

# Update

## Corporate Securities Law

April 28, 2009

### A Focus on Director's Indemnity Rights - the *Bennett* Decision

The recent decision of the Ontario Court of Appeal in *Bennett v. Bennett Environmental Inc.* in certain respects will be a comfort to directors of public issuers, and in other respects highlights issues that should cause directors to not take indemnification for granted. In a period of challenging markets and increasing litigiousness the case is a reminder of the significance of indemnity rights.

#### The Background

Bennett Environmental Inc. (“BEI”), a soil removal company, publicly disclosed in June 2003 that it had been awarded the largest soil remediation contract in its history. In August 2003, BEI was notified that the contract would actually be much smaller than had been originally planned. Nevertheless BEI continued to disclose the original larger contract as part of its inventory of contracts until July 2004, when it issued a press release explaining the change in the size of the contract. In the ten days following disclosure of the reduced size of the contract the share price of BEI fell by close to 50%. Actions were brought by securities regulators in both the United States and Canada.

The litigation arose because BEI refused to provide indemnification to John Bennett, BEI's former CEO and director, in connection with a settlement reached with the Ontario Securities Commission. BEI's grounds for refusing indemnification were that Bennett did not satisfy the indemnification test in its by-laws (which mirror applicable corporate law) and limited cash resources. The Ontario Superior Court of Justice ruled in Bennett's favour, and the company appealed.

#### The Decision

On March 5, 2009, the Court of Appeal upheld the Ontario Superior Court of Justice's decision that Bennett is entitled to indemnification. In so doing, the court made a number of findings that should provide some comfort to public issuer directors:

- *Onus is on the corporation* – Under applicable corporate law (which is typically mirrored in indemnity agreements), in order for a director or officer to be entitled to indemnification the individual must have acted honestly and in good faith in the best interests of the corporation and, in the case of criminal or regulatory penalties, the individual must have had reasonable grounds for believing his or her conduct was lawful. The court found that the company bears the burden of proving that the individual is not entitled to indemnification; in effect, directors and officers are assumed to have acted in good faith unless proven otherwise by the corporation denying indemnification.
- *No hindsight involved* – The court also concluded that entitlement to indemnification must be analyzed solely on the basis of the circumstances that existed at the time of the

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relevant conduct. In other words, the reasonableness of the individual's grounds for believing that his or her conduct was lawful will not be compared to the actual outcomes.

- *Reliance on advice* – Finally, the court underlined the importance of professional advice. While it was held that reliance on legal advice is not a prerequisite to prove a director's conduct was lawful in such situations, the court stated that the failure to obtain such advice may raise questions and prompt a closer look into the reasonableness of the director's belief.

While the court's decision in the *Bennett* case offers some support for the protection provided by indemnity agreements, it is a cautionary example of the effect on directors and officers if issuers challenge the right to indemnity.