

Understanding and Minimizing the Risks Associated with your Role as a Director April 2006

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Because of your training and skill as a lawyer and your presumed good judgment, it is likely that you will be asked to sit as a director on a not-for-profit or a for-profit board. You may consider saying yes to this request for a number of reasons – business, social, charitable or personal. Before you accept, be sure you understand the responsibilities and risks associated with a director's role and how you can minimize those risks.

In this article I canvas the following:

- risks involved in acting as a director
- what to ask before agreeing to act as a director
- what to do to minimize risks and protect yourself when acting as a director
- insurance issues
- when and how to report to an insurer
- relevant legislation
- information as to where directors and officer's professional liability insurance might be obtained

Insurance

As a lawyer practicing in Nova Scotia, you might assume that your lawyers' professional errors and omissions policy will cover you if you are sued in your capacity as a director. It does not. Our errors and omissions policy can be viewed on the LIANS website at www.lians.ca. Coverage under this policy is only for professional errors and omissions that occur when rendering professional services to others.

In our policy, professional services means:

- a. services normally provided or supervised by a lawyer within the scope of a usual lawyer-client relationship;
- b. services rendered in alternative dispute resolution as an arbitrator or a mediator or in an equivalent role; and
- c. incidental services that are substantially related to services described in paragraph (a),

But does not include Ancillary Activities

Part 111 Paragraph 3.9 of the Policy states that an insurance coverage doesn't apply to:

- 3.9 an Insured's acting in the capacity of director or officer of any enterprise other than LIANS or the Law Society.

Your "lawyers' insurance" does not provide coverage for claims made against you in your capacity as a director of any enterprise, other than LIANS or the Barristers' Society.

Risks Involved

Provincial and federal statutes impose many different responsibilities on directors. Pursuant to 227 (1) of the Income Tax Act¹, you can be held personally liable for unremitted federal income tax withheld from wages or salary paid to employees. While sub-section 227.1 (3) provides that a director is not liable where he or she exercises due diligence, the burden of proof is on the director to prove on a balance of probabilities that he or she has exercised due diligence in his or her role as a director. Whether you will be found to have exercised due diligence will depend on the factors and circumstances of the particular case and your particular skills. Claims against directors have also been experienced in various other areas including employment, the environment and securities.

Depending on the circumstances, you could as a director, be responsible for the payment of company debts, can have fines imposed on you personally and face imprisonment for serious violations (see s.384 Criminal Code of Canada).

What to Ask and Consider Before Agreeing to Act

In Chapter 13 of the Directors Duties in Canada 2nd Edition, 2002,² Margot Priest and Hartley R. Nathan, Q.C., discuss what due diligence one should undertake before becoming a director and how a director can establish that he or she has been diligent while serving as a director. The following summarizes in part their recommendations:

- Is directors' and officers' insurance coverage available to you – if so, what are its scope, limits, exclusions and reporting requirements?
- Is the organization financially strong and well run?
- What specific responsibilities are expected of you?
- What are the skills and personalities of the current directors and the board dynamics?
- Are materials circulated to directors before meetings and on a timely basis?
- What has the attendance record been for directors?
- How much time will you need to dedicate to this position and how will this impact on your current personal and professional commitments?
- Does the organization pay for the services of independent outside advisors, such as lawyers and accountants, when necessary?
- Review the minutes from previous board and committee meeting – do they contain sufficient detail?
- Is there is an orientation program for directors?
- Does the organization have guidelines and procedures to deal with conflicts on the board?
- Is there outstanding or pending litigation against the organization and/or its officers and directors?
- If investments are being made by the organization, are they in compliance with relevant legislation and/or a donor's wishes?

¹*Income Tax Act* R.S.C. 1985, c.1 (5th Supp.)

²Priest and Nathan, *Directors Duties in Canada: Managing Risk*, 2nd Edition, 2002 (Toronto, Ontario, CCH Canadian Limited) p. 234-40

When serving as a director:

- know and clarify your role;
- attend as many meetings of the board or any committee as possible;
- read the materials sent to you before a meeting;
- take accurate notes at board meetings and review minutes to ensure accuracy;
- make sure your concerns, if any, are set out in the minutes of the meeting;
- consult independent experts where necessary;
- be thoroughly familiar with operations of the organization;
- maintain familiarity with the financial status of the organization and circumstances that should be drawn to the attention of the board;
- ensure, via the chair, there is ample time for discussion of each issue at a board or committee meeting;
- ensure that the treasurer or person in the organization fulfilling that function confirms in writing that there has been compliance with the various taxing statutes that allow for a due diligence defence;
- ask probing questions and be satisfied with the answers;
- exercise due diligence at all times.

During your tenure as a director it may happen that an issue for which your legal expertise is well known arises, and you are asked to provide legal advice to the board and you do so. Be clear that you are giving advice as a lawyer (if that is the case), so as to avoid insurance coverage issues.

Also ensure that you:

- have a detailed written retainer for the legal services you provide;
- give advice in writing, whenever possible;
- document in writing all verbal advice given;
- confirm in any written or verbal communication to the board when your advice is given pursuant to your retainer for legal services, or whether your opinion is offered as a director; and
- accurately reflect in your billings to the organization whether the account is for legal services or simply for expenses as a director or officer.

Reporting

Whenever you have knowledge of facts or circumstances that could give rise to a claim against you as a director, you must report immediately to your Directors' and Officers' Liability insurer. A Directors' and Officers' Liability insurance policy is a "claims made" policy. To be covered, the claim must have been made against you during the policy period and you must report it to the insurer before the policy expires. Insurance is determined by the date the director first becomes aware and reports it to the insurer. Make the organization staff aware of this important reporting function. Report as soon as you are aware of a claim or a potential claim. Maintain a copy of your report for your own records.

Non-profit organizations - Volunteer Protection Act

While Nova Scotia has enacted the *Volunteer Protection Act*³ that applies to “non-profit” organizations, I caution you not to rely solely on this legislation to protect you in your capacity as director of non-profit organizations.

Section 2(h) of the *Volunteer Protection Act* states that volunteers **may** (emphasis mine) include a Director, Officer, or Trustee or Employee of the company. Use of the word “may” in this context suggests that directors, officers and employees of non-profit organizations **may not** (emphasis mine) always qualify as volunteers under the *Volunteer Protection Act*.

As well, it is important to note that the *Volunteer Protection Act* does not override federal legislation relating to any liability directors may have for remittances of source deductions under Federal Tax Legislation.

Where to obtain coverage

National Directors’ and Officers’ Liability insurance is available through Aon Reed Stenhouse Inc., a company that has partnered with Volunteer Canada to provide such coverage to all non-profit organizations who are members of Volunteer Canada. Volunteer Canada can be accessed on the web at: volunteer.ca. Directors’ and Officers’ Liability insurance is also available through the Canadian Bar Insurance Association. (CBIA)

³*Volunteer Protection Act* S.N.S. 2002, c. 14