



Spring 2015

TOPICS:

**DUE DILIGENCE BEFORE AND
AFTER BECOMING A DIRECTOR**

page 1

**CORPORATE GOVERNANCE
ESSENTIALS FOR DIRECTORS**

page 4

**Firm News &
Professional Notes**

page 8

Due Diligence **Before & After** Becoming a Director

Duties of Directors

Directors owe certain duties to the corporation when they take on the role and responsibility of sitting on a board. Every director should be aware of these duties and should act in accordance with these if they wish to avoid potential liability.

1. Directors have a duty to behave in an honest and fair manner by sharing important information and preventing harm to their corporation.
2. Directors owe a duty of loyalty to the corporation and their fiduciary obligations lay first and foremost to their organizations.
3. Directors face potential liability if they do not attend meetings and fail to dissent within seven days of receiving the minutes.
4. Directors must be adequately prepared for board meetings and must be sufficiently informed of material information to make effective and accurate decisions.

5. A director should insist on access to all relevant information to be considered by the board.
6. Directors have a right to inspect corporate records and other documents related to the corporation.
7. Directors should not support a course of action if there is any doubt that a proposed course of action is inconsistent with a director's fiduciary duties. Seek independent legal advice as soon as possible to clarify the issue.
8. Directors cannot shirk their responsibilities by leaving everything to others. Reliance on co-directors and officers should not be unquestioning.
9. Directors should not rely blindly on management or on subordinates if they have failed to act where they knew or ought to have known that something was not right.
10. Directors should consult with a lawyer if he or she is uncertain about the exercise of his or her duties or responsibilities.

Due Diligence Before Becoming a Director

While it is impossible to be aware of every obligation and liability imposed upon a director, a potential director can limit his or her potential liability by conducting comprehensive due diligence and recording the results prior to becoming a director.

Outlined below are some of the steps that a potential director should take in conducting his or her due diligence. The considerations will vary from organization to organization, depending on its make-up.

1. Consider why you want to be a director.
2. Determine whether the organization is financially strong and stable.
3. Request and receive a written job description detailing specific responsibilities expected of a director and what committees you may be requested to sit on.
4. Find out what the organization's selection criteria are for directors.
5. Speak to other directors to get their perspective on the organization.
6. Find out what materials are usually circulated to directors before meetings and if they are sent on a timely basis.
7. Find out how much time will have to be devoted to the position.
8. Ascertain the organization's policy for appointing the chair of the board and the role of the chair.
9. Find out if the organization pays for the services of independent outside advisers such as lawyers and accountants when it is deemed necessary.
10. Request and take the opportunity to review board and committee minutes for the past two or three years.
11. Find out if there is an orientation program for new directors.
12. Ask whether the organization has guidelines and procedures to deal with conflicts on the board.
13. Request and receive a report on the current areas of concern for directors.
14. Request and receive from the organization's solicitors details of any outstanding and pending litigation or regulatory proceedings against the organization and/or its officers and directors.
15. Ascertain if there are formal policies for compliance with regulatory requirements.
16. Make sure the Act that governs the organization allows the indemnification of directors.
17. Obtain a contractual indemnity from the organization and from the person (be it a friend or client) who appointed you.

- 18. Ascertain whether directors' and officers' insurance coverage is available to the directors and determine its limits and exclusions.
- 19. Ensure that investments made by the organization comply with relevant legislation, especially for charitable corporations.

Due Diligence While Serving as a Director

Directors who carry out their responsibilities in a diligent way are unlikely to incur personal liability. The director has to establish that he or she was diligent in making the decision that he or she made. To this end, there are a number of things a director could and should do.

- 1. Attend as many meetings of the board or any committee as possible.
- 2. Read the material sent to directors before a meeting.
- 3. Take accurate notes at board meetings and review minutes to ensure accuracy.
- 4. Make sure concerns, if any, are set out in the minutes of the meeting.
- 5. Consult independent experts where necessary.
- 6. Be thoroughly familiar with operations of the organization.
- 7. Maintain familiarity with the financial status of the organization.
- 8. Determine from management that there are systems in place to monitor financial variations that should be drawn to the attention of management and the board.

What the Organization can do to Protect Directors

In many cases, the organization can take measures to protect its directors from liability. While this is not an exhaustive list, it provides some useful ways in which organizations can take an active role in protecting its directors.

- 1. The organization should appoint a staff person to be the "point person" in the organization to answer questions of board members so there is consistency in answers.
- 2. There should be a policy that candidates have some financial literacy.
- 3. Ensure that directors are adequately prepared for meetings.
- 4. Ensure via the Chair that there is ample time for discussion of each issue at a board or committee meeting.
- 5. Restrict directors to membership on no more than a set number of other boards.
- 6. Organizations should ensure that appropriate directors and officers insurance is available to the directors.
- 7. Establish a Code of Conduct for Directors and ensure that directors abide by the established rules.



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Corporate Governance Essentials for Directors

Difficulties arise for corporations that lack a formal process for governing the calling and conduct of board meetings. It is therefore important for directors to be aware of the problems that may arise and how to deal with them.

Right to Attend Board Meetings

Only the directors of the corporation may attend meetings of the board of directors. Other persons, such as counsel for a party, may be admitted with the consent of the meeting.¹ This is, however, subject to the provisions of the by-laws of the corporation, which can provide that other individuals may attend, such as an executive director. Directors and officers are under a duty of confidentiality, which others such as the media or special guests are not. At times, guests, like observers, are asked to sign confidentiality agreements.²

Every director has the right to attend and participate in all meetings of the board of directors. As such, a director cannot be excluded from meetings.

No Attendance by Proxy

The law is settled on the issue that a director cannot attend a meeting by proxy, as directors cannot delegate their duties to a third party.³ This law extends to resolutions in writing, which cannot be signed on behalf of a director by power of attorney.

Who can Chair the Meeting

Most by-laws provide that the chair of the board, if present and willing, will preside at meetings of the board. In the absence or refusal of the chair to preside, or to continue presiding, the president shall preside, unless the by-laws provides otherwise. If no such provision exists, a quorum of

1. *Mayor, Alderman and Burgesses of Tanby v. Mason*, [1908] 1 Ch. 457 (CA)

2. *Hayes v. Bristol Plant Hire Ltd.*, [1957] 1 All ER 685 (Ch D).

3. *McGuire & Forester Ltd. v Cadzow* [1933] 1 D.L.R. 192 (Alb. C.A.)

the board may elect a new chair from among the directors.⁴

Conflict of Interest

Directors must disclose their interest at the meeting of directors and must also refrain from voting on any contract in which they may have an interest.

In addition, the *Ontario Business Corporations Act*⁵ (“OBCA”) provides that a director cannot attend any part of a board meeting where the contract in which he or she has an interest is being discussed.⁶ This provision is stricter than that of the *Canada Business Corporations Act*⁷ (“CBCA”), which only provides that the director may not vote on the contract. By-laws of a CBCA corporation could be expanded to incorporate the provisions of the OBCA.

To know which Act governs your company, determine the jurisdiction in which it is incorporated. This information is in the Articles of Incorporation or Letters Patent of the company; otherwise, seek legal advice.

Quorum Issues

Directors must maintain a quorum throughout a meeting. If a quorum is not maintained, the business conducted at the directors’ meeting is not lawfully transacted.

Beware of the “disappearing quorum”. This is where a quorum is present at the start of the meeting but is lost at some point during the meeting itself. In this situation, the meeting must be adjourned, as any business transacted after the quorum is lost is invalid.

Dissent Votes

A director is often faced with a position put forward at a meeting with which he or she does not agree. That person should vote “No” to the resolution and request that his or her dissent vote be

recorded in the minutes. Failure to do so may lead to potential liability since the corporate legislation deems the director to have consented to the resolution if the dissent is not recorded in the minutes.

A director not present at a meeting is also deemed to have consented unless, within seven days after becoming aware of the resolution, the director requests that his or her dissent be noted within the minutes of the meeting.⁸

Minutes of Meetings

Corporations are required to prepare and maintain records containing minutes of meetings and resolutions of directors. The minutes may be kept in a bound or loose-leaf book, or electronically. The corporation must take reasonable steps to prevent the loss or destruction, or the falsification, of the minute books. Minute books are also admissible in court as proof of all the facts contained within in the absence of any evidence to the contrary.

Directors have the right to review all minutes of board meetings. Under the CBCA, any shareholder may review that portion of the minutes of meetings where a director has declared a conflict of interest, but otherwise shareholders do not have the right to review minutes of the board.⁹

Some considerations that directors should keep in mind at all times are the following:

- Prior to their approval, minutes should be critically and carefully reviewed by directors;
- The reasoning and process behind directors’ decisions at board meetings on crucial matters should be understood and noted in the minutes;
- Management should be clear as to whether it is providing documents for information only and where no immediate action is required, or if it is seeking the directors’ approval on a particular matter;
- The materials provided to the directors before and at the meeting should be carefully reviewed and included as attachments to the minutes;

4. *Klein v. James* (1986), 36 B.L.R. 42 (B.C.S.C.) affirmed (1987), 37 B.L.R. (XXV1) (B.C.C.A.).

5. R.S.O. 1990, Ch. B. 16.

6. OBCA at s. 132(5).

7. R.S.C 1985, c. C-44.

8. OBCA, s. 135(3).

9. *Ibid* at s. 120(6.1).

Election of Directors and Appointment of Officers

Whether a for-profit or a not-for-profit corporation, the rules on election or appointment of directors are the same. The basic rule is that shareholders/members elect directors. However, where there is a vacancy on the board, the directors in office may appoint a suitable replacement for the departed director to hold the office until the end of the term of the departing director.

If there are not enough directors remaining on the board to constitute a quorum, a meeting of shareholders/members must be called to elect new directors to the board to fill any vacancy.

Removal of Directors

In Canada, when a director is considered to be a problem because of misbehavior, or where a faction of the board refuses to attend meetings and thereby frustrates a quorum, the available remedies are limited.

A special meeting of shareholders or members could be convened to remove the “dissident” directors and to replace them with ones that are more compatible. The current *Ontario Corporations Act*¹⁰ requires that the right to remove directors be set out in the Letters Patent or by-laws and requires a 2/3 majority of members (s.67), otherwise a director cannot be removed during his or her term. The

CBCA and OBCA provide that the removal is by a simple majority vote. The percentage of votes required for this purpose cannot be increased in the charter documents. A resolution signed by all the shareholders would normally be binding. However, directors may not be removed by a resolution in writing, but only at a properly constituted meeting of the shareholders pursuant to Section 123 of the OBCA and Section 110 of the CBCA.

If the director ceases to be qualified, for example, if he or she becomes certified as mentally incapable; becomes bankrupt; or if the by-laws of a charity so provide, becomes an “ineligible individual” under the *Income Tax Act*¹¹, the director is automatically off the board.

Removal of Officers

Subject to any unanimous shareholder agreement, directors normally appoint officers. There are no provisions dealing with the removal of officers under corporate statutes. It has been assumed those who appointed the officers have the power to remove them.

Conclusion

While we do not address all of the issues that a director may encounter, these are some of the most prevalent issues that directors face on a regular basis.



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10. R.S.O. 1990, C c.38.

11. R.S.C. 1985, c. 1 (5th Supp.).

Congratulations to Samantha Prasad who was elected to the Meritas Board of Directors

Minden Gross LLP is pleased to announce that tax partner Samantha Prasad was appointed for a three-year term to the Board of Directors for Meritas, a global alliance of independent business law firms. Samantha will be responsible for reviewing and establishing policy and setting strategy for the alliance as an organizational leader.

Samantha is an active Meritas member. She served as a part of the Meritas Leadership Institute, which created a green practice guidelines distributed to over 6,500 lawyers worldwide, and later chaired the program. Samantha currently sits on the Meritas Executive Committee for Member Engagement.

Professional Notes

Irvin Schein hosted a webinar on Reasonable Notice on February 25 and continues to publish his blog including "Some Thoughts and Observations by a Toronto Mediator" on February 24.

Eric Hoffstein presented "The Enforceability of 'no contest' and *in terrorem* Clauses" at The Six-Minute Estates Lawyer on May 6; "The Use and Abuse of Exculpatory Clauses" at the Estate Planning and Real Property Spring Symposia on April 30 in Washington, DC; and "Enforcing Charitable Gifts" at the Canadian Association of Gift Planners National Conference on April 22-24. Eric also co-chaired the Ontario Bar Association's program on The Litigation and Administration of Foreign Trusts and Assets on April 9.

Samantha Prasad published "3 Lucrative Last-Minute Tax-Filing Strategies for Canada" in *The Epoch Times*. She also published five articles on *The Fund Library*, including "Tax Traps of owning U.S. real estate," which was also in *The Battlefords News-Optimist* and *Property Prospects Australia*. Samantha published three articles in *The TaxLetter*, including "Tax filing tips," and spoke on "Income Splitting and Attribution Rules" at the RBC Wealth Management Services Conference on March 31.

Matt Maurer was appointed to the Board of Trustees of the Toronto Lawyers Association (TLA) where he will be a part of the Advocacy Committee, the Communications Committee, and the Young Lawyers Committee. Matt also published his biweekly blog at Slaw.ca including "Plaintiff Spends \$550,000 on Legal Fees to Recover \$10,000."

David Ullmann was quoted in *The New York Times*' "Target's Hasty Exit From Canada Leaves Anger Behind" on April 21. He was quoted twice in *The Globe and Mail* in "Target's retreat tactics raise questions about CCAA" on April 3 and "Target owed \$1.9-billion from its own property firm" on March 4 as well as in April's *Canadian Lawyer* in "When the lustre fades."

Michael Goldberg led the Meritax Group meeting on April 17 in Denver, Colorado. He published "The Effective Use of Trusts in Connection with Income Splitting – Part 1" in *Tax Notes* and "The Effective Use of Trusts in Connection with Income Splitting – Part 2" in *The Estate Planner* in April. Michael hosted the third Tax Talk 2015 on February 11.

Howard Black was quoted in "Mediation plus arbitration a one two punch" in *The Lawyers Weekly* on April 10.

The Commercial Leasing Group's **Stephen Posen**, **Stephen Messinger** and **Christina Kobi** attended ICSC RECon in Las Vegas on May 17-18. The Group also took part in the ICSC Canadian Shopping Centre Law Conference on April 14-15 with the following Breakfast Roundtables: **Enzo Saltese** - "Can I Still Sue? How Far Back Can I Go? Limitation Issues"; **Benjamin Radcliffe** - "Releases, Indemnities & Waivers of Subrogation"; **Stephen Posen** - "Co-Tenancy Issues"; **Adam Perzow** - "Early Termination/Kick-Out Clauses"; **Melodie Eng** - "When Can a Landlord Withhold Consent?"; and **Boris Zayachkowski** - "Top Ten Items for Landlord's Checklist When Working with the Tenant's Standard Form of Lease." **Christina**



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Kobi moderated a Plenary Session on "Overholding or Overstaying Your Welcome? Somewhere Over the Rainbow..." **Michael Horowitz** was a Planning Committee Member and moderated a Plenary Session on "Getting to the Expiry of Your Lease...In One Piece!"

Christina Kobi was quoted in the article "Canada's Business Environment Is Too Cold: Target Goes Home!" in *The Article*, Spring 2015. She attended the CREW Network Winter Leadership Summit in San Diego, CA, on February 12-13. Christina spoke on "The Covenant to Insure and Assuming Risk" and **Stephen Posen** spoke on "Mistake and Rectification" at The Six-Minute Commercial Leasing Lawyer 2015 on February 18.

Stephen Messinger taught a session entitled "Working with Your Attorney" at the John T. Riordan School for Retail Real Estate Professionals in Phoenix,

AZ, on April 14. He also attended and presented as a member of the Advisory Board at the Georgetown Law Center Advanced Commercial Leasing Institute in Washington, DC, on April 15-17.

Matthew Getzler spoke at the Canadian Bar Association's Tax Update on March 24.

Joan Jung published "Ontario's New Estate Information Return" in February's *STEP Inside*. She presented "Discussion of Annotated Discretionary Trust" and was a panelist on "Professionalism Issues, Including Client Retainer, Maintaining Books and Records, Responding to Client Pressure etc." at The Annotated Alter Ego Trust and Discretionary Trust seminar on February 19.

Tim Dunn presented "When A Business Fails – Who Gets What?" at the Law Society of Upper Canada program on Commercial Priorities for Real Estate and Business Lawyers on February 24.

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