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**LAW AND SOCIETY**

*Being an outside director of a company can be a risky business, says Bryan Schwartz*

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OUTSIDE directors of Canadian companies used to earn princely pay for a mere courtier's work. They would show up for a few board meetings a year, hobnob with the executives, enjoy the poached salmon, pick up 10 grand and score an extra line in Who's Who.

Nowadays, being an outside corporate director can be risky business. An error or omission can get you sued into financial oblivion, or even sent to jail. In fact, you can be wiped out even if your only "fault" was to be on hand when a company collapsed.

In theory, corporate executives are supervised by the board of directors. In practice, the board usually includes the senior executives. The other board members, the "outside directors," used to be reluctant to challenge them.

But these days, shareholders are demanding more. They expect outside directors to keep executives from making foolish or self-serving decisions. For example, shareholders expect boards to stop executives from making whopping salaries while the company tailspins and workers fly off.

A director found negligent in protecting a company's financial standing can be held liable to the company or its shareholders. Sometimes, the company will buy liability insurance for its officers. But even if your losses are covered, being dragged through the courts can fray your nerves and reputation. Furthermore, insurers sometimes refuse to insure against certain kinds of losses. To assuage anxious directors, some U.S. states have already passed statutes to limit their exposure to private lawsuits.

In Canada, however, new laws often say that corporate officers can be personally charged with offences. The theory is that threatening officials personally helps to ensure compliance. If the company alone is charged and fined, the entire cost may be passed on to innocent shareholders, employees or customers.

Canadian law is hard on defendants charged with "regulatory offences" such as polluting. The government need not prove that the defendant had criminal intent. Instead, corporate officials must prove that they tried, with "due diligence," to prevent the legal violation. In practice, top officials often escape convictions by showing they gave the right general orders to their subordinates. Middle-level officials tend to be blamed instead. These are the people whose careers and salaries depend most on cutting costs and raising revenues. As a result, they sometimes have the wrong priorities.

When companies go bust in Canada, directors can be held personally liable for unpaid taxes and wages. "Company bailout" has acquired a new meaning: directors fleeing from companies that are troubled - and which may desperately need their skills and experience.

SOME legal theorists say that directors should be held more accountable to employees as well. Under the current law in Canada and the United States, employees cannot sue directors who fail to protect employee jobs.

At most, employees' interests can be used as a defence against disgruntled shareholders. Directors can say to shareholders, "We're not liable just because we sacrificed a bit of profit to save a lot of jobs." Attempts to increase directors' legal liability in all directions could become counterproductive. People who are informed and prudent enough to make good directors would, by reason of those very qualities, refuse to serve. Or directors might switch the company's registration or operations to a place that treats directors more kindly.

So corporate governance cannot always be improved merely by adding to the potential penalties for making mistakes. Another approach is to restructure corporate decision-making so there are fewer botched decisions in the first place. Among the possibilities: Shareholders' interests: To act as a stiffer check on corporate executives, boards can be composed mostly of outside directors. The chair would not be the same person as the company president. Some outside directors would be chosen directly by shareholders; senior executives would not be able to stack boards with their pals. The reports of a company's financial, environmental and human-rights officers would be sent directly to boards, and not filtered through senior management.

Public interest: Regulators would be clearer in telling companies what they expect. They would monitor and warn more, prosecute less. Governments would also rely more on creating incentives for useful corporate behaviour, less on restrictive regulations.

Employees interests: Governments should take more responsibility for covering workers against the consequences of corporate collapse. Directors should not routinely be held responsible for unpaid wages and the like.

Canadians should examine the German system, in which boards must include several representatives of the workers. The increased flow of information might increase both profits and wages.

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