
ORANGEVILLE OPTIMISTS CLUB

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

Orangeville – December 1, 2010

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

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

tcarter@carters.ca


1-877-942-0001

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Ottawa · Toronto
Mississauga · Orangeville
Toll Free: 1-877-942-0001

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|  | ORANGEVILLE OPTIMISTS CLUB Orangeville – December 1, 2010 |
| Directors' and Officers' Liability: The Essentials And Beyond Part II - Due Diligence in Avoiding Risks for Directors and Officers of Charities and Not-for-Profits | |
| By Terrance S. Carter, B.A., LL.B., Trade-mark Agent tcarter@carters.ca © 2010 Carters Professional Corporation | |
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| A. OVERVIEW OF TOPICS <ul style="list-style-type: none">• 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 <p>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</p> <p style="text-align: right;"><small>www.carters.ca</small></p> |

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| B. DUE DILIGENCE THROUGH GOOD GOVERNANCE <ul style="list-style-type: none">• Developing a mission and strategic plan<ul style="list-style-type: none">– Ensure that the mission statement is consistent with corporate objects– Do periodic reviews of both• Ensure transparency and communication<ul style="list-style-type: none">– Communicate to members, donors and the public– Focus on ensuring accountability• Maintain organizational structure<ul style="list-style-type: none">– Be knowledgeable of corporate structure <p style="text-align: right;"><small>www.carters.ca</small></p> |

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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

Third Party Claims →

Executive

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

The diagram shows a dashed circle labeled "Charitable Purpose". Inside the circle, the word "Trustees" is written at the top. Below "Trustees" is "Charitable Purpose". To the right of the circle, an arrow labeled "Donors" points into the circle. To the left of the circle, an arrow labeled "To Benefit Beneficiaries of the Charitable Purpose" points out of the circle. Above the circle, an arrow labeled "Third Party claims" points towards the circle.

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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

The diagram is a pyramid divided into five horizontal sections. From top to bottom, the sections are: "Public", "Employees & Volunteers", "Officers", "Directors", and "Members (Non-Owners But Often Beneficiaries)". To the left of the pyramid, an arrow labeled "Third Party Claims" points towards the "Directors" section.

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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 (Ontario) *Corporations Act (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"?
 - Is there a historical record of insurance policies?

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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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