BRAUTI THORNING LLP
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Personal Liability of Directors During COVID-19

The federal government has launched a number of initiatives in the past few weeks aimed at helping businesses weather the economic effects of COVID-19. While these initiatives offer short-term solutions, companies will still be required to pay most of the amounts currently being loaned or deferred.

Accordingly, it is important for companies to carefully monitor their revenues and expenses during the pandemic, even if accessing government benefits, as there may still be risks of insolvency at a later date. Directors in particular should be aware of these risks, as they could be liable for corporate debts if a *de facto* insolvency occurs.

In this article, we discuss the how directors might be exposed to these liabilities under certain statutes, and what they can do now to mitigate their risk through due diligence.

Government Initiatives to Defer Payments and Receive Subsidies

In recent weeks, among other initiatives, the federal government has implemented or proposed the following measures in response to COVID-19:

- Deferrals of GST/HST remittances owing between March 27, 2020 and June 29, 2020 until June 30, 2020. No interest will apply so long as payment is made by June 30, 2020. Businesses should still file their returns for GST/HST pursuant to the usual deadlines.

- A Canada Emergency Business Account, which will provide an interest-free, government-guaranteed loan of $40,000 to help pay operating costs that cannot be deferred. $10,000 may be eligible for loan forgiveness.

- A 10% wage subsidy for smaller businesses, charities, and non-profit organizations. Eligible businesses claim this subsidy by decreasing remittances that would ordinarily be made from an employee’s wages or salary.

- The 75% Canada Emergency Wage Subsidy (“CEWS”).

- The CEWS is provided as payment directly from the federal government to employers to pay wages. Employers are expected to make best efforts to provide employees with the balance of their wages or salary.

- Finance Minister Bill Morneau recently announced that any business caught defrauding the subsidy program could face fines of 225% of the amount they received, and there could be prison sentences and up to five years, presumably for directors.

- The federal government will refund pension and employment insurance premiums to businesses that qualify for the subsidy.

Arguably, these initiatives place a greater burden on companies to manage their affairs carefully, and for directors to monitor these affairs perhaps more closely than may be otherwise usual. Deferred remittances and wage subsidies do not mean that companies no longer have obligations to remit taxes or to pay wages; the taxes are due eventually and failing to use a subsidy for the sole purpose of paying an employee's salary can result in significant fines. All of this may simply delay insolvency in the current economic climate. If that happens, directors could be liable for corporate debts because of an express statutory obligation.

Potential Liability of Directors

Though a corporation is generally considered a separate legal entity from its directors, a number of statutes can hold directors liable for the corporation's debts. Among others, directors may be found jointly and severally liable for a corporation's duty to:

- remit and refund "net tax", including GST/HST remittances, under section 323 of the *Excise Tax Act* ("ETA");

- deduct, withhold, remit, or pay an amount of tax (source deductions) for a taxation year, under section 227 of the *Income Tax Act* ("ITA");

- make CPP deductions, under section 21.1(1) of the *Canada Pension Plan Act* ("CPPA");

- make EI deductions, under section 46.1 of the *Employment Insurance Act* ("EIA");

- pay wages (including vacation pay, holiday pay, and overtime pay) owing to employees under section 81 of the *Employment Standards Act, 2000* ("ESA"). In particular, directors are liable for up to six months of wages unpaid to employees; and

- pay debts, primarily wages, owing to employees for services performed, under section 131(1) of the Ontario *Business Corporations Act* ("OBCA").

In addition to the amounts owing under such statutes as the ETA, ITA, CPPA, or EIA, directors can become liable for interest on those amounts or penalties if they remain unpaid.

Under the ESA and the OBCA, directors can also become jointly and severally liable for all debts owing to the employees. These are debts owed to employees for services performed for the corporation, that become payable while they are directors of that corporation, for up to six months. "Debts" may include amounts owing for vacation pay, public holiday pay, overtime pay, regular earnings, benefits, and out-of-pocket expenses incurred while performing services for the corporation.

Importantly, though an employee may eventually recover more by pursuing an action under the OBCA, the ESA allows for substantial recovery against directors through a simple administrative complaint to the Ministry of Labour ("MOL"). Upon receiving a complaint, the MOL investigates on behalf of the employee. After the investigation, an Employment Standards Officer, rather than a Court, decides the issue of a director's liability. Proceedings against corporate employers under the ESA do not have to be exhausted before an employee can begin a complaint against the corporation's directors to collect wages before the MOL.

Avoiding Liability – The Due Diligence Defence

Directors may avoid the liabilities above if they show that they acted with "due diligence". This means the director took positive steps to ensure that the corporation complied with its statutory obligations. A director must show that she exercised "the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances." A defence of due diligence is not conditional upon evidence that the default did not occur.

In considering relevant "circumstances", the Courts inform their analysis by looking at, among other things, the director's background and experience, as well as the complexity, customs, and practices of the corporation. Typically, directors can rely on a due diligence defence where they have ensured that appropriate protocols are in place to guarantee that required payments are made, or if a payment is not made that the protocol guarantees that this fact was brought to the attention of the board of directors and/or the finance committee of the board.

Regardless of their background, the due diligence defence will not assist a director who is:

- willfully blind about her statutory obligations; or

- ignores problems that are obvious or ought to have been obvious to reasonable persons exercising a reasonable amount of care in the same circumstances.

The due diligence defence therefore places positive obligations on directors. They should remain actively informed about the corporation and their obligations. A court will be very unlikely to accept an argument that a director was unaware of a corporation's failures if the director has not made appropriate inquiries about the corporation's activities.

Still, directors are not expected to know everything. The due diligence defence will apply where a director acted in good faith and in reliance on the performance or opinion of qualified individuals. For example, if a director causes a corporation not to remit certain payments because a legal opinion advised her it was unnecessary, she may still be able to rely on the due diligence defence.

Unlike the OBCA, the ESA does not contain "due diligence" provisions. Directors may therefore face "strict liability" under the ESA for employee debts/wages. This means that once it is established an individual was a director at the times that a debt was not paid to an employee, there is no basis for relief, even if the director shows that she exercised due diligence.

Proactive Steps for Directors

While every case will be different, there are things any director can do to help mitigate her risk and increase the chances that she can successfully rely on a due diligence defence.

Of course, the primary objective should be to always act in good faith and as seems reasonable in the circumstances. With that in mind, however, directors should be sure to at least do the following:

1. **Consider whether the benefits of being a director are balanced with the potential risks of acting as a director.** As noted above, directors have positive obligations to ensure a corporation is acting in accordance with statutory requirements. Dilatory participation in that process might result in personal liability for the corporation's debts, and in some cases for little actual benefit to the director. A director may be found responsible for debts until she has resigned as a director of the corporation.

2. **Implement Protocols.** As noted, a due diligence defence can be supported by ensuring that protocols are in place. Protocols should guarantee appropriate channels of accountability to the board of directors with respect to any corporate payments for which a director may be personally liable under a statute.

3. **Review corporate by-laws and other constating documents and agreements.** Directors should know their responsibilities. Liability is based on a director's sphere of responsibility. A director cannot act diligently if she does not know what is contained in that sphere.

4. **Stay informed and know what is going on within the sphere of responsibility.** Directors should always be receiving information about what is happening in their sphere of responsibility. If no reports, or deficient reports, are being received, then directors should ask for them and/or get them up to a proper standard. Directors should also review all materials before meetings and votes and ask questions when things are unclear. As noted, directors can rely on the due diligence or expertise of others, but not if they fail to be proactive. The importance of good reporting will be especially acute in the following months.

5. **Act on the information.** Directors cannot rely on a due diligence defence merely because they were aware of an issue. They must act, in good faith and reasonably, to avoid or remedy the issue. If an issue is not fixed but a director acted to prevent it in this way, then the due diligence defence may still be available to her.

6. **Document everything.** Good records will show that the steps above were actually taken. Merely claiming to have acted in a reasonable manner will be unlikely to succeed as a defence. Evidence that reasonable steps were taken will be necessary. Records can include notes from meetings, memos to file, communications, financial statements, reports, written advice from or to employees or officers or other directors, and so on.

7. **Rely on others.** Directors are not expected to act alone. If there is an issue or situation that seems beyond their knowledge or experience, they can and likely should ask for assistance. Experts and other directors are an excellent source of guidance and should be relied upon where appropriate.