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

**Windsor – January 19, 2005**

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**Part III  
Due Diligence in Avoiding Risks  
for Directors of Charities  
and Not-for-Profits**

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**Note:** For a more detailed discussion, see attached Appendix C. See also Chapter 6 Risk Protection by Terrance S. Carter in “Primer for Directors of Not-for-Profit Corporations” at <http://www.carters.ca/pub/book/2002/dirprimch6.pdf>

**A. DUE DILIGENCE IN THE CHOICE OF CHARITABLE STRUCTURES**

- **Charities as unincorporated associations**
  - Use of unincorporated association is simpler, faster and less expensive
  - But exposes members and leaders to personal liability

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- **Charities as Corporations**
  - Separate legal entity protects members from personal liability
  - Directors may still be exposed to personal liability from fiduciary and management responsibilities
- **Using a multiple charitable corporation structure**
  - Multiple charitable corporations can help to protect charitable assets in one charity and contain liabilities in another charity

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- **Need integrated corporate structure and trade-mark licensing to avoid loss of control**
- **Multiple charitable corporations can include parallel foundations and associated operating charities**
- **Parallel foundations have become more common in protecting long term gifts and endowment funds as a result of recent case law**

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- **Multi-tiered provincial or national charities**
  - **Single corporate structure provides ease of administration, but results in greater risk of liability exposure for total assets of a single corporate entity**
  - **Multiple corporate structure reduces risk of liability, but top tier organization may still be exposed to liability where too much control is imposed or employer/employee relationship exists**
- **Need to avoid overlapping board of directors to reduce the chance of crossover liability**

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**B. DUE DILIGENCE IN RELYING UPON STATUTORY PROTECTION**

- **Due diligence defence**
  - **The new *Canada Not-for-Profit Corporation Act* will provide a due diligence defence**
  - **Will be available where a director exercises the care, diligence and skill of a reasonably prudent person**
- **Protection from third party contractual liability**
  - **Protection available for corporations under the *Canada Corporations Act* (CCA) but not under *Corporations Act* (Ontario) (OCA)**
  - **Protects directors and officers against contracts entered into within the scope of authority of directors or officers**

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- **Protection from conflict of interest**
  - **Both CCA and OCA permit directors to remain on the board of directors where a director declares a conflict of interest**
  - **Common law rule, though, does not permit directors of a charity to remain on the board even if conflict of interest declared**

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**C. DUE DILIGENCE IN OPERATIONS**

**1. The Rights and Powers of a Director in Exercising Due Diligence**

- **Corporate authority**
  - **Directors need to know governing documents of the charity**
  - **Directors must not authorize *ultra vires* activities**
  - **Membership approval may be required for certain activities**
  - **Amendments to governing documents may be necessary**

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- **Management access and control over the affairs of the corporation**
  - **Directors are responsible for all aspects of operations of the charity**
  - **Directors must be proactive in management and not be limited to setting policy only**
- **Proactive protection of charitable assets**
  - **Directors have a fiduciary duty to protect charitable property**

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- **Need to invest in accordance with prudent investment standard under the *Trustees Act* (Ontario)**
- **Need to take an inventory of charitable assets**
  - **Review annual financial statements**
  - **Review bank statement and records**
  - **Review past and current restricted funds**
  - **Review property deeds**
  - **Comply with statutory requirements where applicable**

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- **Protecting and managing intellectual property**
  - **Registering trade-marks and copyright**
  - **Securing internet domain names**
  - **Proper marking of trade-marks and copyrights**
  - **Licensing of trade-marks and copyrights**

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- **Fundraising**
  - **Monitor fundraising costs compared to 80/20 disbursement quota for receipted gifts and other applicable disbursement quotas**
  - **Ensure proper donation receipting**
  - **Ensure gifts are used for charitable purposes**
  - **Review and enforce terms of restricted and endowed gifts**
- **Notice/attendance at meetings/minutes**
  - **Right to notice of board meetings**
  - **Right to attend board meetings**

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- **Right to vote**
  - **Equal voting rights**
  - **Must declare conflict of interest**
  - **Need to record contrary vote**
- **Appropriate delegation**
  - **Can delegate day to day operations, including officer duties**
  - **But directors must retain control and require accountability**
  - **Establish an audit committee for finances and legal liability**

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**2. Policies and Procedures in Achieving Due Diligence**

- **Establishing and following policy statements and procedures**
  - **Develop policies and procedures for staff, volunteers and board members**
  - **i.e. Policy statements on sexual abuse, sexual harassment, work place safety, counseling and third party use of facilities of the charity**

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- **Screening procedure**
  - **An appropriate screening process is an important protection against increase in abuse claims**
  - **Screening involves utilizing appropriate questions, interviews, reference of employees and volunteers, together with police checks when individuals are dealing with children**
- **Training/education**
  - **Directors should maintain their skills and knowledge in the area of the charity's current operation**
  - **Directors need to educate themselves about changes in the law affecting directors' duties**

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- **Directors need to ensure that senior management are also kept adequately informed on current legal issues**
- **Utilizing due diligence checklists**
  - **Legal Risk Management Checklist**
  - **Sexual abuse checklist**
  - **Fundraising compliance due diligence checklist**
  - **Anti-terrorism due diligence checklist**
  - **Insurance checklist**

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### **3. Reliance on Professional Advice in Achieving Due Diligence**

- **Management**
  - **Directors need to retain professional managers to oversee operations**
  - **Directors are responsible for activities delegated to management**
  - **Directors should receive and review reports from management at every board meeting**

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- **Outside professionals**
  - **Relying on professional advisors like accountants and lawyers provides evidence of due diligence**
  - **Reduces exposure to liability**
- **Delegation of investment decision making to investment manager requires agency agreement and investment policy under *Trustee Act (Ontario)***

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## **D. DUE DILIGENCE IN INDEMNIFICATION AND INSURANCE**

### **1. Statutory Basis for Directors and Officers insurance and Corporate Indemnity**

- **Federal and Ontario corporate statutes now permit corporate indemnity and director and officer insurance**
- **But in Ontario, charities must first consider the following under the *Charities Accounting Act (Ontario)***
  - **What is the degree of risk?**
  - **Are there alternatives to insurance?**
  - **What is the cost of insurance in relation to the risk?**

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- **What is the cost of insurance in relation to revenue?**
- **Does indemnity or insurance further the management of charitable property?**

## **2. Corporate Indemnification**

- **Corporate indemnification provides compensation for the following:**
  - **Legal fees**
  - **Fines that were paid under a statute**
  - **A financial settlement that result from a lawsuit**
  - **Any other obligation that a director was required to fulfill**

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- **Corporate indemnification should always be implemented but may be of limited benefit**
  - **Indemnification is only as good as the financial state of the charity**
- ## **3. Insurance Considerations**
- **Insurance policies to consider obtaining would include**
    - **General liability insurance**
    - **Directors' and officers insurance**
    - **Sexual abuse and/or harassment**
    - **Insurance for particular risks, i.e. counseling, non-owned auto, third-party use of property, etc.**

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- **Factors to consider**
  - **How much coverage does the policy provide for?**
  - **Who are the named insured?**
  - **Does insurance cover all past and present directors, officers and committee members?**
  - **Is coverage on a “claims made basis” or on an “occurrence basis”?**
  - **Are there exclusionary clauses that limit the protection offered by the policy, such as sexual abuse?**

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- **Are there geographical limits to the coverage?**
- **Insurance will likely not provide coverage for actions by public authorities for breach of trust, improper investments, or violations of the *Anti-terrorism Act* (Canada), **Bill C-45** amendments to the *Criminal Code* (Westray Mines) or other similar strict liability legislation**
- **Advise agent in writing each year of all activities of the charity and all known risks**

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- **Ask agent/insurance company to respond in writing to the following:**
  - **What risks are covered?**
  - **Who is covered under the policy?**
  - **What is the amount of the coverage?**
  - **What risks are not covered under the policy?**
  - **What additional insurance should be obtained by the charity?**

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## **E. OTHER MEANS OF DUE DILIGENCE IN REDUCING RISK**

### **1. Legal Risk Management Committees**

- **Legal risk management committee need to be formed to conduct review and identify risk**
- **Need to conduct ongoing review of assets and risks utilize legal risk management checklist**

### **2. Independent Legal Advice**

- **Independent legal advice needed for directors in high risk situations**

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- **Directors may need to seek independent legal advice before resigning from the board of directors**
- 3. Size of the Board**
  - **Reducing size of board reduces risk**
  - **Smaller board may also allow for more effective control**
- 4. Committees and Advisory Boards**
  - **Committees and advisory boards can be an effective means of attracting volunteers without the risk of being directors**

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- **But board of directors must always remain in control**
- 5. Transfer of Assets**
  - **Directors will always be somewhat exposed to liability risks**
  - **Therefore directors should consider transferring personal assets to spouse**
  - **However any transfer of assets must be done before becoming a director so as not to defeat claims of creditors**

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