



To sit or not to sit

Lawyers who act as directors or officers on corporate boards need to be aware of the risks involved.

By Lester Lee

Once upon a time, if a lawyer was asked to sit on a board of directors, the answer would have been a simple and immediate “Yes.” In the year 2001, however, a lawyer asked the same question, after a moment’s hesitation, would probably respond, “Thank you, I’d like to think about it.”

There are many compelling reasons for a lawyer to agree to sit on a board of directors, including business, professional or personal motivations. And from the clients’ perspective, lawyers possess the unique combination of legal skills, experience and sound judgment that a board requires.

A board of directors includes both “inside” (employees of the company) and “outside” (non-employees) directors. The latter type are often considered to be “watchdogs” for the shareholders of the company. The vast majority of directors on Canadian boards are outside directors.

Not surprisingly, a significant number of these outside directors are members of the legal profession. Indeed, an independent study conducted by the Toronto Stock Exchange in 1999 found that lawyers constituted 32% of all outside directors in Canada, a significantly greater representation than any other professional group.

So why the reluctance to make an immediate commitment? Because lawyers are realizing that the risks associated with taking on the role and responsibilities of a director. Moreover, it’s quite possible that a lawyer director may be held to a higher standard of care than a non-lawyer director.

Re Cartaway Resources Corporation, a decision of the Alberta Securities Commission (ASE) in August 2000, underscores this point. Cartaway had issued press releases, indicating misleading

test results from a mining project, that caused the stock price to rise significantly. The ASE charged two directors with breaches of Alberta’s *Securities Act*. One was an “inside” director, the company’s CEO. The other was an “outside” director — a lawyer whose firm also did work for Cartaway.

While the lawyer director was wholly exonerated, the ASE did say this:

Even though [the lawyer director] was not involved in the management of Cartaway, his dual role as director and lawyer gave him access to more information regarding Cartaway’s affairs than an outside director ... would normally have. That was especially true in relation to Cartaway’s material change, because [the lawyer] dealt with almost every detail of the transactions involved. *Because of this dual role, [the lawyer] was an inside director, and assumed a higher degree of responsibility, in relation to these transactions.* [Emphasis added]

This decision implies that if a lawyer sits as a director and performs legal services as a lawyer (which, it is suggested, is the norm rather than the exception), then he or she will be held to a higher standard of care than other “outside” directors.

A wide array of provincial and federal statutes impose myriad responsibilities on directors. In some circumstances, directors can be held responsible for the payment of company debts (including the unpaid wages of employees), have fines imposed on them personally and, in a worst-case scenario, face imprisonment if a serious corporate offence has taken place.

In addition to the sanctions that can be imposed under statute, there is also the ever-present spectre of the civil lawsuit

PRÉCIS

Siéger à un conseil d’administration : risqué!

De nombreux juristes ne sont pas suffisamment protégés en tant qu’administrateurs de sociétés.

Selon une étude publiée en 1999 par la Bourse de Toronto, les avocats compteraient pour 32 % de tous les administrateurs externes au Canada, une représentation bien supérieure à celle de n’importe quel autre groupe professionnel. Pas étonnant. Qu’ils soient avocats ou notaires, les juristes présentent les connaissances, les habiletés, l’expérience et le jugement solide qui les qualifient pour cette fonction. Mais, de plus en plus, ils hésitent avant d’accepter un siège à un conseil d’administration. En effet, l’engagement n’est pas sans risque.

Le fardeau des administrateurs ne cesse de s’accroître. Ils peuvent être tenus, en certaines circonstances, des dettes de la société (y compris les salaires impayés des employés); ils peuvent être condamnés au

paiement d’amendes et même à l’emprisonnement en cas d’infractions graves de la société. Et cela sans compter la possibilité de poursuites civiles dont les recours collectifs représentent la forme la plus menaçante. Au surplus, des décisions judiciaires récentes laissent entendre qu’un degré de diligence et de responsabilité plus élevé peut être exigé des juristes par rapport aux administrateurs non-juristes.

À tort, les juristes présument souvent que leur police d’assurance-responsabilité professionnelle régulière couvre leurs activités en tant qu’administrateurs de société. Lorsqu’elle existe, l’assurance-responsabilité civile des administrateurs souscrite par la société elle-même est souvent insuffisante et la clause d’indemnisation qui se trouve parfois dans les statuts ou les règlements est

précaire si la société se trouve en difficulté.

Depuis 1989, l’Association d’assurances du Barreau canadien (AABC) offre un programme de protection, souscrit par certains assureurs des Lloyd’s, qui prend en charge les conséquences pécuniaires de la responsabilité civile incombant aux juristes qui siègent à un conseil d’administration à l’extérieur de leur société de personnes ou association professionnelle. Cette assurance produit ses effets dans la mesure où l’administrateur n’est pas indemnisé totalement par la société ou dans la mesure où d’autres assurances n’interviennent pas.

Avant d’accepter un poste au conseil d’administration d’une société commerciale ou d’un autre organisme, les juristes devraient s’assurer qu’ils sont suffisamment protégés en cas d’erreur ou d’omission de leur part.

An insurance solution

The Canadian Bar Insurance Association (CBIA) recognized that a potential “gap” exists in the protection for lawyers who sit as directors, by reason of a lack of insurance coverage or the possibility that there is no valid indemnity available from the company.

As a result, in 1989 CBIA introduced an insurance program for lawyers who serve as outside directors. Today, the CBIA-sponsored Outside Directorship Liability (ODL)

Program, underwritten by certain syndicates at Lloyd’s, insures over 15,000 directorships held by over 6,000 lawyers across Canada. The policy is designed to sit above the company’s primary directors’ and officers’ liability insurance policy and the company’s indemnification, if any.

In many cases, the ODL program will cover a lawyer’s activities as director of a company in the absence of any directors’ and

officers’ insurance coverage, or under certain circumstances: for example, if no company indemnity exists, or if the company does not have the financial resources to honour its indemnity.

The CBIA’s ODL insurance provides coverage of up to \$3 million for sole practitioners and law firms of six or fewer lawyers, and up to \$10 million for firms of six lawyers or more.

— class actions are currently the most chilling prospect facing any company’s officers and directors.

Lawyer-directors often assume that since they are using their legal skills while sitting as a director, their professional errors and omissions insurance policy will cover them if they’re sued. This is a mistaken assumption. Such policies’ definitions of “professional services” do not include the lawyer’s activities as a director.

Many companies carry directors’ and officers’ liability insurance, but this coverage is often narrowly drafted. A recent study conducted by Tillinghast Towers Perrin determined that in Canada, 26% of all claims reported to directors’ and officers’ insurers either were denied or faced uncertain coverage. An additional 19% of claims were only partially covered.

Some companies’ bylaws contain indemnity clauses for their officers and directors. But if a company is experiencing financial difficulties, the indemnity may have little or no value. When a

company’s finances come into question, shareholders start looking for someone to blame. Inevitably, the lawyer may be looked upon as a “deep pocket.”

Lawyers will continue to play an important role in their client companies’ affairs, providing good legal services in all venues. If asked to sit as a director, they will continue to exercise sound judgment and wisdom in the boardroom.

However, as lawyers dispense advice to their clients about the risks arising from their actions, so too should they understand the nature of the risks they themselves take as directors, and ensure they are protected. •

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Lester D. Lee is a lawyer and consultant with Dion Durrell + Associates Inc. in Toronto. In addition to consulting to the insurance industry, he is involved in the management of a number of professional liability insurance programs, including the CBIA-sponsored ODL program.