

2002 Church and The Law Seminar – November 5, 2002

Due Diligence in Avoiding Risks for Directors & Leaders

by Terrance S. Carter, B.A., LL.B.

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2002 CHURCH & THE LAW SEMINAR

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November 5th, 2002

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1

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A. OVERVIEW OF TOPICS

- Due Diligence in the Choice of Charitable 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 Risks

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2

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B. DUE DILIGENCE IN THE CHOICE OF CHARITABLE STRUCTURES

- Using Existing Charities as an Alternative to a New Charity
 - Option of Using Existing Charity may be Simpler and Less Expensive Than Creating a New Charity
 - But Increases the Exposure of Board of Directors of Existing Charity to Personal Liability
- Charities as Unincorporated Associations
 - Use of Unincorporated Association Is Simpler, Faster and Less Expensive
 - But Exposes Members and Leaders to Personal Liability

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3

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- Charities as Corporations
 - Separate Legal Entity Protects Members from Personal Liability
 - Directors May Still be Exposed to Personal Liability from Fiduciary and Management Responsibilities
- Using a Multiple Charitable Corporation Structure
 - Multiple Charitable Corporations can Help to Protect Charitable Assets in One Charity and Contain Liabilities in Another Charity
 - Need Integrated Corporate Structure and Trade-Mark Licensing to Avoid Loss of Control
 - Multiple Charitable Corporations Can Include Parallel Foundations and Associated Operating Charities

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4

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- Parallel Foundations Have Become More Common in Protecting Long Term Gifts and Endowment Funds as a Result of the Christian Brothers Decision
- 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 Single Corporate Entity
 - Multiple Corporate Structure Reduces Risk of Liability, But Top Tier Organization May Still be Exposed to Liability Where Too Much Control is Imposed or Employer/Employee Relationship Exists
- Need to Avoid Overlapping Board of Directors to Reduce the Chance of Crossover Liability

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C. DUE DILIGENCE IN RELYING UPON STATUTORY PROTECTION

- Protection from Third Party Contractual Liability
 - Protection Available for Corporations Under the *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 to Remain on the Board Even if Conflict of Interest Declared

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D. 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
 - Directors Must Not Authorize *Ultra Vires*
 - Amendments to Governing Documents may be Necessary
- Management Access & Control Over the Affairs of the Corporation
 - Directors are Responsible for all Aspects of Operations of the Charity
 - Directors Must be Proactive in Management and not be Limited to Setting Policy only

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- **Protection of Charitable Assets**
 - Directors Have a Fiduciary Duty to Protect Charitable Property
 - Need to Invest in Accordance With Prudent Investment Standard Under the *Trustee Act*
 - Need to Protect Intellectual Property Including Trademarks and the Goodwill of the Charity
- **Fundraising**
 - Monitor Fundraising Costs Compared to 80/20 Disbursement Quota for Received Gifts
 - 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 Meeting
 - Right to Attend Board Meeting
- **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

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2. Policies and Procedures in Achieving Due Diligence

- **Establishing and Following Policy Statements and Procedures**
 - Develop Policies and Procedures for Staff, Volunteers and Board Members
 - i.e. Policy Statements on Sexual Abuse, Sexual Harassment, Counseling and Third Party Property Use of Facilities of the Charity

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- **Screening Procedure**
 - An Appropriate Screening Process is an Important Protection Against Increase in Abuse Claims
 - Screening Involves Utilizing Appropriate Questions, Interviews, Reference 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 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
 - General Liability Checklist
 - Sexual Abuse Checklist
 - Fundraising Compliance Due Diligence Checklist
 - Anti-Terrorism Due Diligence Checklist
 - Insurance Checklist

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3. *Reliance on Professional Advice in Achieving Due Diligence*

- Management
 - Directors Need to Retain Professional Managers to Oversee Operations
 - Directors are Responsible for Activities Delegated to Management
 - Directors Should Receive and Review Reports from Management at Every Board Meeting
- Outside Professionals
 - Relying on Professional Advisors like Accountants and Lawyers, Provides Evidence of Due Diligence

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- Delegation of Investment Decision Making to Investment Manager Requires Agency Agreement and Investment Policy under *Trustee Act*
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E. DUE DILIGENCE IN INDEMNIFICATION AND INSURANCE

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*
 - 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 Charitable Property?

2. *Corporate Indemnification*

- Corporate Indemnification Provides Compensation for the Following:
 - Legal Fees
 - Fines That Were Paid Under a Statute
 - A Financial Settlement That Result 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

3. *Insurance Considerations*

- Insurance Policies to Consider Obtaining Would Include
 - General Liability Insurance
 - Directors' & Officers Insurance
 - Sexual Abuse and/or Harassment
 - Insurance for Particular Risks, ie. Counselling, Non-Owned Auto, Third-Party Use of Property, Etc.

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- Factors to Consider
 - How Much Coverage Does the Policy Provide For?
 - Does Insurance Cover all Past and Present Directors, Officers and Committee Members?
 - Is Coverage on a "Claims Made Basis" or on an "Occurrence Basis"?
 - Are There Exclusionary Clauses That Limit the Protection Offered by the Policy, such as Sexual Abuse?
 - Are There Geographical Limits to the Coverage?

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- Insurance will Likely not Provide Coverage for Actions by Public Authorities for Breach of Trust, Improper Investments, or Violations of the *Anti-Terrorism Act* or other similar strict liability legislation
- Advise Agent in Writing Each Year of All Activities of the Charity and all Known Risks
- 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?

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F. OTHER MEANS OF DUE DILIGENCE IN REDUCING RISK

1. *Legal Risk Management Committees*

- Legal Risk Management Committee Need to be Formed to Conduct Review and Identify Risk
- 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

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- Directors May Need to Seek Independent Legal Advice Before Resigning from the Board of Directors

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 Should Consider Transferring Personal Assets to Spouse
- However Any Transfer of Assets Must be Done Before Becoming a Director So as Not to Defeat Claims of Creditors

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23

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24

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