THE JOHN MCININCH FOUNDATION
MCININCH SYMPOSIUM ON RISK MANAGEMENT

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

Part II
Due Diligence in Avoiding Liability for 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
• Due diligence through good governance
• Due diligence in the choice of organizational structure
• 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

B. DUE DILIGENCE THROUGH GOOD GOVERNANCE
• Developing a mission and strategic plan
  – Ensure that the mission statement is consistent with corporate objects
  – Do periodic reviews of both
• Ensure transparency and communication
  – Communicate to members, donors and the public
  – Focus on ensuring accountability
• Maintain organizational structure
  – Be knowledgeable of corporate structure
- Letters patent
- By-laws
- Special resolutions
- Policies
  - Be prepared to change corporate structure as necessary to better reflect programs undertaken
- Understand the role of the board
  - Continually educate board members
  - Develop conflict of interest and code of conduct policies
  - Prepare a board manual

- Exercise fiscal responsibility
  - Establish and maintain a budget
  - Monitor all fiscal expenditures and/or commitments
  - Monitor human resources
  - Review and approve all fundraising and initiatives and donation receipts
- Plan for the diversity and succession of the board
  - Determine specific needs of the board and recruit in accordance with those needs
  - Plan for an orderly succession of directors

### C. DUE DILIGENCE IN THE CHOICE OF ORGANIZATIONAL STRUCTURE

- Charities and Not-for-Profits as Unincorporated Associations
  - Not a legal entity
  - Generally used for starting up a charity or not-for-profit in its early stages
  - Flow through liability to members
Charities as Charitable Trusts
- A trust is a relationship between trustees and beneficiaries involving the separation of legal and beneficial ownership of property
- Available for charitable organizations, public foundations and private foundations
- Trustees are exposed to liability

Charitable Purpose

Trustees

Third Party claims

Beneficiaries

of the Charitable Purpose

Donors

Charities and Not-for-Profits as Corporations
- Separate legal entities
- Members are not exposed to liability
- Directors may be still exposed to personal liability from fiduciary and management responsibilities

Third Party Claims

Public

Employees & Volunteers

Officers

Directors

Members

(Non-Owners But Often Beneficiaries)

Using a multiple charitable corporation structure
- Multiple charitable corporations can help to protect charitable assets in one charity and contain liabilities in another charity
- Multiple charitable corporations can include
  - Parallel foundations
  - Parallel operating charities
  - Umbrella organizations
Parallel foundations have become more common in protecting long term gifts and endowment funds as a result of recent case law.

Need to give consideration to balancing control of multiple corporations with issues involving the possibility of cross over liability?

Need integrated corporate structure and trade-mark licensing to avoid loss of control.

Need to give consideration to implementing effective control through contracts and/or licensing agreements as an alternative to overt corporate control?

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.

The reverse is also a risk: top-tier corporations can lose control over subsidiaries without proper corporate control in place and/or appropriate agreements.

Are relationships with national organizations and/or subsidiary chapters adequately documented to protect the rights of both parties?

Are relationships between national and international structures adequately documented with specific reference to controlling trademarks in Canada?

Is there need for an international umbrella organization?

Has the ownership of trade-marks and/or copyrights been determined and protected and licensed in Canada?
D. DUE DILIGENCE IN RELYING UPON STATUTORY PROTECTION

- It is important for directors and officers to know what statutory defences are available to them
- Protection from third party contractual liability
  - Protection available for corporations under the current 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

E. 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
• 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

• 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, if applicable
    ▪ Review intellectual property, if applicable
• Notice/attendance at meetings/minutes
  – Right to notice of board meetings
  – Right to attend board meetings

• 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
2. Policies and Procedures in Pursuing 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, workplace safety, counseling and third party use of facilities of the charity

- 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

- 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
• Utilizing 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)

F. 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?

2. Corporate Indemnification
• Corporate indemnification provides compensation for the following:
  – Legal fees
  – Fines that were paid under a statute
  – A financial settlement that results from a lawsuit
  – Any other obligation that a director was required to fulfill
Corporate indemnification should always be implemented but may be of limited benefit.

Indemnification is only as good as the financial state of the charity and its insurance.

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.

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?
– Are there exclusionary clauses that limit the protection offered by the policy, such as sexual abuse?
– Is coverage on a “claims made basis” or on an “occurrence basis”?

– Are there geographical limits to the coverage?
– Insurance may 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.
• 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?

G. 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
3. Directors may need to seek independent legal advice before resigning from the board of directors
4. 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
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