
CERTIFIED GENERAL ACCOUNTANTS OF ONTARIO

**LIABILITY OF DIRECTORS AND OFFICERS
FOR NOT-FOR-PROFITS**

Toronto – November 11, 2010

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

- **Power Point**
- **Summary**
- **Charity Law Bulletin #209**
- **Charity Law Bulletin #211**

By Karen J. Cooper, LL.B., LL.L., TEP

© 2010 Carters Professional Corporation

kcooper@carters.ca

1-866-388-9596

CARTERS™.ca

Carters Professional Corporation / Société professionnelle Carters
Barristers, Solicitors & Trade-mark Agents / Avocats et agents de marques de commerce

Ottawa (613) 235-4774
Mississauga (905) 306-2791
Orangeville (519) 942-0001

Toll Free: 1-877-942-0001

www.charitylaw.ca

CERTIFIED GENERAL ACCOUNTANTS OF ONTARIO

Toronto – November 11, 2010

LIABILITY OF DIRECTORS AND OFFICERS
OF NOT-FOR-PROFITS

By Karen J. Cooper, LL.B., LL.L., TEP
© 2010 Carters Professional Corporation



CERTIFIED
GENERAL
ACCOUNTANTS

11/4/2010 1
We see more than numbers.

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 entitled "The Legal Duties of Directors of Charities and Not-for-Profits"

2

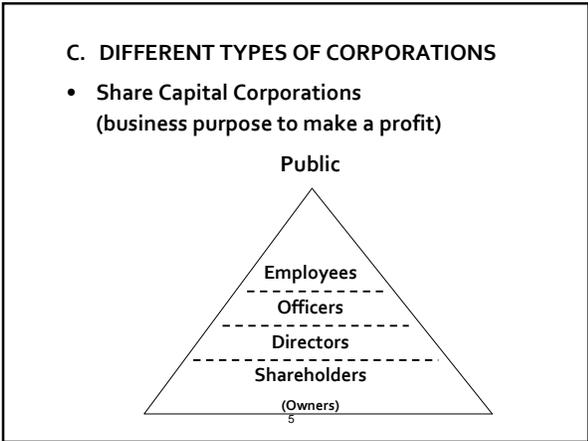
B. DEFINITION OF DIRECTOR AND OFFICER

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

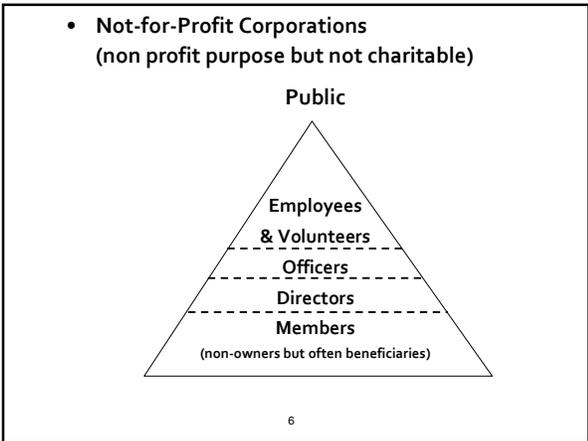
3

- 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 if the officer takes on the functions of a director
- For purposes of this presentation, reference to directors is deemed to include officers unless stated otherwise

4



5



6

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



7

- 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

8

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, training, 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

9

– For charities, the courts have an inherent equitable jurisdiction to supervise and can interfere in charitable matters if mismanagement occurs

- The court may interfere if the charity is not administered in accordance with its charitable purposes or if funds are misused
- i.e. The Toronto Human Society decision (2010)

10

• 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

11

- Not-for-profit corporation
 - Common law subjective standard of care (will change with new legislation)
 - 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

12

- **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

13

- 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

14

- **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

15

- 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

16

- 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

17

- 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

18

- 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

19

- If this procedure is not followed, directors may be made to account for any profits that they have made
- 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

20

- 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

21

- 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 available, provided that regulations are complied with

22

- 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

23

- 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

24

- Commingling of donor restricted funds
 - Are gifts subject to restrictions or limitations?
 - Commingling of donor restricted gifts 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)

25

E. STATUTORY DUTIES AND LIABILITIES

- Overview
 - Many federal and provincial statutes impose offences and penalties for acts and omissions of corporate directors
 - Strict liability generally applies
 - Directors can be held personally liable, as well as jointly and severally, with other directors for statutory duties
 - Only defence is due diligence
 - Resigning as a director may not limit liability though there are generally limitation periods

26

- Federal Statutes
 - *Canada Corporations Act*
 - Unpaid wages
 - Directors are jointly and severally liable for all unpaid wages due for services by employees for the corporation while they were directors
 - Conflict of interest
 - Every director with an interest in a contract with the corporation must disclose such interest

27

- Reporting requirements
 - Annual summary for the corporation to be filed each year
- Books, minutes and records
 - Corporation required to maintain proper books, records and accounting records
- General penalty
 - Directors will be liable to fine of \$1000 and imprisonment not more than a year for doing anything contrary to the legislation or failing to comply where specific penalty not prescribed

28

- *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: 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)

29

- 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

30

– *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

31

- 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

32

- Ontario Statutes
 - *Corporations Act (Ontario)*
 - Unpaid 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

33

- *Employment Standards Act (Ontario)*
 - The ESA sets out the statutory duties that employers have towards employees’ employment standards
 - Part XX of the ESA sets out the liability of directors, which includes liability in relation to directors who authorize, permit or participate in the failure of a corporation to pay wages, termination pay or severance pay are liable to pay such amounts to employees
 - However, Part XX does not apply with respect to directors of non-share capital corporations

- Instead, directors of non-share capital corporations will be liable for wages in accordance with the provisions set out in the specific statute under which their corporation has been incorporated
 - e.g. *Canada Corporations Act*
 - e.g. *Corporations Act (Ontario)*

- *Retail Sales Tax*
 - Directors jointly and severally liable where corporation fails to remit
- *Workplace Safety and Insurance 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

– *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

– *Employer Health Tax Act (Ontario)*

- Directors will be held personally liable for premiums and health tax not paid by corporation

37

– *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

38

– *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
- Charities, not-for-profit corporations and their directors and officers may be liable where employees fail to report abuse or where it occurs because of failure to monitor employees and operations

39

- *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

40

- Charitable property as well as fundraising practices
- Amendments in Bill C-212, the *Good Government Act*, 2009, have expanded some of the powers of the PGT
- *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 organizations₁

- Fundraising
 - Specific charitable statutes concerning fundraising:
 - *Income Tax Act* (Canada), including the proposed new CRA fundraising policy
 - *Charities Accounting Act* (Ontario)
 - *Charitable Gifts Act* (Ontario)
 - *Charitable Fund-Raising Act* (Alberta)
 - *Charitable Fund-raising Businesses Act* (Saskatchewan)

42

- *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)

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

DISCLAIMER

This handout is provided as an information service by Carters Professional Corporation. It is current only as of the date of the handout and does not reflect subsequent changes in the law. This handout is distributed with the understanding that it does not constitute legal advice or establish a solicitor/client relationship by way of any information contained herein. The contents are intended for general information purposes only and under no circumstances can be relied upon for legal decision-making. Readers are advised to consult with a qualified lawyer and obtain a written opinion concerning the specifics of their particular situation.

© 2010 Carters Professional Corporation

THE LEGAL DUTIES OF DIRECTORS OF CHARITIES AND NOT-FOR-PROFITS

*By Terrance S. Carter, B.A., LL.B. and
Jacqueline M. Demczur, B.A., LL.B.*

A. INTRODUCTION

Liability risks for directors of charitable and not-for-profit corporations can arise at common law and by statute. A director can be held personally liable for his or her own actions or inactions, as well as jointly and severally with the other members of the board of directors. This summary outline discusses both the common law as well as statutory duties and liabilities that directors of charitable and not-for-profit corporations face. An explanation of steps that can be taken to protect directors from liability exposure faced by directors is contained in a separate summary entitled “Due Diligence in Avoiding Risks for Directors of Charities and Not-For-Profits”.

B. COMMON LAW DUTIES AND LIABILITIES

1. Management of the Corporation

- ◆ Directors are responsible for all aspects of the corporation’s operations. In properly fulfilling their duties as directors, they must:
 - ensure the objects of the corporation are properly carried out
 - ensure the corporation does not undertake activities outside its corporate objects
 - provide adequate authority for the activities that the corporation does undertake (by amending letters patent, bylaws, etc.)
 - set long-range objectives and strategic plans for the corporation
 - ensure the corporation’s financial stability and overall performance
 - hire and supervise management and staff to do the day-to-day work of the corporation

2. Duty of Care

- ◆ Directors of all corporations must exercise a certain standard of care in carrying out their duties. However, this standard of care varies depending on the type of corporation involved.

- a) Business Corporation:
 - directors of a for-profit business are held to a statutory objective standard of care
 - directors need to ask: how would a “reasonably prudent person” conduct the affairs of the corporation?

- b) Not-for-Profit Corporation:
 - directors of a not-for-profit non-charitable corporation are held to a common law subjective standard of care under the Ontario *Corporation Act* and *Canada Not-for-Profit Corporations Act*
 - under the new *Canada Not-for-Profit Corporations Act* an objective standard of care, will apply
 - directors need to ask: what level of skill and care can reasonably be expected from a person with my knowledge and experience?
 - the standard is different depending on the director’s knowledge and experience (e.g. lawyers, accountants)
 - however, the minimum expectation would be the level of care expected from a “reasonably prudent person”

- c) Charitable Corporation:
 - in addition to the already high subjective standard of care, directors of charitable corporations face additional expectations
 - this is because the courts in Ontario have held that directors of charitable corporations are also subject to a fiduciary duty to act as a quasi-trustee of the charitable property of the corporation
 - this fiduciary duty involves an obligation to act honestly, in good faith and in the best interests of the corporation which precludes the director from acting in a self-serving manner
 - thus directors of charitable corporations are held to the highest possible standard of care; similar to the standard expected of a trustee of the estate of an infant beneficiary
 - directors need to ask: what level of care would a reasonable and prudent person managing his or her own affairs exercise?

3. Liability Risk for Lack of Corporate Authority

- ◆ a corporation’s corporate authority is defined by the corporate objects set out in its letters patent, as amended by supplementary letters patent and other governing documents

- ◆ the activities of the corporation can only be undertaken within the parameters of the corporate objects
- ◆ where directors act outside the scope of their authority contained in the governing documents, i.e. by undertaking activities that are outside the authority of the corporation's objects, they may be found potentially liable for the consequences of such decisions or actions
- ◆ such potential liability for lack of corporate authority arises under the common law, tort, contract and statute
- ◆ where necessary, amendments to the governing documents should be made by the corporation

4. Liability Risk for Negligent Mismanagement (Tort)

- ◆ a tort is a civil wrong recognized by the courts for which an injured party can seek damages, e.g. slip and fall accident
- ◆ directors can be personally liable for torts committed by the corporation where their own conduct in managing the corporation also contributed to the victim's injury, e.g. situations involving negligent mismanagement
- ◆ if their carelessness in the oversight of the corporation's operations leads to injury, directors of charities and not-for-profit can be found liable in tort for negligent mismanagement for:
 - failing to adequately supervise the hiring of staff and volunteers
 - failing to monitor the on-going conduct of staff and volunteers, especially with regard to sexual abuse of children and/or harassment of employees
 - wrongful dismissal where directors acted with malice or otherwise improperly dismissed the employee
 - permitting unsafe conditions on corporation's property leading to an accident
 - negligent operation of corporate vehicle involved in corporation's activities
 - knowingly drawing cheques against insufficient funds
 - failing to prevent depletion of the corporate assets
 - allowing unauthorized investments
 - paying excessive salaries, bonuses or benefits to staff

5. Liability Risk in Contract

- ◆ directors are generally not personally responsible for contracts they sign for the corporation provided they have the proper authority to do so, which is determined by the corporation's governing documents or by board resolutions
- ◆ however, directors of charities and not-for-profits may face potential liability where:
 - they enter a contract lacking the necessary authority to do so
 - they do not properly identify the corporation in any contract or to the contracting party
 - the other party believes the director is signing in his or her own name
 - they are found to have induced a breach of contract prior to the signing of the contract

- they do not follow through to ensure that the corporation complies with a contract
- ◆ to reduce liability exposure, directors should ensure contracts are duly authorized by either the board or the membership before entering into them
- ◆ directors should also exercise due diligence to ensure that the terms of contracts are complied with to avoid allegations of wrongful interference in inducing breach of contract

6. Liability Risk for Breach of Fiduciary Duty

a) Overview

- directors of charitable corporations are also subject to a fiduciary duty to act as a quasi-trustee of the general charitable property of the corporation
- this fiduciary duty involves an obligation to act honestly, in good faith and in the best interests of the corporation which precludes the director from acting in a self-serving manner
- as part of their fiduciary duty, directors have a primary obligation to exercise due diligence in overseeing and managing the corporation and its charitable property
- exercising due diligence includes attending board meetings, supervising operations, monitoring compliance with corporate objects, and ensuring board resolutions are adopted by informed decisions of the directors
- fiduciary duties are owed to the charitable objects of the corporation, the charity itself, its donors, and its creditors

b) Summary of Fiduciary Duties

i) Duty to Act Honestly

- ◆ directors must deal honestly with the corporation
- ◆ conflicts of interest with the corporation are to be avoided and must be disclosed if any exist
- ◆ directors must not act fraudulently

ii) Duty of Loyalty

- ◆ a director's sole interest is to the corporation
- ◆ the interests of the director must not be placed in conflict with those of the corporation

iii) Duty of Diligence/Duty to Act in Good Faith

- ◆ directors must be diligent in attending to their legal duties
- ◆ where directors fail to attend to their legal duties or those of the corporation, e.g. failure to comply with requirements under the *Income Tax Act* resulting in fines or loss of charitable status, directors may have liability exposure at common law for such failures
- ◆ this is complied with by being familiar with all aspects of the corporation's operations through attending board meetings and reviewing the minutes of missed board meetings

- ♦ implementation of due diligence by the board of directors will provide good defence to claims of negligence and alleged statutory violations where directors can show that positive action was taken to ensure compliance by the corporation
 - ♦ where advice of a specialized nature is required by the corporation, directors must obtain services of qualified professionals
- iv) Duty to Exercise Power
- ♦ directors are responsible for managing the corporation, i.e. developing and ensuring the implementation of policies and direction, supervising management and staff
 - ♦ may delegate certain responsibilities and/or authority, but they must supervise
 - ♦ must pursue the corporate goals and objectives
 - ♦ directors must hold funds collected from the public in trust for designated charitable purposes
 - ♦ in order to justify accounts and decisions made regarding charitable monies, directors must properly maintain books, records and minutes of the corporation
- v) Duty of Obedience
- ♦ directors must comply with all applicable legislation and the corporation's governing documents (letters patent, by-laws, etc.)
 - ♦ need to ensure that valid corporate decisions are implemented
- vi) Duty to Avoid Conflict of Interest
- ♦ directors must declare and avoid any conflicts of interest or anything that give a director the appearance of a personal benefit
 - ♦ where a conflict of interest arises, it must be declared, the director must not participate in any discussion or vote and, depending on the circumstances, the director may have to resign
 - ♦ directors cannot receive remuneration from the charitable corporation directly or indirectly
- vii) Duty to Continue
- ♦ directors have continuing obligations to the corporation which cannot be relieved by resignation
 - ♦ can only resign from the corporation where there are adequate individuals to replace the resigning director
 - ♦ resignation to avoid personal liability is ineffective and may constitute breach of fiduciary duty where the director put own interests ahead of those of the corporation

7. Liability for Breach of Trust

a) Overview

- in addition to fiduciary/quasi-trustee duties, directors of charitable corporations may also be trustees of restricted charitable property
- however, the reality is that fiduciary duties and trustee duties in relation to charitable property are essentially the same
- this was confirmed in the recent decision of the Ontario decision in *Public Guardian and Trustee v. Aids Society of Ontario* (for more information, see Charity Law Bulletins #9, #13 and #17 at www.charitylaw.ca)
- the *Aids Society* case emphasizes that directors of charitable corporations have an obligation to apply charitable property toward the charitable objects of the charity
- this requires directors to take pro-active steps to protect charitable property
- any loss of charitable assets due to inactivity or failure to act by the directors could result in breach of fiduciary duty or even breach of trust

b) Potential Liability Risks

i) Remuneration of Directors

- ♦ in Ontario, directors of charitable corporations may not receive any direct or indirect remuneration from the corporation without court approval
- ♦ it is unclear if this requirement applies in other provinces
- ♦ this means that a director cannot be a paid employee, contractor, etc. of the corporation
- ♦ this prohibition also applies to director's family members living at home
- ♦ this rule does not apply to reimbursement to directors for legitimate out-of-pocket expenses
- ♦ while a consent order from the PGT permitting remuneration of directors may be possible, it will likely be difficult to obtain and is both time consuming and costly
- ♦ may only receive indemnification and directors' insurance from the corporation subject to the provisions of Reg. 4/01 under the *Charities Accounting Act* (Ontario) (for more information see Charity Law Bulletin #4 available at www.charitylaw.ca)

ii) Dealing with Charitable Property

- ♦ directors are responsible for the way charitable property is handled
- ♦ where mismanagement occurs, directors can incur personal liability to the full amount of any loss

iii) Dealing with Charitable Objects

- ♦ charitable property must only be applied to the charitable objects contained in the governing documents of the corporation
- ♦ failure to properly apply charitable property may expose directors to breach of corporate duty, breach of fiduciary duty as well as breach of trust

- iv) Dealing with Special Purpose Charitable Trusts
 - ◆ directors of charitable corporations have fiduciary obligations to donors
 - ◆ breach of trust is possible where:
 - directors fail to apply donated funds in accordance with donors' restrictions
 - funds are redirected for a different purpose than the one for which they were given
 - directors fail to hold and invest the capital of an endowment fund in perpetuity

- v) Investment of Charitable Funds
 - ◆ directors have a duty to protect charitable property and have a specific duty to invest charitable assets
 - ◆ directors may face liability exposure as a result of a failure:
 - to determine and comply with the investment power in the corporation's governing documents or gift agreements
 - to determine and comply with the applicable statutory investment power of the applicable province
 - to invest in accordance with the prudent investor standard, including the mandatory investment criteria, as required by the *Trustee Act* (Ontario) (for more information, see Charity Law Bulletin #8 available at www.charitylaw.ca)
 - to develop and implement investment and delegation plans, as applicable
 - ◆ liability can range from bad investments to overly conservative investment decisions to missed opportunities

- vi) Commingling of Donor Restricted Funds
 - ◆ are there gifts which are subject to restrictions, limitations, etc., including endowment funds, donor restricted use funds and 10-year gifts under the *Income Tax Act*?
 - ◆ at common law, gifts are to be held in separate accounts from other restricted trust funds and cannot be commingled
 - ◆ in Ontario, regulations under the *Charities Accounting Act* (Ontario) now allow charities to commingle restricted funds in single account for investment purposes
 - ◆ however, before commingling can be done, there are numerous statutory requirements to comply with
 - ◆ improper commingling will expose directors to personal liability for breach of trust
 - ◆ but cannot commingle restricted funds with general funds
 - ◆ see Charity Law Bulletin #4 available at www.charitylaw.ca for more information

C. STATUTORY DUTIES AND LIABILITIES

1. Overview

- ♦ many federal and provincial statutes impose specific offences and penalties for acts and omissions committed by directors of corporations
- ♦ purpose of such liability on directors is that the corporation cannot be sufficiently punished itself, therefore its directors must be exposed to same liability as the corporation
- ♦ legislation imposes liability on directors and *de facto* directors
- ♦ a director can be held personally liable for his or her own actions or omissions, as well as jointly and severally with other directors of the corporation
- ♦ offences are strict liability offences, meaning it is immaterial whether or not the directors intended that the corporation violate the statutory provisions in question
- ♦ only defence that can be established is one of "due diligence", which requires that the directors be able to prove to the satisfaction of a court that the directors have taken reasonable steps in the circumstances to ensure that the provisions of the Act in question could have been complied with
- ♦ penalties for non-compliance with statutory requirements can result in directors being subject to fines, repayment of debt and even imprisonment
- ♦ resigning as a director may not limit liability, although limitation periods generally exist
- ♦ while the focus of this presentation is the federal and Ontario jurisdictions, not-for-profit corporations either located or operating in other provinces must also review the comparable provincial legislation and statutory obligations

2. Federal Statutes

a) *Canada Corporations Act*

- statute under which all federal non-share capital corporations are incorporated; note that it will soon be replaced by the new *Canada Not-for-Profit Corporations Act* which received Royal Assent on June 22, 2009

i) Wages

- ♦ directors are jointly and severally liable for all unpaid wages due for services by employees for the corporation while they were directors (section 99)
- ♦ debt liability limited to six months' wages and claims must be commenced within six months after wages were due and must be brought while person is still a director or within 12 months of ceasing to hold office
- ♦ no similar liability for vacation pay

ii) Conflict of Interest

- ♦ every director with an interest in a contract with the corporation must disclose such interest (section 98)

- ♦ where director fails to disclose conflict of interest, he or she will be potentially subject to summary conviction and minimum fine of \$1000 (section 149)
- iii) Reporting Requirements
- ♦ failure to file required information with Industry Canada can lead to personal liability with no limitation period or defense for director who permits breach to occur
 - ♦ an annual summary for the corporation is to be filed on or before June 1st each year for information effective as of March 31st of the year in question
 - ♦ default in filing will result in a fine to the corporation of \$20 to \$100 for each day default continues and directors who permit such default are liable to same fine (section 133(3))
 - ♦ if failure to file annual report results in winding up of the corporation by court order, then directors aware of default may be held liable for costs incurred in winding-up the corporation (section 150(2))
- iv) Books, Minutes and Records
- ♦ corporation required to maintain proper books, records and accounting records (sections 109, 112 and 117)
 - ♦ failure to comply will result in summary offence with penalty of maximum of \$20 for each day neglect continues (section 113)
- v) Identification of Corporation
- ♦ directors have obligation to ensure against flawed or incomplete representation of corporation on business documents or to third parties
 - ♦ failure to do so may result in fine to director of \$200 along with personal liability to the holder of any financial instrument for the full amount if the corporation does not pay (section 27)
- vi) Membership Lists
- ♦ directors face liability for failure to provide membership lists to members upon request, for misuse of membership lists for prohibited purposes under the Act, and for sale of membership lists (section 111)
 - ♦ such offences will possibly result in fine of \$1000 and up to six months imprisonment or both
- vii) Winding Up
- ♦ the Act imposes liability on directors where the Attorney General applies to wind up and dissolve the corporation for operating outside its Letters Patent (section 5.6), for failing to hold an annual meeting of members for two years or for failing to file an annual return (section 150)

- viii) General Penalty
 - ♦ a general offence provision in the Act exists for breach of any section of the legislation for which no penalty has been prescribed (section 149)
 - ♦ directors will be liable to fine of \$1000 and imprisonment not more than a year for doing anything contrary to the legislation or failing to comply

- b) *Income Tax Act (Canada)*
 - directors jointly and severally liable to pay all employee income tax deductions which the corporation fails to remit for two years following ceasing to be a director
 - directors of charitable corporations may be personally liable if charity fails to comply with numerous reporting requirements under the Act, e.g. filing of annual charity information return (section 238)
 - directors may also face fines and imprisonment where they are involved in making false or deceptive statements in any return required under the Act or wilfully evading compliance with the Act, e.g. the improper issuance of charitable receipts, the improper disbursement of charitable monies or the failure to meet disbursement quota requirements (section 239 & Jones case in CRA Registered Charities Newsletter No. 11)
 - directors also face penalties where they provide improper tax advice to others
 - to avoid liability, director needs to show that positive steps were taken to ensure that corporation complied with the Act's requirements, e.g. establishing payroll trust account and requiring the CEO to provide regular reports to board on remittances

- c) *Excise Tax Act (Canada)*
 - directors are liable for any failure by corporation to collect and remit GST, which liability continue for two years after person ceases to be director
 - the establishment of a separate trust fund for GST remittances is recommended

- d) *Canada Pension Plan*
 - directors also jointly and severally liable where corporation fails to remit appropriate pension contribution premiums for employees

- e) *Canadian Environmental Protection Act*
 - imposes positive duties on directors to ensure that corporation complies with the Act regarding air and water pollution, as well as proper storage and disposal of toxic substances
 - failure to comply can result in prison terms and fines up to \$1 million

- f) *Anti-terrorism Legislation*
 - the *Anti-terrorism Act (Canada)* has number of serious liability risks for charitable corporations and its directors, particularly those involved in overseas work

- liability risks include seizure of charitable property, loss of charitable status and even *Criminal Code* charges against the charity or not-for-profit its directors and even its donors for fundraising that directly or indirectly supports or facilitates broadly defined “terrorist activities” or “terrorist groups”
- careful review of the Act should be done by charities and not-for-profits to determine if its activities potentially expose it to liability
- if so, the directors should take steps to complete a due diligence review of the corporation under the Act
- more information on the Act and due diligence is available at www.charitylaw.ca and www.antiterrorism.ca

g) *Criminal Code*

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

3. Ontario Statutes

a) *Corporations Act* (Ontario)

- directors are jointly and severally liable to the employees, apprentices and other wage earners for all debts due for services performed for the corporation, not exceeding six months wages and twelve months vacation pay
- however, a director will not be liable unless the corporation has been sued in the action against the director and employees cannot collect from the corporation, or before or after an action has been commenced the corporation has ceased operations by liquidation, winding up or bankruptcy and the debt has been proved
- failure to keep proper books, records and registers at the head office of the corporation and failure to make such books, records and registers available for inspection by entitled persons may result in personal liability for the directors
- directors are required to disclose their interest in a contract to be entered into by the corporation at the next meeting of directors
- failure to disclose is an offence under the Act, resulting in liability being imposed on the director for any profit realized from the contract, the voidability of the contract, and a penalty on conviction up to \$200
- the Act also has a general offence provision for any breach of its provisions for which no penalty is prescribed, which could result in a fine up to \$200 on conviction

b) *Employment Standards Act, 2000* (Ontario)

- sets out the statutory duties that employers have towards employees’ employment standards
- Part XX of the Act sets out the liability of directors, which includes liability in relation to directors who authorize, permit or participate in the failure of a corporation to pay wages, termination pay or severance pay are liable to pay such amounts to employees

- however, Part XX does not apply with respect to directors of non-share capital corporations
 - instead, directors of non-share capital corporations will be liable for wages in accordance with the provisions set out in the specific statute under which their corporation has been incorporated, e.g. *Canada Corporations Act* (section 99), *Corporations Act* (Ontario) (section 81(1), etc.
- c) *Retail Sales Tax Act* (Ontario)
- failure on the part of the corporation to remit Ontario retail sales tax will shift responsibility to the Directors jointly and severally for such remission failures
- d) *Workplace Safety and Insurance Act, 1997* (Ontario)
- directors are not liable for any failure by the corporation to remit these premiums unless it can be shown that they intended not to pay them
- e) *Pensions Benefits Act* (Ontario)
- a corporation is obligated to make contributions to an employee pension plan and to hold this money in trust for its employees
 - directors who fail to pay these pension benefits may be ordered by the court to make up the contributions
 - failure to comply will subject directors to maximum fine of \$100,000
- f) *Employer Health Tax Act* (Ontario)
- corporations are required to pay OHIP premiums for all its employees
 - it is an offence for corporations to not pay a tax to the health insurance scheme. Directors are subject to a penalty if they direct, authorize or participate in any way with tax avoidance.
- g) *Occupational Health and Safety Act* (Ontario)
- directors are required to take all reasonable steps to ensure that the corporation complies with the provincial workplace health and safety requirements
 - failure to do so will result in maximum fine of \$500,000 to the corporation with the directors also subject to a maximum fine of \$25,000 and one year in prison
 - important that directors ensure that the corporation implement a system to ensure health and safety in the workplace
 - legislation generally requires the appointment of a health and safety representative if there are more than five employees and a health and safety committee if there are more than twenty employees

h) *Environmental Protection Act* (Ontario) and Related Legislation

- directors are required to take reasonable care to prevent the unlawful discharge of a contaminant into the natural environment, with failure to fulfil do so being an offence
- *Pesticides Act* (Ontario) and the *Ontario Water Resources Act* also contain similar offences
- *Environmental Protection Act* (Ontario) mandates that the people in control of a contaminant are responsible for the cleaning up or reimbursing others for the clean-up costs related to a spill of the contaminant, with directors potentially being held liable for such costs if the corporation does not pay itself (e.g. *Bata Corporation case*)
- directors may become liable for contamination simply by virtue of the corporation owning land in Ontario, therefore before either purchasing or receiving a gift of land, it is essential that an appropriate environmental audit first be obtained to ensure that there is no contamination on the property.

i) *Child and Family Services Act* (Ontario)

- certain persons in the course of their professional or official duties who have reasonable grounds to suspect child abuse has or is about to occur have a duty to report it to the appropriate authorities
- non-reporting of suspected child abuse is a provincial offence
- charities, not-for-profits, and their directors and officers may be liable where its employees fail to report suspected child abuse and where child abuse occurs as a result of its failure to properly monitor its employees and operations.

j) *Trustee Act* (Ontario)

- power of directors of a federal charitable corporation to make investments is generally derived from its letters patent, however provincial legislation may also mandate the investment power with which a corporation operating in a particular province may invest its assets
- in Ontario, the *Trustee Act* (Ontario) establishes that directors of a charitable corporation have the power and duty to invest the assets of the corporation as a prudent investor would
- this includes power to invest in mutual funds and the power to delegate investment decision making to qualified investment managers, provided that the corresponding statutory requirements are strictly complied with, such as complying with mandatory investment criteria, establishing and complying with an investment plan, and ensuring that a written agency agreement is entered into between the corporation and the qualified investment manager appointed by the board of directors
- for more information, see *Charity Law Bulletin #8* available at www.charitylaw.ca

k) *Charities Accounting Act* (Ontario)

- this Act gives rights to donors and to the PGT that allow directors of charitable corporations to be called to account for improper use of charitable property
- donors can complain about the fundraising practices of a charitable corporation to the court which may then order an investigation by the PGT (section 6)

- penalties may be imposed against a charity and its directors if they fail to abide by specific donor directions (section 4) which could result in court ordering compliance with the directors and imposing either a penalty on the charity or imprisonment of its directors
- recent regulations under the Act also permit charities to commingle donor restricted funds, but this must be done in strict compliance with numerous requirements under the Act, e.g. cannot commingle restricted funds with general funds
- commingling of donor restricted funds in contravention of the regulations under the Act will expose directors to personal liability for breach of trust
- proposed amendments in Bill C-212, the *Good Government Act, 2009*, will expand some of the powers of the PGT

4. Fundraising

- ◆ a charitable corporation and its directors must comply with a number of statutes affecting charitable fundraising
- ◆ failure to comply with these statutory requirements will expose directors to personal liability
- ◆ some of the more important federal and provincial legislation regarding fundraising include:
 - a) Specific Charitable Statutes concerning Fundraising:
 - the *Income Tax Act* (Canada) and proposed new CRA fundraising policy;
 - the *Charities Accounting Act* (Ontario);
 - the *Religious Organizations' Lands Act* (Ontario);
 - the *Charitable Fund-Raising Act* (Alberta);
 - the *Charitable Fund-raising Businesses Act* (Saskatchewan);
 - the *Charities Endorsement Act* (Manitoba); and
 - the *Charities Act* (Prince Edward Island).
 - b) General Statutes Affecting Charitable Fundraising:
 - the *Competition Act* (Canada);
 - the *Privacy Act* (Canada);
 - provincial insurance legislation, such as the *Insurance Act* (Ontario);
 - provincial loan and trust corporation legislation, such as the *Loan and Trust Corporations Act* (Ontario);
 - provincial securities legislation, such as the *Securities Act* (Ontario);
 - provincial trustee legislation, such as the *Trustee Act* (Ontario);
 - the *Business Name Act* (Ontario)

For more information and resource materials on Director Liability and Legal Risk Management see:

www.carters.ca
www.charitylaw.ca
www.churchlaw.ca
www.antiterrorismlaw.ca

ONTARIO COURT AFFIRMS THE FIDUCIARY OBLIGATIONS OWED BY DIRECTORS OF CHARITABLE ORGANIZATIONS

*By Terrance S. Carter**

A. INTRODUCTION

On April 13, 2010, Justice Brown of the Ontario Superior Court of Justice released the most recent decision in the ongoing litigation involving the Ontario Society for the Prevention of Cruelty to Animals (“OSPCA”) and the Toronto Humane Society (“THS”). This decision affirms that directors of charitable organizations have fiduciary duties toward the charity, and also emphasizes that with these enhanced duties comes an enhanced power of the courts to monitor and regulate charities.

In fact, the jurisdiction of the courts to oversee the management of charitable property extends so far as to provide them with the authority to order the destruction of charitable property, as the April 13, 2010 decision illustrates. This *Charity Law Bulletin* discusses the history of the dispute between OSPCA and THS, as related by the Court, and highlights Justice Brown’s observations about the fiduciary duties of directors of charities. The Bulletin concludes with a discussion of what lessons Justice Brown’s decision can teach the management of charities and their legal counsel.

B. HISTORY OF THE LITIGATION BETWEEN THE OSPCA AND THS

The THS is a not-for-profit corporation incorporated in 1887 by way of a Declaration of Incorporation. It operates an animal shelter and veterinary hospital in Toronto, Ontario, and relies largely on charitable

* Terrance S. Carter, B.A., LL.B., Trade-Mark Agent, is the managing partner of Carters Profession Corporation, Orangeville, Ontario, Canada, and counsel to Fasken Martineau DuMoulin LLP. The author would like to thank Jennifer Schwass, Student-at-Law, for assisting in the preparation of this Bulletin.

donations from the public to provide its services. The OSPCA was founded in 1873 and was incorporated by special act, now known as the *Ontario Society for the Prevention of Cruelty to Animals Act* (“*OSPCA Act*”).¹ The OSPCA has the ability to confer affiliate status on animal shelters in Ontario, and regularly conducts visits to its affiliates to provide guidance and assistance to them.² The OSPCA also has the ability to enforce standards of animal care throughout the province.³ THS had affiliate status with the OSPCA until June 2009, when the OSPCA suspended THS’ affiliate status.

The current litigation arose as a result of an investigation by the OSPCA, which was conducted based on allegations in early 2009 against THS by current and former employees and volunteers. On June 2, 2009, the OSPCA conducted an investigation of THS’ facility, and issued two compliance orders under section 13(1) of the *OSPCA Act*. THS appealed the compliance orders to the Animal Care Review Board (“ACRB”), pursuant to section 17(1) of the *OSPCA Act*. After a further inspection of the facility, the OSPCA revoked the two compliance orders. However, THS maintained its appeal to the ACRB.

The ACRB decided that it had the jurisdiction to hear THS’ appeal notwithstanding the fact that the compliance orders had been revoked. The ACRB decided that it could consider, under section 17(6)(b) of the *OSPCA Act*, whether THS was entitled to reimbursement by the OSPCA of any costs it may have incurred in complying with the orders prior to their revocation. The ACRB ordered the OSPCA to pay THS \$231.70 to reimburse it for the amounts it paid to another animal hospital to comply with one of the compliance orders.⁴

After the ACRB hearing, the OSPCA continued to investigate THS. In November of 2009, the OSPCA executed a search warrant on THS. In support of the search warrant, numerous allegations were made about the condition of the animal cages, lack of food supply, inadequate care of animals in the care of THS staff, and insufficient levels of staffing to care for the number of animals in the care of THS. THS applied to the court to quash the search warrant, and requested an order that the OSPCA had no lawful authority to continue to occupy the premises pursuant to the search warrant.

¹ R.S.O. 1990, c. O.36.

² *Ibid.*, s. 11.4.

³ See Justice Brown’s description of THS and OSPCA in *Ontario Society for the Prevention of Cruelty to Animals v. Toronto Humane Society*, 2010 ONSC 608 at paras. 3-10.

⁴ For a more detailed discussion of the ACRB decision, see *ibid.* at paras. 14-18.

The OSPCA launched a court application on December 22, 2009, seeking a wide range of relief under Ontario's *Charities Accounting Act*.⁵ More particularly, the OSPCA sought the following in the court application:

- A declaration that the directors of THS are in breach of the corporation's charitable trust;
- An order directing Ontario's Public Guardian and Trustee ("PGT") to conduct an investigation of the breach and to report to the court and the Attorney General of Ontario;
- The appointment of a receiver and manager of THS until the PGT completes its investigation and report;
- An order permitting the OSPCA to remain in the THS premises until the completion of such investigation;
- An order granting leave to unseal an affidavit which refers to evidence obtained from the execution of the search warrant; and
- Orders under the *Corporations Act* calling for a special general meeting of THS, and related relief.⁶

On January 26, 2010, Justice Brown of the Ontario Superior Court of Justice granted the OSPCA's request for interim relief that permitted the OSPCA to remain in control of the animal care operations of THS facilities. Furthermore, Justice Brown appointed a monitor of the business and financial affairs of THS to provide the court with information about how THS is administering its charitable trust. Justice Brown also set out a schedule for the hearing of the main application on an expedited basis.⁷

Over the next two months, Justice Brown made several interim orders dealing with issues, such as the admissibility of seized materials as evidence. April 5, 2010 was set as the date on which the application would be heard.

On April 1, 2010, the parties appeared before Justice Brown asking for a settlement agreement to be approved by the Court.⁸ The first part of the settlement agreement addressed corporate governance issues,

⁵ R.S.O. 1990, s. C.10.

⁶ *Supra* note 3 at para. 24.

⁷ *Ibid.* at paras. 1-2.

⁸ *Ontario Society for the Prevention of Cruelty to Animals v. Toronto Humane Society*, 2010 ONSC 1953.

requiring that a special general meeting of THS members be held for the purposes of electing a new board of directors under the supervision of an independent Election Supervisor. The remainder of the settlement agreement addresses the allegations made by the OSPCA regarding the performance of THS's charitable objects. Paragraph 12 required THS to report to the PGT, as requested, on any financial matter which might arise prior to the May 30th special meeting. Paragraph 13 provides that as of April 12, 2010, THS will close to the public. By April 12, 2010, THS is to have divested itself of all of its animals, and if there are any remaining animals on April 11, 2010, they must be surrendered to the OSPCA.⁹

The settlement agreement also provided for a transition period from April 12th to May 30th, during which THS would revise and implement policies and protocols regarding various issues, including euthanasia and animal care procedures. As well, during this time THS is to undertake a deep cleaning of the facility, implement a retraining program for its staff, and improve operations through the use of software and other assets.¹⁰ Justice Brown approved the settlement, but reminded THS that it "owes fiduciary duties to the public who support it, and it must operate within a defined regulatory regime. Meeting those obligations must always remain the focus of the decision-makers at the THS."¹¹

However, on April 13, 2010, the THS moved before Justice Brown to vary the settlement order so that "Bandit" the pit bull could remain in its possession.¹² Bandit, a dog with a history of aggression and violence, was originally ordered to be destroyed in 2004. THS then appealed the destruction order, and obtained a stay of the destruction order pending the appeal, but the appeal was never heard.

Justice Brown vehemently dismissed the motion to vary the settlement order to permit THS to keep Bandit, noting that "an appellant has an obligation to pursue an appeal with reasonable diligence" and that "[e]vidently, the THS can move an appeal along quickly when it suits its own purposes."¹³ The Court heard evidence that, contrary to the terms of the destruction order, THS did not keep Bandit under leash and muzzle control when outside its cage, and that Bandit had bitten three people since admission to THS.

⁹ *Ibid.*, Sched. A.

¹⁰ *Ibid.*

¹¹ *Ibid.*, at para. 18.

¹² *Ontario Society for the Prevention of Cruelty to Animals v. Toronto Humane Society*, 2010 ONSC 2182.

¹³ *Ibid.*, at para. 12.

Of importance in this decision is the manner in which the Court addresses the fiduciary obligations of the directors of charitable organizations:

For a charitable organization, such as the THS, to appeal a court destruction order, sit on its hands for years after obtaining a stay, continue to harbor an animal which then proceeds to bite three more people and, to top it off, fails to control the dog on THS premises in the manner mandated by a court order, is nothing less than scandalous.¹⁴

Justice Brown affirms that “[t]he Board of Directors of the THS is responsible for the direction and control of the affairs of that charitable organization”, but that the board has failed to comply with the court-approved settlement agreement.¹⁵ Furthermore, Justice Brown indicated that the board of directors has “dropped the ball big-time on the issue of what to do with Bandit...signal[ing] to me that the Board perhaps has not yet recognized its obligations to the public and under the defined animal care regulatory regime, and that I was premature in giving the Board credit for having done so in paragraph 19 of my April 1 reasons.”¹⁶

Justice Brown concluded his firm stance against THS by commenting that, “If the board of the THS truly intends to turn over a new leaf, then do so. Stop playing games.” The Court ordered that either THS itself must destroy Bandit, or that THS must file a notice of abandonment of its appeal and turn Bandit over to the OSPCA to destroy the dog. Justice Brown gave the THS one day to decide what course of action to take, noting that if Bandit remained in the possession of THS after the deadline, he would reconvene a further hearing on his own motion “pursuant to the court’s broad jurisdiction to supervise charities.”¹⁷ Bandit was euthanized shortly thereafter by THS.

C. IMPACT OF JUSTICE BROWN’S DECISION

Justice Brown’s decision regarding the destruction of the pitbull Bandit should be juxtaposed to the inherent jurisdiction of the courts to supervise the activities of charities. Directors of charities have significant fiduciary duties to which they must adhere, and along with these enhanced fiduciary duties comes the increased common law *parens patriae* powers of the courts to supervise the carrying out of the organization’s charitable objects and to monitor the use of the organization’s charitable property. As Justice Brown noted in his January 22, 2010 decision, the court has a “broad, historic jurisdiction to supervise the

¹⁴ *Ibid.*, at para. 14.

¹⁵ *Ibid.*, at para. 20.

¹⁶ *Ibid.*, at para. 23.

¹⁷ *Ibid.*, at paras. 24-25.

activities of a charitable corporation to ensure that they accord with its charitable purpose and to intervene if the charity is not administered in accordance with its purpose or if charitable funds are misapplied.”¹⁸

While the recent decisions of Justice Brown do not include any ground-breaking pronouncements regarding fiduciary duties, they serve to reaffirm previous case law which addressed the role of the courts with regards to charities:

It is in this sense that the court in its inherent jurisdiction and within the framework of the *Charities Accounting Act* has required a charitable corporation to act in accordance with its charitable purposes and to intervene if charitable funds are misapplied... There is an implicit acknowledgement that the fiduciary owes a duty to the public in general which supports the privileges extended to charitable corporations and to the public in particular which turns over its money to the charitable corporation for the charitable purposes it wishes to support.¹⁹

In fact, Justice Brown references the earlier decision of *Ontario (Public Trustee) v. Toronto Humane Society*,²⁰ which also involved the THS. Justice Brown quotes this 1987 decision to support the principle that directors are impressed with fiduciary obligations to carry out the trust created for a charitable purpose:

Without going the length of holding that the Society is in all respects and for all purposes a trustee, I have concluded that it is answerable in certain respects for its activities and the disposition of its property as though it were a trustee; specifically I am satisfied that it is amenable to the ancient supervisory equitable jurisdiction of the court ... Whether one calls them trustees in the pure sense (and it would be a blessing if for a moment one could get away from the problems of terminology), the directors are undoubtedly under a fiduciary obligation to the Society and the Society is dealing with funds solicited or otherwise obtained from the public for charitable purposes.²¹

The fiduciary duties imposed on directors and officers of charities involve the requirement that they act with a reasonable degree of prudence, are diligent, act in good faith and with honesty and loyalty, and avoid conflicts of interest.

¹⁸ *Supra* note 3 at para. 39.

¹⁹ *Ontario (Public Guardian & Trustee) v. AIDS Society for Children (Ontario)*, [2001] O.J. No. 2170 (S.C.J.), at para. 26. For a discussion of the *AIDS Society for Children* case, see Terrance S. Carter and Jacqueline M. Connor, “Fiduciary Relationships in Fundraising: The Impact of the *AIDS Society for Children* Decision” in *Charity Law Bulletin* No. 9 (September 29, 2001), online: <http://www.carters.ca/pub/bulletin/charity/2001/chylb09.htm>.

²⁰ (1987), 60 O.R. (2d) 236 (H.C.J.).

²¹ *Ibid.*

What is interesting about Justice Brown's decision is that it emphasizes the immense power of the courts to ensure charitable purposes are being carried out by the organization. In fact, courts have the power to direct the management and control of charitable property, as they must ensure that charitable property is being dealt with properly. For example, Justice Brown warned THS that if Bandit remained in THS's possession after the deadline, he reserved the right to call the parties back to court to deal with the issue, based on the court's inherent jurisdiction to supervise charities. As this decision demonstrates, the power of the court to ensure charitable objects are being met can go so far as giving courts the authority to order the destruction of charitable property (i.e. Bandit) and to bring the matter back before the Court on the judge's own initiative if the order is not followed. While this is not a new power, the decision should serve to remind boards of directors of charities of the high fiduciary obligations placed upon them.

D. CONCLUSION

The OSPCA and THS litigation emphasizes that fiduciary obligations continue to be a very relevant and important consideration when addressing governance and management issues for charities. Directors have a continuing obligation to apply charitable property to the charitable objects, with the distinct possibility of court interference if they do not do so. This decision is an example of the court exercising its supervisory role in relation to the proper management of charitable property.

This litigation should also remind directors and officers of charities that where mismanagement of charitable property occurs, directors and officers can be held personally liable for breach of trust. It is therefore essential that charities, their boards of directors, and their legal counsel be fully aware of the extent of the fiduciary obligations placed upon the management of charities, and also of the negative consequences that could ensue from a breach of those fiduciary duties.

NO ENTITLEMENT TO DIRECTOR INDEMNIFICATION FOR BAD FAITH ACTS

*By Nancy E. Claridge**

A. INTRODUCTION

The question of whether a corporation has the legal and financial capacity to provide its directors with an indemnity in relation to their duties for the corporation is a fundamental issue one should consider before accepting a position on the board of directors. While this is true whether it is a for-profit corporation or a not-for-profit/charitable corporation, the issue has special resonance for those acting in a volunteer capacity on the boards of charities, since there is a common law prohibition on remuneration of a charity's directors. Indemnification is the process by which the corporation agrees to cover the cost of, or compensate the director for, any loss or damage sustained as a result of the acts or omissions of the director in the course of his capacity as a director of the organization. The indemnity provides a measure of protection for the director and thereby enables charities to attract capable individuals to the position.

In a recent decision, the Ontario Superior Court of Justice has provided some necessary guidance on the issue of the availability of indemnification for directors of charities or not-for-profit organizations who incur costs in relation to their acts or omissions as directors of the charity. While not creating new law, the decision in *Deol v. Grewal*, [2009] O.J. No. 3217, 2009 CarswellOnt 4521 (Sup. C.J.) (the "Deol Decision") confirms that the principles established in for-profit corporations are applicable to not-for-profit entities. This *Charity Law Bulletin* reviews the highlights of the decision.

* Nancy E. Claridge, B.A., M.A., LL.B., is an Associate with Carters Professional Corporation practicing corporate and commercial, charity and not-for-profit and anti-terrorism law, as well as wills and estates, with the Orangeville office.

B. BACKGROUND ON CHARITIES PROVIDING AN INDEMNITY

In order for a charity to provide an indemnity to its directors, such power must be included in the organization's by-laws. Many corporate statutes, such as the *Corporations Act* (Ontario), R.S.O. 1990, c. C.38, permits a corporation to indemnify a director for all "costs, charges and expenses" arising from an action in relation to the director's execution of the duties of his office:

Director indemnified in suits respecting execution of office

80. Every director and officer of a company, and his or her heirs, executors and administrators, and estate and effects, respectively, may, with the consent of the company, given at any meeting of the shareholders, from time to time and at all times, be indemnified and saved harmless out of the funds of the company, from and against,

(a) all costs, charges and expenses whatsoever that he, she or it sustains or incurs in or about any action, suit or proceeding that is brought, commenced or prosecuted against him, her or it, for or in respect of any act, deed, matter or thing whatsoever, made, done or permitted by him, her or it, in or about the execution of the duties of his, her or its office; and

(b) all other costs, charges and expenses that he, she or it sustains or incurs in or about or in relation to the affairs thereof, except such costs, charges or expenses as are occasioned by his, her or its own wilful neglect or default.

Section 133 of the *Corporations Act* (Ontario) permits a non-share charitable corporation to indemnify its officers and directors. Ontario Regulation 4/01, under the *Charities Accounting Act* (Ontario), R.S.O. 1990, c. C.10, goes further to specifically restrict the indemnification of directors for liability that relates to their failure to act honestly and in good faith in performing their duties. However, prior to a charity consenting to the indemnification of its directors, Ontario Regulation 4/01 requires that the board of directors consider the following five factors:

1. The degree of risk to which the executor, trustee, director or officer is or may be exposed.
2. Whether, in practice, the risk cannot be eliminated or significantly reduced by means other than the indemnity or insurance.
3. Whether the amount or cost of the insurance is reasonable in relation to the risk.
4. Whether the cost of the insurance is reasonable in relation to the revenue available to the executor or trustee.

5. Whether it advances the administration and management of the property to give the indemnity or purchase the insurance.

The Regulation also permits the purchase of insurance as an alternative to the indemnity. However, the purchase of the insurance cannot impair the charitable purpose of the organization, and the insurance or indemnity cannot result in rendering the corporation insolvent.

C. THE DEOL DECISION

The Deol Decision is a costs decision relating to a five-day trial involving a dispute over control of the governance of the Sikh Spiritual Centre Toronto (the “Sikh Centre”), and who were the proper members and directors of the Sikh Centre. The main action was commenced following a series of meetings of the board of directors and the members which resulted in the defendants taking control of the Sikh Centre from the plaintiffs.

In addition to seeking an order setting aside the improper resolutions passed at the invalidly constituted meetings, and setting aside the election of members at these meetings, the plaintiffs sought an order requiring the defendants to repay the \$51,000.00 of the Sikh Centre’s funds paid to the defendant’s solicitors with respect to the matters in issue in the action.

In ruling in favour of the plaintiffs on the main action, the court found, amongst other things, that the defendants had fabricated a meeting and altered the minutes of another, and breached an order of the court by paying the \$51,000.00 to their legal counsel.

In their costs submission, the plaintiffs sought costs on a substantial indemnity basis in the amount of over \$400,000 to be paid by the individual defendants without the benefit of indemnification by the Sikh Centre. The defendants, on the other hand, submitted that no costs should be awarded, but if they were that they should only be on a partial indemnity basis of no more than \$115,000.00. The defendants also submitted that they should be indemnified by the Sikh Centre pursuant to an indemnity provision contained in the Sikh Centre’s By-law No. 1 (which mirrored section 80 of the *Corporations Act* (Ontario)), as well as sections 80 and 133 of the *Corporations Act* (Ontario).

In this regard, the defendants submitted that they were entitled to the indemnity because their acts during the meetings at issue were undertaken to administer and manage the Sikh Centre, in accordance with their duties as officers and directors. They also submitted that such actions were carried out with a view to the best interests of the corporation and not for personal gain. However, the plaintiffs submitted that the defendants were not entitled to be indemnified because their impugned acts as directors were not properly undertaken in the administration of the Sikh Centre and were not undertaken with an honest and reasonable view as to their validity.

The court noted that the legislative rationale for permitting indemnification was twofold: firstly, to provide assurance to corporate directors that they will be reimbursed for any adverse consequences arising from “well-intentioned entrepreneurship” undertaken on the corporation’s behalf; and, secondly, to encourage appropriate director conduct by prohibiting indemnification for director misconduct. If the directors were to be indemnified, their conduct would have to fall within the provisions of the By-law. Specifically, the defendants’ acts would have to be shown to be “in respect of any act, deed, matter or thing whatsoever, made, done or permitted by him, her or it, in or about the execution of the duties of his, her or its office.” Both parties agreed that the applicable test to be applied in determining whether a director or officer is entitled to indemnification in this regard is contained in the decision of *Ontario (Public Guardian and Trustee) v. Unity Church of Truth*, [1998] O.J. No. 1291 (Gen. Div) (the “Unity Decision”). In the Unity Decision, the court, in an *obiter* comment, adopted the position of the Ontario Public Guardian and Trustee (“PGT”) which provided that “a director of a charity ought to be indemnified from personal liability only for those acts properly undertaken in the administration of the charity or undertaken in breach of trust but under an honest and reasonable mistake.” In this regard, the PGT indicated it would object if a charity paid legal fees to cover a director from personal liability for acts which he knew to be wrong. The court in the Deol Decision agreed with this position, stating that “such a test, in my view, permits indemnification based on reasonable good faith behaviour. Bad faith on the part of a director or officer will not entitle him or her to indemnification.”

On the issue as to the scale of costs, the court held that notwithstanding the impugned conduct of the defendants, the conduct did not constitute reprehensible, scandalous or outrageous conduct sufficient to impose substantial indemnity costs. However, the impugned conduct was held by the court to be a breach of the directors’ duties. That breach, coupled with the findings that the defendants disregarded the provisions of

the *Corporations Act* (Ontario) and the By-Law in not providing proper notice to the plaintiff directors of special meetings; the removal and appointment of directors; and electing new members, led the court to the conclusion that the defendants were not acting in the best interests of the Sikh Centre. Instead, it was the view of the court that the defendants were acting in pursuit of their own interests to gain control of the Sikh Centre in circumstances where they knew that if they proceeded in accordance with the By-law and the Act, they would not be in control. Although there were no allegations of misuse of corporate funds or misappropriation of property, the court further held that the impugned conduct constituted *mala fides*, disentitling the defendants to indemnification.

Finally, although some defendants submitted that they should not be personally liable for costs as they had virtually no connection to the factual issues in dispute, the court concluded that they would be jointly and severally liable since there was no evidence that any of the defendants took issue with the improper actions of the board.

The plaintiffs were awarded costs on a partial indemnity basis, fixed at \$186,000.00 inclusive of disbursements and costs. The defendants were not entitled to an indemnity for the costs awarded or for their own legal costs incurred.

D. CONCLUDING COMMENTS

With regard to the issue of whether a charity is financially able to effectively provide an indemnity to its board of directors, the Deol Decision makes it clear that the directors must always give careful consideration to their actions, as their actions may disqualify them from indemnification. This is not new law and is a standard position for both for-profit and not-for-profit corporations, including charitable corporations. In this regard, the Supreme Court of Canada laid out three pre-conditions to a director receiving an indemnity from a corporation: (1) the person must have been made a party to the litigation by reasons of being a director or officer of the corporation; (2) the costs must have been reasonably incurred; and (3) the person must have acted honestly and in good faith with a view to promoting the best interests of the corporation.

The Deol Decision emphasizes the need for effective risk management by directors of corporations. This includes exercising effect due diligence in the operation and control of the corporation, as well as establishing and following policy statements and procedures. Effective due diligence includes having a good

knowledge of the governing documents of the charity, ensuring *ultra vires* acts are not authorized by the board of directors, ensuring effective management access and control over the affairs of the corporation, protection of the charity's assets, and developing and enforcing policies and procedures for staff, volunteers and board members. When in doubt as to the appropriate course of action, the board and/or individual directors should seek advice from their legal counsel.