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**ONTARIO LAND TRUST ALLIANCE  
WORKSHOP**

**DIRECTORS' AND OFFICERS' DUTIES  
REGARDING CONFLICTS OF INTEREST**

**Barrie - November 3, 2006**

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

**Part II - Considerations Involving Conflict of Interest  
Standard 4 of the Ontario Land Trust Alliance**

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**By Terrance S. Carter, B.A., LL.B.**  
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**A. OVERVIEW OF TOPICS**

- Introduction
- Common Law Duties and Liabilities
- Statutory Duties and Liabilities

**Note:** For a more detailed discussion, see attached Summary "A" entitled "The Legal Duties of Directors of Charities and Not-for-Profits"

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**B. 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 or board member

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- An officer carries out the day to day functions of the corporation at the direction of the board and generally includes corporate officer positions of president, vice-president, secretary and treasurer
- An officer can also be a member of the board of directors, but not necessarily
- 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, except where stated

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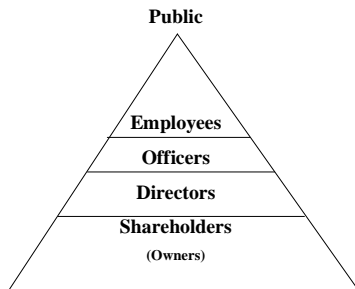
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**DIFFERENT TYPES OF CORPORATIONS**

- Share capital corporations  
(business corporation to make a profit)



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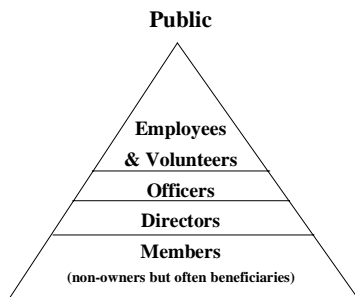
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- Not-for-Profit Corporations  
(non profit purpose but not charitable)



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- **Charitable Corporations**  
(charitable purpose akin to a public trust)



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**D. COMMON LAW DUTIES AND LIABILITIES**

- **Management of the Corporation**
  - Directors are responsible for all aspects of corporation's operations on a joint and several basis
  - 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

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- **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

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- **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

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- **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

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- **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

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• **Liability Risk for Breach of Fiduciary Duty**

– **Overview**

- **Directors of charitable corporations are subject to fiduciary duty to act as quasi trustee of charitable property**
- **Directors of not-for-profit corporations also have fiduciary duties to put the interest of the corporation ahead of their own interest**
- **Fiduciary duties owed to charitable objects, corporation, donors, members and creditors**

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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**

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- **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**

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- 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

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- 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

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- 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

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• **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**

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- **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, provided that regulations are complied with**

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- **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 be applied to charitable objects**
  - **Failure to properly apply charitable property may result in personal liability**

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- **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

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- Liability can result from failure to comply with investment powers as well as bad investments, overly conservative decisions and missed opportunities
- **Commingling of donor restricted funds**
  - Are gifts subject to restrictions or limitations?
  - Commingling 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 commingle with general funds

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**E. 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

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• **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**

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– *Income Tax Act (Canada)*

- **Directors jointly and severally liable to pay employee income tax deductions for two years after term of office**
- **Directors may be personally liable if charity fails to comply with numerous reporting requirements, e.g. annual charity information return, improper charitable receipts, or 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**

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– *Excise Tax Act (Canada)*

- **Directors jointly and severally 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**

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– *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

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- Risks include seizure of charitable property, loss of charitable status and *Criminal Code* charges
- See [www.antiterrorismlaw.ca](http://www.antiterrorismlaw.ca)

– *Criminal Code*

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

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- Ontario Statutes
  - *Corporations Act (Ontario)*
    - Wages and vacation pay
      - Directors jointly and severally liable to employees for all debts due for services performed for the corporation
      - 6 months wages and 12 months vacation pay is maximum
    - Reporting requirements
    - Conflict of interest
    - General offence provision

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– *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**

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– *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**

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– *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**

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- 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

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– *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](http://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

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Charitable property as well as fundraising practices

- Commingling of donor restricted funds is permitted provided there is strict compliance with the act's requirements

– *Human Rights Code (Ontario)*

- Possible discrimination against employees
- Possible discrimination against members of the public, i.e. sexual orientation, as well as possible new exemption involving denial of same sex marriages for religious organizations

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- **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)*

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- *Charities Endorsement Act (Manitoba)*
- *Charities Act (Prince Edward Island)*
- *Proposed ULCC Uniform Charitable Fundraising Act (see Charity Law Bulletin #79)*
- **General statutes affecting charitable fundraising:**
  - *Competition Act (Canada)*
  - *Privacy Act (Canada)*

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

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**REVIEW OF THE LAW INVOLVING  
CONFLICTS OF INTEREST**

**A. THE COMMON LAW**

- **Fiduciary Duties of Directors and Officers**
  - Both directors and officers of a charity have a fiduciary duty to put the best interest of the charitable corporation or trust ahead of their own
  - Both directors and officer of a charity must carefully scrutinize both their actions and their motives to ensure that achieving the charitable purpose of the charity is paramount and that their own interests are either non-existent or secondary

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- **Duty to Avoid Conflicts of Interest**
  - Both directors and officers of charities in Ontario must identify and avoid conflicts of interest
  - Directors and officers must avoid anything that gives even the appearance of a personal benefit and be diligent in declaring any conflict of interest to the board
  - Where a conflict of interest occurs, in addition to declaring the conflict of interest, a director must not participate in any discussion or vote and, depending on the outcome of the vote, may even have to resign

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- **Prohibition on remuneration of directors**
  - The following discussion applies to only directors of a charity not an officer
  - In Ontario, directors of charitable corporations cannot receive direct or indirect remuneration or other pecuniary benefit from the charity without prior court approval
  - This means that a director cannot be a paid employee, contractor, etc. of the charity, or enter into a contract to buy or sell land or anything else of the charity without prior court approval
  - Failure to do so will result in the director being exposed to breach of trust and/or breach of fiduciary duties

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- The prohibition on remuneration and other pecuniary benefit extends to individuals who the director is not at arm's length with from an economic standpoint
  - i.e. family members who are economically dependent
  - i.e. business partners
- All board members are liable to be found jointly and severally liable for the remuneration or other pecuniary benefit paid to a director

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- While a consent order from the Ontario Public Guardian and Trustee (“OPGT”) permitting remuneration of directors may be possible, it will likely be difficult to obtain and it is both time-consuming and costly
- This prohibition does not apply to reimbursement to directors for legitimate out-of-pocket expenses

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**B. STATUTORY PROVISIONS**

**• Limited Statutory Protection From Conflicts of Interest for Directors**

– The following statutory provisions afford some protection from the more stringent requirements under the common law regarding conflicts of interest for directors:

▪ **Federal corporations - section 98 and 49 of the *Canada Corporations Act***

**Section 98**

- A director of a corporation must disclose his or her direct or indirect interest in a contract or proposed contract with the corporation

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- The director must give notice of his or her interest in the contract by declaring it at the next board meeting held once the interest is established
- The director must not vote on the contract or proposed contract. If he or she does vote, the vote will not be counted
- If the director has declared the conflict of interest in a contract and has not voted on it, he or she is not accountable to the corporation, its members or its creditors for any profit realized

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**Section 49**

- Where a director fails to disclose a conflict of interest, he or she will be potentially subject to summary conviction and a minimum fine of \$1000
- **Ontario corporations - section 71 of the *Corporations Act (Ontario)***
  - A director of a corporation must disclose his or her direct or indirect interest in a contract or proposed contract with the corporation
  - The director must give notice of his or her interest in the contract by declaring it at the next board meeting held once the interest is established

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- **If the director has declared the conflict of interest in a contract and has not voted on it, he or she is not accountable to the corporation, its members or its creditors for any profit realized, and the contract is not voidable by reason of the director holding that office**
- **If the director realizes a profit and the interest in the contract is found to be voidable, the director is guilty of an offence and on conviction is liable for a fine of up to \$200**

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- **The above statutory provisions collectively mean that if a conflict exists, the director of a not-for-profit corporation must declare the conflict of interest at the meeting of the board of directors and not participate in any discussion or vote, but otherwise may stay on the board of directors**
- **However, directors of a charity cannot stay on the board if a conflict of interest continues even though they may have complied with the statutory provisions to declare a conflict of interest. They must resign or face the possibility that they will be found in breach of trust and/or breach of fiduciary duty**

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**COMMENTARY ON THE CURRENT CONFLICT OF INTEREST STANDARD 4**  
*Standard 4: Conflicts of Interest*

- *The land trust has policies and procedures to avoid and manage real or perceived conflicts of interest.*
- **The rules involving conflicts of interest identified in Standard 4 include the following:**
  - A. Disclosure
  - B. Remuneration
  - C. Insider Transactions

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**A. Dealing with Conflicts of Interest (Disclosure)**

**EXCERPT**

- *The land trust has a written conflict of interest policy to ensure that any conflicts of interest or the appearance thereof are avoided or appropriately managed through disclosure, recusal or other means.*

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**COMMENTARY**

- **“Recusal” is a term used when a board member has a conflict of interest and abstains from voting on any issues relating to that private interest**
- **A written conflict of interest policy is essential and demonstrates due diligence**
- **However, it is important to remember that disclosure and abstaining from voting does not mean that a director of a charity can engage in self-dealing**
- **Rather, prior approval from the court on a consent basis through the OPGT is required for self-dealing. Failure to obtain court approval can result in breach of trust and/or breach of fiduciary duties**

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**EXCERPT**

- *The conflict of interest policy applies to insiders, including board and staff members, substantial contributors, parties related to the above, those who have an ability to influence decisions of the organization and those with access to information not available to the general public. Federal and provincial disclosure laws are followed*

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**COMMENTARY**

- **Federal and provincial disclosure laws apply only to directors of federal and provincial corporations, but not to officers nor to trustees of trusts**
- **In any event, federal and provincial disclosure law is overridden by the common law in Ontario with respect to directors of charities**
- **The common law rules regarding conflicts of interest apply to directors of charities as well as to individuals who the director is not at arm's length with from an economic standpoint**

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- **Officers, staff or substantial contributors to a charity who are not members of the board of directors are not subject to the same rules as directors concerning conflicts of interest, although officers are subject to the same fiduciary duties as directors**
- **However, it might be possible for a non-director to become a “*de facto* director”, in which event the common law rules would apply**

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- **Substantial contributions to a charity by a donor may trigger provisions in the *Income Tax Act* dealing with**
  - **Whether the charity is a public foundation/charitable organization or a private foundation**
  - **Gift of non-qualifying securities**
- **The definition of “insider” is inclusive, i.e. “including” as apposed to exclusive i.e. “consisting of”**
- **No definition of what “staff” or “substantial contribution” means**
- **No definition of what “parties related to” means**

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**B. Board Compensation (Remuneration)**

**EXCERPT**

- *Board members do not serve for personal financial interest and are not compensated except for reimbursement of expenses, and in limited circumstances, for professional services that would otherwise be contracted out*

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**COMMENTARY**

- **Board members of a charity cannot receive any remuneration for their service on the board, nor can they receive any “professional services that would otherwise be contracted out”, unless they first obtain prior court approval**
- **To do so would be a breach of trust and/or breach of fiduciary duties**
- **Other board members may be jointly and severally liable**
- **The only remuneration of directors that is permitted is for out-of-pocket expenses**

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**EXCERPT**

- *Any compensation must be in compliance with charitable trust laws that apply in the jurisdiction that land trust operates in. The board’s executive officers are never compensated for professional services*

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**COMMENTARY**

- **Important to look at the applicable terms of trust**
  - Applicable trust agreements
  - Letters patent and by-laws of the charity
- **A charity’s paid executive officers (e.g. president, chief executive officer) who are not members of the board may receive compensation for professional services to the charity**
- **A charity’s executive officers who are members of the board may not receive any remuneration, whether it be for their professional services or for being an officer, because of the rule prohibiting directors from receiving any remuneration from a charity**

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**EXCERPT**

- *In Ontario, it is the position of the Public Guardian and Trustee (OPGT) that no board members of organizations with charitable status may accept compensation for any form of professional services without first obtaining court approval*

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**COMMENTARY**

- **The position of the OPGT is based on the common law as stated above**
- **The OPGT has indicated that the current common law rule continues to apply – no remuneration for directors of charitable organizations either directly or indirectly, apart from reimbursement for out-of-pocket expenses instead of being limited to “compensation for any form of professional services”**
- **The issue is how broadly will the common law be applied**
- **It is unclear if this requirement applies in other provinces, but one should presume it does**

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**C. Transactions with Insiders (Insider Transactions)**

**EXCERPT**

- *When engaging in land and conservation agreement transactions with insiders, the land trust: follows its conflict of interest policy; documents that the project meets the land trust’s mission; follows all transaction policies and procedures; and ensures that there is no impermissible private benefit*
- *For purchases and sales of property to insiders, the land trust obtains a qualified independent appraisal by a provincially licensed or certified appraiser who has verifiable conservation agreement or conservation real estate experience*

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**COMMENTARY**

- Not clear what an “impermissible private benefit” is
- An “insider transaction” would only be permitted with a director of a charity where the director declares the conflict of interest, abstains from discussion or voting on the transaction and prior court approval is obtained
- The transaction would need to take place at fair market value as determined by an independent and licensed appraiser

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- The same rules may apply to officers of a charity involved in an “insider transaction” because of the fiduciary duty that applies to officers of a charity
- Neither substantial contributors nor staff, other than officers, are subject to the same rules as directors involved in an “insider transaction”, but there may be circumstances where they may apply

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**EXCERPT**

- *When selling property to insiders, the land trust widely markets the property in a manner sufficient to ensure that the property is sold at or above fair market value and to avoid the reality or perception that the sale inappropriately benefited an insider*

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**COMMENTARY**

- **The same comments apply to the sale of land by a charity to an “insider”**
- **Selling the property at or above fair market value is essential**

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