DIRECTOR AND OFFICER LIABILITY AND BEYOND

Fall/Winter 2004 (revised)

Part I – The Legal Duties of Directors of Charities and Not-for-Profits
Part II - Good Governance in Meeting the Duties of Directors of Charities and Not-for-Profits
Part III - Due Diligence in Avoiding Risks for Directors of Charities and Not-for-Profits
Part IV - How to Avoid Liability in Fundraising
Part V - Recent Changes to the Income Tax Act and Policies Relating to Charities and Charitable Gifts

Appendix A,B and C

By Terrance S. Carter, B.A., LL.B.
© 2004 Carter & Associates
A. OVERVIEW OF TOPICS
• Introduction
• Common Law Duties and Liabilities
• Statutory Duties and Liabilities

Note: For a more detailed discussion, see attached Appendix A

B. COMMON LAW DUTIES AND LIABILITIES
• Management of the Corporation
  – Directors responsible for all aspects of corporations operations
  – To fulfill duties, directors must ensure:
    • Objects are properly carried out and activities comply with objects
    • Corporation’s financial stability and overall performance
    • Proper hiring and supervision of management and staff
• Duty of Care
  – Directors of all corporations must exercise certain standard of care in carrying out duties
  – But standard of care varies depending on type of corporation
    • Business corporation
      – Statutory objective standard of care
      – Reasonably prudent person

• Not-for-profit corporation (non-charity)
  – Common law subjective standard of care
  – Director’s own knowledge and experience important

• Charitable corporation
  – Additional expectations beyond subjective standard
  – Directors of charities also subject to fiduciary duties as quasi-trustees of charitable property

• Liability Risk for Lack of Corporate Authority
  – Corporate authority defined by corporate objects in governing documents
  – All corporate activities must fall within parameters of these objects
  – Liability results where directors act outside scope of this authority
Liability Risk for Negligent Mismanagement (Tort)
– Tort is civil wrong for which injured party can seek damages from the court
– Directors can be personally liable for corporation’s torts where own conduct or inaction contributed to victim’s injury

Liability Risk in Contract
– Directors generally not personally responsible for contracts signed for corporation
– However, need to have proper corporate authority to sign contracts and ensure contractual terms are complied with

Liability Risk for Breach of Fiduciary Duty
– Overview
  • Directors of charitable corporations, subject to fiduciary duty to act as quasi trustee of charitable property
  • Directors have primary obligation to exercise due diligence in overseeing corporation
  • Fiduciary duties owed to charitable objects, corporation, donors and creditors

Summary of fiduciary duties
• Duty to act honestly
  – Conflicts of interest to be avoided and disclosed
  – Directors must not act fraudulently
• Duty of loyalty
  – Director’s sole interest is to the corporation
  – Director’s interests not to be placed in conflict with those of corporation
• Duty of diligence/duty to act in good faith
  - Directors to diligently attend to duties by being familiar with all aspects of corporation
  - Directors may have liability exposure at common law for failure to attend to their legal duties or those of the corporation
  - Where necessary, advice of qualified professionals to be sought

• Duty to exercise power
  - Directors responsible for managing corporation

• Delegation to management, staff and volunteers is possible, but directors must always supervise

• Duty of obedience
  - Directors must comply with applicable legislation and corporations governing documents
  - All valid corporate decisions must be implemented

• Duty to avoid conflict of interest
  - Conflicts of interests to be avoided
  - Directors must also avoid anything that gives director appearance of a personal benefit
  - Where conflicts occur, they are to be declared, director to not participate in discussions or vote, and may even have to resign
Duty of prudence
- Directors with special expertise must use it prudently to achieve best result for corporation

Duty to continue
- Resignation as director will not relieve all obligations
- May even constitute breach of trust
- Independent legal advice should be obtained in considering resignation

Liability for Breach of Trust
- Overview
  - In addition to fiduciary quasi trustee duties, directors of charitable corporations may also be trustees of charitable property
  - However, fiduciary duties and trustee duties essentially the same
  - Aids Society case emphasizes that directors have obligation to apply charitable property to charitable objects

Where charitable property lost as a result of actions or inactions of directors, breach of trust could be found
- Potential liability risks
  - Remuneration of directors
    - In Ontario, directors of charitable corporations cannot receive direct or indirect remuneration, e.g., as employee or contractor, without court approval
    - Indemnification and directors’ insurance now available
### Dealing with charitable property
- Directors responsible for handling of charitable property
- Personal liability results where mismanagement occurs

### Dealing with charitable objects
- Charitable property only to be applied to charitable objects
- Failure to properly apply charitable property may result in liability

### Dealing with special purpose charitable trusts
- Directors of charitable corporations have fiduciary obligations to donors
- Liability for breach of trust possible where donor restrictions or terms of endowment funds are not complied with

### Investment of charitable funds
- Directors have a duty to invest charitable property

- Liability can result from failure to comply with investment powers as well as bad investments, overly conservative decisions and missed opportunities

### Co-mingling of donor restricted funds
- Are gifts subject to restrictions or limitations?
- Co-mingling of donor restricted gifts now possible under *Charities Accounting Act* (Ontario) regulations
- See Charity Law Bulletin #4 at [www.charitylaw.ca](http://www.charitylaw.ca)
- But cannot co-mingle with general funds
C. STATUTORY DUTIES AND LIABILITIES

• Overview
  – Many federal and provincial statutes impose offences and penalties for acts and omissions of corporate directors
  – Directors can be held personally liable, as well as jointly and severally, with other directors
  – Only defence is due diligence
  – Resigning as a director may not limit liability though there are generally limitation periods

• Federal Statutes
  – Canada Corporations Act
    • Wages and vacation pay
    • Conflict of interest
    • Reporting requirements
    • Books, minutes and records
    • Identification of corporation
    • Membership lists
    • Winding up
    • General penalty

• Income Tax Act (Canada)
  • Directors jointly and severally liable to pay employee income tax deductions for two years after term of office
  • Directors maybe personally liable if charity fails to comply with numerous reporting requirements, e.g. annual charity information return or improper charitable receipts, or for giving improper tax advice
  • Directors may also face fines and imprisonment if they are involved in making false or deceptive statements or evading compliance with the Income Tax Act
  • Avoid liability by showing positive steps taken to ensure compliance
Excise Tax Act (Canada)

- Directors jointly and severely liable for corporation’s failure to collect & remit GST
- Liability continues for two years after cease to be director

Canada Pension Plan

- Joint and several liability where corporation fails to remit employee pension premiums

Canadian Environmental Protection Act

- Positive duties imposed on directors to ensure compliance in relation to air and water pollution as well as toxic substance storage and disposal
- Failure to comply could result in prison terms and fines

Anti-terrorism Legislation

- Legislation has serious liability risks for charitable corporations and directors, particularly those involved in overseas work
- Risks include seizure of charitable property, loss of charitable status and criminal code charges
  - See www.antiterrorismlaw.ca

Criminal Code

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

Ontario Statutes

- Corporations Act (Ontario)
  - Reporting requirements
  - Conflict of interest
  - General offence provision
- Employment Standards Act (Ontario)
  - Fines imposed on directors for failure of corporation to pay wages, vacation pay and severances
  - 6 months liability for wages and 12 months liability for vacation pay, plus fines
  - However, limitation periods are available

- Retail Sales Tax
  - Directors jointly and severally liable where corporation fails to remit

- Workplace Safety and Insurance Board Act (Ontario)
  - Directors are not liable for corporation’s failure to remit premiums unless it can be shown they did not intend to pay them

- Pension Benefits Act (Ontario)
  - Directors who fail to pay corporation premiums for employee’s pension plans and to hold monies in trust may be ordered to make up contribution
  - Failure to comply may subject directors to fines

- Ontario Health Insurance Program
  - Directors will be held personally liable for premiums and health tax not paid by corporation
– Occupational Health and Safety Act
(Ontario)
  • Directors required to take reasonable steps to comply with workplace health and safety requirements
  • Failure to do so will result in fines to corporation and its directors
– Environmental Protection Act (Ontario) and Related Legislation
  • Directors required to take reasonable care to prevent unlawful discharge of contaminants

• Persons in control of contaminants are responsible for cleanup and related costs
• Appropriate environmental audits need to be obtained before purchasing or receiving land
– Child and Family Services Act (Ontario)
  • Failure to report child abuse is an offence
  • A charitable corporation and its directors may be liable where employees fail to report abuse or where it occurs because of failure to monitor employees and operations

– Trustee Act (Ontario)
  • Act establishes that directors of charitable corporations have power and duty to invest assets of charity
  • Investments must be in accordance with prudent investor standard
  • See Charity Law Bulletin #8 at www.charitylaw.ca
– Charities Accounting Act (Ontario)
  • Act gives rights to donor and Public Guardian and Trustee (PGT) to call directors to account for improper use of
Charitable property as well as fundraising practices
- Co-mingling of donor restricted funds is permitted provided there is strict compliance with the act’s requirements
- Fundraising
  - Specific charitable statutes concerning fundraising:
    - Income Tax Act (Canada)
    - Charities Accounting Act (Ontario)
    - Charitable Gifts Act (Ontario)

- Religious Organizations’ Lands Act (Ontario)
- Charitable Fund-Raising Act (Alberta)
- Charitable Fund-raising Businesses Act (Saskatchewan)
- Charities Endorsement Act (Manitoba)
- Charities Act (Prince Edward Island)
- General statutes affecting charitable fundraising:
  - Competition Act (Canada)
  - Privacy Act (Canada)

- Insurance Act (Ontario)
- Loan and Trust Corporations Act (Ontario)
- Securities Act (Ontario)
- Trustee Act (Ontario)
- Business Name Act (Ontario)