HALTON LAW SERIES

HALTON REGION & COMMUNITY PARTNERS PRESENT…

"Leadership Matters: Building Your Legal Know How"

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

Burlington – June 23, 2010

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

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

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A. OVERVIEW OF TOPICS

- Due diligence through good governance
- Due diligence in the choice of organizational structures
- Due diligence in relying upon statutory protection
- Due diligence in operations
- Due diligence in indemnification and insurance
- Other means of due diligence in reducing risk

Note: For a more detailed discussion, see attached Summary "B" entitled "Due Diligence in Avoiding Risks for Directors of Charities and Not-for-Profits". See also Chapter 6 Risk Protection by Terrance S. Carter in "Primer for Directors of Not-for-Profit Corporations" at http://www.carters.ca/pub/book/2002/dirprimch6.pdf

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B. DUE DILIGENCE THROUGH GOOD GOVERNANCE

- Developing a mission and strategic plan
  - Ensure that the mission statement is consistent with corporate objects
  - Do periodic reviews of both
- Ensure transparency and communication
  - Communicate to members, donors and the public
  - Focus on ensuring accountability
- Maintain organizational structure
  - Be knowledgeable of corporate structure

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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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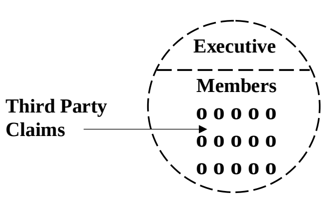
C. DUE DILIGENCE IN THE CHOICE OF ORGANIZATIONAL STRUCTURE

- 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



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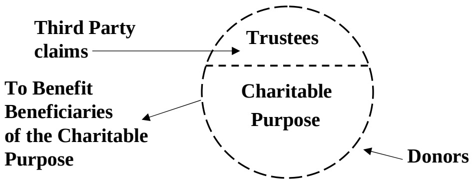
- **Charities as Charitable Trusts**
  - **A trust is a relationship between trustees and beneficiaries involving the separation of legal and beneficial ownership of property**
  - **Available for charitable organizations, public foundations and private foundations**
  - **Trustees are exposed to liability**



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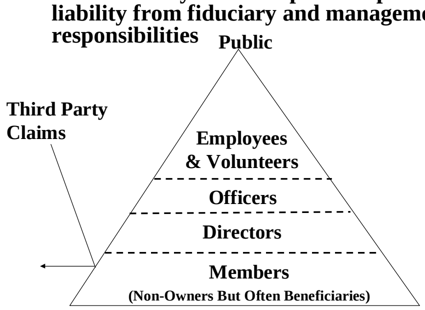
- **Charities and Not-for-Profits as Corporations**
  - **Separate legal entities**
  - **Members are not exposed to liability**
  - **Directors may be still exposed to personal liability from fiduciary and management responsibilities**



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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 and violence, 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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