The Importance of D&O Liability Insurance: a discussion on the personal risk exposure of directors and officers of a private construction company

The myth
Directors and officers of a privately-owned construction company have little or no personal risk exposure.

The reality
Construction is an industry in which companies face significant risk exposure due to the nature of the work that is carried out. The directors and officers of construction companies are not immune to this and will share in this risk exposure in certain situations. A number of statutes in Canada impose personal liability on directors and officers for the actions of their corporation or their corporation’s employees. This can result in directors and officers facing criminal charges, significant fines or civil lawsuits. Litigation can go on for years and result in substantial legal costs being incurred before resolution. While a corporation may indemnify a director or officer in most situations, if the director or officer is also the owner of the company, the owner is going to end up paying the cost of indemnification indirectly out of his or her pocket.

As discussed further below, in the course of business, directors and officers of a construction company have the potential to be held liable with respect to workplace health and safety requirements, corporate breaches of trust, civil fines, unpaid employee wages, government remittances and employment claims. Therefore, it is prudent business practice for directors and officers of private construction companies to transfer these risks by obtaining Directors’ and Officers’ (D&O) Liability insurance.

Liability for compliance with workplace health and safety requirements
In addition to obligations under provincial health and safety legislation, Section 217.1 of the Criminal Code of Canada (the “Code”) creates a potential criminal liability for every organization or individual in Canada directing or overseeing work being carried out by employees. Under the Code, organizations and individuals have a legal duty when directing the work of others to take reasonable steps to ensure the safety of workers and the public. This obligation has been interpreted broadly by the courts. Since its enactment in 2004, there have been a number of cases where charges have been laid against individuals within an organization for violation of Section 217.1 of the Code, including directors and officers who were not directly overseeing the task being performed when a worker was injured.

The following are examples where Section 217.1 has been used to impose charges on directors and officers of private construction companies:
In 2013, the Ontario Court of Appeal found a construction company criminally negligent after four workers died when a suspended swing stage collapsed from 14 floors above the ground. The owner and sole director of the company was also charged with criminal negligence under Section 217.1 of the Criminal Code. At the time of the collapse, the swing stage was occupied by three times as many workers as there were lifelines and only one of the lifelines was being used properly. The supervisor on duty at the time of the deaths was also killed in the accident, but was found by the court to be a senior officer of the company and therefore, the company was held liable for the actions of the supervisor who failed to take reasonable steps to prevent bodily harm and death. The company was fined $750,000. The criminal charges against the owner were withdrawn when he pled guilty to four charges under the Occupational Health and Safety Act and was personally sentenced to pay a fine totaling $90,000.

In 2010, police charged the owner of a crane rental company and the crane operator with criminal negligence causing death after a municipal worker was killed by a crane that fell on top of him while he was working in an excavation hole. A Ministry of Labour inspection found that the crane was in a state of disrepair. The company and its owner were charged for failing to ensure the crane operator was properly licensed, failing to ensure the crane was maintained in a condition that did not endanger a worker and failing to ensure that the crane was not defective. In 2011, the Crown dropped the criminal charges against the company and its owner due to insufficient evidence linking the negligent maintenance of the crane to the accident. The company was found guilty of failing to maintain the crane properly under the Ontario Occupational Health and Safety Act and was fined $70,000.

**Liability under the Ontario Construction Lien Act**

Under Section 13 of the Ontario Construction Lien Act (the “Act”), directors and officers of a corporation in control of the corporate activities may be held liable where they are found to have directed, assented or acquiesced to conduct they knew, or ought reasonably to have known, would amount to a breach of trust by the corporation. In the case of a private construction company, a D&O might be held personally liable for a breach of trust under the Act where the company receives funds that are to be paid to a subcontractor, or other persons who have supplied materials or services for a project, and those funds are not distributed properly or are used for other purposes. The following are examples of two cases where the directors and officers of a corporation were required to pay the outstanding amount owing to a sub-contractor:

In 2013, the Ontario Superior Court held a defendant corporation and three of its directors and officers liable for $135,982.44 owed to a flooring company because the corporation had insufficient funds to pay the amount owing. Even though there was no direct evidence to indicate that the funds owing had been appropriated by the company or its employees, the court found that the directors and officers of the corporation must have been aware that the sub-contractor had not been paid in full when the funds were used to pay other bills.

In a case where a sub-contractor brought an action against the corporate defendant and its director for a breach of trust by the corporation, the court held that the threshold for liability under the Act is less than the standard of “actual knowledge, recklessness or wilful blindness.” It is enough that the defendants had sufficient control within the corporation and assented or acquiesced to actions by the corporation that they knew, or should have known, would constitute a breach of trust. Thus, a director or officer may be unable to rely on ignorance to a breach of trust where their conduct is such that they should have known that funds were not being used as intended to pay a sub-contractor.

**Liability for civil fines**

A number of provincial statutes across Canada contain provisions which permit the imposition of liability upon directors or officers of a corporation for the payment of fines where a corporation’s actions result in a statutory violation. Many of these statutes do not require a director of officer to go so far as to direct the
corporate actions which result in the violation of the legislation for liability to attach. In many cases, a director or officer may still face a fine if their actions are found to constitute acquiescence to actions by the corporation that violates a statute.

In Ontario, the Corporations Tax Act, the Occupational Health and Safety Act, the Human Rights Act, Employment Standards Act, Consumer Protection Act and Pension Benefits Act all contain provisions that permit the imposition of fines on directors and officers of a company. D&O Liability insurance would likely provide coverage for these fines to the extent that they are insurable under the law.

**Liability for government remittances**

If a corporation goes bankrupt and fails to remit taxes or GST, the directors of the corporation may be liable to pay the outstanding taxes. Under federal and provincial tax acts, where a corporation fails to remit taxes that it collected from others, such as deductions from employees’ wages and GST collected from customers, directors will be liable along with the corporation to pay any amount owing, including interest and penalties, in the event the corporation is insolvent or cannot pay a certificate registered in Federal Court. Directors might also be held liable for a period of time after they cease to be director of the company if they were a director at the time that the company failed to pay the taxes.

The Tax Court of Canada has found a director to be liable for a failure to remit taxes despite his alleged resignation more than two years prior to the assessment. The court found that even though the director resigned, he was still responsible for managing the affairs of the corporation and was therefore deemed to be acting as a director of the corporation.

In addition, liability for directors and officers might arise if the company fails to collect and remit pension and employment insurance premiums. The Canada Pension Plan Act and the Pension Benefits Act in Ontario will hold directors and officers liable if a corporation fails to deduct or remit contributions as required by the Act, while the Employment Insurance Act will impose the same liability with respect to a failure to remit employment insurance premiums.

In a 2002 case, a defendant was held liable for a corporation’s failure to remit taxes even though he was never formally appointed the director of the corporation. The court held that persons who take it upon themselves to direct the affairs of a corporation where it is operating without a director of record will be deemed “de facto directors” and may be held liable for the acts of the corporation.

**Liability for unpaid wages**

The federal and provincial business corporations’ statutes contain provisions respecting directors’ liability for unpaid wages of the company’s employees in the event the company is insolvent. Under these provisions, employees may seek reimbursement from the directors of their corporate employer for up to six months of unpaid wages where: (i) the corporation has been sued for the wages and execution against the corporation does not suffice to cover the entire amount owed; (ii) the corporation has commenced legal liquidation and dissolution proceedings, or has been dissolved; or (iii) the corporation has made an assignment or a bankruptcy order has been made against it. While there are certain limitations placed on the liability of directors and officers of a corporation for employee debts (i.e., there is a limit on the time period under which an action can be brought and the type of employee debts that they will be required to cover), if a corporation is unable to meet its payment obligations to its employees this can result in an enormous liability for its directors and officers.

Director liability for unpaid wages may be mitigated to some extent by the federal government Wage Earner Protection Program (WEPP). However, the amount of wages paid to an employee by this program is capped at a maximum equivalent to four weeks of insurable Employment Insurance earnings ($3,738 for 2014) and employees will not qualify if they fail to apply during the limited time period for eligibility.

**Liability for employment claims**

It is not uncommon for employees to make a claim alleging wrongful acts in the workplace, such as wrongful termination, harassment or discrimination. Directors and officers may face liability where they are named as defendants in an action against the company alleging wrongful dismissal or discrimination. In smaller organizations, the company’s key personnel are more likely to be named in litigation brought by employees. Directors and officers may be named as direct actors in an employment claim or as indirect actors who did not meet their supervisory obligations. For example, the employee could make allegations that the directors and officers of
the corporation were negligent in their supervision of employees in allowing the wrongful act to take place, or failed to take appropriate actions to prevent the wrongful act.

Directors’ and Officers’ Liability Insurance

Aon recommends that a private construction company maintain a D&O liability program for the benefit of the directors and officers of itself and its subsidiaries. The risks of directors and officers in private construction companies related to workplace health and safety, the Construction Lien Act, employment claims, government remittances and unpaid wages can be transferred with the purchase of D&O liability insurance rather economically.

A corporation in Canada is required to indemnify its directors and officers where they have acted honestly, in good faith and in the best interests of the corporation. Additional indemnification can be contractually agreed to between the corporation and its board. However, there are situations where a corporation is not permitted, refuses or is unable to indemnify its directors and officers.

D&O insurance will provide coverage for directors and officers when indemnification is not available to them. It will typically respond when a director or officer faces a written demand for monetary payment, criminal proceedings, civil proceedings, administrative or regulatory proceedings. Coverage for these types of claims will usually include defence costs, judgments, settlements and can include investigatory expenses. Civil and administrative fines are often covered to the extent that they are insurable under the law.

D&O policies can also provide coverage for the corporation for amounts paid to its executives as a result of its indemnification obligations. This coverage is especially important for the owner of a company that is also a director or officer, as it will allow the owner to recoup the costs of the company where money is spent to indemnify himself for actions undertaken in his capacity as a director or officer.

Financial Services Group

Aon’s national Financial Services Group (FSG) is considered one of the leading executive risk brokers in Canada. It comprises over 30 individuals who have unequalled experience in devising manuscript policy wordings and providing consulting services for private, public, not-for-profit, and government corporations.

FSG is familiar with the particular needs of private construction companies and will identify any gaps or “grey areas” in current insurance coverage as well as provide recommendations as to how risk exposure may be corrected or mitigated. Further, Aon has leveraged current relationships with insurers to provide clients with the best in-class coverage, competitive premiums and a streamlined and efficient renewal process.

To ensure clients are receiving the most comprehensive coverage available, FSG collaborates closely with Aon’s Legal and Research Practice group (LARP). LARP is comprised of experienced lawyers who utilize their legal expertise to provide a deeper level of risk management advice and risk transfer solutions.

Thus, working with Aon provides access to a sophisticated, knowledgeable and experienced team of professionals in Canada to analyze the executive risks, design appropriate policy terms and provide a broad range of options for a company’s consideration.

NOTES: