DUAL LOYALTIES ON NON-PROFIT BOARDS: SERVING TWO MASTERS

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CBA-OBA National Symposium on Charity Law

Friday, May 6, 2011

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> No one can serve two masters. Either he will hate the one and love the other, or he will be devoted to the one and despise the other. You cannot serve both God and Money. [Matthew 6:24]

1. Outline of Topic

Dual loyalty is a topic that is not discussed very often. When it is discussed, it is usually confused or lumped in with a discussion on conflict of interest. Even though there are significant similarities between the two, there are also quite a few differences and the law that applies should be different, as well. There should also be other ways of dealing with dual loyalties.

The rules relating to conflict of interest are clear and in most cases have been reduced to statutory provisions[2]. A director may not profit directly or indirectly from his or her position and may not favour the interest of someone not at arms' length with the director over that of the corporation. The statutory conflict of interest provisions generally require a director to disclose a conflict of interest in a material contract or transaction and refrain from voting on it. The ONCA and CNCA go further and prohibit the director from participating in the debate and being counted in the quorum[3].This does not reflect the reality of the director who has been elected or appointed to the board to represent the interests of a stakeholder in the corporation. These directors are actually expected to serve as representatives of the stakeholder and to promote its interests. If they are prevented from speaking and voting on the very issues that they are on the board to deal with, the interest of the stakeholder is muzzled. Yet they undoubtedly have a fiduciary duty to act in the best interest of the corporation. If they are also a director of the

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[1] The author gratefully acknowledges the assistance of Hartley R. Nathan, Q.C., Anais Benamran, Sarah Petersen and Jan Barrett.

[2] *Corporations Act* (Ontario), R.S.O. 1990, c.38 ("OCA"), s.71; *Canada Corporations Act*, R.S.C. 1970, c.C-32 ("CCA"), s.98,:*Non-Profit Corporations Act, 2010* (Ontario), S.O. 2010, c.15 ("ONCA"), s.41; *Canada Not-for-Profit Corporations Act*, S.C. 2009, c.23 ("CNCA"), s.141; *Non-Profit Corporations Act, 1995*(Saskatchewan), Statutes of Saskatchewan, 1995 Chapter N-4.2 ("Saskatchewan Act"), s.107. The ONCA is scheduled to come into effect in late 2012, while the CNCA is expected to be in effect by the fall of this year.

[3] The Alberta *Companies Act*, R.S.A., c.C-21, s.92(5)(c), specifically excludes from the prohibition against voting on a transaction in which there may be a conflict of interest a director of another corporation who is not a shareholder of that corporation (other than nominal director's qualifying shares)

stakeholder, they will have two competing fiduciary duties, one of which they may very well have to breach when a controversial matter comes before the respective boards. What we face is an "unnecessary separation of legal doctrine from corporate activity that can create confusion, expense and possible liability."[4]

This paper will examine the legal position of the director who represents the interests of a stakeholder of the corporation and explore possible methods to reflect the reality of the situation.

This discussion will be limited to incorporated non-profit organizations, including charities. Directors or trustees of unincorporated associations and trusts may be subject to similar common law and, in some cases, statutory provisions, but they will not be dealt with in any detail. In addition, this paper will only be concerned with the director in his or her capacity as director, even though he or she might also be an officer, member or employee of the corporation.

2. **Background**

There are two types of non-profit organizations – "membership" and "public benefit"[5].

Membership organizations exist to promote the interests of, or provide services to, a specific group of individuals or corporations. The Canadian Bar Association is an example. Public benefit organizations exist to provide services to the public, or a segment thereof, or to promote a point of view or standard. Some, but not all, of these organizations are charities. Examples would be Canadian Wildlife Federation or United Way. The scope of activities of these organizations is huge. They include municipalities, trade and agricultural associations, government mandated bodies, hospitals and clinics, private schools, universities and colleges. In this paper I will use "non-profit" to include all of the different types of non-share capital corporations, unless the specific context requires a distinction.

It is extremely common for the boards of non-profit organizations to consist in whole or in part of representatives of the constituent bodies, stakeholders or members. For example, invariably a hospital support foundation will have on its board the president of the hospital and the chair of

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4 Corporate governance (the representative director problem), by Cyril Moscow. http://www.honigman.com/files/Publication/373290f2-2ff2-498f-a2be-fcb786f6d380/Presentation/PublicationAttachment/7688914d-81d2-4e38-9720-d809182852b7/imgimgMoscow.pdf

5 In the ONCA corporations are classified as "public benefit" corporations and those which are not. The test, however, is not based on the purposes of the corporation, but the source of its funding. Similarly under the CNCA, there are two classes – "soliciting corporations" and those which are not. Again the source of funding is the basis for assigning a corporation to one category or the other. This can produce anomalous results, since member organizations may end up as public benefit or soliciting corporations. In some cases charities could end up as non-public benefit or non-soliciting corporations. This could have an effect on the scope of the director's fiduciary duty.

the board of the hospital. Hospital boards have representatives of the medical and nursing staff. An organization promoting recycling or managing recycling programs will have representatives of the industries which manufacture or distribute the products which will ultimately be recycled. These may include directors appointed by industry associations, as well as the manufacturers, wholesalers or retailers[6]. Sometimes directors are appointed to represent the interests of the public. The Law Society of Upper Canada[7], for example, has up to eight non-lawyers appointed as "benchers" by the Province of Ontario, as well as a number of *ex-officio* benchers, including the current and all former Attorneys-General. Most of the *ex-officio* benchers are non-voting, which is an issue we shall look into in the course of this paper.

2.1 Stakeholders and Nominees.

For want of a better word, I will use "stakeholder" to represent the person, corporation or organization that elects or appoints a director to a non-profit board. Although this word originally meant only someone who held the proceeds of a contest to deliver to the owner once the right to legal possession had been established, it is now most commonly used in quite a different context:

> "stakeholder" has become more commonly used to mean a person or organization that has a legitimate interest in a project or entity. In discussing the decision-making process for institutions – including large business corporations, government agencies, and non-profit organizations – the concept has been broadened to include everyone with an interest (or "stake") in what the entity does. This includes not only its vendors, employees, and customers, but even members of a community where its offices or factory may affect the local economy or environment. In this context, "stakeholder" includes not only the directors or trustees on its governing board (who are stakeholders in the traditional sense of the word) but also all persons who "paid in" the figurative stake and the persons to whom it may be "paid out" (in the sense of a "payoff" in game theory, meaning the outcome of the transaction).[8]

In this context, the stakeholder may or may not have an economic interest in the business, activities or assets of the non-profit. In the charity context, stakeholders may also include donors and supporters, clients or beneficiaries and the provincial attorney-general, who represents the public interest in ensuring that charitable property is properly managed and applied[9], and may include such abstract concepts as the environment or the actual local, national or international community.

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6 *Waste Diversion Act, 2002*. S.O. 2002, c.6.

7 Law Society Act, R.S.O. 1990, c. L.8

8 http://en.wikipedia.org/wiki/Stakeholder; see also R. Edward Freedman, *Strategic Management: A Stakeholder Approach*, 1984.

9 In Ontario the Attorney-General is represented by the Public Guardian and Trustee.

It is very important to bear in mind the distinction between share capital and non-share capital corporations in this context. In the case of a share capital corporation, the major stakeholders are its shareholders, employees and lenders and other parties with whom the corporation has a contractual connection. By contrast, in many cases the stakeholders of a non-profit may not have any economic interest or contractual relationship to the corporation. This will be important when it is necessary to consider the questions of what is in the best interests of the corporation and to whom do the directors owe their fiduciary duty.

For the purposes of this paper, when I refer to "corporation", I usually mean the non-share capital, non-profit entity to which a stakeholder has elected or appointed a director to represent its interests. I will use "nominee" to describe such a director.

2.2 Duties of a Nominee Director.

Obviously, a nominee director has a dual loyalty. As a director of the non-profit, he or she has a duty to the non-profit of a fiduciary nature. This is usually called the "duty of loyalty". The scope of that duty may be summarized as:

- To act in the best interests of the corporation at all times
- Not to favour the interests of the stakeholder who arranged for his or her appointment, if the stakeholder's interests differ from the interests of the corporation
- Not to disclose the corporation's confidential information to the stakeholder who arranged for his or her appointment
- To disclose to the corporation information coming from the stakeholder which relates to a planned transaction or operation likely to have a negative impact on the corporation.

The first two of these points is sometimes described as a duty to act independently[10]. On the other hand, there will usually also be a contractual or moral duty to the stakeholder to represent its interests on the board of the corporation. If the representative is also a director of the stakeholder, there will be an identical, but separate, set of duties to the stakeholder.

Much of the discussion which follows is applicable to corporations in the share capital world, as well, but it may be that the issues involved are different in the non-profit world in that it is less likely that there will be financial transactions between the corporation and the stakeholder. A

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[10] See *Directors' Duties in Canada*, Bennett Jones LLP (3rd ed., 2006), Ch 2, p. 56.

common exception to this, of course, would be in the case of a support foundation for a hospital, university or cultural institution where the primary function of the non-profit organization is to raise funds for the benefit of the stakeholder organization. However, in many cases there will be no financial relationship between the two organizations and the conflict will likely arise in the situation where the corporation makes a decision which, in an indirect manner, could affect the financial status of the stakeholder or the constituent members of the stakeholder. Dual loyalty arises quite frequently and has to be dealt with. Some organizations have adopted a conflict of interest by-law which provides that in the case of a matter involving dual loyalty, these individuals have a recognized “sectoral” interest[11].

These attempts to deal with confidential information and duty of loyalty are unsatisfactory in general since they do not answer the basic question of when it is appropriate to be able to discuss confidential information. They also leave the director still in the position of having to vote in a manner which might be against the interest of his or her stakeholder[12] or, having voted against something which is passed by the corporation, not being the position to oppose it in any way other than internally among the board members. There is also the question of when the position of the director becomes a conflict of interest and when he or she is merely representing a sectoral interest in which there is no personal conflict. The duty is clear, but the result can often be unsatisfactory and there seems to be no simple solution that all corporations can adopt.

The analysis is further complicated by the fact that the vast majority of the case law and any legislative consideration is from the for-profit world, the applicable rules are derived from conflict of interest models, and the principles are focussed on maximizing economic values – whether it is permissible to take into account the competing interests of shareholders, creditors and employees. Into this mix in recent years the concept of corporate social responsibility (“CSR”) has been introduced[13]. While CSR issues are relevant for the non-profit world, there is

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[11] See the example in Appendix “A”

[12] As Farley J. put it in *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991) 3 B.:L.R. (2d) 113 at para. 106 (Ont. Gen. Div.): “It may well be that the corporate life of a nominee director who votes against the interest of his "appointing" shareholder will be neither happy nor long.” In his post-judicial life, he added this thought: “However, if a nominee director tries to straddle two horses, he will end up falling off both. A director must ride the corporate horse; if he rides the nominator horse, he will become roadkill.” “Could Pinocchio Ever be a Director?” http://www.mccarthy.ca/article_detail.aspx?id=4187

[13] “Corporate social responsibility (CSR, also called corporate conscience, corporate citizenship, social performance, or sustainable responsible business) is a form of corporate self-regulation integrated into a business model. CSR policy functions as a built-in, self-regulating mechanism whereby business monitors and ensures its active compliance with the spirit of the law, ethical standards, and international norms. The goal of CSR is to embrace responsibility for the company's actions and encourage a positive impact through its activities on the environment, consumers, employees, communities, stakeholders and all other members of the public sphere. Furthermore, CSR-focused businesses would proactively promote the public interest by encouraging community growth and development, and voluntarily eliminating practices that harm the public sphere, regardless of legality. CSR is the deliberate inclusion of public interest into corporate decision-making, that is

no shareholders' value to consider and CSR issues which would be only one consideration for a business corporation are often the raison d'être for a non-profit corporation's existence.

2.3 The Basic Rule.

The leading Canadian cases on the issue of the liability of nominee directors stand for a strict interpretation of the rule that:

> A director nominated by a particular shareholder of the corporation is not in any sense relieved of his or her fiduciary duties to the corporation. A nominee director is not accorded an attenuated standard of loyalty to the corporation. The director must exercise his or her judgment in the interests of the corporation and comply with his duties of disclosure, and must not subordinate the interests of the corporation to those of the director's patron[14].

In Canada the nominee director and dual loyalty problems are barely mentioned in commentary, and then only for the purpose of stating the principle that the nominee director must always act in the best interests of the corporation (notwithstanding the fact that he or she has been placed on the board to represent the interests of a stakeholder), and that such nominees must refrain from publicly opposing the decisions of the corporation and disclosing confidential information to their stakeholders[15].

However, although they were not dealing with nominee directors, the Supreme Court of Canada in the Peoples and BCE cases, which will be discussed below, have established that directors can at least take into consideration the interests of the various stakeholders in determining what might be in the best interests of the corporation. In addition, where the director exercises his or her business judgment in good faith, the courts will not second guess the decision.

The time has come for a more robust discussion of this problem in Canada, at least on the non-profit side. New rules are needed to reconcile the duty of loyalty of the nominee director to the

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the core business of the company or firm, and the honouring of a triple bottom line: people, planet, profit". http://en.wikipedia.org/wiki/Corporate_social_responsibility

14 *PWA Corp. v. Gemini Group Automated Distribution Systems Inc.* (1993), 8 B.L.R. (2d) 221 and 221n (Ont. Gen. Div.); aff'd (1993), 10 B.L.R. (2d) 109 (C.A.), leave to appeal to SCC refused (1993), 10 B.L.R. (2d) 244, per Callaghan CJOC at 8 B.L.R. 265. See also *Scottish Co-operative Wholesale Society Ltd. v. Meyer* [1959] A.C. 324 (HL); *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991). 3 B.L.R. (2d) 113 a1 123 (Ont. Gen. Div.), additional reasons at (May 7. 1991), Doc. RE 1305/90 (Ont. Gen. Div.), aff'd (1991). 3 B.L.R. (2d) 113 (Ont. Div. Ct.); *Deluce Holdings Inc. v. Air Canada* (1992), 12 O.R. (3d) 131 (Ont. Gen. Div.)

15 After an extensive search of the literature, the only discussion of the real issues and suggestion for legislative change is in Hartley R. Nathan, Q.C. "Nominee Directors – Need to Exercise Caution", *CCH Corporate Directors Manual*, ¶3-315; also at http://www.mindengross.com/publications/2009/p2009_12_04_Nominee_Directors_Need_to_Exercise_Caution.asp

corporation with his or her duty to represent the interests of the stakeholder. Whether this requires legislation or can come from the courts will be one of the topics discussed below.

For the most part, the discussion will be limited to the provisions of the OCA, ONCA, CCA, CNCA and the Saskatchewan Act[16]. Other provincial statutes, in existence or pending, may or may not have similar provisions[17].

3. **<u>What the Law Should Be</u>**

The position I intend to take in this paper is that the strict rule that a nominee director is bound to vote and act in the best interests of the corporation, albeit with due consideration of the position of the stakeholder, must be modified to account for the reality of the of the relationship between the corporation, the stakeholder and the nominee.

- Where all parties agree, either in the form of a written agreement or by inclusion of a relevant provision in the articles or by-laws of the corporation, the nominee can vote and act in favour of the stakeholder's position

- The nominee must clearly disclose his or her position and relationship to the stakeholder and the nature of the interest of the stakeholder in the proposed vote or action

- The nominee is bound to consider the effect on the corporation of his or her vote or action, but can prefer the position of the stakeholder

- If a disinterested quorum exists, the nominee should be free to vote, regardless of the consequences. The nominee's freedom to act after a vote should continue to be subject to the existing rules

- If the matter is one in which a genuine conflict of interest exists – i.e., the nominee has a direct or indirect interest in an existing or proposed material

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[16] A useful summary of the non-share capital corporations acts of other provinces and territories can by found in See Karen J. Cooper and Jane Burke-Robertson, A Comparison Of Corporate Jurisdictions For Charitable Organizations, 2010: http://www.carters.ca/pub/article/charity/2010/kjc0816.pdf.

[17] The relevant statutes are Alberta *Companies Act.* R.S.A. 2000, c. C-21 and *Societies Act*, R.S.A. 2000, c. S-14; British Columbia *Societies Act*, R.S.B.C. 1996, c. 433 (currently under review); Manitoba *Corporations Act*, C.C.S.M. c. C225; New Brunswick, *Companies Act,* R.S.N.B. 1973, c. C-13; Newfoundland, *Corporations Act*, R.S.N.L. 1990, c. C-36; Nova Scotia, *Societies Act,* R.S.N.S. 1989, c. 435; Prince Edward Island, *Companies Act,* R.S.P.E.I. 1988, c. C-14; Quebec, *Companies Act,* R.S.Q., c. C-38; Northwest Territories and Nunavut *Societies Act,* R.S.N.W.T. 1988, c. S-11; and Yukon *Societies Act*, R.S.Y. 2002, c. 206.

contract or transaction with the corporation – the standard conflict of interest rules will continue to apply

- The laws applicable to charitable property should continue to apply to any vote or action of the nominee

- The "business judgment rule" will apply to the nominee, modified to the extent necessary to give effect to these principles

4. **Definition of Fiduciary**

The concept of fiduciary duty developed over centuries as a means of protecting a person who is vulnerable to the actions of another in a position of power or authority over the beneficiary or the beneficiary's property. In *Frame v Smith*[18], the Supreme Court of Canada stated:

> [57] In the past the question whether a particular relationship is subject to a *fiduciary* obligation has been approached by referring to categories of relationships in which a *fiduciary* obligation has already been held to be present. Some recognized examples of these categories are relationships between directors and corporations, solicitors and clients, trustees and beneficiaries, agents and principals, life tenants and remaindermen, and partners. As well, it has frequently been noted that the categories of fiduciary relationship are never closed: see, for example, *Guerin v. The Queen*, 1984 CanLII 25 (S.C.C.), [1984] 2 S.C.R. 335, at p. 384 *per* Dickson J. (as he then was); *International Corona Resources Ltd. v. Lac Minerals Ltd.* (1986), 53 O.R. (2d) 737 (H.C.); *Standard Investments Ltd. v. Canadian Imperial Bank of Commerce* 1985 CanLII 164 (ON C.A.), (1985), 52 O.R. (2d) 473; *English v. Dedham Vale Properties Ltd.*, [1978] 1 All E.R. 382, at p. 398; *Tufton v. Sperni*, [1952] 2 T.L.R. 516, at p. 522; R. Goff and G. Jones, *The Law of Restitution* (2nd ed. 1978), at pp. 490-91. An extension of fiduciary obligations to new "categories" of relationship presupposes the existence of an underlying principle which governs the imposition of the fiduciary obligation.
>
> …..
>
> [60] Relationships in which a fiduciary obligation have been imposed seem to possess three general characteristics:
>
> > (1) The fiduciary has scope for the exercise of some discretion or power.
> >
> > (2) The fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary's legal or practical interests.

[18] [1987] 2 SCR 99

> (3) The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.

5. **<u>Corporate Director as Fiduciary</u>**

Modern corporate statutes impose a statutory duty of care, the first part of which is essentially a compilation of the director's common law fiduciary duty to the corporation[19]. In addition, if the corporation is a charity, the Ontario *Charities Accounting Act* provides:

> 1(2) Any corporation incorporated for a religious, educational, charitable or public purpose shall be deemed to be a trustee within the meaning of this Act, its instrument of incorporation shall be deemed to be an instrument in writing within the meaning of this Act, and any real or personal property acquired by it shall be deemed to be property within the meaning of this Act.[20]

This does not of itself make the director a trustee, but imposes on directors a duty akin to that of a trustee[21]. However, the scope of the fiduciary duty is such that, absent specific issues dealing with charitable property, there should be no difference in principle between the fiduciary duty of a director of a corporation with non-charitable objects or purposes and a director of a charity. The director of a charitable corporation may be subject to a higher standard of care than under the OCA or CCA, but possibly only with respect to the duty as it applies to the charitable property of the corporation and not in other respects. However, this would have no bearing on the other aspects of the director's fiduciary duty.[22]

Neither the OCA nor the CCA currently provide a statutory duty of care for directors and officers. The ONCA, CCA and the Saskatchewan Act[23] all contain similar provisions. The CNCA provides:

> 148**.** (1) 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

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19 See statutes cited *infra.* n.2

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

21 *Re French Protestant Hospital v. Attorney General* (1951) Vol. 1 Chancery Div., p. 938); *Re Public Trustee and Toronto Humane Society et al* (1987) 60 O.R. 2nd 236 (Ont S Ct.); *Re David Feldman Charitable Foundation* (1987), 58 O.R. (2d) 626 (Ont. S.C.); *R. Harold G. Fox Foundation Fund et al.* and *Public Trustee* ((1989) 69 O.R. 2nd 742). The addition of the words "public purpose" in Section 1(2) has apparently never been considered. In conversations with representatives of the Ontario Public Guardian and Trustee I have been advised that they consider their jurisdiction to extend only to charitable purposes.

22 See Hugh Kelly, *Duties and Responsibilities of Directors of Not-for-Profit Organizations,* Canadian Society of Association Executives, p.18 (2004).

23 ONCA, s.43(1); CNCA, s.148(1) and Saskatchewan Act, s.109(1)

(*b*) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

Similar provisions exist in corporate statutes in the rest of Canada, including Quebec[24]. A series of decisions applicable to memorandum of association corporations demonstrate that this common-law principle can be modified explicitly in the memorandum of association[25]. This position is based on the general principle that:

> . . . the person entitled to the benefit of the rule may relax it, provided he is of full age and *sui juris* and fully understands not only what he is doing but also what his legal rights are in that he is in part surrendering them[26].

In recent years, the courts have begun to consider the issue of dual loyalty in a situation where there is no overt conflict of interest. The issues they have looked at include:

- Is the fiduciary duty applicable to a director who has been appointed to represent a stakeholder?
- If so, what is the scope of this duty – i.e.:
  - To whom is it owed?
  - What are the best interests of the corporation?
- To what extent can the director take the interests of the stakeholder into consideration?
- Can the director consult with the stakeholder prior to exercising his or her vote?
- How does the director behave who is faced with a situation in which the duty to the corporation directly contravenes the duty to the stakeholder?

Two major decisions of the Supreme Court of Canada in the first decade of this century, *Peoples Department Stores Inc. (Trustee of) v. Wise*[27] and *BCE Inc. v. 1976 Debentureholders*[28] have completely changed the way we now look at this particular aspect of directors duties.

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[24] In the case of companies constituted pursuant to the Companies Act (Quebec) and most other legal persons, the relevant provisions are found in Articles 322, 323 and 324 of the Civil Code of Québec.

[25] (*Imperial Mercantile Credit Association v. Coleman* (1871), L.R. 6 CH 558 (English Chancery Division); *Boulting v. Association of Cinematograph Television and Allied Technicians* [1963] 1 All E.R. 716 (C.A.).

[26] *Boulting, ibid.* n. 25 at p. 729

[27] 2004 SCC 68, [2004] 3 S.C.R. 461 2004 SCC 68 (CanLII) • 244 D.L.R. (4th) 564, 49 B.L.R. (3d) 165, 4 C.B.R. (5th) 215 URL:http://www.canlii.org/en/ca/scc/doc/2004/2004scc68/2004scc68.html ("Peoples")

[28] 2008 SCC 69, [2008] 3 S.C.R. 560. 2008 SCC 69 (CanLII) • 301 D.L.R. (4th) 80 • 71 C.P.R. (4th) 303, 52 B.L.R. (4th) 1 URL:http://www.canlii.org/en/ca/scc/doc/2008/2008scc69/2008scc69.html See part V, paras. 36-40 ("BCE")

5.1 The Peoples Case.

In Peoples the Wise brothers, were the principals of Wise Stores Inc., the majority shareholders of Peoples Department Stores Inc. In their capacity as the entire board of Peoples they made certain business decisions which unfortunately led to the bankruptcy of both companies. The trustee of Peoples sued them for breach of fiduciary duty as directors of Peoples. The Supreme Court held they were not liable.

> ¶32 Section 122(1) of the [*Canada Business Corporations Act* ("CBCA")] establishes two distinct duties to be discharged by directors and officers in managing, or supervising the management of, the corporation:
>
> > 122. (1) 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.
>
> The first duty has been referred to in this case as the "fiduciary duty". It is better described as the "duty of loyalty". We will use the expression "statutory fiduciary duty" for purposes of clarity when referring to the duty under the CBCA. This duty requires directors and officers to act honestly and in good faith with a view to the best interests of the corporation. The second duty is commonly referred to as the "duty of care". Generally speaking, it imposes a legal obligation upon directors and officers to be diligent in supervising and managing the corporation's affairs.
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> ……………
>
> ¶42 This appeal does not relate to the non-statutory duty directors owe to shareholders. It is concerned only with the statutory duties owed under the CBCA. Insofar as the statutory fiduciary duty is concerned, it is clear that the phrase the "best interests of the corporation" should be read not simply as the "best interests of the shareholders". From an economic perspective, the "best interests of the corporation" means the maximization of the value of the corporation: see E. M. Iacobucci, "Directors' Duties in Insolvency: Clarifying What Is at Stake" (2003), 39 *Can. Bus. L.J.* 398, at pp. 400-1. However, the courts have long recognized that various other factors may be relevant in determining what directors should consider in soundly managing with a view to the best interests of the corporation. For example, in *Teck Corp. v. Millar* (1972), 33 D.L.R. (3d) 288 (B.C.S.C.), Berger J. stated, at p. 314:
>
> > A classical theory that once was unchallengeable must yield to the facts of modern life. In fact, of course, it has. If today the directors of a company were to

> consider the interests of its employees no one would argue that in doing so they were not acting *bona fide* in the interests of the company itself. Similarly, if the directors were to consider the consequences to the community of any policy that the company intended to pursue, and were deflected in their commitment to that policy as a result, it could not be said that they had not considered *bona fide* the interests of the shareholders.
>
> I appreciate that it would be a breach of their duty for directors to disregard entirely the interests of a company's shareholders in order to confer a benefit on its employees: *Parke v. Daily News Ltd.*, [1962] Ch. 927. But if they observe a decent respect for other interests lying beyond those of the company's shareholders in the strict sense, that will not, in my view, leave directors open to the charge that they have failed in their fiduciary duty to the company.

The case of *Re Olympia & York Enterprises Ltd. and Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254 (Div. Ct.), approved, at p. 271, the decision in *Teck*, *supra*. We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment.

¶43 The various shifts in interests that naturally occur as a corporation's fortunes rise and fall do not, however, affect the content of the fiduciary duty under s. 122(1)(*a*) of the CBCA. At all times, directors and officers owe their fiduciary obligation to the corporation. The interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders.

……………

¶64 The contextual approach dictated by s.122(1)(*b*) of the CBCA not only emphasizes the primary facts but also permits prevailing socio-economic conditions to be taken into consideration. The emergence of stricter standards puts pressure on corporations to improve the quality of board decisions. The establishment of good corporate governance rules should be a shield that protects directors from allegations that they have breached their duty of care. However, even with good corporate governance rules, directors' decisions can still be open to criticism from outsiders. Canadian courts, like their counterparts in the United States, the United Kingdom, Australia and New Zealand, have tended to take an approach with respect to the enforcement of the duty of care that respects the fact that directors and officers often have business expertise that courts do not. Many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made. Business decisions must sometimes be made, with high stakes and under considerable time pressure, in circumstances in which detailed information is not available. It might be tempting for some to see unsuccessful business decisions as unreasonable or imprudent in light of information that becomes available *ex post facto*. Because of this risk of hindsight bias,

> Canadian courts have developed a rule of deference to business decisions called the "business judgment rule", adopting the American name for the rule.

5.2 The BCE Case.

In BCE the directors approved a plan of arrangement which affected the economic rights of certain security holders, who brought an action for oppression. The Supreme Court held in favour of the directors.

> [38] The fiduciary duty of the directors to the corporation is a broad, contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation. The content of this duty varies with the situation at hand. At a minimum, it requires the directors to ensure that the corporation meets its statutory obligations. But, depending on the context, there may also be other requirements. In any event, the fiduciary duty owed by directors is mandatory; directors must look to what is in the best interests of the corporation.
>
> ………….
>
> [40] In considering what is in the best interests of the corporation, directors may look to the interests of, *inter alia*, shareholders, employees, creditors, consumers, governments and the environment to inform their decisions. Courts should give appropriate deference to the business judgment of directors who take into account these ancillary interests, as reflected by the business judgment rule. The "business judgment rule" accords deference to a business decision, so long as it lies within a range of reasonable alternatives: see *Maple Leaf Foods Inc. v. Schneider Corp*. 1998 CanLII 5121 (ON C.A.), (1998), 42 O.R. (3d) 177 (C.A.); *Kerr v. Danier Leather Inc.*, 2007 SCC 44 (CanLII), [2007] 3 S.C.R. 331, 2007 SCC 44. It reflects the reality that directors, who are mandated under s. 102(1) of the *CBCA* to manage the corporation's business and affairs, are often better suited to determine what is in the best interests of the corporation. This applies to decisions on stakeholders' interests, as much as other directorial decisions.
>
> ………….
>
> [66] The fact that the conduct of the directors is often at the centre of oppression actions might seem to suggest that directors are under a direct duty to individual stakeholders who may be affected by a corporate decision. Directors, acting in the best interests of the corporation, may be obliged to consider the impact of their decisions on corporate stakeholders, such as the debentureholders in these appeals. This is what we mean when we speak of a director being required to act in the best interests of the corporation viewed as a good corporate citizen. However, the directors owe a fiduciary duty to the corporation, and only to the corporation. People sometimes speak in terms of directors owing a duty to both the corporation and to stakeholders. Usually this is harmless, since the reasonable expectations of the stakeholder in a particular outcome often coincide with what is in the best interests of the corporation. However, cases (such

> as these appeals) may arise where these interests do not coincide. In such cases, it is important to be clear that the directors owe their duty to the corporation, not to stakeholders, and that the reasonable expectation of stakeholders is simply that the directors act in the best interests of the corporation.
>
> …..
>
> [81] As discussed, conflicts may arise between the interests of corporate stakeholders *inter se* and between stakeholders and the corporation. Where the conflict involves the interests of the corporation, it falls to the directors of the corporation to resolve them in accordance with their fiduciary duty to act in the best interests of the corporation, viewed as a good corporate citizen.

5.3 The Scope of the Duty of Loyalty.

It is clear from cases such as *Canadian Aero Service Ltd. v. O'Malley*[29] and a long line of earlier cases that a director has fiduciary duties to a corporation apart from the statutory fiduciary duties. Most of these cases deal with misappropriation of corporate opportunity or liability of a director for making a decision that is unfair to a stakeholder of the corporation. However, there is no difference in the rationale for making decisions that favour the interest of one group of stakeholders over another. The fiduciary duty of the directors is to act in the best interests of the corporation. If those interests conflict with the interests of stakeholders, "the directors' duty is clear — it is to the corporation"[30].

It follows from this principle that, in the situation where there is a conflict of interest between a corporation and one of its stakeholders, the director must put the interest of the corporation first and not breach his or her duty of loyalty to the corporation. This may mean voting against the interest of, or refraining to vote in favour of, the interest of the sectoral organization or stakeholder. Also, the nominee must retain in confidence and not disclose to the stakeholder any information which he or she may receive as a director of the corporation which is determined to be of a confidential nature.

In *Re Neath Rugby Ltd.,* a commercial case in the U.K. Court of Appeal[31], the court expressed the applicable law in a similar manner. Mr. Cuddy had been appointed to the board of Osprey to represent the interests of one of its shareholders, Neath Rugby Club Ltd. His co-owner, Hawkes,

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[29] [1974] S.C.R. 592
[30] As put by the Court at para. 37 in *BCE*
[31] [2009] EWCA Civ 291

was attempting to use the oppression remedy against him and the question of dual loyalty and duty to the nominator was raised. The Court held:

> 32. In my judgment, the fact that a director of a company has been nominated to that office by a shareholder does not, of itself, impose any duty on the director owed to his nominator. The director may owe duties to his nominator if he is an employee or officer of the nominator, or by reason of a formal or informal agreement with his nominator, but such duties do not arise out of his nomination, but out of a separate agreement or office. Such duties cannot however, detract from his duty to the company of which he is a director when he is acting as such….
>
> 33. ….an appointed director, without being in breach of his duties to the company, may take the interests of his nominator into account, provided that his decisions as a director are in what he genuinely considers to be the best interests of the company; but that is a very different thing from his being under a duty to his nominator by reason of his appointment by it.
>
> …………..
>
> 45. In these circumstances, I consider that the judge's finding that the only effective duty of Mr. Cuddy when acting as a director of Osprey was to consult with Mr. Hawkes was justified. The purpose of such consultation would have been for Mr. Cuddy to be better informed when deciding what was, in his view, in the best interests of Osprey.
>
> 46. The fact that there were occasions when Mr. Cuddy when acting as a director of Osprey did in fact seek to advance Neath's interests is not inconsistent with this conclusion: it does not show that Mr. Cuddy was under a legal duty to do so. Nor does it show that Mr. Cuddy acted in what he did not see were the interests of Osprey.
>
> …………………..
>
> 189 ….There are, however, three Australian cases which point in a different direction. Bowen CJ commented on the position of nominee or representative directors in *Re News Corporation Limited* (1987) 70 ALR 419 at 437 in these terms:
>
> > "It is both realistic and not improper to expect that such directors will follow the interests of the company which appointed them subject to the qualification that they will not so act if of the view that their acts would not be in the interests of the company as a whole."
>
> 190 Similarly it was held in *Re Broadcasting Station 2GB Pty Ltd* [1964-5] NSWR 1648 at 1663 that it is consistent with a director's duty for the director to follow the wishes of a particular interest which has brought about his appointment, without the need for a close personal analysis of the issues, unless the director is of the view that in doing so he or she is not acting in the best interests of the company as a whole. In *Canwest Global* (1997) 24 ACSR 405, the court quoted uncritically the statement of a broadcasting regulator that:

> "Directors usually act in accordance with the wishes and interests of a party that has brought about their appointment and on whose goodwill their continuation in office depends unless that places them in breach of their duties."

> 191 None of the Australian cases go as far as saying that a nominee director *must* follow the wishes of his appointor, and the *Kuwait Asia Bank*[32] and *Boulting* cases suggest that he would be wrong to do so. HH Judge Havelock-Allen QC was shown the Australian cases only, and told that there was no English authority on the point. He expressed his conclusion as follows:
>
> > "The answer, in my judgment, is that the appointee's primary loyalty is to the company of which he is a director. He is obliged to act in the best interests of that company. He is quite entitled to have regard to the interests or requirements of his appointor to the extent those interests or requirements are not incompatible with his duty to act in the best interests of the company. Whether having regard to the appointor's wishes is a matter of entitlement or obligation must depend on the terms, express or implied, of the agreement pursuant to which the director was appointed…"

Here is the dilemma: in addition to the duty of loyalty, the director has a duty of neutrality, since he or she cannot favour the interests of the corporation over those of the stakeholder, or vice versa. But if it is in the best interests of the corporation to favour its interests over that of the stakeholder, the director is paralyzed and would be in breach of his or her duty to the stakeholder under a separate contract or relationship. At best the director can abstain and hope that there are enough independent directors who will vote in a way that favours the stakeholder's position on the item. If it is reasonable to argue that the two interests are aligned, then it is possible to put the stakeholder's interest forward at a meeting of the board, but on the single and supportable basis that the best interest of the corporation is that put forward by the stakeholder. In that instance, the director should be able to speak in favour of the motion and even vote in favour, as long as his or her status as stakeholder's nominee has been clearly disclosed. If the director cannot in good faith take that position – i.e., that he or she is putting the position forward as being in the best interests of the corporation, notwithstanding that it also represents the stakeholder's position – then the fiduciary duty requires the director to abstain from argument and from voting and even, if the situation is a true conflict of interest, to withdraw from that portion of the meeting. A director in this situation could be incurring personal liability by speaking and voting.

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[32] *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd.* [1991] A.C. 187, PC (from New Zealand).

6. **Duty of Confidentiality**

This is a two-way duty. The director has a duty to refrain from disclosing confidential information to third parties and may also be obligated to disclose confidential third-party information to the corporation.

6.1 Duty Not to Disclose.

A director has a duty to retain in confidence and not disclose to the stakeholder, or any other non-insider, any information which he or she may receive as a director of the corporation which is determined to be of a confidential nature. See Wilton-Siegel J. in *SRM Global Master Fund Limited Partnership v. Hudbay Minerals Inc.*[33]:

> [23] Although I agree with the Applicants that no privilege attaches at law to such minutes, I think this is an important commercial interest. The board of directors of a corporation is charged with the responsibility to manage the corporation. The directors must be able to conduct open and frank discussions if they are to discharge their responsibilities to the corporation and the shareholders. In the ordinary course, it is certainly arguable that, for this reason, disclosure of minutes of board meetings, and related notes of participants, would give rise to a serious risk to an important commercial interest.

This confidentiality can be lost if the information in them is disclosed, for example in litigious proceedings. This is another example of the importance of enforcing the duty of confidentiality. In addition, all non-profit corporation statutes seemingly limit disclosure of directors' meeting minutes to the directors. They do this by not including these minutes in the list of corporate information available to members and other interested parties – CNCA, ss. 21 and 22; ONCA, 2010 ss.92, 95; OCA, ss. 299, 300, 305; the CCA requires the minutes to be kept (s.112), but contains no provision for access to them except for auditors or specially appointed inspectors. The absence of such provisions is impliedly confirmation of their confidentiality.

One commentator has discussed enforceability of the duty of confidentiality of proceedings at directors meetings[34]:

> Specific requirements of confidentiality are seen most often in the by-laws of not for profit corporations. Many such organizations include provisions for disciplining board members for breaches of confidentiality, even to the extent that the board itself may

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[33] [2009] O.J. No. 797 (S.C.J.); http://www.canlii.org/en/on/onsc/doc/2009/2009canlii9377/2009canlii9377.pdf

[34] Quoted with permission. from Chris J. Matthews, "Confidentiality of Board Minutes: An Important Commercial Interest "http://www.airdberlis.com/Templates/Articles/articleFiles/689/Confidentiality%20of%20Board%20Minutes.pdf..

> remove the director. [The enforceability of such a by-law is questionable. For instance, the removal of a director by the board (as opposed to the members) does not appear to be permitted by the Ontario Corporations Act. This impediment may be overcome, however, by the directors personally agreeing to such a provision upon joining the board.] The fact that such provisions exist highlights the importance some boards place on confidentiality. It may seem counter-intuitive that it is the not-for-profit sector in which confidentiality appears to be more of a concern. It is the not-for-profit sector, after all, in which transparency is most vocally demanded and most often granted. This apparent contradiction can be seen in cases where a not-for-profit has both a strict confidentiality clause for its directors but also puts the minutes of board meetings on its website.
>
> The reason specific confidentiality covenants are required may be because volunteer directors are more likely to be inexperienced in board procedure. They may also have come to the board with an agenda that is focused on one issue or constituency and not on serving the interests of the corporation as a whole. It is no secret that not-for-profit boards can sometimes be embroiled in disputes and politics that take on an emotional, if not vicious, tone. As Henry Kissinger said, this is because “the stakes are so small”. In any case, a confidentiality covenant will at least help to control wayward board members.

6.2 Duty to Disclose Third-Party Information.

In addition to retaining information in confidence, a director who possesses information coming from the stakeholder who arranged for his or her appointment may have an obligation, as a director, to disclose to the company any part of the information which relates to a planned transaction or operation which may have a material impact on the company. For example, in *PWA Corporation v. The Gemini Group Automated Distribution Systems Inc. et al.*[35], directors of PWA on the Gemini board were held not to be liable for non-disclosure that PWA was negotiating to merge with American Airlines. However it went on to find that they were liable for not disclosing that PWA was contemplating withdrawal from the Gemini hosting system:

> 143 In this case, however, the trial judge was completely justified in finding a breach of fiduciary duties on the part of the directors representing PWA because they failed to disclose that part of the negotiations with AMR which affected the Gemini Partnership in a vital aspect of its business. Indeed, the transaction with AMR contemplated a serious loss to the partnership, the loss of the hosting service.

The distinction seems to be that non-disclosure will be found to breach the director’s fiduciary duty only if the information could have a material negative impact on the corporation.

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[35] [1993] O.J. No. 1793, 15 O.R. (3d) 730, 103 D.L.R. (4th) 609, 64 O.A.C. 274, 10 B.L.R. (2d) 109, 49 C.P.R. (3d) 456, 41 A.C.W.S. (3d) 1204 (Ont. CA)

7. **Application of the Business Judgment Rule**

In Peoples and BCE the Supreme Court held that the statutory fiduciary duty is owed to the corporation, not to be confused with the interests of creditors or other stakeholders[36]. Prior to these decisions, it was widely considered that the best interests of the corporation were those of the shareholders (or members) in the long term. Peoples and BCE changed all this. Now, as long as the directors act in the best interests of the corporation, having regard to all relevant considerations and the interests of all stakeholders, whoever and whatever they may be, their business judgment will not be questioned. These considerations include, but are not limited to, the need to treat affected stakeholders fairly. But where it is impossible to treat all stakeholders fairly, it is irrelevant that the directors may choose a less favourable alternative for one group.

In Peoples the Court stated that the business judgment rule will ordinarily be available to protect officers and directors from liability, provided their decisions were made in good faith, they attempted to obtain and consider the relevant information and alternative courses of action, and they considered the interests of the different stakeholders of the corporation, even if the end result of those efforts are that the directors and officers did not make the best decision in the circumstances. Courts must be reluctant to second-guess business decisions by directors, but are capable of determining on a case by case basis whether an appropriate degree of prudence and diligence was brought to bear in reaching what the board considers a reasonable business decision.

The business judgment test has been applied in the case of a charitable corporation in *Hadjor v Homes First Society*[37], where the board amended the by-laws to remove the residents of low cost housing as members of the corporation. The action was taken in response to a consultant's report which warned that potential control of the board by residents might result in a loss of charitable status, which could reduce or eliminate funding. The judge accepted that the board's decision was made in what they considered to be in the best interests of the corporation. Whether this test or the higher standard of trust law would have applied if the board decision involved charitable property has been raised by one commentator[38].

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[36] The Court also held that the statutory duty of care was more open-ended than the duty of loyalty and could include interests of e.g. creditors: Peoples para. 43.

[37] 2010 O.J. No. 4079, (2010), 70, B.L.R. (4th) 101 (Ont. S.C.)

[38] Terrance S. Carter and Ryan M. Prendergast, "Duties and Liabilities of Directors and Officers of Charities and Non-Profit Organizations" in The Law Society of Upper Canada: Emerging Issues in Directors' and Officers' Liability, Mar. 29, 2011

So what are the best interests of the corporation and what test can be applied to determine them? Is it simply the overall interests of the stakeholders? If a charity, is it the beneficiaries? If not a charity, is it the objects and purposes? The latter two suggestions deserve serious consideration.

This is clearly stated in *London Humane Society (Re)*[39]:

> [19] Directors of not-for-profit and charitable organizations are subject to fiduciary duties at common law. The Supreme Court of Canada has held that directorial fiduciary duties are owed primarily to the corporation, not to the corporation's shareholders or other stakeholders (See *Re BCE Inc.*, 2008 SCC 69 (CanLII), 2008 SCC 69 at paras. 36-38). While most litigation in this area focuses on for-profit corporations, various academic texts apply the same concept to the directors of not-for-profit corporations (See McCarthy Tétrault, *Directors' and Officers' Duties and Liabilities in Canada*, M.P. Richardson, Ed. (Toronto: Butterworths, 1997)). Consequently, the Board of Directors at the LHS owed a fiduciary duty to the LHS as a corporation, but not separately to its members.

Donors to a charity are among the stakeholders whose interests should in appropriate cases be taken into consideration. In *OSPCA v. Toronto Humane Society*[40], the court stated that the Society "owes fiduciary duties to the public who support it". While this may be the case for a corporation[41], the duty of directors is clearly and solely to the corporation, but it is an indication of the scope of a charity's stakeholders. The corporation has been set up at least in part to further the interests of the stakeholders. If the interests of some of the stakeholders compete with those of other stakeholders, it may be appropriate to determine the best interests of the corporation by examining the purpose for which the corporation was formed. This is probably strongest when the corporation is established for a charitable or public purpose.

It seems as if each situation must depend on its facts and there is no strict rule or bright line test which tells the director whether to refrain or participate from voting or acting. If there is a possibility that liability might ensue, the director would be better advised to refrain. If the director strongly believes that the stakeholder's position is in the best interests of the corporation and is satisfied that a court would defer to his or her business judgment, and if the balance of the board is independent and the decision for or against would be carried without the stakeholder-director's vote, then there is no reason to refrain.

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[39] 2010 ONSC 5775 (CanLII)

[40] 2010 ONSC 1953 (CanLII)

[41] *Pathak v. Sabha* 2004 CanLII 10850 (ON S.C.J). There are cases which suggest that directors who misappropriate charitable property may be compelled to account to the public, but these do not seem to be appropriate when dealing with the duty of loyalty and to whom it is owed. See Carter and Prendergast at n.40.

If the director is not confident that the business judgment test will protect him or her from liability, then the director should still be allowed to advocate the stakeholder's position, but then should refrain from voting – but if there is a true conflict of interest involving an ONCA corporation, then the director "shall not attend any part of a meeting during which the contract or transaction is discussed and shall not vote on any resolution to approve the contract or transaction"[42].

8. **How duty of loyalty applies to decisions**

Once a board decision is made, what is the scope of the director's fiduciary duty of loyalty? The director now has a new duty, the "duty of neutrality" between the corporation and the stakeholder. The scope of this duty is not necessarily clear, since nothing prevents the director from continuing to advocate the position at the board of either entity. But the director's duty of loyalty:

> requires a director to accept decisions validly made by such board at the conclusion of its deliberations. While such a director can, and indeed is expected to, vigorously promote the views that have been espoused by the first board, all directors must accept the decision of the majority of the directors of the second board once the vote has been taken, regardless of whether the result does or does not support the stance taken by the first board and the views promoted by the director common to both. Although such a director is free to indicate, even publicly, what views the person holds on the particular topic, he/she should not actively promote a viewpoint that is contrary to the decision made by that second board, while at the same time representing himself/herself as a director or spokesperson of the second board. He/she should make very clear that his/her views are either personal or those of the first board, and not the position of the second[43].

A nominee who publicly opposes or covertly works against the decision is doing so at his or her peril.

9. **Contracting Out – Unanimous Member's Agreement**

Can a unanimous member's agreement ("UMA") relieve the director of the duty of loyalty and the duty of confidentiality? The OCA and CCA make no provision for such an agreement. Since the director's fiduciary duty under these statutes arises under the common law, it is likely that such an agreement is unenforceable. Section 170(1) of the CNCA provides:

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42 ONCA, s.41(5), CNCA

43 Miller Thomson LLP. Charities & Not-For-Profit Newsletter. Conflict of interest: one director, two boards, the difficulty of serving two masters. By Hugh M. Kelly and Robert R. Berry, October 2005. http://www.millerthomson.com/assets/files/newsletter_attachments/issues/charities_october_2005%20v.1.pdf

> 170. (1) An otherwise lawful written agreement among all the members of a corporation that is not a soliciting corporation, or among all the members and one or more persons who are not members, that restricts, in whole or in part, the powers of the directors to manage, or supervise the management of, the activities and affairs of the corporation is valid.
>
> …..
>
> (5) To the extent that a unanimous member agreement restricts the powers of the directors to manage, or supervise the management of, the activities and affairs of the corporation, parties to the agreement who are given that power to manage or supervise the management of the activities and affairs of the corporation have all the rights, powers, duties and liabilities of a director of the corporation, whether they arise under this Act or otherwise, including any defences available to the directors, and the directors are relieved of their rights, powers, duties and liabilities, including their liabilities under section 146, to the same extent.

The definition of "soliciting corporation" in the CNCA is broader than merely charities, so the types of corporations that could take advantage of this provision are limited. However, most member-benefit organizations which receive no donations or government funding will be able to use this provision. The ONCA does not have a similar provision and it would not be possible for a director of an ONCA corporation to contract out of his or her statutory fiduciary duty. This could in some cases be a factor in choice of jurisdiction of incorporation.

Section 136 of the Saskatchewan Act contains a similar provision and provides:

> (5) A member who is a party to a unanimous member agreement has all the rights, powers and duties of a director of the corporation to which the agreement relates to the extent that the agreement restricts the powers of the directors to manage the activities and affairs of the corporation, and the directors are relieved of their duties and liabilities, including any liabilities pursuant to section 106, to the same extent.

The Saskatchewan Act contains numerous instances where such an agreement can remove or restrict the powers of the directors.

Shifting the decision-making authority to the stakeholder has not changed the legal position. The liability for breach of fiduciary duty has simply shifted to the stakeholder, which is probably where it should have been in the first place. The stakeholder will have the same fiduciary duties as the nominee would have. It is essentially a shifting of the burden, not a solution to the problem.

10. **The Position of the Non-Voting Director**

Many organizations provide for a member of their staff to be on the board as an *ex officio* director – e.g., the CEO. This does not generally raise the dual loyalty problem. However, when the *ex o*fficio appointee is on the board to represent the interests of a stakeholder, which may be a member, parallel organization (such as a hospital appointing its CEO or board chair to the board of the hospital's fundraising foundation), or a representative of a funding body, such as the government, or even a member appointed to represent the interests of the public on the governing body of a professional organization, the issue of dual loyalty will arise.

10.1 Is a Non-Voting Director Really a Director?

It has been suggested that by making the director non-voting the problems associated with dual loyalty can be reduced or eliminated. One explanation for this point of view is that a non-voting director is, technically speaking, not really a director, and therefore, if he or she does not participate in a decision, there can be no responsibility for it. The reasoning is that he or she cannot effectively act as a director without the power to vote. In this view, however, even if the appointee is non-voting, a number of complex issues still remain:

> Whatever title is given, technically speaking, a "director" who does not have voting privileges is not a director and does not have the same duties and responsibilities as a voting director. That said, if a non-voting director or other individual acts like a voting director, making decisions along with the rest of the board, there is a risk that he or she could be found by a court to be subject to the same fiduciary duties and other obligations as well as liabilities as an elected or appointed director[44].

Regardless of whether or not they have voting rights, *ex officio* board members have the same legal duties and responsibilities as regular directors. Where an *ex officio* director does not have a vote, he or she takes on liability without the opportunity to oppose a board decision or register a dissent. In these circumstances, where possible, provision should be made to provide such a director with indemnity and/or insurance protection[45].

According to the Primer, persons described as "honourary" directors, but not given voting rights, may have similar rights and responsibilities to other non-voting directors, including the right to

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[44] Jane Burke-Robertson, "20 Questions Directors of Not-for-profit Organizations Should Ask about Fiduciary Duty", Canadian Institute of Chartered Accountants, 2009; see also *Primer for Directors of Not-for-Profit Corporations*, Industry Canada, 2002, at p.5, http://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/cl00689.html (henceforth, the "Primer") - Chapt. 1, n. 12 gives source as H. Kelly & M. Frederick, *Duties and Responsibilities of Directors of Non-Profit Corporations*, (Canadian Society of Association Executives: Toronto, 1999) at p.32 – n.10

[45] Primer, p.5

receive notice of and attend board meetings, including *in camera meetings.* Given the reason for appointing such individuals, it would be preferable to call them something else, such as "patrons" or "advisory council members".[46]

The writer disagrees that non-voting directors are technically not directors. It is really a matter of semantics[47]:

> Regardless of whether or not they have voting rights, *ex officio* board members have the same legal duties and responsibilities as regular directors[48]. Where an *ex officio* director does not have a vote, he or she takes on liability without the opportunity to oppose a board decision or register a dissent. In these circumstances, where possible, provision should be made to provide such a director with indemnity and/or insurance protection. (See chapter 6 for a detailed discussion of indemnification and insurance.) As well, it should be noted that except where a conflict of interest arises, the *ex officio* director will be entitled to be present during any in camera discussions of the board.[49]

The power to vote is certainly only one incident of directorship, albeit a very important one. Directors deliberate, review, recommend and carry out many other activities that do not always result in a vote. And it is likely that in many instances the non-voting director's participation influenced the final vote.

> The potential trap of the "*ex-officio*" director should be mentioned here. Many organizations have *ex-officio* directors, individuals who sit on a board of directors as a matter of right by virtue of holding some other office. Some *ex-officio* directors are specified to be voting and some are non-voting. In order to avoid being considered a full director (with all of the attendant duties and potential liabilities), it is very important for the by-laws of the organization to specifically state that the individual is "non-voting". The same applies in some organizations with regard to advisory boards[50].

In organizations where the President, Executive Director or CEO is an *ex-officio* director, it has been suggested that making this official non-voting eliminates "a situation where the executive director is charged with implementing a decision he or she voted against at the board level"[51].

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46 Primer, p.6

47 A number of statements have been made to the effect that such individuals are technically not directors, but no judicial or statutory authority is cited. See for example "Don't Rock The Vote – Answers To Common Questions About Voting By Directors", Dana Young http://nonprofitrisk.imaginecanada.ca/files/insuranceinfo/en/publications/dana_young_sept_2009.pdf

48 Primer, Endnotes, n.12,

49 Wayne Amundson. Primer, Chapt. 1 "Rights, Duties and Practices)**"**, http://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/cl00691.html

50 Burke-Robertson and Drache, *Non-Share Capital Corporations,* p.6-12. Again, no authority is given for the legal position of a non-voting director.

51 Primer, p.5

However, a volunteer voting member of the board who voted against a measure may also be charged with the responsibility of implementation. In either case the director is bound by the duty of loyalty.

10.2 Hospital Boards.

For some reason, not entirely explained, the government of Ontario chose to amend the Hospital Management Regulation under the *Public Hospitals Act*[52], which formerly required certain medical staff (the Chief of Staff or Chair of the Medical Advisory Committee, President of the Medical Staff and, for most hospitals, the Vice President of the Medical Staff) to be voting members of a hospital's governing board. Most hospitals appointed their president or CEO to the board, as well[53]. Under the amended Regulation, which took effect January 1, 2011, the CEO (administrator), the president of the medical staff, the chief of staff (or chair of the medical advisory committee where there is no chief of staff) and the chief nursing executive must be on the board, but these individuals will be non-voting. In addition any member of the medical, dental, extended class nursing or midwifery staff or any employee of the hospital is prohibited from being a voting member of the hospital board[54]. While the rationale for the change has not been published, it is assumed that the government believed that the changes would relieve these *ex-officio* directors from the duty to act in the best interests of the hospital, and allow them to act in the best interests of the professional staff which they consider themselves to represent. It may have also been thought that they were relieved from the duty of confidentiality[55]. Since there is a scarcity of legal authority on the position of a non-voting director, it is questionable how effective this change will be – non-voting directors are, in this writer's opinion, still directors, albeit they may under certain circumstances be immune to any liability which is based solely on how a director voted on a particular matter. They violate board confidentiality and the duty to stand behind board decisions at their peril. It will be interesting to consider what liability such an *ex-officio* director would face if he or she refused to assume a board position under these circumstances[56].

52 R.S.O. 1990, c. P.40
53 The president/CEO is usually a paid employee, and there was concern that this conflicted with the position taken by the Ontario Public Guardian and Trustee ("PGT") that no director can be remunerated for services to the corporation in any capacity. In 2008, the PGT and the Ministry of Health and Long Term Care released a joint statement authorizing such compensation, subject to certain conditions. See Lynn Golding, "Removal of Voting Privileges on Boards of Ontario Public Hospitals" http://www.fasken.com/en/removal-of-voting-privileges-on-boards-of-ontario-public-hospitals
54 O. Reg. 448/10, amending Reg. 965, RRO, 1990.
55 Op. cit., n.53.
56 Both the Ontario Medical Association and the Ontario Hospital Association opposed the non-voting director change.

10.3 Consensus Decisions.

In many cases the board operates on a consensus basis, under which votes are not taken but the result is recorded as if they had been. In such instances the non-voting director is effectively participating in the same manner as a voting director. Until now there has been no statutory sanction for this method of decision-making, since the usual result is a recorded decision which, unless specifically stated in the minutes, can be assumed to have been unanimous.

But s.137 of the CNCA now attempts to provide a legislative sanction for this type of decision:

> Decisions made by consensus
>
> **137.** (1) The by-laws may provide that the directors or members shall make any decision by consensus, including a decision required to be made by a vote, except a decision taken
>
> (*a*) by a resolution referred to in subsection 182(1);
>
> (*b*) by special resolution; or
>
> (*c*) by a vote if consensus cannot be reached.
>
> Meaning of consensus, etc.
>
> (2) By-laws that provide for consensus decision-making shall define the meaning of consensus, provide for how to determine when consensus cannot be reached and establish the manner of referring any matter on which consensus cannot be reached to a vote.
>
> Voting requirements satisfied
>
> (3) A decision made by consensus in accordance with this section is deemed to satisfy any requirement under this Act for the taking of a vote.

Surprisingly, the CNCA has chosen not to define “consensus”, leaving that to the by-laws. Presumably if the corporation does not have a by-law defining the term, it can’t use this method, or at least the recorded decision will still have to appear as a motion which was approved by the board[57]. An appropriate definition of consensus would be “sense of the meeting”, which the

[57] In its joint submission on Bill C-4, the draft CNCA, dated February 2009, the National Business Law Section and National Charities and Not-for-Profit Law Section of the Canadian Bar Association was critical of this provision:

person chairing the meeting would determine in the first instance. Any director present should have the power to challenge this determination and require a vote. “Consensus” is not used in British corporate legislation, but is used in a number of Irish statutes, e.g.:

> Universities Act, 1997 (Ireland) - No. 24/1997:
>
> 12. Every question at a meeting of a governing authority shall be determined by consensus, but where in the opinion of the chairperson or other person presiding consensus is not possible, the question shall be decided by a majority of the votes of members present and voting on the question and, in the case of an equal division of votes, the chairperson or other person presiding shall have a second or casting vote.

There are a small number of statutes in which “consensus” is used for board-level decision-making[58], but the context is often confusing and leads to the conclusion that even where the chair determines there is a consensus of the meeting, he or she should then state that unless anyone objects, it will be recorded as having been passed by a unanimous vote.

Robert’s Rules of Order: Newly Revised, 1990 Edition, does not define “consensus” but discusses “Adoption of a Motion or Action Without a Motion, by Unanimous (or General) Consent[59]. This is often called a “general consent”. In essence, if the chair sees that there is on opposition *on questions of routine or little importance,* the chair can abridge the proceedings and state that a matter will be approved or decided on consent unless someone objects. In practice, this must be what a consensus decision by-law would accomplish, although Roberts seems to believe that this must be limited to non-material issues.

> Section [137] provides for directors and members (the latter is placed in Part 10 rather than in Part 9 which otherwise sets out the rules relating to meetings of members) making decisions by consensus if the by-laws so provide. There is no definition of "consensus" in the Act. This might make use of the provision confusing. Since s. [137] is permissive and opt-in, it would impliedly rule-out the legitimacy of consensus decision-making unless the corporation explicitly opts-into s. [137] in its by-laws.

The Library of Parliament’s Parliamentary Information and Research Service’s Legislative Summary of Bill C-4, revised June 26, 2009 only mentions Section 137 in a very brief footnote, calling it a “curious provision on consensus”. There is no other evidence that this Section was even considered at Committee level.

[58] New South Wales *Water Management Act* 2000 – Schedule 6, s.12 provides that “(1) At any meeting of a management committee, all members present are to strive for consensus in reaching decisions.” However the following subsections seem to require a recorded vote in respect of any decision. See also New South Wales *National Parks and Wildlife Act* 1974 – Schedule 14A, 11.

[59] pp. 52-55

Law dictionaries, with the exception of *Black's Law Dictionary*[60], do not refer to "consensus" in this context:

> consensus. A general agreement; collective opinion...."The regular method for the chair to use is to ask the members. 'Is it the consensus of this meeting that . . . is agreed to?' or, 'Is it the will of the assembly that . . . is agreed to?' or, 'Is there an objection?' Consensus has been used successfully throughout the years by Quakers, Indians, New England town meetings, and others as a decision-making procedure. It permits compromise. In small groups where less formality is required, it is a simple method for making decisions.
>
> "General consent is an equivalent to consensus, when done without objection. Otherwise, a formal vote must be taken." Floyd M. Riddick & Miriam H. Butcher, Riddick's Rules of Procedure 56 (1985).

Wikipedia has an extensive article on "consensus"[61] which never mentions the words "board", "directors" or "corporation" and appears to have little application to board culture. An extensive search did not turn up any other use of the term in a statute of general application to corporations.

Since the issue of liability of non-voting directors is so little understood, such individuals are to be treated as if they are directors to all intents and purposes, with the same rights and duties, save and except when it comes to whether they are required to refrain from voting on a matter on which they have a conflict, since they cannot vote in any event. When it comes to liability, it would seem that the only difference between them and other directors is that, if a director who voted in favour of a matter would be liable to the corporation or a third party for the consequences of the matter, the non-voting director is *a priori* immune to judgment in respect of that matter. However, the non-voting director could still be subject to liability if, for example, he or she participated in the implementation of the resolution. The danger is that a non-voting director who participated in a consensus decision, even if there was no actual vote, may have incurred whatever liability flows from breach of his/her duty to act in the best interests of the corporation. Since there is as yet no case-law on this point, it would be dangerous for a nominee who wants to avoid such liability to participate in a decision and it may be that he or she should ask to have it recorded that he or she did not participate in the consensus.

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[60] 8th ed., 2004. Other sources checked include *Jowitt's Dictionary of English Law* (2d), *Words & Phrases (Canada), Sangan's Encyclopedia of Words & Phrases Legal Maxims Canada* (5th), *A Dictionary of Modern Legal Usage (2d)*. The only reference I could find in a Canadian text is in Leighton, David S.R. & Thain, Donald H., *Making Boards Work: What Directors Must Do to Make Canadian Boards Effective*. Toronto, McGraw-Hill Ryerson Limited, 1999, which has a section headed "Skillful Chairmen Seek Consensus" in Chapter 14, "Board Culture". Clearly this is not used in the sense of the legal decision-making process.

[61] http://en.wikipedia.org/wiki/Consensus

10.4 Summary.

On balance, I agree with those who say that non-voting directors are still directors, with the full rights, liabilities and duties of directors, except to the extent that these may be tempered by the inability to vote. To say they are not truly directors is simply to avoid the issue, since those commentators usually conclude that any non-voting director can still face liability for acting as a director. The issue is the extent of that liability, a subject on which the courts have not yet had much to say.

11. Workarounds and Precautions

While it may not be possible in some situations to eliminate the possibility that a director will be put in a situation where there is a breach of his or her fiduciary duty of loyalty or non-disclosure, certain steps can be taken to minimize the possibility, as well as to provide mechanisms to deal with the breach, once one occurs[62]:

For a Stakeholder:

- If the corporation is incorporated under the CNCA, use a unanimous members agreement to transfer to the stakeholders some of the powers that may be transferred to members and require higher or lower levels of support for various types of decisions according to the importance of the decision (e.g. the strategic plan) – this is not available if the corporation is a "soliciting corporation" under the CNCA;

- Insert provisions in the by-laws or in an administrative resolution providing for the disclosure of the same information to the stakeholders as is disclosed to the directors and authorizing the directors to make such disclosure;

- Do not disclose confidential information to the nominee on projects likely to conflict with the corporation's interests.

- In the case of a subscription for a membership, include in the subscription or membership agreement certain conditions regarding the disclosure of information (preferably, the explicit consent of all the other stakeholders should be obtained);

- Appoint a contact person distinct from the nominee to look after the interests of the stakeholder.

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62 This list is adapted, with thanks, from one prepared by Lavery, de Billy LLP, "The "Nominee" Director and Conflicting Loyalties", at http://www.hg.org/articles/article_1507.html.

<u>For the Corporation Itself:</u>

- Ensure that the chair of the board and the secretary of the corporation do their best to avoid placing a nominee in a conflict of interest situation by taking precautions, for example:

    - by informing the nominee, before transmitting any document or information to him or her, of the risk of a conflict arising out of a matter which must be referred to the board and of the advisability of obtaining an independent and confidential opinion regarding what he or she should do in this specific situation;

    - by avoiding the transmission of any relevant information or document to him or her before such opinion is obtained;

- Establish rules in advance with stakeholders who intend to arrange for the election of nominees;

- Adopt a policy and guidelines for the directors which include specific provisions or operating parameters covering nominees;

- Provide training to the directors on the notions of "in the best interests of the corporation" and "conflict of interest" and on the best ways to prevent noncompliant conduct; integrate the essentials of this training into a directors' manual or guide.

<u>For the Nominee:</u>

- Disclose any real or potential conflict of interest immediately, abstain from voting on the matter which presents the conflict and avoid taking cognizance of documents or information relating to the matter; if mere disclosure of the conflict may, in itself, constitute a disclosure of confidential information or a breach of the fiduciary duty to the stakeholder who arranged for the nominee's election to the board of the corporation, resign from the board, in the case of a material conflict of interest, or obtain an opinion from an independent external legal adviser on the proper course of action;

- Do not disclose confidential information or documents of the corporation to the stakeholder who arranged for the director's appointment;

- Obtain a written acknowledgment, by the stakeholder who arranged for the director's appointment, of the parameters of his or her independence, including specific acknowledgements that his or her fiduciary duty to the corporation takes precedence over his or her fiduciary duty to the stakeholder and that the fact of honouring his or her obligations as a director can in no case constitute a breach of any obligation to the stakeholder;

- Obtain a clear and broad indemnification commitment from the stakeholder who arranged for his or her appointment[63].

These precautions, although not exhaustive, are nevertheless a good way to guard against regrettable faux pas or unfortunate mistakes. A well-informed nominee will take the precautions that the circumstances dictate for him, whether separately or concurrently.

11.1 Limits to Workarounds.

While resigning might eliminate the problem with the sectoral interest, it does not deal with the underlying reason for the director to have been placed on the board in the first place. There may well be many occasions on which the stakeholder's interests will be aligned with those of the corporation and the resignation will leave the stakeholder without a representative when those issues are to be considered. To justify resignation the conflict between the two loyalties would have to be on a matter of significant materiality and the likelihood of the conflict would have to extend over a considerable length of time, so that the effectiveness of the director would be impaired beyond the level that would prevent him or her from continuing in office.

If the conflict is not pecuniary, but 'sectoral', then consider whether there is potential liability from advocating and voting in favour of the stakeholder's interest. If not, then the director should be free to participate and vote.

It is always a question whether by-laws, agreements and codes of conduct that attempt to alter the law of fiduciary duty will be enforceable. Jane Burke-Robertson has commented "Both the corporation and the directors should have a clearly defined policy to follow in the event of a conflict of interest. However, the legal validity of any policy that allows a board to disregard a conflict of interest in breach of its fiduciary obligations is doubtful".[64] Statutory authority will override the common law, however.

In *Orangeville (Town) v. Dufferin (County)*[65], two councillors sat on the councils of both an upper tier and lower tier municipality that each entered into a contract to sell lands to a third party for a specific development. The court concluded that the councillors were not prevented from discussing or voting on the matters at both councils and did not have a conflict of interest

[63] This should include coverage by directors and officers insurance and be incorporated into a written agreement that will survive the termination of the nominee's appointment to the board of the corporation, as well as the nominee's position with the stakeholder.

[64] I am not aware of any decision in which a director has been held liable where the statutory requirements for approval of a material contract have been followed, including obtaining the requisite members or shareholders approval. Primer, p.25; See also Burke-Robertson & Drache, op.cit. n.50, at p.6-15.

[65] [2010] O.J. No. 429 (S.C.J.)

under the *Municipal Conflict of Interest Act*. The legislature had chosen to have them sit on both councils and they were "well placed to understand and represent the interests of the lower-tier municipality and to coordinate the activities of both tiers. If they were prevented from discussing and voting on matters of interest to both tiers simply because the lower-tier had a pecuniary interest in the matter, they would be prevented from doing the job they were elected to do and that the legislature intended." Leo Longo comments that unfortunately the court did not deal with the issue of dual loyalty and whether, in supporting the interests of the lower-tier at the upper tier council, they would be acting with a "closed mind" and should thus be disqualified from participating and voting. By a "closed mind" he meant that they might be favouring the interests of the lower tier and not acting in the best interests of the upper tier[66].

11.2 Conclusion.

In most cases, the interests of the stakeholder who arranged for the nominee's election should correspond to the best interests of the corporation. Nonetheless, the nominee should study the situation carefully before executing an "order" of the stakeholder and avoid any action that could constitute an abuse of rights or "oppression" vis-à-vis the corporation or other stakeholders.

12. **Remedies and Sanctions**

What are the protections and remedies available to the corporation or any stakeholder who suffers damage by a nominee's breach of fiduciary duty?

12.1 Removal of Director.

With the exception of the CCA, all corporate statutes contain provisions for the removal of a director[67]. In all such cases, the removal is by the members, either by a majority or 2/3 majority vote, depending on the statute. However, it is questionable if this power could be used to remove an *ex-officio* director, especially one appointed by a stakeholder. Because the CNCA does not permit *ex officio* directors, the most likely work-around will be to create a separate class of members with the right to elect one or more directors. Such a nominee can only be removed by

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66 See Leo Longo article "When Councillors Sit on Two Councils", in *The Lawyers Weekly*, October 1, 2010

67 OCA s.67(1) by a resolution passed at a meeting of members by 2/3 of the members present. It is common to include a similar provision in the by-laws of a CCA corporation; CNCA, s.130(1) provides for a resolution to be passed by a majority of the members and s.7(5) provides that the percentage of members required cannot be increased by any provision in the articles; Saskatchewan Act, s.96(1) provides for an ordinary members' resolution and s.6(4) prohibits any increase in this percentage; ONCA, s.26(1) provides for removal by an ordinary resolution of members and specifically excludes *ex-officio* directors from the provisions of the section.

the members of the class which appointed him or her[68]. Even if it were possible to remove a director, the stakeholder which has the right to appoint a director could simply reappoint the removed director, unless for some other reason – e.g., bankruptcy or insanity – he or she was not qualified to act as a director[69].

It may be possible in some cases for a director to be removed by court order[70]:

> In *Catalyst Fund General Part I Inc. v. Hollinger Inc.*[71] the oppression remedy provided for in section 241 of the *CBCA* was recognized as a statutory basis for the court to remove a director. However, Justice Ground in *Albrecht v. Kuhn*[72], in refusing to remove a director from a corporation's board, noted that the court will exercise its power of removal in only the most extraordinary circumstances where the continuation of the board of directors in its present state would be harmful to the corporation or where the conduct of the director rises to the level of misconduct. A summary of cases dealing with circumstances where the judiciary has removed a director of a corporation was set out in *Walker v. Betts*[73].

Generally the courts have not permitted the board of directors to remove a director. This power is reserved to the members[74]. In *Kwantlen University College Student Assn. v. Canadian Federation of Students*[75] a federation of universities and colleges incorporated under the B.C. Societies Act refused to allow a director who had been appointed by one of its members to take his seat because he had actively worked to have his school withdraw from the organization. The B.C. Court of Appeal held that the board did not have the power to exclude him:

> 38 …. The directors elected by the local associations are not simply members of the board of directors; they are "local Representatives" with special duties to represent their local associations. They act as liaisons between those associations and the society. It would be very strange to call these directors "local Representatives" if their appointment as directors ultimately depended on the preferences of directors from other institutions rather than on the students at their own schools.

However, there are a number of steps which a corporation may take which arguably allow the board to do so. Hartley Nathan has set them out as follows[76]:

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68 s.130(2)

69 e.g., ONCA, s.23(1)

70 Hartley R. Nathan, Q.C., "Removal_of_Directors_of_Business_Corporations" http://www.mindengross.com/publications/2011/p2011_01_25Removal_of_Directors_of_Business_Corporations.asp

71 (2006), 79 O.R. (3d) 288 (C.A.)

72 (2006) 15 B.L.R. (4th) 8 (O.N.S.C)

73 (2006), 20 B.L.R. (4th) 152 (B.C.S.C) at 158

74 *Re: Lajoie Lake Holdings Ltd.*. (1991), 24 A.C.W.S. (3d) 1332 (B.C.S.C). Wegenast, *Canadian Companies*, 1931, a must-have for anyone working with the CCA, was of the view that certain types of corporations could include the power to remove in their constating documents and the court would permit it to be exercised (at pp.415-417).

75 2011 BCCA 133, [2011] B.C.W.L.D. 2877

76 *op. cit.* n.70

1. Frequently a corporation's Code of Conduct, usually adopted by by-law, provides as a consequence of a breach of duty that a director may be suspended or even removed from his or her office.

   There are no Canadian and U.S. cases to the writer's knowledge which have considered the issue whether this would be an enforceable provision.

2. A director may be required to file an undated resignation with the secretary or the corporation when he or she is elected to the board.

   The triggering event for implementing the resignation may be a resolution of the remaining directors as long as the grounds for its exercise are set out in advance and there is fairness in the process.

3. A director may agree in advance to removal by the board when he or she has been elected, again as long as the grounds for its exercise are set out in advance and there is fairness in the process.

4. Provisions may be made in a corporation's articles for resignation in certain circumstances. In *Lee v. Chou Wen Hsien*[77], a case in the Privy Council, a Hong Kong company provided in its articles of association that a director must resign if a written request to do so was submitted by the co-directors of the corporation. The Privy Council upheld the removal of the director in this fashion where execution of the provision was administered in accordance with the stipulated method.

12.2 <u>Exclusion of Director.</u>

Another possible method of dealing with a nominee director who is acting in a manner which is inconsistent with his or her duties of loyalty or confidentiality is to exclude him or her from attending one or more board meetings. Normally a chair would not have the power to exclude a director[78], unless the director has a conflict and the relevant corporate statute requires the director to leave the meeting[79]. Likely an exclusion provision in a by-law or code of conduct would also be enforceable to exclude the director from a meeting.

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77 [1984] 1 W.L.R. 1202 (P.C.)

78 Hartley R. Nathan, Q.C., "The Preparation For and Conduct Of Board Meetings" http://www.mindengross.com/publications/2011/p2011_04_25_preparation_for_and_conduct_of_board_meetings.asp#_ftnref49; *Hayes v. Bristol Plant Hire Ltd.* [1957] All E.R. 685 (Ch. D.).

79 ONCA, s.41(5); CNCA, s.141 does not contain such a provision.

12.3 Denial of Access to Records.

Directors have the right to inspect corporate records and other documents germane to the corporation[80]. The courts have enforced this right even in a case where the director was suing the corporation for oppression[81]. Presumably, an exclusion provision in a by-law or code of conduct could be used to protect in this situation.

12.4 Civil Liability.

A director who breaches his or her fiduciary duty to the corporation can always be sued for any damage caused to the corporation and possibly by someone who suffers damage as a result of that breach. There is considerable case law that affirms both of these propositions[82].

12.5 Liability of a Stakeholder in Tort and Oppression Remedies.

If the nominee director is legally or practically the employee or agent carrying out the directions of the stakeholder, then it would seem that the law of agency or the vicarious liability of an employer for its employee should allow any party who has suffered damage by the actions of the nominee to sue the stakeholder. However, the decision of the Privy Council in *Kuwait Asia Bank*[83] stands for the principle that a shareholder cannot be held liable in an action in tort for the wrongful act of its nominee on the board of the corporation. Surprisingly, this issue has not been frequently raised in Canada. *Kuwait* has been referred to in only two decisions, and in only one of them, *Mutual Construction v. Hardwick*[84], was the issue commented on: "A shareholder does not, by reason only of his position as shareholder, owe any duty to anybody." It appears that this is still the law of Canada insofar as a tort action is concerned. However, an aggrieved shareholder can bring an action against another shareholder under the oppression remedy provisions of the relevant corporate statute, as in *Deluce Holdings Inc. v. Air Canada*[85]. Since

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80 CNCA, s.21(1)-(3) lists the records a corporation is required to maintain, and s.21(7) provides "(7) The records described in subsections (1) and (3) shall at all reasonable times be open to inspection by the directors. The corporation shall, at the request of any director, provide them with any extract of the records free of charge." The ONCA contains similar provisions in ss.92 and 94.

81 *Boreta v. Primrose Drilling Ventures Ltd* (2010), 70 B.L.R. (4th) 88 (Alb. Q.B.).

82 See e.g., *Ontario (Public Guardian & Trustee) v. AIDS Society for Children (Ontario),* [2001] O.J. No. 2170 (S.C.J.); *Kuwait Asian Bank*, *supra.* n.32; see also Paul Martel, *Business Corporations in Canada: Legal and Practical Aspects,* Chapt. 24.

83 *Supra.* n. 32. A strong argument that the decision is wrong is made in Thomas, *op. cit.* n. 97

84 2009 BCSC 117 (CanLII) at para.48; the other decision was *Yordanes v. Bank of Nova Scotia*, 2006 CanLII 1777 (ON S.C.), in which the court did not have to consider this issue.

85 (1993), 12 O.R. (3d) 131 (Ont. Gen. Div.)., in which Blair J commented: "There will almost always be a tension between the director's position as a director of the corporation in question and the director's position as a shareholder of the nominee of a shareholder. Where an issue arises, hindsight and after-the-fact rationalizations all too naturally make it easy for the directors to believe that they were, indeed, acting for the benefit of the corporation." See also *Harold E. Ballard Ltd., supra.* n.14.

oppression remedies are available under the CNCA and ONCA to persons other than members, this may be of some assistance[86]. The U.K. *Companies Act, 2006*[87] attempts to deal with this situation by instituting the concept of a "shadow director", defined as:

> 251 "Shadow director"
>
> (1) In the Companies Acts "shadow director", in relation to a company, means a person in accordance with whose directions or instructions the directors of the company are accustomed to act.
>
> (2) A person is not to be regarded as a shadow director by reason only that the directors act on advice given by him in a professional capacity.
>
> (3) A body corporate is not to be regarded as a shadow director of any of its subsidiary companies for the purposes of–
>
> > Chapter 2 (general duties of directors),
> > Chapter 4 (transactions requiring members' approval), or
> > Chapter 6 (contract with sole member who is also a director),
>
> by reason only that the directors of the subsidiary are accustomed to act in accordance with its directions or instructions.[88]

Given how recent this provision is, it will be interesting to see if it is possible for a plaintiff to get past the burden of proving that a director was acting under compulsion, or merely because he or she was "accustomed to act" as instructed. In the US, there is apparently no difficulty, at least in some states, in suing the shareholder[89].

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[86] CNCA, s.253; ONCA s.174, which is somewhat limited compared to the CNCA provision. A discussion of the oppression remedy is beyond the scope of this paper. Most corporate guides and textbooks contain extensive discussions of the remedy. See, e.g., Martel, *op.cit.* n. 82

[87] Henceforth the "2006 UK Act"

[88] Section 170(5) makes Section 172 applicable "to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply."

[89] See e.g., CDX Liquidating Trust v. Venrock Ass, 10-1953, Court of Appeals for the Seventh Circuit, Tuesday, March 29th, 2011, per R. Posner, Circuit Judge

13. **Other Jurisdictions**

The topic of dual loyalty has received consideration and, in some cases, partial legislative solutions, in other common-law jurisdictions, including the United Kingdom, United States, Australia and New Zealand. What follows is only a brief summary.

13.1 United States.

The common and corporate law in the U.S. has developed along lines similar to those in Canada. The courts often take a rigid approach to a director with divided loyalties. Despite this, however:

> Despite the rigidity of the general proposition that a representative director must act independently, cases allow promotion of a sponsor's interest and transactions with the sponsor if reasonable procedures are followed. In one of the few discussions of the problem of the representative director, the author … concluded that
>
> > The cases that deal with self-dealing transactions between a controlling stockholder and the controlled corporation cannot be reconciled with the existence of any general prohibition against action by a director who represents a particular stockholder to further that interest. What may be required, however, is first, a high degree of candor by the representative director, and second, in situations in which the potential for conflict is acute, the informed vote of the disinterested board members.
> >
> > Even where disinterested director approval is not achievable, cases … suggest that, outside the realm of true self-dealing, there is a broad zone in which the assertion of a particular stockholder's interest will not defeat application of the business judgment rule.[90]

Beginning in 1986, more than half of the American states have passed stakeholder statutes[91]. Most of these are permissive – i.e., they allow, but do not require, the directors to take the interests of employees and other stakeholders into consideration when making decisions. Two, Connecticut and Arizona specifically require the directors to consider the interests of other stakeholders. Section 33-756 of the Connecticut Business Corporations Act

> (d) A director …. shall consider, in determining what he reasonably believes to be in the best interests of the corporation, (1) the long-term as well as the short-term interests of the corporation, (2) the interests of the shareholders, long-term as well as short-term,

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[90] Moscow, op.cit. n.4

[91] Summarized from Shelley Marshall and Ian Ramsay, "Shareholders and Directors Duties: Law, Theory and Evidence", June 2009, http://cclsr.law.unimelb.edu.au/files/Stakeholders_and_directors__duties_paper_%2810_05_09%291.pdf

> including the possibility that those interests may be best served by the continued independence of the corporation, (3) the interests of the corporation's employees, customers, creditors and suppliers, and (4) community and societal considerations including those of any community in which any office or other facility of the corporation is located. A director may also in his discretion consider any other factors he reasonably considers appropriate in determining what he reasonably believes to be in the best interests of the corporation.

Section 33-756(e) goes on to provide that a “director is not liable for any action taken as a director, or any failure to take any action, if he performed the duties of his office in compliance with this section”.

The vast majority of the U.S. stakeholder statutes are implicitly or explicitly intended to protect employees and focus on change of control issues.

13.2 United Kingdom.

Prior to the coming into force of the provisions of ss.172-175 of the 2006 UK Act on October 1, 2007:

English law solves such problems by requiring nominee directors to ignore the interests of the nominator, though it may be doubted how far this injunction is obeyed in practice[92].

There was in fact no statutory codification of the duties of a director. Section 172 was “designed to support the United Kingdom’s general law directors’ duty to act in the interests of the company and capture the current law”[93]. Section 172 of the 2006 UK Act states:

> 172 Duty to promote the success of the company
>
> (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to–
>
> (a) the likely consequences of any decision in the long term,
>
> (b) the interests of the company's employees,

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[92] *Gower and Davies’ Principles of Modern Company Law*, 7th ed., 2003, p.391, *Boulting v ACTT* Lord Denning M.R.; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd*. [1991] A.C. 187, PC. However, section 309(1) of the Companies Act 1985, which section 172 of the 2006 Act replaced, did allow the directors to have regard to the interests of the company’s employees in general, as well as the interests of its members.

[93] Patricia Dermansky “Should Australia Replace Section 181 Of the Corporations Act 2001 (Cth) With Wording Similar to Section 172 of the Companies Act 2006 (UK)?” http://cclsr.law.unimelb.edu.au/files/Should_Austalia_replace_s181_of_the_Corporations_Act1.pdf

> (c) the need to foster the company's business relationships with suppliers, customers and others,
>
> (d) the impact of the company's operations on the community and the environment,
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
>
> (f) the need to act fairly as between members of the company.
>
> (2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.
>
> (3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

This doesn't of itself authorize a nominee director to act exclusively in the interests of the stakeholder, but on first reading it does seem to provide a wider scope for exercise of the director's discretion. However, it has been argued that "the actual wording of the section is ambiguous and difficult to apply… The section has many flaws"[94], discussion of which is beyond the scope of this paper. A detailed examination of the section also supports the conclusion that it goes beyond codification and introduces a number of new statutory requirements. The UK government announced that it would issue a plain language guidance to help directors to understand it[95]. The difficulty of dealing with this issue is showcased by the necessity to issue a plain language guidance to explain the meaning and consequences of a plain language statute.

13.3 Australia.

Section 181 of the Corporations Act 2001 is similar to Canadian standard of care statutory provisions:

> Good faith--directors and other officers
>
> (1) A director or other officer of a corporation must exercise their powers and discharge their duties:

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[94] *Op.cit.* See also Marshall and Ramsay, *supra.* n. 91

[95] So far that guidance does not appear to have been issued.

(a) in good faith in the best interests of the corporation; and

(b) for a proper purpose.

There have been two official government reviews of this section, both completed in 2006, one by the Parliamentary Joint Committee on Corporate and Social Responsibility, and the second by the Corporations and Markets Advisory Committee, Parliament of Australia (CAMAC")[96]. Both of these reviews came up with essentially the same conclusion, essentially that the current legislation is sufficiently flexible to allow directors to taken into account the relative interests of stakeholders. CAMAC concluded that "changes of the kind proposed from time to time do not provide meaningful clarification for directors, yet risk obscuring their accountability".

13.4 New Zealand.

The law in New Zealand seems to have developed along similar lines to that in Australia and Canada[97]. There is no "stakeholder" legislation, apart from section 131 of the Companies Act 1993:

> 131 Duty of directors to act in good faith and in best interests of company
>
> (1) Subject to this section, a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company.
>
> (2) A director of a company that is a wholly-owned subsidiary may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company, act in a manner which he or she believes is in the best interests of that company's holding company even though it may not be in the best interests of the company.
>
> (3) A director of a company that is a subsidiary (but not a wholly-owned subsidiary) may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company and with the prior agreement of the shareholders (other than its holding company), act in a manner which he or she believes is in the best interests of that company's holding company even though it may not be in the best interests of the company.

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96 Summarized from Dermansky, *op.cit.,* n.93

97 Summarized from "The Role of Nominee Directors and the Liability of Their Appointors", Justice E W. Thomas in Corporate Governance and the Duties of Company Directors, Ian Ramsay (ed.), 1997. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=924312. He is writing from the context of for-profit companies and does not delve into areas of CSR which, in 1997, were probably not high on corporate law radar.

This does nothing for nominee directors. Justice Thomas comments that the law applicable to nominee directors does not reflect commercial reality. He argues that nominee directors who are answerable to their appointors are in effect employees or agents. If they allow their stakeholder's interest to fetter their decision-making, it is the stakeholder who should be held vicariously liable for the results[98].

> In the first place, the nominee directors certainly breach the rule ….which requires directors to avoid situations of actual or possible conflict. Secondly, directors are required to bring an independent judgment to bear in the exercise of their powers. Yet the very nature of the arrangement or understanding which brings directors within the definition of "nominee directors" means that they have fettered their discretion to act independently. Thirdly, directors are obliged to shun extraneous ends, but the nominees' dutiful regard to the interests of their sponsors is collateral to the interests of the company (even where the interests coincide). In essence, good faith predicates the absence of a collateral purpose.
>
> Finally, the duty of directors not to disclose company information or use confidential information without the consent of the company is incompatible with the nominee directors' position. Indeed, in many cases, reporting back to their appointors may be their primary function. It is certainly essential to the control or supervision which the major shareholder or lender will wish to exercise.

Thomas then cites several New Zealand cases as authority for the proposition that the strict rule has been modified somewhat, with the result that "nominee directors need not necessarily approach company problems with an open mind and may pursue their appointors' interests provided that, in the event of a conflict, they prefer the interests of the company of which they are a director. In such circumstances, the breadth of the fiduciary duty has been narrowed by agreement amongst the body of shareholders. In other words, the corporators have agreed upon an adjusted form of fiduciary obligation." His conclusion is that quite limited changes in the extent of the nominee director's fiduciary obligation to the corporation can be brought about by including the nature of the nominee's position in its articles of incorporation, and by ensuring that the extent of the nominee's interests are publicly disclosed (for the benefit of shareholders and creditors).

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[98] He would reverse the decision in *Kuwait Asia Bank EC, supra.* nn. 32 and 92, which provides that the shareholder cannot be liable for the actions of its nominee on the board. This decision has not been frequently cited in Canadian courts. However, Canadian cases, including *Wood v. C.F.N. Precision Inc.,* 2008 CanLII 19797 (ON S.C.) have at least considered this issue, without coming to a similar conclusion.

14. **Do We Need Legislation, Or Can The Courts Handle This?**

14.1 The Case for the Courts.

As mentioned in the discussion of section 172 of the 2006 UK Act, if all that legislation does is codify the common law, there is no need for such legislation in Canada. Instead, we should simply allow the courts to continue to deal with the issues as they arise, as they have done in the BCE and Peoples cases. There is every reason to believe that the rationale of these decisions will be applied equally to non-profits. Given that the courts now recognize that the best interests of the company are not simply those of the shareholders or members, but that the directors can consider the interests of many other stakeholders, we do not need legislation to establish that. If legislation is required, it will be to deal with the more limited issue of the nominee director and the extent to which he or she can take the interests of the stakeholder into consideration – as set out in section 122(4) of the Alberta *Business Corporations Act*[99] (which does not apply to non-share corporations):

> Duty of care of directors and officers
>
> 122(4) In determining whether a particular transaction or course of action is in the best interests of the corporation, a director, if the director is elected or appointed by the holders of a class or series of shares or by employees or creditors or a class of employees or creditors, may give special, but not exclusive, consideration to the interests of those who elected or appointed the director[100].

This is essentially a restatement of the principle enunciated in the case law, including BCE. However, it is at least helpful to remind directors that the strict statement of the duty of loyalty no longer applies in Canada. There is no similar statutory provision in any other Canadian statute. Since Peoples, BCE and the other decisions referred to always qualify the ability to consider the interests of the stakeholder with the requirement that, in the final analysis, the nominee can only support the stakeholder's position if he or she has a reasonable belief that to do so was in the best interests of the corporation.

Peoples summarizes the current state of the law as "We accept as an accurate statement of law that in determining whether they are acting with a view to the best interests of the corporation it

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[99] R.S.A. 2000, c. B-9

[100] The use of the words 'special, but not exclusive, consideration' was adopted so that the purpose of a nominee director would not be stultified by virtue of their obligations to advance the corporation's interest. Despite its admitted vagueness, the provision was adopted to give a degree of guidance in evaluating the conduct of a nominee director in situations where it was alleged the director was acting as agent to the appointing shareholder, and therefore in breach of his fiduciary duties. The Alberta Institute of Law Research and Reform, Proposals for a new Alberta Business Corporations Act, Report No. 36, 1980, at 66

may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment."[101]

In the final analysis, the courts will not be able to override statutory standards of care and can make only limited inroads into the scope of the duty of loyalty.

14.2 What Would Legislation Look Like?

It may take a long time for the courts to fully explore the implications of BCE and Peoples. In the interim, and as guidance for the courts, it would not hurt to have legislation similar to section 122(4) of the Alberta BCA added to the ONCA, Saskatchewan Act and CNCA, as well as to pending new legislation in British Columbia. Explanatory notes stating that the legislation is intended to clarify and codify the current law, rather than to expand it, would be a strong aid to interpretation. It is somewhat ironic that CSR, which specifically emanates from the for-profit sector[102], should be the source of a drive for common law and legislative reform in the non-profit sector. Nevertheless, CSR is clearly a strong underlying principle of section 172 of the 2006 UK Act. It has also been given judicial sanction in Peoples, building on earlier cases. However, to specifically list only the environment as an exception would exclude other relevant stakeholders, and it would be necessary to list them, as well. Section 172 of the 2006 UK Act is not a good model for such legislation.

I submit that such legislation need not and should not be prescriptive. The fact situations under which these issues can arise are often too different to be covered in a long list of what directors may consider. The courts have already stated that each situation must be considered on its own merits. Of course, hard and fast rules are easier to work with, but they would not serve a complex and evolving situation. Over time, the courts and corporate practice should be able to evolve universal bright line standards for nominee directors which will form the basis for codes of conduct.

This, however, only clarifies and strengthens the existing legal regime for nominee directors. It does not solve the more thorny problem of how to deal with a director whose primary role is to represent the interests of the stakeholder, not those of the corporation.

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[101] At ¶42
[102] See definition of CSR *supra.* n.13

14.3 A More Radical Legislative Approach.

As to whether such legislation needs to go beyond the current common law, important policy issues must first be brought into consideration. Do we want to give nominees *carte blanche* to support their stakeholders? Should this allow them to vote unequivocally in favour of the stakeholder's interest, without any consideration for the best interests of the corporation? Should the duty of loyalty be relaxed to permit the nominee to continue to publicly oppose board decisions after they have been made? There are strong arguments that can be made for and against such positions, but a full debate of the possible consequences needs to be undertaken before we decide whether change is desirable. Admittedly, the "danger, of course, in adopting such a provision …. is to dilute the established fiduciary duties owed to a corporation by a director, namely to act in the best interests of the corporation[103]".

Since the courts will not second-guess a board decision if they are satisfied that the directors were reasonable in applying their business judgment to the facts at hand, we are already part way to protecting nominee directors. If the nominee director can establish that he or she had a reasonable belief that in supporting the position of the stakeholder, he or she was doing so in the best interests of the corporation, that should be a sufficient shield against liability. Legislation opening up what may, or must, be considered, could result in exposing directors to litigation from new sources and requiring boards to create extensive records supporting every decision taken.

I am suggesting here that it is necessary to consider the implications of amendments to non-share corporation statutes such as the ONCA, CNCA and Saskatchewan Act:

- To permit articles and by-laws to amend certain statutory provisions relating to dual loyalty, such as is permitted in some memorandum and articles of association jurisdictions;
- Specifically, since articles can not currently contain a provision to exempt directors from the statutory duty of care[104], nor can a corporation agree with its directors to a similar effect, the acts should allow such provisions to be included in the articles or by-laws, subject to reasonable restrictions as to the extent to which such a duty can be excluded;
- The acts should also allow the articles or by-laws to exclude stakeholder directors from relevant portions of meetings, as well as from having access to sensitive information;

[103] See Nathan, *supra.* n. 15
[104] s.43(1) ONCA, s.148(1) CNCA or s.109(1) of the Saskatchewan Act

- There could be a provision sanctioning agreements which compel a director to resign at the request of the board if he or she breaches the duty of loyalty, as modified by these suggestions;
- A specific provision might provide, that where all parties agree, either in the form of a written agreement or by inclusion of a relevant provision in the articles or by-laws of the corporation, the nominee can vote and act in favour of the stakeholder's position, subject to certain protective provisions, including full and complete disclosure of his or her position and relationship to the stakeholder and the nature of the interest of the stakeholder in the proposed vote or action. I would also suggest that the nominee be required to consider the effect on the corporation of his or her vote or action, but can prefer the position of the stakeholder if, in the nominee's reasonable opinion, the corporation will not suffer material injury from that position. Finally, if a disinterested quorum exists, the nominee should be free to vote, regardless of the consequences. The nominee's freedom to act after a vote should continue to be subject to the existing rules.

This legislation would allow corporations to build complete codes of conduct flexible enough to cover a variety of corporation-stakeholder situations.

14.4 Remedies.

Legislation to create remedies for stakeholders who have no direct connection to the corporation is not needed. The corporate oppression remedies and the discretion of the courts as to who can have access to them are well established. They can readily be expanded to meet changing circumstances. There seem to be no doctrinal grounds, apart from remoteness, for denying such a judicial remedy. Remoteness should not be an issue if the stakeholders are connected to the corporation in an economic sense, such as creditors or certain classes of members. Whether such a remedy should be extended to more remote stakeholders is questionable and can be left to the courts.

It appears that the law relating to confidentiality of board information needs no overhaul. There is no reason why a board cannot of its own volition, allow nominees to share this information with their stakeholders on a "need-to-know" basis, subject to suitable protections against misuse or further dissemination.

15. **The End**.

This paper began with a suggestion that no man can serve two masters. In the world of non-profits, however, it seems that it is necessary to find a way in which a nominee director can do so in a fair and reasonable way, which allows the corporation's and stakeholder's interests to be advanced and protected.

16. Appendix "A" - Sample By-law Sectoral Interest Provisions

Under the *Waste Diversion Act, 2002* (Ontario), an industry funding organization ("IFO") is established to create and manage a program for recycling for end of life products created by a particular industry or group of industries. To date, IFO's have been established in Ontario to manage packaging, municipal and hazardous waste, electrical and electronic equipment and scrap tires. Each of these organizations has a board which is established by a regulation passed under the Act, consisting of representatives of the constituent industries which produce and sell the product which, at the end of its life, will have to be recycled. Ontario Tire Stewardship, which is the IFO for the Used Tires Program, has a board which consists of representatives of the Rubber Association of Canada, being the manufacturers and importers of tires, the Retail Council of Canada, representing the major tire sellers and the Ontario Tire Dealers Association, representing the mainly independent tire dealers. Provision is made for automobile manufacturers to be represented, if they wish to do so. Directors are appointed by the constituent organizations, rather than elected, and each director is clearly representing both his or her organization and the interests of the IFO. Here is an extract from the standard code of conduct implemented by the three existing IFO's:

> **1.1.1.1**"**Sectoral Interest**" means a pecuniary or non-pecuniary interest of the Director, Officer or Committee Member held in common with a Group;
> **1.1.1.2**"**Stakeholder Organization**" means a body entitled to appoint members of the Board and includes V, W, X, Y and Z;
>
> 1.2 Exclusion for Sectoral Interests
>
> It is acknowledged and recognized that a Director, Officer, or Committee Member may hold a position of influence in a member of a Group or Stakeholder Organization representing a Sectoral Interest. Such Stakeholder Organizations may have taken positions on issues related to ones under discussion by the Corporation. A Director, Officer, or Committee Member shall not be deemed to have a conflict of interest simply by virtue of such stated positions.
>
> A Director, Officer or Committee Member shall not be deemed to have a conflict of interest simply because he or she holds a position of influence in a member of a Group or Stakeholder Organization representing a Sectoral Interest which may be affected by a decision of the Corporation and shall be permitted to advocate the positions of such Group or Stakeholder Organization in discussions before the Board. However, once the Board has made a decision with respect to any matter, any statements or actions of a Director, Officer or Committee Member which are directed at opposing or preventing the carrying out of such decision, except for motions or statements of a Director, Officer or Committee Member made in a meeting of the Board or a Committee, will be considered

to be a breach of the Director, Officer or Committee Member's duty of loyalty to the Corporation.

Notwithstanding [*the definition of what constitutes a conflict of interest*], conflict of interest should not be deemed to exist where a pecuniary or non-pecuniary interest of the Director, Officer, or Committee Member is a Sectoral Interest, and the Director, Officer, or Committee Member does not prefer his/her individual personal or business pecuniary or non-pecuniary interests over those of other members of the Group.

1.3 Non-Disclosure Exceptions

(i) Notwithstanding the foregoing, confidential information may be disclosed by a Director, Officer or Committee member only on a need-to-know basis to the Stakeholder Organization which he or she represents, provided that each such Stakeholder Organization has first agreed in writing with the Corporation to hold such information in confidence.

17. **Appendix "B" – Fact Situation**

The Canada Widget Marketing Association ("CWMA") is a non-share not-for-profit corporation, established by regulation made under the *Canadian Widget Marketing Act* (the "Act"). Except as provided in the Act, the *Canada Corporations Act* applies to CWMA. The regulation provides that the members of CWMA are its board of directors, who consist of individuals directly appointed by the Canadian Widget Manufacturers' Association, the Widget Transportation Association, the Independent Widget Sellers Association, Widget Workers Union, Widget Purchasing Consortium, Canada Department of Widgets, Widget Exporters of Canada ("WEC") and the Canadian Widget Users Council[105].

Under the Act, CWMA is required to come up with a plan to regulate the quality, production and quantity of Widgets sold to the domestic and export markets, as well as to establish pricing, transportation standards, packaging and employment in the Widget industry (the "Plan"). Having come up with the Plan, the next task is to implement it. Unfortunately, the Plan adopted with the support of the majority of the board is not acceptable to the Widget Exporters of Canada, whose representative on the board, Sarah Sharp, has spoken out vocally at board meetings and at meetings of WEC, of which she is a director and the CEO. At board meetings of CWMA she has also been party to confidential discussions on matters which could affect the foreign markets for Canadian Widgets, which she wishes to make known to WEC and its members. She also wants to work on a campaign to be mounted by WEC to oppose the coming into effect of the Plan, which will involve lobbying, appearing on business television shows, letters to the press and hiring a high-intensity public relations firm which will write speeches for her.

During this time, Sarah remains in her position on the CWMA board.

The Chair of the CWMA Board comes to you with this fact situation and asks for advice on the following questions:

1. As a director of CWMA, what were Sarah's duties to CWMA prior to approval of the Plan?

2. Does this change when the Plan has been approved?

3. To what extent can Sarah promote the interests of the WEC, which may not, at least in the majority opinion, be in the best interests of either CWMA or the Canadian Widget industry?

4. Can Sarah disclose CWMA confidential information to WEC, and if so, can she further disclose it to members of WEC?

5. What are the legal remedies available to CWMA or its constituent organizations against Sarah or WEC?

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[105] Forgive me if I have accidentally invented the name of a real entity somewhere in this list.

6. Would such remedies be available to stop Sarah from continuing to act publicly against the Plan, allow her to be removed from her directorship, or give CWMA damages from her or WEC?

7. Would any of this change if Sarah's position on the CWMA board was non-voting?

8. Would any of this change when the new Canada Not-for-Profit Corporations Act is proclaimed, if the constituent organizations who appoint the CWMA board were the members, instead of the directors, and enter into a unanimous members' agreement, under which they assume responsibility for decision-making?

9. Would it make a difference if Sarah has a genuine belief that a different version of the Plan, not coincidently the one proposed by WEC, would work better and be in the best interests of CWMA?

10. What if CWMA has a code of conduct, similar to Schedule "A" to the paper, which specifically permits its directors to put their stakeholder interest first?

11. What if that code also provided for disclosure to the stakeholder of confidential information on a "need to know" basis, provided the stakeholder also agreed to maintain it in confidentiality?

12. To what extent is such a code of conduct effective, in the light of common law and statutory requirements?