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**Strategies for Protecting Charitable Assets
Through Multiple Corporate Structures**

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

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STRATEGIES FOR PROTECTING CHARITABLE ASSETS THROUGH MULTIPLE CORPORATE STRUCTURES⁺

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Strategies for Protecting Charitable Assets Through Multiple Corporate Structures

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A. INTRODUCTION

In Canada, directors of charities have a fiduciary duty to manage and protect charitable assets in order to apply those assets to their stated charitable purpose.¹ Directors of a charity must therefore be proactive in identifying the risks to charitable property and must take appropriate steps to protect charitable property from those risks. One such risk is a charity's exposure to liability where a member or employee of the charity or an entity affiliated with the charity is found liable for damages in a lawsuit. Recent case law has affirmed that charities and non-profit corporations are not immune from liability in such instances simply because of their non-profit or charitable status. Directors of charitable organizations need to be just as diligent and proactive as for-profit corporations in this regard.

This paper briefly discusses areas of liability which charitable and non-profit organizations may face exposure to and need to be aware of, including vicarious liability and cross-over liability. The paper then discusses strategies in containing those liabilities and protecting assets through the use of multiple corporate structures. The three main types of multiple corporate structures are discussed: parallel operating charities, parallel foundations and umbrella associations. In addition, the paper reviews how, in using a multiple corporate structure, a governing organization² can co-ordinate and standardize the operations of the separately

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¹ See *Ontario Public Guardian and Trustee v. AIDS Society for Children*, [2001] O.J. No. 2170 (Sup. Ct. J.) in which Haley J., citing *Re The French Protestant Hospital*, [1951] 1 Ch. 567, affirmed that directors of a charity, "are to all intents and purposes, bound by the rules which affect trustees".

² For the purposes of this paper, the term "governing organization" is used for ease of reference to describe a charity that implements a multiple corporate structure. The term is not intended to reflect that a charity should have any direct control over its separate but affiliated entities in the multiple corporate structure.

incorporated member organizations by way of contractual and/or licensing mechanisms, provided that an arm's length relationship is maintained in the day to day operations of the corporations within the multiple corporate structure.

B. OVERVIEW OF VICARIOUS AND CROSS-OVER LIABILITY

At the outset of this paper, it is important to define the types of liability which may be imposed on charitable and non-profit organizations. "Vicarious liability" is imposed on an employer or principal for the wrongful conduct of an employee or agent whose actions result in a loss to a third party. Unlike direct liability, vicarious liability does not require that the employer or principal actually have caused the loss sustained by the third party.

The Supreme Court of Canada, in the seminal case of *Bazley v. Currey*, provided a two-part approach for determining whether and when vicarious liability should be imposed on an employer.³ First, a court should determine whether there are precedents which unambiguously determine whether vicarious liability should be imposed under the circumstances in the case. Second, "[i]f prior cases do not clearly suggest a solution, the next step is to determine whether vicarious liability should be imposed in light of the broader policy rationales behind strict liability". The Supreme Court of Canada has explained the policy rationale for vicarious liability as follows "[a] person who puts a risky enterprise into the community may fairly be held responsible when those risks emerge and cause loss or injury to members of the public...The hope is that holding the employer or principal liable will encourage such persons to take steps to reduce the risk of harm in the future."⁴

In general, vicarious liability will be imposed by the courts where the plaintiff can establish the following:

- (1) the relationship between the tortfeasor (i.e. the employee) and the person against whom liability is sought (i.e. the employer) is sufficiently close; and
- (2) the wrongful act was sufficiently connected to the conduct authorized by the employer.

In determining whether a sufficient connection exists under part 2 of the test referred to above, the factors set out by the Supreme Court to be considered include, but are not limited to, the following:

³ [1999] 2 S.C.R. 534 at para. 15 [*Bazley*]. See also *Jacobi v Griffiths*, [1999] 2 S.C.R. 570 at para. 31 [*Jacobi*].

⁴ *John Doe v. Bennett*, [2004] S.C.J. No. 17 at para. 20 [*Bennett*].

- The opportunity that the enterprise of the employer or principal affords to the employee or agent to abuse his or her power;
- The extent to which the wrongful conduct may have furthered the employer's enterprise;
- The extent to which the wrongful act was related to friction, confrontation or intimacy inherent in the employer's enterprise;
- The extent of power conferred on the employee in relation to the victim; and,
- The vulnerability of potential victims to wrongful exercise of the employee's power.⁵

Recent case law has affirmed that charities and non-profit organizations can be held vicariously liable for the conduct of their employees and agents, and they do not enjoy any special “immunity” on account of their non-profit status.⁶ As a result, charities and non-profits have a significant obligation to carefully supervise and monitor the conduct of their employees, especially where those employees are in a position of power and authority over others. The importance of such supervision and of implementing risk management mechanisms, such as a policy against child abuse, can not be understated.

However, in addition to these due diligence steps, it is important for charities to assess and, if necessary, modify their organizational structure so that, in the event that a tort claim is successfully brought against the charity, liabilities may be contained and charitable property protected. This paper will discuss ways for charities to effectively use multiple corporate structures to assist in achieving these goals, such as separately incorporating one or more operating divisions of a charity which involve a greater degree of liability risk than others (i.e. schools and children’s camps) or incorporating foundations to hold assets, such as endowments, as well as land and buildings.

A number of large Canadian charitable organizations, especially national denominations of religious bodies, have already started to adopt such a multiple corporate organizational structure, composed of separately incorporated yet affiliated entities which are located across the country but overseen by a national governing

⁵ *Bazley*, *supra* note 3 at para. 41.

⁶ See *Bazley*, *ibid.*, where the Supreme Court of Canada rejected the argument that non-profit organizations should be shielded from tort liability in the public interest. See also *John Doe v. Bennett*, *supra* note 4, at para. 24, where the Supreme Court of Canada confirmed that non-profit status in itself would not be sufficient grounds to obviate a finding of vicarious liability. For more information see Mervyn F. White, “Supreme Court of Canada Brings Clarity to Vicarious Liability of Churches in Canada” (2005), *Church Law Bulletin* No. 11, online: <http://www.carters.ca/pub/bulletin/church/index.html>.

entity. As indicated above (and discussed in more detail below), such multiple corporate organizational structures can help to insulate charitable assets from the liabilities of other separate yet affiliated entities. However, despite the more sophisticated nature of multiple corporate structures, affiliated corporate entities within the relational corporate structure can still be exposed to liability where it can be shown that affiliated corporations have not operated at arm's length from one another.

In that regard, where it can be shown that one corporation is effectively controlled by another corporation, then the legal integrity of the separate corporations could be lost. Where this is found to be the case, the liabilities of the controlled corporation could potentially become the liabilities of the controlling corporation. This type of liability between corporations is generally referred to as "cross-over liability". This paper offers a number of steps that can be taken in order to reduce the possibility of one affiliated corporation being exposed to cross-over liability for the actions of another affiliated organization. First, however, the paper will identify different types of multiple corporate structures which may be employed by charitable organizations.

C. DIFFERENT TYPES OF MULTIPLE CHARITABLE CORPORATIONS

While there are different types of multiple charitable corporations that are utilised, the three discussed in this paper are: (1) parallel operating charities, used to contain liabilities of high risk operations from the assets of the main operating charity; (2) parallel foundations, used to protect assets from the liabilities of the main operating charity; and (3) umbrella associations, used to control liability exposure between the main operating charity and its member organizations, as well as among the member organizations themselves.

1. Parallel Operating Charities

A parallel operating charity could be used when an incorporated charity has one or more operating divisions involving a greater degree of liability risk than others. For example, if a church corporation operates a school or children's camp, as well as operating a traditional church facility, then the risks associated with those operating divisions could severely prejudice the future viability of the church and the assets that it owns, including its land and buildings. A parallel operating charitable corporation, such as a summer camp or a school, could be established to take over these various high risk operations. They could be operated through one or more separately incorporated entities for the purposes of containing the liability associated with their operations, thereby protecting the assets of the main operating charity, such as a church corporation.

2. Parallel Foundations

A parallel foundation can be used for a broad range of reasons, including:

- ◆ The protection of donor-restricted funds, as a result of the Ontario Court of Appeal's decision in *Christian Brothers of Ireland*⁷, briefly discussed below;
- ◆ The establishment and management of endowment funds, including coordinating the delegation of investment management;
- ◆ The protection of surplus funds from government directives for health care institutions in Ontario as a result of Local Health Integrated Networks (LHINs);⁸
- ◆ The separation of capital fundraising campaigns from operating fundraising campaigns; and
- ◆ The encouragement of *inter vivos* gifts, testamentary gifts and planning giving programs.

Before the *Christian Brothers* decision, it was assumed that donor restricted funds, such as endowment funds, were protected as trust property from claims against the charity. However, the Ontario Court of Appeal held in this case that all assets of a charity, whether beneficially owned or held as a special purpose charitable trust, are available to satisfy the claims of tort victims upon the winding-up of the charity. Donors have become more sophisticated in their charitable giving and demand more accountability from charities, yet the *Christian Brothers* decision means that charities are no longer able to assure donors that the gift of a donor restricted fund to a charity will be protected.⁹

Given the *Christian Brothers* decision, the utilization of parallel foundations has now become very important for purposes of protecting future donor-restricted gifts, as well as endowment funds, where the capital is held in perpetuity and is not subject to any operating liabilities of the charity.

⁷ *Christian Brothers of Ireland in Canada (Re)* (2000), 47 O.R. (3d) 674 (C.A.) [*Christian Brothers*].

⁸ See Terrance S. Carter, assisted by Nancy E. Claridge, "Implications of New Ontario Health Legislation for Charities" (2006), *Charity Law Bulletin* No. 90, online: <<http://www.carters.ca/pub/bulletin/charity/>>.

⁹ For a more detailed examination of the issues involved in the *Christian Brothers* case, see Terrance S. Carter, "Donor Restricted Charitable Gifts Revisited: Part I", in *The Philanthropist*, Vol. 18, No. 1, September 2003 and "Donor Restricted Charitable Gifts Revisited: Part II", Vol. 18, No. 2, December 2003, online: <<http://www.charitylaw.ca/articles.html>>. Reference can also be made to Terrance S. Carter, "Supreme Court's Refusal To Grant Leave To Appeal In *Christian Brothers* Case Prejudices Charities" (2001), *Charity Law Bulletin* No. 3 and Terrance S. Carter & R. Johanna Blom, "Update on *Christian Brothers*" (2003), *Charity Law Bulletin* No. 24, both online: <<http://www.charitylawbulletin.ca/>>.

A parallel foundation can also be used as a form of holding corporation for other assets of the charity, such as holding lands and buildings, intellectual property, specialized libraries and/or existing endowment funds. However, the option of utilizing a parallel foundation as a holding company is dependent upon the charity complying with applicable creditor protection legislation in each province.¹⁰

As a result, generally only future or existing assets not subject to past or present claims can be transferred to a parallel foundation without residual claims against those assets remaining.

Where a parallel foundation is established for the purpose of holding land and buildings for a church or other types of religious organizations, consideration needs to be given to the *Assessment Act* (Ontario).¹¹ This is to ensure that the church parallel foundation would meet the definition of a “religious organization” in order to maintain the municipal tax exemption of the property of the church or other type of religious organization.¹² It may also be necessary to develop a license or lease agreement between the church parallel foundation and the church, as well as possibly seeking a pre-ruling from the Municipal Property Assessment Corporation (“MPAC”)¹³ with regard to the ability to maintain the tax exemption on the church property.

3. Umbrella Associations

The use of an umbrella association would involve structuring a national or provincial charity that consists of member organizations into multiple legal entities instead of operating under the auspices of a single corporation. This would involve having a separately incorporated governing organization, normally established as a federal corporation, to act as the umbrella organization. Each member organization, *e.g.*, local churches and/or separate ministries, could then be separately incorporated under the auspices of the governing organization.

The alternative way of structuring a national and/or provincial charity would be by operating it through a single corporation that includes all of the various divisions and chapters as part of the single legal entity. While a single corporate entity provides simplicity in administration and operations, the

¹⁰ For example, in Ontario, see the *Fraudulent Conveyances Act*, R.S.O. 1990, c. F.29 and the *Assignments and Preferences Act*, R.S.O. 1990, c. A.33, both of which may void a conveyance of property if it was made with the intent to defeat, hinder, delay or defraud creditors.

¹¹ R.S.O. 1990, c. A.31.

¹² *Ibid.* at par. 3(1)(3).

¹³ Municipal Property Assessment Corporation, online: <<http://www.mpac.ca>>.

disadvantage is that all the assets of the various divisions are left in one single legal entity. This would result in the loss of all of the assets of the national or provincial charity in the event that a claim was successfully made against any one of the divisions or chapters of the charity.

The advantages of utilizing an umbrella association model in comparison include the following:

- Reduced overall liability exposure in operating a national or provincial charity by containing the liability associated with a member organization within a corporate entity that is separate and apart from the governing organization;
- The use of separate corporations to co-ordinate the operations and administration of the entire organization being carried out in different parts of the world, where applicable, while maintaining the overall co-ordination and supervision of a single governing body having general oversight;
- In addition to separate corporations to carry out national and international work, a separate intellectual property holding corporation could be established to hold all of the intellectual property of the governing organization, *i.e.*, trade-marks, copyrights and domain names, and control its use, even on an international basis to ensure that there is consistency and quality assurance in its use throughout the world;
- Where one member organization owns real estate that is subject to toxic contamination, the costs associated with the clean up of the contamination will generally be limited to only the assets of the incorporated member organization;
- If a member organization was to lose its charitable status with CRA, the charitable status of the governing organizations and other member organizations would not be at risk;
- For national charities which carry on operations in Ontario, the creation of a separate charitable corporation in Ontario to oversee Ontario activities would mean that the jurisdiction of the Public Guardian and Trustee in Ontario (“PGT”) would generally be limited to only the assets of the Ontario charity; and

- Similarly, the operations of the umbrella association that are carried on outside the province of Ontario through separate corporations in other provinces would not be subject to the provisions of the *Charities Accounting Act* (Ontario).¹⁴

However, the utilization of an umbrella association can also involve the following disadvantages:

- The governing organization could lose control over the various member organizations unless an inter-corporate structure is implemented to ensure that the member organizations are subject to appropriate corporate, contractual and/or licensing mechanisms;
- The member organizations would need to utilize the industry name and/or trade-marks of the governing organization. As such, if the industry name and/or trade-marks of the governing organization have not been properly protected by obtaining trade-mark registration as necessary, or the usage of the trade-marks by the member organizations is not properly documented through appropriate trade-mark license agreements, then the ability of the governing organization to protect and enforce the trade-marks of an umbrella association could be seriously prejudiced due to unintentional infringement of trade-marks by the various member organizations, or by unauthorized third parties.
- Effective utilization of an umbrella association requires the creation of multiple charitable corporations, as well as the implementation of numerous and sometimes complex relational provisions as discussed below. The complexity in the relationship could result in confusion of the operations of the various corporations unless the relational mechanisms are carefully established and consistently applied.

D. ISSUES TO ADDRESS IN UTILIZING A MULTIPLE CORPORATE STRUCTURE

As discussed at the beginning of the paper, recent case law suggests that separate incorporation, in and of itself, may be inadequate to protect the assets of a governing organization where a tort claim is successfully brought against a separate but affiliated entity or member organization based upon the concept of cross-over liability.

¹⁴ R.S.O. 1990, c. C.10.

Many of the legal principles concerning cross-over liability are derived from cases involving abuse that occurred at residential schools operated by religious denominations.¹⁵ Those general principles are as follows:

- ◆ Cross-over liability is more likely to be imposed on an incorporated national entity which has a significant degree of control over the actions of the members or employees of associated incorporated entities, as in employer/employee or principal/agent relationships;¹⁶
- ◆ Indicia of control that can be considered by a court in reviewing whether vicarious liability should be imposed includes, but is not limited to, the following:
 - Direct supervision over activities carried out by the employees;
 - Financial contributions to the general operating expenses of the affiliated entity;
 - Responsibility for hiring and firing of the manager who oversees the employees;
 - Contributions to the pension plan for employees;
 - Annual inspections of the program; and
 - Appointment of committees to monitor implementation of policies.¹⁷

¹⁵ See Esther S.J. Oh and Nancy E. Claridge, “Update on Case Law Involving Cross-Over and Vicarious Liability for Charitable and Not-For-Profit Organizations” (2007), *Charity Law Bulletin* No. 114 and Esther S.J. Oh and Terrance S. Carter, “Cross-Over Liability: Principles from the Residential Schools Cases” (2003), *Charity Law Bulletin* No. 19, online: <http://www.carters.ca/pub/bulletin/charity/index.html>. The cases discussed in those articles include: *John Doe v. Bennett*, [2004] 1 S.C.R. 436; *Blackwater v. Plint* [2005] S.C.J. No. 59 [*Blackwater*]; *E.B. v. Order of the Oblates of Mary Immaculate in the Province of British Columbia* (2005), 258 D.L.R. (4th) 385 (S.C.C.); *Doe v. O’Dell*, [2003] O.J. No. 3546 (Sup. Ct. J.) (QL); *Doe v. Avalon East School Board*, [2004] N.J. No. 426 (Nfld. S.C.T.D.) (QL); *Wilson v. United Church of Canada* (2004), 138 A.C.W.S. (3D) 764 (B.C.S.C.); *J.R.S. v. Glendeinning*, [2004] O.J. No. 285 (Sup. Ct. J.) (QL); *Residential Schools (Re)*, [2002] A.J. No. 1265 (Q.B.) (QL); *B.M. v. Mumford*, [2000] B.C.J. No. 2490 (S.C.) (QL) [*Mumford*]; *Lariviere v. General Synod of the Anglican Church of Canada* (2001), 207 D.L.R. (4th) 765 (Ont. Sup. Ct. J.) [*Lariviere*]; *F.S.M. v. Clark*, [1999] B.C.J. No. 1973 (S.C.) (QL) [*Clark*]; *S. (G.) v. Canada (Attorney General)* (2001), 108 A.C.W.S. (3d) 459 (Sask. Q.B.); and *Wunnamin Lake First Nation v. Rowe*, [2002] O.J. No. 2810 (Sup. Ct. J.) (QL) [*Wunnamin Lake First Nation*].

¹⁶ See for example, *Blackwater, ibid.*, where the Supreme Court of Canada found the United Church of Canada and the Government of Canada vicariously liable as employers of a dormitory supervisor who committed sexual abuse at a residential school in British Columbia. See also *Clark, ibid.*, where the British Columbia Supreme Court held the Anglican Church of Canada vicariously liable for assaults on Indian residential school students perpetrated by a dormitory supervisor. Although the residential schools in both cases were unincorporated, they were deemed to have been operated, at least in part, by the defendant Churches, and the analysis employed by the courts in finding a connection between the Churches and the schools could be applied to impose cross-over liability in the context of a multiple corporate structure. See, for example, *Wunnamin Lake First Nation, ibid.*, where the Ontario Superior Court of Justice refused to dismiss an action against the General Synod of the Anglican Church of Canada (the national incorporated church body) for sexual abuse committed by a minister under the direct control of a separately incorporated Anglican Diocese. Citing *Clark* and the trial decision in *Blackwater*, the court observed at para. 11 that “incorporated national church bodies may have vicarious responsibility when mission work is done in a diocese” and concluded that a trial was a “more appropriate setting for resolution of the issues in [the] action”. It appears that this matter may have settled, as the authors are not aware of a reported decision by a trial court.

¹⁷ *Blackwater, ibid.* at paras. 21-31.

- ◆ Cross-over liability is less likely to be imposed where a separately incorporated national entity has little or no involvement in the actions of members or employees of associated entities¹⁸;
- ◆ It appears similar principles of cross-over liability apply equally between associated entities that operate on an equal horizontal level as those relating vertically within a hierarchical relationship; and,
- ◆ In the situation of a single national legal entity, liability in any part of the entity will likely affect the assets of all of the other parts of the national entity.¹⁹

While it is important to ensure that exposure to cross-over liability is minimized as much as possible between affiliated corporations involved in a multiple corporate structure, it is usually the case that the governing organization does not wish the separately incorporated member organizations to operate completely autonomous without regard to maintaining co-ordination and standards amongst the various corporations. As such, there are various relational types of mechanisms that can be utilized in order for a governing organization to retain an appropriate level of input, while at the same time minimizing any potential cross-over liability between them.

In this regard, when businesses use multiple corporations, the parent corporation can maintain control over subsidiary corporations through the ownership of the majority of the voting shares of a subsidiary corporation. Charities, however, are non-share capital corporations that do not permit such control through the ownership of shares.

As a result, non-share capital corporations need to utilize other types of relational mechanisms between multiple corporations in order to ensure co-ordination and the maintenance of standards. This is normally achieved through appropriate provisions being included in the incorporation documents of the member organizations, as well as the contracts between the governing organization and the member organizations. Such types of relational mechanisms usually involve ensuring that the member organizations are subject to specific contractual and/or licensing requirements.

¹⁸ See *Mumford*, *supra* note 15; *Lariviere*, *supra* note 16; *Residential Indian Schools (Re)*, *supra* note 16; and *S. (G.) v. Canada (A.G.)*, *supra* note 16.

¹⁹ See *Christian Brothers*, *supra* note 7, at para. 82 where the Ontario Court of Appeal held that, when judgment is obtained against a charitable corporation, “[a]ll of its assets are answerable for that judgment whether they are held beneficially or on trust for the charitable purposes of the corporation, including one or more of those purposes.”

When dealing with the relationships between a governing organization and a member organization, the separate nature and autonomy of each charitable corporation must be recognized and respected. As separate and autonomous legal entities, a governing organization and a member organization have to carefully structure their relationship to ensure that the two organizations work cooperatively under the oversight but not the control of the governing organization. Carefully structuring this relationship from the inception will help to avoid “re-writing the rules” of the relationship later.

Outlined below are some important considerations with respect to that various types of relational models, as well as the related association agreements. As well, a list of practical steps that can be taken in order to reduce the risk of exposure to cross-over liability between corporations is also included in this section of the paper.

There are three types of inter-corporate relational models that can be considered, which can establish different degrees of inter-corporate relationships between a governing organization and a member organization: (1) Ex Officio Relational Model; (2) Corporate Relational Model; and/or (3) Franchise Relational Model.

1. Ex Officio Relational Model

Historically, the Ex Officio Relational Model has been the more common method of relating member organizations with a governing organization. This model requires that the by-laws of the member organization provide for ex officio directors who are either directors or officers of the governing organization. This is for the specific purpose of allowing those individuals to sit as representatives of the governing organization on the board of the member organization. The number of ex officio board members can vary from one all the way up to all of the board members of the member organization.

Both the *Canada Corporations Act*²⁰ and the *Corporations Act (Ontario)*²¹ permit the establishment of ex officio directors in their corporate by-laws. A variation involves having all the board members or corporate members of the governing organization being deemed to be the corporate members of the member organization ex officio.

²⁰ R.S. 1970, c. C-32.

²¹ R.S.O. 1990, c. C.38.

However, the Ex Officio Relational Model should not be relied on to any great extent, *i.e.*, there should be no more than one or two ex officio members on the board. This is because an excessive number of ex officio directors could result in an increased risk of cross-over liability between the corporations, as it could be argued that the directors of the governing organization who are “ex officio directors” are essentially the governing minds of the member organization. In addition, the Ex Officio Relational Model fails to address the performance expectations between a governing organization and its member organizations or related intellectual property licensing considerations.

2. Corporate Relational Model

The Corporate Relational Model has also been commonly used by governing organizations as a means of maintaining inter-corporate relationships with member organizations. The Corporate Relational Model, in essence, involves the governing organization exercising a limited right of approval or veto over certain key aspects of the corporate governance structure of the member organization. This model can involve different variables, such as a percentage (*e.g.*, up to 49 per cent) of the directors/members of the member organization being required to receive and maintain the approval of the governing organization, provided that these “approved directors” do not constitute a majority of directors for quorum purposes at board meetings. Of course, it is possible under corporate law to have more than 49 per cent approval, but a higher percentage increases the possibility of cross-over liability between the corporations. There could be some overlap of the board of the member organization with the board of the governing organization, but such overlap should be kept to a minimum for the same reasons set out above in the Ex Officio Relational Model. Another variable would be a requirement that approval be obtained from the governing organization before any changes could be made to the corporate documents of the member organization, specifically the corporate objects, the corporate name and dissolution clause of the member organization or any by-law provisions granting specific rights to the governing organization. Another possible variation would be to grant key representatives of the governing organization the right to attend board and member meetings of the member organization, but not the right to be members thereof or to vote at those meetings.

Although the utilization of ex officio directors can be an effective means of maintaining an inter-corporate relationship with a member organization, it is not recommended that it be relied upon as the only means of maintaining an inter-corporate relationship, since this model does not encompass contractual arrangements or intellectual property licensing considerations.

Because of these limitations, the Corporate Relational Model should be used in conjunction with the Franchise Relational Model described below.

3. Franchise Relational Model

A practical parallel can be drawn involving the relationship between a franchisor and its franchisees and the relationship between structuring multiple charitable corporations. By way of example, in applying the Franchise Relational Model to an umbrella association, the governing organization of an umbrella association, as the franchisor, must establish an alternative means of exercising co-ordination and standards with regard to its member organizations as the franchisees. This would be done through the contractual relationship of a franchise agreement, which can be adapted to establish an effective inter-corporate relational mechanism between a governing organization and its member organizations.

By utilizing the Franchise Relational Model, a governing organization can establish a contractual relationship with its member organizations to address key factors, such as the contractual requirements for a relationship with the governing organization and the consequences of losing that relationship. The franchise agreement would also be used to authorize the licensing of trade-marks, corporate names and copyrights owned by the governing organization.

However, it should be noted that the Franchise Relational Model can only be practically implemented if the name or trade-marks of the member organizations are some type of derivatives of the name or a trade-mark of the governing organization. This is because the effectiveness of the Franchise Relational Model is premised upon the ability of the governing organization to terminate the right of the member organizations to utilize the goodwill of the governing organization by having their corporate names or trade-marks being very similar to that of the governing organization.

The Franchise Relational Model works well with all types of multiple charitable corporations discussed above. One example of this is with an umbrella association, such as a religious denomination or other types of national charities, since the model provides an effective tool to ensure compliance by member churches with denominational standards and expectations.

The implementation of the Franchise Relational Model would involve the establishment of an umbrella association, the development of an association agreement between the governing body of the umbrella

association and each member organization as a form of franchise agreement, including appropriate relational provisions within the incorporation documents of each of the member organizations, and implementing a licensing arrangement to protect the applicable intellectual property. Each of these key aspects of the Franchise Relational Model are briefly described below.

a) Association Agreement

The association agreement (or “charter agreement”, “affiliation agreement”, or “membership agreement”) sets out the contractual relationship between the governing organization and its member organizations. There are a number of fundamental considerations that should be included in an association agreement:

- The preamble should state that the governing organization and the member organizations have similar charitable purposes, that the governing organization and the member organizations are recognized at law as being separate and distinct corporate entities with separate boards of directors and that the governing organization and the member organizations are to remain independently responsible for their own management and governance;
- The term of the association agreement should be set out and should be of a reasonable length, e.g., a five-year term with an automatic renewal provision thereafter for additional five-year terms, subject only to termination under limited circumstances as set out in the agreement;
- An explanation of the parameters under which the name and trade-marks of the governing organization can be utilized by the member organization, with particulars to be set out in a separate trade-mark license agreement, including the consequences of violating the agreement;
- The actions by the member organization which can lead to termination, such as the member organization being in default of specific obligations under the agreement which are not cured within a specific period of time, or the loss of charitable status, bankruptcy, or dissolution or winding up by the member organization;
- The resulting consequences of that termination, such as the loss of an ongoing right to use its corporate name, the loss of a right to represent itself as being associated with the governing organization, the loss of a right to use the governing organization’s intellectual property and, in some situations, the requirement to transfer its remaining charitable property to another registered charity as discussed below; and

- An arbitration or mediation clause which outlines how disagreements between the entities will be resolved and, failing a resolution, that the direction of the courts will be sought.

The basic requirements for the member organization's incorporation documents should also be clearly articulated, including the following:

- The letters patent of the member organization should include at least the general parameters for the charitable purposes of the member organization, a requirement that the member organization include a denominational statement of faith (if applicable), the wording for the dissolution clause, etc.;
- The qualification requirements of the directors, officers and members of the member organizations, such as religious affiliation;
- The incorporating documents for the member organization should be drafted or amended in accordance with the requirements set out in the association agreement;
- The governing organization should then be given an opportunity to review and approve the final form of the application for letters patent and the initial general operating by-law for the member organization for the purpose of consistency; and
- The governing organization should also be given an opportunity to review and approve limited fundamental changes to the corporate documentation, such as the corporate objects, the corporate name and the dissolution clause in the letters patent and/or specific rights given to the governing organization under the by-laws.

Provided that the member organization complies with the terms of the association agreement, it will normally be entitled to the following rights flowing from the association relationship:

- The right to use of the governing organization's trade-marks, industry names and copyrighted materials in accordance with a license agreement;
- The right to use a particular way of operating a charitable program or a fundraising campaign, both of which might be copyrighted and possibly even patentable; and

- The right to seek advice, but not direction, from the governing organization on fundraising, administrative, governance, donor care, public relations, human resources and programming matters;
- The right to obtain resource, promotional, administrative and financial services from the governing organization.

It should be noted that the expenses connected with these rights are often at the sole expense of the member organization, and as such Goods and Services Tax (GST) may be due and payable by the member organization, depending on the particular circumstances of the rights prescribed.

In exchange for these rights, the member organization will be required to comply with certain expectations that would need to be clearly articulated, including the following:

- The member organization is expected to operate pursuant to agreed upon charitable objects and within the parameters of broadly described, preapproved charitable programs, provided that the specifics of those programs are implemented in the discretion of the board of directors of the member organization;
- The member organization must maintain identifiable standards in conducting its charitable programs;
- The member organization must maintain its corporate status and charitable status;
- The member organization is required to provide regular reporting to the governing organization to evidence how its programs are achieving its intended charitable purposes; and
- In the event that the member organization fails to provide regular reporting, or the reports create a cause for concern, the governing organization would reserve the right to inspect the member organization's operations in order to determine that the intended charitable purposes of the member organization are being achieved.

Finally, the association agreement should articulate the consequences of termination of the association relationship, which would generally include the following as referenced earlier:

- The loss of the member association's right to use the governing organization's trade-marks, copyrights, and industry name; and

- In some situations, such as where a governing organization has gifted property to a member organization as would be the case with a gift of land and buildings, the transfer of its remaining charitable property from the member organization to another registered charity with similar charitable purposes, subject to consultation with and, in limited circumstances, approval by the governing organization, in order to ensure that the said charitable property is utilized in accordance with the intended charitable intent of the donors, particularly in relation to donor restricted charitable gifts.

b) Intellectual Property Considerations

Generally, a member organization will need to utilize the intellectual property (i.e., trade-marks, corporate names, domain names and copyrighted material) of the governing organization. Some or preferably all of these rights should be owned by the governing organization. The correct ownership and usage of this intellectual property requires proper protection and licensing.

In this regard, the most important asset of a charity is the goodwill associated with its name as a trade-mark.²² In the context of a governing organization, its name as a trade-mark and associated design logo constitute the basis by which the public will identify the organization and the activities that it carries on. Generally, the corporate name and various operating names and logos of the governing organization should be separately registered as trade-marks. The registered trade-marks should then be licensed to each member organization by a separate trade-mark license agreement that is attached to the association agreement as a schedule to include the following:

- Recognition of the ownership of the trade-marks by the governing organization;
- An explanation of how the trade-marks can be used by a member organization and sufficient means by which the governing organization can exercise control over the use of the trade-marks;
- How the trade-marks are to be protected and enforced; and

²² For further discussion on the importance of trade marks and branding for charitable and not-for-profit organizations, as well as guidance on how organizations can best protect and advance these assets, see Terrance S. Carter, "Avoiding Wasting Assets II – Trade-mark and Domain Name Protection for Charities" (Paper presented to the 2nd National Symposium on Charity Law, April 2004), online: <<http://www.carters.ca/pub/article/charity/2004/tsc0414.pdf>>. See also Terrance S. Carter & U. Shen Goh, *Branding & Trade Marks: Handbook for Charitable and Not-for-Profit Organizations* (Toronto: Butterworths, 2006).

- A description of what constitutes default under the trade-mark license agreement and the consequences resulting from the termination of the trade-mark license.

Copyright issues can also be an important part of establishing an inter-corporate relationship between a governing organization and a member organization. Once the issue of ownership of the copyrighted material has been established, it may be prudent to register the copyright, particularly if the materials are going to be used in the public domain, such as on an internet web page.

Examples of copyright materials belonging to the governing organization that are used by member organizations include resource materials, audiotapes, videotapes, training manuals, checklists, brochures, fundraising documentation, charitable programs, etc. A copyright license should be prepared and entered into similar to a trade-mark license. It is important that the governing organization set out in a copyright license agreement an acknowledgment of its ownership rights in the copyrighted materials, the parameters under which the member organization can use those copyrighted materials, the basis by which the copyright license will be terminated and the consequences of such termination.

c) Reducing the Risk of Cross-over Liability

A fundamental aspect of utilizing multiple charitable corporations is the need to maintain the integrity of the limited liability protection of the various incorporated entities. While the concept of limited liability protection is still the general rule for corporate entities, there are instances where the governing organization or operating charity could be found liable for the actions of a member organization or affiliated corporation as a result of the equitable doctrine known as “piercing the corporate veil.”

Instances where courts in the U.S. have been prepared to “pierce the corporate veil” have occurred where a subsidiary corporation has been found to be a mere instrument or alter-ego of the parent

corporation and where there have been significant elements of common identity established between the parent and the subsidiary corporation.²³

In Canada, recent case law involving residential schools has suggested that a multiple corporate structure could still leave affiliated corporate entities exposed to liability where a member or employee of either an affiliated member entity or a governing entity is found liable for damages in a lawsuit. The *Christian Brothers*²⁴ decision was a landmark case on the application of cross-over liability for charitable and not-for-profit organizations. This is also true in the for-profit sector, as franchisors may be held liable for the negligent acts of their franchisees, especially where it is not made clear that the two are separate and independent of each other.²⁵ However, if the Corporate Relational Model together with the Franchise Relational Model is used correctly, exposure to cross-over liability can be minimized.

As discussed at the beginning of this paper, based on a review of recent residential school case law, cross-over liability may result where a governing organization which has a significant degree of control over the actions of the members or employees of associated incorporated entities, either based on the assertion of an employer/employee relationship or a principal/agent relationship. In the case of a single national legal entity, such as a national religious denomination, liability arising in any part of the entity will affect the assets of all of the other parts of the national entity.²⁶

While there are no guarantees, the following are some practical steps that can be taken to reduce a finding of cross-over liability between multiple charitable corporations:

- Ensure separate incorporation of each entity is properly done;
- Expressly define the limits of power and authority of each entity so that each separate entity is clearly self-contained in its operations and publicly state that each entity is independently operated;

²³ See Robert E. Crotty and Russell G. Bogin, "Parent Corporation Liability for the Acts of its Subsidiaries", 3 *Review of International Business Law*, 205 at 207 (1989).

²⁴ *Supra* note 7.

²⁵ See for example, *Leahy v. McDonald's Restaurants of Canada Ltd.*, [1993] O.J. No. 2226 (Gen. Div.) (QL) and *Beuker v. H&R Block Canada Inc.*, [2001] 10 W.W.R. 274 (Sask. Q.B.).

²⁶ *Supra* note 19.

- Permit only very limited cross-over board membership, if not completely separate boards of directors and board meetings;
- Permit only minimal overlap of membership in key committees of the corporations; and
- Have each incorporated entity keep up-to-date records of activities in its own corporate minute book to show its independence from other affiliated entities.

In addition to different board composition between corporations, each corporation should ideally have:

- A separate head office address;
- Separate staff; and
- In some situations, even separate lawyers and accountants

All of the above will assist in evidencing that each charitable corporation in the multiple corporate organizational structure operates on an arm's length basis from other entities in the structure.

Some of the factors suggesting "central control" over multiple corporations, which should be avoided, where possible, are as follows:

- Having the governing organization involved in the licensing, hiring, disciplining, payment or general day-to-day direction and supervision of employees of the member organization;
- Having common banks accounts or investments shared between the governing organization and the member organization;
- Making explicit or implicit representation that the governing organization is responsible for the operations of the member organization;
- Having both organizations occupy the same location for either operational or administrative activities;
- Using the same officers or employees unless there is documentary evidence establishing that one organization is invoicing the other organization for the services provided by the employees of the other organization;

- Using the land, buildings or property of the other organization without an arm's length lease or license agreement;
- Having the same individuals serve on the board of directors or key committees of both entities where there is a significant overlap in membership; and
- Indicating on letterhead, signs, brochures or other documentation that the member organization is an operating division of the governing organization.

Notwithstanding all of the above considerations, given recent case law, it is important to recognize that no guarantee can be given that the establishment of any type of multiple corporate structure will necessarily stop a finding of cross-over liability by the courts.

E. CRA DRAFT POLICY ON UMBRELLA ORGANIZATIONS

1. Overview

CRA released a draft policy on umbrella organizations in July 2005, entitled *Consultation on Proposed Guidelines for the Registration of Umbrella Organizations*²⁷ (the "Guidelines").²⁸ The Guidelines will be relevant in the establishment of a multiple corporate structure involving property holding and umbrella organizations. The Guidelines define a charitable umbrella organization as one that "works to achieve a charitable goal by supporting, improving, and enhancing the work of groups involved in the delivery of charitable programs."²⁹ The Guidelines make it clear that an umbrella organization can now qualify for registration, since it is the position of CRA that "umbrella organizations that, through their activities, improve and enhance the charitable activities of other, generally community-minded organizations, are also advancing a charitable purpose." It should be noted that there are other taxation issues that should be addressed in establishing a multiple corporate structure that are beyond the scope of this paper, such as: disbursement quota issues on inter-charity transfers, the possible imposition of land transfer tax on the transfer for land and buildings in Ontario, as well the possible incursion of GST involving payments under lease and license agreements between an operating charity and a property holding charity.

²⁷ Canada Revenue Agency, online: <http://www.cra-arc.gc.ca/tax/charities/consultations/umbrella-e.html>.

²⁸ See Jacqueline M. Connor and Terrance S. Carter, "New CRA Policy on Umbrella Organizations" (2005), *Charity Law Bulletin* No. 78, online: <<http://www.carters.ca/pub/bulletin/charity/index.html>>.

²⁹ *Supra* note 27.

2. Types of Umbrella Organizations

a) Charities Established to Assist Other Registered Charities

These are organizations that support the charitable sector by promoting the efficiency and effectiveness of registered charities. The beneficiaries of the services of an umbrella organization must be predominantly other registered charities, although some incidental support of organizations that are not registered charities is permitted, *i.e.*, must not exceed 10% numerically and in terms of devoted resources.

The objects of these charities must clearly reflect that the purpose of the organization is to improve the efficiency and effectiveness of other registered charities. As well, the activities must be the logical means of accomplishing its charitable purposes and reasonably result in the improvement and effectiveness of the other registered charities.

b) Umbrella Organizations Advancing a Recognized Charitable Purpose

These are organizations which are established to further a particular charitable purpose, *i.e.*, other than assisting charities, which may convey benefits on constituent groups as ancillary to the achievement of that purpose. Where these types of umbrella organizations are specifically designed to increase, enhance or improve services to charitable beneficiaries, then it is also acceptable for such umbrella organizations to increase the capacity and ability of member organizations as a secondary result of their work. The purposes of this type of umbrella organization must always be stated in relation to the charitable purpose that the organization is established to advance. As well, acceptable activities are only those that achieve or advance the charitable purpose of the organization.

c) Charities Established to Hold Title to Property

The recognition by CRA that organizations established to hold title can be charitable organizations, as opposed to charitable foundations, is an important development. It is now possible for charitable foundations to incur debts in taking title to property, thereby increasing the availability of asset protection arrangements to both charitable organizations and foundations. The beneficiaries of this third type of umbrella organization must only be registered charities. Its formal purpose must be to

provide a charitable service or benefit to the tenant or licensee charity and not merely to passively hold title to the property, as this alone is not charitable at law.

The activities of these title-holding organizations can vary from merely title-holding entities to ones that provide a more comprehensive range of services, *e.g.*, property management services. Further, the land holding charity must show that it provides some benefit to the tenant or licensee charity, although it is not clear why, since the provision of land, typically with a building on it, should be recognized as an inherent benefit to the charity.

The Guidelines³⁰ then address the requirements of these title holding entities with regard to reporting expenses. CRA takes the position that a mere permission to occupy the premises does not constitute an expenditure, nor does it constitute a gift to the tenant charity. However, if the provision of services to other charities is considered to be charitable for the first type of umbrella organization, *i.e.*, charities established to assist other registered charities, there is no reason why the fair market value of the provision of the premises to the tenant or licensee charity should not also constitute a charitable expenditure for a title-holding charity.

F. CONCLUSION

There are many advantages for a charity in the utilization of a multiple corporate structure as an effective means of assisting in containing liabilities and protecting assets. A charity can choose from a wide variety of structures, including a parallel operating charity, a parallel foundation and an umbrella association. In addition, inter-corporate relational mechanisms can be utilized in a multiple corporate structure to require separately incorporated member organizations to abide by standard and co-ordinating efforts by the governing organization. However, since the implementation of a multiple corporate structure can leave affiliated corporate entities exposed to cross-over liability in some situations, it is essential for charities to take careful steps in implementing such a structure in order to avoid the appearance of “central control” by the governing organization over its member organizations.

³⁰ *Supra* note 27.