
**THE JOHN MCININCH FOUNDATION
MCININCH SYMPOSIUM ON RISK MANAGEMENT**

**Where It All Starts: Governance and Fiduciary Risk
Toronto – November 23, 2007**

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

By Terrance S. Carter, B.A., LL.B., Trade-mark Agent

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A. OVERVIEW OF TOPICS

- Definition of Director and Officer
- Different Types of Organizations
- 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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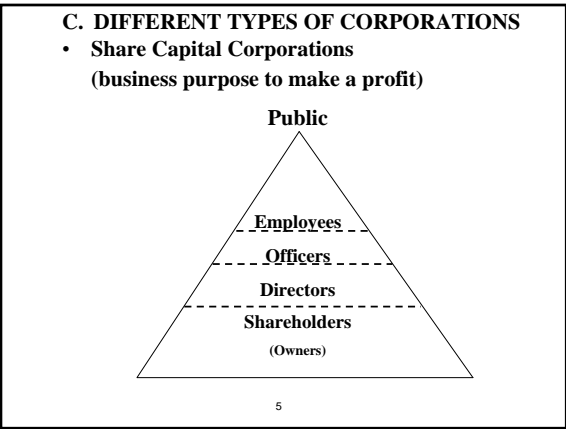
B. DEFINITION OF DIRECTOR AND OFFICER

- For this presentation, references to corporation include an unincorporated association and 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

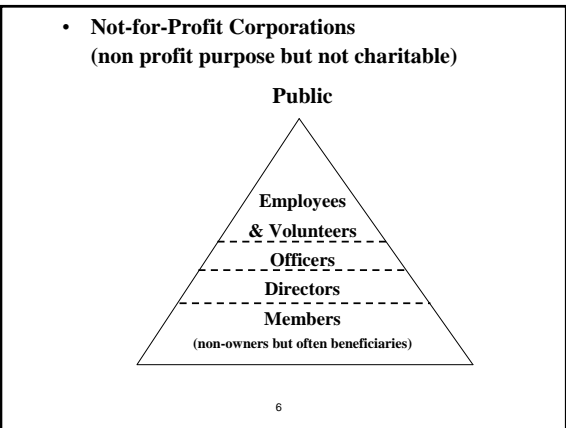
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- An officer carries out the day to day functions of the corporation at the direction of the board
- An officer can also be a director or can become a *de facto* director and be subject to fiduciary obligations
- For purposes of this presentation, reference to directors is deemed to include officers unless stated otherwise

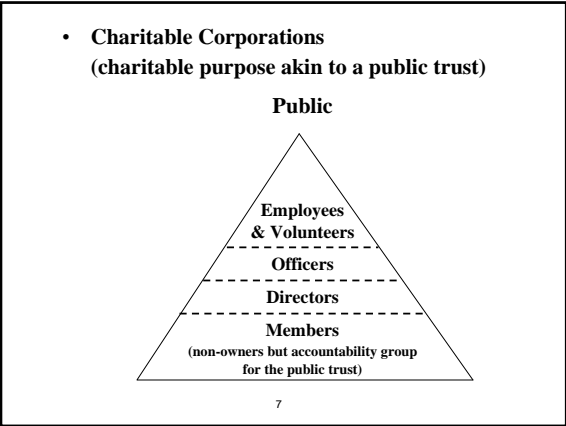
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- **Directors of not-for-profit and charitable corporations may be found liable for their actions under more than 200 statutes or regulations (in Ontario and federally)**
- **Directors of not-for-profit and charitable corporations may also be found liable at common law for their actions and inactions**

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D. COMMON LAW DUTIES AND LIABILITIES

- **Management of the Corporation**
 - **Directors are responsible for all aspects of the 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, staff and volunteers**
 - **Failure to act, i.e. inaction, can result in personal exposure to liability, i.e. liability of WorldCom and Enron 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**
- **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**
- **Liability Risk for Negligent Mismanagement (Tort)**
 - **Tort is civil wrong for which injured party can seek damages from the court**

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– Directors can be personally liable for corporation’s torts where own conduct or inaction contributed to victim’s injury (e.g. the tort of nuisance or trespass for actions of harm to the environment)

- **Liability Risk in Contract**
 - Directors generally not personally responsible for contracts signed for corporation unless they are found to have intended to assume personal liability
 - 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 not-for-profit corporations also have fiduciary duties to put the interest of the corporation ahead of their own interest
 - Directors of charitable corporations are subject to fiduciary duty to act as quasi trustee of charitable property
 - 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 the 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
- **Duty to maintain an even hand**
 - Directors must conduct themselves in an even fashion as between those to whom their duty is owed

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- **Duty of confidence**
 - Directors must not disclose confidential information that they acquire to outside parties
- **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
 - If this procedure is not followed, directors may be made to account for any profits that they have made

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

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- **Where charitable property is 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**

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

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- 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
- Additionally, directors of not-for-profit and charitable corporations may be liable for breach of trust for allowing funds in trust to be paid to non-beneficiaries (e.g. pension contributions)

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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

- **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 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* (e.g. improperly characterizing employees as independent contractors)
 - Avoid liability by showing positive steps taken to ensure compliance

– *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**

– *Criminal Code*

- **Bill C-45 (Westray Mines) for 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
- Persons in control of contaminants are responsible for cleanup and related costs

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▪ Appropriate environmental audits need to be obtained before purchasing or receiving land

– *Ontario Environmental Assessment Act*

- Directors must ensure that undertakings of the corporation comply with environmental assessment requirements and orders
- Failure to comply would result in directors being found guilty of an offence

– *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

– *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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