
THE OTTAWA REGION
Charity & Not-for-Profit Law Seminar

Ottawa – February 2, 2012

**Director and Officer Liability Issues
for Charities and Not-for-Profits**

By Ryan M. Prendergast, B.A., LL.B.


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A. INTRODUCTION

- The 2007 National Survey of Giving, Volunteering and Participating by Statistics Canada reported that a third of all Canadian volunteers hold positions on boards and committees
- Religious organizations received the largest percentage of volunteer hours (18%) in 2007
- Specifically, when volunteers were asked to report what they did for the organization to which they contributed the most hours sitting on committees or boards constituted 9% of volunteers time

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B. OVERVIEW OF TOPICS

- Definition of Directors and Officers
- Common Law Duties of Directors and Officers
- Common Law Liabilities of Directors and Officers
- Statutory Duties and Liabilities of Directors and Officers

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C. DEFINITION OF DIRECTORS AND OFFICERS

- 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 or church board
- 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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- 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

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- Directors of religious organizations and other charities may be found liable for their actions under more than 200 statutes or regulations (in Ontario and federally).
- For organizations operating across Canada applicable legal requirements in other provinces would also apply
- Directors of religious organizations or other charities may also be found liable at common law for their actions and inactions

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C. COMMON LAW DUTIES

- 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:
 - Purposes are properly carried out and activities fit within those purposes
 - Corporation's financial stability and overall performance
 - Proper hiring, training, and supervision of management, staff and volunteers

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- Failure to act, i.e. inaction, can result in personal exposure to liability
- 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 misapplied
 - ex. The Toronto Human Society decision (2010) where the court ordered the destruction of charitable property (a dangerous dog)

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- Duty of Care
 - Directors of for-profit corporations are held to an objective standard of care under the *Canada Business Corporations Act* ("CBCA") and the *Ontario Business Corporations Act* ("OBCA")
 - A statutory standard of care is not provided for religious organizations and other charities incorporated under either the *Ontario Corporations Act* or *Canada Corporations Act*

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- Therefore, at present the duty of care remains the common law subjective standard, i.e., they “need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience
- In contrast, *Canada Not-for-Profit Corporations Act* (“CNCA”) and *Ontario Not-for-Profit Corporations Act* (“ONCA”) will mirror the objective standard provided for under the CBCA and OBCA

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- As such, like most business corporate statutes, the CNCA and ONCA set out this objective standard as the duty to exercise the “care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances”
 - Known as the “Business Judgment Rule”, the rule protects directors and senior officers against hindsight and second guessing by creditors and other stakeholders
 - i.e. The court will defer to the expertise of the directors and will not interfere with reasonable business decisions

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- Directors therefore will need to ask themselves in fulfilling an objective standard of care:
 - Have they analyzed and understood the issue before them?
 - Have they retained independent advisors or advisors recommended by management and do the advisors have the requisite expertise and experience?
 - Have they tested and challenged their advisors, or merely followed recommendations without question?

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- Is the amount of time that they have spent on the issue proportionate to its importance and complexity?
- Have they debated the issue amongst themselves and engaged in a candid exchange of views?
- Were they actually present at the applicable board meeting?
- Were the discussions and decision properly documented, for example, in minutes or resolutions of the board?

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- Directors and officers have a fiduciary duty to put the best interests of the corporation ahead of their own
- Fiduciary duties that generally apply to religious organizations and other charities are as follows:
 - Duty to Act in Good Faith, Honestly, 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
 - Duty of Diligence
 - Directors to diligently attend to duties by being familiar with all aspects of corporation

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- Duty to exercise power
 - 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
- Duty of obedience
 - Directors must comply with applicable legislation and the corporation's governing documents
 - All valid corporate decisions must be implemented

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- 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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- If this procedure is not followed, directors may be made to account for profits they have made
- CNCA expands the provisions concerning conflict of interest to apply to address transactions the corporation enters into on a more general basis as opposed to being limited to contracts
- Duty to Continue
 - 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

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- High fiduciary obligations with respect to charitable property
 - In addition, when religious organizations and other charities are responsible for charitable property, they have high fiduciary obligations to that charitable property
 - In Ontario, the *Charities Accounting Act* ("CAA") deems a charitable corporation to be a trustee
 - The courts in Ontario have held that directors of charitable corporations are subject to high order fiduciary obligations similar to those of trustees

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- The following duties relate specifically to the high fiduciary duties where charitable property is involved
- Duty to Carry out the Charitable Purpose
 - Directors have a positive duty to further the charitable purposes of the corporation
 - The charity's resources must be used to carry out the purposes of the charity

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- Duty to Protect and Conserve Charitable Property
 - Directors must protect charitable property
 - Restricted charitable purpose trusts are no longer recognized as separate trusts distinct from the general assets of the charity for exigibility purposes
 - Therefore, it is important for directors to consider what steps can be taken to assist in protecting restricted charitable purpose trusts

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- Duty to Act Gratuitously for the Charity
 - Directors in Ontario cannot receive any remuneration, either directly or indirectly, from the charity
 - Can seek approval for remuneration from the court under section 13 of the CAA for payment for services other than as a director but difficult to attain
 - Directors and officers insurance, as well as indemnification, is available provided that the CAA and incorporating statute are complied with

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- Duty to Account
 - Directors of charities must keep records to evidence that the charitable property has been properly managed
 - The Ontario Public Guardian and Trustee ("OPGT") can compel the directors of a charity to pass the accounts of the organization before the court
 - This can be a long and expensive process

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D. COMMON LAW LIABILITIES

- Liability for Breach of Fiduciary Duty
 - Examples of breach of fiduciary duty can include mismanagement of corporate funds and property, or the misappropriation of corporate opportunity
 - Directors and officers are liable for any loss that the corporation suffers as a result of a breach of fiduciary duty

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- Liability for Breach of Corporate Authority
 - Directors may be found personally liable for *ultra vires* actions if corporation acts beyond the scope of the authority set out in the corporation's objects
 - The issue of acting *ultra vires* will no longer be a concern once the ONCA and CNCA come into force
- Liability Risk for Negligent Mismanagement (Tort)
 - Tort is civil wrong for which injured party can seek damages from the court

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– If their carelessness in the oversight of the corporation's operations leads to injury, directors of religious organizations and other charities can be found liable in tort for negligent mismanagement for:

- Failing to adequately supervise hiring of staff and employees
- Failing to implement a child protection policy

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- Failing to monitor the on-going conduct of staff and employees, especially in regard to sexual 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
- Knowingly drawing cheques against insufficient funds
- Failing to prevent depletion of the corporate assets

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- Liability Risk in Contract
 - Directors generally not personally responsible for contracts signed for the 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
 - To reduce liability exposure, directors should ensure contracts are duly authorized by the board before entering into them

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- Common problems in relation to breach of contract for directors:
 - The directors 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
 - The directors are found to have induced a breach of contract prior to the signing of the contract
 - The directors do not follow through to ensure that the corporation complies with a contract

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- Liability for Special Purpose Charitable Trusts
 - Case law has confirmed that a charitable corporation owns its general assets beneficially and not as trustee for those assets, a corporation can still receive charitable property under express or implied terms in trust and thereby be trustee of such funds
 - To the extent that a gift constitutes a special purpose charitable trust the charity can only use the gift to accomplish the specific charitable purpose established by the donor and for no other purpose

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- Liability for Imprudent Investments
 - Section 10.1 of the CAA confirms that sections 27 to 30 of the *Trustee Act* apply to all charities that deal with charitable property unless the constating documents of the charity or the gift agreement state otherwise
 - The *Trustee Act* establishes a prudent investment standard governing investment decision-making of trustees of charitable property
 - The board needs to have a investment policy in order to obtain protection under the *Trustee Act*

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F. STATUTORY DUTIES AND LIABILITIES

- Overview
 - Many federal and provincial statutes impose offences and penalties for acts and omissions of corporate directors
 - Directors can be held personally liable, as well as jointly and severally, with other directors for breach of statutory duties
 - Ignorance of law is not an excuse
 - Resigning as a director may not limit liability, though there are generally limitation periods that apply

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- Offences are generally 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 legislation in question could have been complied with

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- Penalties for non-compliance with statutory requirements can result in directors being subject to fines, repayment of debt and even imprisonment
- While the focus of this summary is the federal and Ontario jurisdictions, religious organizations and other charities either located or operating in other provinces must also review the comparable provincial legislation and statutory obligations
- The following are a few select federal and provincial statutes for directors and officers to be aware of from a liability perspective

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- Federal Statutes
 - *Income Tax Act* (Canada)
 - Directors jointly and severally liable to pay employee income tax deductions for claims brought within two years after end of term of office
 - Directors may be personally liable if charity fails to comply with numerous reporting requirements
 - 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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- *Excise Tax Act* (Canada)
 - Directors jointly and severally liable for corporation's failure to collect & remit HST
- *Canada Pension Plan*
 - Joint and several liability where corporation fails to remit employee pension premiums
- *Criminal Code*
 - Bill C-45 (Westray Mines) potential criminal liability for negligence in work place safety
 - s. 336 – criminal breach of trust

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- Ontario Statutes
 - *Charities Accounting Act*
 - OPGT can seek an order under section 4 of the CAA on various grounds and can seek imposition of fines if, for example, there has been a misapplication or misappropriation of any charitable funds
 - Third-parties can bring applications under subsection 6(1) without notice to the charity or anyone else, with the court being able to order the OPGT to conduct a public inquiry under the *Public Inquiries Act*

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- Subsection 10(1) of the CAA permits two or more individuals to make a court application where they allege a breach of a trust created for a charitable purpose or seek the direction of the court for the administration of a trust for a charitable purpose
- *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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- *Employer Health Tax Act (Ontario)*
 - Directors will be held personally liable for premiums and health tax not paid by corporation
- *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

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- *Child and Family Services Act (Ontario)*
 - Failure to report child abuse is an offence
 - Directors of religious organizations and other charities may be liable where employees fail to report abuse or where it occurs because of failure to monitor employees and operations
- *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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