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ADVISING THE CHARITABLE CLIENT: PRO-ACTIVE LEGAL RISK MANAGEMENT ADVICE†

*Terrance S. Carter**

1. *Introduction*

To collectively describe charities in Canada as "big business" may be perceived by some to be an oxymoron, to others it is a self-evident truth. The Canadian Centre for Philanthropy reported that in 1993 there were over 71,000 charities registered with Revenue Canada which had combined revenues of $86.5 billion with more than 1.3 million employees representing approximately 13 percent of the gross domestic product of Canada.[1] While most of this reported revenue is concentrated in the hands of a small percentage of charities made up of hospitals and educational institutions, the remaining vast array of charities are responsible for more than 25 percent of all reported income for charities in Canada and involve tens of thousands of charitable organizations, hundreds of thousands of employees, and an even greater number of volunteers assisting the myriad of charitable institutions as board members, officers and unpaid workers. Charities have clearly become a major component of the economic engine of Canada as the "third sector"[2] of voluntarism after the governmental public sector and the business private sector.

However, with the exception of a limited number of lawyers who regularly advise health care and educational institutions or provide specialized tax advice involving charities and donations, the vast majority of lawyers who are called upon to advise charitable clients do so on an infrequent basis and either treat charitable clients as step-children compared to their "real" clients, or perceive the professional service that they render to be akin to an act of charity itself, either because the service is given *pro bono* or because acting on behalf of a charity provides a sense of satisfaction in the hope that the advice provided has furthered charitable purposes that are of general benefit to the community. While such motivation is laudable, lawyers should not lose sight of the fact that the services that they provide, whether

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† This article has been abridged for publication here.

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1 *A Portrait of Canada's Charities: The Size, Scope and Financing of Registered Charities* (Toronto: The Canadian Centre for Philanthropy, 1994).

2 Theodore Levitt, *The Third Sector: New Tactics For a Responsive Society* (New York, 1973).

it be done on a *pro bono* basis or at a reduced rate, must be done in a competent and professional manner.

Meeting this requirement, though, is becoming increasingly difficult. Lawyers called upon to advise charities are expected to have an understanding of numerous and diverse areas of the law, including corporations, charitable trusts, associations, taxation, contracts, real estate, leasing, employment, insurance, risk management, and trust accounting, to name only some of the major areas. Coupled with increasing complexities involved in running charities is a heightened level of expectation placed upon leaders of charitable organizations by the courts, the government and the public at large. When individuals who are faced with the responsibility of establishing and operating a charity seek legal advice, it is incumbent upon the lawyer to not only provide answers to the specific question asked, but to also take the initiative to ensure that the charitable client is aware of the duties and responsibilities that charities are now facing, as well as knowing what steps can be taken to avoid liability exposure before problems occur.

While the practice of law dealing with charities is not yet a speciality, the provision of legal services in a lack lustre manner based upon the assumption that charitable clients require less effort than full paying clients is no longer an option. Charitable clients not only require competent and complete advice, they also require legal counsel that will take the initiative in guiding them through the intricacies and complexities of the law now inherent in operating a charity in Canada.

Advising the charitable client therefore extends beyond simply "doing good" by assisting individuals who wish to benefit the community. Instead, it requires the provision of professional advice on complicated areas of the law rendered in a manner that reflects an increasing reliance by clients on counsel to identify legal risks and provide recommendations on how those risks can be avoided. To that end, this paper suggests that a more active professional mindset is now required in dealing with charities and that lawyers should assist charities in identifying areas of risk by utilizing tools such as, for instance, a charity legal risk management checklist, a sample of which is attached to this paper as an appendix. The paper also explains a number of problems that lawyers may encounter from time to time in advising charities, and concludes by emphasizing the importance of communicating with the charitable client and providing informational reports to both assist the client and establish clear evidence of the advice rendered by the lawyer.

This paper is not a technical discussion of legal issues but instead attempts to provide a practical guide for practitioners who wish to develop a proactive approach in advising charitable clients. As such, the paper does not focus upon technicalities such as directors and officers liability or how to establish a charity, since these issues have already been well documented in other papers and articles. In addition, while many of the issues discussed do have some application to non-profit organizations, the paper focuses on the specific problems of charitable non-profit organizations.

In consideration of the escalating cutback in government funding of social programs, the increased pressure upon charities to meet the needs of the community no longer being met by the government will have the effect of both increasing the number of charities and the services that they provide as well as increasing the need for reliance upon competent legal advice. The charitable sector is clearly going through fundamental changes in its evolution into a major presence in the Canadian economy. At the same time, the legal services that lawyers are now called upon to provide to charitable clients is also going through fundamental changes, from that of benign passivity to proactive legal risk management advice.

2. *The Challenge in Advising the Charitable Client*

(1) The Nature of the Charitable Client

The challenge in advising the charitable client is a direct result of the unusual nature of a charity that makes it different from advising any other type of client. For instance:

(a) Whereas most clients are motivated by self-interest, those involved in directing a charity are generally motivated by the sense of a greater good that extends beyond themselves. However, due to this increased expectation of good will, the sensitivities of those involved with charities are heightened and are often subject to greater disappointment and misunderstandings than is the case in a business context.

(b) Whereas there is usually continuity in acting as legal counsel for a business or for an individual, due to the frequent changeover in board members involved with charities, there is often an inherent lack of continuity when acting for a charity. As a result, individuals on the board for whom the lawyer provided advice in one year may be different the next year.

(c) Whereas a business client will generally evidence a reasonable level of commitment to complete a required task, the extent of commitment of volunteers involved in a charity can range from a superhuman effort that far surpasses anything found in a profit-making business, to those who perceive their involvement as only a position of honour with a corresponding limited sense of commitment to the task at hand.

(d) Whereas a business client by necessity will normally have a well-established structure on which the business is based, the nature of voluntarism for those involved with the board of a charity will often mean that there will be a significant difference of opinions concerning how to formally structure the charitable organization or how to run it on a day-to-day basis.

(e) Whereas a business client understands the importance of process to achieve an end result, individuals on the board of a charity will often focus on the charitable purpose that they wish to achieve and feel thwarted by the process required to achieve that goal, particularly when the process involves what is assumed to be bureaucratic and legalistic exigencies.

(f) Whereas the business client is generally not surprised to find that there are legal niceties that must be complied with in running a business, the charitable client is often surprised and frustrated to find that they must comply not only with normal legal hurdles associated with regular operations, such as compliance with employment standards legislation, but are also subject to often onerous and complicated legal expectations imposed upon charities and their boards under the *Income Tax Act*,[3] as well as trust law that applies to charitable property. The lack of understanding of legal requirements is generally so pervasive with charitable organizations that it is often necessary to assume that the charitable client knows little, if anything, about the legalities that are involved in operating a charitable organization.

(g) With increased cutbacks in government funding to community charities, board members and officers of charities are, by necessity, having to concentrate more

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[3] R.S.C. 1985, c. 1 (5th Supp.).

on the means of raising the necessary moneys to maintain the charitable programs, often at the expense of ensuring the quality of the program or even compliance with basic legal requirements. In addition, there may be a corresponding proliferation of charitable organizations to fill the vacuum once occupied by government funded charitable organizations. Those involved in starting newly created charities, though, will frequently focus almost exclusively on the current needs that must be met at the expense of putting the necessary charitable structure in place and ensuring that applicable rules and laws are complied with.

(h) Of all of the tens of thousands of the individuals who serve as unpaid directors and officers of charitable organizations, it has been correctly stated that "it is unlikely that more than a small fraction of these individuals have any clear idea of the risks that they are incurring by accepting such positions".[4]

(2) Unrealistic Expectations of the Lawyer by the Charitable Client

In addition to having to deal with the unique character of the charitable client, the lawyer who is called upon to advise charities will generally encounter at least a few of the following unrealistic expectations of the charitable client:

(a) Unless the lawyer is dealing with a large institution with a secure source of government funding, the charitable client will often expect, although not necessarily state, that the lawyer will provide the required legal services either on a *pro bono* basis or subject to a significant reduction. While there is a place for *pro bono* services for a charity, before doing so, the lawyer must first determine the nature of the problem, the solutions required, and whether or not he or she is prepared to devote the time and attention required to provide the necessary legal services on a *pro bono* basis or with a significant reduction. If not, it is incumbent upon the lawyer to clearly identify to the client at the outset that the legal services in question are being done on a fee for service basis at whatever rate the lawyer feels is appropriate in the circumstances.

If the lawyer does undertake a task for a charitable client on a *pro bono* basis or reduced fee, the lawyer must understand that the lack of payment does not justify incomplete or tardy service. If anything, the charitable client may require legal advice and/or services that are much more sophisticated than those which are associated with a medium sized business and, in some instances, such services may be needed immediately.

(b) When a charity retains a lawyer, no matter how small the task and whether or not the lawyer is paid for his or her services, a frequent presumption is that the lawyer's involvement in even a small matter provides the equivalent of a "legal good housekeeping seal of approval" on everything that the charity does. The presumption that is often expressed, after the fact, is that since the charity was not advised by legal counsel that a particular situation or course of action might be a problem, it could assume that the current practices of the charity complied with all applicable laws.

(c) Unrealistic expectations of what the lawyer is to do often flows out of the general confusion and lack of knowledge by volunteer board members concerning

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[4] William I. Innes, "Liabilities of Directors and Officers of Charitable and Non-Profit Corporations" (1993), 13 E. & T.J. 1 at 2.

the operations of a charity. Board members are generally so involved in pursuing programs to achieve charitable purposes that they do not consider that they have either the time or the expertise to ensure that they are complying with legal requirements. It is generally perceived that this is the responsibility of the lawyer, although this assumption may not have been communicated to the lawyer. This presumption is so prevalent that charities that become embroiled in legal problems will often state after the fact that they assumed that since they had not heard any warnings from the lawyer, they assumed that "no news was good news". When a problem does develop, particularly if it involves potential personal liability of volunteer directors of a charitable corporation, it is often the lawyer who is the first person that is singled out for blame in not having warned the director of the risks that could have been avoided.

In summary, the expectation of the charitable client towards a lawyer retained to provide legal advice is that the advice should be provided, as much as possible, on a *pro bono* basis, or at least with a significant discount, that the advice should be accurate, professional, and include appropriate warnings concerning existing or proposed courses of action that may expose the charity and its board to unnecessary legal risks.

(3) Why the Charitable Client Often Experiences Difficulties

The public's perception of charities is that they are generally benign organizations of individuals who are committed to higher ideals for the good of the community, and as such are somehow immune from the complexities and legal niceties that apply to business organizations. This is particularly so with religious organizations that often function on the mistaken assumption that their dedication to spiritual values elevate them above the need to deal with mundane matters of complying with the laws of the land.

As a result, it often comes as a surprise to many individuals, both in the community as well as to those involved in charitable organizations, that charities are not the simple organizations that they are generally perceived to be, but in fact are often sophisticated corporate entities having serious legal issues and complexities in operations that far outweigh those faced by many businesses. For instance, most charities will be faced with having to deal with some or all of the following issues:

(a) compliance with complicated statutory requirements for charities under the *Income Tax Act;*
(b) increased directors and officers liability at common law and in accordance with a growing multitude of provincial and federal statutes;
(c) raising and managing large sums of money each year;
(d) overseeing the supervision of employees;
(e) facing the possibility of termination of employees and the corresponding potential for wrongful dismissal;
(f) maintaining the goodwill of volunteers while at the same time reducing the risk of exposure to legal liability for volunteers;
(g) establishing and maintaining an appropriate organizational structure;
(h) dealing with a diffuse decision-making process reflecting input from both the board of directors and from executive staff members;
(i) ensuring the correct treatment of charitable gifts, including compliance with donor restrictions;

(j) minimizing the potential for sexual abuse and molestation of children and other vulnerable individuals who come in contact with the charity;
(k) compliance with human rights legislation;
(l) compliance with employment legislation;
(m) compliance with requirements of the provincial and federal government concerning operations of charities through both the office of Revenue Canada and the Public Guardian and Trustee of Ontario;
(n) establishing and maintaining the involvement of the charity in both a national and/or international structure, if applicable;
(o) ensuring that applicable investment restrictions are complied with; and
(p) ensuring that the charitable activities constitute appropriate means of fulfilling the charitable purposes as set out in the constitution and/or letters patent of the charity.

(4) Consequences of Legal Deficiencies in Charitable Structure and Operations

Few individuals who are themselves involved in charities give much consideration, if any, to the consequences that could flow from legal deficiencies in charitable operations. Some of the problems, though, that a charity and its board of directors may face at different times include the following:

(a) legal action by aggrieved parties based on negligent supervision of staff and volunteers;
(b) legal action many years after the fact by individuals who allege that they had been sexually or physically abused;
(c) personal liability of board members as a result of breach of trust involving charitable funds;
(d) violations of human rights legislation;
(e) actions for wrongful dismissal;
(f) revocation of charitable status;
(g) loss of corporate status with the corresponding escheat of assets to the Crown;
(h) control by special interest groups intent upon pursuing a specific agenda;
(i) splits in membership of community groups or religious organizations;
(j) court supervised audit of accounts conducted under the *Charities Accounting Act*;[5] and
(k) possibility of a public inquiry under the *Charities Accounting Act*.

For charities that assume that exposure to legal liability is more theoretical than real, reference should be made to the provisions of s. 6 of the *Charities Accounting Act*. The reported and unreported decisions under that section illustrate how disgruntled members of a charity or members of the public can cause upset and significant legal costs for the charity and its directors by requesting a public inquiry. The relevant portions state:

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[5] R.S.O. 1990, c. C.10.

> 6(1) *Any person may complain as to the manner in which a person or organization has solicited or procured funds by way of contribution or gift from the public for any purpose, or as to the manner in which any such funds have been dealt with or disposed of.*
>
> (2) Every such complaint shall be in writing and delivered by the complainant *to a judge of the Ontario Court (General Division).*
>
> (3) Wherever the judge is of opinion that the public interest can be served by an investigation of the matter complained of, he or she *may make an order directing the Public Trustee to make such investigation as the Public Trustee considers proper in the circumstances.*
>
> (4) In making an investigation directed under subsection (3), *the Public Trustee has and may exercise any of the powers conferred on him or her by this Act and any of the powers of a commission under Part II of the Public Inquiries Act, which Part applies to the investigation as if it were an inquiry under that Act. . . .*
>
> (6) As soon as the Public Trustee has completed the investigation, he or she shall report in writing thereon to the Attorney General and to the judge who ordered the investigation.
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> (7) Upon receipt of the report, *the judge may order a passing of the accounts in question, in which case section 23 of the Trustee Act applies, and the judge may make such order as to the costs of the Public Trustee thereon as he or she considers proper. . . .* [Emphasis added.]

In the 1989 decision of *Stahl v. Ontario Society for the Prevention of Cruelty to Animals*,[6] the court held that a complainant under s. 6 of the *Charities Accounting Act* is in the same position as an informant who complains of a breach of the Queen's peace before a justice of the peace. As such, it is assumed that a complainant is acting for the public good and is not liable to costs, although the complainant might be liable for damages from a malicious prosecution, although an unlikely event.

The court in the *Stahl* decision stated that a complainant under the *Charities Accounting Act* need not give notice of his or her complaint to the charity involved. Instead, the matter may be laid before a judge of the court on an ex parte basis. The judge considering the complaint is to act in the same manner as a justice of the peace in considering a criminal information that is presented before him. As such, the judge need consider only whether the public interest can be served by the investigation of the matter complained of and is not called upon to determine the merits of the complaint itself.

A more recent unreported decision provides clear evidence of how effectively s. 6 of the *Charities Accounting Act* can be used to attack a charity. In *Dr. Piero Boldieri v. The Hamilton Naturalist Club*,[7] the complainant made application to the court for a public inquiry under s. 6 of the *Charities Accounting Act* arising out of an incident in which the complainant had asked the Hamilton Naturalist Club, in January of 1995, to contribute towards the publication of his book about a creek in the Hamilton area. The club turned down his request. In February of 1995, the complainant sent a series of letters to the club requesting information about its organization

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6 (1989), 70 O.R. (2d) 355, 35 E.T.R. 234 (Dist. Ct.).

7 Unreported, October 18, 1995 (Ont. Gen. Div.).

and operations. Although the club provided a response, it did not satisfy the complainant. The complainant then commenced an application under s. 6 of the *Charities Accounting Act* raising questions about the manner in which moneys were raised from the public, and expenses related thereto, which included money raised by a local walk-a-thon. The complainant also raised an issue concerning funds transferred by the club to "others". The court stated that this raised a question as to whether donations were made by the club to other organizations controlled or directed by club members and whether or not the transfers were appropriate donations for the club to make as a charity.

The court application was successful and the Office of the Public Guardian and Trustee was directed by the court to hold a public inquiry. This may involve some or all of the members of the board of directors of the club being subpoenaed before a public board of inquiry to scrutinize every aspect of the operations of the club, including how moneys were raised and expended or transferred. This could involve each of its directors having to retain legal counsel at their own expense to represent them before the public inquiry. Depending upon the information that comes out from the public inquiry, the Public Guardian and Trustee could subsequently require a public passing of accounts pursuant to s. 23 of the *Trustee Act*.[8] This could result in the costs associated with such proceedings becoming the responsibility of the directors of the charity on a personal basis.

(5) How the Lawyer can encounter Difficulties in Advising the Charitable Client

Donald J. Bourgeois, in his text, *The Law of Charitable and Non-Profit Organizations*,[9] succinctly states the general nature of the problems encountered by lawyers in providing legal advice to a charitable client as follows:

> The confusion and underdevelopment of the law [makes] it difficult for lawyers to provide legal advice to clients. There are few texts on the subject. The cases often comment on the lack of legal developments in this area and the need to make analogies to other forms of law, including trust and business law. The policies and practices may not be readily available or explicable. The law is not "transparent".[10]

In addition to the general lack of law and commentaries available to help lawyers advise charities, there are increasing expectations expressed by the courts concerning the professional duties of lawyers in dealing with clients in general that have equal application to advising charitable clients. These legal expectations can be summarized as follows:

(a) A lawyer dealing with a charity must ensure that any transaction that the charity is involved with has been fully explained to the client, particularly unsophisticated members of the board.[11]

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8 R.S.O. 1990, c. T.23.

9 Donald J. Bourgeois, *The Law of Charitable and Non-Profit Organizations* (Markham, Ont.: Butterworths, 1990).

10 *Ibid.*, at 9.

11 *Egi v. Dipietro* (1984), 28 A.C.W.S. (2d) 149 (Ont. H.C.).

(b) A lawyer advising a charity has a duty to warn the charity of any risks involved in the course of action contemplated by the client. In this regard, the court in *Major v. Buchanan* stated:

> [A] solicitor has the duty of warning a client of the risk involved in a course of action, contemplated by the client or by his solicitor... and of exercising reasonable care and skill in advising him. If he fails to warn the client of the risk involved in the course of action and it appears probable that the client would not have taken the risk if he had been so warned, the solicitor will be liable. If he warns the client of the risk . . . then he can only proceed to follow such course if the client instructs him so to do.[12]

(c) It is also incumbent upon a lawyer dealing with a charity to not only inform the charity of the inherent risks associated with the contemplated course of action, but also to identify if there are better alternatives. ". . . the solicitor has a duty to advise the client whether or not his instructions are unreasonable, or unworkable, or involve certain risks and better alternatives.[13]

(d) Even where the charity specifically instructs the lawyer to undertake only a certain task and no more, if the lawyer in completing that task becomes aware of a risk that the charity is taking, then the lawyer is obliged to advise the client of the risk notwithstanding the limited nature of the retainer. In *Marbel Developments Ltd. v. Pirani*,[14] the British Columbia Supreme Court held that the existence and extent of a solicitor's duty to advise a client must, in part, depend on the nature and extent of his or her retainer. "[T]he solicitor must not allow his client to define the retainer unilaterally, in ignorance of material risks of which the solicitor is or should be aware."[15] The court found that the solicitor in question using reasonable professional judgment failed to advise the client of certain inherent risks. While the lawyer only intended to undertake the limited task of drafting stratification (*i.e.*, condominium) documentation and effecting filing, his obligations were considerably broader, encompassing, as time elapsed, the duty to warn the client of the dangers of delay in relation to the expiry of a certificate of a land surveyor.

If a lawyer involved with a charity on a specific matter becomes aware of a potential problem on another matter, such as a breach of trust involving donor restricted trust funds, (discussed later in this paper), it is incumbent upon the lawyer to advise the charitable client of the risks associated with the activity that the lawyer has observed.

(6) Conflicts of Interest in Advising the Charitable Client

In addition to the obligation to actively warn the charitable client of risks, a lawyer involved in acting for a charity can on occasion find himself or herself in difficulties as a result of real or perceived conflicts of interest. Some examples of these conflicts are as follows:

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12 *Major v. Buchanan* (1975), 9 O.R. (2d) 491 at 514, 61 D.L.R. (3d) 46 (H.C.).

13 *Elcano Acceptance Ltd. v. Richmond, Richmond, Stambler & Mills* (1985), 31 C.C.L.T. 201 at 219, 47 C.P.C. 256 (Ont. H.C.), reversed (1986), 55 O.R. (2d) 56, 9 C.P.C. (2d) 260, 16 O.A.C. 69 (C.A.).

14 (1994), 18 C.C.L.T. (2d) 229 (B.C. S.C.).

15 *Ibid.*, at 239.

(a) A lawyer as a member of the board of directors of a charity may be asked to provide legal services in return for a fee, whether the fee be at full rate or at a reduced rate. In such a situation, the lawyer would be in breach of his or her fiduciary duty as a director of the charity, no matter how small the amount of remuneration is.[16]

(b) Even if the lawyer in providing legal advice or services while a member of the board of the board of directors does not receive any remuneration from the charity, there may still be a conflict of interest inherent in the lawyer assuming fiduciary responsibilities as a board member while at the same time acting as the professional legal advisor for the charity. The dichotomy in roles may put the lawyer in an untenable situation, where for instance, the board is reluctant to adopt recommendations contained in the legal opinion from the lawyer. In such a situation, it may become difficult if not impossible for the lawyer to fulfil his or her fiduciary obligation to put the best interests of the charity foremost while at the same time having to deal with the professional consequences of whether or not the advice rendered is acted upon by the client.

This is not to suggest that providing free legal services to a charity by a lawyer who is a member of its board of directors necessarily constitutes a breach of fiduciary duty; rather it indicates that there may, in certain circumstances, be a conflict of interest which can only be resolved by the lawyer either ceasing to act as the solicitor for the charity or removing himself or herself from the board of directors to permit the lawyer to provide totally impartial legal advice. The lawyer is already faced with significant liability simply being a member of the board of directors of a charity without also unnecessarily exposing himself or herself to the increased risk of having detrimental reliance placed upon his or her professional advice given free of charge.

(c) A similar type of conflict could arise when the lawyer is acting as solicitor for two related charities, such as an operating charity and a parallel foundation, where the interests of the two charities are at odds. For instance, when the board of directors of one related charity is in disagreement with the direction taken by board of directors of the other charity. In such a situation, the solicitor may need to declare his or her conflict of interest and recommend that one or both of the associated charities obtain independent legal advice.

(d) Conflicts of interest can also arise where the lawyer is called upon to advise the board of directors of a charity and the advice rendered indicates that the directors could be found personally liable. When this occurs, the lawyer should advise each member of the board of directors that the advice being rendered is directed to the board members in their capacity as directors of the charity and is not being given as legal advice to them in their personal capacity. As a result, the lawyer should advise the board of directors that each member should obtain their own independent legal advice to review the consequences of their actions.

(e) A conflict of interest can also arise where the legal opinion sought by the executive director of a charity results in an opinion which the executive director is reluctant to pass along to the board. In such a situation, the lawyer should expressly

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16 See *Public Trustee v. Toronto Humane Society* (1987), 60 O.R. (2d) 236, 27 E.T.R. 40, 40 D.L.R. (4th) 111 (H.C.); *Bray v. Ford,* [1896] A.C. 44; *Re French Protestant Hospital,* [1951] 1 Ch. 567; *Re David Feldman Charitable Foundation* (1987), 58 O.R. (2d) 626, 26 E.T.R. 86 (Surr. Ct.); *Re Faith Haven Bible Training Centre* (1988), 29 E.T.R. 198 (Ont. Surr. Ct.); *Harold G. Fox Education Fund v. Ontario (Public Trustee)* (1989), 69 O.R. (2d) 742, 34 E.T.R. 113 (H.C.).

request that the legal opinion be communicated to the board of directors. If it is not, then depending upon how serious the matter is, the lawyer may want to send a copy of the opinion letter to the home addresses of the directors, particularly if the lawyer has become aware that the executive director is trying to "stone wall" the board from receiving the legal opinion in question.

3. *The Response: Proactive Legal Risk Management Advice*

(1) The Need to Develop a Response

From the case law referred to above, it is clear that it is no longer sufficient for a lawyer in advising a charity to provide the services of a legal technician only without considering and advising the charitable client on the consequences of its action. Since lawyers may now be held liable as much for what they don't say as for what they do say, lawyers by necessity need to become proactive in advising the charitable client.

Most firms that regularly deal with charities have law clerks who are generally capable in technically creating a charitable corporation, preparing the application for charitable registration with Revenue Canada, and completing the necessary government filings. What a lawyer is called upon to do in advising the charitable client is to go a step beyond what the law clerk does and provide active legal counsel to identify and avoid legal problems before they occur. An analogy can be made to the accounting profession between a bookkeeper who provides only financial statements for his clients at the end of the year and a chartered accountant who is expected to go the extra step and identify areas of problems in the business operations and provide recommendations on how to better structure the business to improve the net earnings and reduce taxes where possible. In the context of charities, a lawyer must change from providing passive advice that is reactive only to that of providing legal counsel in a proactive and preventative context to anticipate problems and reduce legal risks in charitable operations.

The need to practise preventative law has been identified by lawyers and consultants who deal regularly in risk management issues, particularly as it relates to recreational activities and events. Brian D. Wynn in his paper "Happenings, A Word on Recreational Accidents, Risk Management and Preventative Law" states as follows:

> Like wellness in medicine, preventative law is a philosophy or regimen which applies to the planning process. It is designed to reduce conflicts so that only the toughest of issues demand expensive dispute resolution mechanism . . . Contrast it to the other, reactive mode of client/lawyer relations where the embattled client habitually calls on the lawyer "when there is a problem" and requests a remedy or solution. It isn't hard to see which style promises greater efficiency in the long run.[17]

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17 Brian D. Wynn, "Happenings, A Word on Recreational Accidents, Risk Management and Preventative Law" in *Fairs, Festivals and Fund Raisers: Legal and Risk Management Issues for Special Event Organizers* (Continuing Legal Education of the Canadian Bar Association, Toronto, 1995), Tab 11 at 15.

(2) What constitutes Legal Risk Management Advice?

In the context of advising charities, proactive legal risk management advice is difficult to define with any exactitude but generally can be said to include the following:

(a) The lawyer must become familiar with the law before he or she can effectively advise the charitable client on how to avoid potential legal risks. This requires that the lawyer have a grasp of different forms of organizational structures for charities, *i.e.*, corporate, unincorporated associations, charitable trusts, and charitable non-share corporations, under both the Ontario *Corporations Act*[18] and the *Canada Corporations Act*.[19] The lawyer should also have an understanding of the history of charities based upon trust law, a working knowledge of the applicable provisions of the *Income Tax Act* as it applies to charities, familiarity with the various reporting requirements of both the federal and the provincial governments, particularly the Public Guardian and Trustee of Ontario under the *Charities Accounting Act*,[20] a general understanding of inclusions and exclusions of general liability insurance policies, familiarity with third party liability exposure and the *Occupiers' Liability Act*,[21] a grasp of title issues related to charities owning real property, an understanding of employment law and contracts, familiarity with the *Trade-marks Act*,[22] and the registrations available thereunder, an understanding of the exposure of directors and officers to personal liability under both the common law and numerous provincial and federal statutes, a grasp of board management issues, familiarity with basic accounting principles involving charitable funds, particularly as it relates to donor restrictive trust funds, as well as a general understanding of national and international charitable structures, if applicable.

Without some knowledge in these areas of the law, a lawyer in attempting to advise a charitable client may have a difficult, if not an impossible, time in trying to effectively guide the client in avoiding problems before they occur, let alone simply trying to ensure that the charity complies with all of the basic requisite statutes that have general application to the day-to-day operations of a charity.

(b) In meeting with the charitable client to conduct a legal risk management review, the lawyer should assume nothing. In other words, the lawyer should not assume that the charitable client knows the relevant law, or is aware of problems that may need to be addressed, or is aware of the consequences of the present or proposed course of action. If there are any assumptions of facts which the lawyer makes, it is essential that those assumptions be expressed and confirmed with the charitable client before proceeding; otherwise, confusion or possible negligence could result if the lawyer gives advice based upon either a wrong or an incomplete assumption of the relevant facts.

(c) In meeting with the charitable client, the lawyer needs to be diligent in asking questions of the client to identify either existing or potential problems that the charity may be facing. A good technique to facilitate this process is to use a form of checklist, which is described in more detail in the next section of this paper.

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18 R.S.O. 1990, c. C.38.
19 R.S.C. 1970, c. C-32.
20 *Supra*, note 5.
21 R.S.O. 1990, c. O.2.
22 R.S.C. 1985, c. T-13.

(d) In reviewing the operations of the charity, it is important that the lawyer explain major areas of the law that are particularly relevant to the client, even when there is not necessarily a problem that has been identified, so that the client will be aware of the need to comply with the applicable law in the future. For instance, even though a particular charitable client may not be gifting moneys to a foreign charity at present, the issue may have to be faced by the charity at some time in the future. It is therefore helpful to explain in advance the correct means of gifting moneys to non-qualified donees outside of Canada so that the charity will be prepared.

(e) When a problem is identified, either in relation to current activities or a proposed action, it is essential for the lawyer to fully explain the consequences of the course of action in question. In this regard, if the consequences may ultimately expose members of the board of directors to personal liability, it is important that this be identified in unequivocal terms, even if the information being conveyed to the charity is not what the client wishes to hear.

(f) Having identified the problem, it is then incumbent upon the lawyer to provide the charitable client with recommendations that can be implemented to rectify the problem, together with other effective alternatives, if possible, that can be adopted to eliminate the risk.

(g) In the event that numerous problems are identified, then at the end of the meeting, it is helpful for the lawyer to set up a priority list of what problems need be dealt with first and in what time frame they should be addressed. Failure to do this can often leave the charitable client overwhelmed by the problems and potential liability and may, on occasion, have the unfortunate effect of leaving the board of the charitable client paralyzed in fear and unable to do anything other than contemplate mass resignation. As such, it is not sufficient for the lawyer simply to provide a list of problems. The lawyer must also provide constructive solutions and an appropriate time frame in which to correct the problems.

(h) It is important that the lawyer then provide a well-organized report to the client confirming the advice given, the problems identified, the solutions suggested, and a realistic time schedule to implement those solutions. The report will then become a reference tool for both the client and for the lawyer in monitoring the progress.

(i) The report should be addressed not only to the executive director, if applicable, but to all of the members of the board of directors of the charity. In some circumstances, it may be appropriate for the lawyer to attend the board of directors meeting to provide a summary of the issues addressed in the report, utilizing overheads or summary sheets to simplify the presentation on what often involves complicated issues and consequences.

(j) After the provision of a comprehensive report to the client, it is then important to explain that it is the responsibility of the charitable client to decide if the board wishes to adopt the recommendations provided in the report, and if so to communicate those instructions to the lawyer. The reason for doing so is to ensure that having identified the problems and provided the recommended procedures to deal with those problems, the onus is put upon the charitable client to provide the instructions to proceed with implementing the recommended remedial steps. Otherwise, the lawyer may find himself or herself at a later time being criticized or possibly being held liable in the event that the recommended course of action is not taken.

(k) Assuming that the client does provide instructions to the lawyer to begin some or all of the remedial steps, the lawyer should prepare and provide the client

with a checklist of the steps that need to be done and the time frame in which those steps are to be accomplished.

(l) In the event that the charitable client does not make an initial decision to proceed with the recommended course of action, the lawyer should send a follow-up letter to the client one or two months after the initial report to remind the client of the need to make a decision and to once again confirm that the onus lies upon the client to provide the instructions to proceed. This is important to clarify with the client, since the charitable client may be reluctant to adopt a particular recommended course of action for various reasons, and as such, the lawyer will want to ensure that there is no confusion concerning the reason why the recommended course of action has not been adopted, particularly when it involves potential personal liability to directors and officers of the charity.

(m) After the initial problems identified in the report have been addressed, the client should be advised to periodically review matters with legal counsel concerning its on-going operation on either an annual or bi-annual basis to determine if further issues may have unnecessarily exposed the charity to legal risks.

(3) Utilizing a Legal Risk Management Checklist

(a) Sample Checklist

The Appendix to this paper is a document called a "Charity Legal Risk Management Checklist". The checklist was developed for two reasons:

(i) First, in meetings with charitable clients, there are so many issues that need to be reviewed, it is difficult to keep track of them all without having some form of checklist to refer to.
(ii) Second, and by far more important, it is to provide a tool to assist the charitable client in identifying areas of potential legal risks on their own, as well as to assist the client in understanding the myriad of legal and risk management issues that need to be addressed to some extent by most charities.

The Charity Legal Risk Management Checklist has been structured so that it both raises legal issues and suggests some tentative solutions. Although the checklist attempts to be as generic and broad as possible, it is clearly neither all-inclusive nor comprehensive in dealing with the issues that are identified. As a result, the lawyer utilizing the checklist will need to modify it as necessary to customize the checklist to reflect the emphasis each lawyer places on the advice given to their respective clients.

(b) How to Utilize a Checklist

When meeting with a charitable client, whether it be to answer a specific question or to conduct a legal review, a copy of the Charity Legal Risk Management Checklist should be given to the client with the lawyer retaining a copy. This will then permit both the lawyer and the client to review the matters dealt with in the checklist in identifying potential problem areas and developing suggested solutions.

Alternatively, a copy of the checklist can be forwarded to the charitable client prior to the meeting so that the client will be familiar with the format that will be followed during the interview. However, the danger of forwarding the checklist in advance of the meeting is that the charitable client can often become overwhelmed by the number of issues that need to be addressed. As such, it is better to meet with the client in person to explain the need for the checklist and its contents.

During the interview, the client should be encouraged to make notations on his or her copy of the checklist, with the lawyer doing the same. These notations will provide a useful tool for the lawyer in structuring the reporting letter concerning the problems that have been identified and the solutions recommended.

A copy of the checklist should be dated and put into the file so that it can be referred to at a later time in monitoring the progress by the charity in rectifying the problems that have been highlighted. This is particularly useful in those situations where there has been a change in a board of directors or a change in the executive staff, since the new individuals may not be aware that a Charitable Legal Risk Management Checklist had been used in earlier meetings to identify problems and recommend solutions.

For those situations where clients have received a copy of the checklist, but for whatever reason do not arrange to meet with the lawyer to review the matters raised, it is recommended that the client be advised that the issues raised in the checklist are complicated, have serious consequences, and as such the client should not attempt to do a review on their own without the assistance of legal counsel. In the event that the client decides not to retain the lawyer further, at least there will be correspondence warning the client that a review of the Charity Legal Risk Management Checklist without legal counsel does not constitute a proper review or determination of the various legal risks that a charity may be facing.

(c) The Structure of the Charity Legal Risk Management Checklist

The checklist begins by explaining in point form why it is important to identify legal risk management issues. This involves reviewing a number of issues and the complexities involved in operating a charity, as well as explaining the types of problems that a charity can face, who is exposed, and the need to take corrective steps.

The checklist then suggests a procedure to identify and manage legal risk liabilities, such as the creation of a liability management committee to oversee, identify and reduce legal risks.

The checklist next deals with some basic issues of deficiencies in legal organization, board management matters, reducing board liability, insurance considerations, third party use of charitable property, real property issues, leasing matters, intellectual property, employment and volunteer matters, charitable activities, fiscal management matters, the dangers of operating with a deficit, compliance with trust fund obligations, maintaining charitable registration, and issues involving national and international structures.

While each lawyer will need to modify the checklist to prioritize the issues in whatever order the lawyer feels is appropriate, it is important that the checklist cover as many issues as possible and as a result in reviewing the checklist, the lawyer and the client should be careful not to rush through the items referred to in it simply because of the volume of issues. It is therefore generally recommended that at least a

two-hour interview be set up to initially review the checklist, with possible additional meetings being subsequently scheduled as necessary.

4. *Selected Problems in Advising Charitable Clients*

To provide a complete discussion of all of the issues referred to in the Charity and Legal Risk Management Checklist is clearly beyond the scope of this paper. Instead the paper highlights a few topics from the checklist that are either unique or are of such significance that they are fundamental to providing effective legal risk management advice to a charitable client. The topics that are highlighted, though, are not intended to be an in-depth discussion of the issues, but rather to bring to the attention of lawyers dealing with charitable clients the existence of some very real risks and the type of advice that may need to be given. For ease of reference, each of the main topics discussed below are cross referenced to the relevant part on the attached Charity Legal Risk Management Checklist.

(1) Is Charitable Status Necessary?[23]

Often charities are created without a clear understanding of whether or not a charity is needed at all and the consequences that flow from establishing a charity. As such, whenever a client indicates that they wish to establish a new charity, there are a number of initial questions that should be reviewed with the client before proceeding with the creation of an organizational structure and its registration as a charity with Revenue Canada under the *Income Tax Act*.

(a) Not Every Non-Profit Organization is a Charity

A potential charitable client should be advised of the basic legal elements that constitute a charity. Although this is a complex area of the law and has been addressed in a number of excellent articles and books,[24] the Court of Appeal for Ontario held in *Re Levy Estate*[25] and *Canada Trust Co. v. Ontario Human Rights Commission*[26] that charitable status involves the following:

(i) the objects or purposes must be wholly and exclusively charitable and there cannot be a mixture of charitable and non-charitable purposes;

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23 See Section 2 of the checklist.

24 See Donald J. Bourgeois, *supra*, note 9 at 9-25; Arthur Drache, Q.C., *Canadian Taxation of Charities and Donations* (Toronto: Carswell, 1994), at I-11; Jane Burke-Robertson and Arthur Drache, Q.C., *Non-Share Capital Corporations* (Toronto: Carswell, 1995), at I-90; D. Lisa Goldstein, "What is a Charity? Who Decides?", *Without a View to Profit, Non-Profits and Charities* (Canadian Bar Association — Ontario, Continuing Legal Education, 1995).

25 (1989), 68 O.R. (2d) 385, 33 E.T.R. 1, 58 D.L.R. (4th) 375, 33 O.A.C. 99 (C.A.).

26 *Canada Trust Co. v. Ontario Human Rights Commission* (1990), 74 O.R. (2d) 481, 38 E.T.R. 1, 12 C.H.R.R. D/184, 69 D.L.R. (4th) 321, 37 O.A.C. 191 (C.A.).

(ii) the objects or purposes must be charitable according to s. 7 of the *Charities Accounting Act* as interpreted and applied by the courts; and
(iii) the objects or purposes must promote a public benefit of a nature recognized by the courts as a public benefit.

The client must therefore understand that a mixture of charitable and business purposes, unless the business purposes are directly related to fulfilling the charitable purposes, will not be acceptable.

In relation to the requirement of charitable purposes, s. 7 of the *Charities Accounting Act* provides that:

> "charitable purposes" means,
> (a) the relief of poverty,
> (b) education,
> (c) the advancement of religion, and
> (d) any purpose beneficial to the community, not falling under clause (a), (b) or (c).

Whether or not a charitable purpose will meet any one of the four general heads for a charitable purpose is the subject-matter of much case law and commentary, but suffice it to say that just because a client wishes to advance, for instance, educating the public concerning a particular philosophy, does not necessarily make it a charitable purpose.

Even if the proposed purpose of the client fulfils qualification number (i) and (ii) as outlined by the Court of Appeal of Ontario above, the object or purpose must still promote a public benefit. The Public Guardian and Trustee of Ontario takes the position that two issues have to be satisfied to meet this requirement:

(i) Do the objects or purposes promote a benefit recognized by the courts as a public benefit?; and
(ii) Is the benefit to the public or to a sufficiently appreciable portion of the public?[27]

As a result, even if the client wishes to establish an organization as a charity, the purpose proposed by the client may not fulfil the legal definition of what constitutes a charity at law. This is particularly important to identify with your charitable client early, since there is a general misunderstanding that "a not-for-profit organization" is synonymous with a "charity". As a result, the client needs to understand how restricted the definition of a charity is compared to non-profit organizations.

(b) Does the Client Understand the Consequences of Obtaining Charitable Status?

For those charitable clients that intend to operate organizations which are charitable at law, it is important to ensure that the client understands the negative

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[27] Eric Moore, "Charitable Registration and Status" in *Fundamentals of Not-For-Profit Organizations and Charities* (Toronto: The Law Society of Upper Canada, Department of Continuing Legal Education, 1995), Tab H at 203.

consequences that are associated with establishing a charity. For instance, a client may only be focusing on the benefits to be obtained from charitable status with Revenue Canada under s. 149.1 of the *Income Tax Act*, including the right to issue receipts for charitable donations in addition to the ability to operate as a nontaxable entity. The lawyer will therefore want to explain to the client that establishing a charity, whether or not it is registered with Revenue Canada, carries with it a number of onerous obligations and restrictions. For instance, the client should understand the following:

(i) Property or funds which the client may be intending to give to the charity, or which is subsequently acquired by the charity in future years, is charitable property and cannot be distributed to the members of the charity upon dissolution. This is particularly important for small religious charities where the founder or founding members may be intending to donate their own personal property, including real estate, to the charity to initially establish it, for instance, as a retreat centre or the like. As such, if the client is expecting to eventually receive the property back, then the organization should be structured as a not-for-profit organization as opposed to a charity, or alternatively, the property in question should be leased or sold for a reasonable price to the charity instead of having it gifted in return for a charitable receipt.

(ii) Even if the client does not intend for whatever reason to immediately apply for charitable status with Revenue Canada, but its purpose is charitable at law, or if an existing charity has been operating for years using the charitable registration number of an associated charity and has not yet obtained its own charitable status, the client needs to understand that all the property owned by the charity is in fact charitable assets and as such cannot be distributed back to the members of the charity either on dissolution or while the charity is operating.

(iii) Charitable status imposes significant higher trustee-like responsibilities and duties upon individuals who direct the operations of the charity than would not otherwise be applicable if the organization was established as a not-for-profit organization only.

(iv) Even if the new organization is not intending to pursue charitable purposes itself, and therefore does not intend to become a registered charity, if the proposed organization will be involved in raising funds from the public to be transferred to a charitable organization, then the organization will still be subject to provincial charities legislation, such as the *Charities Accounting Act* and *Charitable Gifts Act*,[28] as the organization will be holding property for charitable purposes.

Normally, such an organization should be constituted as a charitable foundation and registered as such under s. 149.1 of the *Income Tax Act*. In this regard, those organizations which run into difficulties in obtaining approval for incorporation in Ontario from the Public Guardian and Trustee to establish a foundation based upon the objection that the raising of charitable funds is not a charitable purpose, an alternative would be to create a charitable trust or incorporate federally under the *Canada Corporations Act*, neither of which would require the pre-approval of the Public Guardian and Trustee.

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28 R.S.O. 1990, c. C.8.

(c) Some Fund Raising may not Require Charitable Status

Before deciding to create a charitable organization, to obtain registered charitable status from Revenue Canada, the client should determine whether or not the source of funds being raised to operate the charity requires that charitable receipts be issued. There may in fact be a number of sources of funds that an organization could look to that will not require that charitable receipts be issued. For instance:

(i) in situations where funds are primarily sought from a government source, such as from federal, provincial or municipal governments (although the wisdom of exclusively relying upon government sources of income is neither realistic nor good planning for the future); or
(ii) in situations where the source of funds primarily comes from businesses that can deduct the contribution as business expenses without requiring a charitable donation receipt.

(d) Can a Charitable Purpose be Accomplished without Creating a New Charity?

Another question to discuss with a client considering establishing a new charity is whether or not the charitable purposes that are proposed can be accomplished without actually having to create a new charity. Some options in this regard are as follows:

(i) A determination should be made concerning whether or not there is an existing charity that the individuals wishing to establish a new charity can either work in conjunction with or under the authority of. This is a particularly useful option with regard to a small community charitable program that does not justify the aggravation involved in having multiple registered charities doing similar activities in the same community. This option requires a careful review of the charitable objects of the existing charity to ensure that they were broad enough to include the charitable purpose that the client is contemplating pursuing. If the charitable purposes are not broad enough, then this option cannot be adopted unless the client is able to commit itself to the stated charitable purposes of the existing charity.
(ii) If the proposed charitable purpose has a short lifespan, it might be worthwhile to determine if there is an existing charity which has charitable objects that could encompass the proposed activity. If so, then the client might be appointed as an agent on behalf of the existing charity to carry on a specific project. The requirements for a signed agency agreement with terms satisfactory to Revenue Canada is a clear pre-condition of such an arrangement. The cost, though, of entering into an agency agreement and complying with the terms thereof is a great deal less than having to establish a charitable corporation or charitable trust and obtaining and maintaining charitable status with Revenue Canada.

(2) The Need to Assemble Key Organizational and Legal Documents[29]

To accomplish an effective review of legal risks faced by a charity requires that the charitable client provide the lawyer with copies of all key legal and organizational documents. In addition, it is equally important for the charity itself to identify and create an inventory of such documents. For instance, a charity would need to provide the lawyer with a copy of its trust document if it is established as a charitable trust, or its constitution if it is an unincorporated association, or its letters patent and by-laws if the charity is a corporation, together with copies of all amendments to those documents. In addition, a copy of the mission statement, if applicable, should be produced.

An incorporated charity would also need to produce its complete minute books containing the letters patent, the supplementary letters patent, and the list of all directors' and members' resolutions together with the register of directors, officers, members and copies of all government filings. With most existing charities, the minute book is in a state of disarray, assuming that it can even be located, and, as a result, it is advisable to obtain a historical corporate file search to produce a copy from the microfiche of government records of all documents filed with either the provincial or the federal government as applicable, together with confirmation that the corporate charity has not been dissolved. The historic corporate file search will often show deficiencies in failure to file the necessary corporate documents to record change in head office, change in number of directors, and change in names and addresses of the directors and officers.

For both incorporated and unincorporated charities, the client should also provide the lawyer with copies of other key legal documents, such as deeds, mortgages, leases, agency agreements, licence agreements, trade-mark registrations, business name registrations, as well as a copy of the charitable registration with Revenue Canada.

(3) Review of Letters Patent

(a) Corporate Name

More often than not, the name contained in the letters patent for a corporate charity does not correspond with the actual name that is being used by the charity. Often the name used is a shortened version of the full name of the organization. Sometimes an essential part of the name, such as a geographic designation, *i.e.*, "of Toronto" is left out, or, on occasion, the name is altogether different from the name in the letters patent due to failure of the board or the executive staff, at the time of a name change, to apply for supplementary letters patent.

The charitable client needs to be advised that the full corporate name of the charity should be used on all documentation, letterheads, receipts, contracts, signs, *etc.*, to ensure that liability protection for its members is not put in jeopardy. For those charities that operate under various business names, those business names must be registered under the *Business Names Act*,[30] and renewed every five years there-

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29 See Section 3 of the checklist.

30 R.S.O. 1990, c. B.17.

after, with a clear association shown on all documentation between the business name and the full corporate name of the charity.

For those charities that wish to rectify the confusion between the existing corporate name and the actual functional name of the charity, the lawyer should review with the client the process involved in applying for supplementary letters patent. This is discussed in more detail later in this paper.

(b) Charitable Objects

The most important document to review with a client is the objects clause in its letters patent. What the client needs to understand is that the statement of the charitable purposes in the object clause constitutes what is equivalent to the "DNA" of the charity. It is the key foundational statement of charitable purposes upon which everything else that the charity does is based. However, very few charities regularly review their objects clause, and even fewer circulate a copy of the objects clause in their letters patent to new members of the board or officers. In fact, many charities do not even know where to find a copy of their letters patent, let alone be familiar with its contents.

The first determination to be made in reviewing the objects clause of a letters patent and supplementary letters patent, if applicable, is whether or not they constitute exclusively charitable objects. It is not unusual to find an existing registered charity with Revenue Canada whose objects are in fact not exclusively charitable at law. This may have occurred because the charity obtained registered status under grandfathering provisions when charitable registration came into effect in 1967, or they were incorporated prior to the current review process now required by the Public Guardian and Trustee in exercising their *parens patriae* jurisdiction. For charities in this last category, they will need to be careful before applying for supplementary letters patent, as they may find that either the Public Guardian and Trustee or Revenue Canada will require amendments be made to its charitable purposes to bring the existing objects in line with an acceptable definition of charitable purposes at law.

A key matter to bring to the attention of a client is to explain the concept of *ultra vires* and how it applies to the objects of a charity. Notwithstanding that s. 274 of the Ontario *Corporations Act*, and s. 15 of the *Canada Corporations Act*, state that a non-share capital corporation has all the capacity of a natural person unless limited by the Act or by its letters patent, the concept of *ultra vires* (*i.e.* beyond its corporate powers) still has application to a charitable corporation.

The most practical way of communicating this concept to a charitable client is to explain that though the corporation has the power to do anything that a natural person can, its powers must be exercised only in fulfilling its charitable purposes. This has been succinctly commented on by Maurice Cullity, Q.C. in his paper, "The Myth of Charitable Activities" as follows:

> It is submitted . . . that, except where the propriety of political activities is in issue, the only question in cases of charitable corporations with the powers of a natural person should be whether the acts of the body and its directors are reasonable and prudent methods of advancing its objects. Only confusion will be engendered if the question is not framed in that manner and, instead, the inquiry is directed at the charitable or non-charitable nature of particular activities.[31]

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31 Maurice C. Cullity, Q.C., "The Myth of Charitable Activities" (1990-91), 10 E. & T.J. 7 at 24.

An example of where the courts have found activities of a charitable corporation to be *ultra vires* notwithstanding the corporation's capacity as a natural person was in the case of *Stanishewski v. Tkachuk*,[32] which arose out of a dispute between two religious factions of a non-share corporation created for the purpose of promoting the culture, education and Canadian citizenship amongst Ukrainian people. The dispute resulted in the conveyance of the real and personal property of the corporation to a new congregation to which the majority of the members adhered. The court found that the conveyance did not further the purposes of the corporation in promoting culture, education and Canadian citizenship amongst Ukrainian people in a particular town, and as such it was found by the court to be *ultra vires* its corporate powers, since the objects of the corporation did not include pursuing any particular religious objectives.

As a result, it is important that the lawyer determine whether or not all of the activities that the charity is involved with can reasonably be considered to be furthering the charitable objects of the charity as stated in its letters patent. If they do not, then the client should be advised that such activities are *ultra vires* the corporate authority of the charity, and as such, may leave the directors and officers of the charity personally liable for any indebtedness or liability flowing from such *ultra vires* activities. If the charitable client still wishes to pursue activities that are not contemplated by the charitable purposes, then the client should be advised to consider obtaining supplementary letters patent to expand its charitable purposes.

(c) Power Clauses

Power clauses are often added to an application for letters patent to reiterate and possibly limit the statutory powers provided for non-share capital corporations. However, often in an effort to be complete, the lawyer who drafted the application for letters patent, particularly for an Ontario corporation, may have included clauses suggested by the *Not-for-Profit Incorporators Handbook*[33] without realizing that some of those clauses may not only be unnecessary but their inclusion may very well unnecessarily limit the corporate authority of the charity. For instance:

(i) The letters patent might include a power clause that states "provided further that the corporation shall not have the capacity of a natural person". Why a lawyer would want to include such a provision in the letters patent is not clear. However, where it has been included, it would have the effect of severely limiting not only the charitable purposes that the corporation can pursue, but also the means by which the corporation can pursue those purposes, since the corporation would be restricted to only the powers stated either in its letters patent or in the *Corporations Act*.

(ii) The letters patent might also include a power to invest clause that states, "to invest funds of the corporation in such manner as the director may determine in those investments authorized by law for trustees". Again, why a lawyer would want specifically to restrict the investments of the charitable corporation to

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32 [1955] O.R. 667, [1955] 4 D.L.R. 517 (H.C.).

33 Office of the Public Guardian and Trustee and the Ministry of Consumer and Commercial Relations of the Province of Ontario, *Not-for-Profit Incorporators Handbook* (Toronto: Queen's Printer, 1993).

those provided for under the *Trustee Act* is not clear, since such a provision reflects the law, whether or not it is stated in the letters patent. However, such a provision is often included as a matter of course in letters patent even though it is not a requirement of the Public Guardian and Trustee and even though an alternative broader investment clause could have been included. The charitable client is therefore often surprised to find out that any investment that the charity has made that is not in compliance with the severe restrictions contained in the *Trustee Act* is *ultra vires* the powers of the corporation and may leave the directors and officers of the charity personally liable for any loss resulting from such investment.

(d) Other Clauses

In reviewing the letters patent of an Ontario non-share corporation, a determination should be made concerning whether or not the board of directors of the charity is functioning as a rotating board. If so, then the Ontario *Corporations Act* requires that authorization for a rotating board must be contained within the letters patent or supplementary letters patent of the corporation. Authorization for a rotating board is often missing from the letters patent of Ontario non-share capital corporations and could have the effect of putting the election of the current board of directors in question.

(4) Supplementary Letters Patent[34]

For those charitable clients that find the charitable purposes in the objects portion of the letters patent too restrictive, or that there are unnecessary restrictions in the power clauses of the letters patent, consideration should be given to applying for supplementary letters patent to either expand, alter or amend the current wording of the letters patent of a charity. However, the charitable client should be advised that there are problems in applying for supplementary letters patent in addition to the technical matters involved with the application and its formal submission. These problems can be summarized as follows:

(a) If the charity is an Ontario corporation, then the application for supplementary letters patent will first have to receive the approval of the Public Guardian and Trustee before being processed by the Ministry of Consumer and Commercial Relations. If the charitable purposes stated in the existing objects clause of the letters patent is not exclusively charitable, then the Public Guardian and Trustee may require that the objects be restated so that they are exclusively charitable at law.

(b) Restated charitable objects will also have to be approved by Revenue Canada. In this regard, it is prudent to obtain pre-approval from Revenue Canada prior to making a formal application for supplementary letters patent either provincially or federally.

(c) If the newly stated objects consist of a significant change in charitable objects, then the charitable property held at the time of the application for supplementary letters patent may need to be held and used in accordance with its

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34 See Section 5 of checklist.

prior charitable purposes.[35] In this regard, an application for supplementary letters patent to change the charitable purposes may require the inclusion of a provision that the property of the charity "at the date of issuance of supplementary letters patent shall not be applied except towards the objects of the charity immediately before the issuance of the supplementary letters patent".[36]

For those charities that do want to use their charitable property at the date of application for supplementary letters patent in furtherance of newly expanded charitable objects contained in the supplementary letters patent, it may be necessary to make a *cy près* application to obtain the necessary court approval.[37]

(d) Supplementary letters patent may also be required to establish a rotating board of directors or expand the investment restrictions in the power clause of the letters patent, whether or not an application for supplementary letters patent is already being made to amend or alter the charitable purposes in the objects clause. In this regard, it is important to review with the charitable client all provisions in the letters patent that should be amended at the same time that an application is already proceeding to avoid the necessity of making an additional application for supplementary letters patent at a later time.

(e) In the event that the client instructs the lawyer to apply for supplementary letters patent to change the name of the charity, consideration should be given to whether or not the proposed new name is misleading when compared with its charitable purposes and whether or not the existing supporters of the charity will be left perplexed concerning the new name. In this regard, once supplementary letters patent changing the name of the charity have been issued, the charitable client should be advised to write to all supporters and interested persons involved with the charity to ensure that they are aware of the new name of the charity in relation to sending future donations or including legacies in their wills.

Donors who may have already made their will leaving a gift to the charity under its former name should be encouraged to amend their wills to ensure that the gift is directed to the charity under its new corporate name. This is particularly important when the charity also changes its objects, otherwise a question may arise at the time of distribution of the gift from the estate concerning whether or not a *cy près* court application will need to be applied for to determine whether the testator intended the gift to be used by the charity to reflect its new charitable purposes.

(5) Review of Corporate By-Laws[38]

While it is beyond the scope of this paper to discuss all of the problems that can be encountered with incomplete or incorrect corporate by-laws, the following are examples of some of the more obvious deficiencies that are often found.

(a) If the charitable objects are repeated in the general operating by-law, are the objects an accurate reflection of those contained in the letters patent?

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35 Spencer G. Morris and David B. Parker, *Tudor on Charities*, 7th ed. (London: Sweet and Maxwell, 1984), at 413-14.

36 Moore, *supra*, note 27 at H-217.

37 *Ibid.*, at H-217; see also William I. Innes, "Liability of Directors and Officers of Charitable and Non-Profit Corporations" (1993), 13 E. & T.J. 151, at 164.

38 See Section 5 of the checklist.

(b) If the general operating by-law contains a mission statement, is the mission statement consistent with the charitable purposes as stated in the letters patent or does it contradict or confuse the stated charitable purposes?

(c) Does the general operating by-law provide for a variable size of the board of directors? If so, the client needs to understand that if the charity is an Ontario corporation, a variable size of board members is not permitted. Instead, a fixed number of board members must be established by special resolution, with a copy of such resolution being filed with the Ministry of Consumer and Commercial Relations and published in the Ontario Gazette in accordance with s. 285(1) of the Ontario *Corporations Act.*

(d) Do the by-laws reflect a rotating term for board members? If so, then if the charity is an Ontario corporation, the authority for a rotating board of directors must be included in either the letters patent, or if necessary in the supplementary letters patent in accordance with s. 287(5) of the Ontario *Corporations Act.*

(e) Does the general operating by-law provide for voting members to vote by proxy? If not, since s. 84(1) of the Ontario *Corporations Act* states that a member is to have a right of proxy, the charitable client should be advised that the by-law needs to be amended to include that right.

(f) Do the by-laws include an indemnification of directors and officers? If not, then an indemnification by-law should be adopted as soon as possible by the board and the members of the corporation. Further comments concerning the ability of the charitable corporation to pass an indemnification by-law with or without court approval is discussed later in this paper under the section dealing with insurance.

(g) Has the head office for the corporation changed from the location stated in the general operating by-law? If so, then the charitable client should be advised of the need to take the appropriate corporate steps to authorize and record a change of head office location, either by means of a by-law for a federal corporation or by special resolution published in the Ontario Gazette and filed with the Ministry of Consumer and Commercial Relations for an Ontario corporation.

With a charity that is utilizing either incomplete or defective by-laws, it may be more expedient to provide the charitable client with a draft of a comprehensive general operating by-law precedent together with a recommendation that to save costs, a first draft of the new general operating by-law reflecting the precedent be prepared by the client in accordance with the precedent provided by the lawyer on computer disk, subject to review and amendment by the lawyer as necessary.

(6) Incomplete Corporate Organization[39]

(a) Incomplete Corporate Records

In reviewing the corporate records of a charitable client, it is not unusual to find incomplete or missing corporate records. The first step is to identify what records are missing and then to encourage the client to organize the corporate records into multi-volume minute books, with the minutes in each volume being identified by volume number and page number, *i.e.*, "Vol. I, pg. 1."

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39 *Ibid.*

Often the charitable client may not even know where the minute book is, or if the client does, it may still be with the lawyer who originally incorporated the charity and nothing may have been added to the minute book from the time of the original incorporation. In such an event, the records that the client has maintained reflecting board and/or membership meetings will need to be co-ordinated chronologically and inserted in the proper place within the corporate minute book to avoid discrepancies between the official corporate records in the minute book and the functional records that the client is maintaining.

(b) Failure to Transfer Charitable Property on Incorporation

For those corporate charities that have at some time during their existence become incorporated after operating as either an unincorporated charitable organization or as a charitable trust, a careful review of the minute book needs to be done to determine whether there has ever been a proper transfer of charitable assets to the corporate charity together with a documented assumption of any outstanding debts of the unincorporated charity.

Failure to have proper documentation in place to record the transfer of assets and the assumption of liability could leave the charitable corporation in a state of confusion, with the charitable assets possibly still being held by the charity in its unincorporated state or by the trustees of the previous charitable trust, if applicable.

(c) Incomplete Membership Minutes

Even if a charitable corporation has maintained adequate minutes of board decisions, it is not unusual to find that the charitable client has failed to hold annual meetings of members or, if there have been annual meetings, to record those meetings in accordance with the requirements of either the Ontario *Corporations Act*, or the *Canada Corporations Act* as applicable. In this regard, with charitable clients that have a closed membership, *i.e.*, where the directors and members are virtually one and the same individuals, it is seldom that directors of these charities understand the importance of holding membership meetings in their capacity as corporate members in addition to holding regular board meetings.

Even if the charitable corporation does hold annual membership meetings, there is often failure to approve financial statements, elect directors as necessary, or appoint auditors as required by the applicable corporate statute.

(d) Remedial Action

After completing a review of the corporate records and identifying any deficiencies, the charitable client should be advised of the remedial steps that need to be taken to reconstruct the missing records and deal with any other deficiencies in the corporate organization. Since reconstruction of corporate records can be a very time consuming and expensive exercise, it often becomes an effective incentive for the charitable client to ensure that corporate records are maintained in the future.

(e) Establishing Policy Statements

In addition to ensuring that there are proper corporate records in place, in reviewing the records of a charitable client the lawyer should ensure that the charity is aware of the importance of establishing policy statements dealing with high risk areas, such as policies on avoiding sexual abuse of children, sexual harassment of employees, or ensuring appropriate supervision of counselling activities, if applicable.

In recognition of the increased litigation against charities arising out of sexual abuse of children, it is important that any charity that deals with children in any manner should establish and implement a policy statement on the protection of children from physical and sexual abuse. Such a statement should include amongst other things the following:

(i) a statement of intent to protect children;
(ii) a process for screening employees and all volunteers working with children;
(iii) a protocol setting forth the appropriate supervision of all employees and volunteers working with children;
(iv) guidelines for running regular educational programs for employees and volunteers on the topic of protecting children;
(v) an unequivocal statement of the importance of reporting child abuse in accordance with the statutory requirements of the *Child and Family Services Act*;[40] and
(vi) guidelines on maintaining confidentiality in the application process for employees and volunteers who apply to work with children, particularly as it relates to a check of police records as part of the screening process.

While adopting a policy statement on avoiding abuse of children will not necessarily result in every child that the charity comes in contact with being protected from molestation, it will at the very least establish that the board of directors of the charity exercised a measure of due diligence in taking preventative steps to reduce the possibility of children being molested or abused when brought in contact with individuals who are under the supervision of the charity. This is particularly important considering the comments later in this paper pertaining to the deficiency in insurance coverage for incidents involving sexual and physical abuse of children.

(7) Organizational Issues involving Religious Charities[41]

Since over 45 percent of all registered charities in Canada are religious organizations,[42] lawyers who advise charitable clients will probably at some time advise charitable clients that are operating a religious organization, whether it be a church, a synagogue, a temple, or a para-church organization. There are a number of legal issues that are unique to religious organizations.

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40 R.S.O. 1990, c. C.11.
41 See Section 6 of the checklist.
42 *Supra*, note 1.

(a) Constitutional Issues of Religious Charities

(i) *Documenting Statement of Faith*

For autonomous churches that are not part of a mainline hierarchical structure, the issue of whether the local congregation has a statement of faith and how it is documented is of primary importance. A statement of faith often constitutes an essential extension of the charitable purposes for which the church exists. If the church is either incorporated or contemplating incorporation, care should be taken to ensure that the statement of faith is contained within the letters patent or supplementary letters patent for the church so that it is clearly seen as part of the charitable purposes for the congregation and cannot be easily amended, and even then only with a two-thirds special resolution of members required for an amendment to the letters patent.

(ii) *Have Trustees been Appointed under the Religious Organizations' Lands Act?*

For those churches that are unincorporated and not subject to special acts providing for the holding of land in conjunction with a mainline denomination as is the case with the Anglican Church, a determination should be made concerning whether or not local trustees have been appointed under the provisions of the *Religious Organizations' Lands Act* ("R.O.L.A."),[43] whereby the church is authorized to own, sell, mortgage and lease land through trustees who do so on behalf of an unincorporated religious organization.

For those churches that do have trustees appointed to hold land on behalf of an unincorporated church, there is often confusion concerning the very limited role that trustees play on behalf of a church pursuant to the provisions of the R.O.L.A. In essence, the R.O.L.A. is nothing more than a conveyancing statute to facilitate the owning of land by trustees in perpetuity on behalf of local congregations. The original form of the R.O.L.A. was adopted in 1828 at the request of "dissenting churches", *i.e.*, churches other than the Anglican Church, and was known originally as *An Act for the Relief of the Religious Societies Therein Mentioned*.[44]

Notwithstanding the limited purpose of the R.O.L.A., there are often attempts to extend its authority beyond that of conveyancing matters. For instance, in the recent decision of *Belding v. Carlton Baptist Church*,[45] a presiding Small Claims Court judge found that a decision by the trustees of an unincorporated church to dismiss a minister lacked authority because there was no authorizing resolution of the members which he felt was required under the provisions of the R.O.L.A. As such, the judge found that the minister in question had been wrongfully dismissed. What the judge failed to understand is that the authority given to trustees of an unincorporated

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43 R.S.O. 1990, c. R.23.

44 1828, 9 Geo. 4, c. 2. For a more complete discussion of the history of the R.O.L.A. and its serious deficiencies, see Terrance S. Carter, "To Be or Not to Be: Incorporation Issues for Charities with an Emphasis on Autonomous Churches" in *Fit to Be Tithed: Risks and Rewards for Charities and Churches*, (Toronto: Department of Continuing Legal Education, Law Society of Upper Canada, 1994).

45 Unreported, September 22, 1995, St. Thomas 609/94 (Ont. Small Cl. Ct.).

ch under the R.O.L.A. is statutorily limited to only acquiring, selling, leasing and tgaging land on behalf of an unincorporated religious organization and has noth- to do with the hiring and/or firing of employees, or any other matter pertaining to : operations of an unincorporated church.[46]

(iii) *Do Trustees Understand their Responsibilities and Exposure to Liability?*

For those churches that are unincorporated, the trustees who are appointed under the R.O.L.A. to own the land and buildings of the church on behalf of the congregation generally have little idea of risks that they may be exposed to. Since trustees often do not hold positions of power within a congregation, they experience the worst of both situations, *i.e.* no authority to ensure that liability exposure does not occur, but if problems do occur, then the trustees may face more exposure to those risks than would the general members of the congregation.

A full discussion of liability issues of trustees under the R.O.L.A. is beyond the scope of this paper.[47] However, it is often surprising for clients to find out how extensive the application of the R.O.L.A. is to landholding by churches in Ontario. For instance, trustees appointed by local congregations of the United Church of Canada generally hold their property subject to the provisions of the R.O.L.A.[48]

(iv) *Should an Unincorporated Church Become Incorporated?*

In consideration of increasing liability risks involved in church operations and the corresponding decrease in respect for religious institutions by society in general, a church client that is unincorporated should be given an opportunity to review the pros and cons of proceeding with incorporation. In brief, the advantages of church incorporation can be summarized as follows:

1. There is limited liability protection for members of an incorporated church, *i.e.*, church members cannot be sued or held liable for the debts or legal liability of the church corporation.
2. An incorporated church has perpetual existence and therefore is not dependent upon individuals as either trustees or members to maintain its legal status.
3. The requirement that a church corporation be established according to rules of corporate organization means that a church corporation will generally have a more complete constitution to regulate church operations than an unincorporated church.

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46 *Ibid.*

47 For further discussion of this topic, see Terrance S. Carter, *supra*, note 44, at 18-20.

48 See an unpublished outline prepared for the United Church of Canada entitled "Overview, Duties and Liabilities of Trustees, Church Leaders and Members" by Terrance S. Carter (November 18, 1995). See also a revised article and precedent concerning the incorporation of churches by Terrance S. Carter, "To Be or Not to Be, Incorporation of Autonomous Churches" (January 15, 1995, updated as of November 17, 1995), Canadian Council of Christian Charities, Elmira, Ont.

4. A church corporation can maintain and defend legal action in the name of the corporate entity without having to involve either trustees or members of the church.
5. A church corporation can own, mortgage and lease land and all other assets in its own name without having to rely upon trustees to do so on behalf of the congregation.
6. The numerous limitations and anachronisms of the R.O.L.A. reflecting the 19th century origins of the legislation would not apply to a church corporation. For instance, a church corporation could mortgage its lands for purposes of establishing a line of credit, which is not permitted under the R.O.L.A.
7. Insurance obtained by a church corporation is in the name of the corporate entity. As such, if a member or officer of the church became injured, it is possible that recovery for that individual could be obtained from the church's insurance policy, depending upon the wording of the policy, whereas such a result may not be available with insurance involving an unincorporated church where the injured trustees and/or officers are included as named insureds.

The corresponding disadvantages of church incorporation can be summarized as follows:

1. The incorporation of a church is more costly than organizing an unincorporated church, since legal counsel should be retained and the requisite incorporation fees have to be paid, together with paying for a minute book, corporate seal and name search.
2. Requisite corporate filings, special resolutions, by-laws, and notices as necessary need to be done whenever there are corporate changes, such as changes of directors, officers, head office or by-laws.
3. Proper corporate minutes of meetings of members and directors of the church corporation must be maintained.
4. The drafting of a corporate by-law that both meets statutory requirements as well as reflecting the personality of the church is often a difficult process.
5. The benefit of being able to lease surplus land for up to 40 years pursuant to the R.O.L.A. is not available for an incorporated church.[49]

(v) *Poorly Drafted Church By-Laws*

More often than not, when a church incorporates, the general operating by-law which is adopted, assuming that one has been, reflects "boiler plate" corporate provisions that have nothing to do with how the church in fact operates. In such a situation, the congregation will often revert to using the church constitution that was in place prior to incorporation, or alternatively will take a copy of the pre-incorporation constitution, attach it to a one page by-law, and attempt to incorporate the church constitution by reference into the by-laws of the incorporated church. In either situation, the church is faced with a "split personality", in that it has a corporate document by which the church corporation is supposed to legally function that has no correlation to how the congregation actually operates. This dichotomy can

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[49] For the fuller discussion of the incorporation of a church, see *supra*, note 44.

result in confusion at best and potential for church splits and legal action at worst. This is particularly evident when one group within the church obtains control of the corporation by virtue of being the directors of the church corporation pursuant to the formal corporate by-law, whereas the congregation as a whole functions under the control of deacons or elders appointed or elected by the congregation pursuant to the pre-incorporation constitution.

What is required in such a situation is to ensure that the general operating by-law for a church corporation is drafted to reflect the personality and needs of the congregation. This will ensure that the by-law is "user friendly" for the congregation instead of being simply a formal corporate by-law that is irrelevant to the church. Needless to say, this takes a great deal of time and effort in working with the church client to ensure that the end product is a general operating by-law which, in conjunction with the letters patent, will collectively constitute a practical and usable church constitution for the congregation as a whole.

Even where the church intends to adopt a general operating by-law which reflects the needs of the congregation, poor records kept by the congregation can result in uncertainty concerning which version of the various drafts of the general operating by-law was adopted by the congregation. This problem was identified by the Ontario Court of Appeal in the recent decision of *Mount Hamilton Christian Reformed Church v. Sikkema*[50] where the court, in attempting to resolve a dispute amongst factions of the congregation concerning ordination of women, pointed out that the church congregation established in 1952 had two completely different sets of by-laws, each of which had been marked "By-law No. 1". Since the provisions in each by-law regarding membership were different, and since neither by-law was signed, nor was there any evidence concerning which by-law had been passed, the Court of Appeal could not rule on the issue before it concerning what percentage vote was required to dissolve the church corporation. This case evidences the difficulties that can be encountered with a church where there are poor corporate records and/or a poorly drafted general operating by-law.

As such, a lawyer advising a religious organization should take the opportunity of reviewing the general operating by-law to determine whether or not it was ever properly passed, whether there are any conflicting by-laws in place or any amendments thereto, and whether or not the provisions of the general operating by-law truly reflect how the church in fact governs itself. If not, the congregation would be well advised to adopt a new general operating by-law. This would be done by the lawyer providing the client with a precedent on a computer disk so that the church could make initial modifications to the precedent on its own before having to have it reviewed in detail by the lawyer.

(b) Policy Statements for Religious Charities

Of all the charities that need to have effective policy statements in place to protect children from physical and sexual abuse, religious clients are the most obvious considering the flood of law suits involving religious organizations in the past decade. However, for churches that are not part of a hierarchical denomination, there is often no policy statement in place to protect children and, if there is one, it may be

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50 [1995] O.J. No. 1568 (QL) (Gen. Div).

deficient because it does not provide for an adequate screening process of employees and volunteers, including conducting a criminal records check. As a result, a lawyer acting for a religious charity should emphasize the importance of establishing an effective policy statement on protecting children.

In addition, if the religious charity has lifestyle expectations for employees, members, and volunteers that could form the basis of dismissal or discipline, it is essential that those expectations be clearly set out in a policy statement that is brought to the attention of and agreed to by the employee, member or volunteer at the time they become involved with the religious charity.

As well, the lawyer should advise the religious charity to ensure that its process of adopting a policy statement on important issues, such as avoiding abuse of children and/or lifestyle expectations, is adopted so that the policy statements are deemed to be part of the constitutional documentation of the charity. Otherwise, the individual being dismissed or removed might challenge the authority of the religious organization to assert that the relevant policy statement is a binding document.

(c) Church Discipline

In reviewing the constitution for an unincorporated congregation or the by-laws for an incorporated church, it is important to determine if such organizational documents reflect a comprehensive code dealing with discipline of members that embodies principles of natural justice as articulated by the Supreme Court of Canada in the recent decision of *Lakeside Colony of Hutterian Brethren v. Hofer*.[51]

In addition, in structuring constitutional provisions dealing with the grounds and the process for church discipline, it is important that the church ensure that it has jurisdiction over the individual in question as a church member and that the individual has agreed to be subject to the authority of the church. Unless there is clear evidence of the consent of the individual when he or she became a member to be under the authority of the church, it is highly unlikely that the church will be able to exercise any discipline over that individual at all.[52]

In addition, in accordance with the desire of both the local congregation and society at large, church constitutions should include mechanisms to effect alternative dispute resolutions. Such mechanisms will ensure that disputes between members and the church do not degenerate into legal actions brought before a court.[53]

(d) Ministers and Controlling Board of Churches

In reviewing the constitution of an unincorporated church or the general operating by-law of an incorporated church, care should be taken to ensure that the

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[51] [1992] 3 S.C.R. 165, [1993] 1 W.W.R. 113, 97 D.L.R. (4th) 17, 81 Man. R. (2d) 1, 142 N.R. 241, 30 W.A.C. 1.

[52] See the articles on church discipline attached as an appendix to the paper prepared by Terrance S. Carter, *supra*, note 44.

[53] For a sample of an alternative dispute resolution mechanism, see precedent material for a Church Constitution of an Incorporated Church by Terrance S. Carter (November 17, 1995), Canadian Council of Christian Charities, Elmira, Ont.

minister is not put into a conflict of interest by being a member of the controlling board of the church while at the same time receiving a salary or some other form of remuneration from the church. In accordance with the series of cases in Ontario starting with *Public Trustee v. Toronto Humane Society*,[54] for those churches that want to have their minister on the controlling board of the church, the church client needs to be advised of the different alternatives available which include:

(i) establishing a single board structure without the minister being a member, but ensuring that the minister is given the right to attend and participate at board meetings;
(ii) creating a dual board structure for the church with one board dealing only with spiritual matters on which the minister could be a member and the other board dealing only with administrative matters on which the minister would not be a member but would be entitled to attend and participate on; or
(iii) obtain a court order to permit the minister to receive a salary while remaining as a member of the church board.[55]

(8) Utilizing Multiple Charitable Corporations[56]

While it is also beyond the scope of this paper, in reviewing the organization and activities of a charity, the lawyer should be aware that a charitable client may need to give consideration to the possibility of utilizing multiple charitable corporations. Without discussing this topic in any detail, there are generally two reasons for suggesting the establishment of multiple charitable corporations. They are summarized as follows:

(a) The creation of a separate charitable corporation to carry on existing high risk activity to contain such risks within the new corporate entity and away from the assets of the operating charity.

(b) The creation of a parallel foundation to develop an endowment program and possibly act as a holding corporation for major operational assets to protect them from liabilities associated with the activities of the operating charity.

In reviewing the advisability of establishing an additional charitable corporation, consideration should be given at an early stage to the structure of the new charitable corporation and in particular how the operating charity will exercise indirect control over the new charitable corporation. Unless the charitable client can be assured that there will be some measure of control in place, the client will not want to go through the complexities and expense of establishing a separate charitable corporation no matter how much of a liability reduction there may be.

For a fuller discussion of the issues involved in establishing a charitable corporation associated with a main charity, particularly as it relates to establishing and controlling a parallel foundation, reference should be made to the articles by Jane Burke-Robertson on establishing a parallel foundation.[57] Control over a separate

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54 *Supra*, note 16.

55 See the articles by the author on the remuneration of directors, and in particular the letter from the Public Trustee of Ontario on this issue contained as an appendix to the paper prepared for the Law Society of Upper Canada, *supra*, note 44.

56 See Section 7 of the checklist.

charitable corporation can also be established by setting out qualification requirements for both members and directors of the associated charitable corporation requiring those individuals to first obtain and then maintain the written consent of the board of directors of the main operating charity.

(9) Identifying Key Insurance Considerations for a Charity[58]

Too often lawyers in advising charities omit to make any reference to the importance of reviewing and upgrading the insurance held by the charity. However, since the insurance policy is normally the first line of defence for a charity and its board of directors in the event of legal action, it is important for the lawyer to conduct a basic review of what insurance coverage the charity has or does not have and what steps are necessary to upgrade the coverage.

Without discussing the matter in any detail other than on a cursory basis, the following matters should, as a minimum, be brought to the attention of a charitable client.

(a) Review and Enhancing General Liability Coverage

The client often will not understand the difference between occurrence coverage and claims-made coverage and the consequences that such difference can have on the charity and its board of directors in future years. An occurrence policy means that the insurance coverage that is acquired in 1996 will be the policy called upon to provide protection for claims arising out of an occurrence in 1996 no matter when the claim is actually made. Since an action for abuse, particularly sexual molestation and abuse of a child, may not occur for many years in the future, the charitable client needs to understand that the amount of coverage that is obtained through their insurance policy today will be the maximum amount of coverage that will be available to the charity and its board of directors when a claim arises 5, 10 or 15 years from now.

Since a future claim will invariably reflect the higher court awards then in effect, the charitable client needs to understand that the decision on how much general liability coverage is obtained today will need to provide sufficient protection for court awards that may not be made for many years. As a result, the board of a charitable client should be advised to consider the maximum amount of general liability coverage that is available and appropriate in the circumstances, given the level of risk that the charity is exposed to, the budget of the charity, and the coverage available from insurance companies in general.

Given the escalating court awards and the increasing number of legal actions involving charities, the level of insurance coverage that is available is constantly eroding, so much so that the issue is not whether affordable general liability insur-

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57 Jane Burke-Robertson, "Parallel Foundations" in *Fit to Be Tithed: Risks and Rewards for Charities and Churches* (Department of Continuing Legal Education, Law Society of Upper Canada, 1994); "Establishing a Parallel Foundation: Why? Why not? How?" (1995), 13(2) The Philanthropist 3.

58 See Section 10 of the checklist.

ance coverage is available, but whether or not the relevant risks can be insured against at all.

As a result, more and more insurance companies are including an exclusion for sexual abuse and molestation of children and/or an exclusion for mental anguish and distress. Either exclusion would have the effect of leaving the charity and its board of directors exposed to multi-million dollar claims. Most charitable clients are surprised to learn that they may not have coverage for sexual or physical abuse of children. As a result, they should be encouraged to seek out insurance coverage that will provide them with some level of protection for this important and all too prevalent risk.

In addition, since there are so many exclusions and/or optional endorsements that apply to general liability coverage involving charities, the charitable client should be advised to obtain a written and signed report from their insurance broker on an annual basis which explains the coverage that is in place, what risks are not covered, and what recommendations the insurance broker would make to upgrade the coverage provided. This report should then be reviewed with legal counsel to identify the level of risk that is acceptable and whether or not the coverage being offered by the broker is appropriate. This invariably involves a summary review of the insurance policy. A lawyer dealing with a charitable client on a regular basis may want to consider developing an inventory of insurance policies from major insurers of charities.

A charity also needs to be aware of the importance of advising their insurance broker in writing whenever there is a change in insurable risks, particularly as it relates to special events involving third parties that may not have their own insurance coverage. In a similar vein, at the outset of obtaining a new insurance policy, a summary of all areas of activities and potential risks should be set out in a written report given to the insurance broker and acknowledged in writing. The purpose in doing so is to lessen the possibility of a future denial of coverage by the insurance company for an alleged failure to disclose a material risk.

(b) Maintaining Historical Record of Insurance Coverage

In consideration that general liability insurance is generally on an occurrence as opposed to claims-made basis, it is important for the lawyer to advise the charitable client to maintain a historical record of all insurance policies, as well as a record of all insurance brokers. While this will be relatively easy to establish for future years, it will often prove a daunting task to reconstruct these records for past years and even decades.

However, it is clearly better to start the process now before a claim is made so that the charity will generally know what insurance company provided coverage and whether or not that company is still in existence. The importance of developing historical records can be impressed upon a client by explaining that unless the insurance policy can be found or the name of the insurance company identified, then there may be no insurance coverage to rely on in the event of a future claim arising out of a past occurrence.

(c) Securing Directors' and Officers' Liability Coverage

The number of charities that are securing directors' and officers' liability coverage is increasing, although many charitable clients do not understand the reason for having such coverage. Since a general liability policy will not protect a director or officer in relation to wrongful acts, such as wrongful dismissal, it is important for a charity that is involved in activities that may expose a director or officer to personal liability to seriously consider obtaining a separate policy for its directors and officers and ensuring that the policy is properly worded to include former directors and officers and is an amount similar to the coverage provided for under the general liability policy.

As with other forms of insurance coverage, the insurance broker should be asked to provide a written report on the coverage provided under the directors' and officers' policy, what is not covered, and what recommendations the insurance broker would make to enhance the policy, and possibly obtain coverage through an insurance company separate from the company providing coverage under the general liability policy.

For those charities that do not have coverage for directors and officers or cannot obtain such insurance, it would be prudent for the lawyer to advise the board of directors in writing of the exposure to personal liability that they face and to recommend that they seek coverage under their own homeowners policy, if available, or speak with their own legal counsel concerning what response, if any, the director should make as a result of being a member of a board of a charity that does not provide directors' and officers' coverage.

(d) Paying for Directors' and Officers' Coverage

Some controversy has recently developed concerning whether or not a charity can expend charitable moneys on the acquisition of director and officer liability insurance without first obtaining a court order. The author's understanding of the position of the Public Guardian and Trustee of Ontario is that since a director of a charity is not entitled to receive any remuneration or benefit from the charity without court approval, and since the placement of directors' and officers' insurance would provide a benefit to a director in the event that a claim was made, then before charitable moneys can be used to purchase director and officer liability insurance, court approval would have to be obtained. It is unlikely, though, that the Public Guardian and Trustee's office would bother to require court approval in the event that a policy was purchased in consideration of the relatively small amount of money required to purchase a policy compared to the costs of enforcement proceedings brought by their office.

While the issue has gained some recent public attention, the matter has already been addressed in earlier papers by other legal commentators.[59] Although the position of the Public Guardian and Trustee is not without merit, it would appear that the

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[59] William Innes, "Risk Management in the Charitable and Non-Profit Sectors, Liability of Directors, Officers and Members of Charitable and Non-Profit Corporations", in *Selected Issues, Without a View to Profit: Non-Profit and Charity* (Canadian Bar Association, 1995). See also William Innes, *supra*, note 37, at 160-161.

purchase of directors' and officers' liability insurance by a charity should at most be categorized as a "grey area" instead of emphatically stating that the purchase of such insurance requires court approval. The issue is not a question of whether there is a direct or indirect benefit to a director, but rather whether or not the purchase of the insurance policy is an appropriate expenditure by a charity in fulfilment of its charitable purposes.

There are many things which a charity does from time to time which has some indirect benefit to a director that does not require court approval. For instance, when a charity reimburses a director for car mileage, there is a component in the mileage charge that compensates the director for the purchase of a replacement vehicle. In addition, if a director is provided with travel costs to fly to a city for a board meeting and the location happens to provide the director with an opportunity to visit friends or relatives, there is again a benefit which the director has received but which obviously would not require court approval.

In a similar vein, the purchase of general liability insurance, which has never required court approval, has an element of a personal benefit to a director. Most insurance policies now include the directors and officers as named insureds, since director and officer liability coverage does not provide compensation for a claim based on a personal injury arising out of an allegation of sexual abuse or molestation by an employer or volunteer of a charity. As a result, if a director or officer is included in a claim arising out of sexual abuse and/or molestation, even though the director and officer insurance policy may not provide coverage, the general liability policy may be available to provide protection to the director, including coverage for significant legal costs.

Since it is highly unlikely that a court order would be required for a charity to obtain a general liability policy simply because directors and officers are included as named insureds, the issue is not whether there is a benefit that a director receives, but rather whether the benefit is reasonable and justifiable in the circumstances to accomplish the stated purposes of a charity.

The purchase of a directors' and officers' insurance policy is not done only to provide a benefit to the director, but rather is primarily done out of self-interest by the charity to ensure that the charity can continue to function by being able to attract qualified volunteers to sit on its board of directors. Unlike the payment of a prohibited director's bonus which has the effect of providing a real net benefit to the director, the acquisition of director and officer liability has no immediate benefit to the director, but for many charities is essential to acquire such coverage in order to attract qualified individuals to its board of directors. In this context, the purchase of directors' and officers' liability insurance is a legitimate expense in the operation of a charity akin to the cost of reimbursing a director for travel expenses to come to board meetings that a director could not otherwise afford to attend.

As such, the key issue is whether or not it is reasonable for a charity to acquire director and officer liability insurance, and if it is, how much coverage is appropriate in the circumstances given the extent of the risk in the operations of the charity and the moneys that are available out of the budget of the charity to acquire the insurance in question. This obviously depends upon the particular circumstances of each charity and would be subject to court review in the event that an unrealistic amount of director and officer liability insurance was acquired by a charity which had little or no risks, such as a charitable foundation, or by a charity that could not afford to expend the moneys out of its operational budget.

This is clearly a controversial issue and may require that the matter be settled either through legislation, as has been done in British Columbia under the *Society Act*,[60] or through a court application in the unlikely event that a charity was prepared to go to the expense of having the matter determined by a court. However, in the meantime, it would be appropriate to advise charitable clients that given the unsettled area of the law, it is better to acquire directors' and officers' liability insurance when the risks associated with the operations of the charity justify such expenditure of funds and deal with the possibility of a court review at a later time, if necessary, than not to have such insurance in place and risk not being able to attract new directors or have the current directors face needless personal exposure to liability.

A similar approach would apply to the issue of indemnification of directors. Under s. 80 of the Ontario *Corporations Act*[61] and s. 93 of the *Canada Corporations Act*,[62] a director may be indemnified by the corporation in certain circumstances. While the corporate authority is available for a non-share capital corporation to pass an indemnification by-law, the issue is whether or not in doing so there is some form of indirect benefit to the directors, thereby requiring court approval before the indemnification by-law can be passed. The necessity of a court order would appear to reflect the position of the Public Guardian and Trustee in this matter.

The issue, however, is not whether a court order is required to pass an indemnification by-law, since there is already clear statutory authority to do so, but rather whether the payment being considered by the charity to a director in accordance with an indemnification by-law already passed can be justified as a reasonable expenditure by the charity. In *R. v. Bata Industries Ltd.*[63] the court held that it was not appropriate for a court to impose a probation term that denied the directors the ability to obtain relief from a share capital corporation in accordance with the provision of an indemnification by-law arising out of a penalty against the director. While the decision underscored the statutory authority of a corporation to indemnify a director, it did not deal with the more difficult issue of whether the payment of a penalty was authorized by the indemnification by-law for a share capital corporation pursuant to s. 136 of the *Business Corporations Act*.[64]

In this regard, payment of legal defense costs for an action based on wrongful dismissal might constitute a prudent use of charitable moneys, since the charity would likely benefit by having the claim against the charity defended by separate legal counsel for both the directors and the charity. However, payments of fines or penalties by a non-share capital corporation on behalf of a director arising out of his or her gross negligence may not constitute an appropriate use of charitable moneys notwithstanding the corporate authority to adopt the indemnification by-law in the first instance.

In summary, the primary issue involving the acquisition of directors' and officers' liability insurance and/or the adoption of an indemnification by-law centres around whether or not the application of charitable money concerning either is a

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60 R.S.B.C. 1979, c. 390, as amended.

61 R.S.O. 1990, c. C.38.

62 R.S.C. 1970, c. C-32.

63 *R. v. Bata Industries Ltd.* (1995), 25 O.R. (3d) 321, 22 B.L.R. (2d) 135, 18 C.E.L.R. (N.S.) 11, 101 C.C.C. (3d) 86, 127 D.L.R. (4th) 438, 83 O.A.C. 343 (C.A.).

64 R.S.O. 1990, c. B.16. Non-share capital corporations have statutory authority to enact an indemnification by-law under s. 80 of the *Corporations Act* as opposed to s. 136 of the *Business Corporations Act*.

reasonable and justifiable expenditure in pursuit of charitable purposes, rather than whether there is a resulting benefit to the director. If such expenditure is reasonable, then it is arguably a proper use of charitable funds. If it is not reasonable, then such payment would be inappropriate no matter how small the amount of money was and no matter whether a court order was obtained in advance to authorize the passing of an indemnification by-law or the acquisition of directors' and officers' liability insurance.

(10) Deficiencies in Indemnification[65]

Even though s. 80 of the *Corporations Act*, and s. 93 of the *Canada Corporations Act*, permit non-share capital corporations to indemnify their directors and officers, often charitable corporations fail to either adopt indemnification by-laws, or, if they do, they fail to ensure that they are properly passed. This occurs for various reasons, some of which are summarized as follows:

(a) The corporation may have been in existence for a number of years and the board of directors has never been advised of the importance of passing an indemnification by-law.
(b) The wording of the indemnification by-law incorrectly reflects the indemnification provision of a share capital corporation under business legislation rather than the indemnification provisions provided for in the Ontario *Corporations Act* or the *Canada Corporations Act.*
(c) The indemnification by-law has never been approved by the members of the corporation as required by statute.

Although it is obviously important to adopt an indemnification by-law, such by-law expresses the maximum as opposed to the minimum statutory protection that can be made available to directors of a non-share capital corporation in Ontario, assuming of course that court approval is not required. An indemnification by-law, even if it is put into effect, will be of no use:

(a) in the event that the corporation did not have sufficient assets or insurance to indemnify the director for the costs or expenses incurred by a director;
(b) in the event that the director's acts are beyond the scope of his or her authority as a director;
(c) in the event that the director's actions or lack of actions constitute wilful neglect or default;
(d) in the event that the director's actions or lack of actions constitute a breach of his or her own fiduciary obligations, even if such actions or lack of actions did not amount to wilful neglect or default; or
(e) in the event that a director is held personally liable pursuant to a statutory liability for monetary payments such as unpaid wages, unpaid vacation pay, or government deductions.

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[65] See Section 9 of the checklist.

(11) Real Property Issues Involving Charities[66]

Although there are many real property issues that affect charities, three of the more important matters that often arise with a charity, particularly religious charities, involve the 40-year rule under the *Registry Act*,[67] trust deeds and liability exposure involving toxic property.

(a) Forty-Year Rule under the Registry Act

The 40-year rule has now been clarified by the Supreme Court of Canada in the decision of *Fire v. Longtin*.[68] The court confirmed that a search of title need only go back 40 years. This means that charities that hold property in the registry system for longer than 40 years, such as churches and other older charitable institutions, will want to ensure that a new deed is registered under the *Registry Act* within the 40-year search period to avoid title problems that might occur as a result of fraud and/or an incorrect metes and bounds description with adjoining properties, as well as registered easements that may have expired.

(b) Trust Deeds

Notwithstanding that deeds registered outside of the 40-year search under the *Registry Act* will not affect third parties dealing with church lands, it is still important for churches and other religious institutions that hold property pursuant to a trust deed that sets out terms by which the property is to be held in trust to ensure that the terms of trust can continue to be complied with; failing which it may be necessary to make a *cy près* court application to authorize the current use of the property in question for purposes beyond those specifically provided for under the terms of the trust deed.

(c) Liability for Toxic Property

The charitable client needs to be aware of the consequences which may result in the event that the charity owns or acquires contaminated property. The client should be advised that contamination may occur through something as innocuous as leakage from underground oil or gasoline tanks, or contamination caused by a previous owner, or even contamination caused by present or past tenants.

In all of these situations, the provisions of the *Environmental Protection Act*,[69] would mean not only that the charity would be responsible for the costs of cleaning up the contamination, but that the directors of the charity may be exposed to personal liability for such costs, as well as possible fines or penalties, as was the result in the *R. v. Bata Industries* case.[70]

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66 See Section 12 of the checklist.

67 R.S.O. 1990, c. R.20.

68 [1995] 4 S.C.R. 3, 48 R.P.R. (2d) 1, 128 D.L.R. (4th) 767, 188 N.R. 234, 86 O.A.C. 288.

69 R.S.O. 1990, c. E.19.

70 (1993), 14 O.R. (3d) 354, 11 C.E.L.R. (N.S.) 208 (Gen. Div.) reversed on appeal on the matter of terms of a probation order, *supra*, note 63.

As a result, if there is a possibility that the charity owns contaminated property, then the client should be advised to obtain an environmental audit to determine the extent of the contamination and associated cost of clean-up. This is particularly important in the event that the charity is considering selling the property. If contamination was identified by an audit, then the charity would be able to quantify the cost of clean-up before the property is put on the market. Then, if an interested purchaser is prepared to buy the property notwithstanding the contamination, appropriate acknowledgments and releases could be included at the time that the offer is signed. In the event that an environmental audit does not reveal any contamination, then even if the subsequent owner of the property finds contamination after closing, the fact that the board of directors had obtained an environmental audit prior to closing would help to establish a defence of due diligence if a claim for damages was made against the charity and its board of directors by the new owner.

Similarly, if the charity is offered a gift of real property, whether it be as an *inter vivos* gift or as an estate gift, the charity should be advised not to accept the deed to the property until the risk of contamination has fully been discussed by the board of directors and, if necessary, an environmental audit has been obtained and a satisfactory report has been given to the board. Failure to advise the charity of the consequences of taking title to contaminated property could expose the lawyer to an action in negligence.

(12) Obtaining Trade-mark Registration[71]

The topic of advising the charitable client on obtaining trade-mark registration is beyond what can be dealt with in the parameters of this paper. However, the charitable client should be informed of the importance of obtaining trade-mark registration, since the trade-mark associated with a charity is often its most valuable asset. The goodwill associated with the name of a charity will to a great extent determine the quantity and magnitude of future donations.

Once obtained, a trade-mark registration under the *Trade-marks Act*,[72] will permit the charity to license the use of the trade-mark to local chapters and associated charities, provided that the charity retains control over the trade-mark and enforces standards for its use.

In addition to obtaining trade-mark registration for a particular service or ware, consideration should also be given to whether or not public notice under s. 9 of the *Trade-marks Act* is available to prohibit anyone else from adopting and using the prohibited mark, even if the charity is not currently using the trade-mark with a particular service or ware. A s. 9 notice has the general effect of "occupying the field", but does not alone allow the prohibited mark to be licensed. A s. 9 prohibitive mark, though, is only available if the registrant is a public authority as determined in accordance with the criteria set out in the Federal Court of Appeal decision in *Registered Trade-Marks v. Canadian Olympic Association.*[73] Where a charity does meet the criteria for a public authority, a s. 9 prohibitive mark can be a very effective tool

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71 See Section 14 of the checklist.

72 R.S.C. 1985, c. T-13.

73 *Sub nom. Canadian Olympic Association v. Canada (Registrar of Trade Marks)*, [1983] 1 F.C. 692, 67 C.P.R. (2d) 59, 139 D.L.R. (3d) 190, 43 N.R. 52 (C.A.).

in ensuring that there is not an inappropriate use of the trade-mark by others in the future.

(13) The Effect of On-going Deficit Operations

In consideration of budgetary constraints being faced by many charities, often a board of directors is faced with having to operate a charity with an intentional operating deficit where the anticipated income for the year (excluding estate gifts) is insufficient to meet the matching operational expenses of the charity. Such a decision by the board, if extended over a number of years, may prejudice the ability of the charity to function as well as unnecessarily expose the directors to potential personal liability.

For the purposes of this paper, what is not included in the reference to an "operational deficit" are any of the following:

(a) a deficit arising out of a capital project where there is a source of indebtedness to pay for the project, the repayments for which the charity can meet from normal operational income;
(b) a short term deficit occurring during a financial year due to fluctuations in income which is eventually eliminated by the end of the current financial year; or
(c) a deficit which occurs because of an unexpected expenditure which could not reasonably have been anticipated.

The risks that are associated with having a charity function on a continuous basis with an operational deficit can be summarized as follows:

(a) Under the Ontario *Corporations Act*, the board of directors are jointly and severally liable for the wages of all employees of the charity for a period of up to six months together with all statutory deductions.

(b) If the creditors of the charity are left unpaid, those creditors might look to the board of directors personally for payment of unpaid bills based upon the allegation that there had been an implied misrepresentation by the board to the creditors that they would be paid unless the creditors had been warned that the charity was facing a financial crisis.

(c) The on-going depletion of estate gifts, if applicable, to cover operating deficits would have an obvious impact in reducing or eliminating estate gifts for capital expansion or the creation of a contingency fund to cover unanticipated emergencies.

(d) The continuous reliance upon estate gifts to meet operating budgets could have the effect of gradually discouraging donors from leaving sizeable estate gifts to the charity.

(e) Since most individuals who leave an estate gift to a charity assume that the gifts will be set aside, at least in part, to establish a long-term fund of capital for future projects or be invested with the income being available for operational expenses, it might be argued that even the receipt of unrestricted estate gifts is still subject to an implied restriction or expectation by the donor that the moneys would be used to assist the charity in operating the charity on a long-term basis as opposed to being depleted in the short term to cover intentional operational deficits.

The Saskatchewan Court of Appeal in *Re Y.W.C.A. Extension Campaign Fund*[74] dealt with a situation where a fund had been built up for the purpose of erecting a new building but which the board wanted to use to discharge an operating deficit. The court refused to give its consent because the public was construed to have given the funds for the purpose of constructing a building and, even if a more general intention could be construed, it could not be held to embrace something as different as the discharge of an operating deficit. The case supports the proposition that capital gifts procured from the public, whether it be from estates or otherwise, should not be depleted on a continuous basis to underwrite operating deficits unless the donors were specifically advised that capital gifts would be used in such manner.

(f) In the event that a complaint is made giving rise to a public inquiry under s. 6 of the *Charities Accounting Act*,[75] the board of directors may be criticized for allowing large capital gifts, including estate gifts, to be continuously used to cover intentional operational deficits instead of making the difficult decision to eliminate the deficit.

(g) The importance of a charity eliminating an operating deficit has been underscored in recent years with the "reality check" being faced by universities, hospitals, school boards and private educational institutions across Ontario as a result of recent government cutbacks. Since public bodies are now having to put their financial houses in order, charities that do not have the benefit of relying upon public resources for funding are under even greater pressure to ensure that they are operating in accordance with a balanced budget. In consideration of recent controversies involving the financial operations of charities, it would not be surprising if the donor base for a charity became skeptical to an emergency fund-raising campaign that might become inevitable where the board of directors had intentionally decided over numerous years to operate the charity with a deficit.

(h) Most important, if a charity continues to operate with a deficit, it obviously will not be many more years before the charity will be faced with having to close its doors either because of a lack of funds or, alternatively, due to insolvency and/or bankruptcy. In the event that the board of directors decides to continue to operate a charity with an on-going operational deficit, it is incumbent upon the lawyer to advise members of the board of directors that they should obtain independent legal advice to determine whether or not they wish to remain on the board and what steps should they take and the consequences associated therewith.

(14) Improper Planned Giving Instruments[76]

The implementation of a planned giving program can become an extremely important part of the financial operations of a charity when undertaken with expert advice.[77] However, often charities both large and small will make the mistake of

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74 [1934] 3 W.W.R. 49 (Sask. K.B.).

75 R.S.O. 1990, c. C.10.

76 See Section 17 of the checklist.

77 See Arthur Drache, Q.C., *Canadian Not-For-Profit News (A Newsletter on Current Developments in Canadian Non-Profit Organization)*, Carswell, for practical comments on planned giving instruments available; see also the paper by Arthur Drache, Q.C., on *Tax Assisted Charitable Giving*, 1996 Law Society Special Lectures; see also Frank Minton and Lorna Somers, *Planned Giving for Canadians* (Waterdown: Somersmith, 1994).

implementing improper planned giving instruments without first seeking competent legal advice, often due to a tendency by one charity to mimic what another charity is doing without thoroughly investigating whether a planned giving instrument is either legal or appropriate in the circumstances. Some examples of how charities can become involved in improper planned giving instruments are as follows:

(a) Self-insured Annuities

Although the issuance of charitable gift annuities by an insurance company on behalf of a charity can constitute an effective planned giving instrument when implemented properly, a number of charities mistakenly believe that because there are a few older charities incorporated by special Acts of the provincial legislature that empowered those charities to issue annuities, any charity is able to issue an annuity on its own. The problems inherent in doing so include;

(i) contravention of the *Insurance Act*;[78]
(ii) lack of corporate authority to carry on the business of the issuance of insurance;
(iii) lack of experience and actuarial advice required to establish a professionally run annuity program;
(iv) lack of financial capability to meet all the obligations under annuity contracts; and
(v) exposing directors of the charity to possible personal liability for activities that are illegal and *ultra vires* that could result in losses to the annuitants for which the directors would then become personally responsible to repay.

Notwithstanding the obvious problems involved in issuing annuities, many charities take the position that since Revenue Canada does not prohibit the sale of annuities by charitable organizations, any charity can proceed to issue its own self-insured annuity, even if it has no experience in doing so. The argument often used to justify such a decision is that the regular donors of a charity feel more comfortable with the charity issuing the annuity than having it issued by an insurance company. For those charities that decide to issue annuities notwithstanding the clear risk involved in doing so, the lawyer advising the charity should give serious consideration to whether he or she wishes to continue to act for a charity that intends to proceed with an illegal activity.

(b) Charity Acting as Trustee

On occasion to attract the support of donors, some charities will offer to act as trustees of moneys or property for a donor for a small fee. The trust created may be intended to benefit either the charity or a specific activity which may or may not turn out to be a charitable purpose. The interest of the charity in acting as a trustee is to receive a portion of the interest income earned in return for acting as trustee, as well as the expectation that the charity may be a named beneficiary on the death of the settlor.

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[78] R.S.O. 1990, c. I.8.

What the charity fails to understand is that by acting as a trustee in such circumstances, the charity may be carrying on the business of a trustee without having the corporate authority to do so or being licensed under the *Loan and Trust Corporations Act*.[79]

(c) Promissory Notes Forgivable on Death

Another type of planned gift instrument that is occasionally utilized is the issuance of a debt instrument that is stated on its face to be forgivable on death. This form of planned giving instrument involves the charity becoming indebted to the donor pursuant to a debt instrument, such as a promissory note or a bond, with a low interest rate so that the charity can then reinvest the moneys and earn a one or two percent interest spread, or alternatively use the moneys for operational purposes but at an interest rate less than what a charity would otherwise have to pay to the bank. The charity may not consider the debt instrument to be a real debt, since the charity will have the donor co-sign the promissory note stating that the outstanding indebtedness is to be forgiven upon the donor's death.

What the charity fails to understand with this type of planned giving instrument is that the forgiveness of the debt on death can only be accomplished by a testamentary instrument properly signed and witnessed by two witnesses who are not beneficiaries. When the donor dies, the promissory note would still constitute one of the assets of the estate. However, since the intent to forgive the debt had not been properly executed by a testamentary instrument, the debt would not be forgiven and would remain as an asset of the estate instead of a gift to the charity. Even if an executor of the estate wished to recognize the moral obligation to forgive the debt, the executor could not do so without the authority of a court order.[80]

In such a situation, the directors of the charity who authorized the incurring of debt on the mistaken belief that the debt would be forgiven on death might be exposed to personal liability for allowing the charity to incur an improvident indebtedness that lacked the legal ability to self-liquidate on death. Without the assurance of forgiveness on death, it is questionable whether the directors would ever have incurred the debt in the first instance.

It is evident from these examples that there are serious dangers that charities can encounter when they attempt to implement sophisticated planned giving instruments without knowledgeable professional advice. The charity should be advised that if they embark on a planned giving program, it should be done based upon reliable legal advice or not at all. Half measures in the field of planned giving instruments is nothing less than a recipe for future disasters.

(15) Misrepresentation involving Investors[81]

Where a charity is having difficulty raising donations either to commence a capital project or to maintain a flow of funds to meet its operating expenses, and

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79 R.S.O. 1990, c. L.25.

80 *Re Snowden*, [1970] Ch. 700, [1969] 3 All E.R. 208.

81 See Section 17 of the checklist.

where traditional sources of borrowing from institutions is either not available or too expensive, charities may attempt to borrow funds from their constituents instead of seeking further donations from them. The types of investments that are offered by charities vary widely and include amongst others, unsecured promissory notes, bonds, debentures, and mortgage back certificates.

The danger that a board incurs when a charity becomes involved in offering securities to the public is that even though a charity may be exempt from the registration and prospectus requirements of the *Securities Act*,[82] the charity and its board of directors may be left vulnerable in the event that an investor alleges misrepresentation arising out of not having a full understanding of the nature of the investment being offered by the charity. The Supreme Court of Canada in *Queen v. Cognos Inc.*[83] has held that negligent misrepresentation will be established where:

(a) there is a duty of care based upon a "special relationship";
(b) there is a representation that is untrue, inaccurate or misleading;
(c) the representation is made negligently;
(d) reliance is placed upon the representation; and
(e) damages result.

In the event of an improvident investment that an investor subsequently regrets, or in the event that an attorney appointed under a power of attorney or an executor for a deceased investor investigates the basis on which the investment was originally made, a charity and its board of directors might be found liable for negligent misrepresentation based on the principles stated above. Examples of how misrepresentation involving an investor might occur are as follows:

(a) failure to adequately inform investors of the unregulated nature of the securities offered;
(b) failure to provide prospectus type information concerning the investment, such as a full explanation of the purpose of moneys being raised, the security being offered, if any, the nature of the risk, and the returns available;
(c) making false and misleading statements about the strength of the charity's financial condition;
(d) making false or misleading statements about the true nature of the securities offered for investment, *e.g.* suggesting that the security is in the form of a first mortgage when the mortgage security in fact can be postponed to that of a second mortgage;
(e) inferring that investments may be secured when they are not, *e.g.* offering debentures or bonds when there is no security offered to substantiate what in essence is little more than an unsecured promissory note;
(f) failure to establish a sinking fund to retire the debt that is being incurred;
(g) making unsubstantiated predictions of income from the securities, *e.g.* "better than market investments";

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82 See 35(2) of the *Securities Act*, R.S.O. 1990, c. S.5 for the exemption applicable to charities.

83 [1993] 1 S.C.R. 87, 45 C.C.E.L. 153, 14 C.C.L.T. (2d) 113, 99 D.L.R. (4th) 626, 93 C.L.L.C. 14,019, 147 N.R. 169.

(h) failure to recommend that a potential investor obtain independent legal advice before investing;
(i) listing the names and occupations of the directors of the charity in sales brochures to add credibility to the investments being offered; or
(j) failure to disclose an actual or pending financial crisis of the charity seeking the investment of the funds.

In any of the above situations, if a loss is incurred or if questions are raised, then the charity and its board members may be left vulnerable to legal action or an application for a public inquiry under s. 6 of the *Charities Accounting Act* concerning the raising of funds from the public.

(16) Unauthorized Investments of Charitable Funds[84]

Charities are often surprised to learn that their ability to invest surplus funds is restricted to the very conservative types of investments provided for under the *Trustee Act*,[85] unless the letters patent or constating documents establishing the charitable trust provide otherwise. As such, it is important that the lawyer review the letters patent with the client to determine whether or not broader investment powers have been included, and if not, then to discuss whether the charity should apply for supplementary letters patent to obtain additional investment powers beyond those by which trustees at law are otherwise authorized.

In this regard, the *Not-For-Profit Incorporator's Handbook*[86] specifically contemplates the inclusion of a power clause in letters patent and/or supplementary letters patent for Ontario non-share capital corporations that provides a charitable corporation with the ability to make investments that are not limited to investments authorized by law for trustees.

For those charities that do not have a broader investment power and do not intend to apply to extend their investment powers by supplementary letters patent, the boards should review their investment portfolios to determine whether or not there is compliance with the limited permitted investments under the *Trustee Act*. For instance, lending moneys to employees secured by a second mortgage might appear to be a reasonable incentive to attract an employee, but would not be a permitted investment under the *Trustee Act* because it was a second as opposed to a first mortgage. In addition, in the recent decision of *Haslam v. Haslam*,[87] the court held that investments in mutual funds are not a permitted investment under the *Trustee Act*.

Even if the letters patent or the constating documents for the charity specifically authorize broader investment powers, it may be that funds held pursuant to an express or implied charitable trust will be subject to the limitations of the *Trustee Act* notwithstanding the broader investment powers unless the document establishing the specific charitable trust provides otherwise.[88]

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84 See Section 17 of the checklist.
85 R.S.O. 1990, c. T.23.
86 *Not-For-Profit Incorporator's Handbook*, *supra*, note 33 at 58.
87 (1994), 3 E.T.R (2d) 206, 114 D.L.R. (4th) 562 (Ont. Gen. Div.).
88 Innes, *supra*, note 37, at 167.

In addition to recommending that the charity review its present investment portfolio, the lawyer should explain to the charity that authorization by the board to invest charitable moneys in investments that are either not authorized by the *Trustee Act* or by a broader investment power in the letters patent or constating documents of the charity may very well expose members of the board of directors to personal liability on a joint and several basis for the consequences of the investments.

Even where a charity has broad investment powers, improvident investments can still occur where a charity is anxious to realize a "good return" on its investments. On occasion, charities can become embroiled in controversial investments such as what recently transpired with the New Era scandal in the United States, where numerous universities, colleges, seminaries and large charities, including the Salvation Army, as well as prominent philanthropists such as Laurance S. Rockefeller, William Symons, former Treasury Secretary of the United States, and John Whitehead, the former chairman of Goldman, Sachs & Company, were enticed into investing in excess of $250 million in a matching gift program offered by the New Era Foundation that promised to double each investment within six months due to the assumed generosity of anonymous donors who did not exist. As a result, there are net claims in excess of $128 million that remained outstanding.[89]

The lesson to be learned from the New Era scandal is that if an investment appears too good to be true, it normally is, and that charities should therefore beware of the "follow the leader syndrome". Just because a charity appears to be successful with a particular type of investment, other charities should not blindly follow without investigating whether or not the investment is legal in relation to the investment powers of the charity and whether or not it is a prudent investment.

(17) Avoiding Breach of Trust involving Donor Restricted Trust Funds[90]

More charities are having to deal with the spectre of having mishandled donor restricted trust funds with the sobering consequences of its board of directors being found in breach of trust. As such, it is incumbent upon the lawyer advising a charitable client to explain in practical terms what donor restricted trust funds are, the problems that can be encountered in improperly dealing with such funds, and how to avoid being found in breach of trust.

(a) Examples of Donor Restricted Trust Funds

Donor restricted trust funds are those moneys that are given by the donor to a charity that the donor intends to be used for a specific charitable purpose that the board has approved in advance or is determined by the board to be an acceptable charitable purpose to be involved with. This is to be contrasted with board-restricted charitable funds where an unrestricted gift is received from a donor and then the

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89 A more complete discussion of the New Era scandal is contained in an article by the author published by the Canadian Council of Christian Charities, June, 1995: Terrance S. Carter, " 'New Era' Scandal in U.S. Has Lessons for Canadian Charities", The Church and the Law Update, CCCC Bulletin #3.

90 See Section 18 of the checklist.

board of directors determines on its own that those moneys will be used for a particular purpose. In the latter instance, the board is free to change its decision concerning how the board-restricted funds will be used in the future, provided of course that the new charitable purpose falls within the general charitable purposes of the charity. With the former, where the donor either directly or indirectly restricts how the moneys are to be used, the moneys received by the charity will be impressed with trust restrictions and can only be used in accordance with those terms as a separate charitable trust.

Some examples of donor restricted trust funds are the following:

(i) A charity may establish a special project, such as a building fund or a relief project, and solicit funds from the public to help the charity accomplish the special project. Any moneys received by the charity in response to a request to fund the special project would constitute donor-restricted trust funds.

(ii) On occasion, a charity will receive a donation that is subject to limitations imposed by the donor as opposed to restrictions established by the charity. These restrictions may be created through the terms of a will by which an estate gift is received or through an *inter vivos* gift that is subject to a 10-year restriction or other similar direction that the gift be used for a specific purpose, provided that such purpose is acceptable to the board of the charity and is within the authority of its general charitable objects.

(iii) Where there are two charities that are closely associated with each other and have similar administrative control, a gift directed to one charity on occasion may be deposited into the bank account of the other charity by that charity opening a bank account using the business name of the other charity. Since the administrative staff as well as board members of both charities may believe that the gift could be better used by one charity as opposed to the other charity, or that the two charities are for all intents and purposes one operational charity, they may not understand that the determination by the donor that a gift be directed to one charity constitutes designation by the donor that the charitable funds are to be used for the fulfilment of the charitable purposes of the named charity as opposed to the charitable purposes of the associated charity. As such, in the context of two or more closely associated charities, moneys donated to one charity are in fact donor-restricted trust funds to be used only in accordance with the charitable purposes of that charity and not for those of any other associated charity.

(iv) Most donors making a gift to a parallel foundation assume that the gift will be used to benefit the operating charity. However, many parallel foundations have charitable objects that permit the board of directors of the foundation to use the moneys received by the foundation for purposes other than benefiting the parallel operating charity. If the ability of the foundation to fund other charities has not been communicated to donors of the foundation, particularly where a parallel foundation has the same name as the parallel operating charity, then donors to the parallel foundation may very well claim that since they assumed that the gift to the parallel foundation was only to be used to benefit the parallel operating charity, the moneys received by the parallel foundation were in essence donor restricted trust funds that can only be used to benefit the parallel operating charity as opposed to another charity.

(b) Problems encountered with Donor-Restricted Trust Funds

Examples of problems that can be encountered with donor-restricted trust funds are as follows:

(i) On occasion, the restrictions imposed upon a gift to a charity may require the charity to carry on activities that are either not charitable or are outside the stated charitable purposes of the organization as contained in its letters patent or constating documents. If the charity attempted to follow the restrictions, it could mean that the charity would become involved in *ultra vires* activities outside of its corporate authority as well as being in breach of the restrictions of its charitable purposes.

(ii) Also on occasion, charities that are facing financial difficulties may be tempted to divert moneys from donor-restricted trust accounts to cover operating costs. This would be a clear breach of trust. This misuse of funds could occur either through an outright depletion of the trust moneys or more commonly by a decision to borrow from donor restricted trust funds based upon an intent to repay those moneys as soon as possible once the immediate cash flow "crunch" is over. However, charities that are faced with the necessity of having to borrow from donor-restricted trust funds are normally in serious financial difficulties and may not be able to repay the moneys out of its operating funds. While any funds borrowed from donor-restricted trust funds constitute a breach of trust whether repaid or not, where the funds are not repaid, then the directors will also be exposed on a joint and several basis to repay those moneys from their own personal funds.

(iii) Where a charity has been involved in a public appeal for a specific project, on occasion more moneys will be received than are required to fund the project. In such circumstances, a charity may want to use the surplus for other charitable purposes. However, if the donors have not been advised that the surplus will be used for such other purposes, disillusioned donors may very well be able to argue that all moneys given in response to the public appeal for a special project must be used to further the named project, or alternatively be returned to the donor.

(iv) Where there are closely associated charities or a parallel foundation, the functional operating lines between such charities may often become blurred with the assumption that a gift to one charity can be transferred to the other charity without considering whether or not such transfer is authorized at law or is in accordance with the expectations of the donor. Although a gift to a parallel foundation can be transferred to a parallel operating charity, the reverse is not necessarily true without court approval. In the decision of *Re Baker*[91] an application was made to authorize the transfer of an estate gift from a named hospital to its parallel foundation. The court held that the inherent jurisdiction of the court did not permit it to rewrite a trust for "mere expediency", and as such the court lacked the jurisdiction to vary the terms of the estate gift to the named hospital and give it to the parallel foundation. In *obiter dicta*,[92] the court held that if the named hospital received the gift and then subsequently sought to

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91 (1984), 47 O.R. (2d) 415, 17 E.T.R. 168, 11 D.L.R. (4th) 430 (H.C.).

92 *Ibid.*, at 426 O.R.

divert the proceeds received from the estate to the parallel foundation, the court would intervene to restrain such conduct as being *ultra vires*.

In all of these examples, the misuse of donor-restricted trust funds would constitute a breach of trust. Whether or not a court would be prepared to excuse the breach of trust in an application under the *Trustee Act* would depend upon the circumstances in each case. Clearly, however, in situations where donor-restricted trust funds have not been repaid to the charity, the directors would be held personally liable to repay those moneys on a joint and several basis.

(c) How to Avoid Problems involving Donor-Restricted Trust Funds

Some suggestions of how charitable clients can avoid problems involving donor-restricted trust funds are as follows:

(i) The charity should do an inventory, particularly of its estate gifts, to determine whether or not moneys have been held or should be held as donor-restricted trust funds. If there are, then those moneys should be held as separate trust funds and should be reported in the charities' financial statements by using fund accounting for restricted funds.

(ii) Before accepting donor-restricted trust funds, the board should determine whether or not the intended restrictions are in accordance with the general charitable purposes of the charity and are within the corporate authority as stated in its letters patent.

(iii) Restricted trust funds, once accepted by the charity, must only be used in accordance with the stated restrictions and must not be used for general fund purposes or borrowed against, even by the charity itself.

(iv) In the event that the board is considering using donor-restricted trust funds for another purpose or is considering transferring such moneys to an associated charity or parallel foundation, then a *cy près* application would have to be brought to obtain the necessary court authority, failing which the transfer would be a breach of trust.

(v) With respect to fund-raising appeals to obtain donations for special projects, the written appeal should contain a clear statement that any moneys received by the charity to fund the project after the project has been accomplished will be used for the general charitable purposes of the charity in question unless the donor specifically requests that the donation be returned before the moneys are deposited and a charitable receipt is issued.

(vi) In relation to gifts given to a parallel foundation, particularly a parallel foundation that has the same name as its parallel operating charity, it is important that donors who are requested to give to the foundation are advised that the board of the foundation has the corporate authority to use moneys in the foundation to benefit charities other than the named operating charity, if that is the case, or alternatively, that an application for supplementary letters patent is brought to restrict the objects of the foundation so that the only beneficiary will be that of the named parallel operating charity.

(vii) Gifts that are given to a specific charity must be deposited into the bank account of the that charity and used only by that charity unless the objects and power clauses of the named charity permit its funds to be transferred to benefit another

charity, such as in the case of a parallel foundation; otherwise court approval may be required.

(18) Deficient National and International Structures[93]

Where a charitable client is part of a national or international organizational structure, it is important to understand how the charity fits into the larger overall structure. In this regard, it is not unusual to find deficiencies in the umbrella organizational structure that may need to be explained to the client.

Some examples of deficiencies that are specific to national organizations are as follows:

(a) It may not be clear whether a local chapter is an autonomous legal entity responsible for its own actions or whether it is part of a larger national body, in which event the national body may be liable for the actions of the local charity. This in turn may mean that the local charity may not need to go through the expense of becoming incorporated. On the other hand, the national organization may very well want to defuse liability risks by ensuring that every local chapter is separately incorporated. As such, it is important that there be communication and dialogue between the local chapter and the national organization concerning how much control the national organization wishes to exercise and whether or not there is to be a compartmentalization of the risks by using multiple corporations for local chapters.

(b) Even if the local chapter is an autonomous legal entity, often membership in the national organization will require that the local charity include a clause in its general operating by-law stating that the national organization can exercise a unilateral right to dissolve the local chapter in the event that the chapter fails to comply with certain standards or requirements. This type of unilateral right to terminate would violate the autonomy of the local chapter as a separate legal entity and would not be enforceable. However, the national organization may be surprised to learn that they do not have this form of power over the local chapter and as such may want to look at other means of controlling local chapters.

(c) Many national charities miss the opportunity to exercise effective jurisdiction over local chapters by requiring member charities to enter into a licence agreement to use the trade-mark of the national organization. The licence though must be properly structured so that the national organization maintains standards of control over the use of the trade-mark, otherwise the national organization may lose the enforceability of its trade-mark.

(d) There may also be a lack of documentation in establishing a "local charter" whereby the national organization should be retaining the right to terminate the local charity's membership in the national organization if certain standards and expectations are not maintained, together with a right to revoke the grant of a licence to use the trade-mark of the national organization and require the local chapter to change its name in the event that it is no longer a member of the national organization.

Some examples of deficiencies involving charities as part of an international structure are as follows:

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93 See Section 20 of the checklist.

(a) The general operating by-law for a Canadian charity may attempt to incorporate by reference the by-law of the international charity, which in many cases is no more than the operational by-law of the U.S. charity. Often, such a by-law attempts to establish the U.S. charity as the international parent having the right to exercise jurisdiction over the Canadian charity as a subsidiary organization without recognizing that the Canadian charity is an autonomous legal entity and not subject to control by a foreign charity.

(b) In the event of a dispute between the Canadian charity and the foreign charity, the foreign charity may attempt to demand that the Canadian charity give up its name and/or trade-mark. However, if the Canadian charity was not initially established on the clear understanding that the name and/or trade-mark of the charity was being licensed to it by the foreign charity, or some other form of arrangement whereby the name and/or trade-mark was documented as being used with the permission of the foreign charity, then it may be arguable that the name and/or trade-mark of the charity in Canada remains the property of the Canadian charity as opposed to the foreign charity. In such a situation, if the Canadian charity is being pressured to change its name or give up its trade-mark, then it is up to the board of directors of the Canadian charity to decide whether the board intends to comply with such demand. In this regard, a determination would have to be made concerning whether or not the Canadian charity in changing its name was giving up a valuable asset in favour of a foreign charity. If so, then it would be unlikely that Revenue Canada or the Public Guardian and Trustee would agree to the transfer of charitable property to a foreign charity that is not a qualified donee under the *Income Tax Act*.

(c) Often, the Canadian charity will transfer moneys to a foreign charity without consideration of the restrictions of the *Income Tax Act* concerning what are acceptable charitable activities. In this regard, if funds are being transferred by a Canadian charity to a foreign charity which is not a qualified donee under the *Income Tax Act*, it is essential that the board of directors of the Canadian charity first ensure that there is a written agency agreement in place between the Canadian charity and the foreign charity. In such an agreement, the Canadian charity appoints the foreign charity as its agent and requires that the foreign charity provide regular written reports concerning the expenditure of those moneys on behalf of the Canadian charity in fulfilment of its charitable purposes. The alternative is for the charity to enter into a joint venture arrangement whereby the moneys of the Canadian charity and the foreign charity are pooled together on a joint basis in fulfilment of similar charitable purposes.

While the specific details to be contained in either an agency agreement or joint venture agreement are beyond the scope of this paper, it is important that the charitable client be advised to determine whether moneys of the charity are being transferred to entities that are not qualified donees under the *Income Tax Act*, and that if such transfers are occurring without proper documentation being in place to the satisfaction of Revenue Canada, then the consequences may be the revocation of charitable status with Revenue Canada with a corresponding revocation tax.

While the above-mentioned comments concerning issues involved with national and international structure is by necessity brief, they do indicate that there are potentially complex issues that need to be reviewed with a charitable client to ensure that the necessary structure and documentation is in place to permit the proper functioning of the charity in a national and/or international context.

5. *Effectively Communicating with the Charitable Client*

(1) Confirming Retainer

Since the lawyer is often contacted by the charitable client to provide an answer to a question as a "favour", it is important for the lawyer to determine whether or not he or she is being asked to provide a professional opinion that will be relied upon, or whether he or she has been contacted to provide advice without professional consequences and corresponding liability. More often than not, the lawyer will have been asked a question on the assumption that the charity believes that it can rely upon the answer, whether or not the charity is able to or intends to pay for such advice.

As a result, it is prudent for the lawyer who is contacted by a charity to confirm in writing the advice being sought, the advice given, and whether or not there is to be any charge for the service that has been rendered. Failure to do so could result in an unfortunate situation of the charitable client relying upon an opinion that the lawyer never intended to constitute a professionally researched opinion.

(2) Educational Reports

By far the most frequent task that lawyers are called upon to assist charities with is to complete the incorporation process and obtain charitable registration. The lawyer will normally consider the task completed when letters patent have been obtained, the minute book has been organized, and a charitable registration number has been obtained from Revenue Canada.

However, it is also good practice for the lawyer to explain to the charitable client how the charity is to function as a non-share capital charitable corporation, how to comply with the numerous requirements under the *Income Tax Act* applicable to charities, how to comply with various government reporting requirements, as well as providing an explanation of the basic responsibilities and liabilities that members of the board of directors will face in operating the charity. As a result, not only must the lawyer provide a reporting letter on the incorporation and initial organization to the charity, which is often never done, but the reporting letter should be structured as an "operating manual" so that the letter can be used for reference by both the current and future members of the board of directors.

(3) Documenting Advice Given

When acting on behalf of a charitable client in conducting a legal risk management review, it is important that the lawyer provide a comprehensive report to the charity on the risks that have been identified, the consequences of those risks, and the recommendations made to reduce exposure to legal liability.

Even after a legal risk management review has been completed, there will often be need for subsequent consultations with the client to monitor the progress being made by the charity to implement the recommendations. In addition, an on-going charitable client will invariably need to contact the lawyer on a "as needs" basis to answer specific questions that may arise out of the legal management review. In all

of these situations, it is essential that timely and complete reports be provided to the client concerning the advice sought and the recommendations provided.

In the event that the lawyer is unable to prepare a report shortly after the advice has been given, a practical technique to ensure that timely reports are provided is to do an inventory of all files involving charities at the end of each month to ensure that up-to-date reports as necessary have been prepared and sent to all charitable clients.

6. *Conclusion*

Whether or not advising charities will become a speciality practice of law remains to be seen. There are good reasons why this may occur considering the number of charities in Canada, the size of the operations and the complexities of the law involving charitable operations. In the meantime, what is clear is that lawyers who are called upon by charities to provide legal advice must either do so in a thorough and professional manner or not at all, whether or not the work is provided on a *pro bono* basis or at a reduced rate. There is nothing at law which justifies a reduced level of service simply because the work is done as an act of charity itself. What the law does state is that all clients are entitled to assume that their legal counsel will take the initiative to warn of pending problems and the consequences associated therewith. This professional expectation has as much application to the charitable client as it does to any other.

As a result, lawyers who are called upon to assist charitable clients should approach their task in the context of not only providing technically correct legal services but going further and providing proactive legal counsel to anticipate and advise the client on avoiding unnecessary legal risks before they occur. It is hoped this paper will assist those practitioners in accomplishing this goal. Those who decide to conduct their practice in this context, they will find that the experience of counselling the charitable client will change from one of frequent frustrations to that of achieving a measure of personal satisfaction in having undertaken a difficult task in what one hopes is a thorough and competent manner.

7. *Appendix: Charity Legal Risk Management Checklist**

The following are key points for identifying and avoiding legal risks for charities.

1. Why it is Important to Identify and Manage Legal Risks

(a) *Increasing complexities and liabilities involved in operating charities*

(a) Large budgets
(b) Employee relationships
(c) Statutory employee deductions
(d) Wrongful dismissal
(e) Volunteer liability
(f) Charity rules under *Income Tax Act* and common law
(g) Relationships with the community
(h) Counselling practices
(i) Human rights legislation
(j) Public use of facilities
(k) Potential for child abuse and sexual harassment
(l) Directors and officers liabilities
(m) Lifestyle expectations for employees and/or members
(n) Discipline of employees and/or members
(o) Fundraising issues
(p) Corporate compliance requirements
(q) National/international relationships
(r) Insurance issues
(s) Trust funds
(t) Donor expectations
(u) Creditor relations
(v) Government regulatory bodies
(w) Diffuse decision-making structure
(x) Investment restrictions
(y) Maintaining the goodwill of volunteers
(z) Challenges to institutional authority

(b) *Consequences of deficient legal organization and charitable operations*

(a) Legal actions by aggrieved parties
(b) Increased damage awards
(c) Changing limitation period
(d) Legal costs in remedying problems
(e) Personal liability exposure for breach of trust
(f) Violation of human rights legislation
(g) Revocation of charitable status
(h) Loss of corporate status
(i) Control by special interest groups
(j) Public inquiries under the *Charities Accounting Act*
(k) Potential for splits in churches and/or community groups

(c) *Who is affected by deficient legal risk management*

(a) The charity and its assets
(b) The board of directors
(c) Officers
(d) Staff
(e) Volunteers

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(d) *Need to be proactive in reducing liability exposure*

(a) Waiting to react to problems is too late
(b) Need to be proactive to avoid problems before they occur
(c) Less expense in avoiding problems than repairing damage after the fact

(e) *Recommended procedures to identify and manage legal liabilities*

(a) Establish small committee as a Liability Management Committee to oversee reducing liability exposure
(b) Identify areas of liability exposure
(c) Obtain input from board and membership
(d) Obtain input from lawyer and accountant as required
(e) Upgrade insurance in consultation with insurance broker
(f) Develop historical record of insurance coverage
(g) Develop risk management procedures
(h) Educate membership on need for legal risk management
(i) Implement practical solutions expeditiously
(j) Regular monitoring of legal risk management procedures

2. Is Charitable Status Necessary?

(a) *Not every non-profit organization is a charity*

(b) *Is charitable status necessary or even desirable?*

(a) Restricted purposes of a charity
(b) Charities must be operated with significantly higher level of duty for directors
(c) There is no distribution of charitable property to members
(d) Involuntarily becoming a charity

(c) *Some form of fund raising may not require charitable status*

(a) Government funding, if available
(b) Moneys raised from businesses which can write off contributions

(d) *Can charitable purpose be accomplished without creating a new charity?*

(a) Joining forces with an existing charity with similar objects
(b) Acting as agent for established charity to carry out specific purpose

3. General Overview of Organizational and Legal Documentation

(a) *Identifying key organizational documents*

(a) Do key documents exist?
(b) Who has documents?
(c) Documents should be maintained at head office
(d) Do board members have copies of key documents?

(b) *Key organizational documents for an unincorporated charity*

(a) Constitution
(b) Amendments to constitution, if applicable
(c) Membership covenant, if applicable
(d) Mission statement

(c) *Key organizational documents for a corporate charity*

(a) Letters patent
(b) Supplementary letters patent, if applicable
(c) Membership covenant, if applicable
(d) Mission statement
(e) By-laws
(f) Directors resolutions
(g) Members resolutions
(h) Directors & officers register
(i) Members register
(j) Register of debts
(k) Copies of government filings

(d) *Determining other key legal documents*

(a) Leases
(b) Deeds
(c) Mortgages
(d) Agency agreements
(e) Licence agreements
(f) Association agreements
(g) Joint venture agreements
(h) Business name registrations
(i) Trade-mark registrations
(j) Charitable registration number

4. Review of Documents for Unincorporated Charity

(a) Is the charity structured as a trust or an association?
(b) Is correct name of charity shown on the constitution?
(c) Is name in constitution confusing with other existing charities?
(d) Are all constitutional documents available?
(e) Are there objects stated in the constitution?
(f) Are the objects exclusively charitable?
(g) Is there an organizational structure in the constitution?
(h) Do constitutional documents correctly reflect how the organization is actually structured and operated?
(i) Is there a dissolution clause in constitution to other charities?
(j) Does Revenue Canada have a copy of the constitution?
(k) Does Public Guardian and Trustee have a copy of the constitution?

5. Review of Corporate Structure

(a) *Review of letters patent*

(a) Is the name in letters patent the correct name of the charity?
(b) Is the name misdescriptive of the objects?
(c) Are there exclusively charitable objects?
(d) Are power clauses ancillary to charitable objects?
(e) Is there a membership covenant, if applicable?
(f) Is a rotating board authorized for Ontario corporations?
(g) Is an expansion of investment powers needed?
(h) Is there a dissolution clause to other charities?
(i) Are powers of a natural person restricted?

(b) *Review of supplemental letters patent*

(a) Change of name
(b) Change of objects
(c) Effect of change of objects upon existing charitable property
(d) Establish rotating board for Ontario corporations
(e) Possible need to apply for further supplemental letters patent as necessary

(c) *Letters patent of amalgamation*

(a) Only available for Ontario corporations
(b) Requires the same or similar charitable objects
(c) Existing charitable property must be held in trust for previous charitable objects
(d) Requires professional assistance in drafting amalgamation agreement

(d) *Review of corporate by-law for basic terms*

(a) Are objects correctly repeated?
(b) Is there a variable size of board? (not Ontario)
(c) Rotating term of board members
(d) Definition of directors
(e) Qualifications of directors
(f) Removal of directors
(g) Procedures for board meetings
(h) Board meetings by telephone (not Ontario) conference call
(i) Is an advisory board appropriate?
(j) Definition of membership
(k) Qualifications and rights of membership
(l) Discipline procedure
(m) Procedure for membership meetings
(n) Proxy vote of members (mandatory for Ontario)
(o) Description of officers' positions
(p) Appointment and removal of officers
(q) Establishment of an effective committee structure
(r) Provision for policy statements
(s) Lifestyle expectations for employees
(t) Alternative dispute resolution mechanism (ADR)
(u) Corporate year end
(v) Corporate seal
(w) Incorporation by reference of corporate by-law of another charity

(x) Indemnification of directors and officers
(y) Borrowing authorized
(z) Change in head office location
(aa) Appointment of auditor
(bb) Appointment of audit committee
(cc) Requirement for two signatures for cheques
(dd) By-law amendment procedure

(e) *Incomplete initial corporate organization*

(a) Initial by-laws not adopted by directors or members
(b) No initial directors resolutions
(c) No initial members resolutions
(d) No records of who are initial members
(e) No transfer of membership to incorporated charity
(f) No assignment of charitable registration number
(g) No transfer of assets to incorporated charity
- Real estate
- Bank accounts
- Investments
- Copyrights
- Business names
- Trade-marks

(h) No assumption of debts and obligations by incorporated charity
- Mortgages
- Bank loans
- Accounts payable
- Promissory notes

(i) No indemnification of directors and officers of unincorporated charity
(j) No consent to act as directors
(k) No signed application for membership
(l) No directors or officers register
(m) No membership register
(n) No debt register
(o) No registration under *Business Names Act* (Ontario)
(p) No banking by-law or resolution

(f) *Incomplete records of board decisions*

(a) Board minutes not kept in minute book or signed by chair
(b) No standardized format of board minutes
(c) Failure to maintain quorum of directors in by-law
(d) Failure to maintain at least three directors

(g) *Inadequate records of membership meetings*

(a) No records of admission of new members
(b) Membership minutes not kept in minute book or signed by chair
(c) Missing annual meetings to approve financial statements and appoint an auditor
(d) Failure to give notice to members
(e) Failure to elect directors
(f) Failure to admit directors as members within 10 days after election or appointment (for Ontario corporations)
(g) Failure to obtain membership approval for by-law

(h) Failure to record special resolutions requiring membership approval and publish in Ontario Gazette for Ontario corporations
- Change in head office
- Change in number of directors

(i) Failure to maintain quorum and/or at least three members to avoid personal liability for Ontario corporations

(j) Possible need to seek court order to remedy deficient records

(h) *Inadequate board and/or members authorization for indebtedness*

(a) Bank borrowing
(b) Unsecured loans
(c) Mortgages
(d) Planned giving vehicles

(i) *Maintaining corporate records*

(a) Need for multiple volumes
(b) Proper format of minutes for annual meetings
(c) Directors, officers & members register
(d) Location of corporate records
(e) Debt register

(j) *Maintaining corporate filings and registration*

(a) Ontario
- Initial form — 1
- Notice of change
- *Business Names Act* registration
- Report to Public Guardian and Trustee

(b) Canada
- Annual form 3 — Canada
- Extra-provincial form 2 — Ontario
- *Business Names Act* — Ontario registration
- Report to Public Guardian and Trustee — Ontario

(c) Jurisdiction of Public Guardian and Trustee applies to all charities operating in Ontario no matter where established

(d) Maintaining registration and information returns under federal *Lobbyists Registration Act*

(k) *Developing, recording and implementing policy statements*

(a) Preparing policy statements on
- Avoiding and reporting child abuse
- Avoiding sexual abuse
- Avoiding sexual harassment
- Supervising appropriate counselling

(b) Adopting policy statements by members

(c) Recording policy statements as part of corporate records

(l) *Loss of corporate status and dissolution*

(a) Dissolution through failure to maintain government filings
(b) Effect of dissolution and the *Escheats Act* of Ontario (vesting of property in the Crown)
(c) Compliance with the *Income Tax Act* upon dissolution
(d) Reviving a dissolved corporation
(e) Developing a contingency plan for dissolution

(m) *Proper use of corporate name*

(a) Is the name consistent with the charitable objects?
(b) Always use full corporate name
(c) Use of correct name on all letterhead and documents
(d) Proper signing of documents using full corporate name

(n) *Proper use of business names other than corporate name*

(a) Identification of business names
(b) Registration required under *Business Names Act* of Ontario with renewals every five years
(c) Relationship of business name and corporate name must be shown on all letterhead and documents

6. Specific Organizational Issues for Religious Charities

(a) *Constitutional issues for churches*

(a) Are religious objects exclusively charitable or only motivational?
(b) Is statement of faith documented?
(c) Have trustees been appointed under the *Religious Organizations Lands Act* to hold land for unincorporated churches?
(d) Do trustees understand their responsibility and exposure to liability?
(e) Should an unincorporated church become incorporated?
(f) Do objects of local churches reflect objects of a local congregation or those of a denomination?
(g) Are adherents as well as members to be bound by church constitution?

(b) *Specific policy statements for religious charities*

(a) Lifestyle expectations for members
(b) Avoiding and reporting child abuse
(c) Avoiding sexual harassment
(d) Ensuring that all members and employees are informed of and agree to abide by policy statements

(c) *Church discipline*

(a) Is the church to exercise discipline over its members and/or employees?
(b) Is the basis for church discipline explained in church constitution?
(c) Does the church constitution set out a procedure for church discipline?
(d) Does the procedure for church discipline reflect principles of natural justice?
(e) Is there a process of mandatory alternative dispute resolution (ADR) to reduce the threat of legal action?
(f) Are there limitations on withdrawal from membership in the event of church discipline?

(d) *Ministers on controlling boards of churches*

(a) Case law applied in a church context means that ministers should not be members of controlling board of churches
(b) Alternatives available
- Create one board to deal with spiritual matters only (*e.g.*, elders) and another board to deal with administrative matters only (*e.g.*, deacons)
- Establish a single board structure but ensure the minister is given right to attend and participate at board meetings
- Obtain court order to permit minister to be on church board

7. Utilizing Multiple Charitable Corporations

(a) *Use of multiple charitable corporations to reduce liability exposure activities*

(a) Contains liabilities of an associated charitable activity in a separate corporation
(b) Maintaining control over associated charitable corporations by controlling qualifications to be a director

(b) *Establishing and utilizing a parallel foundation*

(a) To assist in developing an endowment program
(b) To protect future assets in a separate corporation
(c) Using parallel foundation as a holding corporation for existing assets
(d) Maintaining control over parallel foundations by controlling qualifications to be a director
(e) Are foundation objects charitable?
(f) Are restrictions in objects needed to coincide with implications of foundation name?
(g) Are funds of operating charity deposited into parallel foundation?
(h) Are funds of operating charity being transferred to parallel foundation with different objects?
(i) Does dissolution clause of foundation conflict with limitations implied by name of foundation?

8. Board Management Issues

(a) *Identifying what group is in charge of the charity*

(a) Where does de facto control lie?
- Executive staff
- Key committees
- Key donors
- The board
- The membership

(b) Is board authority recognized by membership?

(b) *Determining lines of control between board and CEO*

(a) Is CEO in charge or is board?
(b) Is CEO accountable to the board?
(c) Is there regular contact by board with CEO?
(d) Are U.S. board models being relied upon without consideration of Canadian law?

(c) *Frequency and attendance of board meetings*

(a) Need to meet between 2-12 times a year depending on size of operations
(b) Board membership is not an honourary position
(c) Regular attendance at board meetings is mandatory

(d) *Establishment of audit committees*

(a) Number of members of audit committee
(b) Number of board members/non-board members
(c) Frequency of meetings of audit committee

(e) *Communicating board responsibilities to existing and future board members*

(a) Need to create a board binder consisting of
  (i) Letters patent
  (ii) Supplemental letters patent
  (iii) Membership covenant, if applicable
  (iv) Mission statement, if applicable
  (v) By-laws
  (vi) Policy statements
  (vii) Legal explanation of
    - General operation of a corporation
    - Operating a corporation as a charity
    - Board legal duties and liabilities

(b) Need to regularly update board binder
(c) Provide all future board members with copies of board binder
(d) Ensure return of board binder on retirement of directors

(f) *Developing an effective board*

(a) Provide agenda and relevant information to board members in advance of meetings
(b) Do not allow chairperson to pre-empt meetings
(c) Develop long range and short term goals
(d) Identify critical issues and deal with them
(e) Develop a board succession plan
(f) Develop a board with a broad range of experience
(g) Encourage board members to take and keep notes

9. Reducing Board Liability

(a) *Addressing conflict of remuneration of directors*

(a) Are executive director or other employees members of the board?
(b) Do board members receive any form of direct or indirect remuneration or benefit from the charity?
- Salary
- Contracts
- Free services
- Interest on outstanding loans to charity

(c) Is a court order appropriate to permit remuneration?
(d) Structure by-law to avoid problems
- Establish an advisory board
- Ensure that appropriate executive employees are given right to attend and participate at board meetings

(b) *Indemnification of directors and officers*

(a) Need to establish indemnify of directors and officers by by-law
(b) Need to approve indemnification by-law by members
(c) Review wording of indemnification by-law

(c) *Caution in delegating board responsibilities*

(a) Potential liability of committee members if doing work of board
(b) Potential liability of members of corporation if doing work of board

(d) *Reducing the size of the board*

(a) Reduces number of people exposed
(b) Alternative means of obtaining participation by non-board members
- Officer positions
- Committee members
- Advisory board

(e) *Effective use of committees*

(a) Delegate work of board to committees where possible
(b) Committee recommendations must be subject to board approval
(c) Committee members may avoid exposure as board members but must be limited to recommendations only

(f) *Implementing an advisory board*

(a) Advisory board facilitates obtaining advice from larger constituency
(b) No exposure of advisory board as directors if the advisory board does not function as a board of directors

(g) *Protecting personal assets of directors*

(a) Wealthier directors may be more exposed to claims as "deep pockets"
(b) Investigate financial viability of charity before accepting appointment to board
(c) Possible use of spouse as "safe haven" for family assets
(d) Need to comply with *Fraudulent Conveyances Act* in conveying assets
(e) Secure director and officer liability coverage through either the charity or homeowner policy, if applicable
(f) Mass resignation from board may not relieve directors from liability
(g) Do directors need to obtain independent legal advice?

(h) *Establishing due diligence procedures for board members*

(a) Obtain professional advice for difficult decisions and/or general guidance
(b) Regular review of governing documents and mission statement
(c) Regular review of activities of CEO and senior management
(d) Regular training sessions for staff
(e) Regular monitoring of staff supervision
(f) Regular review of payroll and statutory deduction from payroll
(g) Regular review of charitable activities compared to charitable objectives
(h) Regular review and update of corporate records
(i) Annual review and upgrade as necessary of insurance policies
(j) Maintaining board confidentiality
(k) Annual assessment of board's effectiveness
(l) Maintaining, updating and distributing board binder (See H — 5 above) to all board members
(m) Establishing and monitoring work of Legal Risk Management Committee
(n) Ensuring that policy statement on avoiding sexual harassment and child molestation is enforced
(o) Compliance with statutory duties to report child abuse
(p) Reduce physical hazards on premises
(q) Identify high risk ministries requiring greater monitoring
(r) Obtain release and waivers from the public as necessary
(s) Annual review of risk management policies

10. Insurance Considerations

(a) *Maintain historical record of insurance coverage*

(a) Type of insurance coverage, *i.e.*, occurrence basis v. claims made
(b) Need for historical records of insurance policy occurs where policy is on occurrence basis
(c) Maintain historical list of insurance companies
(d) Maintain historical list of names of insurance brokers

(b) *Annual report on existing coverage and recommendations from insurance broker*

(a) Insurance broker as professional advisor
(b) Need to obtain and carefully review annual report from insurance broker to determine coverage provided, coverage excluded and recommendations for additional coverage

(c) *Review and upgrade property insurance*

(a) Does policy cover protection for replacement cost?
(b) Is the amount of property coverage adequate?
(c) Review and upgrade policy endorsements as necessary
(d) Review and eliminate exclusions in policy as necessary or as possible

(d) *Review and enhance general liability coverage*

(a) Is the amount of general liability coverage adequate to cover future claims?
(b) Need to provide written disclosure of all changes in material risks to insurance broker annually
(c) Liability insurance provides coverage for negligent actions but does not generally provide coverage for:
    1. Intentional acts
    2. Criminal acts
    3. Fines and penalties
    4. Punitive and exemplary damages
    5. Wrongful acts of directors and officers, *e.g.*, discriminatory practices and breach of fiduciary duty
    6. Pollution and contamination
    7. Contract liability
(d) Possible problems in general liability policy
    1. Sexual abuse or harassment exclusion
    2. Molestation of children exclusion
    3. Mental anguish and distress exclusion
    4. Clergy malpractice
    5. Counselling coverage limitations

- Breadth of coverage
- Coverage only for named individuals

6. Exclusion for broadcasting, telecasts and advertising
7. Who are the insured?
   - Directors
   - Committee members
   - General membership
   - Volunteers
   - Spouses
8. Limitations on geographic area covered
9. Non-owned automobile liability rider
10. Professional liability coverage for specialized services
11. Are legal defence costs a part of or in addition to coverage limit?

(e) *Securing directors and officers liability coverage*

(a) Is director and officer coverage for wrongful acts a justifiable expenditure of charitable moneys?
(b) Is amount of director and officer coverage adequate?
(c) General exclusions in coverage for:
   - Criminal acts
   - Fines and penalties
   - Libel and slander
   - Wrongful dismissal
   - Personal injury including mental anguish and distress
   - Pollution and contamination

(d) Is coverage for directors and officers or for corporate indemnification?
(e) Are former directors, officers, trustees, managers and other leaders of the charity included as named insureds?
(f) What geographic area is covered and can it be extended?
(g) Are legal defence costs a part of or in addition to the coverage limit?
(h) Possibly use separate insurance company depending upon financial capability
(i) Possibly obtain director and officer endorsement on homeowner coverage

11. Third Party use of Charitable Property

(a) *Potential liability*

(a) Exposure under the *Occupiers' Liability Act*
(b) Charity owned or operated vehicles
(c) Contaminated food
(d) Defective equipment

(b) *Develop a property use policy*

(a) Property use policy needs to be in writing
(b) Develop appropriate forms as necessary
(c) Property use policy applies to land, buildings and vehicles
(d) Need for signed waiver from members of the public in some situations

(c) *Develop a sample licence agreement with indemnification*

(a) Licence agreement can be built into application form to use properly
(b) Indemnification of charity needed

(d) *Obtaining evidence of liability insurance*

(a) Require certificate of insurance from licensee
(b) Does insurance policy of charity cover use by licensees?

(e) *Appropriate rental charges*

(a) Flexible charges for charities
(b) Fair market value charge required for non-charities

(f) *Effectively implementing a property use policy*

(a) Establishing a property use committee
(b) Consistently applying property use policy

12. Real Property Issues

(a) *Re-register deeds within 40 years to maintain priority under the Registry Act (Ontario)*

(a) Need to deal with lands at least once every 40 years if not in Land Titles
(b) Possible loss of lands through fraud and/or boundary misdescription
(c) Problems of inadequate legal description in old deeds

(b) *Possible loss of exemption from municipal taxation for churches under the Assessment Act*

(a) Sale of church lands to third parties with lease back
(b) Effect of transfer to an associated corporation or parallel foundation

(c) *Implications of terms of trust under a church trust deed*

(a) Relevancy of old church trust deeds outside of 40-year search period in *Registry Act*
(b) Possible reversion to the grantor
(c) Doctrinal trusts
(d) Use trusts
(e) Possible need for *cy-près* court application if trusts cannot be complied with

(d) *Planning Act (Ontario) pitfalls*

(a) Merging of properties in the same name
(b) Inability to convey assembled parcels of land separately

(e) *Encroachments with neighbouring land*

(a) Ten-year rule in *Limitations Act*
(b) Documenting a beneficial encroachment
(c) Eliminating a prejudicial encroachment

(f) *Municipal zoning and legal non-conforming uses*

(a) Determine current zoning
(b) Monitoring change in zoning
(c) Effect of legal non-conforming use
(d) Upgrading zoning designation

(g) *Forced sale of land under Charities Accounting Act*

(a) Only applies to charitable corporations
(b) Public Guardian and Trustee may register notice on title of intent to sell land if
- Land is not actually used for charitable purposes for three years
- Land is not required for actual use for charitable purposes
- Land will not be so required in the immediate future

(h) *Liability for toxic property*

(a) Potential contamination from
- Underground oil/gas tanks
- Previous owners
- Tenants

(b) Effect of environmental legislation on current owners
(c) Liability exposure for trustees and/or directors
(d) Disclosure requirements on sale of property
(e) Investigate possibility of contamination before accepting gift of land from donors or estates
(f) Is an environmental audit needed?

13. Leasing Issues

(a) *Pitfalls in offers to lease*

(a) Long form of lease not attached to offer
(b) Improper description of parties and premises
(c) Need for subsearch and corporate search

(d) Tenant required to sign landlord's "standard form"
(e) No definition of "proportionate share" of operating expenses
(f) Limiting operating expenses in additional rent
(g) Permitted use by tenant
(h) Possible restriction on usage by other tenants
(i) Right of renewal
(j) Right of first refusal for additional space

(b) *The effects of personal guarantees in leases*

(a) Do guarantors understand effect of guarantee on their credit rating?
(b) Guarantee applies to whole debt not just pro-rata share of debt
(c) Guarantee should be limited in time
(d) Guarantee should be terminated on assignment of lease

(c) *Registering notice of lease on title — when and why*

(a) Seven-year priority rule under *Registry Act* (Ontario)
(b) Effect of amendments to lease on registered notice of lease

14. Intellectual Property Issues

(a) *Trade-mark Registration*

(a) Protection of key names and/or logos may require trade-mark registration
(b) Possibly extend trade-mark registration to include future use of trade-mark or "Section 9" registration to block use by others
(c) Proper notation of trade-marks, *i.e.*, "TM" for unregistered marks and "R" for registered marks

(b) *Ownership of copyright*

(a) Who owns copyright for books, pamphlets, and audio/video tapes
(b) Possible need to register copyright
(c) Possible need to assign and/or licence copyright

15. Employment and Volunteer Matters

(a) *Hiring policies and practices*

(a) Developing a hiring policy
(b) Compliance with exception provisions of the human rights legislation
(c) Application forms for employment
(d) Maintenance of personnel records

(b) ***Documenting lifestyle expectations for employees***

(a) Establishing general policy statements on lifestyle expectations
(b) Specific policy statements for employees and volunteers

(c) ***Establishing employment contracts***

(a) Form of contract
(b) Developing job description
(c) Use of contracts with present employees
(d) Use of contracts with future employees

(d) ***Documentation for volunteers***

(a) Written acknowledgment to set out expectations
(b) Consistent application of volunteer policies

(e) ***Developing and implementing an employee and volunteer manual***

(a) Initial development of an employee and volunteer manual
(b) Updating manual
(c) Consistently applying manual

(f) ***Discipline process***

(a) Development of employee discipline policy
(b) Application of discipline policy
(c) Natural justice requirements for discipline policy

(g) ***Occupational health and safety***

(a) Employer's duties
(b) Health and safety committees
(c) Employee refusal to do unsafe work

(h) ***Collateral statutory compliance matters***

(a) Pay equity
(b) Employment standards legislation
(c) Human rights legislation

16. Charitable Activities

(a) *Ensuring that operations are done in accordance with charitable objects*

(a) Activities that are *ultra vires* corporate authority
(b) Activities that contravene charitable purposes
(c) Need to regularly review charitable operations compared to objects

(b) *Related business activities*

(a) Permitted if related to charitable activities
(b) Need to regularly monitor related business operations
(c) Private foundations not permitted to carry on business operations

(c) *Deemed related business activities*

(a) Unrelated business activities will be deemed related business activities if done exclusively by volunteers
(b) Otherwise unrelated business activities need to be carried out through separate non-charitable corporation

(d) *Determine if charitable moneys are used to fund deficits in business operations*

(a) Are charitable moneys used to fund deficits in related or unrelated business operations?
(b) Potential liability for using charitable moneys to cover deficits in unrelated business operations

(e) *Political activities*

(a) Is activity fundamentally charitable or fundamentally political
(b) If activity is fundamentally political then
- must not involve partisan political activities
- must ensure that substantially all of its resources are devoted to charitable activities
- must not exceed 10% of disbursement quota on political activities

(f) *Restrictions on gifting of charitable property*

(a) Charitable property can only be gifted to another registered charity
(b) Not every "qualified donee" under *Income Tax Act* is a charity
(c) Dissolution clause should refer to transfers to other charities not qualified donees

(g) *Prohibited fundraising activities by charitable staff*

(a) Staff drafting wills for donors
(b) Staff drafting powers of attorney for donors
(c) Staff acting as an executor for a donor
(d) Staff acting as an attorney under a Power of attorney for a donor

17. Fiscal Management Issues

(a) *Are all salaries and benefits being paid?*

(a) Board needs to ensure regular payments of salaries and deductions
(b) Statutory and directed deductions must be treated as trust funds

(b) *Is the charity operating with a deficit and for how long?*

(a) Charity should not operate with continuing deficits
(b) Problematic deficits can occur through
- on-going operating deficits
- substantial cost overruns in a building program
- improvident investments

(c) Potential liability of directors to creditors if bills left unpaid
(d) Continuing deficits may expose directors to liability if charitable objects or statutory obligations cannot be met

(c) *How is deficit being funded?*

(a) Mortgaging of equity
(b) Promissory notes — unsecured
(c) Bonds and debentures — secured and unsecured
(d) Mortgage investment certificate programs
(e) Accounts payable to creditors
(f) Improper use of trust funds

(d) *Has a sinking fund been established to retire debt?*

(a) Debt requires a plan to repay debts, *i.e.*, a sinking fund
(b) Consequences if no repayment plan
(c) Continuing deficit may require wind-up of charity

(e) *Are improper fund raising vehicles in use?*

(a) The danger of "follow the leader syndrome" in fund raising
(b) Improper or illegal issuance of annuities
(c) Unsecured bonds
(d) Charity acting as trustee

(e) Government audits are not necessarily a "seal of approval"
(f) May need a court ruling or a definitive legal opinion before utilizing a particular fund raising program

(f) *Are investments being offered to the public without full disclosure?*

(a) Possibly need a "prospective" type of disclosure
(b) Is there full explanation of risk?
(c) Can obligations arising out of investment be met by charity?
(d) Need for independent legal advice for investors

(g) *Are funds being correctly invested and managed?*

(a) Restriction on investment powers in *Trustee Act*
(b) Possible expansion of investment powers in letters patent
(c) Improvident investments by charity
(d) The danger of "follow the leader syndrome" in investments
(e) Are charitable funds being held by charity officers either personally or through a private corporation?
(f) Are two signatures required on cheques and contracts?
(g) Are precautions being taken against fraud and theft?
(h) Is there full disclosure of terms of consulting contracts?
(i) Are payments under consulting contracts reasonable?

18. Trust Fund Issues

(a) *Are there donor designated trust funds being held by the charity?*

(a) Donor designated vs. board designated funds
(b) Donor designated moneys are trust funds to be used only in accordance with designation

(b) *Are trust funds kept segregated from operating funds?*

(a) Must be held as segregated funds (b) Must be accounted for separately

(c) *Are trust funds used for operational purposes or borrowed against?*

(a) Improper use of trust funds for operational purposes
(b) Improper borrowing from trust funds for operational purposes

(d) *Are charitable funds used only in accordance with charitable objects?*

(a) Charitable funds must only be used for charitable objects
(b) Effect of using charitable funds for non-charitable purposes

(c) *Misdirection of charitable funds*

(a) Are funds of one charity deposited into bank account of another charity?
(b) Are funds of operating charity being transferred to charity with different objects?

(f) *Trust funds issues in building projects*

(a) Are statutory trust obligations under construction lien legislation being complied with?
(b) Are holdbacks in building projects being complied with?

(g) *Consequences of breach of trust*

(a) Personal liability of directors and officers
(b) Involvement of Public Guardian and Trustee under *Charities Accounting Act* (Ontario)
(c) Violation of the *Trustee Act* (Ontario)

19. Maintaining Charitable Registration

(a) *Co-ordinating correct name of charity with records of Revenue Canada*

(a) Compare name in letters patent to that recorded with Revenue Canada
(b) Communicate with Revenue Canada to rectify any errors

(b) *Maintaining current address with Revenue Canada*

(a) Does Revenue Canada have current head office address?
(b) Improper head office address may result in deregistration of charity

(c) *Obtaining Quebec charitable registration*

(a) Is Quebec registration required?
(b) Procedure to obtain registration in Quebec
(c) Annual filings within six months of financial year end

(d) *Maintaining statutory requirements of Revenue Canada*

(a) Is 80% disbursement quota being met?
(b) Do more than 50% of the directors deal with each other at arm's length?
(c) Does more than 50% of the capital contributed come from one person or persons not dealing at arm's length?
(d) Has annual return (Form T3010) been filed with Revenue Canada within six months of fiscal year end?

(e) *Monitoring improper issuance of charitable receipts*

(a) Improper receipts for mix of purchase of goods and donations
(b) Improper receipts for donations that benefit donors
(c) Improper receipts for gifts of service
(d) Improper receipts for gifts of kind
(e) Improper receipts for gifts with inducements

(f) *Properly documenting agency relationship with non-qualified donees*

(a) Agency requirements of Revenue Canada when transferring funds and/or assets to non-qualified donees
(b) Agency documentation required

(g) *Properly documenting joint venture arrangements*

(a) Determine if a joint venture agreement is needed with non-qualified donees
(b) Preparing and negotiating a joint venture agreement
(c) Complying with terms of the joint venture agreement

(h) *G.S.T. considerations*

(a) When to register for G.S.T.
(b) Availability of input tax credit and rebates for charities

20. National/International Relationships

(a) *Documenting relationship with national organizations and/or subsidiary chapters*

(a) Relationship with national organization
- Membership in national organization
- National board structure

(b) Relationship with subsidiary chapters

- Separate incorporation of chapters to limit liability
- Grant of licence of charity name to chapters
- Structure to oversee standards of chapters
- Alternative dispute resolution mechanism (ADR) to reduce litigation
- Improper control by national organization over chapters, *e.g.*, unilateral imposition of dissolution on chapters

(b) *Documenting relationship of national organization to international structure*

(a) Documenting international structure
(b) Grant of licence of name to national organization
(c) International input through national board qualification
(d) Alternative dispute resolution mechanism (ADR)

(c) *Establishing ownership of trade-marks and licensing documentation*

(a) Who owns key trade-marks internationally
(b) Registration of trade-marks
  - In Canada
  - In other jurisdictions
(c) Usage of trade-marks through licensing
(d) Revoking grant of licence