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THE LEGAL DUTIES OF DIRECTORS OF CHARITIES AND NOT-FOR-PROFITS (ALBERTA)

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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, memorandum of association, bylaws, articles of association, 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 (e.g. lawyers, accountants)
- however, the minimum expectation would be the level of care expected from a “reasonably prudent person”

c) Charitable Corporation:

- in Ontario case law states that directors of charitable corporations are subject to a fiduciary duty to act as a quasi-trustee of the charitable property of the corporation
- this fiduciary duty means directors need to ask: what level of care would a reasonable and prudent person managing his or her own affairs exercise?
- this law has not been recognized as the law of Alberta, although the Alberta Law Reform Institute has produced a report on the possibility of applying a trustee standard of care to directors of non-profit corporations with charitable purposes

3. Liability Risk for Lack of Corporate Authority

- ◆ a corporation’s corporate authority is defined by the corporate objects set out in its memorandum of association or letters patent as altered by special resolutions or supplementary letters patent as well as 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, e.g. slip and fall accident
- ♦ directors can be personally liable for torts committed by the corporation where their own conduct in managing the corporation also contributed to the victim's injury, e.g. 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 both not-for-profit and charitable corporations are subject to a fiduciary duty to 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
- 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 corporate objects of the corporation, the corporation itself, its donors, and its creditors
- Ontario case law has found that directors of charitable corporations are subject to fiduciary duty to act as quasi trustees of charitable property

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
- ♦ where directors fail to attend to their legal duties or those of the corporation, e.g. failure to comply with requirements under the *Income Tax Act* resulting in fines or loss of charitable status, directors may have liability exposure at common law for such failures
- ♦ this is complied with 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, i.e. 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 (memorandum of association, bylaws, 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
 - ♦ in Ontario, directors of charitable corporations cannot receive any remuneration from a charitable corporation, directly or indirectly, without court approval
- 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

- the recent Ontario decision in *Public Guardian and Trustee v. Aids Society of Ontario* emphasized that directors of charitable corporations may be bound to trustee standards when they are dealing with charitable property (for more information, see Charity Law Bulletins #9, #13 and #17 at www.charitylaw.ca)
- the *Canada Corporations Act*, the *Companies Act*(Alberta), and the *Societies Act* (Alberta) are silent on this issue
- but if a donor makes a gift to a charitable corporation that restricts or limits what can be done with the gift, a trust may be found
- under these circumstances, directors may become trustees of the gift and would need to abide by the principles of trust law including those outlined in the *Trustee Act* (Alberta)

b) Potential Liability Risks for Directors as Trustees

i) Remuneration of directors

- ♦ in Ontario, directors of charitable corporations cannot receive direct or indirect remuneration from the charity, e.g. as an employee or contractor, without court approval
- ♦ as well in Ontario, corporate indemnification of directors and officers can be given and director and officer insurance can be obtained provided that regulations under the *Charities Accounting Act* (Ontario) are complied with
- ♦ there is not case law on this issue in Alberta

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 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 investment criteria, as required by the *Trustee Act* (Alberta) (for more information on similar Ontario legislation, see Charity Law Bulletin #8 available at 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) Commingling 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 under the *Income Tax Act*?
 - ◆ at common law, gifts subject to restrictions should be held in separate accounts from other restricted trust funds and not commingled
 - ◆ regulations under the Ontario *Charities Accounting Act* now makes commingling possible in that province
 - ◆ but cannot commingle restricted funds with general funds in Ontario
 - ◆ see Charity Law Bulletin #4 at www.charitylaw.ca for discussions of regulations under the *Charities Accounting Act* in Ontario in this regard

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 Alberta 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 March 31st of the year in question
- ♦ 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 may be personally liable if charity fails to comply with numerous reporting requirements under the Act, e.g. filing of annual charity information return (section 238)
 - directors may also face fines and imprisonment where they are involved in making false or deceptive statements in any return required under the Act or wilfully evading compliance with the Act, e.g. the improper issuance of charitable receipts, the improper disbursement of charitable monies or the failure to meet disbursement quota requirements (section 239 & Jones case in CRA Registered Charities Newsletter No. 11)
 - 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, e.g. 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 and www.antiterrorism.ca

g) *Criminal Code*

- Bill C-45 (Westray Mines) for negligence in work place safety
- section 336 – criminal breach of trust

3. Alberta Statutes

a) *Companies Act* (Alberta)

- directors are jointly and severally liable to the clerks, labourers, servants and apprentices for all debts due for services performed for the corporation, not exceeding six months wages
- however, a director will not be liable unless the corporation has been sued within one year after the debt becomes due, and execution against the corporation is returned unsatisfied and the director is sued within one year from the time they ceased to be a director
- 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 \$500
- 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 \$500 on conviction
- directors must ensure that a minimum of 50% of the directors of the corporation are resident in Alberta and that meetings of the board finds a minimum of 50% of members resident in Alberta present
- failure to meet the residency requirement can make the corporation and directors liable to a penalty

b) *Societies Act* (Alberta)

- there is no specific provision in the *Societies Act* (Alberta) that provides for the liability of directors
- the bylaws that a corporation submits at the time of application must set out the process for the appointment and removal of directors and officers and their duties, powers and remuneration

- c) *Workers Compensation Act (Alberta)*
 - 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

- d) *Employment Pension Benefits Act (Alberta)*
 - a corporation is obligated to make contributions to an employee pension plan and to hold this money in trust for its employees
 - failure to comply may subject directors to a penalty by fine

- e) *Health Insurance Premiums Act (Alberta)*
 - corporations that have agreed to pay premiums on behalf of their employees must submit those premiums to Alberta Health Care Insurance
 - failure to do so will make the corporation liable to remit the payments and can subject the directors to a maximum fine of \$500

- f) *Occupational Health and Safety Act (Alberta)*
 - directors who have been specifically assigned the task of overseeing the occupational health and safety of workers must ensure that the corporation does not contravene provincial health and safety requirements
 - failure to do so will result in maximum fine of \$500,000 and additional fines of up to \$30,000 per day that the offence continues or imprisonment for up to six months
 - subsequent offences will result in a maximum fine of \$1,000,000 and additional fines of up to \$60,000 per day that the offence continues or imprisonment for up to one year
 - it is important that directors ensure that the corporation implement a system to ensure health and safety in the workplace
 - corporations may be required to create work site health and safety committees, written health and safety policies and/or a code of practice

- g) *Environmental Protection and Enhancement Act (Alberta)*
 - corporations are required to comply with environmental protection and enhancement procedures
 - failure to do so may result in directors being liable to penalty.

- h) *Human Rights, Citizenship and Multiculturalism Act (Alberta)*
 - Directors who have directed, authorized, assented to, acquiesced in or participated in the corporation hindering, obstructing or interfering with the administration of the Alberta Human Rights Citizenship Commission may be liable to a penalty

i) *Trustee Act* (Alberta)

- power of directors of a charitable corporation to make investments is generally derived from its memorandum of association and some provincial legislation may also mandate the investment power with which a corporation operating in a particular province may invest its assets
- legislation in Alberta is silent on the power of directors to make investments, but if a restricted gift leads to a trust being found, directors of charitable corporations may be held to the standard of trustees, and would be required to abide by the *Trustee Act* (Alberta)
- the *Trustee Act* (Alberta) establishes that directors of a charitable corporation, where found to be trustees, 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 investment criteria
- for more information on similar legislation in Ontario see *Charity Law Bulletin #8* available at www.charitylaw.ca

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) The Charitable Fund-Raising Act (Alberta);
 - the director (s) that have been made responsible for making solicitations for the corporation must comply with the Charitable Fund-Raising standards of practice
 - all directors must take reasonable steps to ensure the employees of the corporation who are responsible for making solicitations for the corporation comply with the Charitable Fund-Raising standards of practice
 - directors may be required to return contributions or pay a sum equal to contributions if corporation is not using contributions received as a result of solicitation for the purpose stated or implied at the time the contribution was solicited
 - b) Other 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 Businesses Act (Saskatchewan);
 - the Charities Endorsement Act (Manitoba); and
 - the *Charities Act* (Prince Edward Island).
- c) General Statutes Affecting Charitable Fundraising:
- the *Competition Act* (Canada);
 - the *Privacy Act* (Canada);
 - provincial insurance legislation, such as the *Insurance Act* (Alberta);
 - provincial loan and trust corporation legislation, such as the *Loan and Trust Corporations Act* (Alberta);
 - provincial securities legislation, such as the *Securities Act* (Alberta);
 - provincial trustee legislation, such as the *Trustee Act* (Alberta);

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

www.carters.ca
www.charitylaw.ca
www.churchlaw.ca
www.antiterrorism.ca