**"PRO-ACTIVE PROTECTION OF CHARITABLE ASSETS"**
**A SELECTIVE DISCUSSION OF LIABILITY RISKS**
**AND PRO-ACTIVE RESPONSES**

# I N D E X

*Law Society of Upper Canada*

# "PRO-ACTIVE PROTECTION OF CHARITABLE ASSETS" A SELECTIVE DISCUSSION OF LIABILITY RISKS AND PRO-ACTIVE RESPONSES

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## A. INTRODUCTION

There is a new reality that charities are now having to face by necessity: survival. Litigation against charities is rampant and if there ever was a perception that charities would be treated more leniently by the legal system, such a misconception has in recent years been unequivocally put to rest.

In *Christian Brothers of Ireland in Canada (Re)*[1], the Ontario Court of Appeal reconfirmed that in Canada there is not now and there never has been immunity from liability for charities. This affirmation of the rejection of charitable immunity is not all surprising. The doctrine of charitable immunity considered by the Canadian Courts originated in the dicta of two early English cases: *Feoffees of Heriot's Hosp. v. Ross*[2] and *Holiday v. The Vestry of the Parish of St. Leonard*[3]. However, these two cases were soon after overruled in England by *Mersey*

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1 (2000), 47 O.R. (3d) 674.
2 [1846] 8 All E.R. 1508.
3 [1861] 142 All E.R. 769.

*Docks v. Gibbs*[4]. As a result, in England, charities have not had charitable immunity for over 100 years and are therefore subject to liability for their torts. In the United States, where charitable immunity once did have a foothold, many states have since eliminated charitable immunity or instead greatly limited the immunity given to charities[5]. Similarly, in Canada, the Supreme Court of Canada in *Bazley v. Curry*[6] (also known as *B. (P.A.) v. Curry*), ruled there was no basis for creating a status-based liability exemption for charity and non-profit organizations at common law. Accordingly, absent explicit granting of statutory immunity, Canadian charities and non-for-profit organizations cannot assert any immunity defense for tort-related offences.

As is apparent from newspaper and law reports, charities in general, and churches and religious charities in particular, are now facing insurmountable liability claims and even insolvency as a result of lawsuits for sexual abuse, sexual harassment and other tort claims[7]. Plaintiffs asserting claims against charities are tending to use more aggressive measures to seek damages from the perceived "deep pockets" of charities. In some cases, tort creditors are also seeking punitive and/or exemplary damages against charities, while in others they have sued the directors and officers of charities in their personal capacities. In *Christian Brothers,* the Ontario Court of Appeal went even further and ruled that any special purpose charitable trust funds of a charity are exigible to tort claims arising from wrongs committed by the charity even if such wrongs are totally unrelated to the special purpose charitable trust funds in question[8].

The exposure of charitable assets to tort liability goes further than just the loss of charitable assets and/or the insolvency or winding up of a charity. Directors of these charities may now also be faced with possible legal action being brought against them personally by donors, members, third parties and governmental authorities for breach of their fiduciary duties or even breach of trust in failing to protect the assets of a charity and in not applying those assets for their intended charitable purposes. Given the threats to both charities and their directors, there is developing an

4 [1866] 11 All E.R. 1500.
5 See *Restatement*, 2d, Torts, §895E.
6 [1999] 2 S.C.R. 534.
7 See *M. (F.S.) v. Clarke*, 2000 BCSC 432, and *ibid.*
8 See *supra*, note 1.

urgent need to protect charitable assets from future lawsuits and creditors and to do so on a "pro-active basis[9]."

The purpose of this paper is to outline the responsibility of directors of charities, whether incorporated or not, to protect charitable assets, and then to provide an overview of some new and existing areas of liability exposure currently being faced by charities in Canada as well as the means available to protect charities against such risks. It is impossible for one paper to adequately discuss all aspects of the liability exposure being faced by charities today and the pro-active steps that charities and their board of directors need to take to protect themselves. Instead, this paper will selectively discuss a few of the more important issues that are thought to be of practical assistance to legal practitioners so that they may be better equipped to provide substantive advice on these matters to their charitable clients.

## B. DUTY OF DIRECTORS TO PROTECT CHARITABLE ASSETS

### 1. Fiduciary and Other Common Law Duties

The recent decision of the *Ontario (Public Guardian and Trustee) v. Aids Society for Children (Ontario)*[10] case has re-emphasized the fiduciary responsibilities that are placed upon directors of charities. In her decision, Madam Justice Haley of the Ontario Superior Court of Justice defined "fiduciary" as *"someone who stands in a position of trust to another individual."* She stated further that:

> *The position of the directors of the Society is equally clear. The directors stand in a fiduciary relationship to the Society and are therefore required to act in such a way as to support and further the objects of the Society as a charitable institution[11].*

9 For a discussion of pro-active advice for charities and the utilization of a checklist in this regard, see Terrance S. Carter, "Advising the Charitable Client: Pro-active Legal Risk Management Advice" in *Law Society of Upper Canada Special Lecture Series 1996, Estate Planning, Administration and Litigation* (Toronto: Carswell, 1996)(also available at www.charitylaw.ca)

10 (2001), 39 E.T.R. (2d) 96

11 *Ibid.*, para. 29.

However, the fiduciary duties of directors go beyond the mere furtherance of the charitable objects of a charity. Rather, the court held that directors of a charity, although they may not be trustees of the charitable property of the charity in question, *"are, to all intents and purposes, bound by the rules which affect trustees*[12]*."*

The essence of the fiduciary relationship is that the interests of the charity are put ahead of the interests of the directors. The duty of a director of a charity, as a fiduciary, goes beyond mere diligence in decision making, investing charitable property, or performing corporate governance. It includes the active management and protection of the charitable assets[13]. Therefore, any loss of charitable assets due to the inactivity or nonfeasance of the directors may render such directors liable for breach of their fiduciary duties, or possibly even breach of trust, for the director's failure to conserve the charitable property[14].

Whether charities are trustees of all or part of their charitable property, or whether directors are trustees of a charity and its property, has been the topic of some interesting legal debate[15]. The reality is that the fiduciary obligation upon directors of a charity to protect charitable property is akin to that of a trust[16]. In recognizing the trustee nature of the fiduciary obligation of directors of a charity, the court, in the *Aids Society for Children* case, emphasized that directors of a charity have a fiduciary duty to apply charitable property towards the charitable objects of the charity. This in turn requires the preservation of charitable property. Whether the failure to do so is seen as a breach of trust or a breach of fiduciary duty is of little consequence in practical term, since in both situations, the directors would be faced with personal liability for having permitted the dissipation of charitable property.

In imposing fiduciary duties upon directors to preserve the assets of a charity, the common law imposes a "subjective test" in determining whether a director of a charity has exercised reasonable care in protecting and administering the charitable assets. Under this test, a director of

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12 *Ibid.*, para. 30.

13 H. Picarda, *The Law and Practice Relating to Charities*, 2d ed. (Toronto: Butterworths, 1995) at 459-465.

14 J. Warburton & D. Morris, *Tudor on Charities*, 2d ed. (London: Sweet & Maxwell, 1995) at 254.

15 See Justice Maurice C. Cullity, "The Charitable Corporation: A 'Bastard' Legal Form Revisited" (Paper presented to Fundamental New Developments in the Law of Charities in Canada, held on October 27, 2000 by Canadian Bar Association – Ontario Continuing Legal Education)

16 See *Public Trustee v. Toronto Humane Society* (1987), 60 O.R. (2d) 236.

a charity is expected to act with a degree of skill and care that would be reasonably expected from a person with that particular person's knowledge and experience as opposed to an objective test of what a "reasonably prudent person" would do[17].

The position taken by the Office of the Public Guardian And Trustee ("PGT") regarding the duties of directors of a charity assists in understanding the fiduciary duties of directors of charities in Ontario. The PGT is of the opinion that the directors of a charity have, *inter alia*, the following duties[18]:

a) Duty to be reasonable, prudent and judicious;
b) Duty to carry out the charitable purposes of the charity;
c) Duty to avoid conflict of interest situations;
d) Duty to act gratuitously;
e) Duty to account;
f) Duty to manage the charity's assets; and
g) Duty to exercise specific powers, such as investment powers and the power to hold realty under the *Charities Accounting Act.*

According to the PGT's Bulletin, the directors of a charity have a duty to manage the charity's asset, and cannot delegate this responsibility to anyone else. They must make the necessary decisions concerning the charitable assets. Even where they require assistance with the day-to-day management of the charity from employees, or assistance from outside consultants or professionals, they must maintain supervision and control over the work performed by such employees, consultants and professionals, and must remain fully responsible for the work carried out by employees. This is very different from the "Carver Model of Board Governance" originating out of the United States that generally advocates that directors should limit themselves to policy matters only and leave responsibility for administration and day-to-day matters with the executive staff of the charity[19].

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17 See *Re City Equitable Fire Insurance Co. Ltd.*, [1925] 1 Ch. 407 (C.A.), and also see D. J. Bourgeois, The Law of Charitable and Non-profit Organizations, 2d ed. (Toronto and Vancouver: Butterworths, 1995) at 135.

18 Ontario Public Guardian and Trustee, "Duties, Responsibilities and Powers of Directors and Trustees of Charities" *Bulletin #3: Information from the Public Guardian and Trustee's Charitable Property Program* (Toronto: Office of the Public Guardian and Trustee of Ontario, 1999) (also available at www.attorneygeneral.jus.gov.on.ca/html/PGT/bullet3.htm)

19 See J. Carver, *Boards That Make a Difference* (Jossey-Bass Inc., 1990); Also see Hannibal B. Johnson, "Getting on Board: Legal, Ethical, and Practical Considerations for Nonprofit Board Members" (1997) Winter, Tulsa Law Journal.

The PGT also takes the position that directors of charities have a duty to guard charitable assets from undue risk of loss, and not only the actual loss of such assets[20]. A director of a charity may therefore be personally liable for placing charitable assets under undue risk of loss even though an actual loss has not yet occurred. This requires that directors of charitable organizations need to foresee undue risks that the charity may be facing and take pro-active steps to avoid placing charitable assets under such risk even before any losses actually occur.

Some of the other common law duties that flow from the fiduciary responsibility of directors of a charity to protect charitable property are outlined below as follows[21]:

a) Duty to comply with the terms of special purpose trusts and to apply charitable assets toward the charitable purposes.

Directors of a charity have the duty to monitor the application of charitable assets towards the charitable objects contained in its constating documents. In case of special purpose trusts, the directors have the duty to ensure that the trust is carried out in accordance with the terms set out in the trust instrument. It is a breach of trust for directors of a charity to divert a fund intended for a particular charitable purpose to another, or to co-mingle any special purpose trust funds with its general funds.

b) Duty to invest charitable assets including trust funds.

Directors of a charity have an obligation to invest the trust funds held by the charity if a particular trust instrument provides so, or if the constitution of the charity mandates. However, the directors may also have duties to invest the general charitable assets of the charity if those assets are not in use. Since the common law imposes a higher duty of care on directors of a charity to guard the charitable assets from undue losses, the "corporate opportunity loss" or the "opportunity cost" in failing to take active steps to take advantage of investment opportunities for charitable assets may also constitute an undue loss of charitable property.

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20 *Supra*, note 18 at para. 2.

21 See *supra*, note 14, at 236-261; *Supra*, note 13, at 459-461.

c) Duty to conserve the trust property from misappropriation.

This duty is closely related to the duties of directors of a charity to protect charitable assets. It is a breach of trust for directors of a charity to cause the destruction or undue loss of any trust property or other charitable property. Directors of charities may be found in breach of their duties if charitable properties are transferred to nonqualified donees, as defined in the *Income Tax Act*[22], without receiving fair market value, or if the properties are improperly transferred to qualified donees. Directors of a charity may also be found liable for the failure to take active steps to protect a charity's trademarks, domain names, associated goodwill, and other intellectual property.

d) Duty to act gratuitously.

A trustee must not allow himself to derive a personal profit from his trust in the absence of the express authority in the trust or gift instrument. Under this rule, a director of a charity similarly shall not take or hold any interest in property belonging to the charity or receive remuneration from the charity unless the courts, other relevant government authorities, statutory law, or the trust or gift instruments themselves permit otherwise.

e) Duty to apply for *cy-prés* use of charitable property.

Where it is no longer possible to utilize charitable property for its original intended purpose, directors of a charity have a duty, where the case law permits and requires the property to be applied *cy-prés* (i.e., "as near as possible"), to secure the most effective use of such charitable property by taking active steps to apply it for a charitable purpose as similar to the original intended purpose as possible. The directors may apply to the PGT under Section 13 of the *Charities Accounting Act*[23] or to the courts for direction if there are any uncertainties or administrative difficulties in utilizing charitable property in such an amended manner.

22 R.S.C. 1985, c.1 (5th Supp.)
23 R.S.O. 1990, c. C-10.

2. Statutory Liabilities under the *Charities Accounting Act*

The *Charities Accounting Act* complements the fiduciary duties placed upon directors to manage and protect charitable assets by imposing liability upon directors for their failure to do so. This imposition of liability is achieved by providing certain rights to donors and to the PGT to call directors to account for their improper application of charitable funds.

The applicable donors rights provided for under the *Charities Accounting Act* ("CAA") are summarized below as follows[24]:

a) Section 6 of the CAA

Section 6 of the CAA allows a donor to make a complaint about the fundraising practices of a charity by simply delivering a written complaint to any judge of the Ontario Superior Court of Justice. The judge may then order an investigation by the Office of the Public Guardian and Trustee ("PGT") in the same manner as if the PGT were conducting a public inquiry under the *Public Inquiries Act.* In this regard, Section 6 (1) and (2) of the CAA provide for the following procedures:

> *Section 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.*

> *Section 6(2) - Every such complaint shall be in writing and delivered by the complainant to a judge of the Superior Court of Justice.*

Section 6(6) of the CAA states that the report of the PGT concerning the investigation is to be given to the judge who ordered the investigation, as well to the Attorney General of Ontario

24 For a more detailed discussion on directors statutory duties under the *Charities Accounting Act*, see Terrance S. Carter, "Looking a Gift Horse in the Mouth" (Paper prepared for the Osgoode Hall Law School Professional Development Program, 2000) (also available at www.charitylaw.ca)

in writing. Under section 6(7) of the CAA, a judge may then subsequently order a passing of accounts of the charity that is being investigated. Section 6(8) of the CAA, though, states that the right to complain to a judge about the fundraising practice of a charity does not apply to a "religious or fraternal organization".[25]

b) Section 10 of the CAA

Section 10(1) of the CAA provides a mechanism whereby two or more people can allege a breach of trust involving a charitable purpose and may apply to the Ontario Superior Court of Justice for an order or direction as the Court considers just, including an order for an investigation by the PGT. Such investigation could lead to a demand for a formal passing of accounts by the charity under Section 3 of the CAA, as well as an order under section 4(d) of the CAA to enforce donor directions as explained below.

c) Section 4(d) of the CAA

Although not a specific right of a donor under the CAA, a complaint concerning the fundraising practices of a charity could result in the PGT seeking an order under section 4(d) of the CAA that would indirectly cause a review of the fundraising practices of the charity. In this regard, section 4 of the CAA provides a mechanism that allows the PGT to obtain a court order, amongst other remedies, to enforce directions established by a donor in making a charitable gift. The relevant wording of section 4 of the CCA is set out below as follows:

> *Section 4 - If any such executive or trustee,...*
>
> *<u>(d) is not applying any property, fund or money in the manner directed by the will or instrument</u>, ...*

25 For more judicial discussions concerning the impact of s.6 of the *Charities Accounting Act*, see *Stahl v. Ontario Society for the Prevention of Cruelty to Animals* (1980), 70 ).R. (2d) 355; *Dr. Piero Boldieri v. The Hamilton Naturalist Club* Unreported, October 18, 1995 (Ont. Gen. Div.). For commentary of these cases, see Carter, *supra*, note 9 at 273.

*a judge of the Superior Court of Justice upon the application of the Public Trustee, may make an order,*

*(e) directing the executor or trustee to do forthwith or within the time stated in the order anything that the executor or trustee has refused or neglected to do in compliance with Section 1, 2 or 3, or with regulations made under this Act; ...*

*(g) removing such executor or trustee and appointing some other person to act in the executor's, or trustee's stead;...*

*(j) giving such directions as to the future investment, disposition and application of any such property, funds or money as the judge considers just and best calculated to carry out the intentions of the testator or donor; ...*

*(k) imposing a penalty by way of fine or imprisonment not exceeding twelve months upon the executor or trustee for any such default or misconduct or for disobedience to any order made under this section...* [Emphasis added]

The procedure set out in section 4 of the CAA means that if a charity fails to comply with a direction by a testator in a will or by a donor in a written instrument, then the PGT, either on its own initiative or as a result of a complaint received from a donor or anyone else, has the ability to bring the matter before the court and to request that the charity be removed as the trustee of the directed fund and that a new trustee be appointed. Alternatively, the PGT could request that the court require the charity to comply with the terms of the directions given by the donor, as well as possibly impose a penalty or even imprisonment on the charity or its directors.

d) Section 3 of the CAA

Under section 3 of the CAA, if a donor makes a complaint to the PGT concerning a fundraising practice of a charity or a misapplication of directed funds, the PGT has the statutory right to require a charity to submit its accounts for a formal passing of accounts before a judge. The relevant wording of section 3 of the CAA sets out the following procedures:

> *Section 3 - Whenever required so to do by the Public Guardian and Trustee, an executor or trustee shall submit the accounts of dealings with property coming into the hands or under the control of the executor or trustee under the terms of the bequest or gift to be passed and examined and audited by a judge of the Superior Court of Justice.*

The requirement for a formal passing of accounts could then result in the court issuing an order under section 4 of the CAA as already discussed above.

## C. <u>IDENTIFYING AND RESPONDING TO NEW LIABILITY RISKS</u>

### 1. <u>Exigibility of Special Purpose Trust Funds</u>

#### a) Description of Risk

Canadian charities in recent years have expanded the use of donor restricted charitable gifts or special purpose charitable trusts in fundraising, in part on the understanding that they would be protected from tort claims and other creditors of the charity. Special purpose charitable trusts include gifts to endowment funds, scholarship funds, building funds, 10-year gifts under the *Income Tax Act*, donor advised funds, and testamentary gifts where the testator imposes restrictions on the use of funds. Until recently, it was assumed that special purpose charitable trusts of a charity were protected as trust property from claims against the charity as trustee. This understanding was thrown into turmoil when the Ontario Court of Appeal in the *Christian Brothers* case held that special purpose charitable trusts are exigible to tort claims even though such claims arose from wrongs which were not perpetuated within the framework of the particular special purpose charitable trust in question. In 2001, the Supreme Court of Canada denied leave to appeal from the Ontario Court of Appeal decision[26]. However, an application is being made to request the Supreme Court of Canada to reconsider its decision in conjunction with an application for leave to appeal from the British Columbia Court of Appeal's decision in the *Christian Brothers* case[27].

The Ontario Court of Appeal decision in the *Christian Brothers* case arose out of an appeal from the lower court judgment of Mr. Justice Blair concerning a question about the exigibility of charitable property [28]. The lower court decision involved an application to determine whether property held in trust by the Christian Brothers of Ireland in Canada ("CBIC") was available to compensate tort creditors of CBIC, which was being wound-up under the *Winding-Up and Restructuring Act*[29]. The matter had arisen because the CBIC had general corporate assets totaling only four million dollars ($4,000,000.00) but judgments obtained by tort victims from the Mount Cashel Orphanage in Newfoundland totalled in excess of thirty-six million dollars ($36,000,000.00). A primary issue dealt with by the lower court was whether two schools located in British Columbia that the CBIC purportedly owned in trust were exigible to satisfy the claims of the tort victims in Newfoundland.

The lower court held that general corporate property of a charity is not immune from exigibility by tort creditors. However, property held as a special purpose charitable trust by a charity would not be available to compensate tort creditors of a charity unless the claims arose from a wrong perpetrated within the framework of the particular special purpose charitable trust in question.

In the Ontario Court of Appeal decision, Madam Justice Feldman agreed with the lower court that there was no general doctrine of charitable immunity applicable in Canada. However, Justice Feldman stated that once the lower court judge had determined that there was no doctrine of charitable immunity in Canada, it then became redundant for the judge to analyze whether special purpose charitable trusts of a charity were exigible to pay the claims of tort creditors. As

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26 For a more detailed discussion on the Supreme Court of Canada denial of the leave to appeal from the Ont. C.A. decision in Christian Brothers case, see Terrance S. Carter, "Supreme Court's Refusal to Grant Leave to Appeal in Christian Brothers Case Prejudices Charities" Charity Law Bulletin #3, at www.charitylaw.ca.

27 *Brothers Pascal Rowland et al. v. The Christian Brothers of Ireland in Canada et al.*,2001 BCCA 527.

28 See *supra*, note 1.

29 R.S.C. 1985, c. W. 11.

a result, the Ontario Court of Appeal held that all assets of a charity, whether they are beneficially owned or whether they are held pursuant to special purpose charitable trusts, are available to satisfy the claims of tort victims upon a winding-up of a charity.

By exposing special purpose charitable trusts to the claims of creditors, the Ontario Court of Appeal has undermined one of the primary means by which charities raise monies from donors, i.e. by encouraging donors to give endowment funds and scholarship funds. As donors become more sophisticated in their charitable giving and demand more accountability from charities, the use of special purpose charitable trusts is more and more becoming a major fundraising vehicle, particularly for donors wishing to make large gifts to charities. However, as a result of the Ontario Court of Appeal's decision in The *Christian Brothers* case, charities will now be unable to assure donors that special purpose charitable trusts will be protected and accordingly, this important means of fundraising will likely become less prevalent in the future.

An earlier commentary on the impact of the Ontario Court of Appeal's decision by the author was contained in an article entitled "*Donor Restricted Charitable Gifts: A Practical Overview Revisited*", dated November 22, 2000, prepared for the Law Society of Upper Canada[30].

Some additional comments concerning the problematic rationale of the Ontario Court of Appeal's decision in the *Christian Brothers* case and its long-term impact upon charities are set out as follows[31]:

- Although not specifically stated in its decisions, the rationale by which that the Ontario Court of Appeal has been able to conclude that the assets of charitable purpose trusts are exigible to pay unrelated claims against the trustee is to make an apparent distinction between private trusts and charitable purpose trusts. There appears to be an underlying assumption by the Ontario Court of Appeal that a charitable purpose trust held by a charitable entity as trustee is tantamount to a trustee

30 Terrance S. Carter, "Donor Restricted Charitable Gifts: A Practical Overview Revisited" (Paper presented to the Law Society of Upper Canada 3rd Annual Trusts and Estates Forum, held on November 22, 2000) (also available at www.charitylaw.ca)

31 See *supra*, note 26.

holding property in trust for itself, thereby precluding a trust in the first place. This line of reasoning appears to come from a misconception that charitable purposes trusts do not have identifiable beneficiaries who are able to enforce the charitable purpose and it is therefore as if the trustee is holding the charitable trust property in question for itself.

- The Ontario Court of Appeal failed to recognize that a basic attribute of a charitable purpose trust is that it is exempt from the requirement of having identifiable beneficiaries as required for a private trust. This is because the public at large receives the benefit of a charitable purpose trust and consequently the members of the public are collectively the beneficiaries of such a trust. Since it would be impossible for all members of the public to enforce the trust, it falls upon the Attorney General on behalf of the Crown to enforce the terms of a charitable purpose trust in accordance with its *parens patriae* role. A charitable purpose trust has always been recognized at law to be as valid a trust as a private trust. Accordingly, it follows that this decision to allow creditors to seize property held by a charitable trustee in a charitable purpose trust, where the creditors' claims are unrelated to the trust in question, could be argued to mean that any trust property held by a trustee, including trust property held pursuant to a private trust, is available to satisfy unrelated claims against the trustee personally.

- The court's decision introduces significant uncertainty in the law and in its impact on the operations of charities and trusts generally. As a result, it has caused considerable confusion for charities and therefore will prejudice the financial viability of the charitable sector in Canada.

- Lawyers who act on behalf of charities which operate as part of international charitable organizations will now likely advise against establishing international operations in Canada because of a fear that to do so would expose charitable purpose trusts acquired from international sources to the claims of tort claimants in Canada.

- The Ontario Court of Appeal's decision may result in discriminatory treatment between otherwise identical charitable purpose trusts. In some cases, charitable trust documents provide a mechanism for amending the trust to ensure that the trust property can continue to be used for its intended charitable purpose, similar to what a court could do in exercising its inherent *cy-prés* power. For example, some charitable purpose trust declarations contain clauses to the effect that if the charitable purpose in question becomes impossible or impracticable to carry out, the trustee may apply the capital to another charitable purpose without obtaining a court order. In practical terms this would mean that a charity facing insolvency or winding up which holds an endowment fund for a particular purpose would be authorized to transfer that fund to another charity.

  However, the majority of trusts, particularly testamentary trusts drafted before the mid-1990s, will not have adequate *cy-prés* clauses. In particular, older trusts drafted by solicitors who did not have experience in dealing with charities on a regular basis do not likely have such an amendment clause included in them. Trusts in this latter (and larger) class are therefore more likely to be adversely affected by the decision.

- Further discrimination may result between funds donated to incorporated charitable entities and those donated to unincorporated charities. The Ontario Court of Appeal's decision appears to conclude that charitable purpose trusts do not have real beneficiaries who are distinct from the trustee and so when the trustee ceases to operate, the trust purposes also cease to exist and the obligation to use the assets for the trust purposes also ceases. There is a concern that this analysis may be interpreted to mean that charitable purpose trusts do not exist at all because the charity is only holding property in trust for itself. If this is how the decision is applied, it could adversely affect the validity of donations to charities that are organized as unincorporated associations.

  A charitable gift to an incorporated charity is not dependant upon the gift being a charitable purpose trust, since a charitable corporation can hold property in accordance with its corporate objects whether or not there is a charitable purpose trust. As such, the Ontario Court of Appeal's decision would not adversely affect the validity of a charitable gift to an incorporated charity. However, an identical gift to an unincorporated charitable entity may be defeated because such charities do not have the legal capacity to receive gifts absolutely, as they are not legal entities. Gifts to such charities would be upheld, however, if the gift was in fact a trust for a charitable purpose. The Ontario Court of Appeal's decision calls into question whether such trusts even exist at law and accordingly there is a concern that it could be applied so as to invalidate such charitable gifts. This may lead to increased estate litigation involving donations to unincorporated charities.

- Many lawyers who have advised charities and/or donors in the past that special charitable purpose trusts are exempt from unrelated claims against the charity as trustee will now have to explain why funds that had been previously donated are now at risk of being used to pay claims that are unrelated to the specific charitable purpose trust to which they were donated.

- The proceedings leading to the Ontario Court of Appeal decision were winding-up proceedings pursuant to the *Winding-up and Restructuring Act*. The Court's decision appears to presume to apply to Vancouver College and St. Thomas Moore Collegiate, two schools in British Columbia which the courts in British Columbia have concluded are held in trust for the specific purposes of those specific schools. It is apparent from reading the decision, and in particular, paragraph 103 therein, that the Ontario Court of Appeal did not have before it the facts related to those two specific schools and did not have the jurisdiction to deal with charitable property in another jurisdiction.

- In *Brother Pascal Rowland et al. v. Vancouver College Limited et al.*[32], issued September 20, 2001, the British Columbia Court of Appeal addressed the specific issues related to the ownership of the two British Columbia schools. The majority

[32] See *supra*, note 27.

judgment of the British Columbia Court of Appeal did not address the applicability of the Ontario Court of Appeal decision to a trust in British Columbia. However, Mr. Justice Braidwood, in dissent, concluded that the law of British Columbia, and not the Ontario Court of Appeal decision, would apply to the two charitable purpose trusts which the British Columbia Court of Appeal found to exist for the purpose of the two schools. Mr. Justice Braidwood also concluded that the Ontario Court of Appeal decision does not reflect the law of British Columbia and that under British Columbia law the assets of a charitable purpose trust would only be exigible where the wrong had been perpetrated within the framework of the particular charitable purpose trust in question.

- Mr. Justice Braidwood's analysis does highlight another area of concern raised by the Ontario Court of Appeal's decision and that is a concern that a court in one jurisdiction could affect the assets of a charitable trust in another jurisdiction. This possibility, together with the fact that an appellate court judge in one province has now concluded that the law on this fundamental question is not uniform across the country, will also contribute to the continued confusion for charities arising from the Ontario Court of Appeal's decision.

b) Responses to the Risk

Given the risk that charities may lose significant assets contained in special purpose trust funds to tort claimants as a result of the Ontario Court of Appeal's decision in the *Christian Brothers* case, it is incumbent upon directors of charities and their legal counsel to review the options available to protect those special purpose trust assets. Since it is uncertain whether anything can be done to "credit-proof" existing special purpose trust funds, the task for professionals who advise charities and donors will be to focus on how to structure future special purpose charitable gifts so that they will not become exigible by future tort creditors of the charity. Some strategies that could be considered in dealing with this issue include the following:

- Creating a special purpose charitable trust by the donor giving the intended gift to an arms length parallel foundation established to advance only the purposes of the intended charity.

- Creating a special purpose charitable trust by the donor giving the intended gift to a community foundation or to a trust company to be held in trust for the benefit of a specific named charity.

- Structuring a donation as a conditional gift with a condition subsequent that would become operational upon the winding-up, dissolution or bankruptcy of the charity, accompanied by a "gift over" to another charity that has similar charitable purposes or, instead, providing that the gift revert back to the donor.

- Alternatively, a clause could be included in the gift instrument requiring that if the special purpose charitable trust in question becomes impossible or impracticable to carry out, the trustees or directors of the charity would be obligated to apply the assets under the trust to another similar charitable purpose. As such, if the charity was to face insolvency or winding-up as the result of general tort claims against the charity, the funds in the special purpose trust could be transferred to another charity with similar charitable purposes in accordance with the "gift over" requirement contained in the gift instrument.

- A similar type of "gift over" clause for special purpose charitable funds could also be included in the Letters Patent of the charity. Although it is not known whether the inclusion of such provision in the Letters Patent for a charity would have priority in the event of an insolvency or bankruptcy of the charity, its inclusion in the dissolution clause of a charity incorporated by a Special Act of the Federal or Provincial Government would more likely result in it being afforded priority as a statutory directive. In this regard, the author has been successful in having such a provision added to the incorporating legislation of at least one provincial Special Act corporation.

All of these options, particular the utilization of conditional gifts, would require addressing a number of important legal issues, including determining the income tax consequences to the donor that are beyond the scope of this article[33].

## 2. Anti-Terrorism Legislation

### a) Description of Risk

In response to the September 11th terrorist attacks in the United States, Bill C-36 was introduced in the House of Commons by the federal government on October 15th, 2001 as part of the Government Anti-Terrorism Plan. The stated objective of this new legislation is to take aim at terrorist activities and organizations by strengthening measures to identify, prosecute, convict and punish terrorist groups, and by providing new investigative tools to law enforcement and national security agencies. To this end, Bill C-36 amends and incorporates various statutes, including the *Criminal Code*[34], *Income Tax Act*, *Canada Evidence Act*[35], *Canadian Human Rights Act*[36], *Immigration Act*[37], *Proceeds of Crime (Money Laundering) Act*[38], *Access to Information Act*[39], *Privacy Act*[40], and the earlier proposed Bill C-16 *Charities Registration (Security Information) Act*, in an effort to create a comprehensive scheme to penalize those who engage in or support terrorist activities. Bill C-16 had been introduced in March, 2001 to authorize the deregistration of charities that fundraise for terrorist activities. Bill C-16 languished until it was replaced by and incorporated into Bill C-36[41].

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33 See *supra*, note 24 and note 30, for detailed discussions on gift planning issues.
34 R. S. 1985, c. C-46.
35 R. S. 1985, c. C-5.
36 R. S. 1985, c. H-6.
37 R. S. 1985, c. I-2.
38 S. C. 2000, c. 17.
39 R. S. 1985, c. A-1.
40 R. S. 1985, c. P-21.
41 For a detailed discussion concerning the impact on charities by Bill C-16, see an article by Aaron Leahy, "The Potential Effect on Charities of Proposed Anti-Terrorism Legislation – (Bill C-16)", Charity Law Bulletin No. 6 at www.charitylaw.ca.

In Part 1, Bill C-36, extensively revises the federal *Criminal Code,* which reflects the intention of Parliament to criminalize terrorist activities to the fullest possible extent. In Part 4, Bill C-36 amends the *Proceeds of Crime (Money Laundering) Act*, which now becomes the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act,* with the intention of preventing or deterring the financing of terrorist activities and inter-country money laundering. In Part 6, the Bill enacts the *Charities Registration (Security Information) Act* by incorporating most of the content of Bill C-16.

Given its comprehensive scope, Bill C-36, if passed, will have an extremely prejudicial impact upon Canadian charities and their charitable activities carried out both domestically and internationally[42].

i) *Criminal Code Provisions*

(1) Proposed amendments

Under the amendments to the *Criminal Code*, a Canadian charity would violate the *Criminal Code* and therefore potentially face criminal charges if it does any of the following:

(a) Collects, provides or solicits property that facilitates terrorist activity or a terrorist group.

It would be a *Criminal Code* offence (s.83.03) to directly or indirectly collect property, provide property, or invite a person to provide property, financial or other related services that facilitate or carry out a terrorist activity or which will be used or will benefit a terrorist group.

(b) Uses or possesses property to facilitate terrorist activity.

42 For a detailed discussion, see Wen Wu & Terrance S. Carter, "The Proposed Anti-Terrorism Legislation (Bill C-36) – Its Impact on Charities," Charity Law Bulletin No. 10 at www.charitylaw.ca.

It would be a *Criminal Code* offence (s.83.04) to use or possess property that is used or knowing that it will be used, directly or indirectly, in whole or in part, for the purpose of facilitating or carrying out terrorist activity.

(c) Provides or collects property which is intended to be used for terrorist activity.

It would be a *Criminal Code* offence (s.83.02) to directly or indirectly provide or collect property that is intended to be used or knowing that it will be used, in whole or in part, in a terrorist activities.

(d) Facilitates transactions or financial services.

It would be a *Criminal Code* offence (s.83.08) for a person in Canada, or a Canadian outside of Canada, to deal with property owned or controlled by or on behalf of a terrorist group; to facilitate directly or indirectly, any transaction with respect thereof; or to provide any financial or other related services in respect thereof for the benefit of or at the direction of a terrorist group.

(e) Enhances or facilitates terrorist activity.

It would be a *Criminal Code* offence (s. 83.18) to directly or indirectly participate or contribute to any activity that enhances the ability of any terrorist group to facilitate or carries out or enhances a terrorist activity or the accused knows the specific nature of any terrorist activity that may be facilitated or carried out. An offence is committed whether or not activity facilitates or carries out or enhances a terrorist activity or whether the accused knows the specific nature of any terrorist activity that may be facilitated or carried out.

(f) Instructs a person to carry out a terrorist activity.

It would be a *Criminal Code* offence (s.83.22) to directly or indirectly instruct any person to carry out a terrorist activity. An offence in this regard is committed whether or not the terrorist activity is carried out, whether the accused knows the identity of the person instructed, or whether the person instructed knows that it is a terrorist activity.

(g) Obligation of a financial institution to monitor property of a listed entity (a terrorism entity).

It would be a *Criminal Code* offence (s.83.11) if banks, trust companies, and other financial institutions do not continually determine if they are in possession of property that is owned or controlled by a listed entity. A charity may be included in the definition of a financial institution for the same reasons that they may be included under the money laundering portion of Bill C-36 described below.

(2) Breadth and Vagueness of the Definitions

The broad and vague definitions of “terrorist activities”, “terrorist group” and “facilitate” will have a significant and adverse impact on any legitimate Canadian charity which carries on charitable activities in another country as well as within Canada. A Canadian charity may be caught under the revised *Criminal Code* by providing funds to a legitimate agent in another country, which in turn unwittingly provides monies, property or other resources to an organization which is involved in “terrorist activities” as defined under the new legislation. The broad definition of “terrorist group” in its current form may also include environmental, political or economic protesters, various unions, and groups opposed to dictatorial regimes.

The broad definitions also fail to distinguish between a dictatorial regime and a democratic regime. Under the new legislation, people in a repressive country who are fighting for freedom may become “terrorist groups,” and Canadian charities which provide medicine, food and other assistance to such groups may be considered to commit criminal offences as “facilitating” and financing such “terrorist groups” in providing such assistance. The current form of Bill C-36 raises the following questions: would a group fighting for democracy and freedom in a dictatorial country be classified as a “terrorist group”? and would the support or aid given by Canadians or the Canadian government to support such democratic movements in a dictatorial country constitute an act facilitating or financing such "terrorist activity"? Since the answer to these questions appears to be "yes" or at least "maybe", the definitions are consequently too broad or too vague. Such broad and vague definitions in the absence of judicial interpretation may result in a disastrous effect upon the support of freedom and democracy through the world by legitimate charities in Canada.

(3) Facilitating and Financing of Terrorism

The broad scope of sections 83.03, 83.04, 83.08 and 83.18 of Bill C-36 will have a serious and unwelcome impact on legitimate charitable fundraising in Canada. This is because the new legislation indiscriminately penalizes both those who facilitate and finance terrorism activities and those who provide donations to groups which are fighting for democracy and freedom within a repressive regime. The ramifications of these overly broad definitions is heightened by the lack of a *mens rea* requirement for the commission of the "facilitation" of a criminal offence under the definition of "facilitate" in the Bill. In subsection 83.01(2), "facilitation" is defined as follows:

> *83.01(2) For the purposes of this Part, a terrorist activity is facilitated whether or not:*
>
> *(a) the facilitator knows that a particular terrorist activity is facilitated;*
>
> *(b) any particular terrorist activity was foreseen or planned at the time it was facilitated; or*
>
> *(c) any terrorist activity was actually carried out.*

By broadly defining "terrorist activity" and eliminating the *mens rea* component for a criminal offence involving serious punishment, Bill C-36 is at odds with the long established rule of law requiring a *mens rea* component for a criminal offence. If the Bill is passed in its present form, many legitimate Canadian charities carrying on international operations may be caught by the *Criminal Code*.

### ii) *Charities Registration (Security Information) Act*

In Part 6, Bill C-36 enacts the *Charities Registration (Security Information) Act* by incorporating most of the content of the earlier Bill C-16, with some amendments to the said Bill and to the *Income Tax Act* respectively. The amendments were made as a result of the terrorist attacks of September 11th, 2001, and the commitment of the Canadian government in fighting terrorism both domestically and abroad. However, the broad definition of what constitute "terrorism activities," what are "terrorism groups," what activities constitute terrorism offences in the revised *Criminal Code*, and the procedures concerning the issuance of a security certificate will have a serious impact on Canadian charities.

Under Bill C-16, the Solicitor General of Canada and the Minister of National Revenue ("Ministers") have the authority to issue a certificate to any charity or any charity applicant if the Ministers have reasonable grounds to believe that such organizations are involved in supporting terrorist activity. In reaching their decision, the Ministers may rely on security or criminal intelligence reports as well as information obtained in confidence from foreign governments, institutions and agencies. Such information is not accessible to the charity, the applicant charities and their legal counsel. The Minister will refer the certificate to the Federal Court for judicial review, and the determination of the Federal Court is conclusive, and not subject to appeal to any other courts. If the certificate is determined to be reasonable, the certificate will be valid for three years. The charity or the charity applicant cannot keep or apply for charitable status in this period unless they can show to the Solicitor General of Canada that there exists a material change in their circumstances.

#### (1) Proposed Amendments

The major amendments to Bill C-16 in Bill C-36 are as follows:

(a) Bill C-36 incorporates new definitions of "terrorism," "terrorism activities," and "terrorism entities" to be found in the revised *Criminal Code.*

The effect of these overly broad definitions have been discussed in an earlier section of the paper.

(b) Bill C-36 expands the conditions for issuing a security certificate to charities from "made" to "has made, make, or will make".

In section 4(1), Bill C-36 expands the grounds permitting the Ministers to sign a certificate if there are reasonable grounds to believe that the registered charity or charity applicant <u>*has made, make or will make*</u> available any resources, directly or indirectly, to a listed entity as defined in subsection 83.01(1) of the revised *Criminal Code*.

(c) In section 13, Bill C-36 states that unless it is cancelled earlier pursuant to the Bill, a security certificate issued is effective for a period of seven years (as compared to three years in Bill C-16) beginning on the day it is first determined to be reasonable by the Federal Court.

Bill C-36, if passed, would not only create an extra layer of scrutiny for registered charities and organizations seeking registered charity status, but may create a "chill effect" on Canadian charities and their charitable activities, both domestically and internationally. By imposing serious liabilities on charities without according statutory or common law defenses, the new Bill will undoubtedly shackle the operation of Canadian charities.

(2) Lack of Fairness In, Under and Before the Law

(a) Lack of Procedural Fairness

(i) Limited Access to and Disclosure of Information

Bill-36 limits the disclosure of the information obtained in confidence from a foreign government, institution or agency to the subject charity and its counsel. Charitable organizations are precluded under the Bill from inquiring about what kind of foreign information is being considering, and from cross-examining the credibility of that information. As a result, a hostile foreign government or foreign entity may manipulate the information they provide in order to harm a particular charitable organization, particularly one of a religious nature, thus leaving the Canadian charity defenseless to such intentional and malicious manipulations.

(ii) Evidence Law

Bill C-36 provides that in determining whether a certificate submitted by the Ministers is reasonable or not, a Federal Court judge may admit any relevant information even though such information would not be normally admissible in a court of law. Under the new Bill, the judge's discretion to admit such information is only subject to a few limitations. Accordingly, the judge could admit information which might not be subject to cross-examination, and could therefore be very prejudicial to the subject charitable organization. As a result, a charitable organization is deprived of its rights to cross-examine the credibility of those providing information during a hearing and to exclude prejudicial evidence - rights which are otherwise available under common law evidence rules.

(iii) No Right of Appeal

Bill C-36 restates the position originally contained in Bill C-16 that a security certificate determined to be reasonable by the Federal Court judge is conclusive. It is not subject to appeal or review by any court. This strict clause may not be justified or warranted in considering the serious nature of the allegation and the consequences to the subject charity or organization seeking charitable status. The fairness of the law is undermined by such a clause.

(b) Limited Defense

(i) No Due Diligence Defense

Bill C-36 penalizes a registered charity or an applicant for charitable status for directly or indirectly providing funds or services to terrorist entities. Considering the complexity of the social, political, and cultural structure in a foreign country, it is very onerous, if not impossible, for a Canadian charity to ensure that any of its funds distributed to a foreign entity will not be abused and eventually end up in the hands of a terrorist entity.

Under Bill C-36, if a foreign entity receives funds from a Canadian charity, and the foreign entity uses those funds directly or indirectly to support terrorist activities, the Canadian charity would be denied charitable status and also face possible law suits by its donors, its members and any victims of the terrorist activities. Bill C-36 does not provide a due diligence defense to a *bona fide* Canadian charity which may inadvertently distribute funds to a foreign entity in good faith, even if the charity and its directors exercise due diligence to prevent its commission. Considering the heightened stigma and severe penalties of the legislation on a *bona fide* charity and its directors, providing no due diligence defense, requiring no *mens rea* for an indictable criminal offence, and providing no rights of appeal is itself an attack on both freedom and democracy.

(ii) Act Does not Consider Knowledge and Intention

Although the revised *Criminal Code* creates a specific intent crime for providing property to and financing terrorist groups, the *Charities Registration (Security Information) Act* under Bill C-36 did not distinguish charities or applicant organizations who have knowledge of an intention to use charitable assets for terrorism activities from those charities or applicant organizations who, in good faith, distribute charitable assets to foreign entities and could not possibly foresee that the assets so distributed may go to terrorist groups. In other words, the new legislation punishes equally both criminals and legitimate charities who honestly try to help others in good faith.

(3) The *Charter of Rights* and Discrimination Concerns

Discrimination concerns arise from the possible stereotyping of certain charities which have links to specific cultural, religious or ethnic backgrounds. The new Bill allows for the possibility of a charity losing its charitable status or for an organization to be denied charitable status if the Ministers and the Federal Court have reasonable grounds to believe that the charity, or the applicant, will make any of its resources available to an organization or person that will engage in terrorism or activities in support of terrorism. This provision may be more easily triggered by some organizations than by others based on stereotypes, especially in light of the recent attacks in the United States. Specifically, certain charities may be singled out by the Minister based on culture, race, religion, or national origin. This may amount to an act of discrimination based solely upon those factors, an act which is prohibited by the *Canadian Charter of Rights and Freedoms*.

(4) Negative Effect On Public Perception, Charitable Activities And Fundraising

(a) Negative Effect on Public Perception on Charities

Bill C-36 may create a negative impact upon the public perception of certain charities linked to particular cultures, religions or ethnic groups. It may in turn have a negative impact of the image of charities as a whole.

(b) Negative Effect on Charitable Activities

Bill C-36, if passed, will have a "chill effect" on Canadian charities in carrying on charitable activities internationally. The severity of the liability under Bill C-36 may forestall many Canadian charities from carrying out international operations especially in certain volatile regions.

(5) Severe Liability And Penalty

(a) Criminal Offence

Although a *bona fide* charity under Bill C-36 is unlikely to be caught by the *Criminal Code*, its directors, if they intend to or knowingly make available its resources either directly or indirectly to support terrorism activities, could be charged under the *Criminal Code*. Although we do not know the legal implications on the charity and other innocent directors from such a situation, the charity may face possible civil law suits by its donors, members and the victims of terrorism activities on the grounds of breach of trust, breach of fiduciary duty or negligence.

(b) Vicarious Liability In International Operations

Under the *Income Tax Act*, a Canadian charity is not permitted to distribute its charitable assets to foreign entities unless: (i) the recipient entities are foreign “qualified donees” as defined in the *Income Tax Act*, or: (ii) the recipient entities are not “qualified donees”, but an agency agreement, a joint venture agreement, or a cooperative partnership agreement has been signed between a recipient foreign entity and a Canadian charity. By entering into an agency, joint venture, or cooperative partnership agreement, the Canadian charity may to differing degrees become liable for the acts committed by foreign recipient entities.

In practice, if a foreign recipient entity as an agent of the Canadian charity engages, or will engage, in terrorist activities, the Canadian charity is liable under the law of agency and under Bill C-36. The liability of the Canadian charity affects not only its charitable status under Part 6 of the new legislation, but also affects civil penalties since the Canadian charity may also be held vicariously liable for the conduct of its agent. *Bona fide* Canadian charities could therefore be found guilty for criminal conduct committed by foreign recipient entities. Bill C-36 will therefore open the gates to Canadian charities being subject to unexpected criminal law charges and accompanying civil law suits.

(c) Breach Of Fiduciary Duty

The recent decision of the Ontario Superior Court of Justice in the *Ontario (Public Guardian & Trust) v. Aids Society for Children (Ontario)*[43] case has established that a charity and its directors have a fiduciary duty to donors. In light of this case, it can be reasonably presumed that if a charity’s assets are found to be directly or indirectly benefiting terrorism activities and its charitable status is revoked under the new Bill, the charity and its directors may be held liable for a breach of their fiduciary duties owed to donors in relation to their failure to protect and apply charitable assets for the intended purposes. As a result, donors may be able to sue the charity and its directors for breach of fiduciary duty and/or breach of trust. The charity and its directors would not have a defense under Bill C-36, since it does not provide for a due diligence defense. This could impact the civil liability of the directors of a charity to its donors.

[43] See *supra*, note 10.

(d) Insurance Concerns

The extent to which general liability and/or directors and officers liability insurance will cover claims arising from Bill C-36 is not known, although normally fines, penalties and criminal charges are excluded from many insurance policies. Any lack of insurance coverage could result in a reduction in the number of volunteers willing to serve as directors and officers of a charity.

iii) *Anti-Money Laundering Legislation*

The *Proceeds of Crime (Money Laundering) Act* received Royal Assent on June 29th, 2000, as a part of the Canadian government's commitment to fight domestic and international organized crime. Most of the Act will come into force over the next 12 months commencing on November 8th, 2001.

In Part 4, Bill C-36 amends the *Proceeds of Crime (Money Laundering) Act*, which now becomes the *Proceeds of Crime Money Laundering and Terrorist Financing Act*. The amendments were made in light of the Canadian government's international commitments to fight terrorist activity. Specifically the revised Act aims to assist various government agencies to detect and deter the financing of terrorist activities, to combat the laundering of the proceeds of crime, and to facilitate the investigation and prosecution of terrorist activity financing offences and money laundering offences.

The legislation imposes various statutory duties on certain entities to report and to keep records of three different types of transactions: (1) Suspicious transactions for which there are reasonable grounds to suspect that the transaction may be related to the commission of money laundering offences or terrorist activity financing offences; (2) Currency and monetary instrument transactions in importation or exportation; and (3) Large cash transactions and cross-border currency and monetary instruments over a certain amount ($10,000)[44].

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[44] For some extra information concerning this legislation, see Dan Pinnington, "Understanding Your Obligations Under the Anti-Money Laundering Legislation" available at www.practicepro.ca.

The new legislation may have a direct impact upon Canadian charities. Under the new legislation, persons and entities authorized under provincial legislation to engage in the business of dealing in securities have statutory obligations to record and report the financial transactions defined in the Act. Under the Ontario *Securities Act*[45], Canadian charities are exempted from the registration requirements in issuing and trading securities. The *Securities Act*, in subsection 35.(2) 7, states that registration is not required to trade in the securities issued by an issuer organized exclusively for educational, benevolent, fraternal, charitable, religious or recreational purposes and not for profit, where no commission or other remuneration is paid in connection with the sale. As a result, in Ontario, it could be argued that charities are "authorized to engage in the business of dealing in securities" because they are statutorily exempted from registration under the *Securities Act*. If so, a charity in Ontario, and possibly in other provinces, may be subject to the statutory recording and reporting obligations imposed by the Act.

The new legislation may also have an indirect impact upon Canadian charities. In its current form, the Act imposes recording and reporting obligations on various financial institutions, which are also interpreted to be applicable to accountants and legal counsel. The Act may impose these same obligations on more persons, entities or professionals in the future as a result of new regulations that can be passed by the federal government to include other "persons" or "entities" to which the Act would apply.

In addition, the word, "suspicious," is not defined in the Act, nor are details provided concerning what constitutes "reasonable grounds." Under such broad definitions, Canadian charities may frequently and unknowingly become the subject of such reports when they carry on international operations and transfer funds to certain foreign jurisdictions.

As the Act creates an absolute obligation on specific persons and entities to report "prescribed" transactions, any transactions by Canadian charities involving a substantial amount of cash may also be reported by banks, credit unions, trust companies, and other financial institutions. This provision will also have an impact upon charitable fundraising involving large

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[45] R.S.O. 1990, c. S.5.

cash donations or international donations. It may unduly deter *bona fide* donors from making donations to Canadian charities, or discourage Canadian charities to transfer much needed cash to foreign jurisdictions. A Canadian charity which transfers charitable assets to a foreign charity under an agency or a joint venture agreement may become the subject of such reports.

By the same token, the mandatory obligations on certain persons and entities to report cross-border currency and monetary instruments over $10,000.00 may subject Canadian charities to being reported to FINTRAC when the charities carry on international operations. This may have the practical effect of discouraging legitimate cross-border charitable activities.

b) Responses to the Risk

Bill C-36 is still under debate. It is, therefore, premature to discuss what Canadian charities should do and should not do in response to this intrusive legislation. However, since Bill C-36 will almost inevitably pass and will not likely be extensively amended, Canadian charities and their board of directors need to become familiar with the many provisions of Bill C-36 and take appropriate steps, such as the following, to avoid being unwittingly caught by the legislation:

- Charities will need to conduct a due diligence review of their operations to determine if the charity is generally in compliance with Bill C-36.

- Charities will need to review and monitor how monies are raised and whether the charity might be used as a conduit in contravention of the *Criminal Code* provisions of Bill C-36.

- Charities will need to review and monitor international relationships to protect against third party agents, directly or indirectly, facilitating terrorist activities with the funds and property of the charity.

- Charities will need to obtain appropriate releases and indemnities from third parties to obtain some measure of financial security since insurance policies will not normally cover the costs, fines and penalties for criminal charges.

- Charities will need to develop extensive internal policies as necessary to ensure compliance with the applicable provisions of Bill C-36.

3. <u>New Investment Power and Delegation Authority</u>

a) Description of Risk

As a result of an initiative taken by the Ontario Bar Association, recent amendments to the *Trustee Act* (Ontario)[46] have been enacted, which will now permit the delegation of investment decision making by charities in Ontario. Bill 57 (Chapter 9, Statutes of Ontario, 2001), known inelegantly as *An Act to Promote Government Efficiency and to Improve Services to Tax- payers by Amending or Repealing Certain Act*s, was given third reading on June 28, 2001, and received Royal Assent on June 29, 2001("Bill 57"). Bill 57 amends certain portions of the *Trustee Act* (Ontario) and the *Charities Accounting Act* (Ontario), as well as adding new provisions to the *Trustee Ac*t, that collectively mean that charities that are either incorporated in Ontario, have their offices in Ontario or invest in Ontario, will now have the ability to delegate investment decision making to qualified investment managers.

This important amendment to the *Trustee Act* follows on the new investment powers given under amendments to the *Trustee Act* as of July 1, 1999, which earlier established a prudent investor standard to replace the more archaic statutory list of investment powers. What was missing from the July 1999 amendment to the *Trustee Act* was the ability to delegate investment decision making to qualified investment managers. This anomaly resulted in the unsatisfactory situation that charities had to satisfy the prudent investor standard in investment decision making but were not able to delegate day to day investment decision making to qualified professionals. This was contrary to what one would expect of a prudent investor who did not have the

46 R.S.O. 1990, c. T-23.

sophistication necessary to make daily investment decisions, often involving large sums of money.

Given that most large charities with surplus funds or endowment funds have for many years utilized the services of investment managers to make day-to-day investment decisions on behalf of the board of directors of a charity, the lack of legal authority to continue with such arrangements was clearly a major impediment for charities. If the board of a charity continued to delegate investment decision making, it ran the risk of being found in breach of trust for having permitted unauthorized delegation of investment decision making. On the other hand, if the board did not use the services of a qualified investment manager, it ran the risk of being found in breach of the new statutory requirement to exercise the standard of care expected of a prudent investor.

With the amendments provided under Bill 57, directors of charities will now be able to delegate investment decision making to qualified investment managers in accordance with investment community standards and in accordance with the practice of most large charities.

However, the statutory requirements that apply to the authority granted to delegated investment decision making must be carefully reviewed and complied with. The failure of directors to do so could result in possible personal liability to them for non-compliance with statutory requirements for the investment of charitable funds.

The following is a brief overview of the applicable provisions of the *Trustee Act* as amended by Bill 57.

i) When Do the Investment Powers of the *Trustee Act* Apply?

Whether or not the *Trustee Act* applies to the trustees of a charity (i.e. its board of directors) has always been a matter of some debate, particularly as a result of the Ontario Court of Appeal decision in the *Christian Brothers* case. However, Bill 57 has amended the *Charities Accounting Act* (Ontario) to state that Sections 27 to 30 of the *Trustee Act* apply to trustees and corporations that are deemed to be trustees under the *Charities Accounting Ac*t, i.e. all charities that deal with charitable property in the Province of Ontario, whether organized as corporations, charitable trusts, or unincorporated charitable associations.

One exception to this rule is if the terms of the trust dealing with charitable property provide for a different investment power. For instance, if an endowment agreement or testamentary trust imposes a specific investment power on the gift being made. The other exception is found in subsection 27(9) of the *Trustee Act* which states that the investment powers set out in the *Trustee Act* do not require a trustee to act in a manner that is inconsistent with the terms of the trust. Subsection 27(10) provides that the constating documents of a charitable corporation under the *Charities Accounting Act* are deemed to form part of the terms of the trust. This means that if the letters patent of the charitable corporation provide for investment powers different from the investment powers contained under the *Trustee Act*, then the investment powers of the letters patent of the charitable corporation will take precedence, regardless of whether the charitable corporation is incorporated in Ontario, federally, or in another province.

From a practical standpoint, in the event that the charity wishes to adopt investment powers that are different from the investment powers set out under the *Trustee Ac*t, it is unlikely that the Public Guardian and Trustee of Ontario will permit the charity to do so when applying for supplementary letters patent. This means that only charities incorporated federally or in another province other than Ontario will be able to obtain investment powers which are different from those within the *Trustee Act*, and only then if its letters patent specifically provide for different investment powers than those provided for under the *Trustee Ac*t. Whether or not a charity would want to have different investment powers than those provided for in the *Trustee Act* is a matter which the charity and its legal advisor will need to carefully review.

ii) What Investment Powers Apply?

Subsection 27(1) of the *Trustee Act* states that a trustee *"must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments"*. Based upon the standard of care of a prudent investor, subsection 27(2) of the *Trustee Act* states that a trustee *"may invest trust property in any form of property in which a prudent investor might invest."*

Subsection 27(3), which is amended by Bill 57, states that *"any rule of law that prohibits a trustee from delegating powers or duties does not prevent the trustee from investing in mutual funds, pooled funds or segregated funds under variable insurance contracts"*. This authority to invest in mutual funds or other funds is not now subject to the statutory requirements concerning the delegation of investment decision making which are contained in the balance of Bill 57.

Although the *Trustee Act* does not define what is meant by a *"prudent investor"*, subsection 27(5) states that a trustee must consider the following criteria in the planning of investment of trust property, in addition to any others that are relevant in the circumstances:

- General economic conditions.
- The possible effect of inflation or deflation.
- The expected tax consequences of investment decisions or strategies.
- The role that each investment or course of action plays within the overall trust portfolio.
- The expected total return from income and the appreciation of capital.
- Needs for liquidity, regularity of income and preservation or appreciation of capital.
- An asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

In addition to the said mandatory investment criteria, subsection 27(6) of the *Trustee Act* states that a trustee must diversify the investment of trust property to an extent that is appropriate to:

- the requirements of the trust; and
- general economic and investment market conditions.

Subsection 27(7) and (8) of the *Trustee Act* state that a trustee may obtain advice in relation to the investment of trust property and will not be held liable for losses to the trust where he or she relied upon such advice, provided that a prudent investor would rely upon the advice under comparable circumstances. Unfortunately, these two subsections are of little practical assistance, since they do not identify the criteria by which a prudent investor would rely upon such advice. The ability to rely upon investment advice does not constitute statutory authority for delegation of investment decision making. Such authority has only now been given by Bill 57, as discussed below.

iii) Is an Investment Plan Required?

It is not a statutory requirement that trustees must develop and utilize an investment plan or strategy ("Investment Plan") unless the trustee is delegating investment decision making. However, it is recommended that a charity and its board of directors should do so in any event. The following are reasons for doing so:

- In accordance with Section 28, an Investment Plan will provide trustees of the charity with protection from personal liability in the event that a loss occurs if such a loss resulted from the trustees relying upon an Investment Plan for the investment of trust property that constituted a reasonable assessments of risk and return which a prudent investor would have adopted under comparable circumstances.

- An Investment Plan will assist in ensuring that the trustees have addressed the statutory requirements to comply with the mandatory investment criteria of Section 27(5) of the *Trustee Ac*t, as well as the mandatory requirements regarding diversification under Section 27(6) of the *Trustee Act.*

- If the trustees of a charity, either now or in the future, delegate investment decision making to an investment manager, as discussed below, then the trustees can only do so if there is an Investment Plan in place.

iv) What Are The Requirements In Order To Delegate Investment Decision Making?

Subsection 27.1(1) of the *Trustee Ac*t, as amended by Bill 57, states that *"a trustee may authorize an agent to exercise any of the trustee's functions relating to investment of trust property to the same extent that a prudent investor, acting in accordance with ordinary investment practice, would authorize an agent to exercise any investment function"*. However, there are certain statutory conditions that must be complied with before the authority to delegate investment decision making will apply. Those requirements are summarized as follows:

(1) Investment Plan

Subsection 27.1(2)(a) requires that a trustee must comply with section 28, which is the requirement that a trustee conform to a written plan or strategy (i.e. "Investment Plan") for *"the investment of trust property, comprising reasonable assessments of risk and return, that a prudent investor could adopt under comparable circumstances"*. The Investment Plan must be in writing and need to take into account the mandatory investment criteria referred to above.

(2) Best Interest of Beneficiaries

Subsection 27.1(2)(b) requires that a trustee must ensure that the Investment Plan is *"intended to ensure that the functions will be exercised in the best interests of the beneficiaries of the trust"*, i.e. in the best interests of the charitable purpose for which the charitable property is to be applied.

(3) Agent's Agreement

Subsection 27.1(3) requires that a trustee must have a written agreement ("Agency Agreement") between the trustee and the agent. An Agency Agreement is to include:

- a requirement that the agent comply with the Investment Plan in place from time to time; and

- a requirement that the agent report to the trustee at regular stated intervals.

Although not a statutory requirement, in the event that a charity has a Delegation Plan in place, as described below, then the Agency Agreement would also require the agent to comply with the terms of a Delegation Plan in place from time to time.

(4) Prudent Selection of Agent

Subsections 27.1(4) and (5) require that a trustee exercise prudence in selecting an agent, which includes compliance with the regulations made under section 30 of the *Trustee Ac*t, as amended by Bill 57. Section 30, states that:

> *The Attorney General may make regulations governing or restricting the classes of persons or the qualifications of persons who are eligible to be agents under section 27.1 in establishing conditions for eligibility.*

From a practical standpoint, the Attorney General, through the Office of the Public Guardian and Trustee of Ontario, will be able to determine the categories of who qualifies to be investment managers for purposes of receiving delegated investment decision making under the *Trustee Ac*t. The criteria that is eventually established will likely reflect the current industry standards for qualified investment managers. This means that individuals who are not professional investment managers would not be appropriate individuals to whom investment decision making should be delegated to. However, at the date of this Bulletin, no regulations have been adopted under section 30 of the *Trustee Act*. Pending the adoption of such regulations, it would be prudent for directors of a charity in choosing an agent to limit their selection to individuals who have appropriate professional credentials as investment managers.

(5) Prudence in Monitoring Agents

Subsection 27.1(4) of the *Trustee Act* states that a trustee must exercise prudence in monitoring the agent's performance to ensure compliance with the terms of the Agency

Agreement. Subsection 27.1(5)(b) states that prudence in monitoring an agent's performance includes:

- Reviewing the agent's reports;

- Regularly reviewing the Agency Agreement and how it is being put into effect, including considering whether the Investment Plan should be revised or replaced, replacing the Investment Plan if the trustee considers it appropriate to do so, and assessing whether the Investment Plan has been complied with;

- Considering whether directions should be provided to the agent or whether the agent's appointment should be revoked; and

- Providing directions to the agent or revoking the appointment if the trustee considers it appropriate to do so.

(6) Delegation Plan

Although not a statutory requirement, it would be prudent for the board of directors of a charity to adopt a plan to summarize all that is required for the board to be able to delegate investment decision making in accordance with the statutory requirements of the *Trustee Act* as described above ("Delegation Plan"). A Delegation Plan could then be incorporated by reference into the mandatory Agency Agreement that must be in place between the charity and the agent.

v) Duties of Agent

Subsection 27.2(1) of the *Trustee Ac*t, as amended by Bill 57, states that an agent who is authorized to exercise a trustee's functions relating to the investment of trust property has a duty to do so:

- with the standard of care expected of a person carrying on the business of investing the money of others;
- in accordance with the agreement between the trustee and the agent; and
- in accordance with the Investment Plan.

Subsection 27.2(2) states that an agent who has been authorized to exercise a trustee's functions relating to the investment of trust property may not further delegate that authority to another person.

vi) Action Against Agent

Subsection 27.2(3) of the *Trustee Ac*t, as amended by Bill 57, states that when an agent has been authorized to exercise a trustee's functions relating to the investment of trust property and the trust then suffers a loss because of the agent's breach of the duty owed under subsection 27.2(1) or (2), then legal action may be commenced against the agent by:

- the trustees (i.e. the board of directors of a charity); or
- a beneficiary (which would include the charity itself, and possibly even its members, such as the members of a church) if the trustee does not commence a proceeding within a reasonable time after acquiring knowledge of the breach.

This means that members of a charity, or individuals who receive a benefit from the charity in question, can themselves initiate legal proceedings against the agent who has received delegated investment decision making power.

vii) Liability of Trustees

If directors of charities, as trustees, fail to meet the statutory requirements to delegate their investment power, they may become exposed to breach of trust for loss of charitable property. Some considerations in this regard are set out below as follows:

- Relief from technical breaches of trust under the section 35 of *Trustee Act* is not available for losses resulting from investment of trust property.

- The *Trustee Act* provides that a trustee will not be liable for losses from the investment of trust property if the conduct that led to the loss conformed to an investment plan that a prudent investor would adopt under comparable circumstances[47].

- Failure to comply with mandatory requirements for delegation will preclude liability protection under the *Trustee Act* and will expose trustees to liability for breach of trust for unauthorized delegation of investment decision making.

- The insurers for the charity should be consulted to determine if directors' and officers' insurance covers trustees' liability from investment losses.

- Section 29 of the *Trustee Act* states that anti-netting rule does not apply to the calculation of damages for investment losses, but this does not affect a finding of breach of trust.

- The calculation of damages against directors include not only losses but income that might have been earned; and

- Other areas of exposure to liability for trustees relating to investments:
    - The Ontario *Charitable Gifts Act*[48] prevents a charity, other than a religious organization, from owning more than 10% of any business;
    - The *Charities Accounting Act* prevents a charity, other than a religious organization, from holding land not required for its charitable purposes, such as investment property, for more than three years;
    - Special purpose funds, like endowment funds, must be invested separately from the general funds of a charity;

47 *Ibid.*, s.28.23.
48 R.S.O. 1990, c. C.8.

- Co-mingling of special purpose funds for investment purposes must comply with the stringent accounting requirements pursuant to the new regulations under the *Charities Accounting Act*; and
- A charity incorporated under the Ontario *Corporations Act*[49] is required to prepare the annual audited financial statements, which should detail the investments of the charity.

b) Responses to the Risk

The amendments to the *Trustee Act* arising from Bill 57 are a welcome solution to the problems which had resulted from the 1999 amendments to the *Trustee Act* omitting to permit delegation of investment decision making and the corresponding liability risks to directors. However, before the statutory authority to delegate investment decision making can be utilized, it will be necessary for the board of directors of a charity to develop, implement, regulate and review two and possibly three separate documents; i.e. an Investment Plan to evidence compliance with the mandatory investment criteria, an Agency Agreement between the charity and the agent who is retained to make investment decision making, and possibly a Delegation Plan to summarize the statutory as well as any additional requirements that need to be complied with before investment decision making can be delegated to an agent.

For those charities that have not yet developed these documents, legal advice should be obtained to determine whether it is necessary or appropriate for a charity to do so, and whether such documentation should be deemed in effect retroactive to the date that delegation decision making commenced, notwithstanding the fact that such commencement date may have been prior to the enactment of Bill 57 on June 29th, 2001.

Even if an Investment Plan, an Agency Agreement and a Delegation Plan have been developed and implemented, it will still be necessary for the board of directors of the charity to review such documentation on a regular basis, preferably annually. The amended *Trustee Act* is

[49] R.S.O. 1990, c. C.38.

clearly good news for charities in Ontario, but will require careful study, implementation and monitoring by directors of charities and their legal counsel.

In this regard, the board members of a charity should consider the following proactive steps to assist in reducing the risk of exposure to liability from investments of charitable funds:

- Determine what investment powers apply to the charity and in which jurisdiction.

- Consider taking the appropriate corporate steps to have the charity come under the investment power regime of the *Trustee Act*, if necessary.

- Take proactive steps to comply with statutory requirements of the *Trustee Act*, when it applies:

    - establish and implement an investment plan; and
    - where investment decision making is delegated, then establish and implement a delegation plan and an agency agreement.

- The investment plan should focus on meeting statutory requirements of trustees which would override contrary provisions of an investment plan prepared by an investment manager.

- All the documents should be reviewed on a regular basis, preferably each year, by the board of the charity and by their legal counsel.

- Determine if other investment powers apply to special purposes funds and comply with the applicable terms.

- Obtain assistance from an investment or finance committee of the charity but require the committee to be accountable back to the trustees.

- Where the trustees conduct investment decision making by themselves, retain the services of a qualified investment advisor, where appropriate.

- Where a trustee disagrees with an investment decision made by the trustees collectively, the trustee should record his or her opposition and obtain independent legal advice to determine the appropriateness of resigning as a trustee.

4. Co-mingling of Donor Restricted Funds

a) Description of Risk

Donor restricted funds include gifts to a charity that are subject to restrictions, limitations, conditions, terms of reference, directions, or other restricting factors imposed by the donor that would constrain or limit a charity concerning how the gift can be used. Donor restricted funds or special charitable purpose trusts include[50]:

- endowment funds;
- donor restricted use funds;
- restricted charitable trust property; and
- implied special purpose charitable trust funds

At common law, each donor restricted trust fund is required to be held separately from other restricted trust funds and cannot be co-mingled together. Very few charities, though, comply with this common law prohibition against co-mingling. Enacted earlier this year, Regulation 04/01[51] under the *Charities Accounting Act* (the "Regulation") now allows charities to co-mingle multiple restricted funds held by the charity into a single account or investment portfolio. However, restricted funds cannot be co-mingled with the general funds of a charity.

Under the new Regulation, a charity may now co-mingle property and/or funds received for a restricted or special purpose with other property or funds similarly received into a single

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[50] See *supra*, note 30.
[51] O. Reg. 4/01, *Approved Acts Of Executors And Trustees.*

account or investment portfolio[52]. However, a number of restrictions and obligations are imposed by the Regulation which may make the option of co-mingling funds difficult or impractical. Co-mingling restricted or special purpose funds in contravention of the Regulation will expose the directors to allegations of breach of trust and resulting personal liability.

b) Responses to the Risk

Directors of a charity which is intending to co-mingle property or funds held for restricted or special purposes must take steps to ensure that it complies with the applicable authority and requirements of the Regulations set below as follows:

- The directors may only co-mingle if it advances the administration and management of each of the individual restricted funds;
- The directors may allocate all gains, losses, income and expenses rateably on a fair and reasonable basis to the individual funds; and
- The directors must maintain detailed records relating to each individual fund, including the following:

  - the value of the individual fund immediately before it becomes part of the combined fund, and the date on which it becomes part of the combined fund;
  - the value of any portion of the individual fund that does not become part of the combined fund;
  - the source and the value of contributed fund (i.e. additional fund that is added to and forms part of a pre-existing individual fund) relating to an individual fund, and the date on which the contributed fund is received;
  - the value of the contributed fund immediately before it becomes part of the combined fund, and the date on which it becomes part of the combined fund;
  - the amount of revenue received by the combined fund that is allocated to the individual fund, and the date of each allocation;

[52] *Ibid.*, s. 3.

- the amount of the expenses paid from the combined fund that are allocated to the individual fund, and the date of each allocation; and
- the value of all distributions from the combined fund made for the purposes of an individual fund and the purpose and date of each distribution.

- The directors must maintain detailed records relating to the combined fund, including the following:

    - the value of each individual fund that becomes part of the combined fund, and the date on which it becomes part of the combined fund;
    - the value of each contributed fund that become part of the combined fund, the date on which it becomes part of the combined fund, and the details of the individual funds to which the contributed fund relates;
    - the amount of the revenue received by the combined fund, the amount allocated to each individual fund, and the date of each allocation;
    - the amount of expenses paid from the combined fund, the amount allocated to each individual fund and the date of each allocation; and
    - the value of all distributions from the combined fund made for the purposes of an individual fund and the purpose and date of each distribution.

In light of the double records that must be maintained and the detail required for those records, a charity and its board of directors may decide that it is simpler and less problematic to maintain each restricted or special purpose trust fund in a separate account for investment purposes notwithstanding the likely lower rate of return for the over all portfolio investment of the charity. It is therefore important for the board of directors of a charity to weigh the benefits to be gained from combining restricted and special purpose funds against the significant administrative costs and aggravation of keeping the necessary records in order to co-mingle restricted and special purpose funds. It is also important for the board of a charity to realize that co-mingling restricted or special purpose funds in contravention of the Regulation will expose the directors to allegations of breach of trust and resulting personal liability.

5. Indemnification and Director and Officer Liability Insurance

a) Description of Risk

Under Regulation 04/01 issued pursuant to the *Charities Accounting Act*, a charity may indemnify a trustee or executor or, where the executor or trustee is a corporation, indemnify the directors or officers of the corporation for personal liability arising from an act or omission in performing his or her duties[53]. However, a charity may not indemnify a director or officer for liability arising from a failure to act honestly and in good faith in performing those duties.

The ability of a charitable corporation to adopt an indemnity by-law had been in question as a result of an error in the wording in previous amendments to the *Corporations Act* (Ontario). However, this omission has recently been corrected through a further amendment to the *Corporations Act* which now ensures that Ontario non-share capital corporations can indemnify their directors and officers, provided that the requirements of the Regulation adopted under the *Charities Accounting Act* have been followed.

The Regulation also provides that insurance may be purchased to cover personal liability arising from the act or omissions of the executors, trustees, directors or officers of a charity in performing their duties. However, the terms of the insurance or indemnification must not impair a person's right to bring legal action against the executor, trustee, director or officer. In addition, the Regulation states that the purchase of the insurance policy must not unduly impair the carrying out of the religious, educational, charitable or public purposes for which the charity holds property. The Regulation further states that the executor or trustee, or if the executor or trustee is a corporation, then board of directors of the corporation, must consider the following before giving an indemnity or purchasing insurance:

- The degree of risk to which the executor, trustee, director or officer is or may be exposed;
- Whether, in practice, the risk cannot be eliminated or significantly reduced by means other than the indemnity or insurance;

53 *Ibid.*, s. 2.

- Whether the amount or cost of the insurance is reasonable in relation to the risk;

- Whether the cost of the insurance is reasonable in relation to the revenue available to the charity; and

- Whether it advances the administration and management of the charitable property to give the indemnity or purchase the insurance.

The Regulation states that no indemnity may be paid or insurance purchased if to do so would result in the amount of debts and liabilities exceeding the value of the charitable property or, if the executor or trustee is a corporation, render the corporation insolvent. Another limitation is that the indemnity may only be paid or the insurance purchased from the charitable property to which the personal liability relates and not from any other charitable property. This would appear to mean that income from segregated funds, such as endowment funds, that would otherwise not normally attract potential liability for a director or officer should not be used to purchase directors and officers liability insurance or to pay an indemnity.

b) Responses to the Risk

The steps that a charity would need to take to allow indemnification of directors and officers and the purchase of liability insurance are summarized below as follows:

- It is important for the directors of a charity to carefully review all of the Regulation to ensure that the directors are complying with its terms before proceeding with the adoption of an indemnification by-law or the purchase of directors and officers liability insurance;

- If the charity complies with the Regulation, it is important to determine whether the indemnification by-law has been passed and/or insurance has been purchased prior to the publication of the Regulation on February 3rd, 2001. Since the Regulation is not stated to be retroactive, it is possible that an indemnification by-law adopted prior to the publication of the Regulation may need to be passed as a new by-law or may require the adoption of a current resolution confirming that the board of directors have reviewed the conditions and terms of the Regulation and are satisfied that the indemnification in question and/or the purchase of liability insurance complies with the terms and conditions of the Regulation.

- Since charities will in most circumstances now be able to purchase directors and officers liability insurance from the funds of the charity, it will become less problematic to recruit qualified volunteers as directors to the board of directors of a charity.

6. Fundraising and The Aids Society for Children Case

a) Aids Society For Children (Ontario) Case

i) Background Facts

The Aids Society for Children (Ontario) (the "Aids Society") was created by Letters Patent issued on November 28th, 1994. It obtained charitable status from Revenue Canada (now Canada Customs and Revenue Agency - "CCRA") three days after the date of incorporation on December 1st, 1994. The Aids Society operated offices in various southern Ontario cities and distributed pamphlets indicating that the monies raised from public donations would be used to build a home (hospice) for children living with HIV/AIDS. The Aids Society subsequently entered into fundraising agreements with two fundraising companies in 1996. One company was retained to solicit charitable donations from the public by telephone. The other company was retained to solicit charitable donations using door to-door canvassing.

The contracts with the third party fundraising companies involved different arrangements, but both required that all expenses involved with the applicable fundraising were to be paid by the Aids Society and that the fundraising company would then receive a percentage of the remaining amount raised. Of the $134,380.00 raised by the telephone campaign, 76% of those monies, or $102,216.00, was paid to the fundraising company retained to conduct the telephone campaign for its fees and expenses, with only the remaining 24%, or $32,163.00, being paid to the Aids Society. Of the $241,012.00 raised through door-to-door canvassing, 80% of the monies raised or $193,238.00 was paid to the fundraising company conducting the door-to-door campaign for fees and expenses, and only the remaining 20% or $47,774.00 was paid to the Aids Society.

In 1996, the Public Guardian and Trustee ("PGT") began receiving complaints from the public, other Aids organizations as well as the media about the Aids Society, specifically that the Aids Society was not applying its funds for its charitable purposes. The PGT discovered, from admissions of the directors of the Aids Society, that despite raising $921,440.00 through public donations, no funds had been expended on the charitable programs of the Aids Society and that in fact the Aids Society was in debt. Through an initiative of the PGT, the activities of the Aids Society were suspended by the Court and the PGT was made trustee of all of its assets.

In 1997, CCRA subsequently revoked the charitable registration number that it had issued to the Aids Society. The PGT brought an application for the passing of accounts pursuant to the *Charities Accounting Act* (Ontario). In the course of making the application, the PGT sought directions from the Court concerning the following questions:

- Is the Aids Society and/or its directors responsible as fiduciaries to the public for all of the funds collected from the public, including the gross amount of funds received by the two fundraising companies?

- What is the nature of the legal relationship between the individual donor, the canvasser, the unit/crew manager, the fundraising companies and the Aids Society?

- Does the duty to account by the fundraising companies extend to the gross receipts collected from the donors on behalf of the Aids Society?

- Is all or part of the fundraising agreements void or voidable as being contrary to public policy or for some other reason?

- Did the Aids Society offend the 80/20 disbursement rule under the *Income Tax Act* (Canada), and, if so, what is the effect, if any, upon the contractual arrangements between the Aids Society and the fundraising companies?

ii) Summary of Decision

In its decision, the Court first re-affirmed that it had inherent jurisdiction to direct or control the administration of charities and that the PGT as nominee of the Attorney General acts in a *parens patriae* role in overseeing the administration of charitable property in accordance with the power historically given to the Crown over charities and charitable property. As a result, the Court therefore had no difficulty with exercising jurisdiction in responding to the questions put to it by the PGT.

Similarly, the Court held that directors of a charity, although not strictly trustees, have a fiduciary obligation at law to the charity and the charitable property held by the charity. The Court went on to explain that while a fiduciary is someone who stands in a position of trust to another individual, a fiduciary relationship does not require that a "true trust" relationship exist. Accordingly, it is not necessary that the legal title of property be held in trust for another individual, only that there is a legal obligation on the part of the fiduciary to another individual to put the interest of that other individual ahead of the interests of the fiduciary.

The comments and answers provided by the Court in response to the questions submitted to it by the PGT are summarized below as follows:

- Although charitable corporations do not hold their unrestricted property as trustees for the general charitable purposes of the charity, they do have a fiduciary obligation to hold property that the charity receives for the charitable purposes of the charity. As such, the Aids Society, as a fiduciary of the monies donated to it, is responsible to account to the public for all monies publicly raised from it, including the gross amount of monies raised by the fundraising companies, and not simply the net balance that was eventually turned over to it by the fundraising companies. Similarly, the directors of the Aids Society have a similar fiduciary duty to account for all of the monies raised by the Aids Society from the public and to utilize such monies to further the objects of the Aids Society as a charitable institution.

Without commenting upon whether or not entering into the fundraising agreements were in fact a breach of fiduciary duty, the Court was careful to point out that a fiduciary relationship can be breached whether or not a loss occurs. As a result, the fact that a charity and its board of directors may have entered into an improvident fundraising contract may in and of itself be a breach of their fiduciary relationships to the public, regardless of whether or not any loss subsequently occurs.

- The Court found that the contract entered into between the Aids Society and the fundraising companies established a principal/agent relationship. This means that the actions of the fundraising companies are deemed to be the actions of the Aids Society as its agents, thereby exposing the Aids Society to liability as the principal. As agents of the Aids Society, the fundraising companies had a duty to account for the monies received by it on behalf of the Aids Society, although not necessarily a fiduciary duty. The Court stated that upon the passing of accounts, aspects of a developing fiduciary relationship between the fundraising companies and the Aids Society would likely become clearer in relation to the duty of the fundraising companies to account for the monies raised from the public on behalf of the Aids Society.

  The Court explained that there is a fiduciary obligation placed upon the Aids Society and its directors to apply the monies raised from the public for the purposes of the Aids Society. However, there is no legal relationship between donors and the fundraising companies, their canvassers, and/or their unit/crew managers.

- As agents of the Aids Society, the fundraising companies have a duty to account for the gross amounts of monies raised as donations from the public and not simply the net amount that was to be paid to the Aids Society by the fundraising companies pursuant to the terms of the fundraising contracts.

- In relation to the question concerning whether the fundraising contracts were either void or voidable as being contrary to public policy or for any other reason, the Court indicated that Courts in the past have been normally loath to interfere with freedom of the parties to enter into contracts. However, given public charitable giving, the nature of the administration of charitable property, and the fact that donors were not advised that between 70% to 80% of the donations would be deducted for expenses, the Court held that the fundraising contracts could be voidable as being contrary to public interest. The voidability of the contracts would be based upon breach of public policy, as well as misrepresentation to donors concerning the amount of money raised that was actually going to fulfill the charitable purposes of the Aids Society.

- Although the Court recognized that the failure of the Aids Society to comply with the 80/20 disbursement quota might be a material factor to be considered by the Court, the Court held that there was no evidence available before it to determine whether or not the disbursement quota under the *Income Tax Act* had been complied with. Therefore, the Court declined to comment upon the impact of the 80/20 disbursement quota rule in relation to the Aids Society.

With the Court having provided its answers to the questions raised by the PGT, the PGT is able to proceed with the completion of the formal passing of accounts of the Aids Society and its directors.

b) Risks Involving Fundraisers as Agents of the Charity

i) Description of the Risk

The Ontario Superior Court of Justice in the *Aids Society for Children* case suggested:

- A charity is responsible as a principal for the actions of its fundraiser, and any subcontractors of the fundraiser, as agents of the charity. A charity cannot avoid responsibility for its fundraiser by describing it as an independent contractor.

- If a charity engages fundraisers for the purpose of soliciting funds, regardless of whether or not the fundraiser is entitled to receive some portion of the funds raised, the charity is responsible to account for the gross amount of all donations received from the public and not simply the net amount payable to the charity in accordance with the contract with the fundraisers.

- The charity, as principal, has the power to require the fundraiser, or sub-contractors of the fundraiser, to account for the full amount of monies that the fundraiser has raised, and the charity must do so in accordance with the fiduciary relationship between the charity and the public.

The court held that the relationship between a charity and the third party fundraisers with whom it contracts is that of a principal and agent. The court also held that the same relationship also applies to the charity and the subcontractors hired the third party fundraiser even though the charity is not itself involved in the hiring of those subcontractors.

Under the principal/agent relationship, the acts committed by the third fundraiser and its subcontractors will expose the principal charity to liability. The court held that directors of a charity have a fiduciary relationship to the charity akin to that of a trustee. As well, the court found that directors of a charity also stand in a fiduciary relationship to the public at large. Therefore, an excessive payment to fundraisers, or any wrong committed by the fundraiser and its subcontractors, will not only subject the charity to liability as well, but will also subject its directors to personal liability for breach of fiduciary duty as well breach of trust.

ii) Responses to the Risk

A charity is responsible as a principal for the actions of its fundraiser, and any subcontractors of the fundraiser, as agents of the charity. A charity cannot avoid responsibility for its fundraiser by describing it as an independent contractor.

Therefore, directors of a charity must therefore pro-actively review, approve and oversee all fundraising activities of a charity, including the terms of contractual relationships with professional fundraisers. Specifically, the fundraising agreement between the charity and the third party fundraiser must be carefully reviewed by the charity to address the following concerns:

- The agreement must clearly state the principal charitable objects of the charity, the objectives of the subject fundraising program, and the method to be used in pursuit of these objectives.

- The agreement must set up a manual which governs the conduct of the fundraisers and the subcontractors in performing their relative duties associated with the fundraising. The fundraiser must work in compliance with a strict written code of ethics or manual for the fundraising, such as that recommended by the Canadian Centre for Philanthropy or the Canadian Association of Gift Planners. The fundraiser, its employees and its subcontractors should be prohibited from misleading the public by misstating the purposes of fundraising, how much of the funds raised will go to the charity, and their status. The agreement should also include a provision that any violation of the agreement or the fundraising code by the fundraiser or subcontractor will render them personally liable for the misconduct committed by them.

- The charity must maintain full control of the receipts and deposits of charitable contributions received from the fundraising program, and the content and method of the fundraising initiatives presented to the public.

- The charity must also exercise due diligence to inspect the premises of the fundraiser and its subcontractors, and to verify the methods of solicitation and calculation being employed by the fundraiser from time to time. The charity needs to examine all documents and financial records of the fundraiser and its subcontractors in relation to the fundraising programs in question on a regular basis.

- The agreement must contain a termination provision which will enable the charity to terminate the contract if the fundraiser employs false or misleading solicitation practices, or if it performs its duties in a manner inconsistent with the stipulations of the fundraising agreement. The fundraising agreement should give the charity the right to recover damages if such termination is due to the misconduct of the fundraiser or its subcontractors.

c) Fiduciary Duties of Directors to the Charity and to the Public

i) Description of Risk

The Court in the *Aids Society for Children (Ontario)* case stated the following in relation to fundraising:

- Although the Court confirmed that unrestricted gifts to charities are owned by the charity beneficially and not held in trust for the charitable purpose of the charity, the charity still has a fiduciary obligation to apply the gifts received for its charitable purposes. As a fiduciary, a charity has some of the characteristics of a trustee, including the responsibility to account for the application of funds that it receives from the public.

- A fundraising contract could be void or voidable on the grounds of breach of public policy or misrepresentation to donors concerning the actual amount of donations that are actually going to fulfill the charitable purposes of the charity.

- Therefore, directors have a fiduciary relationship not only to the charity but to the public at large. Directors of a charity are personally responsible to account for all monies raised by its fundraisers and their subcontractors.

- Exposure to liability by the charity and its board of directors is not limited to only losses of charitable monies. Rather, the fiduciary relationship will have been breached if the charity and its directors are found to have entered into a contract which may tend to cause a prejudice to the charity.

- Although there is a distinction at law between a charity receiving unrestricted gifts as property that it holds beneficially for its charitable purposes and gifts received in trust for specific charitable purposes, given the fact that a charity and its board of directors have a fiduciary obligation to the public to apply the funds received for its charitable purposes, there is little difference in a practical sense. A finding of a breach of fiduciary duty by a charity and its board of directors could be every bit as damaging as finding of a breach of trust.

- If a charity engages a fundraiser for the purpose of soliciting funds, regardless of whether or not the fundraiser is entitled to receive some portion of the funds raised, the charity is responsible to account for the gross amount of all donations received from the public and not simply the net amount payable to the charity in accordance with the contract with the fundraiser.

ii) Responses to the Risk

Given the serious implications of the imposition of fiduciary obligations upon charities and their board of directors in relation to fundraising activities, it is essential that charities, their board of directors, their executive directors and their legal counsel be fully aware of the following issues and take pro-active steps to address such concerns:

- The charity, as principal, has the power to require the fundraiser, or any sub-contractors of the fundraiser, to account for the full amount of monies that the fundraiser has raised, and the charity must do so in accordance with the fiduciary relationship between the charity and the public.

- Given the fiduciary obligation of a charity and its board of directors to apply donations received by a charity for the stated charitable objects of the charity, it is essential that a charity carefully review its charitable objects on a regular basis and revises and/or expands them as necessary, i.e. to include the ability to make donations to other qualified donees.

- Given that a fundraising contract can be rendered voidable if there have been misrepresentation to the public by fundraisers who do not disclose fundraising costs, the determination of the fiduciary obligation between the charity and its donor is a subjective one in the minds of the donor, i.e. what did the donor think that the donation would be used for. As a result, it is essential that a charity review all aspects of fundraising literature and communication to determine what impression is left with the donor concerning the application of donations by the charity. This determination of the reasonable interpretation by a donor concerning how the funds would be used will become the standard by which the charity and its board of directors in the future will be called to account in relation to the fulfillment of their fiduciary duty.

## D. PROACTIVE PROTECTION OF CHARITABLE ASSETS THROUGH DUE DILIGENCE

### 1. Take an Inventory of Charitable Assets

A prerequisite to all other steps to protect charitable assets is to know what assets a charity owns and the nature of such assets, i.e. whether they are charitable property to be used for the general charitable purposes of the charity or whether they are restricted charitable gifts to be used for special purposes only. As in the general business sector, directors of charitable organizations must establish and maintain an inventory of charitable assets on an ongoing basis, and must keep proper records in relation to the receipting and distribution of charitable assets. Separate records need to be set up and maintained concerning special or restricted purpose trusts. In general, directors of charities should do the following to obtain and maintain proper documentation and records:

- Review current and past financial statements;
- Review bank statements and records
- Identify current and past restricted funds;
- Review property deeds for names and terms of trust;
- Maintain charitable status as a registered charity within CCRA; and
- Create an inventory record and keep it up-to-date.

These tasks should be given to a committee of the board of directors of a charity, and such a committee should be asked to report back to the board on a regular basis.

2. <u>Review and Upgrade Insurance</u>

Directors of a charity should become familiar with the basic terms and provisions of comprehensive general insurance coverage of the charity, as well as directors and officers liability insurance, and upgrade those policies as necessary. Insurance will provide the first line of defense in the event of a claim being made against the charity and/or its directors and officers. Therefore, the directors must take the following matters under consideration when reviewing and upgrading insurance policies:

a) Report From Broker and Insurance Company

It is important that the broker and the insurance company for the charity provide a joint written report to the charity concerning the insurance coverage that is currently in place, the insurance coverage that is not provided for under its policies, and a list of recommendations for improvements to the coverage that the charity needs to consider.

b) Amount of Liability Insurance

The amount of insurance that the charity obtains to cover liability claims will need to be sufficient to cover all occurrences that may happen during the current policy year, no matter when the claim may subsequently come to light. This is because general liability coverage is issued on an "occurrence basis" as opposed to a "claims made basis." An "occurrence based" policy means that the insurance coverage acquired in a year will only provide coverage for claims arising out of incidents that occurred in that particular year no matter when the claims may be made.

Since the Supreme Court of Canada had delayed the running of the limitation period for abuse matters, a claim arising out of sexual abuse and/or molestation may occur many years in the future, and even possibly decades from now, as is presently being experienced by many charities. Since a claim ten or more years from now will invariably reflect higher court awards then are currently in effect, the insurance coverage that a charity acquires today needs to anticipate the size of court awards that may be made many years in the future. As a result, it is recommended that a charity should talk with its insurance broker and obtain the greatest amount of liability insurance that is available and that the charity can afford.

c) Coverage for Sexual Abuse

Most insurance policies have some form of limitation on coverage for claims arising out of sexual abuse, sexual harassment, or mental anguish. While it is difficult to obtain insurance for these risks, it is essential that a charity investigate these matters further to satisfy themselves about what coverage, if any, they can obtain for this very significant area of risk. Some policies may require that a charity exercise due diligence in satisfying themselves that individuals working with children are not likely to be at risk to the children that they are working with. This means that a sexual abuse policy statement should be adopted and implemented by the charity.

If the current coverage of a charity does not provide protection for sexual abuse and/or harassment, it is essential that the board of the charity be made aware of this, since the board members stand a greater risk of being personally exposed to liability claims in this regard.

Further, it would be advisable that directors of a charity obtain insurance on an "occurrence basis" as opposed to a "claims made basis". Although it may be possible to obtain a specific policy for claims arising out of sexual abuse based upon "claims made" coverage, such coverage is normally not retroactive. This means that abuse allegations which took place prior to the implementation date of the "claims made" coverage are expressly excluded from the policy. In addition, "claims made" insurance would mean that there would be gaps in the insurance coverage which could lead, in the event of a claim being made, to exposure of the personal assets of the directors, as well as of those of the charity in question, to a court award and costs in the event of a successful lawsuit.

The other option is to obtain and maintain "occurrence based" coverage which has the benefit of providing coverage for those in leadership at a particular point in time (i.e. the coverage period of the policy), regardless of when the claim is ultimately made and regardless of whether or not a future board of directors maintains insurance in the future. As such, it is in the best interests of the current board of a charity to ensure that there is sexual abuse insurance coverage in place and if possible that it be "occurrence based" coverage.

d) Counselling

Most general liability insurance policies contain an absolute exclusion for all professional services, including counseling services. The only way to cover liability exposure for counseling services is to include it as a rider or an exception to the comprehensive general liability exclusions or to obtain coverage on a separate professional liability basis for an errors and omissions policy.

Failure to have counseling insurance in place would have a serious effect upon a charity, its directors and the individuals doing counseling, since there would be no insurance coverage to defend a legal claim and any resulting damages that are awarded. As a result, it is important to ensure that the counseling coverage, if obtained, is properly worded to include not only professional counselors but any other individuals involved in the counseling service, such as directors, officers, employees or volunteers, as well as untrained paid staff.

### e) Geographic Limitation

Most insurance policies are restricted in their coverage to North America. If the charity has employees or volunteers who are traveling outside of North America on behalf of the charity, then it is essential that insurance coverage be extended to provide a broader geographic base than is normally the case.

### f) Non-owned Automobile Insurance Coverage

In the event that the charity has individuals, such as staff or volunteers, who are involved in driving their own vehicles on behalf of the charity, it is essential that the charity have insurance coverage to provide protection for claims involving non-owned automobiles. It is generally unwise, though, to require volunteers and employees to use their personal vehicles to provide transportation for individuals who are being served by the charity, since it unnecessarily exposes those individuals to potential lawsuits in the event that their own insurance coverage is inadequate for any number of reasons.

### g) Directors and Officers Liability Insurance

It is essential that directors and officers liability insurance be obtained to complement the general liability coverage of the charity. The amount of such coverage should match the amount of the general liability policy, assuming that such coverage is available and that the charity in question can afford the premiums. The type of coverage afforded by a directors and officers liability policy ensures against risks that are otherwise not covered under the general liability insurance policy. However, directors and officers liability insurance does not cover all actions against directors and as a result it is important to review the exclusions contained in the coverage and where possible, to obtain additional coverage, as necessary. In addition, it is important for the directors to understand that directors and officers liability insurance will not likely provide coverage in the event of a claim being brought against them for breach of trust by public authorities arising out of any mishandling of trust funds or improper investments.

h) Punitive Damages and Legal Defense Costs

Most insurance policies will contain an absolute denial of coverage for punitive damages, as well as legal defense costs for *Criminal Code* charges. Some insurance companies, however, are now providing limited coverage for these risks. It would therefore be worthwhile to see if some type of insurance coverage in this regard is available when reviewing the coverage available from the insurance broker for the charity.

3. <u>Protecting and Managing Intellectual Property</u>

The name and goodwill of a charity are its most important and valuable assets. Trade-mark representing the goodwill of a charity will attract donations from regular supporters and from estate gifts, will enhance the reputation of a charity and will allow for the future expansion of charitable activities. They also assist in distinguishing one charity from another and in developing identification for associated charities. Failure by the directors to protect the intellectual property of a charity will constitute a breach of their fiduciary duty, or even a breach of trust. Given the widespread violation and appropriation of intellectual property rights, it is essential for directors of charitable organizations to take a pro-active approach to protecting its intangible assets.

The author in the article, *"Avoiding Wasting Assets – Trade-Mark Protection for Christian Charities – Checklist and Reference Guide*[54]*,"* states that the following steps should be taken by the directors of a charity to protect a charity's intellectual property:

- The name and the trademark of a charity should be registered as both a registered trademark and as a Section 9 official mark.

- Any use of the trademarks by a third party must be done in accordance with a trademark license agreement.

[54] For a more detailed discussion concerning trade-mark protection, see Terrance S. Carter, "Avoiding Wasting Assets – Trade-Mark Protection for Christian Charities – Checklist and Reference Guide" (Paper prepared for Continuing Legal Education of the Canadian Bar Association, Toronto, 1997) (also available at www.charitylaw.ca)

- Separate trademark registration should be done in each country in which the charity is operating.

- Domain names, including the trademarks of the charity and any variations on them, should be registered within multiple top-level domain names.

- Key domain names should be registered as trademarks.

- Trademarks should be properly identified and then monitored on a pro-active basis.

- Copyrights should be identified, appropriately marked, and registered and/or licensed where necessary.

4. <u>Avoid Liability From Third Party Use of Charitable Property</u>

Another high risk area for a charity involves individuals or groups who use the facilities of the charity for third party activities that are unrelated to those of the charity. Although it is beyond the scope of this article to provide a comprehensive commentary in this regard, there are some basic considerations that a charity and its directors should take into account in allowing third parties to use the charity's facilities, particularly since doing so exposes the charity to additional liability for activities that have nothing to do with the charity's own program. Some of the following measures should be used by the charity to contain or avoid potential liabilities associated with the use of its charitable facilities by third parties:

a) The charity must determine whether or not the third party using the facilities is a registered charity. If so, the third party can be charged less than fair market value rent for use of the facilities. Otherwise, the charity will need to receive fair market value rent form the thirds party. This is because the charity must ensure that all of its property is dedicated towards charitable purposes.

Allowing the facilities of the charity to be used by a non-charitable third party for less than fair market value rent would not constitute an acceptable use of its charitable property by the charity.

b) The third party using the facilities must provide evidence of general liability insurance showing that the charity as a named insured. Otherwise, the charity must advise their own insurance broker in writing of the third party use of the charity's facilities and obtain written confirmation from the insurance company that the risks associated with such third party usage is covered under the charity's own insurance policy.

c) With regards to the insurance coverage to be provided by a third party, it is important to ensure that the following matters are addressed:

- Is the full legal name of the charity shown as a named insured?

- Is the amount of insurance adequate to protect against the risk associated with the usage of the property by a third party? For instance, $1,000,000.00 might be appropriate for a small single event such as a music recital, but would be totally inadequate for other third party usage. For high risk activities, it is recommended that the amount of insurance be, if possible, in the same amount as the charity's own policy.

- Depending upon the nature of activities of the third party, the insurance may need to include coverage for allegations of sexual abuse, molestation and harassment.

d) Since there are many situations that are not covered by insurance, such as claims arising out of sexual abuse, harassment, molestation, mental pain and suffering, punitive damages, fines and penalties, to name just a few, it is essential that any third party using the charity's facilities also sign a comprehensive indemnity agreement to ensure that the third party is held accountable in the event that the charity was sued. Even a broadly worded indemnity, though, is only as strong as the individual who is signing it, and often the third party using the facilities are individuals with limited personal assets.

e) In consideration of the significant risks involved in having third parties use the facilities of a charity, many charities are not seriously reconsidering whether or not they wish to have their facilities made available for public use at all. Therefore, directors of a charity need to understand that if the charitable facilities are made available for use by the public and a claim arises that is not covered by insurance, then both the charity and the directors could be unnecessarily exposed to liability claims. In such a situation, the indemnification provided by the third party user to the charity may be of limited assistance, since the third party in question may very well be impecunious (i.e. without funds) as a result of the lawsuit brought against them.

f) If the charity does decide to continue allowing the charity's facilities to be used by third parties, then the charity should meet with its insurance broker to determine what the third party activities are, whether they are covered under the existing insurance policy and whether the charity requires that a comprehensive license and indemnity agreement be signed by any third party using the charity's facilities. Such document should be signed in the personal capacity of the third party in question or as a personal guarantees as opposed to being signed only by a corporation with limited liability.

## E. UTILIZING MULTIPLE CHARITABLE CORPORATIONS

### 1. Purpose of Multiple Charitable Corporations

The business sector has utilized multiple corporations for years to contain liabilities and to protect assets. Charities, though, have been generally slow to establish and implement multiple charitable corporations to the same end. The traditional use of a corporation by charities has been focused almost exclusively in obtaining limited liability protection for members of the charity. Very little thought has been given to the benefits associated with carrying on charitable operations within a separate corporation in order to contain liabilities and to protect charitable assets. Not only are charitable assets protected by utilizing charitable corporations, but the directors of charities are less likely to face exposure to personal liability because they are either managing fewer assets, are exposed to fewer liability risks, or both.

What follows in this section of the paper is a brief overview of some of the more common types of multiple charitable corporations that can be utilized to contain liabilities and to protect assets. This overview is followed by a discussion concerning how multiple charitable corporations can be effectively controlled, as well as a brief discussion of how to protect corporate assets which might be seized.

What this portion of the paper does not address is the numerous income tax issues that arise in utilizing multiple charitable corporations. A discussion in this regard is beyond the scope of this paper and should be the subject of a separate paper. The reader is cautioned, however, that there are numerous and potentially complicated tax issues that would need to be addressed before embarking on establishing multiple charitable corporations, such as issues involving associated charity status, specified gifts, compliance with applicable disbursement quotas, transfer of 10-year gifts, as well as designation of charitable corporations as either charitable organizations, public foundations or private foundations.

## 2. Different Types Of Multiple Charitable Corporations

While there are many types of multiple charitable corporations, the three types that this paper focuses on are: (i) the Parallel Operating Charity; (ii) the Parallel Foundation; and (iii) the Umbrella Association. A brief summary of each is set out below. This is not to suggest that there are not other types of charitable corporations that are of importance, but rather for practical purposes, it is not possible to include a description of every type of multiple charitable corporation in this paper.

For ease of reference, when reference is made to all three types of multiple charitable corporations described in the balance of this paper, they are collectively referred to as “affiliated corporations”.

a) Parallel Operating Charity

A Parallel Operating Charity can be used when an incorporated charity has a number of operating divisions, some of which involve a greater degree of liability exposure than others. For instance, if a church corporation operates a school or a children's camp, as well as operating a traditional church facility, then the risks associated with those operating divisions might severely prejudice the future viability of the church and of the assets that it owns, including land and buildings. A Parallel Operating Charity, such as a summer camp or a Christian school, could be established to take over these various high risk operations and to operate them through one or more separate corporations for purposes of containing the liability associated with their operations and protecting the assets of the main operating charity.

b) Parallel Foundation

A Parallel Foundation can be utilized for a broad range of reasons, ranging from protection of surplus funds from governments, such as is the case with hospital foundations, the establishment and management of endowment funds, the separation of capital fundraising campaigns from operating fundraising campaigns, the encouragement of intervivos and testamentary gifts, as well as the encouragement of planned giving programs.

As a result of the Ontario Court of Appeal's decision in the *Christian Brothers* case, however, the utilization of Parallel Foundations has now become very important for purposes of protecting donor restricted gifts that may be received in the future, and in particular endowment funds where the capital is to be held in perpetuity and is not be subject to any operating liabilities of the charity.

A Parallel Foundation can also be used as a form of holding corporation for the assets of a charity, such as holding land and buildings and/or holding existing endowment funds. However, the option of utilizing a Parallel Foundation as a holding corporation for existing assets is dependant upon the charity complying with creditor protection legislation, such as the

*Fraudulent Conveyances Act*[55] and/or the *Bankruptcy and Insolvency Act*[56]. As such, the option of transferring existing assets to a Parallel Foundation is normally limited to protecting only those existing assets that are not subject to claims either past or present.

Where a Parallel Foundation is established for the purpose of holding land and buildings for a church, consideration should be given to section 3(3)(b) of the *Assessment Act*[57] to ensure that the church Parallel Foundation would meet the definition of a "religious organization" in order to maintain the municipal tax exemption of the church property. This in turn would require that a license agreement be entered into between the church Parallel Foundation and the church in order to ensure the status of the church Parallel Foundation as a "religious organization". In addition, a pre-ruling from the Assessment Office, as well as the local municipality in question, should be considered to confirm the exempt status of the land and buildings from municipal taxation.

A further utilization of a Parallel Foundation is where the Parallel Foundation receives and holds mortgage security on the assets of the operating charity. This would be accomplished by transferring the land and buildings of a charity to a separately incorporated charity at fair market value upon payment of land transfer tax, as well as G.S.T., if applicable. The recipient charity would pay for the land and buildings in question by giving a mortgage back to the transferor charity. The transferor charity would then transfer the mortgage in favour of the Parallel Foundation by means of giving a "specified gift" under the *Income Tax Act*. The Parallel Foundation would then hold the mortgage as security against the equity of the land and the buildings of the operating charity in the event that future creditors of the operating charity attempted to seize the equity in the land and buildings utilized by the operating charity. The mortgage would be on a demand basis and would carry interest at a current market rate. The mortgage held by the Parallel Foundation for the stated capital and accrued interest, would then be available to protect the existing equity and future capital gains in the property from future creditors of the operating charity.

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55 R.S.O. 1990, c. F.29.
56 R.S. 1985, c. B-3, s.1.
57 R.S.O. 1990, c. A. 31.

### c) Umbrella Association

The utilization of an Umbrella Association would involve structuring a national or provincial charity that consists of member organizations into multiple legal entities instead of operating under the auspices of a single corporation. An Umbrella Association involves having a separatly incorporated governing body, normally established as a federal corporation, to act as the governing body, with each member organization being separately incorporated. An example of an Umbrella Association would be a national religious denomination where the national office of the church as been separately incorporated as the governing body and each local church and/or separate ministry, such as camps, are separately incorporated under the auspices of the national denomination.

The utilization of multiple charitable corporations to effect an Umbrella Association is to be contrasted with a national and/or provincial charity that operates through a single corporation that includes all of the various divisions and chapters as part of the single legal entity. The advantage in operating a national and/or provincial charity as a single legal entity is simplicity in administration and operations. However, the disadvantage in doing so is that all the assets of a charity are left in one single legal entity, which may result in the loss of all the assets of the national or provincial charity in the event of a claim being made against any one of the divisions or chapters of the charity.

National charitable organizations, and religious denominations in particular, that have been traditionally structured as a single corporations, are now having to look at the option of restructuring their national operation into multiple corporate entities for the purposes of protecting the assets of the national organization by containing operating liabilities within separately incorporated local entities.

For reference purposes, the pros and cons of utilizing an Umbrella Association can be summarized below as follows:

i) Pros

- The primary benefit of utilizing an Umbrella Association is that of reduced overall liability exposure in operating a national or provincial charity by containing the liability associated with a member organization within a separate corporate entity so that the claims made against a member organization does not affect the assets of other member organizations or that of the governing body.

- In the event that one member organization owns real estate that is subject to toxic contamination, the costs associated with the clean up of the contamination will generally be limited to only the assets of the incorporated member organization as opposed to affecting the assets of other member organizations or of the governing body of the Umbrella Association.

- In the event that a member organization was to become involved in activities that resulted in its loss of charitable status with Canada Custom and Revenue Agency ("CCRA"), only the charitable status of that member organization would be at risk instead of risking the charitable status of other member organizations of the Umbrella Association or of its governing body.

- For national charities which carry on operations in Ontario, the creation of a separate charitable corporation in Ontario to oversee Ontario activities would mean that the jurisdiction of the Public Guardian and Trustee in Ontario ("PGT") would generally be limited to only the assets of the Ontario charity instead of affecting those of the Umbrella Association or member organizations in other provinces.

- By establishing a separate corporation in Ontario, then the operations of the Umbrella Association that are carried on outside the province of Ontario through separate corporations in other provinces would not be subject to the provisions of the *Charities Accounting Act*, and in particular section 6(8) of the said Act which permits an individual to apply for an *ex-parte* order to require a public inquiry by the PGT in the event of a complaint concerning the solicitation of funds and the manner in which those funds are utilized.

- For a national charity that did not want to be subject to the provisions of the investment powers set out in the *Trustee Act* of Ontario, the establishment of a separate corporation to coordinate activities in Ontario would generally limit the application of the investment powers under the *Trustee Act* to only those investments held by the Ontario corporation or investments held in this province.

ii) The Cons

- A negative factor in establishing an Umbrella Association, is that the governing body can more easily lose control of its separately incorporated member organizations if necessary steps are not implemented to ensure that the member organizations are subject to appropriate contractual and/or licensing control mechanisms. The techniques used to ensure effective control in this regard are discussed later in this paper.

- Often a member organization will need to utilize the name and/or trade-marks of the Umbrella Association, which trade-mark rights are usually owned by its governing body. However, if the name and/or trade-marks of the national or provincial charity have not been protected by obtaining trade-mark registration, or the usage of the trade-marks by member organizations is not properly documented through appropriate trade-mark license agreements, then the ability of the governing body to protect and enforce the trade-marks of an Umbrella Association could be seriously prejudiced due to unintentional infringement of trade-marks by member organizations, or by unauthorized third parties.

- With member organizations that have names that are similar to that of the Umbrella Associations, there is frequently confusion which occurs with gifts given to the wrong charity, particularly where testamentary gifts fail to properly describe whether the governing body or the member organization is the intended beneficiary. This confusion could result in the estate having to apply for a *cy-prés* court application to determine which charitable organization is legally entitled to the testamentary gift.

- Effective utilization of an Umbrella Association requires the creation of multiple charitable corporations, as well as the implementation of numerous and sometimes complex control provisions. The complexity in the relationship could result in serious confusion unless the control mechanisms are carefully crafted and consistently applied. Failure to take appropriate steps in this regard could result in a general state of confusion that might be even more problematic than the negative liability associated with operating a national or provincial charity through a single corporate entity.

## 3. <u>Control of Multiple Charitable Corporations</u>

### a) The Need for Control

When businesses utilize multiple corporations, the parent corporation can maintain control over subsidiary corporations through the ownership of the majority of the voting shares of a subsidiary corporation. Charities, however, are non-share corporations that do not afford themselves control through the ownership of shares.

For ease of terminology, reference will be made to the relationship between a governing body and its member organizations, but such terminology has equal application to the relationship between an operating charity and a parallel operating charity and/or a parallel foundation.

When dealing with the relationship between a governing body and a member organization, the separate nature and autonomy of each charity must be recognized and respected. As a result, it is extremely important that the relationship between a governing body and a member organization be addressed early in the structuring process and that it be carefully considered. Once a member organization is created and becomes operational, it is normally very difficult for the governing charity to "rewrite the rules" and require that member organization relinquish any measure of control back to the governing body.

What follows is a discussion of two different types of control models that can be put in place to establish different degrees of controlled relationship between a governing body and a member organization. Although, as indicated above, these types of relationships would also be applicable to the relationship involving multiple charitable corporations, such as those including a parallel operating charity or a parallel foundation. Since the circumstances of each charity are different, there is no one general approach which will be right for every organization. As a result, the description of the two models set out below recognizes that they involve both advantages and disadvantages which will need to be carefully considered on a case by case basis.

A more complete discussion of the issues involving control by governing bodies with member organizations in the context of both national and international charities is set out in the paper by the author entitled *"National and International Charity Structures: Achieving Protection of Control."*[58] What follows is a summary of some of the more relevant portions of that paper in the context of protecting charitable assets.

b) Ex Officio Control Model

The most common method of indirectly controlling member organizations by a governing body is the Ex Officio Control Model. This model requires that the by-laws of the member organization provide for ex officio directors who are either directors of the governing body or alternatively hold officer positions in the national organization for the specific purpose of allowing those individuals to become qualified to sit as national representatives on the board of the member organization. Both the *Canada Corporations Act*[59] and the Ontario *Corporations*

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58 For a more detailed discussion on charitable structures, see Terrance S. Carter, "National and International Charitable Structures: Achieving Protection and Control" (Presented to the Law Society of Upper Canada, Toronto, 1998) (also available at www.charitylaw.ca)

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

*Act* permit the establishment of ex officio directors in the form of corporate by-laws that are permitted.

Although the utilization of ex officio directors can be an effective means of maintaining control of the member organizations, it should not be relied upon as the only means of doing so, since the Ex Officio Control Model does not encompass the contractual arrangements described below that can often better reflect the expectations between a governing body and its member organizations or licensing considerations between them involving intellectual property.

c) Franchise Control Model

A practical parallel can be drawn between the relationship of a franchisor and its franchisees and the relationship between a governing body of an Umbrella Association and its member organizations. Just as a governing body cannot control member organizations by owning the "shares" or other equity interest of an member organization, a franchisor, in a business context, is not the owner of shares in the franchisee corporation. As such, the franchisor must establish an alternative means of control over the franchisee. This is done through the contractual relationship of a franchise agreement. There is no reason why the Franchise Control Model cannot and should not be adopted in the context of establishing effective control mechanism between a governing body and its member organization in a charitable context, particularly involving an Umbrella Association.

By utilizing the Franchise Control Model, a governing body can establish an effective contractual relationship with its member organizations involving key factors, such as the requirements for membership in the Umbrella Association and the consequences of losing that membership. The Franchise Control Model can also be used to authorize the licensing of trade-marks and copyrights owned by the governing body. The Franchise Control Model can also implemented in conjunction with the Ex Officio Control Model. As such, the Franchise Model and the Ex Officio Control Model can be used to complement each other or be used independently, depending upon the circumstances.

i) Application of Franchise Law

In order to understand how the Franchise Control Model can apply to multiple charitable corporations, it is important to understand how franchise law applies to charities.

The concept of franchising originated in the United States. For many years, Alberta was the only province or territory in Canada which has franchise legislation[60]. Ontario adopted its own franchise legislation, called the *Arthur Wishart Act (Franchise Disclosure)*[61], passed by the Ontario Legislature on May 17, 2000, with Royal Assent being granted on June 8, 2000 (the "Act").

If a relationship falls with the meaning of "franchise" as defined by the Act, the Act will then impose the duty of fair dealing on both parties to a franchise agreement, and imposes heavy statutory duties upon the franchisor to disclose certain information to the franchisee pursuant to the provisions of the Act. Failure to comply with the Act will give the other parties different remedies ranging from rescinding the franchise agreement to claiming damages[62].

To come within the Act's definition of "franchise," an arrangement must exhibit certain elements. The franchisor must grant the franchisee either representational or distribution rights, or the right to sell goods or services associated with the franchisor's trademarks, advertising and other commercial symbols, while exercising significant control over or assisting in the franchisee's method of operation and location. In return, the franchisee must agree to make one or more payments to the franchisor, which, in some cases, may extend over the course of operations.

To avoid being caught by the definition of "franchise" under this Act when trademark licensing is involved between a governing body and member organization, the governing

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60 *Franchise Act*, R.S.A. 1995, c. F-17.1.

61 S.O. 2000, c. 3, as amended by: 2001, c. 9, Sched. D, s. 1.

62 For a detailed discussion on the application of the *Arthur Wishart Act*, see John Clifford & Brad Hanna, "New Ontario Franchise Law Requires Disclosure and Fair Dealing" (Prepared for the Osgoode Hall Law School Professional Development Program, 2000) (also available at http://osgoode.yorku.ca/pdpwebsite.nsf)

organization would need to be careful to avoid “significant controls or substantial assistance” to member organizations, and avoid accepting any “payment or continuing payments” from member organizations. If the relationship between a governing body and member organization did fall within the meaning of “franchise” under the Act, then considerable care would need to be taken by the governing body and its directors to ensure the compliance with the Act[63].

ii) The Specifics of the Franchise Control Model

The Franchise Control Model works best with an Umbrella Association, such as a religious denomination or other type of national charity, since the model provides an effective tool to ensure compliance by member churches with denominational standards and expectations. The basic components of the Franchise Control Model involve developing an association agreement, the inclusion of appropriate control provisions within the incorporating documents of member organizations, and the implementation of a licensing arrangement to protect the applicable intellectual property. Each of these components are discussed separately below.

(1) Association Agreement

An association agreement is sometimes referred to as a "charter agreement", an "affiliation agreement" or a "membership agreement". The content of the agreement, not the terminology used to describe its is what is important. The association agreement sets out the contractual relationship between the governing body and its member organizations. Some of the more important considerations that should be included in an association agreement are the following:

- The preamble should state that the governing body and the member organizations have similar charitable purposes, that they are recognized at law as being separate and distinct corporate entities with separate boards of directors, and that they are to remain independently responsible for the management and governance of their respective operations. The inclusion of a clear statement to this effect at the beginning of the

63 *Ibid,* for information concerning the statutory duties under the *Arthur Wishart Act*.

agreement will help to offset any attempt to "pierce the corporate veil" between the two organizations as discussed later in this paper.

- There should be a statement that the contractual relationship contained in the agreement does not constitute either a partnership or a joint venture arrangement between the parties.

- The term of the agreement should be indicated. It is suggested that a period of five years is appropriate with an automatic renewal thereafter for an additional five year term, unless written notice is given by one party to the other.

- The basic requirements of the association relationship should be clearly articulated. This could include the following considerations:

  - the specific wording, or at least the general parameters for the charitable purposes of the member organization;
  - if the Umbrella Association is a religious denomination, the agreement should require that the member organization include a denominational statement of faith in its letters patent;
  - the requirements to be included in the by-laws of the member organization concerning such matters as qualification requirements for members, which for a religious organization should include a requirement that the member adhere to a particular statement of faith;
  - the wording for the dissolution clause to be included in the letters patent of the member organization to ensure that the assets of the member organization on dissolution are transferred to another member organization;
  - a requirement that the governing body be able to review and approve the general operating by-law for the member organization, as well as the right to approve other fundamental changes, such as an application for supplementary letters patent, or the adoption of amendments to the general operating by-law of the member organization;

- a requirement with respect to general liability insurance coverage and whether or not the governing body is to be included as a co-insured under the insurance policy of the member organization; and
- an explanation of the parameters under which the name and trade-marks of the governing body can be utilized by the member organization, with particulars to be set out in a separate trademark licence agreement.

- The association agreement should also set out the rights that flow from the association relationship, such as the right of the member organization to use the names and trade-marks of the governing body, as well as the right of the member organization to obtain resource materials, administrative services, as well as ongoing advice and counsel, from the governing body as necessary from time to time.

- The association agreement should clearly state what actions by the member organization would terminate the association relationship, such as the loss of charitable status, a breach of a material term of the association agreement that is not remedied within a reasonable period of time, or a violation of the trade-mark provisions contained in the association agreement or in a related trademark licence agreement.

- The association agreement should then delineate the consequences that flow from the termination of the association agreement, such as termination of the right to use the trademarks of the Umbrella Association and a requirement that the member organization return all copyrighted materials back to the Umbrella Association.

- The association agreement would also need to set out the mechanism, if applicable, by which the Umbrella Association can obtain a reversion of assets of another organization to be included in deeds and/or bills of sale. Such mechanisms can include a reversionary trust, a condition subsequent, or an option to purchase agreement, depending upon the nature of the association and the assets in question.

- Finally, the association agreement should set out a mechanism for conflict resolution by including a provision in the agreement requiring mandatory mediation and/or arbitration to avoid costly and divisive legal action.

(2) Incorporating Documentation for Member Organizations

The incorporating documents for a member organization should be drafted or amended in accordance with the requirements set out in the association agreement. This could be done by having the member organization utilize standard incorporating precedent materials that are either attached to the association agreement as a schedule or are incorporated by reference into the association agreement.

The governing body should be given an opportunity to review the final form of the application for letters patent and general operating by-law for the member organization before it is filed for incorporation. The same approval process would also apply in the event that another type of Affiliated Corporation applied for supplementary letters patent.

(3) Trademark Considerations

As discussed earlier, the most important asset of a charity is the goodwill associated with its name as a trademark. The value of its name is reflected in its ability to attract donations through either intervivos or testamentary gifts. In the context of a governing body, its name as a trademark and associated logo constitute the basis by which the public will identify the organization and the activities that it carries on. As such, the governing body will need to be diligent in ensuring that the goodwill associated with its trademarks is not compromised.

The trademarks of the governing body can include its corporate name and various operating names and logos. All of these should be protected by applying for trademark registration under the *Trade-marks Act*[64]. In addition, depending upon whether the Umbrella Association receives government funding, it may be possible to obtain the benefit of an Official Mark designation under Section 9 of the *Trade-marks Act* similar to what the Canadian Olympic

[64] R.S.C. 1985, c. T-13.

Association has been able to obtain in the past for its Olympic symbols. The advantage of an Official Mark designation under Section 9 of the *Trade-marks Act* is that it prohibits anyone else from using the mark in question in any manner whatsoever, even if such usage is not associated with the wares and services for which the Umbrella Association has used the mark.

The registered trademarks and, if applicable, Section 9 Official Marks, should be owned by the governing body and then licensed to each member organization. The licensing of the trademarks needs to be done pursuant to a separate trademark license agreement to ensure full compliance with the requirements for an effective trademark licence under the *Trade-marks Act*. Many governing bodies incorrectly assume that by giving their consent to a member organization to use the name of the charity, such consent constitutes an effective trademark licence arrangement. This assumption is incorrect since a formal trademark licence agreement should be entered into to comply with the various licencing requirements of the *Trade-Mark Act*.

A trademark license agreement should include, among other things, the following:

- recognition of the ownership of the trademarks by the governing body;
- an explanation of the manner in which the trade-marks can be used by a member organization and sufficient means by which the governing body can exercise active control over the use of the trademarks;
- how the trademarks are to be protected and enforced, together with a requirement that the member organization advise the governing body of any infringement of the trademarks;
- a description of what constitutes default under the trademark licence agreement and what are the consequences resulting from the termination of the trademark licence; and

- the inclusion of a provision dealing with conflict resolution through mandatory mediation and/or arbitration.

(4) Copyright Considerations

Copyright issues can also be an important part of establishing control by an Umbrella Association. However, copyright law is not often well understood and is frequently ignored altogether in the context of documenting an effective Umbrella Association relationship.

Once the issue of ownership of the copyrighted materials has been established, it may be prudent to register the copyright, particularly if the materials are going to appear in a public source, such as on an internet web page.

In relation to copyrighted materials belonging to the governing body that are used by member organizations, such as resource materials, audiotapes, videotapes, training manuals, checklists, brochures, fundraising documentation, etc., it is important that the governing body set out in a copyright licence agreement an acknowledgment of its ownership rights in the copyrighted materials and the parameters under which the member organization can use those copyrighted materials. The licence agreement should also set out the basis by which the copyright licence will be terminated and the consequences of such a termination of the licence which will require the immediate return of all copies of the copyrighted materials.

## 4. Piercing the Corporate Veil

Fundamental to utilizing multiple charitable corporations is the need to maintain the integrity of the limited liability protection of the various incorporated entities. While the concept of limited liability protection is still the general rule for corporate entities, whether the corporation is in the form of a share capital or a non-share capital corporation, there are instances where the governing body or an operating charity might be found to be liable for the actions of a member organization or affiliated corporation as a result of the equitable doctrine known as "piercing the corporate veil". In those few situations where the court will "pierce the corporate veil", the "piercing" seems to happen freakishly. "Like lightning, it is rare, severe, and unprincipled in its approach".

Although flow through liability between multiple charitable corporations can occur as a result of claims based upon principal/agent relationships, master/servant relationships, and vicarious liability though claims based on negligence, such a discussion is beyond the scope of this paper and would need to be addressed as a separate topic. As such, the discussion that follows will be limited by design to a brief commentary on issues involving piercing the corporate veil.

Instances where courts in the U.S. have been prepared to "pierce the corporate veil" have occurred where a subsidiary corporation has been found to be a mere instrument or alter-ego of the parent corporation and where there has been significant elements of common identity established between the parent and the subsidiary corporation resulting in the courts finding the following:

a) that there has been total domination and control of the subsidiary by the parent so that the subsidiary corporation has no separate mind, will or existence of its own;

b) that the subsidiary has been used to commit a fraud or wrong to insulate the parent from responsibility; and

c) that injury has been caused to the plaintiff by the fraud or wrong.

In Canada, the equitable doctrine of "piercing the corporate veil" has been rejected in a number of Ontario decisions, most recently *Gregorio vs. Intrans-Corp*.[65], and *Transamerica Life Insurance Company of Canada vs. Canada Life Assurance Company*[66]. In the *Transamerica Life Insurance* case, the court held that it is difficult to precisely define when the corporate veil can be lifted but that the lack of a precise test does not mean that a court is free to act as it pleases on some loosely defined "just and equitable" standard. The court went on to state in that case that the separate legal personality of a corporate entity will only be discarded when it is completely dominated and controlled and being used for fraudulent or improper conduct.

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65 (1994), 18 O.R. (3d) 572.

66 (1996), 28 O.R. (3d) 423.

The court also held that the first required element, that of "complete control", involves more than ownership. It must be shown that there is complete domination and that the subsidiary company does not in fact function independently. Not only did the court find in that case that there was no fraudulent or improper conduct, but there was insufficient evidence to conclude that the subsidiary was only a "puppet" of the parent corporation, notwithstanding the fact that all members of the board of directors of the subsidiary corporation were senior executives of the parent corporation. The decision of the court was primarily based on the fact that the subsidiary corporation had its own head office and branch offices distinct from those of the parent corporation and was managed and operated independently of the parent corporation.

Although the doctrine of "piercing the corporate veil" does not necessarily threaten the viability of utilizing multiple charitable corporations to carry on charitable operations to avoid circumstances that might lead to allegations of complete domination and control by a governing body over the operations of its member organization. Some of the factors suggesting "central control" that should be avoided where possible are outlined below as follows:

i) having common bank accounts or investments shared between the governing body and a member organization;

ii) making explicit or implicit representation that the governing body is responsible for the operations of the member organization;

iii) having both organizations occupy the same location for either operational or administrative activities;

iv) using the same officers or employees unless there is documentary evidence establishing that one organization is invoicing the other organization for the services provided by the employees of the other organization;

v) having either the governing body or a member organization use the land, buildings or property of the other organization;

vi) having the chief executive officer of the member organization act on the direction and in the interest of the governing body;

vii) failing to observe the legal formal requirements of the member organization in its operations and direction;

viii) having the same individuals serve on the board of directors or key committees of both the governing body and member organization, such as where there is a significant overlap in the membership of the finance committees of the two organizations;

ix) directly or indirectly indicating on letterhead, signs, brochures, or other documentation that the member organization is an operating division of the governing body;

x) having the governing body pay the salary and other costs or losses of the member organization;

xi) having the governing body and a member organization use the same lawyers or accountants on a regular basis; and

(xii) failing to have loans from the governing body to the member organization properly documented and formalized through proper corporate formalities and authorization by board resolutions.

The above list of factors is not intended to suggest that there cannot be some similarity in operations or some overlapping in control between a governing body and a member organization. However, it is essential that the board members and executive officers of both the governing body and member organizations understand that both entities must operate as separate and distinct charitable corporations and as such must respect the autonomy and individual integrity of each organization.

## F. CONCLUSION

Given the reality of increased litigation directed against charities, the challenge for charities in the future may very well be to simply ensure their continued existence. To achieve this minimalist objective, charities and their board of directors will need to become familiar with the ever increasing list of liability risks being faced by charities and be able to respond in an effective and pro-active manner to limit unnecessary liability exposure in order to protect the charitable property that has been entrusted to them. This approach is consistent with the intensified fiduciary obligations that have been placed upon directors of charities to effectively manage, protect and apply charitable assets in accordance with the intended charitable purposes.

Charities will therefore need to be encouraged to undertake due diligence procedures, arranging from the mundane, such as maintaining a written inventory of charitable assets, to the more complex, involving conducting ongoing legal risk management audits. Charities will also need to be encouraged to become knowledgeable about new areas of liability exposure that may affect their operations, such as knowledge about new statutory provisions involving investment powers, or recent developments in the courts, such as the imposition of principal/agency relationship in relation to fundraising. Both of these general approaches will assist charities and their legal counsel to develop appropriate pro-active responses, including the utilization of multiple charitable corporations, where appropriate, in order to insulate the charities from unnecessary liability exposure, and thereby protecting charitable assets for the benefit of the public at large.

As can be seen from the number of issues discussed in this paper and the complexity of their interrelationship, the opportunity to advise charities in protecting their assets and operations is a both a challenging and satisfying area of the law to practice in.