

# Director's Liability and Indemnity



## Introduction

Being a director or officer of a co-operative is a heavy responsibility. Directors and officers are expected to contribute time, skill, and energy to an organization in their role as director. They are also expected to make decisions in the best interests of the co-op while they serve, and make those decisions in good faith and adhere to a certain standard of care.

Directors can be held liable for their decisions. This means that even if directors act in good faith and in the best interests of the co-op, it is possible for them to be sued as a result of their actions. Co-ops can provide a measure of protection for directors and officers by stating in their by-laws that directors and officers will be “indemnified” if they are sued. This means that the co-op will cover the legal costs and pay any judgment.

In 2004, the *Co-operative Corporations Act* was amended to give important benefits for directors and officers of Ontario co-operatives. Until this amendment, co-ops could not cover directors if they were not careful enough and made an error

in judgement while they were carrying out their duties. This is called negligence, and it was not possible for a co-operative to purchase insurance to cover directors for this. However, business corporations have been able to provide a much broader indemnity to directors for more than 20 years.

Since the amendment to the *Act*, a director or officer of a co-operative can be covered for negligence, just as car insurance covers an individual if they are negligent in driving a car and get into an accident.

## What Is Good Faith?

The *Act* refers to the need for directors to act in good faith when making decisions or declaring an interest in a contract or transaction—they need to make decisions honestly and in the best interests of the co-op. This is related to another concept referred to in the *Act* as “standard of care”. Standard of care is a legal concept that outlines what standard directors and officers are held to when they make decisions – the directors and officers of a co-op have to exercise the same care, diligence and skill

in their decision making as a reasonably prudent person would in the same situation. In practical terms, this means that directors do not have to be lawyers to make decisions about legal issues, but it does mean that they have to take care to learn about the issues and make sure that they are not negligent in getting the information required to make a decision.

There are no hard and fast rules about what steps need to be taken by directors in making decisions or exercising standard of care, but the concept of standard of care is meant to outline a set of minimum standards that directors and officers should work to meet in their duties.

## Directors Liability: What Is It?

Directors are responsible for the decisions that they make on behalf of the co-op and they are also responsible for ensuring that all the appropriate laws and government regulations that apply to the co-op are followed.

Directors that fail to fulfil their duties can be held liable for their decisions. This means

- There are over 1,300 co-operatives, credit unions and caisse populaires incorporated and operating in Ontario, with 1,900 locations in 400 communities.
- In 2012 alone, 73 new co-ops incorporated in Ontario.
- Housing is Ontario's largest co-op sector (45%), followed by Financial Services (17%), Child care (17%) and Agriculture (6%).
- The co-operative sector in Ontario represents a very conservative \$30 billion in assets (2007).

## Director's Liability and Indemnity

2

## FACT SHEET

that they can be held responsible for any consequences that arise as a result of not performing their duties or adhering to the proper rules and regulations. For example, if a co-op has employees and the board does not make the appropriate tax payments, they can be held liable for this and can be made to cover any losses that result to the co-op. This is why the concepts of standard of care and good faith are important – if directors do not operate in good faith and exercise good judgement and diligence in their actions, they can be sued or financially penalized for the outcomes of those decisions.

### What Is Directors Indemnity?

Even if directors act in good faith, they can be sued and held liable for decisions that they make in their roles as directors or officers, with negative financial consequences to them. The *Act* permits co-operatives to provide protection for directors and officers by 'indemnifying' them, which means the co-op will pay the costs, charges and any expenses associated with a legal suit against the director or officer. This can include any legal judgement against the director or officer.

Co-operatives can indemnify both current and former directors and officers, but

certain conditions have to be met in order to allow the co-op to do this. First and foremost, the directors and officers must have acted in good faith and in the best interests of the co-op, and if the action taken is a criminal proceeding, the director or officer must have had reasonable grounds to believe that the conduct or actions taken were lawful.

### What Situations Can Indemnity be Extended to Cover?

**If the Co-operative sues:** The indemnity can extend (with a judge's permission), to include when a director or officer is sued by the co-op, a member or someone else on behalf of the co-operative.

**Defence Costs:** If a director or officer is sued and incurs costs associated with legal defence against a proceeding, and is substantially successful in their defence (i.e. winning their case), the co-op must cover the costs associated with their defence.

**Insurance:** Co-ops may now purchase insurance to pay for the liability issues that are outlined above. This is commonly called "Directors and Officers Liability Insurance" and in the case of lawsuit or action, the insurance will cover the costs rather than the co-operative having to cover the costs itself.

Co-operatives should also put appropriate bylaws in place that outline the conditions for indemnification and whether or not the co-op will purchase insurance.

### What Should a Co-operative Do?

For co-operatives that were incorporated and operated prior to the amendment to the *Act*, the bylaws should be updated to reflect the new indemnity information.

**Agreement to Indemnify:** By-laws can be changed – especially at a time when a co-op may be upset about being involved in a lawsuit. Under this type of agreement, a co-op promises to indemnify a director, if necessary. This would apply even if the by-law were later changed.

**Insurance:** Co-ops are sometimes sued, and sometimes directors are involved. Many of these suits are covered under a co-operative's ordinary liability insurance – but not all of them. The reason for this option is that the additional premium is not large and the additional protection is worth the premium cost. There have not been many successful legal claims against co-operative directors, but insurance has covered legal costs in many cases. These are often higher than any claim.

### FOR MORE INFORMATION, CONTACT

Ontario Co-operative Association  
30 Douglas Street  
Guelph ON N1H 2S9  
Phone: 519.763.8271  
[info@ontario.coop](mailto:info@ontario.coop)  
[ontario.coop](http://ontario.coop)

**More resources are available at:**  
CoopZone Network  
[coopzone.coop](http://coopzone.coop)

This is one of a series of FACTSheets created by OCA providing general knowledge, best practices, and sector-specific information.

Get the full list of FACTSheets online at  
[ontario.coop/documents\\_downloads](http://ontario.coop/documents_downloads)