

former director wins long battle to recover fines

In March, the Ontario Court of Appeal released its judgment in *Bennett v. Bennett Environmental Inc.*, 2009 ONCA 198, entitling the former CEO and director (Bennett) to indemnity from Bennett Environmental Inc. (BEI) for fines and costs Bennett paid to the Ontario Securities Commission (OSC). While the outcome of the case will be welcome news for directors and officers of Canadian corporations, it highlights what a difficult ordeal the battle for indemnification can become.

background

In June 2003, BEI, a publicly traded company listed on the TSX and AMEX, announced it had been awarded the largest soil remediation contract in its history, a contract issued by the United States Army Corps of Engineers (the Corps). Shortly thereafter, a competitor protested the award of the contract and the Corps notified BEI that it was withdrawing the contract award and rebidding it. Nevertheless, in its subsequent press releases during the next 11 months, BEI continued to disclose the contract as one of its ongoing projects.

A year after the initial award, BEI entered into a new contract on a much smaller scale with the Corps. In the press release announcing the smaller contract, BEI acknowledged that the original contract had been in dispute for 11 months. The price of BEI shares fell almost 50% within 10 days.

As a result of the dramatic loss in share value, class actions were initiated in the U.S. against BEI and its directors. As well, the U.S. Securities and Exchange Commission (SEC) brought proceedings against BEI, Bennett and other BEI directors. The U.S. class actions and SEC proceedings were ultimately settled in 2005 and 2006. BEI advanced undisclosed amounts to Bennett in relation to the U.S. class actions and SEC proceedings.

Meanwhile, however, the OSC also alleged that BEI, Bennett and other BEI directors had violated the continuous disclosure requirements of Ontario securities law. In 2006, the OSC entered into a settlement agreement with Bennett, the terms of which included Bennett's admission that he had violated such disclosure

requirements and his agreement to pay fines and costs totalling C\$300,000. BEI was not ordered to pay any penalty.

It is important to note that Bennett did not engage in any insider trading and that the settlement agreement with the OSC expressly acknowledged that Bennett had had an honest but mistaken belief that, despite the dispute with the Corps, the initial contract was enforceable and that the dispute would ultimately be resolved in BEI's favour. There was external evidence to corroborate his claim – including his election to take his bonus in options and his decision not to sell any shares in BEI.

After settling the OSC investigation, Bennett sought indemnification from BEI for the fines and costs that he paid to the OSC. BEI (citing its "limited cash resources") not only refused to pay Bennett's request for OSC-related indemnification but also counterattacked, seeking repayment of monies that it had previously advanced to Bennett in relation to the U.S. class actions and SEC proceedings. Bennett brought an application for a declaration that he was entitled to indemnification from BEI in relation to the fines and costs incurred in all proceedings, and he was successful before C. Campbell J. in the Ontario Superior Court of Justice. BEI then appealed, challenging the application judge's interpretation and application of the appropriate tests required by BEI's corporate statute, the *Canada Business Corporations Act* (CBCA).

court of appeal's ruling

Pursuant to s. 124(1) of the CBCA, a director or officer is permitted to be indemnified by a corporation for all costs, charges or expenses incurred "in respect of any civil, criminal, administrative, investigative or other proceeding in which the individual is involved because of that association with the corporation". However, s. 124(3) of the CBCA prohibits such indemnification where the director or officer has not complied with two distinct requirements. In all cases, the director/officer must have "acted honestly and in good faith with a view to the best interests of the corporation" (the "good faith conduct" requirement). In addition, where indemnification is sought for "a monetary penalty", the director/officer must have had "reasonable grounds for believing that [his or her] conduct was lawful" (the "belief in lawful conduct" requirement).

The Court of Appeal considered the tension between the competing objectives of encouraging well-intentioned entrepreneurship, on the one hand, and discouraging irresponsible behaviour, on the other, in applying the tests in s. 124(3). Ultimately, the Appeal Court determined that imposing the burden on the corporation to prove that the director or officer did not meet the "good faith conduct" and "belief in lawful conduct" requirements best balances these objectives.

“good faith conduct” requirement

Section 124(3)(a) of the CBCA requires that the director or officer seeking the indemnification must have discharged his or her duty to act honestly and in good faith in the best interests of the corporation.

In considering the good faith conduct requirement, the Court of Appeal followed the reasoning set out in the leading case of *Blair v. Consolidated Enfield Corp.*, [1995] 4 S.C.R. 5, where the Supreme Court of Canada held that the corporation opposing the indemnification bears the burden of proving that the conduct of the director or officer did not satisfy this requirement. The Court of Appeal also agreed that, from the outset, the director or officer is assumed to have acted in good faith and that the corporation must rebut this assumption. Ultimately, the Appeal Court agreed with the application judge that BEI failed to establish that Bennett had acted in bad faith.

“belief in lawful conduct” requirement

Section 124(3)(b) of the CBCA additionally requires that a director or officer must have had reasonable grounds for believing that his or her conduct was lawful in order to be entitled to corporate indemnification for a “monetary penalty”.

Blair did not involve indemnification for any monetary penalty and, therefore, in that case, the Supreme Court did not expressly consider this requirement. However, the Court of Appeal in *Bennett* followed the same line of reasoning with respect to the “belief in lawful conduct” requirement and held that the onus for proving whether the director or officer had reasonable grounds for the belief that his or her conduct was lawful also rests with the corporation. The Appeal Court further noted that placing the burden on the corporation was appropriate from a practical perspective since the corporation, and not the impugned director, would have unrestricted access to corporate documents relevant to any indemnification proceedings.

relevance of professional advice

Both the Supreme Court in *Blair* and the Court of Appeal in *Bennett* placed considerable importance on the extent to which a director/officer seeking indemnification received and relied on professional advice before embarking on the impugned conduct. In *Blair*, the Supreme Court said that, while reliance on legal advice does not guarantee indemnification, such reliance strongly militates against a finding of bad faith or fiduciary breach. In *Bennett*, the Appeal Court held that: (1) while legal or professional advice is not a prerequisite to indemnification, it will substantially assist a director/officer in establishing reasonable grounds for the belief that his or her conduct is lawful; and (2) a failure to obtain professional advice may raise questions about a director’s conduct or belief, making it necessary to look for other evidence of the reasonableness of the director’s belief.

conclusion

The Court of Appeal agreed with the application judge that BEI had failed to satisfy its onus to demonstrate that Bennett did not meet the requirements of s. 124(3) of the CBCA. Thus, Bennett was vindicated in his quest to be indemnified for the fines and costs that he agreed to pay the OSC in 2006. His vindication came, however, after a lengthy ordeal battling the company that continues to bear his name years after his departure as a director and officer. Nor has the last chapter in the story apparently been written yet, as BEI is suing Bennett for C\$10 million relating to BEI's conviction for fraud in the procurement of the same disputed contract. It is worth pondering whether a bit of timely professional advice would have avoided the unfortunate saga that began with the unwinding of that soil remediation contract nearly 6 years ago – saving BEI, Bennett and its other former directors considerable agony and expense.

Written by Matthew B. Langford and Wayne D. Gray

For more information, contact Ted Scott (416.865.7183 | ted.scott@mcmillan.ca) in Toronto or David Rosentzveig (514.987.5038 | david.rosentzveig@mcmillan.ca) in Montreal or any other member of McMillan's Corporate Group.

a cautionary note

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