IN FACT AND IN LAW

Corporate Governance
Securities Law

November 2005

Corporate Directors: Suggested Precautions

By André Laurin

Summary

- Higher standards are imposed on directors
- The key mission of a corporate director: to contribute his knowledge and skills with a view to the best interests of the corporation
- Corporate governance is the best shield against directors' liability (Supreme Court judgment in the *Wise* case)
- Specific precautions may be taken by corporate directors to ensure that they both fulfil their key mission and simultaneously protect themselves against the risk of liability

Background

Even though the basic duties of corporate directors have not changed, the parameters, standards and good practices relating to these duties have been both clarified and raised in recent years. Lawsuits against corporate directors are also on the rise.

Other Publications

We have discussed several aspects of these realities in other newsletters, which you may access by visiting our website (www.laverydebilly.com) or contacting the author's assistant. They include the following:

- "*The New Corporate Governance Rules and Guidelines*"
- "*Recent Developments Respecting Corporate Governance and Directors' Liability*"
- "*Directors' Liability, Indemnification and Insurance Coverage*"

The Key Mission of Corporate Directors

The key mission of corporate directors is to assist the corporation they serve to the best of their knowledge and abilities, while complying with their basic duties under its incorporating statute (diligence and loyalty).

The precautions suggested in this newsletter are not aimed at, and must not result in, changing this key mission. They simply constitute means of complying with the duties imposed on corporate directors. In other words, these means, processes and systems, which are part of what is known as corporate governance, are intended to create a context that promotes the optimal performance of directors' duties in compliance with the law.

Corporate directors who mainly focus their energies on trying to protect themselves against potential liability are not fulfilling their role. Similarly, corporate directors who fail to have the corporations they serve implement true corporate governance practices are acting in a reckless and unprofessional manner.

As mentioned by us on numerous occasions, once put in place, corporate governance should facilitate and not burden the work of the board and of the management, allow for the discussion of the real issues instead of the simple review of financial data and favor a true team work with management.

In 2004, the Supreme Court of Canada stated in *Peoples Department Stores Inc. v. Wise* that the "establishment of good corporate governance rules should be a shield that protects directors from allegations that they have breached their duty of care".

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Corporate Directors: Precautions We Suggest You Take

The following list of suggestions is presented as examples only and is by no means exhaustive.

The 3 Principal Guidelines

- Act **in the best interests of the corporation** and, therefore, of all the shareholders, **while respecting** stakeholders and partners.
- Implement a culture of true **integrity** and **value creation**.
- Perform directors' duties with reasonable **care and diligence**, in a true team spirit and while **focusing on the corporation's priorities** (strategic plan, selection and evaluation of managers, succession plan ...).

The 7 Main Means

- **Acquisition** by corporate directors, **as soon as possible** following their election, of **in-depth knowledge** of the corporation, its strategic plan, the sector in which it operates, its activities, its operating procedures and its management, continuous updating of such knowledge throughout their term, obtaining **relevant information** in a timely fashion and verifying the quality of such information.
- **Personal** study, reflection, questioning and expression of views according to one's own competence and experience during meetings as well as through informal conversations.
- Identification of the corporation's interests, **determination** as to whether such interests **conflict** with one's own **interests** or those of one's employer, partners or family members, disclosure and elimination or reduction of such conflicts to the fullest extent possible and avoidance of any situation of misuse of one's directorship.
- Implementation of measures that ensure that **duties and responsibilities** related to the management of the corporation **are defined** and promotion of the efficient performance of the duties and responsibilities entrusted to the board.
- Use of analyses, opinions and confirmations by independent **experts**, as necessary, appropriate or useful.
- Implementation of **control methods and systems**, and compliance policies and programmes, as well as verification and follow-up regarding the quality and effectiveness thereof.
- Obtaining **insurance coverage** and an **indemnification undertaking**.

The 30 Specific Suggested Precautions

1. Adopt **clear** and simple, **common sense based** operating **rules** and follow them.
2. Avoid adopting or stating **any rule** that the corporation, its directors and management do not subscribe to, that is not relevant in light of the corporation's situation or **compliance with which cannot be verified or controlled**.
3. **Avoid** re-writing the law and regulations and avoid the **ambiguities** which can result from reformulating the same rules in different ways.
4. Regularly revise and **update** these **rules** and carry out an objective and critical assessment of their relevance and effectiveness.
5. Ensure that the corporation's and, more specifically, the board's **operating procedures, practices and rules** allow for and promote independent and reasoned judgment.

   For example:

   - select a Chairman or independant leader of the Board as well as chairmen of committees who are strong and capable of establishing an efficient participation of the directors.
   - establish distinct mandates for the Chairman of the Board and the Chief Executive Officer;
   - appoint only independent directors or, at least, a majority of independent directors on certain committees (audit, human resources, nominating, ...);
   - hold regular meetings of independent directors without representatives of management being present;
   - use external experts;
   - disclose external interests and duties and the corporation's policy respecting such external interests and duties; and
   - adopt and implement a code of ethics.
6. Ensure that members of management are honest and that they implement and promote, through both their actions and words, a true **culture of integrity**.
7. Ensure that each decision, and participation by each person involved in reaching such decision is made **in the best interests of the corporation**.
8. Prior to requesting that a decision be made, and in support of such request, **provide all relevant information**, along with the recommendations of the Chief Executive Officer and the senior officers who will be responsible for its implementation.
9. Treat all shareholders (and their representatives), employees, suppliers, clients, communities in which the corporation carries out its activities and contracting parties with **respect and openness**.
10. Verify and validate the **data collection methods and systems** and ensure their quality particularly in relation to financial data.
11. Identify and manage the main **risks** faced by the corporation.
12. Systematically **monitor** each project, investment, capital expenditure and identified problem or risk.

13. Establish an **approval system for the corporation's commitments** that promotes officers' accountability and double checking, as well as the disclosure of cost overruns and disclosure or denunciation ("whistleblowing") of significant contraventions of laws, regulations, by-laws, resolutions, policies and codes of ethics applicable to the corporation.

14. Implement compliance **policies and programs** that are both simple and clear and apply them to areas in which the corporation or its employees may be put in situations in which there is a risk that laws or regulations may not be complied with or that damages may be caused to other employees or third-parties.

15. Avoid drowning directors in documents; instead, make the relevant information available to them through **executive summaries**.

16. At board and committees meetings, **avoid repeating verbally what has already been provided in writing** and allow ample time for directors' questions and observations, as well as discussions.

17. **Investigate** forthwith any complaint or rumour of non-compliance with laws, regulations, by-laws, resolutions, policies or codes of ethics and take corrective action, as needed.

18. Give top priority to the **quality of management**, the selection of the main managers, as well as to the **succession plan**, regularly assess the performance of senior officers and control **senior executives' compensation** by ensuring that it is consistent with the corporation's objectives and is reasonable in view of market conditions, the performance of the executives, their contributions in achieving the corporation's results and the degree to which they have reached their personal objectives.

19. When preparing the **minutes** or reports of meetings, refer to the documents submitted and reports filed (do not repeat their contents but mention the subject headings); make it clear, in all cases, just above the text of a resolution, that questions were submitted (by summarizing the most important questions), mention that satisfactory answers were provided and that there was an exchange of views on the issues; avoid opening the door to lawsuits and the disclosure of confidential strategic information; record any major dissenting view or objection on an important issue that the directors wish to have noted; ensure that the reports of the board committees, and especially the decisions of such committees, are ratified by the board; **prepare** and deliver the minutes **in the days that follow the meeting** (within 1 to 2 weeks), submit comments and suggested amendments upon receipt of the draft, complete the final version **in a timely fashion** by including the comments retained and have the personal notes of each director, the secretary and the guest participants destroyed.

20. **Identify the external laws, regulations, policies and directives** that apply to the corporation, emphasize those that may involve the liability of directors and:
    - obtain confirmation that they have been complied with or information on claims or risks of claims (management certificates, reports on claims and litigation, certifications by those who prepared documents (executives, legal advisors and auditors)); and
    - carry out appropriate follow-ups (corrective measures and monitoring).

21. **Identify the principal contracts** to which the corporation is a party and:
    - obtain a copy of the relevant provisions of these contracts; and
    - obtain confirmations of compliance therewith or disclosure of the actual or potential events of default.

22. Ensure that **the board is knowledgeably involved** in the strategic planning process and the monitoring of its implementation, as well as in all major transactions and operations (the budget, approval of the financial statements and the selection, assessment and compensation of senior executives).

23. Express the corporation's expectations of its directors and **provide** (management) or **obtain** (directors) the **means** to carry out the directors' duties and responsibilities through:
    - access to management;
    - access to independent advisors; and
    - an appropriate budget.

24. Use standards and parameters for **comparison** ("benchmarking") with similar corporations or corporations in the same industry.

25. Regularly **assess** not only the quality of management's cooperation with the board, but also the quality of the functioning and contribution of the board and of each of its members and ensure the **legitimacy** and **credibility** of the board and of each of its members; in the event that written assessments are used, see to it that they are destroyed as soon as the assessment process is completed.

26. Use detailed questionnaires or specific management **certificates** with respect to audits of financial statements, systems and controls, risk management, the corporation's strategy, compliance with laws, regulations and contracts, and the other important aspects of the corporation's activities.

27. Establish a **calendar** for the meetings of the board and its committees and the subjects to be covered in such meetings and ensure the **distribution of the relevant documentation** at least one (1) week before the meetings whenever possible.

28. Assess every new **candidate for the board** by, among other things, but necessarily, considering the experience and competencies of the candidate and the added value which he or she may bring to the board's activities, as well as the time and effort he or she could contribute as a director.

29. **Use** and update a book of basic information on the corporation or a **corporate governance or directors' handbook** describing the corporation's principal objectives and contractual obligations, its legal environment, its operating procedures, as well as the mandates and work programs of the board and its committees, its compensation policy and the latest data concerning the senior executives, and the corporation's other policies.

30. **At all times, use good common sense and judgment (including the "smell test"**).

Conclusion

A clear distinction must be made between the certification and disclosure obligations imposed on reporting issuers and the establishment of true corporate governance. Sound, clear and effective corporate governance simplifies the functioning of a corporation to the extent that directors do not try to meddle into day-to-day management ("**nose in, fingers out**").

Directors should not hesitate to express their questions, concerns and opinions in private conversations with their colleagues, to discuss these issues in a true team spirit and to communicate directly with the top management.

Finally, have the courage to resign if you cannot assume your obligations adequately and obtain reasonable protections notwithstanding your requests and efforts to establish a proper environment in these regards.

Our corporate governance group can help you implement such a corporate governance regime.

André Laurin
514 877-2987
alaurin@lavery.qc.ca

You may contact any of the following members of the Corporate Governance, Securities Law and Directors' and Officers' Insurance and Liability Law groups with regard to this bulletin.

Corporate Governance

At our Montreal office

Isabelle Lamarre
André Laurin

At our Quebec City office

Jacques R. Gingras

Securities Law

At our Montréal office

Michel Blouin
René Branchaud
Georges Dubé
Isabelle Lamarre
André Laurin
Larry Markowitz
Jean Martel
Michel Servant
Sébastien Vézina

Directors' and Officers' Insurance and Liability

At our Montréal office

Anne Bélanger
Jean Bélanger
Julie Cousineau
Odette Jobin-Laberge
Bernard Larocque
Robert W. Mason
J. Vincent O'Donnell, Q.C.
Ian Rose
Jean-Yves Simard

Montreal
Suite 4000
1 Place Ville Marie
Montreal, Quebec
H3B 4M4

Telephone:
514 871-1522
Fax:
514 871-8977

Quebec City
Suite 500
925 chemin Saint-Louis
Quebec City, Quebec
G1S 1C1

Telephone:
418 688-5000
Fax:
418 688-3458

Laval
Suite 500
3080 boul. Le Carrefour
Laval, Quebec
H7T 2R5

Telephone:
450 978-8100
Fax:
450 978-8111

Ottawa
Suite 1810
360 Albert Street
Ottawa, Ontario
K1R 7X7

Telephone:
613 594-4936
Fax:
613 594-8783

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