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**SOCIAL PLANNING COUNCIL OF PEEL**

**DIRECTORS' AND OFFICERS' LIABILITY:  
THE ESSENTIALS AND BEYOND  
FOR CHARITIES AND NOT-FOR-PROFITS**

**Peel – April 20, 2010**

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

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- Letters patent and supplementary letters patent
- By-laws
- Special resolutions
- By-law and operational 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 for new board members and update it on a regular basis

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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 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

Executive

Members

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Third Party Claims →

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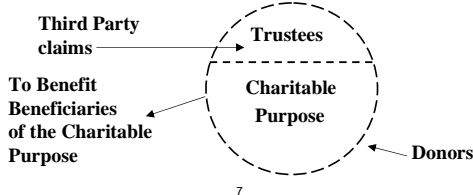
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- **Charities as Charitable Trusts**
  - A trust is a relationship between trustees and beneficiaries involving the separation of legal and beneficial ownership of property
  - Available for charitable organizations, public foundations and private foundations
  - Trustees are exposed to liability



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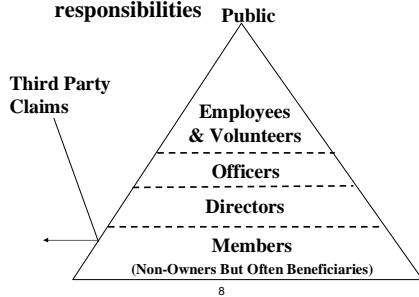
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- **Charities and Not-for-Profits as Corporations**
  - Separate legal entities
  - Members are not exposed to liability
  - Directors may be still exposed to personal liability from fiduciary and management responsibilities



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- **Using a multiple charitable corporate 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

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- 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

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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 structures reduce 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

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- 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?

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**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

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

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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 or not-for-profit organization
  - 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 or not-for-profit organization
  - Directors must be proactive in management and not be limited to setting policy only
- **Proactive protection of assets**
  - Directors have a fiduciary duty to protect property

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- Need to invest in accordance with prudent investment standard under the *Trustee Act* (Ontario) where charitable or a not-for-profit organization holds funds for a charitable purpose
- Need to take an inventory of assets
  - Review annual financial statements
  - Review bank statement and records
  - Review past and current restricted funds
  - Review property deeds, if 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 compared to acceptable new ratio in new CRA Fundraising Guidance (CPS-028)

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- Due diligence enquiries to determine correct amount of “eligible gift” in receipt by determining the FMV of a gift and the amount of advantage received by the donor
- Ensure gifts are used for charitable purposes
- Review and enforce terms of restricted and endowed gifts
- Notice/attendance at meetings/minutes
  - Right to notice of board meetings
  - Right to attend board meetings

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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 Pursuing Due Diligence**
- Establishing and following policy statements and procedures
    - Develop and implement 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 or not-for-profit organization

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- **Screening procedures**
  - An appropriate screening process is an important protection against increase in abuse claims
  - Screening involves utilizing appropriate questions, interviews, references 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 or not-for-profit organization’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
  - Sexual abuse checklist
  - Child protection checklist
  - Fundraising compliance due diligence checklist
  - Anti-terrorism due diligence checklist
  - Insurance/risk management checklist
  - Crisis management checklist (see slide 25)

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- **Utilizing outside professionals**
  - Relying on professional advisors like accountants and lawyers provides evidence of due diligence and reduces exposure to liability
- **Delegation of investment decision making to investment manager requires agency agreement and investment policy under *Trustee Act* (Ontario)**

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**3. Crisis Management**

- The charity or not-for-profit organization should consider having a diverse committee or group that can develop a crisis management plan to cover a full range of potential crises such as:
  - Death or injury of a key individual
  - Loss of access to the use of facilities and equipment
  - Disrupted or significantly diminished operations
  - Loss of crucial information
  - Intense media scrutiny

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**F. DUE DILIGENCE IN INDEMNIFICATION, INSURANCE AND LIABILITY SHIELDS**

**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?

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- What is the cost of insurance in relation to revenue?
- Does indemnity or insurance further the management of 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 or not-for-profit organization and their insurance
- 3. Insurance Considerations
- Insurance policies may 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, employment benefits and practices liability, etc.
  - Wrongful dismissal coverage

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- Additional factors to consider
  - How much coverage does the policy provide for?
  - Who are the named insureds?
  - Does insurance cover all former and existing 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 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 or not-for-profit organization 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 or not-for-profit organization?

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**4. Liability Shields**

- **Charities and not-for-profit organizations should also consider developing and administering effective liability shields, such as the following , as necessary, for program participants:**
  - Informed consents
  - Disclaimers
  - Releases
  - Waivers and indemnities

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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 utilize legal risk management checklist

**2. Independent Legal Advice**

- Independent legal advice needed for directors in high risk situations
- Directors may need to seek independent legal advice before resigning from the board of directors

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**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
- But board of directors must always remain in control

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**5. Transfer of Assets**

- Directors will always be somewhat exposed to liability risks
- Therefore directors may want to consider transferring personal assets to spouse
- However any transfer of assets should be done before becoming a director so as not to defeat claims of creditors
- Independent legal advice for both spouses is recommended

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