## UNITED WAY SIMCOE COUNTY & THE COUNTY OF SIMCOE

# DIRECTORS' AND OFFICERS' LIABILITY AND BEYOND

## November 28, 2006

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1. **Duties and Liabilities of Directors and Officers**
2. **Due Diligence in Managing Risks for Directors and Officers**
3. **Avoiding Legal Liabilities in Fundraising**

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**By Terrance S. Carter, B.A., LL.B.**


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**UNITED WAY SIMCOE COUNTY & THE COUNTY OF SIMCOE**

# DIRECTORS' AND OFFICERS' LIABILITY AND BEYOND

**November 28, 2006**

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# 1. Duties and Liabilities of Directors and Officers

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Part I
Duties and Liabilities of Directors and Officers

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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"

2

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, board member, or even an elder or deacon of a religious organization

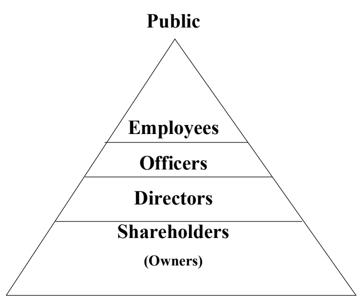
3

- 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 and is subject to fiduciary obligation
- For purposes of this presentation, reference to director is deemed to include officer unless stated otherwise

4

**DIFFERENT TYPES OF CORPORATIONS**

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

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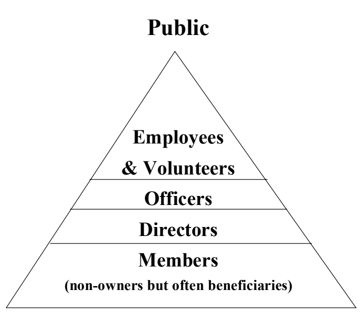
- Not-for-Profit Corporations
  (non profit purpose but not charitable)

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

**Public**


7

**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**

8

- **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**

9

- **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**

10

- **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**

11

- **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**

12

- **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**

13

- **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**

14

- **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**

15

- 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

16

- 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 from the board

17

- 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

18

- **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 are essentially the same**
    - **Recent *Aids Society* case emphasizes that directors have fiduciary obligation to apply charitable property to charitable objects**

19

- **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 but not officers 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**

20

- **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**

21

- **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**

22

  - **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**
  - **But cannot commingle with general funds**

23

**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**

24

- **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**

25

- ***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**

26

- ***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**

27

– *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**

28

- **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 negligence in work place safety**
  - **Section 336 – criminal breach of trust**

29

- **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**

30

– ***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**

31

– ***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**

32

– ***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**

33

- **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**

34

– ***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**

35

**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**

36

- **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)**

37

- ***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)**

38

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

39

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# DIRECTORS' AND OFFICERS' LIABILITY AND BEYOND

## November 28, 2006

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# 2. Due Diligence in Managing Risks for Directors and Officers

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**Part II**
**Due Diligence in Managing Risks for Directors and Officers**

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## A. OVERVIEW OF TOPICS

- Due diligence in the choice of charitable structures
- Due diligence in relying upon statutory protection
- Due diligence in operations
- Due diligence in indemnification and insurance
- Other means of due diligence in reducing risk

Note: For a more detailed discussion, see attached Summary "B" entitled "Due Diligence in Avoiding Risks for Directors of Charities and Not-for-Profits". 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

2

## B. 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

3

- 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

4

- 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

5

- 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

6

**C. 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**

7

- **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**

8

**D. 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**

9

- **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**

10

- **Need to invest in accordance with prudent investment standard under the *Trustee 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**

11

- **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**

12

- **Fundraising**
  - **Monitor fundraising costs compared to 80/20 disbursement quota for receipted gifts**
  - **Reasonable enquiries of donors to determine correct amount for "eligible gift" in receipt**
  - **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**

13

- **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**

14

**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**

15

- **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**

16

- **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**

17

- **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)**

18

**E. 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?**

19

- **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**

20

- **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.**

21

- **Additional 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?**

22

- **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**

23

- **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?**

24

**F. OTHER MEANS OF DUE DILIGENCE IN REDUCING RISK**

**1. Legal Risk Management Committees**

- **Legal risk management committee needs to be formed to conduct review and identify risks**
- **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**

25

- **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**

26

- **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**

27

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# 3. Avoiding Legal Liabilities in Fundraising

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**Part III**
**Avoiding Legal Liabilities in Fundraising**

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## A. OVERVIEW

- **Legal Responsibility of Charities and Directors in Fundraising**
- **Developing a Proactive Risk Management Approach to Fundraising**
- **Donor's Rights and Remedies in Fundraising**
- **Avoiding Liability from Testamentary Charitable Gifts**
- **Avoiding Liability from Donor Restricted Charitable Gifts**
- **Avoiding Liability in Gift and Fundraising Programs**

2

## B. RESOURCE MATERIALS

- **www.charitylaw.ca**
  - **Article entitled "*Looking a Gift Horse in the Mouth - Avoiding Legal Liability in Fundraising*"**
  - **Article entitled "*Donor Restricted Charitable Gifts Revisited: A Practical Overview*"**
  - **Charity Law Bulletins #8, #9, #13, #17, #21, #23, #35, #72 and #98**
- **www.antiterrorismlaw.ca**
  - **Article entitled "*The What, Where and When of Canadian Anti-Terrorism Legislation for Charities in the International Context*"**

3

C. LEGAL RESPONSIBILITY OF CHARITIES AND DIRECTORS IN FUNDRAISING

- **Improper or negligent actions by development officers or fundraisers may expose a charity and its directors to legal liability**
- **The court held in *The Aids Society for Children* (Ontario) that**
  - **Third party fundraisers and subcontractors are agents of the charity and may cause liability for both the charity and its board of directors personally**

4

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  - **Fundraising contracts which provide for unreasonable compensation (i.e. 70% to 80%) will be voidable based upon both violation of public policy and/or misrepresentation**
  - **Misrepresentation is determined by the perception of the donor, not by the intent of the charity or its directors in receiving the gifts**
  - **The fiduciary duty of a charity and its board of directors to account for donations applies to the gross amount of donations raised by third party fundraisers, not to the net amount that the charity may be entitled to pursuant to a fundraising contract**

5

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  - **The directors were found personally liable for unreasonable fundraising costs in the amount of $766,000**
  - **Fundraising companies were required to repay unreasonable fundraising costs**
  - **The directors were subjected to a penalty of $50,000.00 under the *Charities Accounting Act* (Ontario)**
- **The court in *National Society for Abused Women and Children* confirmed**
  - **Fiduciary obligation of directors to account for unconscionable fundraising costs**
  - **Fundraising contract was declared void *ab initio* as being contrary to public policy**

6

- Donors are entitled to know about fundraising and administrative costs when making donations

- For more information on these cases, see Charity Law Bulletins #9, #13 and #17 at www.charitylaw.ca
- PGT recently obtained a restraining order against a Nova Scotia charity operating in Ontario involving 78% fundraising costs (*Canadian's Against Child Abuse Society*)
- The "buck" stops with the board of directors of a charity after everyone else has left the charity
- The board of directors must therefore be made familiar with all fundraising programs and the liabilities that are associated with those programs

7

**D. DEVELOPING A PROACTIVE RISK MANAGEMENT APPROACH TO FUNDRAISING**

- Legal liability in fundraising can be reduced by developing a proactive legal risk management approach to fundraising
- Fundraising must comply with the applicable corporate objects and powers of the charity
  - The fundraising program must not be *ultra vires* the charitable objects of the charity
  - The charitable purpose being furthered by fundraising must not be *ultra vires* the charitable objects
  - A donor restricted gift resulting from fundraising must not be *ultra vires* the charitable objects

8

- Fundraising must not violate applicable statutory provisions
  - Selected specific charitable statutes affecting fundraising
    - *Charities Accounting Act* (Ontario)
    - *Charitable Gifts Act* (Ontario)
    - *Religious Organizations Land Act* (Ontario)
    - *Income Tax Act* (Canada)
    - *Charitable Fund-raising Act* (Alberta)

9

- *The Charities Endorsement Act* (Manitoba)
- *Charities Act* (PEI)
- *Charitable Fund-raising Businesses Act* (Saskatchewan)
- *Anti-terrorism Act* (Canada)
- *Taxation Act* (Quebec)

– Uniform Law Reform Conference has released draft uniform fundraising legislation see website www.ulcc.ca/en/home

• Fundraising must not involve gifts that are contrary to public policy

– Charitable gifts involving discrimination

– Charitable gifts involving illegal activities

10

• The impact of 2001 regulations under the *Charities Accounting Act* (Ontario) for commingling

– No relief to the common law rule prohibiting directors from receiving remuneration

– Indemnification of directors and officers and liability insurance is now permitted under prescribed circumstances

– Charities may commingle restricted and special purpose funds provided that prescribed accounting records are maintained

– However, the *Public Guardian and Trustee* of Ontario does not permit commingling of restricted funds and general funds

11

E. DONOR'S RIGHTS AND REMEDIES IN FUNDRAISING

• General exposure to liability involving donors

– Misrepresentation involving issuance of charitable receipts and/or the amount

– Failure to comply with donor restrictions

– Failure to disclose excessive fundraising costs

– Detrimental reliance upon charitable endorsements

– Detrimental reliance upon improper tax advice involving donations

– Breach of fiduciary duty and/or breach of trust in applying funds to charitable purposes

12

- **Donor's statutory rights**
  - ***Charities Accounting Act* (Ontario)**
    - **Section 6 of the CAA (public inquiry)**
    - **Section 10 of the CAA (alleged breach of trust)**
    - **Section 4(d) of the CAA (non-compliance with donor directions)**
    - **Section 3 of the CAA (formal passing of accounts)**
  - **The *Income Tax Act* (Canada)**
    - **Informal complaint to CRA**
    - **Resulting audits**
    - **Receipting and disbursement violations**

13

**F. AVOIDING LIABILITY FROM TESTAMENTARY CHARITABLE GIFTS**

- **Reducing legal risks from estate planning programs**
  - **Shift the legal risk away from the charity**
    - **Download the risk to professionals, i.e. accountants or lawyers, to establish evidence of due diligence**
    - **Raise the shield of liability insurance whenever possible, if available**
    - **Return any original wills or codicils to donors or their lawyers**

14

- **Avoid circumstances conducive to allegations of undue influence**
  - **Directing work to a particular lawyer**
  - **Paying for a portion of donor's legal costs**
  - **Acting as either an estate trustee (executor) or attorney under a power of attorney**
  - **Preparing a will or power of attorney**
  - **Providing advice on how to structure disposition clauses in a will**
  - **Providing recommendations on how much of the estate should be given to a charity or charities in general**

15

- Completing the will guide on behalf of the testator instead of only assisting with background information
- Meeting with the lawyer when the donor gives instructions for the will
- Being present when the will is being signed
- Offering to store the original will, codicil to a will, or power of attorney

• Managing testamentary gifts
  – Ensure that a copy of the will is received and carefully review charitable gift provisions
  – Review any applicable donor restrictions before agreeing to receive the gift

16

– Require progress reports on the administration of an estate
– Request the distribution of gifts to the estate at the earliest opportunity
– Have legal counsel review estate releases as the charity cannot sign an indemnity for money or cause of action beyond what the estate would have otherwise been liable for
– Have legal counsel review estate accounts before signing estate releases
– Review appropriateness of investments
– Ensure that tax credits are used against 100% of income in the year of death and carried back one year, if applicable

17

– Make sure that only duly authorized signing officers execute the releases

• Resist voluntary renouncement of a gift
  – A charity may be asked to renounce a testamentary gift in situations of financial hardship involving family members of the deceased
  – There is no legal authority for a charity to unilaterally renounce a gift
  – Even court authorization for a renunciation of a testamentary gift is unlikely
  – The charity therefore has a fiduciary obligation to pursue testamentary gifts

• Ensure that testamentary gifts continue to honour outstanding pledges

18

**G. AVOIDING LIABILITY FROM DONOR RESTRICTED CHARITABLE GIFTS**

- **The difference between unrestricted and donor restricted charitable gifts**
  - **What is an unrestricted charitable gift?**
    - **An unrestricted charitable gift is a gift to the charity that is not subject to any restrictions or limitations**
  - **What is a donor restricted charitable gift?**
    - **A donor restricted charitable gift is a gift that is subject to binding restrictions, conditions or limitations**

19

- **Instances of breach of trust involving donor restricted charitable gifts**
  - **Diverting a fund to another application**
  - **Withholding a fund**
  - **Pooling restricted funds with funds of another donor**
  - **Encroaching on the capital of an endowment fund**
  - **Altering the terms of a trust deed**
  - **Borrowing from a restricted fund**
  - **Using surplus funds from a fundraising appeal for a different purpose**

20

  - **Altering terms of a donor restricted fund without court authorization**
- **Can a donor restriction be unilaterally varied?**
  - **Only a court can vary a donor restricted charitable gift on a *cy prés* application**
  - **Exceptions are**
    - **Gift reverting to the donor on a failed *cy prés* application**
    - **Gift reverting to the donor on the failure of either a condition precedent or a condition subsequent**

21

- **How should donor restricted gifts be managed once received?**
  - **Identify the nature of the charitable gift**
  - **Review and approve donor restrictions**
  - **Effective ongoing management of donor restricted charitable gifts**
    - **Deposit into the bank account of the named charity**
    - **Invest fund in accordance with applicable investment power**
    - **Do not borrow against restricted fund**
    - **Commingle restricted funds only in accordance with regulations in Ontario and not with general funds**

22

- **How can donor restricted charitable gifts be avoided in the first instance?**
  - **Encourage unrestricted gifts**
  - **Alternatively, encourage the use of non-binding directions**
  - **Advise donors that all gifts are deemed to be unrestricted unless specifically stated otherwise**

23

- **Preventative steps to reduce liability involving donor restricted charitable gifts**
  - **Public fundraising appeals should state that any surplus funds will be used for the general charitable purposes of the charity**
  - **Ensure that donor restricted gift includes a *cy prés* clause that will allow the charity to amend the purpose**
  - **Ensure that documentation creating donor restricted charitable trusts include the words "in trust"**

24

- **Protecting donor restricted charitable gifts**
  - **Impact of the *Christian Brothers* Ont. Court of Appeal decision**
    - **Claims against charities may increase**
    - **Special purpose trust endowments will be at risk to creditors of the charity**
    - **The ability of donors to create enforceable restricted gifts will be weakened**
    - **Donors will be reluctant to give large gifts directly to an operating charity**

25

- **Developing a strategy in response**
  - **Utilize an arms length parallel foundation**
  - **Utilize a community foundation or trust company**
  - **Structure gift as a determinative gift with a gift over to another charity**
  - **For more information see www.charitylaw.ca article on "*Donor Restricted Charitable Gifts Revisited: A Practical Overview*"**
- **Proposed legislation in B.C. (Bill 63) to protect special purpose charitable trusts**

26

- **Comparison to conditional gifts**
  - **What is the nature of a conditional gift?**
    - **A conditional gift involves the charity becoming the beneficial owner of the gift subject to being defeated by a condition**
    - **With a special purpose charitable trust, the charity never becomes the beneficial owner of the gift but instead holds it in trust**
  - **Receipting conditional gifts**
    - **Condition precedent gifts cannot be receipted**
    - **Condition subsequent gifts may be receiptable:**
      - **Reversion to donor precludes receipting**
      - **Reversion to another charity can likely be receipted**

27

**H. AVOIDING LIABILITY IN GIFT AND FUNDRAISING PROGRAMS**

- **Gifts of Shares**
  - **Gift of shares or interests in a business will be subjected to the *Charitable Gifts Act* (Ontario)**
    - **Charities can not own more than a 10% interest in a business for longer than 7 years**
    - **If a charity owns more than a 50% interest in a business then reporting requirements to PGT apply**
  - **Potential liability in relation to improper valuing and receipting of shares of publicly traded companies**

28

- **Need to review CRA position on determining fair market value**
- **Need to review factors outlined by CRA in valuing shares as set out in Registered Charity Newsletter No. 12**

- **Gifts of real estate**
  - **Three year restriction on leasing property under the *Charities Accounting Act* (Ontario)**
  - **Forty year restriction on leasing property under the *Religious Organization Land Act***
  - **Liability for toxic property and need for environmental assessment**
  - **Need for due diligence searches**
  - **Inability of charity to manage real property**

29

- **Receiving used "gifts in kind"**
  - **Need for appraised fair market value**
  - **Potential liability to third parties from using recycled property**
- **Self insured gift annuities**
  - **The difference between self insured and reinsured gift annuities**
    - **Self insured gift annuity**
    - **Reinsured gift annuity**
  - **Legal risks associated with self insured annuities**
    - **Lack of corporate authority**

30

- Possible violation of the *Insurance Act* (Ont)
- Operational financial risks
- Restrictions on foundations issuing annuities

- Debt instruments forgivable on death
  - Need testamentary instrument to forgive debt
  - If not properly forgiven, will become an asset owing to the estate
- Bill C-45 Amendments to the *Criminal Code* (Westray Mines)
  - In effect criminalizes situations which previously were only matters of negligence

31

- Charities, directors and officers may be exposed to personal liability
- insurance may not be available for defence costs
- See Charity Law Bulletin #35 and #72 at www.charitylaw.ca for more details

- Transferring capital funds between charities
  - Ensure that there are charitable objects to permit the transfer of funds
  - Identify donor restricted charitable gifts
  - Identify impossible or impractical donor restrictions
  - Change of trustees by deed of trust
  - Unrestricted funds to be applied for original charitable purpose

32

- Investment issues in fundraising
  - Determine which investment powers apply and in what jurisdiction
  - Adapt and implement an investment plan
  - Investment plan needs to comply with *Trustee Act* (Ontario) particularly for delegation
  - Investment plan needs to incorporate and override the investment plan and/or agency agreement of an investment manager
  - See www.charitylaw.ca, Charity Law Bulletin #8 and "Looking a Gift Horse in the Mouth Avoiding Liability in Charitable Fundraising" article for more information

33

- **Managed or pooled investment of charitable funds**
  - **Does the recipient charity have the corporate power to operate a pooled fund?**
  - **Does the investment power of each participating charity permit it to invest charitable monies by pooling monies with a third party?**
  - **Does the *Loan and Trust Corporations Act* (Ontario) have application?**
  - **Does the *Securities Act* (Ontario) have application?**
  - **Is court authorization required to pool investment funds of various charities?**

34

- **Federal *Competition Act* - Deceptive telemarketing & false or misleading misrepresentation**
  - **Definition of "business" includes the raising of funds for charitable or other non-profit purposes**
  - **The *Competition Act* does not apply to fundraising that is solely charitable in purpose**
  - **However, if the part of the purpose of the fundraising includes promoting products or services, the *Competition Act* may apply**
  - **Telemarketing is prohibited unless there is statutorily mandated disclosure**
  - **Violation of the *Competition Act* constitutes a criminal offence**

35

  - **A due diligence defence is available**
  - **Directors and officers of a charity can be held personally liable**
  - **The prohibition on false or misleading representation applies to telemarketing, door-to-door solicitation, and items offered for sale by the charity**
  - **A false or misleading representation does not require that it be proven that any person was deceived or mislead**
- **CRTC pending changes to rules for fundraising**
  - **Affects charities that make their own telemarketing calls in-house, as well as third-party, for-profit telemarketing firms engaged by charities**

36

- **On September 28, 2004, the CRTC suspended the application of the new telemarketing rules from May 2004 decision (as of October 2, 2006, the suspension had not been lifted)**
- **Decision is now under review as a result of the Canadian Marketing Association's application to review and vary that decision**
- **The requirement that telecommunications service providers track and report complaint statistics is still valid, effective January 1, 2005**

37

- **Bill C-37, an Act to amend the *Telecommunications Act***
  - **Royal assent given November 25, 2005 (Act not yet in force)**
  - **Enables the CRTC to establish a national do not call list**
  - **Establishes an administrative monetary penalty for the contravention of the do not call list ($1,500 for individuals; $15,000 for corporations)**
  - **Under s.41.7, registered charities are exempted from prohibition orders against unsolicited telecommunications**
  - **CRTC should now proceed to public consultations to work out details of the do not call list**

38

- **Legal issues involving fundraising on the internet**
  - **Territorial jurisdictional issues**
  - **Intellectual property law issues**
  - **Potential for civil action from the internet**
  - **Domain names, trade-marks and the internet**
  - **Marketing and advertising on the internet**
  - **PIPEDA and provincial privacy legislation**

39

- Legal issues in sponsorship arrangements
  - Distinguishing between receiptable donations and non-receiptable sponsorship payments
  - The importance of documenting sponsorship arrangements
  - Protecting and licensing trade-marks in sponsorship arrangements
  - Liability exposure from sponsorship arrangements

40

- Fundraising Liability and Anti-terrorism
  - Anti-terrorism Legislation is very complicated, see www.antiterrorismlaw.ca for article "*Charities and Compliance with Anti-terrorism Legislation: The Shadow of the Law*"
  - Charity and its directors need to have a working knowledge of the anti-terrorism legislation in making a gift to charity

41

- Anti-terrorism legislation is currently under review by the Federal Government
- Anti-terrorism legislation will have serious impact on charities and their board of directors
- Charities that carry on international operations will also need to be aware of the impact of anti-terrorism legislation in other jurisdictions

42

– *Criminal Code* provisions
  - Broad and vague definitions of "Terrorist Activities" and "Terrorist Group"
  - *Mens rea* may be an issue
  - May have the effect of catching legitimate humanitarian charities
– Loss of charitable status through minister's certificate
  - Ministers can issue certificate if minister has reasonable grounds to believe that an organization is supporting terrorist activities

43

- Certificate is referred to federal court judge
- Federal court may hear evidence in private
- Information considered may include information from foreign governments and organizations
- Rules of evidence do not apply
- Certificate in effect for 7 years

44

– Anti money laundering legislation
  - May apply to charities in future regulations
  - May apply to charities immediately because of statutory authority of charities to issue securities under the *Securities Act*
  - Large or cross-border donations may result in mandatory reporting to FINTRAC

45

– **Inherent problems**
  - **Lack of procedural fairness**
  - **No due diligence defence**
  - **Discriminating to ethnic and religious charities**
  - **Negative effect upon public perception**
  - **Severe *Criminal Code* penalties**
  - **Vicarious liability for international operations through agency arrangement**
  - **Breach of fiduciary duty by director**
  - **Concerns about lack of insurance coverage**

46

– **Due diligence response**
  - **Need to become familiar with specifics of anti-terrorism legislation**
  - **Need to establish due diligence policy to comply with the law**
  - **Need to conduct due diligence review of directors, officers and key individuals**
  - **Monitor how monies are being raised and disbursed**
  - **Review and monitor international relationships, i.e. agency agreement and joint venture**
  - **Need release and indemnities from third parties**

47



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