The ***Securities Act*** **(Quebec)**[68] uses it in relation to the words "fact" and "change" in the following way:

[67] *Civil Code of Québec*, L.R.Q., c. C-1991
[68] *Securities Act*, C.Q.L.R. c. V-1.1

- *"material fact" means a fact that may reasonably be expected to have a significant effect on the market price or value of securities issued or securities proposed to be issued;* (Section 5)

- *"(...)material change (...) that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer(...)."* (Section 5.3)

In the English language, the term "material" is often used. In contracts drafted in the English language, we often find the expression "material adverse change".

For the purposes of financial statements, the Canadian Institute of Chartered Accountants defined the term "materiality":

> *"Users are interested in information that may affect their decision-making. Materiality is the term used to describe the significance of financial statement information to decision makers. An item of information, or an aggregate of items, is material if it is probable that its omission or misstatement would influence or change a decision. Materiality is a matter of professional judgment in the particular circumstances."* [69]
>
> (emphasis added)

The **qualification** is **somewhat subjective**, refers to a concept of proportionality and therefore, to the relative character of the item being qualified. This qualification involves an assessment which must be made in the context or the circumstances, reasonably and by using comparables. It will use, as we have seen for securities and accounting standards, the influence or effects that knowledge – or lack of – thereof has or could have had or may have, according to the case, on the reader or investor.

"Independent"

This adjective **refers to the autonomy of a person and his capacity to act or decide freely and without duress**, influence or relationship of subordination which may prevent him to act in the best interest of the legal person on behalf of whom he is called upon to act or decide.

It has been frequently used in the area of governance, for instance, to prescribe or recommend a criterion for selecting a director or a member of a committee of the board or a criterion for retaining a supplier of services.

Thus, the Canadian Securities Administrators ("CSA") discussed the concept of independence by setting out a general criterion and by using certain presumptions of non-independence. This is found in paragraph 1.4 of *Regulation 52-110 Respecting Audit Committees*:[70]

> ***"1.4 Independence***
> *(1) An audit committee member is independent if he or she has no direct or indirect material relationship with the issuer.*

[69] CICA Handbook – accounting, Parts II and III, 2013 Edition, chapter 1000, paragraph 1000.14
[70] Regulation 52-110 Respecting Audit Committees, C.Q.L.R. c. V-1.1, r 28

> *(2) For the purposes of subsection (1), a "material relationship" is a relationship which could, in the view of the issuer's board of directors, be reasonably expected to interfere with the exercise of a member's independent judgement.*
> *(3) Despite subsection (2), the following individuals are considered to have a material relationship with an issuer …*
>
> (emphasis added)

In the same way, the *Act respecting the governance of state-owned enterprises* (Quebec)[71] used at section 4 an approach similar to that of the CSA.

> *"**4**. At least two thirds of the members of the board of directors, including the chair, must qualify as independent directors in the opinion of the Government.*
>
> *Board members qualify as independent directors if they have no direct or indirect relationships or interests, for example of a financial, commercial, professional or philanthropic nature, which are likely to interfere with the quality of their decisions as regards the interests of the enterprise.*
>
> *A board member*
>
> *(...)*
>
> *is deemed not to be an independent director."*
>
> (emphasis added)

The use of the concept of independence has suffered many excessive applications. In the day-to-day reality and the context in which we live in Quebec, only pure spirits would truly be independent. It is therefore important to somewhat put the notion in perspective and favour the criterion of being able to exercise an independent judgement in the best interest of the legal person as the CSA have done. It is also important to note that **the occurrence of a one-time conflict of interests should not result in a director losing his qualification as independent** in the absence of an specific provision to the contrary in the incorporating statute of the legal person or the regulations governing it.

"Reasonable"

The adjective "reasonable" is used approximately 56 times in the Civil Code of Québec. [72]

In the *Peoples'*[73] case, the Supreme Court of Canada referred to it as a criterion for determining whether a director had complied with his duty of care:

> *"The decisions they make must be reasonable business decisions in light of all the circumstances about which the directors or officers knew or ought to have known."*
>
> (emphasis added)

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71 An Act respecting the governance of state-owned enterprises, C.Q.L.R. c. G-1.02
72 Civil Code of Québec, L.R.Q., c. C-1991
73 Peoples Department Stores Inc. (Trustee of) v. Wise, 2004 SCR 68, par. [67]

Many laws and judgments used it to recognize the defence of due diligence which a director may oppose to liability proceedings or a charge against him, whether or not it is based on a presumption of liability or guilt. For example, we refer to section 123(4) of the *Canada Business Corporations Act*[74]:

> *"(4) **[Defence — reasonable diligence]** A director is not liable under section 118 or 119, and has complied with his or her duties under subsection 122(2), if the director exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, including reliance in good faith on*
> *(a) financial statements of the corporation represented to the director by an officer of the corporation or in a written report of the auditor of the corporation fairly to reflect the financial condition of the corporation; or*
> *(b) a report of a person whose profession lends credibility to a statement made by the professional person."*
>
> (emphasis added)

This concept involves the use of principles and means to make a decision or render a judgment. This is similar to **using plain old common sense** in a thoughtful way.

The **characterization** of a decision as reasonable **involves**:

- an analysis of the context and circumstances;
- an analysis of the process followed and the measures taken;
- a comparison of the measures taken by the director with the practices which are followed in the same area by other directors.

As noted by the Supreme Court in the excerpt of *Peoples'* case[75] referred to above, the "reasonability" of the care of a director **needs not to be perfect**. We can add that the duty of care is a **obligation of means and not one of result**. Reviewing compliance therewith cannot be made in a vacuum. The **comparison** with the practices followed in the same area evidences the necessity for directors to get adequate information on the means used by other corporations which may be available in the specific context of the legal person of whom he is a directors and the activities of that legal person.

« Fiduciary out »

This expression mainly describes the **contractual provisions** aiming to **enable a board of directors**, mainly that of a **reporting issuer**, to terminate an agreement with another corporation with whom the legal person has agreed to recommend to its shareholders the acceptance:

- of an offer to purchase the shares they hold; or
- of a transaction for the sale or all or nearly all the assets of the legal person; or

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74 Canada Business Corporations Act, R.S.C. 1985, c. C-44, art. 123
75 Magasisn à rayons Peoples' c. Wise 2004 CSC 68

- another operation of the nature of an arrangement or merger between the legal person and the other corporation,

the whole in a context where a **better or superior offer** would be later made by a third party prior to the closing of the agreement with the co-contracting pary.

The courts have recognized that such contractual provisions are necessary in order to allow directors to discharge what is known in common law as their fiduciary duties and, more precisely, to act to the best of the interests of the legal person.

These **contractual provisions usually include** the following, among others:

- a definition of what would constitute a better or higher offer;
- a framework of the measures which may be taken by the board of directors of the legal person for soliciting or at least consider the offer of a third party;
- a right for the co-contracting party to equal the higher offer of the third party (i.e., a preference pact or right of first refusal); and
- a clause providing for the payment by the legal person of a termination indemnity to the co-contracting party representing a percentage of the amount of the proposed transaction ("break-up fee").

The courts and the regulatory bodies of the securities industry have determined that the **break-up fee** should comply with **limits** which do not in practice preclude the presentation of an higher offer by a third party. Thus, although the percentage of the indemnity may vary according the amount of the consideration offered, it must not exceed 5% and should be in the 2% to 3% range, according to recognized precedents.

43. What is the relevance of meetings without management being present

Management and the board of directors must **work together** to pursue the mission of the legal person and contribute to creating value. Without restricting this collaborative approach, external directors, that is, who are not members of the management team, should however **adopt the practice of meeting without management being present**. Those meetings are often called "closed-door meetings" or "meetings in camera".

The main purpose of such meetings is to allow directors to exchange on the improvements which management should effect in its relationship with the board in order that directors fully play their role, either generally or in respect of specific matters. These meetings also aim to promote **freer expression of concerns or questions** from one or several directors in respect of actions or omissions of management, the behaviour of some management members or the quality of the work of management members. The discussion which may follow the expression of these concerns or questions should allow to ascertain whether these concerns or questions are shared by the other external directors.

The chairman of the board or the **lead director** (independent) must well understand and summarize the results of the discussions and **discuss them with the chief executive officer** as soon as possible after the meeting. He must be transparent but must strive to do so in as positive a manner possible by mainly insisting on the items on which there was a consensus while also mentioning the other points.

The **frequency of these meetings** may vary according to the specific context of each board. For their part, the authors favour a **two-pronged formula**, that is, a short meeting of several minutes only after each formal meeting of the board and a longer, more in-depth meeting at least once a year on the occasion of the assessment of the performance of the board.

Furthermore it would be opportune and desirable, if not necessary in certain circumstances that **independent directors** meet not only without management being present but also **without the other external directors who are not independent being present**. In question # 42 we dealt with the concept of independence.

We wish to add also that the board or a committee of the board should also meet without management being present:

- the **external auditors** following the presentation of the financial statements to discuss, among other things, the collaboration received from management, the disagreements which may have occurred with the members of management as to the treatment or interpretation of some items, deficiencies which they may have identified in the context of the collection, treatment and internal audit of financial information and the quality of internal controls;

- **external compensation experts** on the occasion of making recommendations on management compensation;

- **some other external experts** to discuss their report or recommendations which relate to material aspects of the activities of the legal person for the purpose of obtaining the same comfort sought from external auditors, as described above; so, in the context of a purchase or a merger, the board should meet the legal advisors, accountants, appraisers, environment specialists and other external experts who may have been involved in the due diligence or the seller or the other corporation which is a party to the merger.

ADDITIONAL COPIES

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