



## Ontario Bar Association Navigating Conflicts of Interest for Charities and Not-for-Profits February 26, 2025

### Conflicts of Interest for Lawyers who Work with Charities and Not-for-Profits

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#### Overview

1. Duties & Obligations of Directors & Officers of Not-for-Profit ( NFP) and Charitable Corporations
2. Options available to Directors who wish to Provide Legal Services
3. Regulation 4/01 to the Charities Accounting Act (CAA)
4. Providing Legal Services while serving as a Director: Reality Check
5. Potential Conflict of Interest Scenarios for in-house and external legal counsel
6. Key Takeaways

## 1. Fiduciary Duties of Directors and Officers of Not-for-Profit (“NFP”) and Charitable Corporations

- Directors and officers of NFP and charitable corporations are subject to fiduciary duties under statute and at common law
- *Canada Not-for-Profit Corporations Act* (CNCA) s. 148(1) and *Ontario Not-for-Profit Corporations Act* (ONCA) s. 43(1):
  - Every director and officer of a corporation in exercising their powers and discharging their duties shall
    - (a) act honestly and in good faith with a view to the best interests of the corporation; and
    - (b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.
- In addition to the duties imposed by the CNCA/ONCA, directors continue to be subject to common law principles regarding fiduciary duties of directors

- Under common law, directors stand in a fiduciary relationship to the corporation and its purposes. Duties arising from this fiduciary relationship include:

Duty to Act in Good Faith with Honesty and Loyalty

Duty of Diligence

Duty to Exercise Power

Duty of Obedience

Duty of Confidentiality

Duty to Avoid Conflict of Interest

Duty to Continue

- The fiduciary relationship is that of good faith, trust, and special confidence, and requires directors to (*inter alia*):
  - Have undivided loyalty to the corporation
  - Act at all times in the best interests of the corporation
  - Avoid situations in which their private interests conflict with those of the corporation
  - Not use their position to gain personal benefit
- Duties include the avoidance of possible as well as perceived conflicts of interest
- Directors of charities are also subject to additional high fiduciary obligations as quasi-trustees when managing charitable property, including:
  - The duty to protect and conserve charitable property
  - The duty to use the charity's resources to carry out its charitable purposes
  - The duty to act gratuitously for the charity

- Directors of charitable corporations are prohibited at common law from receiving any direct or indirect remuneration, whether in their capacity as a director or for other services provided to the charity, without court approval
  - (although they can be reimbursed for reasonable out of pocket expenses)
- Section 143 of the CNCA and section 47 of the ONCA permit the board to fix the reasonable remuneration of the directors and allow directors to receive reasonable remuneration for services to the corporation performed in another capacity
- In addition, section 141(9) of the CNCA and section 41(10) of the ONCA would permit a director who has a conflict of interest to declare the conflict, have it ratified by the members of the corporation and not be accountable to the corporation for any profit
- However, in Ontario the common law overrides these provisions
- e.g. ONCA section 5(2) – the law of charities prevails

## 2. Options available to directors of a charity who wish to provide legal services to the charity

What can the director do?

1. Resign from the board of directors
2. Obtain a court order authorizing payments to the director for legal services.
3. Obtain a consent order under section 13 of the *Charities Accounting Act, (Ontario)* (“CAA”) approved by the Public Guardian and Trustee (“PGT”)
  - The PGT is able to exercise the authority of the courts in a limited context by granting consent orders made under section 13 of the CAA
  - Need to show that remunerating the director for their services in another capacity would be in the best interests of the charitable corporation
4. Regulation 4/01 under the CAA

## 3. Regulation 4/01 to the *Charities Accounting Act*

### 1. Regulation 4/01 under the CAA (the “Regulation”)

- Enacted in April 2018 to permit a charitable corporation to make payments to directors or persons connected to directors in certain circumstances
- The PGT also released a guidance document to the Regulation, [Payments to Directors and Connected Persons](#) (the “Guidance”)
- Common law continues to apply, but the Regulation and the Guidance provide another mechanism for authorizing payments to a director (or a person connected to a director) without obtaining a court order or section 13 consent order
- All applicable requirements in the Regulation and Guidance must first be met

### Incorporated Charities and Connected Persons:

- A “corporate trustee” may “...make payments from the charitable property acquired by it to any of the following persons, for goods, services or facilities provided to it” in accordance with the Regulation:
  1. A director of the corporate trustee
  2. A person connected to a director of the corporate trustee (“Connected Person”)
- “Corporate trustee” - the Regulation cannot be used to pay trustees of charitable trusts or non-incorporated charitable organizations. Per the Guidance it includes any NFP operating in Ontario that is a registered charity or has exclusively charitable purposes
- Lengthy list of Connected Persons – includes family members and employers of directors, as well as partnerships in which the director or their family member is a partner

### Payments that are not permitted under the Regulation

- Directors of a charitable corporation cannot receive the following types of payment under the Regulation:
  - Payment to serve as a director
  - Payment to serve as an employee of the charity (while a director)
  - Payment for fundraising services and goods/services relating to fundraising
  - Payments involving the purchase or sale of real property
- In situations where these requirements cannot be met – such as where a religious leader also sits on the board of directors – a court order would be required to pay them (i.e. a consent order under section 13 CAA)

**What the charitable corporation's board of directors must consider before approving a payment under the Regulation**

- The payment must be made with a view to the charitable corporation's best interests, considering the factors set out in the Guidance
- The payment must be in an amount that is reasonable for the goods, services or facilities provided, considering the factors set out in the Guidance
- The payment must not result in the amount of the debts and liabilities of the charitable corporation exceeding the charitable property's value or render the charitable corporation insolvent
- The board's consideration of all applicable requirements should be documented in board minutes as evidence of the board's due diligence

**Before the charitable corporation's board of directors may authorize a payment**

- Every director of the charitable corporation must agree in writing to a maximum amount that the charity can pay for the goods, services or facilities
- If the goods, services or facilities are to be provided by a Connected Person, that person must also agree in writing to the maximum amount
- Payment cannot exceed the maximum amount in the agreement, unless the agreement has been amended – to amend the agreement the charitable corporation would have to again satisfy the requirements under the Regulation
- Every director of the charitable corporation, other than the director receiving the payment, must agree in writing that they are satisfied that the conditions set out in the Regulation have been met
- The board must consider any additional requirements set out in the Guidance

### Other requirements under the Regulation

- There must be at least 4 voting directors on the board (not counting the director receiving the payment or the director connected to the Connected Person, as applicable), *i.e.* at least 5 directors in total
- The total number of persons receiving payment under the Regulation or who are connected to persons receiving remuneration must not exceed 20% of the number of (voting) directors on the board
- The director who is to receive the payment from the charitable corporation or the director connected to the Connected Person, as applicable, must not attend or participate in the board discussion regarding the proposed payment and must not vote on the matter

- The board must ensure that information regarding the payments to a director and/or a Connected Person in a given year is:
  - Noted in the charity's financial statements for that year, and
  - Placed before its members at an annual meeting of the members
- Directors who fail to comply with the requirements in the Regulation and the Guidance could be found in breach of their fiduciary duties and could be liable to repay the funds on a joint and several basis
- If a charitable corporation proceeds with the proposed payment to a director or a Connected Person, it is important to maintain proper documentation showing the due diligence steps taken by the board of directors to comply with the Regulation and Guidance
- The board's consideration of all applicable requirements should be documented in board minutes as evidence of the board's due diligence

#### 4. Providing Legal Services while serving as a Director: Reality Check

- Lawyers should carefully consider the propriety and the wisdom of providing legal services if they are on the board of a charitable corporation notwithstanding Regulation 4/01. Why?
- The remedial steps under Regulation 4/01 are really a last resort/fallback – they may address the payment issue but not the underlying inherent conflict
  - Duties as a director conflict with duties as a lawyer – inherent conflict in advising yourself as one of the directors
- The payments also would have to be included in the charitable corporation's annual financial statements and placed before the members – poor optics
- Blurring the lines between acting as a lawyer and as a director can also result in professional liability, whether or not the lawyer is paid
- Lawyers on the board can play a legitimate role in working with external counsel

#### 5. Potential Conflict of Interest Scenarios for legal counsel working with charities and NFPs

##### 1. In house counsel:

- Law Society of Ontario Rules of Professional Conduct (“LSO Rules”)
- Rule 3.4-29, commentary 1 confirms that the relationship between lawyer and client is a fiduciary one
- Rule 1.1 commentary confirms that the client is the corporation itself
- Where a lawyer is employed by a charitable corporation, the in house counsel's fiduciary duty is to the client charitable corporation and must be foremost
- In house counsel's interests as an employee must be secondary
- In house counsel cannot allow their personal interests to impair the professional advice they are providing to the client charitable corporation



## **2. Dual Obligations of In house counsel:**

- In house counsel has duties to their employer as well as professional duties
- These may come into conflict
- LSO Rules 3.2-8 commentary 5 - A lawyer acting for an organization who learns that the organization has acted, is acting, or intends to act in a wrongful manner is required to report the matter "up the ladder" of responsibility within the organization until the matter is dealt with appropriately. If the organization, despite the lawyer's advice, continues with the wrongful conduct, the lawyer is required to withdraw from acting in the particular matter
- In some but not all cases, withdrawal means resigning from their position or relationship with the organization and not simply withdrawing from acting in the particular matter

## **3. Taking Instructions**

- LSO Rule 1.1 commentary – “the client is the corporation itself and does not include a near-client, such as an affiliated entity, director, shareholder, employee or family member, unless there is objective evidence to demonstrate that such an individual had a reasonable expectation that a lawyer-client relationship would be established”
- The lawyer’s fiduciary duties are owed to the corporation, as represented by the board of directors, and not to the officers, employees, or individual directors that they may customarily deal with
- Who has authority to instruct you? Executive director, board, employees?
- Do others in the charity think you act for them too?
- What if the executive director and the board are not *ad idem*?
- What if employees, individual directors etc. seek casual legal advice?

#### **4. Acting for Parallel Organizations**

- LSO Rule 1.1-1, a conflict of interest exists when there is a substantial risk that a lawyer's loyalty to or representation of a client would be materially and adversely affected by the lawyer's own interest or the lawyer's duties to another client, a former client, or a third person
- LSO Rule 3.4-1 commentary 6 - Duties owed to another current client can impair client representation and loyalty
- LSO Rule 3.4-1 commentary 7 - A lawyer cannot act directly adverse to the immediate legal interests of a current client, without the clients' consent
- Potential for either type of conflict of interest arising when acting for parallel organizations, such as a hospital and its foundation

- LSO Rule 3.4-2 - Lawyer should obtain joint retainer and fully informed and voluntary consent from each client and must reasonably believe that they are able to represent each client without having a material adverse effect upon the representation of or loyalty to either one
- No information from either client can be treated as confidential
- Problem when independent legal advice is required or when the interests of the clients diverge
- Must carefully manage conflicts of interest – if a dispute or conflict the lawyer cannot continue to act for each and may have to withdraw from both

### **5. Split board of directors**

- Situations can arise where there is a dispute among directors
- What if a faction of directors seeks legal advice from corporate counsel with respect to the other faction?
- LSO Rule 1.1 - The lawyer's fiduciary duties are owed to the corporation, as represented by the board of directors, and not to individual directors, even if a majority of directors are in agreement
- The lawyer may need to advise the directors to obtain independent legal advice

### **6. Rogue director scenario:**

- In a related scenario, what if one director is clearly out of sync with the rest of the board and acting in an obstructive fashion?
- In light of the lawyer's fiduciary duty to act in the best interests of the corporation, they may be able to advise the rest of the board, as long as notification of meetings is provided to all directors and the lawyer/board are not trampling the rights of the rogue director
- Whether this is acceptable would need to be determined on a case-by-case basis

**7. Insolvency**

- What if a corporation is in financial distress/insolvent?
- In house counsel and external corporate counsel have a duty to advise their client, which is the corporation, and not the directors, who may be facing their own potential personal liability
- The board of directors therefore may need independent legal advice

**G. Key Takeaways**



Directors of charitable corporations in Ontario are subject to fiduciary duties under both statute and common law, including high fiduciary duties with regard to charitable property



Regardless of whether Regulation 4/01 can be used to authorize payment to a lawyer for providing legal services while a director, they should carefully consider whether it is advisable to do so



Lawyers who act for charitable and NFP corporations need to be aware of the different types situations in which conflicts of interest may arise



In house counsel for charitable and NFP corporations may face particular challenges in identifying and managing conflicts of interest

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