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- Developing and Implementing a Confidentiality Policy
- Due diligence in operations
- Retaining Directors by Protecting Directors
 - Due diligence in indemnification and insurance
- "Ineligible Individuals" Under The *Income Tax Act* (ITA)
- Removal and/or Discipline a Director
- Other means of due diligence in reducing risk

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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
- 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 unless otherwise stated

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D. WHAT ARE THE REQUIREMENTS TO BE QUALIFIED AS A DIRECTOR UNDER CORPORATE LEGISLATION?

Federal Legislation

- *Canada Corporations Act (CCA)*
 - Directors must be at least 18 years of age and have power under law to contract
 - Directors do not have to be a member of the corporation
 - Ex-officio directors are permitted
- *Canada Not-for-Profit Corporations Act (CNCA)*
 - In order to be qualified as a director, an individual must
 - Be at least 18 years of age
 - Have not been declared incapable by a court in Canada or in another country
 - Not have the status of a bankrupt

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- Not required to be a member of a corporation, unless the by-laws state otherwise
- Ex-officio directors are not permitted
- With a "soliciting corporation" under the CNCA, there must be a minimum of 3 directors, at least 2 of which must not be officers or employees of the corporation or any of its affiliates
- A soliciting corporation is generally any corporation that receives more than \$10,000 in its last financial period from public sources (i.e., public donations, federal, provincial and municipal governments or conduit entities)

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Provincial Legislation

- *Ontario Corporations Act (OCA)*
 - Directors must be at least 18 years of age and not an undischarged bankrupt
 - Directors are required to be members of the corporation at the time of election or appointment, or within ten days of being elected or appointed
 - Ex-officio directors are permitted
 - Qualification requirements apply whether the director is elected or ex officio

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- Ontario *Not-for-Profit Corporations Act, 2010* (ONCA)
 - In order to be qualified as a director, a person must
 - Be at least 18 years of age
 - Not have been found to be incapable of managing property under the *Substitute Decisions Act, 1992* or under the *Mental Health Act*
 - Have not been declared incapable by a court in Canada or in another country
 - Not have the status of a bankrupt
 - Not required to be a member of a corporation, unless the by-laws state otherwise
 - Ex-officio directors are permitted
 - The requirements apply whether the directors are elected or are ex-officio

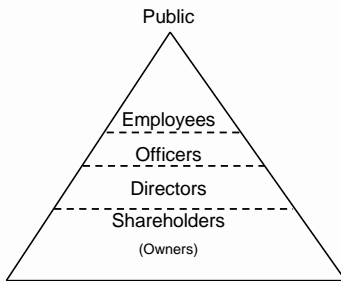
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E. DIFFERENT TYPES OF CORPORATIONS

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

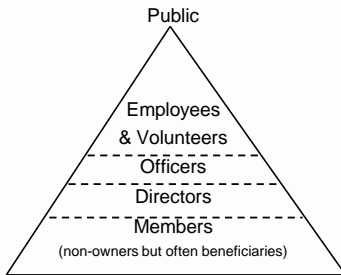


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- Not-for-Profit Organizations
(non profit purpose)



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



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- Directors of NPOs and charitable corporations 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 NPOs and charities may also be found liable at common law for their actions and inactions
- In this presentation, the focus is on the duties and liabilities of directors and officers of both NPOs and charities

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F. 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:
 - 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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- 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 misapplied
 - i.e. 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 charities incorporated under either the *Ontario Corporations Act* or *Canada Corporations Act*
- Therefore, the duty of care for directors under those acts 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"

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- 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
- 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?
 - Is the amount of time that they have spent on the issue proportionate to its importance and complexity?

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- 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?
- Summary of general fiduciary duties that apply to both NPOs and charities in putting the best interest of the corporation ahead of their own
 - 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

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- 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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- 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
- Duty of obedience
 - Directors must comply with applicable legislation and the corporation's governing documents (letters patent, articles, by-laws, etc.)
 - 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
 - If this procedure is not followed, directors may be made to account for profits they have made

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- CNCA, on coming into force, will expand the provisions concerning conflict of interest such that they will apply to both directors and officers and address transactions the corporation enters into on a more general basis as opposed to being limited to contracts
- Duty to Continue
 - 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

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- To Whom is the fiduciary duty owed?
 - The Corporation
 - Case law has affirmed that directors of charities and not-for-profit corporations are in a fiduciary relationship to the corporation, not to its members
 - Duties owed to Members
 - Directors also have certain duties to the members of the corporation, although it is not specifically a fiduciary relationship
 - Directors must ensure that the corporation abide by the terms of its letter patent and by-laws
 - Case law affirms that relationship between corporation and members is an implicit contractual obligation to comply with the constating documents and by-laws

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- High Fiduciary Duties with Regard to Charitable Property
 - The following duties relate specifically to the high fiduciary duties where charitable property is involved, whether such property is held by a charity or by an NPO
 - Duty to Carry out the Charitable Purpose
 - Charities can have one or more charitable purposes
 - The charity's resources must be used to carry out the purposes of the charity
 - Directors have a positive duty to further the charitable purposes of the corporation

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- Duty to Protect and Conserve Charitable Property
 - Directors must protect charitable property
 - Directors in Ontario must ensure that such property is appropriately invested in accordance with terms of the *Trustee Act*
 - 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 *Charities Accounting Act* ("CAA") for payment for services other than as a director but difficult to attain
 - The onus will be on the applicant to show that such payment for services "is in the best interest of the trust in light of the circumstances and the basic rules of equity which affect trustees"
 - Directors and officer insurance, as well as indemnification available provided that regulations under the CAA 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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G. COMMON LAW LIABILITIES

- Liability for Breach of Fiduciary Duty
 - Directors and officers have a fiduciary duty to put the best interests of the corporation ahead of their own
 - 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
 - When directors permit the corporation to act beyond the scope of the authority set out in the corporation's objects, the directors may be found personally liable for *ultra vires* actions
 - The issue of acting *ultra vires* will no longer be a concern once the ONCA and CNCA apply, as they each give the corporation the same powers of a natural person as those given to directors of for-profit corporations under modern business corporations legislation
 - However, every director is still under a duty of obedience to comply with the objects stated in the letters patent or by-laws

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- Liability Risk for Negligent Mismanagement (Tort)
 - Tort is civil wrong for which injured party can seek damages from the court
 - If their carelessness in the oversight of the corporation's operations leads to injury, directors of 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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- Commingling of special purpose charitable trusts
 - Are gifts subject to restrictions or limitations by the donor
 - Commingling of donor restricted gifts possible under *Charities Accounting Act* (Ontario) regulations
 - But cannot commingle special purpose charitable trusts with general funds
 - See Charity Law Bulletin #4 at <http://www.carters.ca/pub/bulletin/charity/2001/chylb04-01.pdf>

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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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H. 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 the law is not an excuse, as offences are generally strict liability
 - Generally, the only defence is due diligence
 - Resigning as a director may not limit liability, though there are generally limitation periods that apply

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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, 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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- *Excise Tax Act* (Canada)
 - Directors jointly and severally liable for corporation's failure to collect and remit 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
- *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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- *Anti-terrorism Legislation*
 - Legislation has serious liability risks for charitable corporations and directors, particularly those involved in work outside of Canada
 - See www.antiterrorismlaw.ca for details
- *Canada Corporations Act*
 - Unpaid wages
 - Directors are jointly and severally liable for 6 months wages and claims due for services by employees for the corporation while they were directors or brought within 12 months of holding office

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- Conflict of interest
 - Every director with an interest in a contract with the corporation must disclose such interest
- 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 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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- *Canada Not-for-Profit Corporations Act ("CNCA")*
 - In addition to the continuing similar liability for wages described under the CCA, directors and officers of charities and NPOs need to be aware that the CNCA generally expand the rights and remedies available to members of not-for-profit corporations
 - CNCA also enhances the accountability of directors to members by providing members with the power to remove directors by ordinary resolution at any time
 - Members will be able to apply to the court for an oppression remedy, a court-ordered liquidation, a derivative action and compliance and restraining order

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- Ontario Statutes
 - *Corporations Act*
 - Directors are jointly and severally liable to the employees, apprentices and other wage earners for all debts due for services performed for the corporation, not exceeding six months wages and twelve months vacation pay
 - Failure to keep proper books, records and registers at the head office of the corporation and failure to make such books, records and registers available for inspection by entitled persons may result in personal liability for the directors

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- *Ontario Not-for-Profit Corporations Act* ("ONCA")
 - Not expected to be in force until late 2012
 - Directors can be held jointly and severally liable to their employees for the following debts if the corporation is sued, and cannot satisfy all or part of the debt
 - 6 month's wages; and
 - Vacation pay (up to 12 months)
 - Significantly increases the rights of members

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- *Charities Accounting Act* ("CAA")
 - OPGT can seek an order under section 4 of the CAA if he or she is of the opinion that there has been a misapplication or misappropriation of any charitable funds, an improper or unauthorized investment of any monies, or failure to apply charitable property as directed by the donor
 - 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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- Could result in an application by the OPGT to obtain a court order requiring the charity to comply with the terms of the donor direction in accordance with s.4(d) of the CAA
- 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

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- *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
- *Employer Health Tax Act* (Ontario)
 - Directors will be held personally liable for premiums and health tax not paid by corporation

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- *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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- *Child and Family Services Act* (Ontario)
 - Failure to report child abuse is an offence
 - Charities, NPOs 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
- *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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- Fundraising
 - Specific charitable statutes concerning fundraising:
 - *Income Tax Act* (Canada), including the new CRA Fundraising Guidance (2012)
 - *Charities Accounting Act* (Ontario)
 - *Charitable Fund-Raising Act* (Alberta)
 - *Charitable Fund-raising Businesses Act* (Saskatchewan)
 - *Charities Endorsement Act* (Manitoba)
 - *Charities Act* (Prince Edward Island)

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I. 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
- Articles of incorporation, articles of continuance
- 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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1. Appropriate Screening During The Director Recruitment Process
- Neither charities nor NPOs are legally required to conduct background checks on potential directors, but the ability to garner information about potential directors is obviously important, considering the CRA's stance on "ineligible individuals" for charities
 - Issue arises when a charity or NPO attempt to independently assess whether an individual is suitable, as the information being assessed may not be publicly or easily available
 - Other than criminal record checks, there is nothing else that is publicly available
 - However, there are still appropriate screening techniques that can be done by a nominating committee

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- Google searches
- Application form can ask relevant questions but the storage of that information needs to be stored in accordance with the privacy policy of that organization
- Preferred qualification requirements (e.g., a faith requirement) establish by bylaw or by nominating process
 - However, need to determine whether a preferred qualification requirement does not constitute a prohibited ground for discrimination under the Human Rights Code
 - If preferred qualification requirement does prima facie violate the Human Rights Code, then check to see if there is an exemption available under the Code

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- Criminal Record Checks
 - Possible to search for relevant criminal offences in Canada through local police force
 - Need to create guidelines in order to determine which offences are relevant and would disqualify an applicant from being a director, as not all criminal offences may be relevant
- Bankruptcy Search
 - Generally must not be an undischarged bankrupt in order to qualify as a director
 - In some situations where there is doubt, it may be necessary for a nominating committee to do a bankruptcy search
 - Can be done through the Office of the Superintendent of Bankruptcy Canada

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- References
 - Important to follow up on references provided by the candidate
 - Specific questions should be asked so that a determination of whether the applicant is suitable can be undertaken
 - References from charities that the applicant has previously worked with would be a valuable source of information
- Interviews
 - Interviews with members of the nominating committee would give an opportunity to discuss the applicant's skills, interests, background and availability for a director position
 - Any doubts about the candidate's suitability could be addressed at this point

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2. Developing And Implementing A Conflict Of Interest Policy

Federal Legislation Requirements

- CCA
 - Directors directly or indirectly interested in a contract with the company must declare such interest at a meeting of directors of the company
 - Declaration occurs at the meeting of directors at which the question of entering into the contract is first taken into consideration,
 - If the director is not at the date of that meeting interested in the proposed contract, at the next meeting of the directors held after he becomes so interested

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- Where the director becomes interested in a contract after it is made, the declaration is to be made at the first meeting of directors held after the director becomes interested
- Directors may not vote in respect of any contract or proposed contract in which they are interested

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- CNCA
 - Contains provisions requiring directors to disclose their interest if they are a party to a material contract or transaction, a director or officer of a party to a contract, or have a material interest in a party to a contract
 - Directors must disclose their interest during meetings of directors or of committees of directors at which a contract is first proposed
 - Can also be disclosed at the first meeting after a director becomes so interested
 - Important ongoing obligation, as a director may be required to account for any profit or gain realized on the contract or transaction

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- Any contract or transaction that has been disclosed is not invalid and the director would not be required to account for any profit if
 - Proper disclosure was made
 - Directors approved the contract
 - Contract was reasonable and fair to the corporation when it was approved

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Provincial Legislation Requirements

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- OCA
 - Directors who are directly or indirectly interested in a proposed contract or a contract with the company shall declare their interest at a meeting of the directors of the company
 - Declaration occurs at the meeting of directors at which the question of entering into the contract is first taken into consideration,
 - If the director is not at the date of that meeting interested in the proposed contract, at the next meeting of the directors held after he becomes so interested
 - Where the director becomes interested in a contract after it is made, the declaration is to be made at the first meeting of directors held after the director becomes interested

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• ONCA

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- ONCA provides that directors must disclose their interest if they are a party to a material contract or transaction, a director or officer of a person who is a party to a contract, or if they have a material interest in any person who is a party to a contract
- Similar procedure as found in the CNCA
 - Directors must disclose their interest at the meeting at which a proposed contract is first considered
 - If the director becomes interested after the contract is made, disclosure must be at the first meeting after he or she becomes so interested
 - Disclosure of the nature and extent of his or her interest should be to the corporation or entered in the minutes of meetings of the directors

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- As with CNCA, any contract or transaction that has been disclosed is not invalid and the director would not be required to account for any profit if
 - Proper disclosure was made
 - Directors approved the contract
 - Contract was reasonable and fair to the corporation when it was approved

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Developing and Implementing a Conflict of Interest Policy

- General operating bylaw may be silent may or include a conflict of interest provision
- Bylaw provision may simply repeat the statutory provisions or it may establish additional requirements
- If the organization is a charity, the bylaw provision should require a director to resign if there is a pecuniary conflict of interest that continues even though the director has declared a conflict of interest and has not voted
- There may be other non-statutory conflicts of interest issues to be addressed, such as not being an employee or board member of a competing association

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- Conflict of interest provision in bylaw can also be supplemented by a specific conflict of interest policy
- Alternatively, a conflict of interest policy can be worked into an overall board conduct policy, which policy could include
 - a conflict of interest section
 - a confidentiality section
 - performance expectations for directors
- A conflict of interest policy should apply to all directors whether they are ex-officio or elected
- Policy should be referenced in the director application and/or consent form to be a director
- Adherence to conflict of interest policy should be renewed on a regular basis

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3. Developing And Implementing A Confidentiality Policy

The Legal Duty of Confidentiality

- Directors have a legal duty to retain in confidence and not disclose any information received as a director which is determined to be of a confidential nature
- This confidentiality can be lost if the information is disclosed, for example in litigation
- Not-for-profit corporate legislation limits disclosure of director meeting minutes to the directors
 - Implied confirmation of their confidentiality

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The Content and Implementation of a Confidentiality Policy

- Preamble
 - Statement of recognition by the organization concerning the importance of confidentiality
 - Statement that directors of the organization owe a fiduciary duty of loyalty to the organization and to its members
 - Discussion of responsibility of directors to act honestly and exercise their best care, skill and judgement for the benefit of the organization
 - Director's responsibility to protect the private nature of the deliberations of the board and ensure the confidentiality of information of the organization

- Responsibilities of Directors/General Provisions
 - Exercise good faith in respect to all transactions involving the organization
 - Fiduciary duty to put interests of the organization first
 - Continuing responsibility to comply with the policy
 - Agreement from directors that, during and after their service on the board/committee, they will keep confidential all direct or indirect information acquired pertaining to the organization and its activities
 - List of information could include: membership information, program information, financial information, employee information, any litigation information, legal advice, etc.

- If organization has a privacy policy, include a statement that it needs to be complied with
- If organization involves in fundraising, should require the donors' personal and financial information must be held confidential
- Requirement to sign acknowledgment of director's agreement to safeguard privacy and protect confidential information of the organization
- Statement of where to direct questions with regard to confidentiality policy

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- Failure to Safeguard Privacy and Confidentiality
 - Statement of organization’s responsibility with regards to addressing any infractions of the policy, and how the board of directors will evaluate the breach and whether there is a need for redress
 - Verbal warnings, letter outlining breach and concerns of board
 - Inclusion of a statement with regards to repercussions of a severe breach of the policy
 - e.g.. possible resolution by the majority of the board to send a report to the members recommending a resolution by the members to remove the director from his or her position before the end of their term

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- Alternative approach would be to have directors pre-sign a resignation at the time of joining the board, which could be triggered in the discretion of the board if there was a serious breach of confidentiality
- Review of Policy
 - Policy should be reviewed on a regular basis
 - Changes be approved by the board in accordance to the corporation’s by-laws
 - Indicate when communication of changes will be done and to whom
- Acknowledgement
 - Statement signed by director that the director acknowledges having read the policy and agrees to be bound by its terms
 - Understanding that failing to comply with the policy will result in appropriate disciplinary action

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J. 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), soon to be replaced with a new Fundraising Guidance in early 2012
 - 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

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- Notice/attendance at meetings/minutes
 - Right to notice of board meetings
 - Right to attend board meetings
- 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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- Utilizing due diligence checklists
 - Legal risk management checklist
 - Insurance/risk management checklist
 - Crisis management checklist
- 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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K. RETAINING DIRECTORS THROUGH PROTECTION

Statutory Due Diligence Defence

- Nothing under either the CCA or OCA
- CNCA
 - Directors provided with “reasonable diligence” defence
 - Directors are not liable if they exercise the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances
 - reliance in good faith on the corporation’s financial statements or the report of “a person whose profession lends credibility to a statement made by that person”
 - But must comply with CNCA, regulations, articles, by-laws and any unanimous member agreement

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- ONCA
 - Directors provided with a “reasonable diligence” defence
 - Reasonable reliance on officers and employees of the corporation and on professional advice
 - Director is not liable if they exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances
 - Including good faith reliance on financial statements and accounting professionals

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Indemnification

- a) Indemnification Under CCA and OCA
 - CCA permits a corporation to indemnify a director or officer for all costs, charges and expenses sustained in any action commenced or prosecuted against him, in relation to the execution of the duties of his office except
 - costs that occur by his own wilful neglect or default
 - OCA permits a corporation, with the approval of the members at a meeting of the members, to indemnify a director or officer for all “costs, charges and expenses” arising from an action in relation to the director’s execution of the duties of his office

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- b) Indemnification Under CNCA and ONCA
 - Mandatory Indemnification
 - A present or former director or officer, due to their association with the corporation, is entitled to indemnification against all costs, charges and expenses reasonably incurred by them in connection with the defence of any civil, criminal, administrative, investigative or other action/proceedings in which they have been involved

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- Permissive Indemnification
 - Indemnification of a present or former director or officer is permitted against all reasonable costs, including an amount paid to settle an action or satisfy a judgment, in respect of any proceeding in which the individual is involved because of their association with the corporation
 - Corporation may advance the money for costs of a proceeding referred to above, provided that the director or officer is found to have acted honestly and in good faith with a view to the best interests of the corporation

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- Prohibited Indemnification
 - Corporation cannot indemnify if the director or officer failed to act honestly and in good faith
 - Corporation cannot indemnify in criminal or administrative proceedings or actions enforced by a monetary penalty, if the director or officer had no reasonable grounds for believing that their conduct was lawful
 - If no court approval, indemnification is prohibited in an action by or on behalf of the corporation to obtain judgment in its favour, where a director or officer may be made a party due to their association with the corporation

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- c) Indemnification Involving a Charity
- Regardless of which corporate statute applies, Regulation 4/01 under the *Charities Accounting Act* ("CAA") requires that prior to a charity indemnifying its directors, the directors must consider certain factors enumerated in the regulation, which consideration need to be documented
 - The ability for directors of the corporation to receive indemnification or purchase of director and officer insurance must not render the corporation insolvent
 - The Ontario Public Guardian and Trustee takes the position that a director of a charity ought to be indemnified only for those acts properly undertaken in the administration of the charity or undertaken in breach of trust under an honest and reasonable mistake

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- d) What Does Indemnification Involve?
- Corporate indemnification generally 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
 - Corporate indemnification should always be implemented but may be of limited practical benefit
 - Indemnification is only as good as the financial security of the corporation and its insurance
 - Indemnification is therefore tied to the strength of the insurance coverage of the corporation

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Insurance Protection

- a) Insurance coverage will generally include
- General liability insurance
 - Directors' and officers' insurance
 - Sexual abuse and/or harassment coverage
 - 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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- b) Both the CNCA and ONCA permit a corporation to purchase and maintain personal liability insurance for the benefit of a present or former director or officer of the corporation, or another individual who acts or acted at the corporation's request as a director or officer or in a similar capacity of another entity
 - Under the ONCA, however, director and officer insurance may not be purchased for a charity unless the corporation complies with the *Charities Accounting Act* and its regulations that permits the purchase of such insurance
 - The same provisions would apply to the CNCA, although nothing is stated in the CNCA to that effect

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- c) Additional Factors to Consider with Director and Officer Insurance
 - 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?
 - Are there geographical limits to the coverage?

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- d) Insurance may not provide coverage for actions by public authorities against directors 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
- e) Need to advise agent in writing each year of all activities of the charity or not-for-profit organization and all known risks and ask for a written report back on the coverage available

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L. "INELIGIBLE INDIVIDUALS" UNDER THE INCOME TAX ACT (ITA)

- The 2011 Federal Budget introduced the concept of "ineligible individuals", which has become a new de facto eligibility requirement for directors of registered charities under the ITA but rules do not apply to NPOs
- CRA had been concerned that applications for charitable status were being submitted by individuals who had been involved with other charities and Registered Canadian Amateur Athletic Associations (RCAAA) that had their status revoked for serious non-compliance
- In the past, CRA could not refuse to register or revoke the status of a registered charity or RCAAA based on these concerns

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- Budget 2011 now permits CRA to refuse or revoke the registration of a charity or a RCAAA or suspend its ability to issue official donation receipts, if a member of the board of directors, a trustee, officer or equivalent official, or any individual who otherwise controls or manages the operation of the charity or RCAAA is an "ineligible individual"
- An "ineligible individual" is a person who
 - Has a "relevant criminal offence" – convicted of a criminal offence in Canada or similar offence outside of Canada relating to financial dishonesty (including tax evasion, theft or fraud), or any other criminal offence that is relevant to the operation of the organization, for which he or she has not received a pardon

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- Has a "relevant offence" – convicted of an offence in Canada in the past five years (other than a relevant criminal offence), or similar offence committed outside Canada within the past five years relating to financial dishonesty or any other offence that is relevant to the operation of the charity or RCAAA
 - Includes offences under charitable fundraising legislation, convictions for misrepresentation under consumer protection legislation or convictions under securities legislation

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- Has been a member of the board of directors, a trustee, officer or equivalent official, or an individual who otherwise controlled or managed the operation of a charity or RCAA during a period in which the organization engaged in serious non-compliance for which its registration has been revoked within the past five years
- Has been at any time a promoter of a gifting arrangement or other tax shelter in which a charity or RCAA participated and the registration of the charity or RCAA has been revoked within the past five years for reasons that included or were related to its participation

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- Why charities and RCAAs should be concerned
 - CRA has yet to make clear what the effect of having an "ineligible individual" on the board will be, but revocation is a statutory right of CRA
 - CRA has so far stated that they
 - Will look at the particular circumstances of a charity or RCAA
 - Will take into account whether appropriate safeguards have been instituted to address any potential concerns
 - Unfortunately, CRA has not stated what those circumstances are and no explanation of what the safeguards might be has been given

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- Charities need to be concerned about the due diligence required to ensure that an "ineligible individual" does not become involved or continue to be involved in the oversight or management of the charity
- Budget 2011 states that a charity will not be required to conduct background checks, but even if the charity wanted to review the information required to independently assess whether an individual is ineligible, it may not be publicly or easily available
 - Possible to search for relevant criminal offences in Canada, but abroad?
 - Many relevant offences (e.g., *Securities Act* convictions) are not tracked in publicly available databases in Canada, or unlikely abroad

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- Names of directors and like officials of revoked charities are not maintained in a single publicly available database
- Not likely that an individual who otherwise controlled or managed the operation of a charity would be identified in publicly available documents
 - likely information solely in CRA's control
- Onus is now shifted to charities to comply in a situation where it is impossible to ensure 100% compliance because the necessary information is not available
- This new cause for revocation is similar to a strict liability offence – no due diligence defence is available in the legislation
- Charities will be required to undertake other forms of due diligence and hope CRA will excuse any inadvertent non-compliance

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- Charities must find a way to deal with a director that is an ineligible individual (generally only the members can remove a director)
 - Bylaws will now need to include a new requirement that the directors must not be an "ineligible individual" as defined under the ITA at the time that they become a director and during their tenure
- Removal of management staff that are "ineligible individuals" could have important employment law ramifications
 - For existing staff it may difficult to remove them
 - For new management staff it will be important to include this in an employment contract

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- Concerns about privacy
 - If CRA alleges that a person is an "ineligible individual", who is to receive such information and how is the information to be protected once received?
 - Should the alleged "ineligible individual" be given an opportunity to rebut the allegation or is it to be left up to the charity to do so on the individual's behalf
 - If so, what personal information can be used to rebut the allegation?

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M. HOW TO REMOVE AND/OR DISCIPLINE A DIRECTOR FROM OFFICE

Federal Legislation

- CCA
 - Legislation only provides for the creation of by-laws to remove directors by members
 - Normally include a provision in the bylaw that allows a members resolution to remove a director by 2/3 of the members present
- CNCA
 - Enhances the accountability of directors by providing members with the power to remove directors by ordinary resolution at any time
 - May apply to court for an oppression remedy except for religious corporations
 - May result in a court appointing directors in place of or in addition to all or any of the directors then in office

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Ontario Legislation

- OCA
 - Members may remove any director before the expiration of his or her term of office by a resolution passed by at least two-thirds of the votes cast at a general meeting of which notice specifying the intention to pass such resolution has been given
- ONCA
 - Members of a corporation may, by ordinary resolution at a special meeting, remove from office any director or directors, except persons who are directors by virtue of their office

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Board Removal or Discipline of Board Members

- Removal or discipline of directors must be done by members
- However, the court could be asked to intervene after a questionable election and order new elections of directors
- A possible indirect approach so that the board can remove or discipline a director
 - Have the prospective director agree to a board code of conduct that would allow the board to discipline or remove a director
 - Have the directors file an undated resignation with the corporation when elected to the board

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N. 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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