

Directors' duties in Canada: Considerations in emergency situations

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The COVID-19 pandemic has presented corporations and other organizations with unprecedented challenges that have required boards of directors to act quickly, with limited information in many cases, in order to safeguard the short-term survival and long-term success of their organizations. In determining the best course of action for their organization to take in an emergency, directors should continue to be mindful of their legal duties and should carefully consider how those duties ought to be discharged in the context of the specific emergency faced.

Directors' duties in Canada: Generally

Even though the landscape in which an organization operates may be shifting rapidly, the duties the directors owe to that organization do not change. Under Canadian corporate law, there are two general duties that directors owe to a corporation: the fiduciary duty and the duty of care.

The fiduciary duty of directors is set out in most Canadian corporate statutes as the duty to act honestly and in good faith with a view to the best interests of the corporation. In the landmark decision of *Re BCE Inc.*,¹ the Supreme Court of Canada (SCC) highlighted that, in order to inform their determination of what constitutes the best interests of the corporation, the directors may consider the interests of the corporation's various stakeholders, such as shareholders, employees, creditors, consumers and governments, including in respect of the environment. The board's concerns in any decision should not be limited to considerations of short-term corporate profit or share value, but instead ought to consider the longer-term interests of all of the applicable stakeholders. This fiduciary duty is often referred to as the duty of loyalty, and incorporates the duties of the directors to avoid conflicts of interest with the corporation and not to take corporate opportunities for themselves.

The duty of care owed by directors is to exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances. Directors are expected to make reasonable business decisions in light of all the circumstances that are known or ought to have been known to the board. As a corollary, directors should act on an informed basis after due consideration of all relevant information and materials reasonably available to the board, appropriate deliberation, and input from applicable advisors. In considering whether directors have met their duty of care, the SCC in *People's Department Stores Ltd. v Wise*¹ held that courts would give deference to the business decisions of directors provided the decisions fall within a range of reasonable alternatives. This legal principle is commonly known as the "business judgment rule."

Specific considerations for directors during emergency situations

While the general duties owed by directors to their organizations continue to apply in an emergency, the discharge of

these duties is, in many cases, made significantly more difficult by the conflicting interests of corporate stakeholders and the need for boards to act very quickly on limited available information.

For instance, in the context of the COVID-19 pandemic, the interests of a corporation's shareholders and its employees may vastly differ. While the employees will be rightfully concerned about their continued employment during the pandemic, the shareholders will likely also have legitimate concerns about the ability of the corporation to continue to employ and pay employees during a time of severe contraction in corporate revenues caused by government-imposed restrictions on the corporation's operations. The directors will necessarily be required to carefully consider trade-offs between these and other stakeholders, but should not make short-term decisions without considering their long-term implications. For example, while laying off employees may decrease short-term corporate losses, failing to have a core of loyal employees in place once pandemic-related restrictions end could negatively affect the corporation's long-term profitability.

By operation of the business judgment rule, courts will generally not use hindsight to assess whether directors made the perfect or even the best decision. However, the basis upon which the directors became informed may be scrutinized in order to determine whether the directors have exercised the requisite duty of care. In the context of the COVID-19 pandemic, vital new information is being provided on a daily basis from industry, governmental and medical sources. Directors must ensure they are keeping apprised of these developments and basing their decisions upon the best, most recent information available.

Board recommendations during the COVID-19 pandemic

During the COVID-19 pandemic, corporate boards should consider adopting the following recommendations, many of which will also be applicable to other emergency situations faced by a corporation:

- 1. Form a working group.** Given the constantly changing environment and vast amount of information being published daily relating to the COVID-19 pandemic, a working group should be established to specifically monitor relevant information and best practices. The group should regularly report and make recommendations to the board on such developments and other steps the corporation takes in response to the situation, including the recommended steps listed below. The information gathered should, at a minimum, include legal restrictions, orders, standards and guidelines imposed by governments on the corporation's operations as a result of the pandemic, and also any incentive and support programs intended to be in place by local, regional and federal governments. See this article for more information on financial relief programs available for businesses to mitigate the losses and impacts of COVID-19.
- 2. Keep sufficiently detailed minutes and records.** As directors must act on an informed basis, it is crucial to keep a record of the information directors considered in making their decision, including the reasons for making each decision. See this article for more information on the level of detail to be included.
- 3. Safeguard the health and safety of employees and customers.** As Canadian employers have a general obligation under applicable occupational health and safety legislation to take every reasonable precaution for the protection of workers, the health and safety of its employees and potential risk of harm to customers should be a primary concern of the board. This can include, in the case of employees, actions such as mandating social distancing measures, allowing or mandating employees to work remotely, or requiring the use of teleconferencing or videoconferencing solutions in lieu of in-person meetings. See the Dentons COVID-19 Global Labor & Employment Tracker for more information on employer responsibilities. Where the need for employees is temporarily diminished because of governmental restrictions on operations, there are a variety of options available to employers, including short-term leaves of absence and temporary layoffs. It is also important to consider how certain proposed measures may have privacy law implications. For example, a corporation that has active projects

with customers requiring proper personnel resourcing has to balance the corporation's privacy obligations to its employees regarding their absences from the project for reasons of compliance with pandemic requirements with the corporation's obligation to perform its obligations and comply with its duties relative to staffing and execution of contracts with its customers.

4. **Consider implications on contractual relations.** Emergency situations have the potential to trigger the operation of contractual clauses in the corporation's contracts, such as "Force Majeure" provisions that have the potential to suspend or excuse performance of the contractual obligations by either the corporation or its counterparty, or even in some cases, allow for the termination of the contract (see here for further discussion). As the implications of these provisions can be significant in the context of an emergency, boards should direct that all material contracts of the corporation be reviewed to determine the effect of COVID-19 on the corporation's contractual obligations and the contractual obligations owed to it under these agreements.
5. **Plan how to communicate with stakeholders.** Communication should continue to be open and honest, and messaging should be consistent. A plan should be in place regarding who will be responsible for communicating information to various stakeholders, such as suppliers, consumers and the broader public, and how new information will be disseminated.
6. **Consult experts when appropriate.** This may include seeking legal advice on specific directors' duties, re-financing possibilities, potential required disclosures, and financial advice regarding the short-term and long-term viability of the corporation. This can be particularly important where the corporation may be in financial distress, where care must be taken in regard to how the corporation deals with creditors vis-à-vis its other stakeholders. For example, a corporation facing financial distress may need to consider how to allocate limited amounts of cash. The interests of the creditors in receiving payment as obligations become due may come into short-term conflict with the interests of management reserving a certain cash balance to satisfy other pressing financial commitments, including payroll and lease obligations. Due consideration must be given to the interests of the creditors weighed against the interests of all other stakeholders. Directors should consider consulting a Licenced Insolvency Trustee, or Chartered Restructuring and Insolvency Professional. Consult Dentons' COVID-19 Client Resources Hub for additional information relating to legal issues arising from the COVID-19 pandemic.

For more information, please contact Tom Sides, Wesley Fairbanks or another member of Dentons' Corporate group.

1. 2008 SCC 69, [2008] 3 SCR 560.↵

2. 2004 SCC 68, [2004] 3 SCR 461.↵

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