

# STANDARD OF CARE AND CONFLICT OF INTEREST

## Standard of Care

- Under the Act, directors must act honestly and in good faith and, "exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.", s.37 (1) (a) & (b)
- This standard of care creates an "objective" test to determine whether a director has breached their fiduciary obligations to a corporation; in short, the actions of one director or a board of directors may be compared to the actions of other directors in other corporations who have been faced with similar circumstances
- The Act provides that directors cannot be found liable for breach of their duties if the breach has arisen as a result of the director relying in "good faith" upon financial statements prepared by the corporation's auditor or manager which are represented to the director as fairly presenting the financial position of the corporation or a report or opinion of a lawyer, accountant, engineer or other person whose profession "lends credibility to the report or opinion", s. 37 (3) (a & b)
- The by-laws may (and usually do) indemnify directors and officers from liability they incur as a result of carrying out their duties except for negligence
- Directors will not be protected if they are found to have breached their duty to act honestly and in good faith, s.38 (1) & (2)

## Conflict of Interest

- Directors must disclose in writing any interest they have, either directly or indirectly, in any contract or transaction the corporation is or may be a party to; the disclosure must describe the nature and the extent of the interest, s.40 (1) and must be entered into the minutes of the meeting at which it is made, s.40 (5)
- This does not apply if the transaction itself or the directors' interest in it are not "material"; what is "material" will depend upon the circumstances (ie. owning shares in the telecommunications company that is offering a bulk cable contract to the corporation is not material since the director, as a minority shareholder, will not receive any significant profit from the transaction), s.40 (2)
- If the transaction or contract involves the purchase or sale of real property (real estate) or personal property (goods) by the corporation, which the seller (the director) acquired within 5 years before the date of the contract or transaction, the director must also disclose what the director paid for it (NOTE: this section is somewhat confusing and will likely be interpreted as meaning that if a director owns, in whole or in part, property that is being sold to the corporation, or has an interest in the company that owns it, this information must be disclosed to the corporation), s.40 (3)
- The disclosure must be made at meeting of the board at which the contract/transaction is first considered or at the next meeting following the date upon which the director does acquire an interest in it, s.40 (4) (a) & (b)
- If the director obtains an interest in a contract/transaction after it has been entered into they must disclose the interest at the next meeting following the date they obtained the interest, s.40 (4) (c)



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- If the contract/transaction is one that, in the ordinary course of business, does not require the board's or owners' approval (ie. work orders or contracts that the manager is authorized to enter into on behalf of the corporation under the management contract) and a director has an interest in that contract/transaction, the director must disclose that interest at the next meeting following the date upon which the director learns about the contract/transaction, s.49 (4) (d)
- A director cannot vote on the contract/transaction, be counted toward the quorum of the meeting at which it is discussed or be present during any discussion about the contract/transaction that the director has an interest in, s.40 (6) but this does not apply where the interest in the contract/transaction relates only to obtaining Director's & Officers Liability Insurance, (s.39) or to directors appointed by the declarant to the first board who are also directors or officers of the declarant company, s.40 (6) (a) & (b)
- Directors who comply with the disclosure requirements and who acted honestly and in good faith at the time the contract/transaction was entered into are not accountable to the corporation or owners for any profits earned from the contract/transaction nor will the contract/transaction be voidable, conversely if the director did not properly disclose or didn't act honestly or in good faith the director may have to "account" (ie. give back the "profit") to the corporation and the contract/transaction may be voided, s.40 (7)
- If the director inadvertently failed to disclose an interest in a contract/transaction but otherwise acted honestly and good faith the director will not be accountable to the corporation or owners for any profits earned from the contract/transaction nor will the contract/transaction be voidable if the interest is disclosed in detail to the owners in the notice of the next owners' meeting and two-thirds of the owners at the meeting confirm the contract/transaction, s.40 (8)
- Essentially the same disclosure rules apply to officers of the corporation who are not directors, s.41