

# The Legal Fundamentals of Serving as a Director of a Charity

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Production of this capacity building workshop for charities has been made possible by a financial contribution from the Canada Revenue Agency

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# Agenda

1. Legal structure of charities
2. Areas of potential director liability
3. Legal duties of directors
  - common law and fiduciary
4. Protection of directors
5. A checklist for directors

# Legal Structure

Most charities are incorporated under provincial legislation

- BC *Society Act*
- Alberta – *Societies Act*
- Saskatchewan – *The Non-Profit Corporations Act, 1995*
- Manitoba *Corporations Act*
- Yukon – *Societies Act*

## Legal Structure

Other charities are incorporated federally under Part II of the *Canada Corporations Act*.

- (On January 28, 2009, Bill C-4, *An Act respecting not-for-profit corporations and certain other corporations*, was tabled in the House of Commons.)

Some charities are trusts

A few charities are unincorporated entities governed by their own constitutions

# Legal Structure

- The legal duties for charity directors arise from the incorporation legislation, the bylaws of each charity, the common law (court decisions), trust law, the federal *Income Tax Act*, plus other acts and regulations.
- Know your incorporation legislation, your constitution (letters patents, articles of incorporation) and bylaws.
- Visit the CRA “Charities and Giving” website:  
<http://www.cra-arc.gc.ca/tx/chrts/menu-eng.html>

## Directors – the basics

- Responsible for the governance and management of the charity.
- Accountable to the members.
- May delegate functions (to officers and staff) but not ultimate responsibility.
- Not immune from individual liability.

# Potential Director Liability

- Criminal (*Criminal Code of Canada*)
  - fraud
  - conspiracy
  - retaliating against whistle blowers
- Rare, but possible

# Potential Director Liability

- Tort – civil liability
- Examples:
  - Personal injury (unsafe property, unsafe work practices)
  - Assault or abuse by staff, volunteers
  - Wrongful dismissal (with malice)
- Directors can be personally liable if they were negligent in their oversight of the organization (action or inaction)

# Potential Director Liability

- Contract
  - Lacking authority
  - Uncertainty as to whether the director is signing on behalf of the organization or personally
  - Failure to ensure that the organization complies with the contract

# Potential Director Liability

- Other Statutes
  - Federal *Income Tax Act*, *Pension Plan Act*, *Employment Insurance Act* – failure to remit employee taxes or premiums – up to \$10,000 fine
  - Failure to remit GST
  - *Environmental Protection Act*
  - *Anti-Terrorism Act*

# Potential Director Liability

## Various Provincial Acts

- Some violations of incorporation legislation can result in fines to directors. BC *Society Act*, s. 93 – fines up to \$2,000 for false statements.
- Workers' compensation, health and safety
- Environment
- Building codes

# Legal Duties of Directors

- The law is not very well developed
- Not much case law
- Some legislative guidance
  - *Nova Scotia Act* silent
  - *BC Society Act* section 25
- 2 sets of duties - common law or corporate law duties and fiduciary duties

# Legal Duties of Directors

(Common Law)

- Duty to Manage
- Duty of Knowledge
- Duty of Care
- Duty of Skill and Prudence
- Duty of Diligence
- Duty to Act Within Scope of Authority
- Duty to Avoid Conflicts of Interest
- Duty of Obedience

# Legal Duties of Directors

- Duties owed to:
  - the organization
  - members
  - employees, staff, and volunteers
  - other directors
  - people or communities served
  - general public

## Duty to Manage

- Directors are responsible for all aspects of the organization
- Members entrust directors with management duties, subject to the act and bylaws
- Directors may delegate to staff
- Directors then set policies and strategic direction, then measure staff implementation performance

# Duty of Knowledge

- Know your memorandum of association, bylaws, and key policies
- Know what the organization does (history, current and future plans)
- Orientation for new directors is critical
- On-going refreshers and education is important
- Review the memorandum, bylaws, and policies periodically

# Duty of Care

- Objective versus subjective test
- BC, SK, MB, NL – objective test:

“A director of a society shall...exercise the care, diligence and skill of a reasonably prudent person in exercising his powers and performing his duties as a director”
- Other provinces – subjective test:

Directors must meet the standard of conduct reasonably expected of a person of such knowledge and experience as the specific director.

# Duty of Skill and Prudence

- Directors must:
  - act practically
  - be cautious
  - try to anticipate problems and opportunities
- Will depend on the Director's role (Secretary, Treasurer, etc.)
- Subjective in some provinces
- Objective in others: the “skill of a reasonably prudent person”

# Duty of Diligence

- Directors are responsible for all aspects of the organization:
  - must act in its best interests
  - must be well informed about the organization:
    - know what's going on
    - prepare for meetings
    - attend and participate
    - ask questions, raise concerns
    - vote

# Duty to Act Within Scope of Authority

- The purposes or objects language in the constitution or memorandum is critical
- Actions outside that scope are *ultra vires* or illegal
- Check your purposes or objects language before starting something new
- Particularly important for charities – consult CRA
- Vote against *ultra vires* actions and ensure that your vote is recorded

# Duty to Avoid Conflicts of Interest

- A personal financial interest in a subject matter also of interest to the organization is a conflict of interest.
- Directors must place the organization's interests first.
- Directors and their families should not benefit at the expense of the organization
  - Disclose conflicts
  - Do not participate in decision-making on the issue
  - Ratification by membership if necessary

# Duty of Obedience

Directors must comply with:

- the organization's memorandum or constitution, bylaws, rules, and policies
- applicable laws

# Fiduciary Duties

- Arise from a trust relationship
- Similar to the common law duties
- Uncertainty as to when they apply
  - Must act honestly and in good faith
  - Be loyal and act in best interests of the organization
  - Avoid conflicts of interest
  - Place interests of organization ahead of your own interests

# Summary of the Duties of Directors

- “A director who acts honestly and meets these standards of conduct and care will not be liable for simple errors of business judgment that occur while the director performs the duties of the office.”

Hugh M. Kelly, Q.C.

Duties and Responsibilities of Directors of Not-For-Profit Organizations  
Canadian Society of Association Executives, p. 15

## Another Summary

- Act honestly, in good faith, and in the best interests of the organization, avoid personal interests that conflict with the organization's interests, and apply your best judgment to each decision.

# Protecting Directors

- Independent advice
- Insurance
- Indemnification
- Ratification
  
- Most effective: manage risks with good management and governance

# Independent Advice

- With issues beyond the Board's scope of knowledge, independent professional advice can protect the directors.
- Legal, accounting, engineering, etc.

# Indemnification

- A promise by the organization to cover costs incurred in carrying out the duties of a director or officer, including:
  - legal fees,
  - settlements,
  - fines.
- Only works if the organization has the resources to pay.
- Insurance is usually part of the equation.

# Insurance

- General Liability Insurance:
  - physical injury or property damage
- Directors & Officers Liability Insurance:
  - errors, omissions, misstatements, breach of duty
- Policies differ – beware of exclusions:
  - dishonest, fraudulent, or criminal actions
  - breach of contracts, wrongful dismissal, discrimination, harassment claims, etc.

# Insurance

- Understand the coverage
- Weigh the costs and potential benefits
- Review insurance needs regularly

# Ratification

- Subsequent approval by the members of a Board decision
- If there is full disclosure of the facts, ratification can transfer potential liability from directors to the organization

# Manage Risks

- Look out for potential harm or loss
  - Take steps to prevent the harm or loss from occurring
  - If problems occur, take steps to minimize or mitigate the harm or loss
  - Apply good judgment
- (staff screening, training and supervision, reasonable rules, inspect facilities, know and meet legal requirements, document decisions)