



Andrew Nathanson

Q&A

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Q: What are some key questions corporate directors should ask to avoid litigation or disputes against them personally and/or against the corporation of which they are a director when navigating through unstable market conditions?

ASK A LAWYER

A: Difficult economic conditions do not change your duties as a director, but they do heighten the stakes for the exercise of your oversight responsibilities. You need to ask the hard questions.

Are the risks under control? Directors should work with management to ensure that the corporation's strategic plan and its implementation reflect current market realities. Together, you should make a careful assessment of the business's risk factors, particularly financial ones. Directors will want to ensure that assets – including receivables – are properly valued, credit policies reviewed, debt covenants observed, cash flow managed to avoid liquidity problems, and the corporation's financial reporting and disclosure remains appropriate. Do not neglect the impacts on the revenue side of the business either. You should consider whether significant contractual commitments can be re-negotiated or avoided altogether, or whether others are at risk of defaulting on their obligations to the corporation. In public companies, this will be done – at least initially – by the risk management or audit committees. Failing to ask the hard questions and act accordingly may have a variety of legal consequences, ranging from securities enforcement actions to investors abandoning the corporation's shares to shareholders targeting directors in proxy contests or court.

Can the corporation meet key liabilities? There is nothing like the risk of personal liability to focus the mind. If the organization's financial position deteriorates, you will want to pay particular attention to key obligations for which directors can be personally liable: employee wages and withholdings, pension contributions and tax remittances. Dividends and providing financial assistance to related parties also require special care.

Is executive compensation appropriate? This is a hot button issue for shareholders and regulators: the U.S. Treasury has imposed compensation restrictions on financial institutions accepting bailout monies. G20 members are considering regulation, demanding that incentives be aligned to avoid excessive risk-taking. Corporations should strive for executive pay that reflects performance, balancing individual performance and market results. Directors should consider whether existing incentive plans ought to be adjusted to reflect market conditions. Compensation should be subject to the same critical evaluation as other parts of the business.

Are your indemnification and insurance arrangements adequate? Review your directors and officers' liability insurance and contractual indemnity from the corporation with the assistance of your lawyer and insurance broker.

Andrew Nathanson is a partner in the Commercial Litigation Group of Fasken Martineau. He advises directors of public and private companies.

2900 - 550 Burrard St, Vancouver, British Columbia, Canada V6C 0A3

T: 604 631 3131 F: 604 631 3232
www.fasken.com