Vicarious directors' liability?!?!

Everyone knows and accepts that legal partnerships are vicariously liable for the acts and omissions of their partners and employees in the course of the law firm's business. Most law firms carry on their practices on the basis that their business is the practice of law.

Some legal partnerships allow or even encourage their employees or partners to act as directors. Often, the corporation is the firm's client. Frequently, the director/partner is required to account to the partnership for his or her director's fees.

This course of conduct has just become more dangerous. In an endorsement released on June 18, 2012, styled *Allen v. Aspen Group Resources Corp.*[1], Justice Strathy declined to grant summary judgment for the defendants and paved the way for a trial on the issue of whether a law firm may be vicariously liable under s. 131 of the *Securities Act* for the actions of one of its partners in his capacity as director of Aspen Group Resources.

This class action arose out of the take-over of Endeavour Resources Inc. by Aspen Group Resources Corporation, pursuant to a take-over bid circular. The class plaintiff claimed damages on behalf of the shareholders as a result of alleged misrepresentations in the take-over bid circular. It is alleged that the circular contained misrepresentations and failed to disclose that insiders of Aspen had engaged in improper self-dealing. As a result, Endeavour shareholders received Aspen shares that were over-valued. The defendants have denied the allegations, and the directors (including the partner in the firm in question) – against whom there are no allegations of self-dealing – deny any knowledge of any improper behaviour.

The firm and the partner are also defendants. The partner was both a director of Aspen, and its corporate solicitor. He and the law firm are sued in both capacities. It is alleged that the partner is liable as a director under s. 131 of the *Securities Act*, because the information circular allegedly contained misleading information, that his alleged contravention of s. 131 is a "wrongful act or omission" within the meaning of s. 11 of the Ontario *Partnership Act,* and that his firm is therefore responsible for the partner's actions.

The firm brought a summary judgment motion to dismiss the claim against it, both on the basis that it owed the plaintiffs no duty of care at common law, and on the basis that it cannot be vicariously liable for the partner's actions as director.

Both aspects of the summary judgment motion were unsuccessful, although both defences may be raised at trial.

With respect to the law firm's vicarious liability, Justice Strathy indicated that the partner's activities as director fell within the ordinary course of the law firm's business. The firm expressly permitted its partner to act as director of Aspen, the firm's client, and took his director's fees as part of the firm's revenues.

From a public policy perspective, although the *Securities Act* is silent on the point, Justice Strathy felt that a case can be made that the purpose of the *Securities Act,*

> "can best be accomplished by holding partnerships and corporations accountable for the actions of those they select to sit on corporate boards. This way, partnerships and corporations can ensure that their employees and partners are competent to fulfill the responsibilities of a board member. They can put in place appropriate standards and controls to make sure that the director exercises due diligence in the discharge of his or her responsibilities. The partnership, or the corporation that employs the director, obtains the benefit of fees earned by the director, and fairness suggests that it should be required to stand behind the director in the event shareholders suffer loss as a result of the director's failure to exercise due diligence."[2]

As the above passage suggests, Justice Strathy leaves open the possibility that a partnership may also be vicariously liable where its employee serves as a director.

Is your legal partnership willing and able to "put in place appropriate standards and controls to make sure that the director exercises due diligence in the discharge of his or her responsibilities," insofar as your firm's partner/director is concerned?

If you are up to what some might see as a daunting task, consider paragraph 103 of Justice Strathy's endorsement:

> "[103] I do not, therefore, accept the submission of [the law firm] that this decision will deter lawyers from acting as directors. On the contrary, it would result in a sharing of the risk and responsibility between the lawyer and his or her law firm. This result accomplishes the goals of both the *Securities Act* and the *Partnership Act*. It provides greater protection for the public, results in higher standards and controls, and puts the risk on the party most able to control and insure it."

No LawPRO insurance for D&O work

On the subject of insurance, LawPRO does not and will not insure directors' liability,

[1] 2012 ONSC 3498
[2] at para 88

either on behalf of individual lawyer/directors, or on account of their firms' alleged vicarious liability. Therefore, if a member of your firm – partner or employee – acts as a director, you had better be certain that ample directors' and officers' (D&O) insurance is in place, preferably with the firm named as an additional insured under the D&O policy.

Justice Strathy's reasoning on these issues may or may not be affirmed or disapproved at some later date. In the meantime, be careful. ■

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More on liability insurance

for lawyer/directors of charities or non-profits

Serving as a director of a charitable or not-for-profit corporation can be a rewarding but potentially risky experience. As the article, "Vicarious directors' liability" demonstrates, a director can be held personally liable for his or her own actions or failures to act, as well as jointly and severally liable with the other members of the board of directors.

Directors with specialized knowledge and expertise, such as lawyers, are held to a higher standard of care. Moreover, a lawyer/director may be perceived to be a "deep pocket" by potential plaintiffs.

Given this exposure to the risk of liability, if you intend to serve as a director of a charity or non-profit, you should ensure that adequate directors' and officers' (D&O) liability insurance coverage is in place.

LawPRO standard policy

LawPRO's standard professional liability insurance policy covers you only for the "professional services" that you provide as a lawyer. It does not provide coverage for liability arising as a result of your activity as a director.

Part 1, A of the standard policy states that in consideration of payment of the premium, LawPRO agrees "to pay all sums which the insured shall become legally obligated to pay as damages arising out of a claim" that results from the insured's "error, omission or negligent act in the performance of or the failure to perform professional services for others."

The policy defines professional services as follows:

> Professional services means the practice of the law of Canada, its provinces and territories, and specifically, those services performed... by... an insured *in such insured's capacity as a lawyer*... and shall include... those services for which the insured *is responsible as a lawyer* arising out of the insured's activity as a trustee, administrator, executor, arbitrator, mediator, patent or trademark agent. [*Emphasis added*]

Services arising out of the insured's activity as a director are not included.

LawPRO excess policy

Like the standard policy, LawPRO's optional excess professional liability insurance policy covers only professional services that you provide as a lawyer. It does not cover liability arising from your activity as a director, or in other words, it does not provide incidental D&O coverage. LawPRO's excess policy incorporates by reference the definition of "professional services" in the underlying standard policy to ensure uniformity in the scope of coverage in the underlying and excess policies.

Generally speaking, most excess professional liability insurance policies do not cover lawyers for their activities as directors or officers. But some excess insurance policies may offer some incidental D&O coverage. You will need to refer to the specific policy wording and consult with your insurance broker or excess insurer to find out whether your excess policy does so. If it does, you should also ascertain whether it "drops down" to afford primary coverage, since the LawPRO standard policy does not afford such coverage. ■

Other useful practicePRO resources on acting as a director

E&O insurance

A more detailed discussion of directors' and officers' (D&O) insurance from which this article was excerpted is available at: www.practicepro.ca/information/nonprofits.asp

Risk of acting as director

1) A summary of risk issues for lawyers acting as directors for client corporations appears at: www.practicepro.ca/information/actingdirector.asp

2) "Lawyers on boards: Assessing the risks, limiting the liability" is a detailed review of the liability risks associated with acting as a director and how to avoid them. This article from *LawPRO Magazine* is available at: www.practicepro.ca/LawPROmag/LawyersOnBoards.pdf

3) "Lawyers on client boards: Handle with care!" also reviews the risks of lawyers acting as directors and appeared in the January 2012 issue of a special Webzine (electronic newsletter) that LawPRO prepared for lawyers in corporate/commercial practice. It is available at: www.practicepro.ca/information/doc/Lawyers-on-client-boards-handle-with-care.pdf

"Sitting on a non-profit board: A risk management checklist" Questions to ask before saying yes: www.practicepro.ca/practice/riskmanchecklist.asp