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**Duties and Liabilities of Directors and Officers of Charities and Non-Profit
Organizations**

**Terrance S. Carter and Ryan M. Prendergast
Carters Professional Corporation**

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A. INTRODUCTION

Many community leaders, particularly professionals, often serve as volunteer directors or officers on the boards of charities and non-profit organizations (“NPOs”). In this regard, the 2007 Canada Survey of Giving, Volunteering and Participating by Statistics Canada and Imagine Canada reported that a third of all Canadian volunteers hold positions on boards and committees.¹ Such volunteerism is laudable and comes with a certain prestige. However, many individuals take on the position of director or officer of a charity or NPO unaware of the significant duties that are imposed on them and the resultant liability that they may face in so doing. While these individuals may hold a position on the board of a for-profit corporation concurrently with their position on the board of a charity or an NPO, there is often a mistaken belief that the position of a director or officer of a charity or NPO somehow involves less exposure to liability, notwithstanding that charities and NPOs are often involved in risky programs, such as working with vulnerable individuals or coordinating the activities of volunteer services for many individuals within a community. While there are many similarities in the duties and liabilities of directors and officers of for-profit corporations compared to those of directors and officers of charities and NPOs, there are also numerous differences in the duties

* The authors would like to thank Jason Todoroff, B.A. (Hons), J.D., Student-at-Law, for his assistance in the preparation of this article.

¹ Michael Hall et al, *Caring Canadians, Involved Canadians: Highlights from the 2007 Canada Survey of Giving, Volunteering and Participating* (Ottawa: Minister of Industry, 2009) at 47. This publication can be found online: <http://www.givingandvolunteering.ca/files/giving/en/csgvp_highlights_2007.pdf>.

imposed upon them that can expose directors and officers of charities and NPOs to a greater degree of liability, in certain situations, than that to which directors and officers of for-profit corporations may be exposed.

The purpose of this paper is to briefly outline the duties and liabilities that are unique to directors and officers of charities and NPOs. In this regard, the paper begins with a brief discussion of the differences between charities and NPOs. The paper next provides an explanation of the standard of care applicable to directors and officers of charities and NPOs, followed by a discussion of the high fiduciary obligations placed upon directors and officers of charities, and in some instances NPOs when dealing with charitable property. Lastly, the paper provides an overview of a select list of statutory duties, liabilities, as well as statutory protections, which are available to directors and officers of both charities and NPOs in certain situations.

B. BASIC CHARACTERISTICS OF CHARITIES AND NON-PROFIT ORGANIZATIONS

1. Preliminary Comments

For definitional purposes, reference to “not-for-profit corporation” in this paper means corporations that are structured as corporate entities without share capital that have a membership base as its governance core as opposed to shareholders. Currently, not-for-profit corporations in Ontario are incorporated either provincially under the *Corporations Act* (Ontario),² or federally under the *Canada Corporations Act*,³ although both acts are soon to be replaced with new legislation as explained later in this paper.

² *Corporations Act*, RSO 1990, c C38 [OCA].

³ *Canada Corporations Act*, RSC 1970, c C32 [CCA].

In general, not-for-profit corporations encompass entities which are registered charities, as defined under subsection 248(1) of the *Income Tax Act* (Canada) (“ITA”),⁴ and NPOs as defined under paragraph 149(1)(l) of the ITA. There are, however, other types of tax exempt entities included in subsection 149(1) of the ITA which operate both as corporations and unincorporated associations in addition to registered charities and NPO’s, such as agricultural organizations, boards of trade or a chambers of commerce,⁵ certain low cost housing corporations,⁶ labour organizations,⁷ pension trusts,⁸ as well as others. However, an exhaustive review of the specific duties and liabilities of each of these other tax-exempt entities is beyond the scope of this paper.

With regard to charities, not only do charities include those entities which are registered charities under the ITA, but also those which are considered to be charitable at common law, meaning an organization that is established exclusively under one or more of the four heads of recognized charitable purposes at common law, as discussed below.

With regard to the nomenclature involving charities and NPOs, many commentators, including those within the not-for-profit sector, mistakenly use the terms charities and NPOs interchangeably. Adding to this confusion in terminology is the fact that charities, as well as certain aspects of NPOs, are still largely governed by concepts developed in the 17th and 19th centuries.⁹ There are differences, however, in the expectations and standards of accountability between these two types of organizations with which directors and officers of such organizations and their legal advisors in particular should be familiar.

⁴ *Income Tax Act*, RSC 1985, c 1 (5th Supp) [ITA].

⁵ *Ibid* at s 149(1)(e).

⁶ *Ibid* at s 149(1)(i).

⁷ *Ibid*, at s 149(1)(k).

⁸ *Ibid*, at s 149(1)(o).

⁹ Donald Bourgeois, *The Law of Charitable and Not-for-Profit Organizations* (Markham: Butterworths, 2002) at 3.

The following is a brief summary of the differences between registered charities and NPOs.¹⁰

2. Charities

At common law, the term “charity” has a specific meaning that often eludes the popular conception. For an organization to be considered charitable at law, its activities must be undertaken to achieve a charitable purpose. At common law, only four categories of charitable purposes are recognized by the courts in Canada, based upon a long history of jurisprudence from the United Kingdom. In the seminal decision of *Special Commissioners of Income Tax v Pemsel*,¹¹ Lord MacNaghten of the House of Lords identified four “heads” or categories of charity as follows:

- Relief of poverty;
- Advancement of education;
- Advancement of religion; and
- Other purposes beneficial to the community not falling under any of the preceding heads.

Although the ITA does not make specific reference to these categories, the Charities Directorate of Canada Revenue Agency (“CRA”), the Ontario Public Guardian and Trustee (“OPGT”), and the courts in Canada rely on the same categories in regulating the charitable sector. In this regard, the Supreme Court of Canada in *Vancouver Society of Immigrant and Visible Minority Women v M.N.R.*,¹² endorsed the categorization of charitable purposes listed above in *Pemsel*.

¹⁰ For a more fulsome discussion of the differences between charities and NPOs, see Kathryn Chan, “Key Differences Between Non-profit Organizations and Charities under the Federal Income Tax Act” (Paper delivered at the Canadian Bar Association/Ontario Bar Association National Charity Law Symposium, 7 May 2007), [unpublished].

¹¹ *Special Commissioners of Income Tax v Pemsel*, [1891] AC 531 (HL) [*Pemsel*].

¹² *Vancouver Society of Immigrant Visible Minority Women v M.N.R.*, [1999] 1 SCR 10, [1999] SCJ No 5 (SCC).

There are clear tax advantages for obtaining charitable status, the primary ones being that a registered charity does not pay tax on income or capital gains and has the ability to issue charitable receipts to individual donors as tax credits, and to corporate donors as tax deductions, for income tax purposes. In this regard, if an organization has exclusively charitable purposes, it is normally the case that it will seek registration under the ITA in order to obtain the ability to issue charitable receipts for its donors. However, as noted above, an organization may qualify as a charity at common law even if it is not registered with CRA as a registered charity under the ITA.

A registered charity is categorized under the ITA as a charitable organization, a public foundation, or a private foundation, depending on which designation by CRA best reflects its objectives, its proposed activities, as well as the composition of its board. Which designation a registered charity falls under is important because it will determine which rules under the ITA will apply. In this regard, the following is a brief explanation of the different types of registered charity designations.¹³

a) Charitable Organization

Under the ITA, a charitable organization is an organization, whether or not incorporated, which devotes all of its resources to charitable activities carried on by the organization itself. In addition, no part of its income may be payable to or otherwise available for the personal benefit of a proprietor, member, shareholder, trustee or settlor of the charitable organization. However, charitable activities are not defined under the ITA. Rather, the meaning of charitable activities is based on jurisprudence. In any taxation year a charitable organization cannot disburse more than

¹³ For more information see Theresa L.M Man, “A Comparison of the Three Categories of Registered Charities”, *Charity Law Bulletin No 74* (5 September 2005) online: Carters Professional Corporation <<http://www.carters.ca/index.php>>; Theresa L.M. Man, “Recent Income Tax Act Amendments that Affect Charities”, *Charity Law Bulletin No 221* (9 July 2010) online: Carters Professional Corporation <<http://www.carters.ca/index.php>>..

50% of its income to “qualified donees.”¹⁴ Accordingly, a charitable organization is generally considered to be a “doer” type of charity.

The definition of "charitable organization" also requires that more than 50% of the directors, trustees, officers or similar officials of a charitable organization must deal with each other and with each of the other directors, trustees, officers or similar officials at arm's length.¹⁵ Charitable organizations are also subject to a “control test”, meaning a charitable organization is permitted to receive contributions of more than 50% of its capital from a donor, provided that the donor does not control the charity or represent more than 50% of the directors and trustees of the charity.

b) Charitable Foundations

A charitable foundation can be either a "public foundation" or a "private foundation". A "charitable foundation" is defined in subsection 149.1(1) as a trust or a corporation (unlike a charitable organization, which is not required to be a trust or corporation, and can include an unincorporated association) that is both constituted and operated exclusively for "charitable purposes" and that is not a charitable organization. Like a charitable organization, no part of its income may be payable to or otherwise available for the personal benefit of a proprietor, member, shareholder, trustee or settlor. While charitable foundations may carry on a limited number of charitable activities, charitable foundations generally provide funds to other charitable organizations or “qualified donees” so that those organizations may carry out their charitable activities. In this regard, charitable foundations are commonly considered to be “funding” organizations.

¹⁴ *Supra* note 4 at s 149.1(6)(b). For a listing of “qualified donee” see s 110.1(1)(a) and s 118.1(1) and definition in s 149.1(1).

¹⁵ *Supra* note 4 at s 149.1.

i) Public Foundation

Like a charitable organization, a public foundation must have more than 50% of the directors, trustees, officers or similar officials deal with each other and with each of the other directors, trustees, officers or similar officials at arm's length.¹⁶ In addition, public foundations are subject to the same “control test” described above with respect to charitable organizations. Unlike charitable organizations, however, a public foundation is not limited in the amount of its income it can disburse to “qualified donees.” However, a public foundation cannot acquire control of other corporations and cannot acquire debts other than those related to current operating expenses, the purchase and sale of investments, or the administration of charitable activities.¹⁷

ii) Private Foundation

The term "private foundation" is defined negatively under the ITA to mean a charitable foundation that is not a public foundation. Generally, a private foundation is an entity established for philanthropic and/or tax planning purposes by either a family or a business which remains under their control. A private foundation is not allowed to engage in any business activity. A private foundation also cannot acquire control of other corporations and cannot acquire debts other than those related to current operating expenses, the purchase and sale of investments, or the administration of charitable activities. Complicated new rules placing limits on excessive holdings in businesses by private foundations were enacted in 2007.¹⁸

¹⁶ *Ibid.*

¹⁷ *Ibid* at s 149.1(3).

¹⁸ *Ibid* at s 149.1(4).

3. Non-Profit Organizations

A NPO is more defined by what it is not than what it is. In this regard, under the ITA, a “non-profit organization” is defined as:

a club, society or association that ... was not a charity ... and that was organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder...¹⁹

As such, the ITA clearly establishes that, for income tax purposes, registered charities and NPOs are two mutually exclusive categories of organizations. It is up to CRA, through an audit, to determine whether or not a corporation qualifies as an NPO under paragraph 149(1)(l) of the ITA. This is a question of fact that will be examined on a year by year basis.²⁰ In this regard, CRA has indicated that it does not maintain a list of NPOs as is done with registered charities, since NPOs are not required to register with the CRA. As noted above, any organization whose objectives and activities fall exclusively within the four categories of charitable purposes does not qualify as an NPO and should therefore seek registration as a charity with CRA in order to avoid becoming a taxable entity.

Common examples of NPOs would include sport clubs, recreation clubs, trade associations and professional associations, such as the Canadian Bar Association. Although an NPO, like a charity, is tax-exempt and does not pay tax on income or capital gains (except income from property of an organization whose main purpose is to provide dining, recreation, or sporting facilities),²¹ an NPO is not able to issue charitable receipts to donors for income tax purposes. NPOs though, are not subject to the considerably onerous set of restrictions and

¹⁹ *Ibid* at s 149(1)(l).

²⁰ CRA document 2009-0329991C6, (9 October 2009).

²¹ *Supra* note 4 at s 149(5)(e)(ii).

requirements that are placed on registered charities, such as the requirement to disburse 3.5% of investment income, the prohibition on unrelated business activities and the prohibition on partisan political activities, to name but a few.

Recently, CRA has taken a much narrower interpretation in relation to a number of definitional aspects involving NPOs under paragraph 149(1)(l) of the ITA. In this regard, an NPO must now be far more vigilant in ensuring that it continues to comply with the definition of an NPO under the ITA. A recent Technical Interpretation by CRA states that an NPO can earn a profit but only so long as it is unanticipated and incidental to carrying out the NPOs exclusively non-profit purposes.²² In this regard, the profit earning activity cannot be the principal activity of the NPO and the income must be used by the NPO to carry out its non-profit purposes.²³ The requirement that business income must be unanticipated is obviously problematic for many NPOs and is not reflective of the common law. Where an NPO accumulates surplus assets that are more than what is required to carry out the purposes of the NPO, CRA has indicated that the organization will not be able to maintain its status as an NPO.

C. STANDARDS OF CARE

1. Charities and NPOs Operating as Unincorporated Associations

While the focus of this paper is on charities and NPOs which are incorporated as not-for-profit corporations, liability may also extend to directors and officers of charities and NPOs operating as unincorporated associations. At common law, an unincorporated association has been described as “... two or more persons bound together for one or more common purposes, not being business purposes, by mutual undertakings, each having mutual duties and obligations,

²² CRA document 2009-0337311E5, (5 November 2009).

²³ CRA document 1998-97046.

in an organisation which had rules which identified in whom control of it and its funds rested and on what terms and which could be joined or left at will.”²⁴ The management of an unincorporated association is generally in the hands of its members, unless specified otherwise in its by-laws or other constating documents. The by-laws of unincorporated associations typically permit the members to elect from amongst themselves an executive body to manage the organization.²⁵

It is not clear what standard of care applies to directors and officers of unincorporated associations. In part, this is because unincorporated associations are not governed by statute at either the federal or provincial level, and therefore no statutory duty of care has been articulated for those who would be considered to be the equivalent of directors or officers of unincorporated associations.²⁶ While some unincorporated associations may have “boards” and director-like positions provided for in their constating documents, it is unclear if the standard of care developed at common law and applied to directors and officers of not-for-profit corporations also applies to directors and officers of unincorporated associations.²⁷ However, the high fiduciary duties applicable to charities as discussed later in this paper will generally apply to directors and officers of an unincorporated charity or NPO that deals with charitable property.

²⁴ *Conservative and Unionist Central Office v Burrell (Inspector of Taxes)*, [1982] 1 WLR 522, [1982] 2 All ER 1 (Austl CA (Civ Div)).

²⁵ Ronald Davis, *Directors’ Liability in Canada*, Loose-leaf, (North Vancouver: Specialty Technical Publishers, 2010), ch 8 at 105.

²⁶ The Uniform Law Conference of Canada released the *Uniform Unincorporated Non-profit Associations Act* in 2008. Section 20(a) of the proposed act imports on “managers” of the unincorporated non-profit association the duties of loyalty, good faith and care that a director or officer of a non-profit corporation in the enacting jurisdiction. Section 20(b) also states that the “manger” is “liable for a breach of any of those duties to the same extent that a director or officer of a non-profit corporation would be liable under that law.” However, this proposed legislation has not been adopted in any Canadian jurisdiction.

²⁷ Sheila Nemet-Brown & Donald J. Bourgeois, *Halsbury’s Laws of Canada - Cemeteries and Interment / Charities, Associations and Not-for-Profit Organizations*, (Markham: LexisNexis, 2008) at 328.

2. Standard of Care for Directors of Incorporated Charities and NPOs

Directors of corporations, whether they be for-profit corporations or not-for-profit corporations, must accord with a certain standard of care at common law in fulfilling their duties, unless they are stated to be otherwise under the applicable statute. In this regard, directors of for-profit corporations are held to an objective standard of care under the *Canada Business Corporations Act* (“CBCA”) and the *Ontario Business Corporations Act* (“OBCA”).²⁸ As a consequence, in exercising their duties, directors of for-profit corporations must act honestly and in good faith with a view to the best interests of the corporation, and exercise the care and diligence that a reasonably prudent person would exercise in similar circumstances.

Unfortunately for directors and officers of charities and NPOs, as opposed to for-profit corporations, identifying the standard of care with any precision is a challenging task. This is because the sources of law governing charities and NPOs are at best a mix of the law of trusts, the law of corporations and the prerogative jurisdiction over charitable property by the courts of equity.²⁹ This difficulty has been described by one commentator as being

... exacerbated by uncertainty about which standard of care is to be applied. Moreover, different persons or authorities may have jurisdiction to apply differing standards or to have the rights, duties and obligations enforced. These persons and authorities include: members of the organization; members of the public; the department incorporating the corporation; Canada Revenue Agency; provincial revenue departments; departments responsible for labour and environmental legislation; the Attorneys General; the Public Guardian and Trustee in Ontario and the courts.³⁰

²⁸ *Canada Business Corporations Act*, RSC 1985, c C 44, s 122(1) [CBCA], and *Business Corporations Act*, RSO 1990, c B 16, s 134(1) [OBCA].

²⁹ Maurice C. Cullity, “The Charitable Corporation: A “Bastard” Legal Form Revisited”, online: (2002) 17:1 *The Philanthropist* 2 at 17 <<http://www.thephilanthropist.ca/index.php/phil/article/view/88/88>>.

³⁰ Donald J. Bourgeois, “Board Governance – When Does It Become Director’s Negligence” (Paper delivered at the Canadian Bar Association/Ontario Bar Association 2nd National Symposium on Charity Law, 14 April 2004), online: Carters Professional Corporation <<http://www.carters.ca/pub/article/charity/2004/djb0414.pdf>> at 8.

Given the multitude of overlapping statutory authorities and regulators, directors of charities and NPOs can be forgiven for not being able to easily identify which standard of care applies to them.

As noted earlier, charities and NPOs that are incorporated at either the provincial level in Ontario or the federal level are currently incorporated under either the OCA or the CCA, which as discussed later in the paper, will soon be replaced with new legislation. Unlike the OBCA and CBCA, a statutory standard of care is not provided for not-for-profit corporations incorporated under either the OCA or CCA. Therefore, the standard of care for directors and officers of incorporated charities and NPOs under the OCA and CCA at present remains the common law subjective standard of care as articulated in *Re: City Equitable Fire Insurance Company Limited* (“*Re City Equitable*”).³¹ In this regard, directors of incorporated charities and NPOs at the federal and provincial level, “need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience.”³²

This common law subjective standard of care is applied differently depending on the knowledge level of the person. Specifically, a more knowledgeable and sophisticated director will be subject to a higher standard of care than a less sophisticated one, and as such will find themselves more exposed to liability. The subjective standard of care has led to the imposition of an unequal standard on members of the same board and could lead to uncertainty concerning the amount of reasonable prudence required from board members with differing degrees of knowledge and skill.³³ While this might lead some to conclude that less sophisticated directors

³¹ *Re: City Equitable Fire Insurance Company Limited*, [1925] 40 ChD 41 [*Re City Equitable*].

³² *Ibid.*

³³ William Innes, C. Michael Kray, & Brian J. Burke, “Selected Issues Regarding the Liability of Directors and Officers of Charitable and Nonprofit Corporations”, online: (2004) 19:1 *The Philanthropist* 1 at 18 <<http://www.thephilanthropist.ca/index.php/phil/article/view/56/56>>.

will be held to a lower standard of care by the courts, Industry Canada's *Primer for Directors of Not-for-Profit Corporations*³⁴ has stated that this may not be the case:

Even when the subjective standard of care applies, this does not mean that a director with few skills or little experience will escape liability. The conventional wisdom is that such a director is required to act in accordance with conduct expected of a reasonably prudent person. This means that a director without the skills required to meet that standard is obliged to acquire them, or some of them. A director must become informed if he or she is not already knowledgeable.³⁵

In addition to the subjective standard of care at common law, directors of charitable corporations in dealing with charitable property are held to a high fiduciary standard of care as discussed later in this paper. In this regard, the OPGT has stated that directors of corporations with charitable property “must handle the charity’s property with the care, skill and diligence that a prudent person would use. They must treat the charity’s property the way a careful person would treat their own property. They must always protect the charity’s property from undue risk of loss and must ensure that no excessive administrative expenses are incurred.”³⁶

This high fiduciary duty of care with regard to charitable property is in part a function of the *Charities Accounting Act* (“CAA”)³⁷ in Ontario, which states in subsection 1(2) that:

Any corporation incorporated for a religious, educational, charitable or public purpose shall be deemed to be a trustee within the meaning of this Act, its instrument of incorporation shall be deemed to be an instrument in writing within the meaning of this Act, and any real or personal property acquired by it shall be deemed to be property within the meaning of this Act.

The purpose of subsection 1(2) of the CAA is not to define what a charitable corporation is, but rather to identify what corporations are deemed to be a trustee within the meaning of the CAA

³⁴ Jane Burke-Robertson, *Primer for Directors of Not-for-Profit Corporations* (Industry Canada, 2002). This publication is available online: Industry Canada <[http://www.ic.gc.ca/eic/site/cilp-pdci.nsf/vwapj/Primer_en.pdf/\\$FILE/Primer_en.pdf](http://www.ic.gc.ca/eic/site/cilp-pdci.nsf/vwapj/Primer_en.pdf/$FILE/Primer_en.pdf)>.

³⁵ *Ibid* at 16.

³⁶ Ontario Public Guardian and Trustee, “Duties, Responsibilities and Powers of Directors and Trustees of Charities”, (9 December 2010) online: Ministry of the Attorney General <<http://www.attorneygeneral.jus.gov.on.ca/english/family/pgt/charbullet/bullet3.asp>> [OPGT].

³⁷ *Charities Accounting Act*, RSO 1990, c C 10 [CAA].

and to provide that any property acquired by such corporations is deemed to be charitable property within the meaning of the CAA. In this regard, while the section is silent on the directors and officers of a charity or NPO, such directors or officers, as the guiding minds of a corporation that falls under subsection 1(2) of the CAA, would likely have to comply with a high fiduciary duty of care with respect to the charitable purposes or charitable property of the corporation in addition to the common law subjective standard of care for corporations.

Notwithstanding the common law subjective standard of care discussed above, certain statutes that not-for-profit corporations are required to comply with for certain specific purposes provide an objective standard of care, as explained later in this paper.

3. Objective Standard of Care Under New Corporate Legislation

The common law subjective standard of care for not-for-profit corporations with regards to both charities and NPOs in their capacity as corporate entities (but not dealing with charitable property) will soon be replaced by an objective statutory standard of care under new corporate governing legislation at both the federal and provincial levels.

At the federal level, the *Canada Not-for-profit Corporations Act* (“CNCA”)³⁸ will provide for an objective standard of care for directors and officers of federal not-for-profit corporations. The CNCA received Royal Assent on June 23, 2009 and is expected to come into force in June of 2011. In this regard, subsection 148(1) of the CNCA states:

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

(b) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

³⁸ *Canada Not-for-profit Corporations Act*, SC 2009, c 23 [CNCA].

At the provincial level, the Ontario *Not-for-Profit Corporations Act* (“ONCA”)³⁹ received Royal Assent in the Provincial Legislature on October 25, 2010, but is not expected to come into force until sometime in 2012. The ONCA provides for an objective standard of care for directors which, like the CNCA, mirrors the objective standard of care provided for under modern for-profit corporate statutes across Canada.

Both the ONCA and CNCA will therefore mirror the objective standard provided for under the CBCA and OBCA. These statutes will also provide for a due diligence defence for directors in the execution of their duty of care, as is explained later in this paper. However, directors and officers of existing not-for-profit corporations currently incorporated under the OCA or the CCA will continue to be held to the common law subjective standard of care until such corporations continue under the legislation applicable to their incorporating jurisdiction, which continuance must be done within three years of the respective statute coming into force.

4. Application of Business Judgment Rule in the Not-for-profit Context

The “business judgment rule” will be familiar to lawyers with experience concerning how an applicable standard of care will be examined by courts in the context of for-profit corporations. In essence, the business judgement rule states that a director will not be held liable for mistakes that had been made after an honest and good faith evaluation of the decision.⁴⁰ The business judgment rule was recently commented on by the Supreme Court of Canada, where the court recognized that:

Directors may find themselves in a situation where it is impossible to please all stakeholders ... There is no principle that one set of interests -- for example the interests of shareholders -- should prevail over another set of interests. Everything depends on the particular situation faced by

³⁹ *Not-For-Profit Corporations Act*, 2010, SO 2010, c 15 [ONCA].

⁴⁰ *Supra* note 34 at 16.

the directors and whether, having regard to that situation, they exercised business judgment in a responsible way.⁴¹

Specifically, the business judgment rule has recently been applied in the context of not-for-profit corporations, including charities. In *Hadjor v Homes First Society*⁴², a charity operated various housing facilities throughout Toronto for persons in need, including women's shelters, and for those with mental illnesses or criminal convictions. The charity received funding from donations, but over 70% of the funding came from the City of Toronto.

The directors of the charity altered the by-laws of the corporation so that some members of the board of directors were required to be residents of housing provided by the corporation. As the City of Toronto was accumulating a deficit, a consultant was appointed to review the affairs of the charity in order to determine if there were any inefficiencies in the governance of the charity. The consultant found that the governance structure of the charity was flawed because a majority of resident members could take over the board, which purportedly would jeopardize the charitable status of the organization and pose a risk to its funding.

The directors therefore implemented the recommendations of the consultant by applying for supplementary letters patent which would change the governance of the charity to ensure that the residents would no longer be members of the charity. In addition, the board also admitted as members 313 non-residents who had made donations to the charity, which the court assumed had been done to ensure that the members would approve the application for supplementary letters patent at the next AGM. Hadjor, who was both a resident of the charity and a former director, brought his application to set aside these amendments. Hadjor's application argued that the board of directors breached their fiduciary obligations, violated the principles of natural justice and acted contrary to the OCA. The application was dismissed.

⁴¹ *BCE Inc. v 1976 Debentureholders*, 2008 SCC 69, [2008] 3 SCR 560, [2008] SCJ No 37 (SCC).

⁴² *Hadjor v Homes First Society* (2010), 2010 ONSC 1589, [2010] OJ No 4079, 70 BLR (4th) 101, (Ont Sup Ct J).

What is worth noting from the decision is that Justice Belobaba applied the business judgment rule to the decision of the board of directors in order to protect the board of directors from being unnecessarily second guessed by the court. Since the implementation of the amendments in the supplementary letters patent purportedly went to the very viability of the charity to maintain its status and carry on receiving funding, Justice Belobaba found that at all times the board proceeded in what was in the best interests of the corporation.

In finding that the business judgment rule applied to the actions of the directors, the court made reference to the decision of *UPM-Kymmene Corp. v UPM-Kymmene Miramichi Inc.*⁴³ In that case, the court explained that, “directors are only protected to the extent that their actions actually evidence their business judgment.”⁴⁴ Therefore, directors of charities and NPOs wanting to rely upon the business judgment rule need to be able to demonstrate that they have been diligent in their decision making, since the business judgment rule will only be available where the directors have conducted adequate scrutiny of the issues prior to making a decision.

While the *Hadjor* case dealt with a registered charity where the directors of the corporation made a decision in order to prevent the corporation from losing its charitable status, as well as charitable donations from United Way, and the extra funding from Toronto, it was not a case where on its face the court was commenting on the high fiduciary duties discussed later in this paper with respect to charitable property. In this regard, a 1997 Missouri Court of Appeal decision of *Nixon v Lichtenstein*⁴⁵ did speak to this issue in an appeal by two board members from a judgment against them which ordered them removed as board members of the Lichtenstein Foundation and that they had to reimburse approximately \$300,000 to the corporation for breach of fiduciary duties arising from improper expenses and misapplied funds.

⁴³ [2002] OJ No 2412, 214 DLR (4th) 496, 27 BLR (3d) 53 (Ont Sup Ct J).

⁴⁴ *Ibid* at para 153.

⁴⁵ (1997), 959 SW 2d 854, (MO Ct App (East Dist, Div 4)) [*Nixon*].

The Lichtenstein Foundation was a foundation created by a trust indenture in 1947. The trust was dissolved in 1991 and its assets put into a corporation with articles of incorporation retaining the provisions and restrictions contained in the original trust. The Attorney General of Missouri filed claims against the board members alleging that the appellants engaged in self-dealing and breached their fiduciary duties to the foundation. The appellants argued on appeal that the lower court erred in applying the stricter standard imposed on trustees rather than the less restrictive standard under the business judgment rule through corporate law principles. The Court of Appeal affirmed the decision of the lower court, finding:

the Corporation's articles of incorporation retained the provisions and restrictions set forth in the trust indenture, including the prohibition against self-dealing by board members and the five percent gross income cap on board members' compensation. The trust indenture did not expressly impose a lesser fiduciary duty on the Corporation's directors. Because of these circumstances, we find no error in the trial court's application of trust law instead of the business judgment rule.⁴⁶

Although the *Nixon* decision is an older decision of a U.S. court, given the comments by the court in the decision, it is possible that the business judgment rule may not have application to a charity where misapplication of charitable property is involved, notwithstanding the decision of the Ontario court in *Hadjor*.

D. DUTIES OF DIRECTORS AND OFFICERS

1. General Fiduciary Duty at Common Law

The following section of the paper provides a brief overview of the common law fiduciary duties owed by directors of charities and NPOs. Whether or not this fiduciary relationship applies to the officers of a charity or NPO is unclear and will be discussed in more detail below.

⁴⁶ *Ibid.*

It is well established law that directors owe a fiduciary relationship to the corporation.⁴⁷ Specifically, directors are responsible for all aspects of the corporation's operations. The most basic role or duty of a director is to manage the affairs of the corporation.⁴⁸ In essence, the directors are the guiding minds of the corporation, while the officers and staff are to manage its day-to-day operations under the oversight of the directors. Overseeing the affairs of the corporation encompasses a broad spectrum of duties, including: ensuring the organization adheres to and carries out the goals of the corporation; setting long-term objectives in accordance with these goals; ensuring financing stability; assessing the corporation's performance; establishing policies; and being the public face of the corporation.⁴⁹

While these common law duties apply equally to charities and NPOs, as will be discussed below, certain high fiduciary duties with respect to charitable property will only apply to charities, or those NPOs that deal with charitable property in the course of their activities as explained further below.

2. High Fiduciary Duties for Charitable Property

As noted above with respect to the standard of care of directors and officers of charities and NPOs, the CAA specifically characterizes the legal nature of any corporation that is “incorporated for a religious, educational, charitable or public purpose” as that of a trustee for the purposes of the CAA. In this regard, the courts in Ontario have held that directors of

⁴⁷ *Canadian Aero Service Ltd. v O'Malley*, [1974] SCR 592, [1973] SCJ No 97 (SCC) [*Canadian Aero*].

⁴⁸ OCA, *supra* note 2 at s 283, ONCA, *supra* note 39 at s 21 and CNCA, *supra* note 38 at s 124.

⁴⁹ R. Jane Burke-Robertson & Arthur B.C. Drache, *Non-Share Capital Corporations*, loose-leaf, (Toronto: Carswell, 1992) ch 5 at 1-2.

charitable corporations are subject to high order fiduciary obligations similar to those of trustees with regard to charitable property.⁵⁰

In the past, the courts in Ontario have held that directors of charitable corporations were akin to quasi-trustees with respect to their relationship to the charitable property of the corporation.⁵¹ Over time, this evolved into the concept that directors are not necessarily akin to trustees, but rather are high order fiduciaries with quasi-trustee responsibilities.⁵²

In this regard, one commentator has stated that “directors of charitable corporations are not themselves trustees of the general assets of the corporation; they appear to be subject to the same types of fiduciary obligations as are directors of other forms of corporations.”⁵³ This is because charitable corporations are not trustees of their general charitable assets. As was noted by Justice Blair in *Christian Brothers*:

A charitable corporation does not hold its assets “as trustee” for charitable purposes ... It holds its assets beneficially, like any other corporation. As a matter of corporate law, of course, it must use those assets in a manner consistent with its corporate objects, and its directors have fiduciary obligations to ensure that such is the case. Where its corporate objects and its charitable purposes coincide – as they do in this case – it must use its assets in a manner consistent with those charitable purposes. Nevertheless, this does not mean that it holds all of its assets in some kind of trust capacity.⁵⁴

....

In the end, while it may be said that for some purposes a charitable corporation is in a position analogous to that of a trustee with respect to the use and disposition of its property – at least with respect to the court’s power to exercise its “ancient supervisory equitable jurisdiction” over it – the weight of authority supports the conclusion that its assets are not held by it “as trustee” for its charitable objects, but are owned

⁵⁰ Ken Goodman, “Fiduciary Considerations Involving Charitable Property” (Paper delivered at the Canadian Bar Association/Ontario Bar Association 2010 Annual Church & Charity Law Seminar, 18 November 2010) at 5 [unpublished].

⁵¹ *Ontario (Public Trustee) v Toronto Humane Society* (1987), 60 OR (2d) 236, 27 ETR 40, (Ont H Ct J) [*Toronto Humane Society*].

⁵² *Supra* note 50.

⁵³ *Supra* note 33 at 10.

⁵⁴ *Christian Brothers of Ireland in Canada (Re)* (1998), 37 OR (3d) 367 at 390-391, [1998] OJ No 823 (Ont Ct (Gen Div)).

beneficially to be used by the corporation in a fashion consistent with its objects.⁵⁵

This position was confirmed by the Ontario Court of Appeal in the same case.⁵⁶

Under the ONCA and CNCA, this approach appears to have been codified. In this regard, section 87 of the ONCA states:

A corporation owns any property of any kind that is transferred to or otherwise vested in the corporation and does not hold any property in trust unless that property was transferred to the corporation expressly in trust for a specific purpose or purposes.

The CNCA does not differ materially, in that sections 31 and 32 state that:

A corporation owns any property of any kind that is transferred to or otherwise vested in the corporation and does not hold any property in trust unless that property was transferred to the corporation expressly in trust for a specific purpose or purposes.

Directors are not, in that capacity, trustees for any property of the corporation, including property held in trust by the corporation.

With respect to the CNCA, the OPGT has informally taken the position that sections 31 and 32 of the CNCA do not change the common law rule with respect to charities. In situations where a charitable corporation holds property subject to express or implied terms of trust, arguably the common law with respect to high fiduciary duties would continue to apply where property has been transferred, either directly or indirectly in trust to a corporation under the CNCA, in that the corporation would hold those funds as trustee. In this regard, while the directors are not themselves trustees, since the corporation can do nothing without the directors acting as its “guiding mind,” the directors would take on a high order fiduciary duty to ensure that the corporation carries out the terms of the express or implied trust with regard to charitable property. Given that section 87 of the ONCA is identical to section 31 of the CNCA, it is likely that the same position would apply under the ONCA as well as the CNCA.

⁵⁵ *Ibid* at 392.

⁵⁶ *Christian Brothers of Ireland in Canada, Re* (2000), 47 OR (3d) 674 at para 69, [2000] OJ No 1117 (Ont CA), as well as *Wasauksing First Nation v Wasausink Lands Inc.*, [2002] 3 CNLR 287 (Ont Sup Ct J).

3. To Whom is the Fiduciary Duty Owed?

a) The Corporation

As noted above, the directors of a charity and/or an NPO are responsible for supervising senior staff, providing strategic planning to the corporation, and developing and implementing corporate policy.⁵⁷ These duties flow from the director's fiduciary relationship to the corporation. This duty was affirmed in a recent 2010 decision of the Ontario Superior Court, *London Humane Society (Re)*.⁵⁸

The court in *London Humane Society* affirmed that directors of both for-profit and not-for-profit corporations are in a fiduciary relationship to the corporation, not its shareholders or members. In this regard, Justice Granger stated that:

Directors of not-for-profit and charitable organizations are subject to fiduciary duties at common law. The Supreme Court of Canada has held that directorial fiduciary duties are owed primarily to the corporation, not to the corporation's shareholders or other stakeholders (See *Re BCE Inc.*, 2008 SCC 69 at paras. 36-38). While most litigation in this area focuses on for-profit corporations, various academic texts apply the same concept to the directors of not-for-profit corporations. ... Consequently, the Board of Directors at the LHS owed a fiduciary duty to the LHS as a corporation, but not separately to its members.

As a consequence of the general fiduciary duty owed to the corporation, directors of charities and NPOs must comply with the following duties:

i) Duty to Act in Good Faith, Honestly and Loyal

As explained earlier, a director's sole interest is to the corporation. Directors must therefore deal honestly with the corporation. In this regard, a director must disclose to the corporation the entire truth in his or her dealings as a director.⁵⁹ A breach of the duty of honesty

⁵⁷ *Supra* note 34 at 14.

⁵⁸ *London Humane Society (Re)*, 2010 ONSC 5775, [2010] OJ No 4827 (Ont Sup Ct J) [*London Humane Society*].

⁵⁹ *Supra* note 49 at 6-16.

involves misfeasance or purposeful error and not merely inactivity.⁶⁰ The interests of the director must not be placed in conflict with those of the corporation.

ii) Duty of Diligence

Directors must be diligent in attending to their legal duties. This is complied with by being familiar with all aspects of the corporation's operations through attending board meetings and reviewing the minutes of missed board meetings.⁶¹

iii) Duty of Obedience

Directors must comply with all applicable legislation and the corporation's governing documents (letters patent, by-laws, etc). In this regard, directors must assist in implementing valid corporate decisions. Failure to do so could amount to a breach of duty to the corporation.⁶² A director is also obliged to see that the corporation and its officers and agents obey the general law applicable to the corporation.⁶³

In this regard, CRA produces numerous administrative publications for registered charities, including publications on topics such as fundraising and how charities can conduct related business. While there is no case law directly on point, it is arguable that compliance with such administrative publications would form part of the duty of obedience, since non-compliance with CRA requirements could result in loss of charitable status and the imposition of a 100% revocation tax.⁶⁴

iv) Duty to Avoid Conflict of Interest

Directors and trustees must avoid the *appearance* of a conflict of interest. Certain investments, such as loans to donors or directors of the charity or NPO, or to companies in which

⁶⁰ *D'Amore v McDonald*, [1973] OJ No 1860, [1973] 1 OR 845 (Ont H Ct J), affd [1973] OJ No 2176, 1 OR (2d) 370 (Ont CA).

⁶¹ *Supra* note 49 at 6-16.

⁶² *Supra* note 33 at 19.

⁶³ *Angus v R. Angus Alberta Ltd.* (1988), [1988] AJ No 207, 39 BLR 1 (Alta CA).

⁶⁴ *Supra* note 4 at s 188.

they have an interest can be a breach of this duty by a director.⁶⁵ Even if these investments are made at market rates, there may be an appearance of conflict of interest.⁶⁶ A conflict of interest can also arise where a director sits on the board of two not-for-profit corporations that wish to contract with one another.⁶⁷

Both the OCA and CCA contain provisions for a director with an interest in a contract to declare their interest in order to avoid liability for any profit realized from that contract. Specifically, section 71 of the OCA permits a director to avoid liability in respect of profit from a contract if the director declares his or her conflict of interest at a meeting of the directors and abstains from any discussion or vote on the matter. The effect of such a declaration means that the director is not accountable to the corporation or to any of its members or creditors for any profit realized from the contract, and the contract is not voidable by reason only of the director holding that office or of the fiduciary relationship thereby established. Under the OCA, if a director is liable in respect of profit realized from any such contract and the contract is by reason only of his or her interest therein voidable, the director is guilty of an offence and on conviction is liable to a fine of not more than \$200.⁶⁸

Section 98 of the CCA, which also deals with conflicts of interest, requires every director with an interest in a contract with the corporation to disclose such interest. Under the CCA any director who fails to disclose a conflict of interest will potentially be subject to a summary conviction with a maximum fine of \$1000.⁶⁹

The ONCA and CNCA, on coming into force, expand the provisions concerning conflict of interest such that they will apply to both directors and officers and address transactions the

⁶⁵ *David Feldman Charitable Foundation (Re)*, [1987] OJ No 1432, 58 OR (2d) 626 (Ont Surr Ct) [*David Feldman*].

⁶⁶ *Supra* note 36.

⁶⁷ *Supra* note 49 at 6-13.

⁶⁸ *Supra* note 2 at s 71(6).

⁶⁹ *Supra* note 3 at s 149.

corporation enters into on a more general basis as opposed to being limited to contracts.⁷⁰ In this regard, the ONCA and CNCA will contain substantially the same statutory conflict of interest regime found in the CBCA and OBCA.

However, neither the OCA and the CCA currently, nor CNCA and ONCA in the future, will extinguish the common law duty regarding directors of a charity avoiding a conflict of interest. In this regard, despite the statutory protection provided where the director declares a conflict of interest, where the high fiduciary duties apply to a director of a charity, no reliance should be placed on these provisions, since the director could still be in breach of their fiduciary duty at common law.

Further regulations will be discussed below concerning the duty to act gratuitously concerning the fact that directors of charities cannot receive remuneration for their services as a director, and cannot receive remuneration for other services without court approval.

v) Duty to Continue

Directors have continuing obligations to the corporation which cannot simply be relieved by resignation. Directors can only resign from the corporation where there are adequate individuals to replace the resigning director. Resignation simply to avoid personal liability is ineffective and may constitute breach of fiduciary duty where the director puts his or her own interests ahead of those of the corporation.

b) High Fiduciary Duties with Regard to Charitable Property

While some of the high fiduciary duties with respect to charitable property, being similar to the duties of trustees, are akin to those that flow from the fiduciary relationship between directors and the corporation, such as the duty of loyalty and the duty to avoid conflicts of interest, the following duties relate specifically to the high fiduciary duties where charitable

⁷⁰ *Supra* note 39 at s 41(1)(a).

property is involved, whether such property is held by a charity or by an NPO as discussed later in this paper.

i) Duty to Carry out the Charitable Purpose

Charities will have one or more charitable purposes, which are found in the letters patent where the charity is incorporated as a not-for-profit corporation. In this regard, the charity's resources must be used to carry out the purposes of the charity.⁷¹ Specifically, the directors have a positive duty to further the charitable purposes of the corporation.⁷² As part of the duty to observe the charitable purposes of the corporation, or special purpose charitable trust property, if the directors determine that the charitable purposes cannot be effectively accomplished, they are under a duty to secure its effective use by applying for a scheme from the court.⁷³

ii) Duty to Protect and Conserve Trust Property

Directors of a charity are under the usual duty to protect and conserve trust property under their administration.⁷⁴ Directors must keep the charitable property safe.⁷⁵ In this regard, directors in Ontario must ensure that such property is appropriately invested in accordance with terms of the *Trustee Act*.⁷⁶ This statutory requirement is explained later in this paper with respect to the liability for directors and officers of charities and NPOs concerning investment of charitable property.

With regard to charitable purpose trust assets of the corporation, the decision of the Ontario Court of Appeal in *Christian Brothers*⁷⁷ means that restricted charitable purpose trusts are no longer recognized as separate trusts distinct from the general assets of the charity for

⁷¹ *Supra* note 36.

⁷² *Harries v Church Commissioners for England* (sub nom *Lord Bishop of Oxford v Church Commissioners of England*), [1992] 1 WLR 124, [1993] 2 All ER 300, (1991) 135 SJLB 180 (Chancery Div).

⁷³ *Andrews v. M'Guffog* (1886) 11 App Cas 313 at 329 (HL).

⁷⁴ George Duke, *The Law of Charitable Uses*, (London: Henry Twyford, 1676) at 116.

⁷⁵ Hubert Picarda, *The Law and Practice Relating to Charities*, 4th ed (Oxford: Bloomsbury Professional, 2010) at 629.

⁷⁶ *Trustee Act*, RSO 1990, c T 23.

⁷⁷ *Supra* note 56.

exigibility purposes. Therefore, it is important for directors to consider what steps can be taken to assist in protecting those trusts. This may mean having the restricted charitable purpose trust property held outside of the charity itself, subject of course to applicable insolvency legislation. Options in this regard include utilizing an arms-length parallel foundation or a community foundation to receive and hold such trust property. This could be achieved by having the parallel foundation or a community foundation named as the successor trustee of the charitable purposes, with the description of the applicable charitable purpose contained in either the trust document itself or in the objects of the parallel foundation or a community foundation being sufficiently broad enough that the charitable purpose extends beyond simply naming the intended charity in the event of such charity's dissolution or insolvency.⁷⁸

iii) Duty to Act Gratuitously for the Charity

Directors in Ontario cannot receive any remuneration, either directly or indirectly from the charity. In *Toronto Humane Society*⁷⁹ the directors of the charity were held to be in a trustee-like position and, as such, were accountable to the OPGT under the CAA, *Trustee Act*, and the “broad inherent jurisdiction in the court in charitable matters.” The court followed the English case of *Re French Protestant Hospital*,⁸⁰ involving the issue of whether the directors of a hospital corporation could receive remuneration for services rendered in their professional capacity. In that case, the court adopted the line of case law with respect to fiduciaries not being

⁷⁸ Terrance S. Carter, “Considerations When Drafting Restricted Charitable Purpose Trusts” (Paper delivered at the Ontario Bar Association, “Trusts, Trustees, Trusteeships, 1 October 2010), online: Carters Professional Corporation <<http://www.carters.ca/pub/article/charity/2010/tsc1001.pdf>>.

⁷⁹ *Supra* note 49.

⁸⁰ [1951] 1 Ch 567, [1951] 1 All ER 938.

permitted to profit by virtue of their position and as such could not receive remuneration. This case has been followed in several subsequent cases in Ontario.⁸¹

In *Faith Haven Bible Training Centre (Re)*, a religious education school which was a registered charity ceased operations and its directors distributed the assets on winding up in part to themselves, despite a provision in the letters patent that directors were to receive no remuneration. The court found that the transfer of property and payments to directors was so egregious that the court held that, “these breaches of trust, particularly in their context of conflict of interest and duty, are so blatant (and therefore should have been so obvious in spite of legal counsel) that I could not conscientiously say that the conduct “ought fairly to be excused””. The court would have ordered the directors to repay to Faith Haven the monies wrongfully paid out with interest, but was prepared to approve the payments under a section of the *Trustee Act* given the time and effort the directors had put in over a nine year period to the charity. However, directors of charities should be aware that they can be compelled by the court to repay improper payments to themselves on a joint and several basis for breach of their fiduciary duty in this regard.

While directors can seek approval for remuneration from the court under section 13 of the CAA for payment for services other than as a director, the onus will be on the applicant to show that such payment for services “is in the best interest of the trust in light of the circumstances and the basic rules of equity which affect trustees.”⁸²

⁸¹ *David Feldman, supra* note 63; *Faith Haven Bible Training Centre (Re)*, [1988] OJ No 969, 29 ETR 198 (Ont Surr Ct) [*Re Faith Haven*]; *Harold G. Fox Education Fund v Public Trustee* (1989), 69 OR (2d) 742, [1989] OJ No 1085 (Ont H Ct J) [*Harold G. Fox*].

⁸² *Harold G. Fox, ibid.*

iv) Duty to account

Directors of charities must keep records to evidence that the charitable property has been properly managed. The OPGT can compel the directors of a charity to pass the accounts of the organization before the court under section 4 of the CAA with respect to charitable property.

c) Duties to the Public/Donors

The high fiduciary duty placed upon directors of charities with regard to public fundraising programs was underscored in the case of *Ontario (Public Guardian and Trustee) v AIDS Society for Children (Ontario)*.⁸³ In that case, complaints had been made that the AIDS Society was not applying its funds for its charitable purposes. It was discovered that despite raising \$921,440 through public donations, no funds had been expended on charitable programs and the AIDS Society was in debt. In an application by the OPGT for the passing of accounts, the court held that directors of a charity, although not strictly trustees, have a fiduciary obligation to the charity and the property held by the charity. Further, the charity and its directors are accountable to the public for all monies publicly raised from it, and to utilize such monies to further the objects of the charitable institution. As agents of the charity, fundraising companies have a duty to account for the gross amounts of monies raised from the public and not simply the net amount that was paid to the charity pursuant to the terms of the fundraising contracts.⁸⁴

This duty was affirmed in the decision of *Pathak v Hindu Sabha*,⁸⁵ in which the court agreed with the OPGT that Hindu Sabha, as a charitable corporation owed a fiduciary duty to the public.⁸⁶ In a related proceeding dealing with the same charity, the court stated:

⁸³ *Ontario (Public Guardian and Trustee) v AIDS Society for Children (Ontario)*, [2001] OJ No 2170, [2001] OTC 432 (Ont Sup Ct J) [*AIDS Society*].

⁸⁴ See also the case of *Ontario (Public Guardian and Trustee) v National Society for Abused Women and Children*, [2002] OJ No 607 (Ont Sup Ct J) [*National Society for Abused Women and Children*] discussed below, wherein the court confirmed that there is a fiduciary obligation of directors to account for all fundraising costs, and that donors are entitled to know about fundraising and administrative costs when making donations.

⁸⁵ *Pathak v Hindu Sabha*, [2004] OJ No 1981, [2004] OTC 406 (Ont Sup Ct J).

The Public Guardian and Trustee submits that Hindu Sabha's interests would best be served by ending the ongoing litigation. The Public Guardian and Trustee submits further that the public has an interest in seeing that charitable property for which income tax receipts have been issued, is applied to carry out the intended charitable purposes and not diverted to fund litigation between groups within the charity. I agree.⁸⁷

More recently, in the 2010 case of *Ontario Society for the Prevention of Cruelty to Animals v Toronto Humane Society*,⁸⁸ the court emphasized that directors of charitable organizations have enhanced duties towards the charity and the court has enhanced power to monitor and regulate charities where funds are mismanaged. The judge in that case re-affirmed that the courts have inherent jurisdiction to supervise the activities of charities. What is interesting about this decision is that it highlights the immense power of the courts to ensure that the charitable purposes are being carried out by the charity with respect to its property. In fact, the court in that decision held that courts have the power to direct the management of the charity in order to control charitable property, as they must ensure that charitable property is being properly applied correctly in relation to its charitable purpose. While this is not a new power, the decision should serve to remind directors of charities of the high fiduciary obligations that are placed upon them in relation to the management of charitable property.

d) Duties owed to Members

Directors have certain duties to the members of the corporation, although as noted above, it is not specifically a fiduciary relationship. Nonetheless, directors must ensure that the corporation abide by the terms of its letter patent and by-laws, which have been considered by the courts as akin to a contract between the corporation and its members.⁸⁹

⁸⁶ *Ibid* at para 29.

⁸⁷ *Pathak v Hindu Sabha*, [2004] OJ No 3317 at para 40, 48 BLR (3d) 207 (Ont Sup Ct J).

⁸⁸ *Ontario Society for the Prevention of Cruelty to Animals v Toronto Humane Society*, 2010 ONSC 608, [2010] OJ No 279 (Ont Sup Ct J) [*Ontario Society*].

⁸⁹ *Supra* note 34 at 27.

In *London Humane Society*, the directors sought to significantly alter the voting privileges of its membership. The court recognized the contractual nature of the relationship between members of charities and their directors, which is “governed by statute, the creational documents of the corporation, its bylaws and fiduciary obligations and duties of good faith.”⁹⁰ In doing so, the court affirmed the earlier decision of the Ontario Superior Court of Justice Divisional Court in *Chu v Scarborough Hospital Corp.*⁹¹ In the *Chu* decision, Justice Linhares de Sousa affirmed earlier case law that a corporation, as well as the individuals who become members, which would include directors, have entered into an implicit contractual obligation to comply with the constating documents and by-laws of the corporation:

The Board has not acted fairly towards the Hospital's Approval Annual Members. It has misconstrued its powers to appoint such members and to amend the Hospital's by-laws. In addition, the Board cannot on the one hand adopt a by-law amendment that by its very language created a reasonable expectation that Approved Annual Members would have meaningful input into the governance review process and resulting by-law amendments, and then dash those expectations by removing the item from the agenda and relying on a highly formalistic position that the memberships of the Approved Annual Members had evaporated. The evidence paints the picture of a Board interpreting the Hospital's by-laws in an unreasonable way that places complete control of governance matters in the hands of the directors and negates any meaningful role for Approved Annual Members.⁹²

The court in *Chu* also stated that, “the court will not intervene with determinations made by a non-share capital corporation in accordance with its by-laws provided the corporation does not demonstrate bad faith or act contrary to the rules of natural justice.”⁹³ Although the court in the *London Humane Society* decision did not find that the directors had acted contrary to the rules of natural justice, the court did cite the above statement prior to embarking on its analysis.

⁹⁰ *Supra* note 58 at para 16.

⁹¹ *Chu v The Scarborough Hospital Corporation*, [2007] OJ No 3131, 35 BLR (4th) 254 (Ont Sup Ct J (Div Ct)).

⁹² *Ibid* at para 15

⁹³ *Ibid* at para 22.

4. Application of Fiduciary Duties to Officers

As noted in the discussion concerning the case law referred to above, the majority of cases dealt strictly with the directors of charities. As such, it is not clear if the same fiduciary duties with respect to directors of the corporation will apply to the officers as well. However, one commentator has concluded that:

Since non-share (nonprofit and charitable) corporations are by their very nature intended to benefit some social welfare purpose, officers of such corporations are, undoubtedly, obligated to serve the corporation loyally and in good faith, and to avoid a conflict of duty and self-interest.⁹⁴

For corporations incorporated under the OCA, certain officers (i.e. chairman and president) must be directors in any event by virtue of subsection 291(1):

Except in the case of the president and the chair of the board of directors, no officer of the corporation need be a director or a shareholder or member of the corporation unless the by-laws so provide.

As such, while it is clear under the OCA that the president and chair of Ontario not-for-profit corporations must be directors, the OCA allows for other officers such as the secretary, treasurer or vice-president not to be directors. However, it is not clear what duties apply to such officers without an examination of their role within the organization. In this regard, the Supreme Court of Canada in *Canadian Aero* held that officers were also subject to the same fiduciary duties as directors where they were ““top management” and not mere employees.”⁹⁵ As one commentator suggests, a fiduciary duty for officers “arises not so much from the formal relationship of the parties - although this is often important in determining whether fiduciary duties are owed - but from the nature of the relationship. If one party undertakes to act primarily for another’s benefit, then a fiduciary duty will arise.”⁹⁶

⁹⁴ *Supra* note 33 at 23.

⁹⁵ *Supra* note 45.

⁹⁶ *Supra* note 33 at 23.

In a recent 2009 decision of the Delaware Supreme Court, *Gantler v Stephens*,⁹⁷ the court stated that, “[i]n the past, we have implied that officers of Delaware corporations, like directors, owe fiduciary duties of care and loyalty, and that the fiduciary duties of officers are the same as those of directors. We now explicitly so hold.” While this case is a decision of the Delaware Supreme Court dealing with for-profit corporations, it is certainly possible that Canadian courts could reach a similar finding in the context of officers of corporations in Canada, including charities and NPOs.

In most instances, the officers of a NPO or a charity carry out the actual day-to-day management and business of the corporation, for example, where they form an executive committee.⁹⁸ Where this is the case, it is likely that the officers, whatever their title, would be seen as “top management” and therefore would arguably be liable for breach of the same fiduciary duties applicable to directors of those corporations. In this regard, the Ontario High Court of Justice decision in *R.W. Hamilton Ltd. v Aeroquip Corp.* held that an officer or manager does not have a fiduciary duty to his employer unless the position he occupies involves the power and ability to direct and guide the affairs of the company.⁹⁹

E. FIDUCIARY DUTIES CONCERNING CHARITABLE PROPERTY FOR NON-PROFIT ORGANIZATIONS

While directors and officers of NPOs do not have the same high fiduciary duties as directors and officers of charities, the fiduciary duties of directors and officers with respect to charitable property discussed above will also apply where NPOs raise funds intended for charitable purposes, such as when a community service club raises money for a local hospital.

⁹⁷ (2009), 965 A 2d 695 at 709 (Del Sup Ct).

⁹⁸ *Supra* note 25 at 8-9.

⁹⁹ (1988), 65 OR (2d) 345, [1988] OJ No 906 (Ont H Ct J).

In this regard, it should be pointed out that each special purpose charitable trust fund for a particular application is generally required under common law to be held separately from other restricted trust funds and cannot be commingled with other funds. However, under regulations adopted under the CAA, the common law rule was changed by legislature so that charities may now commingle funds received for a restricted or special purpose with other funds similarly received into a single account or investment portfolio, provided that the following restrictions and obligations are complied with:

- The directors may only commingle if it advances the administration and management of each of the individual restricted funds;
- The directors may allocate all gains, losses, income and expenses ratably on a fair and reasonable basis to the individual funds;
- The directors must maintain detailed records relating to each individual fund; and
- The directors must maintain detailed records relating to the combined fund.¹⁰⁰

However, the NPO fundraising for a charitable purpose may not commingle any of its restricted charitable purpose funds with its general operating funds. Commingling restricted or special purpose funds with general funds of the NPO in contravention of the CAA regulations could expose the directors and officers of the NPO to allegations of breach of trust and could result in personal liability in the same way that directors and officers of a charity could be liable for misapplication of charitable property.

The above-noted permission, though, to commingle restricted charitable purpose trust funds is only applicable to those entities included in section 1 of the CAA. Section 1(1) specifically refers to executors or trustees who have been vested under a will or “other instruments” in writing with real or personal property for charitable purposes. An “instrument in writing” for the purposes of the CAA does not include the by-laws of the NPO.¹⁰¹ However, the

¹⁰⁰ *Charities Accounting Act*, O Reg 4/01, s 3.

¹⁰¹ *Supra* note85.

OPGT has informally taken the view that the requirements for an instrument in writing in the case where an NPO raises funds for a charity would include any agreement by the NPO to raise funds on behalf of the charity, or even an advertisement or brochure describing or promoting the fundraising event to the public.

While it is not necessarily clear whether this would include NPOs that hold funds raised for charitable purposes, the OPGT takes the position that an NPO that holds funds raised for charitable purposes would be caught by the definition in subsection 1(2) of the CAA and therefore would have to comply with the commingling requirements under the regulations of the CAA.

F. LIABILITIES OF DIRECTORS AND OFFICERS FOR BREACH OF DUTIES

a) Liability for Breach of Fiduciary Duty

Directors and potentially officers who breach their fiduciary duties with respect to the corporation are liable for any loss that the corporation suffers as a result. An example of a particularly notorious breach of fiduciary duty similar to the *AIDS Society* decision discussed above, involved the *National Society for Abused Women and Children*¹⁰² where the directors of the charity entered into fundraising contracts with businesses that they either owned or with whom they were employed, and approved commissions between 75% and 80% of the gross funds raised, together with additional monthly administrative fees.

The fundraising efforts for the National Society for Abused Women and Children raised close to \$1million, but only \$1,365 made its way to charitable work. The court found that the fundraising contracts were void *ab initio*, as the amount of compensation paid to the fundraising

¹⁰²*Supra* note 84.

companies under the contracts was unconscionable. The court required the directors to pay all monies that they had received through the fundraising companies over to the OPGT.

Other examples of breach of fiduciary duty can include mismanagement of corporate funds and property,¹⁰³ or the appropriation of corporate opportunity.¹⁰⁴ The appropriation of a corporate opportunity is distinct from a conflict of interest as a result of the director's interest in a contract, in that the former cannot be permitted, whereas the latter can be excused in limited circumstances under the incorporating statute.¹⁰⁵ An example would occur where the director of the corporation learned of an opportunity by virtue of their position as director, that director would then be precluded from using that information on a personal basis.

b) Liability for Breach of Trust

As noted above, directors and officers of charities and NPOs have high fiduciary duties with respect to charitable property and fulfilling their charitable purposes. The reality is that this high fiduciary duty and trustee like duties in relation to charitable purposes are very similar. They both require directors to take proactive steps to protect charitable property as if it was their own property.

As the guiding mind of the corporation, directors, and to a lesser extent as discussed above, officers, are responsible for the way charitable property is handled and to adhere to the charitable objects of the corporation found in its letters patent. Where mismanagement of charitable property occurs, directors and officers can incur personal liability for the full amount of any loss. Any breach of trust may lead to the director being held personally liable. In this regard, Professor Donovan Waters has described a breach of trust as follows:

¹⁰³ *Dominion Trust Co. (Re)* (1916), 23 BCR 401, [1916] BCJ No 97, 32 DLR 63 (BCSC); *Hart v Felson* (1924), 30 RLNS 109 (unknown court).

¹⁰⁴ *Supra* note 47.

¹⁰⁵ Carol Hansell, *Directors and Officers in Canada: Law and Practice*, loose-leaf, (Toronto: Carswell, 1999) ch 10 at 72.2.

A breach of trust occurs when the trustee's duty to act precisely within the terms of his obligations is not fulfilled. If he fails in this, it is of no significance that he had no intention of departing from his duty. Trustees have been found in various conditions of blame-worthiness – fraudulent, willfully neglectful, slovenly in their conduct of trust affairs, and incompetent – but none of these elements needs to be provided in order to establish a breach of trust. If the letter of the trustee's obligation has not been adhered to for whatever reason, he is liable to his beneficiaries for any loss which has occurred as a result.¹⁰⁶

c) Liability for Special Purpose Charitable Trusts

As noted earlier, a special purpose charitable trust is property held by a charity in trust for a specific charitable purpose that falls within the parameters of the general charitable purpose of the charity as set out in its constating documents.¹⁰⁷ As well, a board would be acting *ultra vires* if it were to authorize the corporation to hold property as a special purpose charitable trust where the special charitable purpose was outside the scope of the charity's corporate objects¹⁰⁸ (pending the exclusion of the *ultra vires* doctrine under the CNCA and ONCA, as discussed below).

To the extent that a gift constitutes a special purpose charitable trust, the charity can only use the gift to accomplish the specific charitable purpose established by the donor and for no other purpose. The Supreme Court of Canada has confirmed this common law principle.¹⁰⁹

d) Liability for Breach of Corporate Authority

When directors act beyond the scope of the authority set out in the corporation's objects, they may be found personally liable.¹¹⁰ In this regard, every director is under a duty of obedience to comply with the objects stated in the letters patent or by-laws. While in general a charity must

¹⁰⁶ Donovan W.M. Waters, Mark Gillen, & Lionel Smith, *Waters' Law of Trusts in Canada*, 3d ed (Toronto: Carswell, 2005) at 1208.

¹⁰⁷ For a more fulsome discussion on special purpose charitable trusts, see Terrance S. Carter, "Donor-Restricted Charitable Gifts: A Practical Overview Revisited II", (Paper delivered at the 2006 CAGP*ACPD Annual National Conference), online: Carters Professional Corporation <<http://www.carters.ca/pub/article/charity/2006/tsc0421.pdf>>.

¹⁰⁸ *Ibid* at 13.

¹⁰⁹ *Guaranty Trust Company of Canada, Executor of the Estate of Dorothy Elgin Towle v. Minister of National Revenue* (1966), 67 DTC 5003 (SCC).

¹¹⁰ *Supra* note 49 at 6-16.

apply its resources to charitable purposes, and an NPO must not pursue a purpose other than to make a profit, they are still limited to what activities they can carry out through the purposes set out in their constating documents.¹¹¹

While a corporation could likely still be found to be in breach of trust for misapplying charitable property, the issue of acting *ultra vires* will no longer be a concern once the ONCA and CNCA come into force, as they each give the corporation the same powers of a natural person as those given to directors of for-profit corporations under modern business corporations legislation.¹¹²

However, this change will not relieve the directors or officers of those corporations from the need to comply with the objects of the corporation. From a practical stand point, the directors will still be exposed to liability notwithstanding the removal of the *ultra vires* doctrine under the ONCA and CNCA.

e) Liability for Imprudent Investments¹¹³

Whether or not Ontario's *Trustee Act* applies to directors has been a matter of some debate in the past. However, amendments to the CAA in 2001 resolved this issue in Ontario. In this regard, section 10.1 of the CAA confirms that sections 27 to 30 of the *Trustee Act* apply to all charities and NPOs that deal with charitable property in the Province of Ontario. Section 10.1 of the CAA provides that an executor and trustee, including a director of a charitable corporation referred to in section 1(2) of the CAA, is required to comply with the investment requirements in the *Trustee Act*. In this regard, the *Trustee Act* established a prudent investment standard

¹¹¹ *Supra* note 10 at 14.

¹¹² ONCA, *supra* note 39 at s 15 and CNCA, *supra* note 38 at s 16.

¹¹³ For more information see Terrance S. Carter, "Considerations in Drafting Investment Policies in Ontario", *Charity Law Bulletin No 207* (29 April 2010) online: Carters Professional Corporation <<http://www.carters.ca/pub/bulletin/charity/2010/chylb207.htm>>; Terrance S. Carter, "Investment Powers of Charities and Not-For-Profits under Ontario's Trustee Act", *Charity Law Bulletin No 192* (24 February 2010) online: Carters Professional Corporation <<http://www.carters.ca/pub/bulletin/charity/2010/chylb192.htm>>.

governing investment decision-making of trustees of charitable property and permits trustees to delegate their investment decision making to qualified investment managers under certain circumstances as set out under the *Trustee Act*.

However, an important exception to this rule is found in section 27(9) of the *Trustee Act*, which states that the investment powers in the *Trustee Act* “do not authorize or require a trustee to act in a manner that is inconsistent with the terms of the trust.”¹¹⁴ The *Trustee Act* further provides that the constating documents of a charitable corporation under the CAA are deemed to form part of the terms of the trust.¹¹⁵ This means that if the letters patent of the corporation contain different investment powers from those under the *Trustee Act*, the investment powers of the letters patent will take precedence, regardless of whether the charitable corporation is incorporated in Ontario, federally, or in another province.

With regard to the “prudent investor” standard of care, subsection 27(1) of the *Trustee Act* states that “a trustee must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments.” Based on this standard of care, subsection 27(2) states that “a trustee may invest trust property in any form of property in which a prudent investor might invest.” Although the *Trustee Act* does not define what is meant by a “prudent investor,” subsection 27(5) states that a trustee must consider the following seven criteria in the planning for investment of trust property in addition to any others that are relevant in the circumstances:

1. general economic conditions;
2. the possible effect of inflation or deflation;
3. the expected tax consequences of investment decisions or strategies;
4. the role that each investment or course of action plays within the overall trust portfolio;
5. the expected total return from income and the appreciation of capital;

¹¹⁴ *Supra* note 76 at s 27(9).

¹¹⁵ *Ibid* at s 27(10).

6. needs for liquidity, regularity of income and preservation or appreciation of capital; and
7. an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries.

Subsection 27(6) of the *Trustee Act* also states that “a trustee must diversify the investment of trust property to an extent that is appropriate to, (a) the requirements of the trust; and (b) general economic and investment market conditions.” Therefore, where the *Trustee Act* applies, before the directors of a charity can make an investment, they must be satisfied that the investment to be made meets the prudent investment stand set out in the *Trustee Act*, failing which directors may be exposed to personal liability for an imprudent investment.

Ontario's *Trustee Act* allows a trustee to obtain advice in relation to the investment of trust property, and can rely on such advice in meeting the mandatory requirements. Specifically, a trustee is not liable for losses to the trust where he or she relies upon such advice, provided that a prudent investor would rely upon the advice under comparable circumstances.¹¹⁶ While these sections give affirmation that charities and NPOs can obtain advice with regard to their investments, they do not give any guidance about how to evaluate whether a prudent investor would rely on such advice. For this reason, it is advisable, if a charity or NPO, where applicable, decides to rely on investment advice, to document the reasons why the directors thought it was reasonable to rely on that advice.

Under the *Trustee Act*, it is possible for the board to delegate investment decision making to an agent (e.g. an investment manager). However, before the statutory authority to delegate investment decision-making can be utilized, it is necessary for the directors to develop, implement, regulate and review two or possibly three, separate documents. These documents include (1) an investment policy to evidence compliance with the mandatory investment criteria,

¹¹⁶ *Ibid* at s 27(7)-(8).

- (2) a specific investment plan for each investment fund requiring a specific investment plan, and
- (3) an agency agreement with the agent to whom investment decision-making is to be delegated.

Such documentation should be reviewed and updated on a regular basis.

In Ontario, the *Trustee Act* requires that there be an investment policy if investment decision making is delegated.¹¹⁷ Although it is not a requirement that there be an investment policy where there is no delegation of investment decision making, it is advisable for a charity or NPO dealing with charitable property to adopt an investment policy for the following reasons:

- An investment policy can provide the board of the organization with protection from personal liability in the event that a loss occurs, if such a loss resulted from the board relying on the policy for the investment of trust property, and the policy was such that a prudent investor would adopt under similar circumstances. Section 28 of the *Trustee Act* enumerates this protection.¹¹⁸
- An investment policy can assist in ensuring that the board has addressed the statutory requirements to comply with the investment criteria set out in the *Trustee Act*, as well as the related statutory requirements under the *Trustee Act* regarding diversification of investments.
- If the trustees of a charity, either now or in the future, decide to delegate investment decision making to an investment manager, there must be an investment policy in place to guide the investment manager.

Generally, the purpose of an investment policy is to ensure that the provisions of the *Trustee Act* and the applicable common law requirements are complied with, while also ensuring that the specific terms of investments for different funds of the organization are set out in separate investment policies often referred to as “specific investment plans.” These specific investment plans are then deemed to be incorporated by reference into and become part of the general investment policy. This approach will generally provide flexibility for the future while at the same time ensuring consistency when multiple specific investment plans are required for different funds.

¹¹⁷ *Ibid* at s 27.1(2).

¹¹⁸ *Ibid* at s 28.

As the forms of investment policies that are currently utilized by investment managers in the investment community do not necessarily comply with the terms of the *Trustee Act*, the investment policy should state that any investment policies that are provided by investment managers are to be incorporated by reference into the investment policy of the organization as a specific investment plan, but are to be read subject to the overriding terms of the investment policy of the organization. In the event there is a conflict between the terms of a specific investment plan and the investment policy of the organization, then the conflicting terms of the specific investment plan would be deemed to be amended in accordance with the applicable terms of the investment policy of the organization. This would help protect the board of directors from exposure to personal liability for unintentionally failing to comply with the applicable terms of the *Trustee Act* because of an erroneous term of a specific investment plan prepared by an investment manager.

G. SELECTED STATUTORY DUTIES, LIABILITIES AND PROTECTION

Many federal and provincial statutes impose specific duties, offences and penalties for acts and omissions committed by directors of corporations, as well as occasional statutory protection. Given that the corporation cannot be sufficiently punished itself, its directors and officers are often exposed to similar liability as the corporation. As will be seen below concerning liability under the ITA, statutory liability may be imposed on directors and even *de facto* directors.

Penalties for non-compliance with statutory requirements can result in directors, and possibly officers, being subject to fines, repayment of debt and even imprisonment, as discussed below. Since the focus of this paper is on federal and Ontario jurisdictions, directors of charities and NPOs located or operating in other provinces must also review the comparable provincial

legislation and statutory obligations. It is obviously beyond the scope of this paper to discuss all applicable statutes that affect charities. As such, only a selection of some of the more important statutory duties, liabilities and protections are described below. For those wanting a more comprehensive resource in this area, *Charities Legislation and Commentary*,¹¹⁹ available from LexisNexis is recommended.

1. Federal Statutes

a) Canada Corporations Act

Although the CCA will soon be replaced by the CNCA over the next three years as more federal corporations convert to the CNCA, the CCA remains the governing statute for federal corporations at the prescribed time and therefore is central to understanding the duties and liabilities of federally incorporated charity and NPO corporations.

In this regard, directors of a charity or NPO are jointly and severally liable for all unpaid wages due for services by employees for the corporation while they were directors.¹²⁰ Debt liability is limited to six months wages and claims must be commenced within six months after wages were due and must be brought while the person is still a director or within 12 months of ceasing to hold office.¹²¹

Failure to file the requisite information with Industry Canada can lead to personal liability with no limitation period or defence for a director who permits a breach to occur. An annual report for the corporation is to be filed on or before June 1st of each year for information effective as of March 31st of the year in question.¹²² Failure to do so can result in a fine to the corporation of \$20 to \$100 for each day the default continues and directors who permit such

¹¹⁹ Adam Parachin, Terrance S. Carter, & Maria Elena Hoffstein, *Charities Legislation & Commentary*, 2011 ed (Toronto: LexisNexis, 2011).

¹²⁰ *Supra* note 3 at s 99(1).

¹²¹ *Ibid* at s 99(2).

¹²² *Ibid* at s 133(3).

default are liable to the same fine.¹²³ If failure to file an annual report or hold an AGM results in winding up of the corporation by court order, then directors who are aware of the default may be held liable for costs incurred in winding-up the corporation.¹²⁴

Directors have an obligation to protect the corporation against flawed or incomplete representation of the corporation on business documents or to third parties. Failure to do so may result in a fine to the director of \$200 along with personal liability to the holder of any financial instrument for the full amount if the corporation does not pay.¹²⁵

Section 149 of the CCA contains a general offence provision which exists for breach of any section of legislation. No penalty has been prescribed but directors can be liable up to \$1000 and imprisoned for up to a year for doing anything contrary to the legislation or for failing to comply with the CCA.

b) Canada Not-For-Profit Corporations Act

In addition to the continuing similar liability for wages described under the CCA as described above, directors and officers of charities and not-for-profit need to be aware that the CNCA generally expand the rights and remedies available to members of not-for-profit corporations. In this regard, members will be able to apply to the court for an oppression remedy, a court-ordered liquidation, a derivative action and compliance and restraining order.¹²⁶ It is also important to note that the CNCA also enhances the accountability of directors to members by providing members with the power to remove directors by ordinary resolution at any time.¹²⁷ Members will also have the right to submit proposals to amend by-laws or nominate directors or

¹²³ *Ibid* at s 133(3).

¹²⁴ *Ibid* at s 150(2).

¹²⁵ *Ibid* at s 27.

¹²⁶ *Supra* note 38 at s 253, 224(1), 251, 252 and 259.

¹²⁷ *Ibid* at s 130 and 131.

require any matter to be discussed at annual meetings.¹²⁸ The CNCA will also provide a due diligence defence for directors and officers as discussed later in this paper.

c) Income Tax Act

Directors of a charity or NPO can be jointly and severally liable in their personal capacities to pay all employee income tax deductions which the corporation fails to remit for two years following ceasing to be a director.¹²⁹ Directors of charities may be personally liable if the charity fails to comply with numerous reporting requirements under the ITA, for example, filing of annual charity information return, T-3010B.¹³⁰ CRA will also revoke the charitable status of a charity that delays in filing this return.¹³¹

Directors may also face fines and imprisonment where they are involved in making false or deceptive statements in any return required under the ITA or willfully evading compliance with the ITA.¹³²

While the OCA and CCA do not provide a statutory standard of care, the Federal Court of Appeal (“FCA”) has articulated the standard of care of directors of NPO’s in the context of the ITA. In *Wheeliker v Canada*¹³³ volunteer directors of an NPO were held personally liable for withholding tax the corporation owed to CRA as the directors had failed to remit to CRA tax withheld from the wages paid to the corporation's employees in the amount of \$17,886.91. The directors were aware of the failure of the corporation to remit the sums, in some cases for up to a year, before the corporation was put into bankruptcy.

¹²⁸ *Ibid* at s152(6).

¹²⁹ *Supra* note 4 at s 227.1.

¹³⁰ *Ibid* at s 238.

¹³¹ *Ibid* at s 168(1)(c)

¹³² *Ibid* at s 239.

¹³³ *Wheeliker v Canada (sub nom Canada v Corsano (C.A.))*, [1999] FCJ No 401, [1999] FC 173, [1999] ACF no 401 (FCA) [*Wheeliker*].

The FCA found that the directors were liable for the sums due because they did not exercise the degree of care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances under subsection 227.1(3) of the ITA. Justice Letourneau commented that the standard of care was no less rigorous for a director of a “not-for-profit corporation” than for a director of a corporation run for profit. In this regard, with respect to compliance under the ITA, directors of not-for-profit corporations will be held to an objective standard of care in ensuring that all returns and source deductions are completed. As such, directors of a charity or an NPO need to take proactive steps to ensure that source deductions are remitted on a timely basis in order to avoid exposure to personal liability.

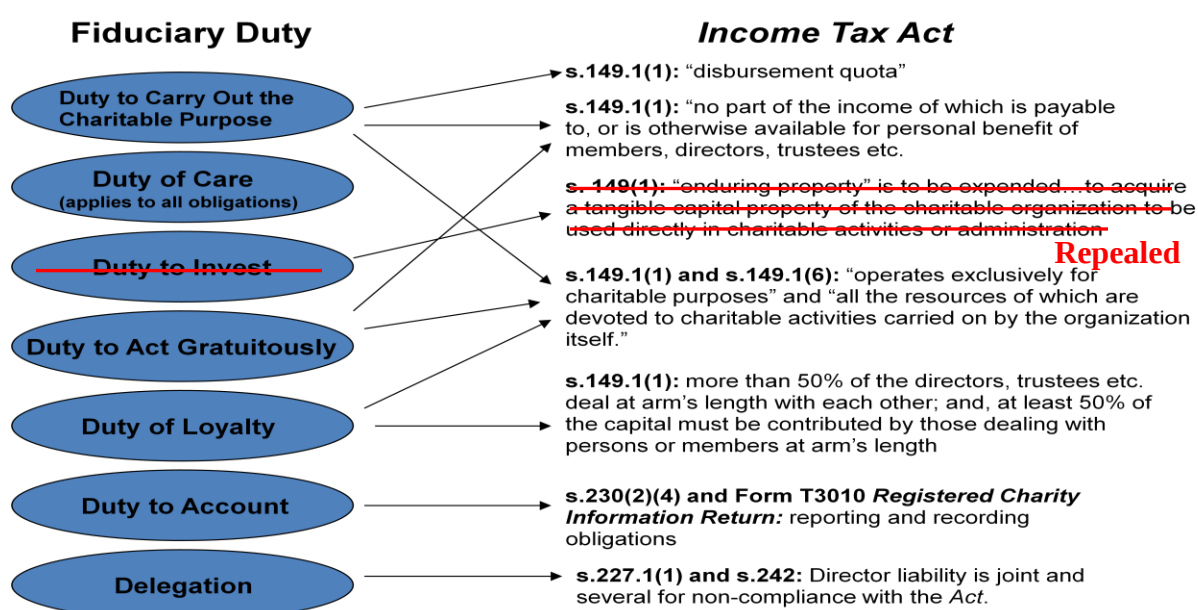
In *Rancourt v Canada*,¹³⁴ the Tax Court of Canada also dealt with the issue of the standard of care to be met by a director of an NPO under the *Excise Tax Act*.¹³⁵ Unlike the *Wheeliker* decision, the director in this case was found to have discharged her duty. In *Rancourt*, the corporation’s activities involved distributing shows and operating a performance hall and bar under the name “L’Espace Alizé.” The corporation failed to pay the amounts of net GST that it was required to remit. The Minister of Revenue sought to have Rancourt, one of the directors, held liable for the outstanding amount and assessed accordingly. The court found that for someone with limited business and management experience similar to that of Rancourt, actions by the corporation, including the appointment of a new accountant, indicated that the decisions made by the directors were the ones needed to redress the corporation’s financial situation and ensure that the GST remittances were paid. Rancourt met the standard of care by doing what a reasonably prudent person would have done in comparable circumstances.

¹³⁴ *Rancourt v Canada*, 2008 TCC 285, [2008] TCJ No 242 (TCC) [*Rancourt*].

¹³⁵ *Excise Tax Act*, RSC 1985, c E-15 [“ETA”].

With regard to the other duties of directors and officers of a charity under the ITA, the OPGT during a recent CBA/OBA Charity Law Symposium outlined the interaction of the common law fiduciary duties of directors and officers described earlier in this paper, with certain statutory requirements of registered charities.¹³⁶ While it's beyond the scope of this paper to fully discuss this interaction, the chart prepared by the OPGT has been reproduced below as a useful reference tool:

General Fiduciary Duties and *Income Tax Act* Obligations



d) Anti-terrorism Considerations

It has become increasingly evident that charities, both in Canada and worldwide, have become one of the silent victims of the global anti-terrorism initiatives that have been carried out during the past decade. Charities face the uncertainty of whether overly broad legislation will be applied to their activities, a literally impossible task of ensuring strict compliance, and uncertainty as to whether they will be able to effectively continue their operations in the face of mounting restrictions.

¹³⁶ *Supra* note 52.

In this regard, directors of charities, as well as NPOs may also need to consider addressing due diligence considerations under Canada's broad reaching anti-terrorism legislation.¹³⁷ The requirements under that legislation can significantly impact charities and NPOs, particularly those operating outside of Canada in conflict zones. Accordingly, a charity or NPO will need to take appropriate steps to ensure that it conducts the necessary due diligence inquiries of donors, staff, volunteers as well as its partners overseas.¹³⁸ The charity may also want to consider retaining discretion in the trust document for any express trust property it receives that it not be required to apply the trust monies to the restricted charitable purpose in the event of anti-terrorism concerns as determined in the sole discretion of the charity.

With regard to exposure to liability, directors and officers of a charity or NPO can be caught under the enhanced anti-terrorism provisions of the *Criminal Code*,¹³⁹ which now broadly defines "terrorist activity" to encompass acts or omissions both inside and outside Canada committed in whole or in part for political, religious or ideological purposes, objectives or causes. The latter component of the definition was recently clarified by the Ontario Court of Appeal in *R v Khawaja*,¹⁴⁰ which noted that the phrase "terrorist activity" does not prohibit or criminalize any political, religious, ideological thought, belief or opinion, but rather defines certain conduct. In fact, section 83.01(1.1) specifically states that "the expression of a political, religious or ideological thought, belief or opinion does not come within ... the definition [of] "terrorist activity" ... unless it constitutes an act or omission that satisfies the criteria of that

¹³⁷ *Charities Registration (Security Information) Act*, SC 2001, c 41, s 113; *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*, SC 2000, c 17, *Anti-terrorism Act*, SC 2001, c 41; *Foreign Missions and International Organizations Act*, SC 1991, c 41; *Public Safety Act, 2002*, SC 2004, c 15.

¹³⁸ For more information see www.antiterrorism.ca. See also Terrance S. Carter, Sean S. Carter, & Nancy E. Claridge, "The Impact of Anti-Terrorism Legislation on Charities in Canada: The Need for an Appropriate Balance" (26 October 2007) online: Carters Professional Corporation <<http://www.carters.ca/pub/article/charity/2007/tsc1026.pdf>>.

¹³⁹ *Criminal Code of Canada*, RSC 1985, c C-46

¹⁴⁰ 2010 ONCA 862, [2010] OJ No 5471, 103 OR (3d) 321 (Ont CA).

paragraph.”¹⁴¹ Notwithstanding this clarification, directors can still face imprisonment under section 83.19 of the *Criminal Code* for a maximum of 14 years for “facilitating” a “terrorist activity.” In this regard, facilitation is deemed under ss. 83.19(2) to have occurred whether or not the person knows that a “terrorist activity” has been facilitated, that any “terrorist activity” was foreseen or planned at the time it was facilitated, or even if the “terrorist activity” was actually carried out.

In addition, directors and officers of charities can still face fines, penalties and imprisonment under numerous other sections of the *Criminal Code*, which under section 83.13 and 83.14 allows a judge to make an order for the seizure or forfeiture of property that is owned or controlled by or on behalf of a “terrorist group” or that has been or will be used, in whole or in part, to “facilitate” a “terrorist activity.”

Apart from compliance with anti-terrorism laws, maintaining due diligence is also mandatory in accordance with the common law fiduciary duties of directors to protect charitable property discussed above. While due diligence is not a defence against anti-terrorism charges, the anti-terrorism laws do not abrogate directors’ fiduciary duties to the charity and its donors. If a charity’s assets are frozen or seized, the charity’s directors and officers could be exposed to civil liability for breaching their fiduciary duty to protect the organizations’ charitable assets, as well as exposed to criminal charges. If they are found to have been negligent, this could be a very significant liability quite apart from any possible criminal sanctions. Directors and officers of charities and NPOs, where applicable, will therefore want to help protect themselves against a finding of negligence by demonstrating their intent to comply through exercising appropriate due diligence.

¹⁴¹ For a fuller discussion of the case, see Nancy E. Claridge, “Ontario Court Of Appeal Restores Motive Requirement in Definition of Terrorist Activity”, *Anti-Terrorism & Charity Law Alert* No. 23 (27 January 2010) online: Carters Professional Corporation <<http://www.carters.ca/pub/alert/ATCLA/ATCLA23.pdf>>.

2. Ontario Statutes

a) Corporations Act

The OCA is the current governing document providing for incorporation of not-for-profit corporations. Like the federal CAA, the OCA is set to be replaced by new governing legislation in the form of the ONCA, but not until sometime in 2012.

Under the OCA, directors are jointly and severally liable to the employees, apprentices and other wage earners for all debts due for services performed for the corporation, not exceeding six months wages and twelve months vacation pay.¹⁴² However, a director will not be liable unless the corporation has been sued in the action against the director and employees cannot collect from the corporation, or before or after an action has been commenced the corporation has ceased operations by liquidation, winding up or bankruptcy and the debt has been proved.¹⁴³

Failure to keep proper books, records and registers at the head office of the corporation and failure to make such books, records and registers available for inspection by entitled persons may result in personal liability for the directors.¹⁴⁴

Directors are required to disclose their interest in a contract to be entered into by the corporation at the next meeting of directors. Failure to disclose is an offence under the OCA, resulting in liability being imposed on the director for any profit realized from the contract, the voidability of the contract, and a penalty on conviction up to \$200.¹⁴⁵ Like the CCA, the OCA

¹⁴² *Supra* note 2 at s 81(1).

¹⁴³ *Ibid* at s 81(2).

¹⁴⁴ *Ibid* at s 109(3).

¹⁴⁵ *Ibid* at s 71.

contains a general offence provision for any breach of its provisions for which no penalty is prescribed, which could result in a fine up to \$200 on conviction.¹⁴⁶

b) Ontario Not-for-Profit Corporations Act

Like the CNCA, the ONCA expands member's rights. A member who is entitled to vote at an annual meeting may raise any matter as a "proposal" but must give 60 days notice. Directors can refuse to discuss the proposal if they give at least 10 days notice, but a member may appeal the refusal decision to court.¹⁴⁷ Members also have a right to access membership lists¹⁴⁸ and the right to inspect financial records.¹⁴⁹ Like the CNCA, the ONCA will also provide a due diligence defence as discussed later in this paper.

c) Charities Accounting Act

Since there are no identifiable beneficiaries that can enforce a charitable purpose, the courts have generally recognized over the centuries that the Crown has an inherent *parens patriae* responsibility over charitable activities to represent and protect the interest of charities.¹⁵⁰ This responsibility is exercised in Ontario by the OPGT. This common law jurisdiction of the Crown has been supplemented by statute through the CAA, which provides the OPGT with the authority to seek an order under s. 4 of the CAA if he or she is of the opinion that there has been a misapplication or misappropriation of any charitable funds, an improper or unauthorized investment of any monies, or failure to apply charitable property as directed by the donor.

As noted earlier in this paper, prior to regulations made pursuant to s. 5.1 CAA coming into effect, charities had to keep money donated to them for a special purpose separate from its

¹⁴⁶ *Ibid* at s 13(5).

¹⁴⁷ *Supra* note 39 at s 56.

¹⁴⁸ *Ibid* at s 96(1).

¹⁴⁹ *Ibid* at s 98(2).

¹⁵⁰ *In Re Baker* (1984), 47 OR (2d) 415 (Ont H Ct J); *Toronto Aged Men's and Women's Homes v Loyal True Blue and Orange Home*, [2003] OJ No 5381, 68 OR (3d) 777 (Ont Sup Ct J); *Asian Outreach Canada v Hutchinson*, [1999] OJ No 2060, 28 ETR (2d) 275 (Ont Sup Ct J); *Pathak v Hindu Sabha supra* note 85; *Ontario (Public Guardian and Trustee) v AIDS Society for Children (Ontario)*, [2001] OJ No 2170, [2001] OTC 432 (Ont Sup Ct J).

general funds and could not combine them even with other restricted funds. While it is now possible to commingle restricted funds (but not with general funds), directors of a charity are obligated keep records set out by regulation as discussed earlier above¹⁵¹. It is also important to note that these requirements are in addition to requirements that may exist under any other law that relates to the combination of the funds for investment purposes, and as a result the records required by other laws relating to the combined funds must also be kept.¹⁵²

In relation to third-parties alleging that a charity has misapplied its charitable property, ss. 6(1) of the CAA states that:

Any person may complain as to the manner in which a person or organization has solicited or procured funds by way of contribution or gift from the public for any purpose, or as to the manner in which any of such funds have been dealt with or disposed of.

Applications under ss. 6(1) can be brought *ex parte* by a complainant, i.e., without notice to the charity or anyone else, with the court being able to order the OPGT to conduct a public inquiry under the *Public Inquiries Act*.¹⁵³ A donor may also complain to the OPGT that a “direction” imposed by the donor on a gift is not being complied with by the charity. This in turn could result in an application by the OPGT to obtain a court order requiring the charity to comply with the terms of the donor direction in accordance with s. 4(d) of the CAA.

Lastly, ss. 10(1) of the CAA permits two or more individuals to make a court application where they allege a breach of a trust created for a charitable purpose or seek the direction of the court for the administration of a trust for a charitable purpose. The only limitation of this provision is that notice must be given to the OPGT who can appear and be represented at a hearing. This is a very powerful section of the CAA which directors of a charity should bear in

¹⁵¹ *Supra* note 100 at s 3(5) and s 3(6)

¹⁵² For more details see, Ontario Public Guardian and Trustee, “Changes to the Charities Accounting Act”, (9 December 2010) online: Ministry of the Attorney General
<<http://www.attorneygeneral.jus.gov.on.ca/english/family/pgt/charbullet/bullet6.asp>>.

¹⁵³ RSO 1990, c P 41.

mind. It should be noted that section 10 is available to any two or more persons and is not limited to only members only, so long as they are alleging breach of trust or seeking the direction of the court in the administration of a charitable purpose trust.¹⁵⁴

3. Statutory Protection of Directors

Unlike their business counterparts, there is little in the way of statutory protection for directors and officers of charities and NPOs. The following, though, provides a brief overview of certain select statutory protections from liability that are either in place at the present time or will come into place in the near future under the ONCA and the CNCA.

a) Canada Not-for-profit Corporations Act

Under the CNCA, the possibility of a corporation's activities being *ultra vires* will be now eliminated, although this will likely be of limited practical benefit as explained earlier in this paper.¹⁵⁵ The CNCA will also increase director protection by including a statutory due diligence defence in sections 149 and 150. Those sections state that a director is not liable if he or she has exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances. This will also include good faith reliance on financial statements and reports of professionals. While this language is reflective of the objective standard that applies under the CNCA, it must be remembered that the common law high fiduciary duties with regards to charitable property will continue to have application notwithstanding the objective standard of care and due diligence defence under the CNCA.

In addition, the remedies discussed above that are available to members for a derivative or oppression action are precluded in the case of a "religious corporation." However, for this

¹⁵⁴ *Ontario Society*, *supra* note 88 at para 28-34; *St. James' Preservation Society v Toronto (City)*, [2006] OJ No 2726 at para 51, 272 DLR (4th) 149 (Ont Sup Ct J).

¹⁵⁵ *Supra* note 38 at s 7(3.1).

exemption to apply, the corporation must: be a religious corporation; the act or omission, conduct or exercise of powers must be based on a tenet of faith held by the members of the corporation; and, it was reasonable to base to decision on a tenet of faith, having regard to the activities of the corporation.¹⁵⁶

b) Ontario Not-for-profit Corporations Act

Similar to the CNCA, the possibility of a corporation's activities being *ultra vires* will also be eliminated under the ONCA. Like the CNCA, directors are provided with a "reasonable diligence defence" including reliance on officers and employees of the corporation and on professional advice. A director or officer is not liable if they exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, and good faith reliance on financial statements and reports of professionals meets this defence.¹⁵⁷

Like the CNCA, a derivative action is not available in the case of a religious corporation.¹⁵⁸ However, religious corporations are not defined under the ONCA.

H. INDEMNITIES AND INSURANCE FOR DIRECTORS AND OFFICERS OF CHARITIES

Given the liabilities to which directors and officers of charities and NPOs are exposed, it is important for board members to ensure that the corporation has provided appropriate provision for indemnification and insurance as necessary.

In this regard, the OCA permits a corporation, with the approval of the members at a meeting of the members, to indemnify a director or officer for all "costs, charges and expenses" arising from an action in relation to the director's execution of the duties of his office. In this regard, section 80 of the OCA states

¹⁵⁶ *Ibid* at s 251(3), 253(2) and s 224(2).

¹⁵⁷ *Supra* note 39 at s 44.

¹⁵⁸ *Ibid* s 183(3).

Every director and officer of a company, and his or her heirs, executors and administrators, and estate and effects, respectively, may, with the consent of the company, given at any meeting of the shareholders, from time to time and at all times, be indemnified and saved harmless out of the funds of the company, from and against,

(a) all costs, charges and expenses whatsoever that he, she or it sustains or incurs in or about any action, suit or proceeding that is brought, commenced or prosecuted against him, her or it, for or in respect of any act, deed, matter or thing whatsoever, made, done or permitted by him, her or it, in or about the execution of the duties of his, her or its office; and

(b) all other costs, charges and expenses that he, she or it sustains or incurs in or about or in relation to the affairs thereof, except such costs, charges or expenses as are occasioned by his, her or its own wilful neglect or default.

Section 133 of the OCA permits a not-for-profit charitable corporation to indemnify its officers and directors. However, Ontario Regulation 4/01 under the CAA¹⁵⁹ specifically restricts the indemnification of directors of charities for liability that relates to their failure to act honestly and in good faith in performing their duties. This requirement has also been written into the ONCA, which limits indemnification for directors and officers to instances where “the individual acted honestly and in good faith with a view to the best interests of the corporation or other entity, as the case may be.”¹⁶⁰

Regardless of which corporate statute applies, Regulation 4/01 under the CAA requires that prior to a charity consenting to the indemnification of its directors, the board of directors must consider the following five factors, of which factors 1, 2 and 5 are relevant to indemnification. The other factors apply to situations where the board is considering purchasing directors and officers insurance, which is discussed later in the paper:

1. The degree of risk to which the executor, trustee, director or officer is or may be exposed.

¹⁵⁹ *Supra* note 100.

¹⁶⁰ *Supra* note 39 at s 46(3)(a).

2. Whether, in practice, the risk cannot be eliminated or significantly reduced by means other than the indemnity or insurance.
3. Whether the amount or cost of the insurance is reasonable in relation to the risk.
4. Whether the cost of the insurance is reasonable in relation to the revenue available to the executor or trustee.
5. Whether it advances the administration and management of the property to give the indemnity or purchase the insurance.¹⁶¹

With regard to directors and officers insurance, charities can also purchase personal liability insurance for their directors and officers without need of a court order provided that the factors referenced above are first considered by the board of directors.¹⁶² However, the regulations stipulate that the terms of the policy must not impair a person's right to bring an action against a director or officer.¹⁶³

The ability for directors or officers of the corporation to receive indemnification or purchase insurance is also restricted in that in doing so it must not render the corporation insolvent.¹⁶⁴ Directors and officers must keep notes to evidence that these requirements have been met.¹⁶⁵

In a recent decision, the Ontario Superior Court of Justice has provided some important guidance concerning the issue of the availability of indemnification for directors of not-for-profit corporations who incur costs in relation to their acts or omissions as directors of the corporation. The decision in *Deol v Grewal*,¹⁶⁶ confirms that the principles established in for-profit corporations are applicable to not-for-profit entities. In *Deol*, the successful plaintiffs sought costs on a substantial indemnity basis in the amount of over \$400,000 to be paid by the individual defendants. The defendants, who were directors of the charity, submitted that no costs

¹⁶¹ *Supra* note 100 at s 2(5).

¹⁶² *Ibid* at s 2(3).

¹⁶³ *Ibid* s 2(4).

¹⁶⁴ *Ibid* s 2(6).

¹⁶⁵ *Ibid* s 1(3).

¹⁶⁶ [2009] OJ No 3217 (Ont Sup Ct J) [*Deol*].

should be awarded, but if they were that they should only be on a partial indemnity basis of no more than \$115,000. The defendants also submitted that they should be indemnified by the charity in accordance with both the OCA and their by-law.

Although there were no allegations of misuse of corporate funds or misappropriation of charitable property, the court held that the conduct exhibited by the defendant directors in taking control of the charity constituted *mala fides*, as they pursued their own interests in doing so above those of the corporation, thereby disentitling the defendants to indemnification. The court held that the test for determining whether a director or officer is entitled to indemnification is set out in the decision of *Ontario (Public Guardian and Trustee) v Unity Church of Truth*.¹⁶⁷ Although the issue of indemnification was not directly dealt with in that decision, Justice Sheard commented in obiter that he agreed with a statement written in a letter by counsel for the OPGT, which stated that a director of a charity ought to be indemnified only for those acts properly undertaken in the administration of the charity or undertaken in breach of trust under an honest and reasonable mistake.¹⁶⁸

In a more recent decision, *Pandher v Ontario Khalsa Darbar*,¹⁶⁹ the Court of Appeal reversed a lower court judgment holding the defeated directors of a charity personally responsible for costs, which arose from litigation between two factions of the same board. The Court of Appeal affirmed the common law position that absent a finding of the directors pursuing their own interests ahead of those of the corporation, the court should not award costs against the directors on a personal basis. The court cited another Court of Appeal decision concerning a for-profit corporation, *Bennett v Bennett Environmental Inc.*,¹⁷⁰ which stated:

¹⁶⁷ [1998] OJ No 1291, 59 OTC 120 (Ont Ct J (Gen. Div)).

¹⁶⁸ *Ibid* at para 44.

¹⁶⁹ 2010 ONCA 273, [2010] OJ No 1471 (Ont CA).

¹⁷⁰ 2009 ONCA 198 at para 23, [2009] OJ No 853 (Ont CA).

the primary purpose of indemnification is to provide assurance to those prepared to become corporate directors that they will be recompensed for any adverse consequences arising from well-intentioned entrepreneurship undertaken on the corporation's behalf.

The Court of Appeal affirmed that this approach applies equally to not-for-profit corporations.¹⁷¹

Although these decisions offer some comfort to the directors and officers of charities, it is still important that charities ensure compliance with the regulations under the CAA in the acquisition of directors' and officers' liability insurance or the adoption of an indemnification by-law.¹⁷²

In addition, it should be noted that directors' and officers' insurance policies are not standard, so the quality of coverage varies substantially between insurers. In this regard, directors should review their policies to make sure they have coverage for all of the potential risks they may face. It is therefore important for directors and officers of charities and NPOs to ask their insurance broker for a written explanation regarding the monetary limits of their policy, the extent of that coverage, and any exclusions contained within the policy to ensure that adequate coverage is available for the above discussed liabilities.

I. CONCLUSION

The duties and liabilities that apply to directors and officers of charities and NPOs criss-cross a mine field of different statutory schemes and common law principles. While the advent of new statutory regimes at the federal and provincial level in providing an objective standard of care and due diligence defence will certainly be of some assistance, directors and officers of charities and NPOs, where applicable, must still have careful regard to the furtherance of their charitable purposes when dealing with charitable property and the common law high fiduciary

¹⁷¹ *Supra* note 169 at para 11.

¹⁷² Robert Hayhoe, "When should Charities Indemnify Directors?", *The Lawyers Weekly* (3 December 2010).

duties with which they must abide. While a position as a director or officer of a charity or NPO can be a worthwhile and satisfying commitment of time, those who do so must recognize the need to exercise appropriate due diligence to ensure compliance with the duties and liabilities imposed upon them at law.