Lang Michener LLP

Employment & Labour

February 2010

Directors and Officers Liability in the Employment Context

A. Introduction

As the recession grinds on and more businesses come to the brink of demise, it becomes all the more relevant to examine the subject of liability of corporate actors. The starting position in law is that corporations are separate legal entities, and as such, individuals are insulated from personal liability for wrongful acts committed by the corporation. Despite this general principle, there are a number of federal and provincial laws that pierce through the corporate veil and expose individuals to substantial personal liability for corporate wrongdoing. The purpose of the paper is to outline the various forms of liability that are imposed by Canadian law on directors and officers in connection with respect to employees. The first part of the paper examines the liability of directors for unpaid employee wages under provincial and federal business corporations, and employment statutes. The second part discusses the prospect of personal liability of directors for unpaid remittances by the corporation of taxes, pension plan and Employment Insurance premiums. The final part discusses the potential grounds for liability of officers and directors in governing or overseeing employee pension plans. Incorporated within each part is a discussion of the available defences that directors may rely upon to shield themselves from liability.

B. Directors' Liability for Unpaid Wages

Unpaid wages is one of the largest areas of potential liability for directors. The public policy rationale underlying this type of liability was put forth by Madam Justice L'Heureux- Dube in *Barrette v. Crabtree Estate* ("Barrette")[1], where she stated that the purpose of holding directors liable for unpaid wages of employees is to lessen the information asymmetry that exists between the two parties. The idea is that directors have full knowledge of the financial health of the corporation, and they must be deterred from misleading vulnerable employees while knowing that the corporation will not be able to compensate them for their services.[2]

This section will discuss key provisions relating to directors' liability for unpaid wages under the business corporations and employment standards statutes, namely, section 131

[1] (1993) 1 S.C.R. 1027.
[2] *Ibid* at para 27.

of the Ontario *Business Corporations Act*[3] (the "OBCA"), section 119 of the Canada *Business Corporations Act*[4] (the "CBCA") and sections 80 and 81 of the Ontario *Employment Standards Act, 2000* [5] (the "ESA").

1. Business Corporations Statutes

The federal and provincial business corporations statutes contain similar though not identical provisions respecting directors' liability for unpaid wages. Subsection 119(1) of the CBCA reads:

> Directors of a corporation are jointly and severally liable to the employees of the corporation for all debts not exceeding **six months wages** payable to each such employee for services performed for the corporation while they are such directors respectively **(emphasis added)**.

Similarly, subsection 131(1) of the OBCA states:

> The directors of a corporation are jointly and severally liable to the employees of the corporation for all debts not exceeding **six months' wages** that become payable while they are directors for services performed for the corporation and for the vacation pay accrued while they are directors for not more than twelve months under the Employment Standards Act, and the regulations thereunder, or under any collective agreement made by the corporation **(emphasis added)**.

Under these provisions, employees may seek reimbursement from the directors of their corporate employer for up to six months of unpaid wages. However, the liability of directors under these corporate statutes is tempered by conditions precedent set out in the acts.[6] Under the CBCA, a director is not considered to be liable unless: 1) the corporation has been sued for the debt in question after it has become due, and execution was returned unsatisfied in whole or in part[7]; 2) the corporation has commenced legal liquidation and dissolution proceedings or has been dissolved; and 3) a claim for the debt has been proved within six months after the earlier of the date of commencement of the liquidation and dissolution proceedings and the date of dissolution[8]; or 4) the corporation has made an assignment or a bankruptcy order has been made against it under the Bankruptcy and Insolvency Act and a claim for the debt has been proved within six

[3] R.S.O. 1990, Chapter B. 16.
[4] R.S.C. 1985, c. C-44.
[5] S.O. 2000, c. 41.
[6] CBCA subsection 119(2), and OBCA subsection 131(2).
[7] CBCA subsection 119(2)(a)
[8] *Ibid* subsection 119(2)(b)

months after the date of the assignment or bankruptcy order.[9] The corresponding provisions in the OBCA are similar but two differences should be noted between them; firstly, the OBCA appears to allow an action to be commenced simultaneously against both the directors and the corporation, whereas under the CBCA it appears that commencing an action against a director before it is instituted against a corporation is a nullity. Secondly, the CBCA provides that a director is not liable unless the corporation is sued within six months after the debts became due, whereas the OBCA does not provide a corresponding time limitation.

If the aforementioned pre-conditions are satisfied and the debts claimed fall within the unpaid wages provisions of the OBCA or CBCA, then director liability arises. This leads to the question of what kind of debts fall within the unpaid wages provisions of the business corporations acts? Although on face value, it appears that the use of the term "all debts" has a broad and over-inclusive scope, the courts' interpretations have limited the term to amounts that constitute a debt for services that the employees have performed for the corporation. For example, in *Mesheau v. Campbell et al*,[10] Weatherston J.A stated that, "… the words 'all debts' are modified by the phrase 'for the services performed for the corporation' and thus subject to be quantitative limit of six months wages payable to each such employee." In other words, the "debt" covered by this section must be tied to the services rendered by the employee.

Deciding what payments constitute debts for the services performed for the corporation is an issue that continues to be litigated in the courts. In *Proulx v. Sahelian Goldfields Inc*.[11] the court found that the obligation of a corporation in respect of "all debts" is not confined to amounts owing for wages or salary and it could include reasonable travel and out-of-pocket expenses that employees incurred in connection with the performance of their duties. The courts have also held that employment benefits fall within the meaning of "all debts" because they constitute debts that result from the employees' performance and services for the corporation.[12]

In recent years, the courts have also addressed the issue of directors' liability in situations where third parties have attempted to bring actions on behalf of the employees. In *Ceridian Canada Ltd. v. Labrecque*,[13] Ceridian was a payroll company that brought proceedings against the board of directors of Tye-Sil Corporation. Ceridian paid Tye-Sil's employees wages on the corporation's behalf but was not reimbursed. Later, Tye-Sil declared bankruptcy and Ceridian was left with a valueless claim. Ceridian made a number of arguments against the directors of the corporation. Of particular relevance was the argument that the claim should be subrogated in the rights of employees of Tye-Sil because of its payroll payments to them. Ceridian relied on 119 of the CBCA against the

[9] *Ibid* subsection 119(2)(c)
[10] (1982) 39 O.R. (2d) 702 (C.A).
[11] [2001] O.J. No. 3728, 55 O.R. (3d) 775 (Ont. C.A.) at paragraphs 19-20.
[12] See for example, *International Union of Bricklayers and Allied Craftsmen et al v. Fazzini* [2008] O.J. No. 4362 (Ont. SCJ).
[13] (2008) Q.J. No. 14590 (Quebec Superior Court).

directors. The court disagreed with Ceridian and held that it could not rely on section 119 of the CBCA for relief because the employee wages were in fact paid, thus no action arose against the directors.

The *Ceridian* decision followed two similar cases, *Canadian-Automatic Data Processing Services Ltd. v. Bentley* ("Bentley")[14] and *Canadian –Automatic Data Processing Services Ltd. v. CEEI Safety & Security Inc.* ("CEEI")[15]. Both cases involved claims by payroll service companies against the directors of a corporation that went bankrupt after the payroll service company had funded the employees' regular wage payments. In *CEEI*, an Ontario Court of Appeal case dealing with section 131 of the OBCA, the Court dismissed the claim by the payroll service company. The Court of Appeal stated that the liability of directors to cover unpaid wages only arose when wages were, in fact, unpaid. It added that since the employees in this case were paid, they had no claim under the OBCA against the directors.[16] In denying the claims of the payroll service companies, the judges were also driven by public policy arguments cited in *Bentley*, with the Court of Appeal stating as follows:

> The general rule is that corporate officers are not liable for the corporation's debts. The separate legal personality of a corporation and its sole liability for its debts are fundamental to our economic system. **The liability of directors and officers for unpaid wages is a statutory exception to the general rule, intended for the protection of employees, not other creditors**…To extend liability beyond the statutory scheme to other creditors erodes the general rule of corporate responsibility, for the benefit of commercial enterprises undertaking known business risks rather than the vulnerable group of employees the legislation was intended to protect…"[17] **(emphasis added)**

Other amounts that are found not to fall under the aforementioned OBCA and CBCA provisions with respect to unpaid wages are termination and severance pay, which are payable pursuant to employment standards legislation. In *Englefield v. Wolf*,[18] the Court stated that the reference to "debts" in subsection 131(1) of the OBCA does not make a director liable for termination and severance payments under the Ontario ESA. In this case, a corporation encountered financial difficulties and sought protection from its creditors. It terminated its employees, who in turn filed a class action against the sole director of the corporation for unpaid wages, termination pay, severance, vacation, loss of health benefits and unpaid expense reimbursements. The director was appointed three

[14] [2004] B.C.J. No. 1513, 11 W.W.R. 406 (B.C.C.A).
[15] [2004] O.J. No. 4879, 246 D.L.R (4th) 400 (Ont. C.A).
[16] *Ibid* at para 21.
[17] Bentley at para 72-73.
[18] (2005)Carswell Ont 6609, 33 BLR (4th) 267, additional reasons at (2006) 33 BLR (4th) 288 (Ont. SCJ)

months before the application for protection and did not defend the claim in time, and the employees moved for judgment against the defendant. The application was allowed in part. The employees were entitled to recover unpaid wages, holiday pay and unpaid expenses from the director. Damages were limited to amounts earned during the period after the director's appointment. Also, the employees were not entitled to recover termination, severance pay and benefits during the severance period from the director. In making this decision, the Court followed the Ontario Court of Appeal decisions of *Mills-Hughes v. Raynor*[19] which involved claims against directors based on the predecessor of subsection 119(1) of the CBCA. In *Raynor*, the Court held that for the purposes of section 114 of the CBCA (now section 119), severance and termination pay are not considered debts for services performed for a corporate employer. The *Raynor* decision was also followed for the purpose of section 131 of the OBCA in *Jonah v. Quinte Transport (1986) Ltd*.[20] The same line of reasoning has been followed with respect to damages flowing from wrongful dismissal – the SCC in *Barette* ruled against the liability of directors for such damages. In refusing to find the directors liable, Madam Justice L'Heureux-Dube stated that damages for wrongful dismissal do not "flow from services performed for the corporation, but rather from the damages arising from non-performance of contractual obligation to give sufficient notice."[21] In other words, termination – related claims are not captured by the unpaid wages provisions.

With respect to vacation pay, the OBCA specifically refers to liability for vacation pay of twelve months, unless there is a collective agreement stating otherwise. The CBCA provision differs in that specific reference is not made; however, the case law has made it clear that vacation pay is in fact recoverable under the CBCA.[22]

As is clear from the above discussion, the directors of a corporation that is unable to meet its payment obligations to its employees can face an enormous liability for wage-related debts of the corporation. However, such liability is not without its limitations. For starters, both the CBCA and OBCA limit the time period under which an action can be brought against a director. Subsection 119(3) states that for a director to be liable under 119(1), an action must be brought within two years after ceasing to be a director. Although the OBCA does not contain a similar provision specifying the duration of the limitation period, it is governed by the two year general limitation period under the Ontario *Limitations Act*.[23] It is important to note that under both corporate statutes, the limitation period begins to run from the date the directors' resignation becomes effective.

[19] (1988) 63 O.R. (2d) 343 (C.A).
[20] [1994] O.J. No. 1507 (Ont. General Division).
[21] *Supra* note 1 at para 44.
[22] See *Brown v. Shearer* [1995] M.J. No. 182, 33 C.B.R (3d) 314 (C.A.)
[23] S.O. 2002, c. 24 at section 4.

2. Due Diligence Defence

Where a corporation is incorporated under federal jurisdiction (CBCA), the directors may employ a statutory defence of reasonable diligence under subsection 123(4) of the CBCA. A director may be relieved of liability where he or she has relied in good faith on financial statements or professional reports that confirm the financial health of the corporation. Under section 123(4), a director is not liable for improper share issuances or payments (s. 118), unpaid wages (s.119), or breach of fiduciary duty and the duty of care (s. 122) if he or she has relied in good faith on:

> 1. Financial statements represented to him or her by an officer of the corporation or in a written report of the corporation's auditor to reflect fairly the financial position of the corporation; or
>
> 2. a report of a lawyer, accountant, engineer, appraiser or other person whose profession lends credibility to a statement made by him or her.

The application of this provision can be utilized in situations where the directors act in good faith and in reliance on other professionals. For example, directors can rely on this provision in situations where they refuse to pay an amount to an employee based on a legal opinion that such payment is not warranted, or based on statements of officers responsible for paying wages, which indicate that the wages have been paid.

The Supreme Court of Canada in *Peoples Department Stores Inc. (Trustee of) v. Wise*[24] reiterated the principle that the honest and good faith efforts by directors to redress a corporation's financial problems do not engage their liability simply because they were unsuccessful in their efforts. In this case, Wise Stores Inc. purchased Peoples Department Stores Inc. The directors of Peoples faced problems after the acquisition in connection with the joint inventory procedure, and consulted with the vice-president of finance of the parent company Wise for a solution. The solution involved the extension of significant credit to Wise, which seemed to work well until both companies went bankrupt. People's trustee in bankruptcy brought an action against the directors of Peoples claiming that they breached their fiduciary duty and duty of care to the creditors of Peoples. The Supreme Court of Canada did not find liability to rest with the directors, and reiterated that the standard of care required of directors is not perfection, but reasonableness. Directors need only act honestly, in good faith, and in a manner that is prudent and reasonable to meet the requisite standard of care.

It is important to note that although the OBCA contains a statutory due diligence defence under subsection 135(4), it is not made applicable to subsection 131(1) and is therefore not available for directors who are the subject of an action for unpaid wages.

---

[24] See *Peoples Department Stores Inc. (Trustee of) v. Wise* (2004) S.C.J. No 64.

3. Employment Standards Act

The Ontario ESA imposes liability on directors for certain unpaid wage claims. Subsection 81(1) provides that the directors of an employer are jointly and severally liable for wages if,

> (a) the employer is insolvent, the employee has caused a claim for unpaid wages to be filed with the receiver appointed by a court with respect to the employer or with the employer's trustee in bankruptcy and the claim has not been paid;
>
> (b) an employment standards officer has made an order that the employer is liable for wages, unless the amount set out in the order has been paid or the employer has applied to have it reviewed;
>
> (c) an employment standards officer has made an order that a director is liable for wages, unless the amount set out in the order has been paid or the employer or the director has applied to have it reviewed; or
>
> (d) the [Labour Relations] Board has issued, amended or affirmed an order under section 119, the order, as issued, amended or affirmed, requires the employer or the directors to pay wages and the amount set out in the order has not been paid.

The provision in the ESA is virtually identical to those in the CBCA and OBCA. Under the ESA, directors must pay interest on wages for which they are liable, and are liable for both unpaid vacation pay and statutory holiday pay.[25] One of the main differences between the provisions for unpaid wages under the ESA and those under the business corporations statutes is that under the ESA, proceedings against an employer do not have to be exhausted before an employee can proceed against the directors to collect wages.[26] In addition, there is an express pronouncement in the ESA against director liability for termination and severance pay.[27]

The liability of directors is also subject to the following express limitation:

> The directors of an employer corporation are jointly and severally liable to the employees of the corporation for all debts not exceeding **six months' wages**, as described in subsection (3), **that become payable while they are directors for services performed for the corporation and for the vacation pay accrued while they are directors for not more than 12 months** under this Act and the regulations made under it or under any collective agreement made by the corporation **(emphasis added)**.

---

[25] *Ibid* at sections 81(4).
[26] *Supra* note 4 at section 81(2).
[27] *Ibid* at section 81(3).

An employment standards officer can make an order against an employer under subsection 106(1), ordering wages to be paid. The employment standards officer may also make an order to pay wages for which directors are liable, against some or all of the directors of the employer. Failure by the directors to comply with such an order can result in penalties under section 136. Subsection 136(1) provides that a director of a corporation is guilty of an offence if he or she fails to comply with an order under the ESA. Where a director is convicted, he or she is liable to a fine of not more than $50,000.[28]

C. Liability for Source Deductions

Directors' liability for unremitted source deductions includes income taxes, Employment Insurance premiums and Canada Pension Plan premiums which have been withheld by the employer and not remitted to the Canada Revenue Agency ("CRA"). The CRA has the right to pursue the directors for unremitted deductions, as well as interest and penalties.

1. Liability Under the Federal and Provincial Income Tax Acts

Subsection 227.1(1) of the Canada *Income Tax Act*[29] ("ITA") was introduced to impose personal liability on directors of corporations for taxes deducted but not remitted. It provides:

> Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or 135.1(7) or section 153 or 215, has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the **directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally, or solidarily, liable,** together with the corporation, to pay that amount and any interest or penalties relating thereto **(emphasis added)**.

The Ontario *Income Tax Act*[30] has a provision to the same effect at section 38 which states:

> Where a corporation has failed to deduct or withhold an amount as required by subsection 153 (1) of the Federal Act, as it applies for the purposes of this Act, or has failed to remit such amount, the **directors of the corporation at the time the corporation was required to deduct or withhold the amount, or remit the amount, are jointly**

[28] *Ibid* at section 136(2)
[29] R.S.C. 1985, c. 1.
[30] R.S.O. 1990, c. 12.

> **and severally liable,** together with the corporation, to pay any amount that the corporation is liable to pay under this Act in respect of that amount, including any interest or penalties related thereto **(emphasis added)**.

Similarly, section 323 of the *Excise Tax Act*[31] ("ETA") imposes joint liability on a director with respect to a corporation's "net tax" remittances and refunds. It provides that where

> … a corporation fails to remit an amount of net tax as required under subsection 228(2) or (2.3) or to pay an amount as required under section 230.1 that was paid to, or was applied to the liability of, the corporation as a net tax refund, **the directors of the corporation at the time the corporation was required to remit or pay, as the case may be, the amount are jointly and severally, or solidarily, liable,** together with the corporation, to pay the amount and any interest on, or penalties relating to, the amount **(emphasis added)**.

Evidently, directors are jointly and severally liable with the corporation if the corporation fails to deduct, withhold, or remit the required income tax. The purpose of the enactment of subsection 227.1(1) of the ITA was to protect the interests of the Minister of National Revenue by preventing directors from using remittance amounts to pay creditors and suppliers to sustain business operations.[32]

The liability of directors under the ETA and ITA is tempered by a number of conditions precedent. Subsection 227.1(2) of the ITA and subsection 323(2) of the ETA contain identical limitations which stipulate that a director is not liable for unremitted source deductions unless:

> (a) a certificate for the amount of the corporation's liability referred to in that subsection has been registered in the Federal Court and execution for that amount has been returned unsatisfied in whole or in part;
>
> (b) the corporation has commenced liquidation or dissolution proceedings or has been dissolved and a claim for the amount of the corporation's liability referred to in that subsection has been proved within six months after the earlier of the date of commencement of the proceedings and the date of dissolution; or
>
> (c) the corporation has made an assignment or a bankruptcy order has been made against it under the *Bankruptcy and Insolvency Act* and a claim for the amount of

[31] R.S.C. 1985, c. E-15.
[32] *Soper v. Canada* [1997] F.C.J. No. 881 (Federal Court) ("Soper").

> the corporation's liability referred to in that subsection has been proved within six months after the date of the assignment or bankruptcy order.

These provisions ensure some measure of balance in how unpaid tax remittances will become potentially payable by directors.

2. Liability for Pension and Employment Insurance Premium Remittances

Section 21.1(1) of the *Canada Pension Plan Act*[33] ("CPP") also calls for holding directors liable if a corporation fails to deduct or remit contributions as required by CPP. It states:

> … if an employer who fails to deduct or remit an amount as and when required under subsection 21(1) is a corporation, the persons who were the **directors of the corporation at the time when the failure occurred are jointly and severally or solidarily liable,** together with the corporation, to pay to Her Majesty that amount and any interest or penalties relating to it **(emphasis added)**.

Section 83(1) of the *Employment Insurance Act*[34] ("EIA") states that:

> If an employer who fails to deduct or remit an amount as and when required under subsection 82(1) is a corporation, the persons who were the **directors of the corporation at the time when the failure occurred are jointly and severally, or solidarily, liable,** together with the corporation, to pay Her Majesty that amount and any related interest or penalties **(emphasis added)**.

Subsection 21(1) of the CPP and subsection 83(2) of the EIA provide that subsections 227.1(2) to (7) of the ITA apply to a director of a corporation under the CPP and EIA. Note that the EI and CPP contribution rates for 2010 are 1.73% and 4.95% respectively.[35]

3. Limitations on Liability

In order to collect from directors for unremitted source deductions, there is a limitation period of two years to bring forth claims; otherwise, they are barred by statute. More importantly, for liability to arise, the subject of the claim must be or must have been acting in the capacity of a director of the corporation when the failure to meet the remittance obligation arose. A review of the case law shows that whether an individual is a director of a corporation or not is not always a very clear answer and there have been instances where the courts have found individuals to be directors, even when they did not meet the required technical requirements.

---

[33] R.S.C. 1985, c. C-8.
[34] S.C. 1996, c. 23.
[35] <http://www.cabusinessadvisor.com/Tax/FactsFig/CPPEI.htm>

In *Moll v. Canada*,[36] the Court found the director to be liable under subsection 227.1 of the ITA despite his alleged resignation more than two years prior to his assessment. The Tax Court of Canada found that even if the director did in fact resign, he continued to manage the affairs of the corporation after the alleged resignation, and was thus deemed to continue to act as a director of the corporation.[37] Similarly, in *Thibeault v. Canada*,[38] one of the issues raised by the director was that he did not serve as a director of the corporation at the time that the failure to remit excise tax payments occurred. He claimed that he had resigned and a corporation had replaced him as director. The Court rejected his argument for two reasons. Firstly, it found that the appointment of the corporation as a director to replace him was contrary to the CBCA and thus a nullity because the CBCA does not permit corporations to be appointed as directors.[39] Second and more importantly, the Court found that despite his resignation, he remained the *de facto* director of the corporation as he continued to perform all managerial acts, he gave instructions, had signing authority, and assumed control.

Bonotto v. Canada (2008) ("Bonotto")[40] offers a more in depth discussion of the liability of *de facto* and *de jure* directors. The Court set out the principle that "…a person carrying out director-like management duties may not be a de facto director for the purposes of section 227.1 unless there has been a holding out that those duties are being carried out in the capacity of a director or there are other related factors that point to that conclusion."[41] The Court found that where there is no holding out of director status, one's powers and management do not create a *de facto* directorship. In *Bonotto*, the appellant claimed that he was not a director of the corporation at the time that the corporation failed to make remittances. However, the Court held that the appellant was liable because assumed total charge of the corporation and its management, and as such, he was a *de facto* director at the time of the remittance failures.

In *Hartrell v. Canada* ("Hartrell")[42] the appellant was not a formally appointed director of the corporation at any point. The only director of record was the incorporating lawyer who never participated in the business and was not aware that he remained a director of the corporation. When the business began to suffer, the appellant became more actively involved in its actual management, particularly during the time where it failed to make source deductions. The Court in *Hartrell* found that the appellant rather than the incorporating lawyer was liable, as he was found to be a *de facto* director. Paris J stated as follows:

[36] [2008] T.C.J. No. 181 (Tax Court of Canada).
[37] *Ibid* at para 19.
[38] [2005] T.C.J. No. 300 (Tax Court of Canada).
[39] *Ibid* at para 45
[40] [2008] T.C.J. No. 190 (Tax Court of Canada).
[41] *Ibid* at para 55
[42] [2006] T.C.J. No. 386 (Tax Court of Canada) appeal dismissed in [2008] F.C.J. No. 228 (Federal Court of Appeal).

> where a corporation operates without having been properly organized and the only director of record plays no part in running the corporation, those **persons who take it upon themselves to direct the affairs of the corporation may be held out to be de facto directors, whether or not they have explicitly represented themselves as directors to any third party.** The essential question is whether those individuals have, in fact, taken on the role of director of the corporation[43] **(emphasis added)**.

Clearly, a review of the aforementioned cases sends a clear warning for individuals who may have informally taken on the role of director within a corporation that they may still be held liable for acts of the corporation, despite the fact that they do not meet the technical legal requirements to be directors.

4. Due Diligence Defence

A director is not personally liable for the failure of the corporation to remit or withhold taxes where it can be shown that the director has exercised "the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances."[44] This is known as the "due diligence defence," which is not only available to directors for claims brought under the ITA; but it also applies to the CPP, ETA and EIA. The starting point in the due diligence defence analysis is to ask whether a director can escape liability for the corporation's failure to remit source deductions because he exercised a degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances. The legal test to apply in measuring a director's actions is a modified objective test. The Federal Court of Appeal in *Soper* referred to the test as a combination of subjective and subjective components, stating:

> …the Act contains both objective elements – embodied in the reasonable person language – and subjective elements – inherent in individual considerations like "skill" and the idea of "comparable circumstances." Accordingly, the standard can be properly described as "objective subjective.[45]

The *Sope*r decision maintains that with regards to the subjective test, the standard of care requires the court to look at the director's background, knowledge, skills and experience in determining if the director exercised due diligence. In assessing the objective reasonableness of the conduct of a director, the factors to take into account include the size, complexity and the type of the business that is carried on by the corporation, as well

[43] *Ibid* Paragraph 27
[44] ITA sub 227.1(3)
[45] *Supra* note 32 at para 38.

as its customs and practices. It is more reasonable for directors of larger and more complex businesses to delegate work, and to rely on the expertise of other staff and personnel.[46]

Generally, the court will hold directors who are experienced in business matters to a higher standard than unsophisticated directors who do not have experience or business acumen. For example, in *Comparelli v. Canada*,[47] the Court held the appellant director to be liable because he was an inside director who was involved in the daily management of the business as its president and CEO, and he was intelligent and experienced in business matters. Contrast this with *Forgione v. Canada*,[48] where the Court held that the appellant director was entitled to rely on the due diligence defence to avoid liability. In the *Fiorgone* case, the director was an uneducated immigrant, who was computer illiterate, did not understand accounting, and relied on other people for assistance in these matters. The Court stated that the director rightfully hired accountants and bookkeepers for the business, and given his limited qualifications, he reasonably relied on these personnel to run the administrative matters of the business and was not liable for their failure to make source deductions.

Moreover, the case law shows that a higher standard of care is imposed on “inside directors” than “outside directors”, particularly if the outside director reasonably relied on assurances from inside directors.[49] Robertson J. in *Soper* described inside directors as those involved in the day-to-day management of the business and who influence the conduct of business affairs, whereas outside directors are those with superficial knowledge and involvement in the affairs of the business. The distinction between the liability of inside and outside directors is well displayed in *Carroll v. Canada*,[50] where the appellant was a director that was re-assessed for amounts in tax, EI premiums and CPP contributions which the corporation failed to remit. The director was an engineer without experience in accounting; he was involved in the science and technology aspects of the business and was living hundreds of kilometres away from the mainstream of the operation. The Court found him to be an outside director and held that he was able to escape liability by relying on the due diligence defence. It was a crucial point for the Court that his responsibilities had nothing to do with the mainstream operations and day-to-day business and financial operations. He did not have enough expertise and was diligent and reasonable in his reliance on the opinion of those with more experience, despite the fact that their assurances were later proven to be faulty.

It is important to note that the due diligence defence will not assist directors who are willfully blind to the statutory obligations of directors, or who ignore problems that are obvious or ought to have been obvious to reasonable persons in the same circumstances.

---

[46] *Smith v. R* [2001] 2 C.T.C. 192 (FCA) at para 11.
[47] [2009] T.C.J. No. 52 (Tax Court of Canada).
[48] [2005] T.C.J. No. 282 (Tax Court of Canada).
[49] *Ibid* at para 13.
[50] [2008] T.C.J. No. 558 (Tax Court of Canada).

See for example *Kanavaros v. Canada*[51] where the director was held to be liable for the company's failure to remit GST and income tax payments. Here the director was aware of the remittance problem, but instead of remedying the problem and making the necessary payments, he used the available funds to keep the business afloat. The Court stated in this case that directors have a positive duty to act when they learn of remittance issues, and this is a positive duty to act arises "where a director obtains information, or becomes aware of the facts, which might lead one to conclude that there is, or could reasonably be a potential problem with remittances."[52] The Court added that the due diligence defence imposes a positive duty on directors to set up controls to account for remittances, to ask for regular reports from the financial officers and to obtain confirmation at regular intervals that the statutory remittance duties have been satisfied.[53]

Following the decision in *Soper*, the Supreme Court of Canada in *Peoples Stores Department* raised some questions about whether the due diligence test remains a subjective/objective one. The Supreme Court stated that the test is an objective one and does not contain any subjective elements. Although this has raised some questions about whether the test in *Soper* has been overruled, later decisions appear to have put these questions to rest, at least for the time being, as they have not treated the test in *Soper* as having been changed. For example, in *Hartrell* the Court affirmed the application of the due diligence defence according to *Soper*, and more recently the Tax Court of Canada made a similar finding in *Liddle v. Canada*.[54]

5. Non-Resident Income Tax

Directors may also be held liable for failing to withhold and remit tax on income from Canada of non-resident persons under section 215 of the ITA. Where a person fails to make the requisite deduction and remittances, they may be held personally liable under subsection 227.1(1) of the ITA. This of course means that the conditions precedent set out in subsection 227.1(2) and the due diligence defence in subsection 227.1(3) apply.

D. Pension Plan Management

The governance of employer sponsored pension plans is of great importance to the corporate community and to the workforce. For all private sector enterprises and many not-for-profit entities, the board of the sponsor of any pension plan has a fiduciary duty as legal administrator of the pension plan or fund to the shareholders or major stakeholders. Under section 8 of the federal *Pension Benefits Standards Act*, 1985 ("PBSA"),[55] the employer must ensure that all amounts in the pension fund including amounts deducted from employees' remuneration and amounts due from the employer are held in trust for entitled persons. Under section 38(1), every person who contravenes: (a) any provision of

[51] [2008] T.C.J. No. 236 (Tax Court of Canada).
[52] *Ibid* at para 55.
[53] *Ibid* at para 63.
[54] [2009] T.C.J. No. 351 (Tax Court of Canada).
[55] R.S.C. 1985, c. 32 (2nd Supp).

the PBSA; (b) avoids compliance with the PBSA by altering or destroying documents or not providing full disclosure by other means; (c) obstructs or attempts to obstruct compliance; or (d) fails to remit the required pension fund amount is guilty of an of offence. Section 38(4) stipulates that proceedings must be commenced no later than two years after the day that the subject matter of the proceedings became known to the Superintendent. Moreover, section 38(5) states that where a corporation is found guilty of an offence, every officer, director, agent or member of the corporation or body who directed, authorized, assented to, acquiesced in or participated in the offence is a party to and guilty of the offence and is liable on summary conviction to the punishment provided for the offence, whether or not the corporation or body has been prosecuted or convicted.

Similarly, under the Ontario *Pensions Benefits Act*,[56] ("PBA"), every director, officer, official or agent of a corporation is guilty of an offence, if such person causes, authorizes, permits or acquiesces in the pension plan or pension fund:

> (a) not being administered correctly;
>
> (b) not complying with the PBA and the regulations; or
>
> (c) does not take reasonable care in the circumstances to prevent the .. corporation from contravening the PBA or regulations.[57]

Punishment on a first conviction is a fine of not more than $100,000, and $200,000 on each subsequent conviction, whether or not the corporation has been prosecuted or convicted of an offence arising from the same facts or circumstances.[58] Note that subsection 110(6) creates a five year time limit after the offence occurred in which prosecution can be commenced.

In *Re Slater Steel Inc.*,[59] the Ontario Court of Appeal commented on the duties of directors and officers who are responsible with administering a pension plan of the corporation. In this case, the corporation Slater Stainless Corporation was the sponsor and administrator of various pension plans, and it delegated the daily administrative duties of the plans to some of its directors and officers. When Slater went under the protection of the *Companies' Creditors Arrangement Act* ("CCAA"), its pension plans were deficient by approximately $18 million. Slater claimed damages against the pension plan actuaries, alleging that the actuarial reports were deficient and caused the plan's under-funding. The defendant actuary then brought third party proceedings against the directors and officers of Slater who assisted in the administration of the plan on the basis that they withheld important information from the actuary that contributed to the deficit in the pension plans. The directors and officers brought a motion to dismiss the action on the basis that any action that is brought against them in their personal capacity was prevented by the court order protecting them under the CCAA proceedings. At the Ontario Superior Court

[56] R.S.O. 1990, Chapter P.8.
[57] *Ibid* ss. 109 and 110(2).
[58] *Ibid* at subsections 110(1) and (3).
[59] 2008 ONCA 196 (CanLII) (Ont.CA).

of Justice level, the Court ruled that third party proceedings cannot be brought because the third party claims did not disclose a reasonable cause of action, but the Court did not address the issue of the duties of Slater's directors and officers when acting as the administrator of pension plans. On appeal, the Ontario Court of Appeal overruled the lower decision and allowed the matter to proceed to trial, finding that directors and officers of Slater were not acting in their capacity as directors and officers of the corporation but rather as "agents and employees of Slater qua administrator."

In *obiter*, the Court of Appeal expressed its opinion regarding the duties of directors and officers in connection with the administration of pension plans. The Court stated that the directors and officers of a company who also administer the company's pension plan act in a dual capacity; they owe a fiduciary duty to the corporation, but they also owe a fiduciary duty to the plan members. Although this finding is not a binding legal precedent, it demonstrates to directors and officers the importance of understanding the capacity in which they are acting when administering pension plans, and the importance of being aware of the duties they owe as directors and officers to the corporation and third parties such as employees, shareholders and other stakeholders.

E. Conclusion

As will hopefully be evident from this discussion, Canadian legislation can in effect impose significant consequences for directors and officers of a corporation that fail to meet its legal obligations and responsibilities. It is vital for directors and officers to be informed and knowledgeable about their statutory duties and responsibilities, as the failure to meet them could lead to tremendous personal liability. This becomes all the more relevant during times of economic stagnation, where businesses face economic troubles and there is an increased likelihood of liability shifting to the directors and officers due to the corporation's failure to meet legal obligations. Officers and directors in particular should consult with their legal advisors to educate themselves of their statutory responsibilities, and to understand how to properly shield themselves from liability.

George Waggott is a partner in the Employment & Labour Law Group in Toronto. Contact him directly at 416-307-4221 or gwaggott@langmichener.ca.

Mariam Al-Shikarchy is a Student At Law in Lang Michener's Toronto office. Contact her directly at 416-307-4249 or malshikarchy@langmichener.ca

Toronto
Brookfield Place
181 Bay Street, Suite 2500
P.O. Box 747
Toronto, ON M5J 2T7
Tel.: 416-360-8600
Fax.: 416-365-1719

Vancouver
1500 Royal Centre
1055 West Georgia Street
P.O. Box 11117
Vancouver, BC V6E 4N7
Tel.: 604-689-9111
Fax.: 604-685-7084

Ottawa
Suite 300
50 O'Connor Street
Ottawa, ON K1P 6L2
Tel.: 613-232-7171
Fax.: 613-231-3191

Hong Kong
1106, Tower 1
Lippo Centre, 89 Queensway
Hong Kong SAR
Tel.: 852 3101 0213
Fax.: 852 3585 1233