
WILD ROSE FOUNDATION – VITALIZE 2008

**DIRECTOR’S AND OFFICER’S LIABILITY:
THE ESSENTIALS AND BEYOND
FOR CHARITIES AND NONPROFITS**

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Part II
**Due Diligence in Avoiding Liability for
Directors and Officers of Charities and
Not-For-Profits (Alberta)**

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- Memorandum of Association (Letters Patent)
- Articles of Association (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

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- 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

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- C. 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
 - Charities as Charitable Trusts
 - A trust is a relationship between trustees and beneficiaries involving the separation of legal and beneficial ownership of property
 - Trustees are exposed to liability

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

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

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

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D. DUE DILIGENCE IN RELYING UPON STATUTORY PROTECTION

- **Due diligence defence**
 - The proposed *Canada Not-for-Profit Corporation Act* would provide a due diligence defence, although its enactment is in doubt
 - 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 current *Canada Corporations Act* but *Companies Act* (Alberta) and *Societies Act* (Alberta) are silent on this matter
 - Protects directors and officers against contracts entered into within the scope of authority of directors or officers

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

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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

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

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

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- Protecting and managing intellectual property
 - Registering trade-marks and copyright
 - Securing internet domain names
 - Proper marking of trade-marks and copyrights
 - Licensing of trade-marks and copyrights
- Fundraising
 - Monitor fundraising costs as part of 80/20 disbursement quota for receipted gifts
 - Monitor which is appropriate fundraising costs under the proposed new Fundraising Policy from CRA – for more details see Charity Law Bulletin #138 at <http://www.carters.ca/pub/bulletin/charity/2008/chv1b138.pdf>

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- Due diligence enquiries of donors to determine correct amount for “eligible gift” in receipt by determining the FMV of a gift and the amount of any advantage received by the donor
- Ensure gifts are used for charitable purposes
- Review and enforce terms of restricted and endowed gifts
- Comply with *Charitable Fund-Raising Act* (Alberta) (See Part III of this presentation for more details)
- Notice/attendance at meetings/minutes
 - Right to notice of board meetings
 - Right to attend board meetings

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

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

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

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- Directors need to ensure that senior management are also kept adequately informed on current legal issues
- **Utilizing due diligence checklists**
 - Legal risk management checklist (see sample checklist at <http://www.carters.ca/pub/checklst/charity.pdf>)
 - Sexual abuse checklist
 - Fundraising compliance due diligence checklist
 - Anti-terrorism due diligence checklist
 - Insurance checklist

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- **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 directors to act prudently in delegating authority and monitoring performance under *Trustee Act* (Alberta)**

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F. DUE DILIGENCE IN INDEMNIFICATION AND INSURANCE

1. Statutory Basis for Directors and Officers Insurance and Corporate Indemnity

- Federal and some Provincial corporate statutes (such as Ontario) permit corporate indemnification and director and officer insurance
- In Ontario, corporations must consider the following under the *Charities Accounting Act*:
 - What is the degree of risk?
 - Are there alternatives to insurance?
 - What is the cost of insurance in relation to the risk?

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

2. Corporate Indemnification

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

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

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- **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”?

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

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

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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 utilizing legal risk management checklist
- Undertake a legal risk audit

2. Independent Legal Advice

- Independent legal advice needed for directors in high risk situations

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- Directors may need to seek independent legal advice before resigning from the board of directors

3. Size of the Board

- Reducing size of board reduces risk
- Smaller board may also allow for more effective control

4. Committees and Advisory Boards

- Committees and advisory boards can be an effective means of attracting volunteers without the risk of being directors

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- But board of directors must always remain in control

5. Transfer of Assets

- Directors will always be somewhat exposed to liability risks
- Therefore directors should consider transferring personal assets to spouse
- However any transfer of assets must be done before becoming a director so as not to defeat claims of creditors

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