

## THE LEGAL DUTIES OF DIRECTORS OF CHARITIES AND NOT-FOR-PROFITS

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### A. INTRODUCTION

Liability risks for directors of charitable and non-profit corporations can arise at common law and by statute. A director can be held personally liable for his or her own actions or inactions, as well as jointly and severally with the other members of the board of directors. This summary outline discusses both the common law as well as statutory duties and liabilities faced by directors of charitable and not-for-profit corporations. An explanation of steps that can be taken to protect directors from liability exposure faced by directors is contained in a separate summary entitled “Due Diligence in Avoiding Risks for Directors of Charities and Not-For-Profits”.

### B. COMMON LAW DUTIES AND LIABILITIES

#### 1. Management of the Corporation

- ◆ Directors are responsible for all aspects of the corporation’s operations. In properly fulfilling their duties as directors, they must:
  - ensure the objects of the corporation are properly carried out
  - ensure the corporation does not undertake activities outside its corporate objects
  - provide adequate authority for the activities that the corporation does undertake (by amending letters patent, bylaws, etc.)
  - set long-range objectives and strategic plans for the corporation
  - ensure the corporation’s financial stability and overall performance
  - hire and supervise management and staff to do the day-to-day work of the corporation

## 2. Duty of Care

- ◆ Directors of all corporations must exercise a certain standard of care in carrying out their duties, however this standard of care varies depending on the type of corporation involved.
  - a) Business Corporation:
    - directors of a for-profit business are held to a statutory objective standard of care
    - directors need to ask: how would a “reasonably prudent person” conduct the affairs of the corporation?
  - b) Not-for-Profit Corporation (Non-Charity):
    - directors of a not-for-profit non-charitable corporation are held to a common law subjective standard of care
    - directors need to ask: what level of skill and care can reasonably be expected from a person with my knowledge and experience?
    - the standard is different depending on the director’s knowledge and experience (eg. lawyers, accountants)
    - however, the minimum expectation would be the level of care expected from a “reasonably prudent person”
  - c) Charitable Corporation:
    - in addition to the already high subjective standard of care, directors of charitable corporations face additional expectations
    - this is because the courts in Ontario have held that directors of charitable corporations are also subject to a fiduciary duty to act as a quasi-trustee of the charitable property of the corporation
    - this fiduciary duty involves an obligation to act honestly, in good faith and in the best interests of the corporation which precludes the director from acting in a self-serving manner
    - thus directors of charitable corporations are held to the highest possible standard of care; similar to the standard expected of a trustee of the estate of an infant beneficiary
    - directors need to ask: what level of care would a reasonable and prudent person managing his or her own affairs exercise?

## 3. Liability Risk for Lack of Corporate Authority

- ◆ a corporation’s corporate authority is defined by the corporate objects set out in its letters patent, as amended by supplementary letters patent, and other governing documents

- ◆ the activities of the corporation can only be undertaken within the parameters of the corporate objects
- ◆ where directors act outside the scope of their authority contained in the governing documents, i.e. by undertaking activities that are outside the authority of the corporation's objects, they may be found potentially liable for the consequences of such decisions or actions
- ◆ such potential liability for lack of corporate authority arises under the common law, tort, contract and statute
- ◆ where necessary, amendments to the governing documents should be made by the corporation

#### 4. Liability Risk for Negligent Mismanagement (Tort)

- ◆ a tort is a civil wrong recognized by the courts for which an injured party can seek damages, eg. slip and fall accident
- ◆ directors will be personally liable for torts committed by the corporation where their own conduct in managing the corporation also contributed to the victim's injury, eg. situations involving negligent mismanagement
- ◆ if their carelessness in the oversight of the corporation's operations leads to injury, directors of charities can be found liable in tort for negligent mismanagement for:
  - failing to adequately supervise hiring staff and volunteers
  - failing to monitor the on-going conduct of staff and volunteers, especially in regard to sexual abuse of children and/or harassment of employees
  - wrongful dismissal where directors acted with malice or otherwise improperly dismissed the employee
  - permitting unsafe conditions on corporation's property leading to an accident
  - negligent operation of corporate vehicle involved in corporation's activities
  - knowingly drawing cheques against insufficient funds
  - failing to prevent depletion of the corporate assets
  - allowing unauthorized investments
  - paying excessive salaries, bonuses or benefits to staff

#### 5. Liability Risk in Contract

- ◆ directors are generally not personally responsible for contracts they sign for the corporation provided they have the proper authority to do so, which is determined by the corporation's governing documents or by board resolutions
- ◆ however, directors of a charity may face potential liability where:
  - they enter a contract lacking the necessary authority to do so
  - they do not properly identify the corporation in any contract or to the contracting party

- the other party believes the director is signing in his or her own name
- they are found to have induced a breach of contract prior to the signing of the contract
- they do not follow through to ensure that the corporation complies with a contract
- ◆ to reduce liability exposure, directors should ensure contracts are duly authorized by either the board or the membership before entering into them
- ◆ directors should also exercise due diligence to ensure that the terms of contracts are complied with to avoid allegations of wrongful interference in inducing breach of contract

## 6. Liability Risk for Breach of Fiduciary Duty

### a) Overview

- directors of charitable corporations are also subject to a fiduciary duty to act as a quasi-trustee of the general charitable property of the corporation
- this fiduciary duty involves an obligation to act honestly, in good faith and in the best interests of the corporation which precludes the director from acting in a self-serving manner
- as part of their fiduciary duty, directors have a primary obligation to exercise due diligence in overseeing and managing the corporation and its charitable property
- exercising due diligence includes attending board meetings, supervising operations, monitoring compliance with corporate objects, and ensuring board resolutions are adopted by informed decisions of the directors
- fiduciary duties are owed to the charitable objects of the corporation, the charity itself, its donors, and its creditors

### b) Summary of Fiduciary Duties

#### i) Duty to Act Honestly

- ◆ directors must deal honestly with the corporation
- ◆ conflicts of interest with the corporation are to be avoided and must be disclosed if any exist
- ◆ directors must not act fraudulently

#### ii) Duty of Loyalty

- ◆ a director's sole interest is to the corporation
- ◆ the interests of the director must not be placed in conflict with those of the corporation

#### iii) Duty of Diligence/Duty to Act in Good Faith

- ◆ directors must be diligent in attending to their legal duties

- ♦ this is done by being familiar with all aspects of the corporation's operations through attending board meetings and reviewing the minutes of missed board meetings
  - ♦ implementation of due diligence by board of directors will provide good defence to claims of negligence and alleged statutory violations where directors can show that positive action was taken to ensure compliance by the corporation
  - ♦ where advice of a specialized nature is required by the corporation, directors must obtain services of qualified professionals
- iv) Duty to Exercise Power
- ♦ directors are responsible for managing the corporation, ie. developing policies and direction, supervising management and staff
  - ♦ may delegate certain responsibilities and/or authority, but they must supervise
  - ♦ must pursue the corporate goals and objectives
  - ♦ directors must hold funds collected from the public in trust for designated charitable purposes
  - ♦ in order to justify accounts and decisions made regarding charitable monies, directors must properly maintain books, records and minutes of the corporation
- v) Duty of Obedience
- ♦ directors must comply with all applicable legislation and the corporation's governing documents (letters patent, by-laws, etc.)
  - ♦ need to ensure that valid corporate decisions are implemented
- vi) Duty to Avoid Conflict of Interest
- ♦ directors must declare and avoid any conflicts of interest or anything that give a director the appearance of a personal benefit
  - ♦ where a conflict of interest arises, it must be declared, the director must not participate in any discussion or vote and, depending on the circumstances, the director may have to resign
  - ♦ directors cannot receive remuneration from the charitable corporation directly or indirectly
- vii) Duty of Prudence
- ♦ directors with special expertise must use their expertise prudently while striving to achieve the most practical result for the charity
- viii) Duty to Continue
- ♦ directors have continuing obligations to the corporation which cannot be relieved by resignation

- ◆ can only resign from the corporation where there are adequate individuals to replace the resigning director
- ◆ resignation to avoid personal liability is ineffective and may constitute breach of fiduciary duty where the director put own interests ahead of those of the corporation

## 7. Liability for Breach of Trust

### a) Overview

- in addition to fiduciary/quasi-trustee duties, directors of charitable corporations may also be trustees of restricted charitable property
- however, the reality is that fiduciary duties and trustee duties in relation to charitable property are essentially the same
- this was confirmed in the recent decision of the Ontario decision in *Public Guardian and Trustee v. Aids Society of Ontario* (for more information, see Charity Law Bulletins #9, #13 and #17 at [www.charitylaw.ca](http://www.charitylaw.ca))
- the *Aids Society* case emphasizes that directors of charitable corporations have an obligation to apply charitable property toward the charitable objects of the charity
- this requires directors to take pro-active steps to protect charitable property
- any loss of charitable assets due to inactivity or failure to act by the directors could result in breach of fiduciary duty or even breach of trust

### b) Potential Liability Risks

#### i) Remuneration of Directors

- ◆ in Ontario, directors of charitable corporations may not receive any direct or indirect remuneration from the corporation without court approval
- ◆ it is unclear if this requirement applies in other provinces
- ◆ this means that a director cannot be a paid employee, contractor, etc. of the corporation
- ◆ this prohibition also applies to director's family members living at home
- ◆ this rule does not apply to reimbursement to directors for legitimate out-of-pocket expenses
- ◆ a consent order from the PGT permitting remuneration of directors is possible, but it is both timely and costly
- ◆ may only receive indemnification and directors' insurance from the corporation subject to the provisions of Reg. 4/01 under the *Charities Accounting Act* (Ontario) (for more information see Charity Law Bulletin #4 available at [www.charitylaw.ca](http://www.charitylaw.ca))

- ii) Dealing with Charitable Property
  - ◆ directors are responsible for the way charitable property is handled
  - ◆ where mismanagement occurs, directors can incur personal liability to the full amount of any loss
  
- iii) Dealing with Charitable Objects
  - ◆ charitable property must only be applied to the charitable objects contained in the governing documents of the corporation
  - ◆ failure to properly apply charitable property may expose directors to breach of corporate duty, breach of fiduciary duty as well as breach of trust
  
- iv) Dealing with Special Purpose Charitable Trusts
  - ◆ directors of charitable corporations have fiduciary obligations to donors
  - ◆ breach of trust is possible where:
    - directors fail to apply donated funds in accordance with donors' restrictions
    - funds are redirected for a different purpose than the one for which they were given
    - directors fail to hold and invest the capital of an endowment fund in perpetuity
  
- v) Investment of Charitable Funds
  - ◆ directors have a duty to protect charitable property and in some cases they have a specific duty to invest charitable assets:
  - ◆ directors may face liability exposure as a result of a failure:
    - to determine and comply with the investment power in the corporation's governing documents or gift agreements
    - to determine and comply with the applicable statutory investment power of the applicable province
    - to invest in accordance with the prudent investor standard, including the mandatory investment criteria, as required by the *Trustee Act* (Ontario) (for more information, see Charity Law Bulletin #8 available at [www.charitylaw.ca](http://www.charitylaw.ca))
    - to develop and implement investment and delegation plans, as applicable
  - ◆ liability can range from bad investments to overly conservative investment decisions to missed opportunities
  
- vi) Co-mingling of Donor Restricted Funds
  - ◆ are there gifts which are subject to restrictions, limitations, etc., including endowment funds, donor restricted use funds and 10-year gifts
  - ◆ at common law, gifts are to be held in separate accounts from other restricted trust funds and cannot be co-mingled

- ◆ in Ontario, regulations under the *Charities Accounting Act* (Ontario) now allow charities to co-mingle restricted funds in single account for investment purposes
- ◆ however, before co-mingling can be done, there are numerous statutory requirements to comply with
- ◆ improper co-mingling will expose directors to personal liability for breach of trust
- ◆ see Charity Law Bulletin #4 available at [www.charitylaw.ca](http://www.charitylaw.ca) for more information

## C. STATUTORY DUTIES AND LIABILITIES

### 1. Overview

- ◆ many federal and provincial statutes impose specific offences and penalties for acts and omissions committed by directors of corporations
- ◆ purpose of such liability on directors is that the corporation cannot be sufficiently punished itself, therefore its directors must be exposed to same liability as the corporation
- ◆ legislation imposes liability on directors and *de facto* directors
- ◆ a director can be held personally liable for his or her own actions or omissions, as well as jointly and severally with other directors of corporation
- ◆ offences are strict liability offences, meaning it is immaterial whether or not the directors intended that the corporation violate the statutory provisions in question
- ◆ only defence that can be established in one of "due diligence", which requires that the directors be able to prove to the satisfaction of a court that the directors have taken reasonable steps in the circumstances to ensure that the provisions of the Act in question could have been complied with
- ◆ penalties for non-compliance with statutory requirements can result in directors being subject to fines, repayment of debt and even imprisonment
- ◆ resigning as a director may not limit liability, although limitation periods generally exist
- ◆ while the focus of this presentation is the federal and Ontario jurisdictions, not-for-profit corporations either located or operating in other provinces must also review the comparable provincial legislation and statutory obligations

### 2. Federal Statutes

- a) *Canada Corporations Act*
  - statute under which all federal non-share capital corporations are incorporated



- i) Wages
  - ♦ directors are jointly and severally liable for all unpaid wages due for services by employees for the corporation while they were directors (section 99)
  - ♦ debt liability limited to six months' wages and claims must be commenced within six months after wages were due and must be brought while person is still a director or within 12 months of ceasing to hold office
  - ♦ no similar liability for vacation pay
  
- ii) Conflict of Interest
  - ♦ every director with an interest in a contract with the corporation must disclose such interest (section 98)
  - ♦ where director fails to disclose conflict of interest, he or she will be potentially subject to summary conviction and minimum fine of \$1000 (section 49)
  
- iii) Reporting Requirements
  - ♦ failure to file required information with Industry Canada can lead to personal liability with no limitation period or defense for director who permits breach to occur
  - ♦ an annual summary for the corporation is to be filed on or before June 1st each year for information effective as of preceding March 1st
  - ♦ default in filing will result in a fine to the corporation of \$20 to \$100 for each day default continues and directors who permit such default are liable to same fine (section 133)
  - ♦ if failure to file annual report results in winding up of the corporation by court order, then directors aware of default may be held liable for costs incurred in winding-up the corporation (section 150(2))
  
- iv) Books, Minutes and Records
  - ♦ corporation required to maintain proper books, records and accounting records (sections 109, 112 and 117)
  - ♦ failure to comply will result in summary offence with penalty of maximum of \$20 for each day neglect continues (section 113)
  
- v) Identification of Corporation
  - ♦ directors have obligation to ensure against flawed or incomplete representation of corporation on business documents or to third parties
  - ♦ failure to do so may result in fine to director of \$200 along with personal liability to the holder of any financial instrument for the full amount if the corporation does not pay (section 27)

- vi) Membership Lists
    - ♦ directors face liability for failure to provide membership lists to members upon request, for misuse of membership lists for prohibited purposes under the Act, and for sale of membership lists (section 111)
    - ♦ such offences will possibly result in fine of \$1000 and up to six months imprisonment or both
  
  - vii) Winding Up
    - ♦ the Act imposes liability on directors where the Attorney General applies to wind up and dissolve the corporation for operating outside its Letters Patent (section 5.6), for failing to hold an annual meeting of members for two years or for failing to file an annual return (section 150)
  
  - viii) General Penalty
    - ♦ a general offence provision in the Act exists for breach of any section of the legislation for which no penalty has been prescribed (section 149)
    - ♦ directors will be liable to fine of \$1000 and imprisonment not more than a year for doing anything contrary to the legislation or failing to comply
- b) *Income Tax Act* (Canada)
- directors jointly and severally liable to pay all employee income tax deductions which the corporation fails to remit for two years following ceasing to be a director
  - directors of charitable corporations are personally liable if charity fails to comply with numerous reporting requirements, eg. filing of annual charity information return, disbursement of funds, etc., if charity improperly issues charitable receipts, or if it fails to meet its disbursement quota requirements
  - directors also face penalties where they provide improper tax advice to others
  - to avoid liability, director needs to show that positive steps were taken to ensure that corporation complied with the Act's requirements, eg. establishing payroll trust account and requiring the CEO to provide regular reports to board on remittances
- c) *Excise Tax Act* (Canada)
- directors are liable for any failure by corporation to collect and remit GST, which liability continue for two years after person ceases to be director
  - the establishment of a separate trust fund for GST remittances is recommended

d) *Canada Pension Plan*

- directors also jointly and severally liable where corporation fails to remit appropriate pension contribution premiums for employees

e) *Canadian Environmental Protection Act*

- imposes positive duties on directors to ensure that corporation complies with the Act regarding air and water pollution, as well as proper storage and disposal of toxic substances
- failure to comply can result in prison terms and fines up to \$1 million

f) *Anti-terrorism Legislation*

- the *Anti-terrorism Act* (Canada) (Bill C-36) has number of serious liability risks for charitable corporations and its directors, particularly those involved in overseas work
- liability risks include seizure of charitable property, loss of charitable status and even Criminal Code charges against the charity, its directors and even its donors for fundraising that directly or indirectly supports or facilitates broadly defined “terrorist activities” or “terrorist groups”
- careful review of the Act should be done by the charitable corporation to determine if its activities potentially expose it to liability
- if so, the directors should take steps to complete a due diligence review of the corporation under the Act
- more information on the Act and due diligence is available at [www.charitylaw.ca](http://www.charitylaw.ca) and [www.antiterrorism.ca](http://www.antiterrorism.ca)

3. Ontario Statutes

a) *Corporations Act* (Ontario)

- failure to keep proper books, records and registers at the head office of the corporation and failure to make such books, records and registers available for inspection by entitled persons may result in personal liability for the directors
- directors are required to disclose their interest in a contract to be entered into by the corporation at the next meeting of directors
- failure to disclose is an offence under the Act, resulting in liability being imposed on the director for any profit realized from the contract, the voidability of the contract, and a penalty on conviction up to \$200
- the Act also has a general offence provision for any breach of its provisions for which no penalty is prescribed, which could result in a fine up to \$200 on conviction

b) *Employment Standards Act (Ontario)*

- where directors authorize, permit or acquiesce in the non-payment of wages, vacation pay, termination pay and severance pay by the corporation, then liability on the directors for large fines may result
- in addition, directors will be personally responsible to pay 6 months' wages and 12 months' vacation pay of employees, with failure to do so subject to \$50,000 fine
- however, a director will not be liable unless the corporation has been sued for the debt within 6 months of it becoming due and employees cannot collect from the corporation or the corporation has ceased operations by liquidation, winding up or bankruptcy
- directors must be sued for debt while still being directors or within one year of ceasing being directors

c) *Retail Sales Tax Act (Ontario)*

- failure on the part of the corporation to remit Ontario retail sales tax will shift responsibility to the Directors jointly and severally for such remission failures

d) *Workplace Safety and Insurance Board Act (Ontario)*

- directors are not liable for any failure by the corporation to remit these premiums unless it can be shown that they intended not to pay them

e) *Pensions Benefits Act (Ontario)*

- a corporation is obligated to make contributions to an employee pension plan and to hold this money in trust for its employees
- directors who fail to pay these pension benefits may be ordered by the court to make up the contributions
- failure to comply will subject directors to maximum fine of \$25,000

f) *Ontario Health Insurance Program*

- corporations are required to pay OHIP premiums for all its employees
- *Health Insurance Act (Ontario)* holds directors personally liable to pay any premiums on which the corporation has defaulted
- *Employer Health Tax Act (Ontario)*, corporations also require a tax to be paid to the health insurance scheme, which is an offence not to pay subjecting directors to a penalty if they direct, authorize or participate in any way with the tax avoidance.

g) *Occupational Health and Safety Act* (Ontario)

- directors are required to take all reasonable steps to ensure that the corporation complies with the provincial workplace health and safety requirements
- failure to do so will result in maximum fine of \$500,000 to the corporation with the directors also subject to a maximum fine of \$25,000.00 and one year in prison
- important that directors ensure that the corporation implement a system to ensure health and safety in the workplace
- legislation generally requires the appointment of a health and safety representative if there are more than five employees and a health and safety committee if there are more than twenty employees

h) *Environmental Protection Act* (Ontario) and Related Legislation

- directors are required to take reasonable care to prevent the unlawful discharge of a contaminant into the natural environment, with failure to fulfil do so being an offence
- *Pesticides Act* (Ontario) and the *Ontario Water Resources Act* also contain similar offences
- *Environmental Protection Act* (Ontario) mandates that the people in control of a contaminant are the ones responsible for the cleaning up or reimbursing others for the clean-up costs related to a spill of the contaminant, with directors potentially being held liable for such costs if the corporation does not pay itself (eg. Bata Corporation case)
- directors may become liable for contamination simply by virtue of the corporation owning land in Ontario, therefore before either purchasing or receiving a gift of land, it is essential that an appropriate environmental audit first be obtained to ensure that there is no contamination on the property.

i) *Child and Family Services Act* (Ontario)

- certain persons in the course of their professional or official duties who have reasonable grounds to suspect child abuse has or is about to occur have a duty to report it to the appropriate authorities
- non-reporting of suspected child abuse is a provincial offence
- a charitable corporation and its directors and officers may be liable where its employees fail to report suspected child abuse and where child abuse occurs as a result of its failure to properly monitor its employees and operations.

j) *Trustee Act* (Ontario)

- power of directors of a federal charitable corporation to make investments is generally derived from its letters patent, however provincial legislation may also mandate the investment power with which a corporation operating in a particular province may invest its assets

- in Ontario, the *Trustee Act* (Ontario) establishes that directors of a charitable corporation have the power and duty to invest the assets of the corporation as a prudent investor would
- this includes power to invest in mutual funds and the power to delegate investment decision making to qualified investment managers, provided that the corresponding statutory requirements are strictly complied with, such as complying with mandatory investment criteria, establishing and complying with an investment plan, and ensuring that a written agency agreement is entered into between the corporation and the qualified investment manager appointed by the board of directors
- for more information, see Charity Law Bulletin #8 available at [www.charitylaw.ca](http://www.charitylaw.ca)

k) *Charities Accounting Act* (Ontario)

- this Act gives rights to donors and to the PGT that allow directors of charitable corporations to be called to account for improper use of charitable property
- donors can complain about the fundraising practices of a charitable corporation to the court which may then order an investigation by the PGT (section 6)
- penalties may be imposed against a charity and its directors if they fail to abide by specific donor directions (section 4) which could result in court ordering compliance with the directors and imposing either a penalty on the charity or imprisonment of its directors
- recent regulations under the Act also permit charities to co-mingle donor restricted funds, but this must be done in strict compliance with numerous requirements under the Act, eg. cannot co-mingle restricted funds with general funds
- co-mingling of donor restricted funds in contravention of the regulations under the Act will expose directors to personal liability for breach of trust

4. Fundraising

- ◆ a charitable corporation and its directors must comply with a number of statutes affecting charitable fundraising
- ◆ failure to comply with these statutory requirements will expose directors to personal liability
- ◆ some of the more important federal and provincial legislation regarding fundraising include:

a) Specific Charitable Statutes concerning Fundraising:

- the *Income Tax Act* (Canada);
- the *Charities Accounting Act* (Ontario);
- the *Charitable Gifts Act* (Ontario);
- the *Religious Organizations' Lands Act* (Ontario);
- the *Charitable Fund-Raising Act* (Alberta);

- the *Charitable Fund-raising Businesses Act* (Saskatchewan);
  - the *Charities Endorsement Act* (Manitoba); and
  - the *Charities Act* (Prince Edward Island).
- b) General Statutes Affecting Charitable Fundraising:
- the *Competition Act* (Canada);
  - the *Privacy Act* (Canada);
  - provincial insurance legislation, such as the *Insurance Act* (Ontario);
  - provincial loan and trust corporation legislation, such as the *Loan and Trust Corporations Act* (Ontario);
  - provincial securities legislation, such as the *Securities Act* (Ontario); and
  - provincial trustee legislation, such as the *Trustee Act* (Ontario).

For more information and resource materials on Director Liability and Legal Risk Management see:

[www.carters.ca](http://www.carters.ca)  
[www.charitylaw.ca](http://www.charitylaw.ca)  
[www.antiterrorismlaw.ca](http://www.antiterrorismlaw.ca)