
ORANGEVILLE OPTIMISTS CLUB

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

Orangeville – December 1, 2010

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

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|  | ORANGEVILLE OPTIMISTS CLUB Orangeville – December 1, 2010 |
| Directors' and Officers' Liability: The Essentials And Beyond Part I - The Legal Duties of Directors and Officers of Charities and Not-for-Profits | |
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| 2 |
| A. OVERVIEW OF TOPICS |
| <ul style="list-style-type: none">• Definition of Directors and Officers• Different Types of Organizations• Common Law Duties and Liabilities• Statutory Duties and Liabilities |
| Note: For a more detailed discussion, see attached Summary "A" entitled "The Legal Duties of Directors of Charities and Not-for-Profits" |
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| 3 |
| B. DEFINITION OF DIRECTORS AND OFFICERS |
| <ul style="list-style-type: none">• For this presentation, reference to a corporation also includes an unincorporated association• A director is generally anyone who takes on the role of the directing mind of a corporation• A director can be known as a governor, a board member, or a trustee as a member of the board of management• The name given to a director is not what is important, rather it is the authority that the person exercises that will determine whether that person is a director |
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4

- A director has a fiduciary obligation to put the interest of the corporation ahead of his or her own interest
- An officer carries out the day to day functions of the corporation at the direction of the board
- An officer also has a fiduciary obligation to the corporation
- An officer can also be a director or can be found to have 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

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5

C. DIFFERENT TYPES OF CORPORATIONS

- Share Capital Corporations
(business purpose to make a profit)

Public

Employees

Officers

Directors

Shareholders
(Owners)

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6

- Not-for-Profit Organizations
(non profit purpose but not charitable)

Public

Employees
& Volunteers

Officers

Directors

Members
(non-owners but often beneficiaries)

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7

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

Public

Employees & Volunteers

Officers

Directors

Members
(non-owners but accountability group for the charitable purpose)

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8

- Directors of not-for-profits 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-profits and charitable corporations may also be found liable at common law for their actions and inactions

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9

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 fit within the objects
 - Corporation's financial stability and overall performance
 - Proper hiring, training, and supervision of management, staff and volunteers

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10

- Failure to act, i.e. inaction, can result in personal exposure to liability, i.e. liability of WorldCom and Enron directors
- 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)

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11

- 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

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12

- Not-for-profit organization (non-charity)
 - Common law subjective standard of care (although this will change to an objective standard under both the new *Canada Not-for-Profit Corporations Act* and the new *Ontario Not-for-profit Corporations Act*)
 - This means the director's own knowledge and experience are important
- Charitable corporation
 - Additional expectations beyond subjective standard
 - Directors of charities are also subject to high order fiduciary obligations similar to trustees with regard to charitable property

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13

- 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

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14

- 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

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15

- Liability Risk for Breach of Fiduciary Duty
 - Overview
 - Directors of not-for-profit organizations have a fiduciary duty to put the interest of the organization ahead of their own interest
 - In comparison, directors of charitable corporations are subject to a higher fiduciary duty with obligations similar to trustees with regard to charitable property
 - Fiduciary duties are owed to the general public, charitable objects, corporations, donors, members and creditors

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16

- Summary of fiduciary duties
 - Duty to act honestly
 - Directors must deal honestly with the corporation
 - 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

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17

- 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
 - 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
 - Where necessary, advice of qualified professionals should be sought

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18

- Duty to exercise power
 - Directors responsible for managing corporation
 - In order to justify accounts and decisions made regarding corporate assets, directors must properly maintain books, records and minutes of the corporation
 - Delegation to management, staff and volunteers is possible, but directors must always supervise

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19

- Duty of obedience
 - Directors must comply with applicable legislation and the corporation's governing documents (articles, by-laws, etc.)
 - 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

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20

- Duty of confidence
 - Directors must not disclose confidential information that they acquire to outside parties
- Duty to avoid conflict of interest
 - Directors must declare and avoid any conflicts of interest or anything that gives a director the appearance of a personal benefit
 - Where a conflict of interest arises, it must be declared, and the director must not participate in any discussion or vote and, depending on the circumstances, the director may have to resign

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21

- If this procedure is not followed, directors may be made to account for any profits that they have made
- Continuation of Duties
 - Directors have continuing obligations to the corporation which cannot be relieved by resignation
 - Resignation to avoid personal liability may be ineffective and constitute a breach of fiduciary duty where the director put own interests ahead of those of the corporation
 - Independent legal advice should be obtained in considering resignation from the board

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- Liability for Breach of Trust
 - Overview
 - In addition to higher fiduciary duties, directors of charitable corporations may also be trustees of specific charitable property
 - However, fiduciary duties and trustee duties in relation to charitable property have general similarities
 - The *Aids Society* case emphasizes that directors have fiduciary obligation to apply charitable property to charitable objects

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23

- Where charitable property is wasted 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

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24

- 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

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25

- 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

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26

- 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-profits 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)

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27

E. STATUTORY DUTIES AND LIABILITIES

- Overview
 - Many federal and provincial statutes impose offences and penalties for acts and omissions of corporate directors
 - Generally strict liability 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

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28

- 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

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29

- 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 of not more than a year for doing anything contrary to the legislation or failing to comply where specific penalty not prescribed

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30

- *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, e.g. 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)

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31

- 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/HST
 - 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

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32

- *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

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33

- 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

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34

- 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

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35

- *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

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36

- 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)

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37

- *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

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38

- *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

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39

- *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
 - Appropriate environmental audits need to be obtained before purchasing or receiving land

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40

- *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 organizations 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

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41

- *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 & #192 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 charitable property as well as fundraising practices

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42

- Commingling of donor restricted funds is permitted provided there is strict compliance with the act's requirements
- 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 organizations

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43

- Fundraising
 - Specific charitable statutes concerning fundraising:
 - *Income Tax Act* (Canada), including the new CRA Fundraising Guidance
 - *Charities Accounting Act* (Ontario)
 - *Charitable Fund-Raising Act* (Alberta)
 - *Charitable Fund-raising Businesses Act* (Saskatchewan)
 - *Charities Endorsement Act* (Manitoba)
 - *Charities Act* (Prince Edward Island)
 - Proposed ULCC *Uniform Charitable Fundraising Act* (see Charity Law Bulletin #79)

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44

- 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 Names Act* (Ontario)

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