UNITED WAY/CENTRAIDE
Windsor – Essex County
DIRECTOR AND OFFICER LIABILITY AND BEYOND

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Part I
The Legal Duties of Directors of Charities
and Not-for-Profits

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A. DEFINITION OF DIRECTOR AND OFFICER

- For this presentation, references to corporation include an unincorporated association or a trust
- A director is generally anyone who takes on the role of the directing mind of a corporation
- A director can be known as a trustee, governor, board member, or even an elder or deacon of a religious organization
- An officer carries out the day to day functions of the corporation at the direction of the board
- An officer can also be a director or can become a *de facto* director
- For purposes of this presentation, reference to director is deemed to include officer

B. DIFFERENT TYPES OF CORPORATIONS

- Share capital corporations (business corporation to make a profit)
• Not-for-Profit Corporations
  (non profit purpose but not charitable)

  Employees
  & Volunteers
  Officers
  Directors
  Members
  (non-owners but often beneficiaries)

• Charitable Corporations
  (charitable purpose akin to a public trust)

  Employees
  & Volunteers
  Officers
  Directors
  Members
  (non-members but accountability group
   for the public trust)
C. COMMON LAW DUTIES AND LIABILITIES

- Management of the Corporation
  - Directors are 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
  - Failure to act, i.e. inaction, can result in personal exposure to liability i.e. liability of Worldcom directors

- 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
- New *Canada Not-for-Profit Corporations Act* will establish an objective standard of care

**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
<table>
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<tr>
<th>Liability Risk for Negligent Mismanagement (Tort)</th>
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<tr>
<td>- Tort is civil wrong for which injured party can seek damages from the court</td>
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<td>- Directors can be personally liable for corporation’s torts where own conduct or inaction contributed to victim’s injury</td>
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<th>Liability Risk in Contract</th>
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<td>- Directors generally not personally responsible for contracts signed for corporation</td>
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<td>- However, need to have proper corporate authority to sign contracts and ensure contractual terms are complied with</td>
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<th>Liability Risk for Breach of Fiduciary Duty</th>
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<tr>
<td>- Overview</td>
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<tr>
<td>- Directors of charitable corporations are subject to fiduciary duty to act as quasi trustee of charitable property</td>
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<td>- Directors of not-for-profit corporations also have fiduciary duties to put the interest of the corporation ahead of their own interest</td>
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<td>- Fiduciary duties owed to charitable objects, corporation, donors, members and creditors</td>
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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 should 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 the corporation’s 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 some charitable property
    • However, fiduciary duties and trustee duties essentially the same
    • Recent *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 can only to be applied to charitable objects
  – Failure to properly apply charitable property may result in personal 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
  – 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 and Charitylaw Bulletin #35

\- 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)
- Upcoming ULCC Model *Fundraising Act*

- 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)