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Chapter 2: Duties of Directors

Primer for directors of not-for-profit corporations (Rights, Duties and Practices)

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Introduction

The role of directors
The board of directors of a not-for-profit corporation is responsible for the management of the corporation. In general terms, this means that the board is responsible for supervising senior staff, providing strategic planning to the corporation, and developing and implementing corporate policy. Board members must be (or at least must become) knowledgeable about the business and financial affairs of the corporation. Where the corporation is a charity, the board has a heightened duty of care with respect to the protection of its charitable property.

In discharging its mandate to manage the corporation's affairs, the board must comply with the objects of the corporation as stated in the letters patent or articles of incorporation and with the bylaws of the corporation. The board must also comply with the relevant provisions of the corporations statute under which the corporation is incorporated and the rules established under the common law (the law established by courts) governing directors' duties.

The duties of directors
Directors are required to exercise their power with competence (or skill) and diligence in the best interests of the corporation. They owe what is called a "fiduciary duty" to the corporation. The duty is a "fiduciary" duty because the obligation to act in the best interests of the corporation, at its core, is an obligation of loyalty, honesty and good faith. Modern corporations statutes governing business corporations provide a concise formulation of the fiduciary obligation owed by directors. Most of the corporations statutes governing not-for-profit corporations do not. The formulation of the fiduciary duty of directors has been developed at common law by Canadian and English courts or set out in the *Civil Code*.

Directors' fiduciary duties can be divided into two main branches:

a) the duty of care; and,
b) the duty of loyalty.

The duty of care imposes on directors a duty of competence or skill **-** i.e., a requirement to act with a certain level of skill; and a duty of diligence. The duty of skill and diligence must be performed to a certain "standard of care".

What level or kind of skill must a director demonstrate? What level or kind of diligence?

For not-for-profit corporations, the answers to these questions are to be found in any one of or any combination of the following sources:

- the legislation under which the corporation is incorporated;
- court decisions which attempt to define the standard of care expected of directors;
- non-corporation laws and statutes which impose additional specific duties on directors;
- in trust law, for not-for-profit directors of a corporation organized to pursue charitable purposes; and,
- in Québec, the directors' duties found in the *CivilCode of Québec*

It is generally accepted that a heightened duty of care is owed by directors of a charitable not-for-profit corporation.

The duty of loyalty requires that a director act honestly and in good faith in the best interests of the corporation. The duty of loyalty is a personal duty and cannot be delegated (the "no-delegation rule"). Among other implications, it means that a director is not allowed to profit from his or her office (the "no-profit rule") and must avoid all situations in which his or her duty to the Corporation conflicts with his or her interests (the "no-conflict rule").

The civil responsibility of directors
In law, a corporation is a distinct legal entity. It has a separate legal personality from its directors, members and other stakeholders. As a separate legal entity, the corporation can own property, enter into contracts, be responsible vicariously for the civil wrongs ("torts") of its employees, and sue and be sued in the courts. It thus has "civil capacity". Directors and members are not generally, personally liable for the contracts and torts of the corporation.[Footnote 1] When a director properly signs a contract on behalf of the corporation, only the corporation is bound, not the director. As a general rule, when an employee of a corporation commits a tort, only the corporation, (as employer), and the employee, are responsible, not the director.

Directors are responsible, however, for breaches of their fiduciary duty to the corporation. They can also be held personally liable for breaches of a growing number of statutory provisions that impose responsibility on them as directors (see Chapter 3). Directors are also liable for the torts that they commit themselves, even if committed while executing their responsibilities as a director. In general, if directors commit a tort, the fact that they were acting as directors when doing so will not be an excuse.

The Duty of Care

(A) The Duty of Skill or Competence
In carrying out their obligations, directors of not-for-profit corporations must use an appropriate degree of skill. The common law holds that what is known as a "subjective" standard applies to directors of not-for-profit corporations incorporated under the *CanadaCorporations Act* or under provincial incorporation statutes, unless those statutes set out a different standard. In some provinces, what has been described as an "objective" skill standard has been set out in legislation. This standard is discussed below. The subjective standard requires that directors:

…exercise such degree of skill and diligence as would amount to the reasonable care that an ordinary person might be expected to take in the circumstances on his or her own behalf, but he or she need not exhibit in the performance of his or her duties a greater degree of skill than may be expected from a person of his or her knowledge and [Footnote 2]

The standard is subjective in the sense that it incorporates a reference to the particular abilities of the particular director. Since the standard is subjective, it can be applied differently among board members of a given corporation. For instance, a lawyer or an individual with business experience will be held to a higher standard of care than someone with less education or experience.

In contrast, under an objective standard of care all board members - regardless of background or experience - are assessed against the same benchmark. The most commonly used objective standard is the conduct that might be expected of a reasonably prudent person. A higher objective standard, which has never been applied by a court, is the conduct that might be expected of a reasonable director.

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.

A lack of case law in this area means that it is impossible to determine with any certainty what distinctions would be made by the courts between the subjective and objective standards of care. Owing to the deference shown by courts to business decisions, and the difficulty of tracing a decision back to the particular skill level of a director or directors, the difference between the two standards may be more perceived than real.

Even so, where the subjective standard applies, this can make it more difficult to attract highly-skilled, experienced or professional nominees for the boards of not-for-profit corporations.

However, the common law has imposed some reasonable limitations on what can be expected of directors:

- a director is not liable for mere errors in business judgement (e.g., considered decisions to pursue a particular commercial course made after honest and good faith evaluation);
- directors are justified in entrusting certain matters of business to officers of the corporation; and,
- directors are justified, in the absence of grounds for suspicion, in trusting that officers of the corporation will perform their duties [Footnote 3]

In practical terms, the following applies:

- Directors should make decisions affecting the corporation based on full consideration of all appropriate material and on the advice of professionals where required.
- Directors should oversee all aspects of the corporation's operations.
- Directors may delegate certain functions to key senior management, but must maintain a supervisory role.

The board of directors is responsible for regularly reviewing the performance of senior staff to whom they are entrusting the implementation of the corporation's mandate on a daily basis.

(B) The duty of diligence

Synopsis
The duty of diligence requires a director to attend meetings and to become as fully informed as possible regarding all aspects of the corporation, including any issues that affect the corporation.

Directors have a duty of diligence in their management of the affairs of the corporation that requires, to the greatest possible extent, regular meeting attendance and development of a sound knowledge of all aspects of the corporation. As noted above, under the *Canada Corporations Act* there is no duty for directors to have a particular skill level. They are only required to act within their particular knowledge and skill level.

The duty of diligence refers to the obligation of directors to educate themselves about the corporation's mandate and all aspects of its operations. It is not enough to merely attend board of directors' meetings. The duty of diligence requires active and concerted effort on the part of directors to be knowledgeable and ready to make informed decisions affecting the corporation.

Practical implications
The duty of diligence has a number of practical implications. Directors should:

- ensure that the board of directors meets regularly;
- attend meetings of the board of directors whenever reasonably possible;
- be thoroughly informed about any decisions the board has to make and ensure that they are provided in a timely manner before the board meeting with all relevant documents including agreements, financial reports and information, legal opinions and other information necessary to make knowledgeable and informed decisions at the board meeting;
- exercise independent judgement when voting in all corporate decisions, and not simply vote with the majority for no well-informed reason;
- ensure that minutes of meetings of the corporation accurately reflect any comments or votes in opposition to matters acted upon;
- carefully review all reports relating to the corporation's financial affairs, including interim and year end financial statements;
- with the assistance of senior staff, carefully review and participate in formulating the annual budget and strategic plan;
- understand and comply with the stated purposes of the corporation as provided for in the letters patent of the corporation;
- understand and carry out their obligations under the corporation's bylaws, including the requirement to call an annual general meeting and to provide information to the members at that meeting;
- require senior management to provide them with any ongoing operational and program information;
- monitor and supervise the chief staff person and regularly assess his or her performance;
- be aware of all internal policies affecting the organization and ensure that certain key policies are in place (such as an investment policy and conflict of interest policy); and,
- be aware of the laws affecting the corporation and obtain necessary legal and accounting advice.

Attendance at board meetings
Although directors are not legally obliged to attend board meetings, their consistent failure to do so would likely be a breach of a director's duty of diligence.

In most provinces and under the *CanadaCorporations Act*, directors cannot vote or participate in meetings by proxy. This is legislative recognition of the importance of full participation by directors at board meetings. Discussion of issues and participation in debate are an essential part of a director's role; his or her responsibility cannot be fulfilled merely through a proxy.

Screening
Allegations of sexual, physical and/or emotional abuse by staff or volunteers of not-for-profit corporations are increasingly commonplace. In light of this, particularly where the corporation is dealing with a vulnerable client population, directors need to consider whether fulfilling their duty of diligence requires ensuring this issue is addressed by the organization in some way. This could involve implementation of a screening protocol (see Chapter 6 for more information on screening).

To date, no court has found that a director failed to discharge this duty because screening or other measures were not taken by the board to lessen the risk of such abuse. However, given the profile of this issue and findings of significant organizational liability against some not-for-profit corporations in recent cases, it is foreseeable that in the future courts may hold directors accountable if their corporations do not take steps to lessen the risk of abusive conduct.

(C) Charitable corporations
Directors of charitable not-for-profit corporations

Synopsis
Where a not-for-profit corporation is also charitable (a"charitable corporation") then as well as the standard of care generally applicable to not-for-profit directors, board members may be required to meet additional expectations-particularly when the corporation carries on all or some of its activities in Ontario.

The law is unclear about the extent to which directors of charitable corporations are considered to be trustees. Generally speaking, however, directors of charitable corporations should meet the standard of care expected of someone in charge of property that is subject to a trust - a "trustee standard".

Among the requirements of this standard, directors must exercise a degree of skill and prudence comparable to a reasonable business person caring for his or her own [Footnote 4]The "trustee standard" is generally considered a more demanding standard in law, and goes beyond what is ordinarily expected of either a not-for-profit or a for-profit director.

Directors should realize that a corporation does not have to be registered as a charity with Canada Customs and Revenue Agency to be considered a charity at common law. In Ontario, the Office of the Public Guardian and Trustee takes the position that all monies entrusted to a public benefit not-for-profit corporation as defined in the *Charities Accounting Act* are monies given for a charitable purpose. As such, the persons responsible for managing those monies must do so as if they were trustees. In Québec, no such higher standard exists for directors.

Specific duties relating to special purpose trusts
Directors of charitable corporations have particular responsibilities relating to special purpose trusts such as restricted trust funds and special purpose trust funds. Where the corporation holds the monies or assets under such trusts, its ability to use them is severely constrained.

Example
A special purpose trust is established to fund a particular educational conference. If a donor is led to believe by the corporation that his or her gift will be used to fund the conference, a special purpose charitable trust is created and the money must be used for this purpose. This also applies where an endowment is created for a particular purpose or subject to the requirement that it be held for a particular period of time.

Where a charitable corporation holds restricted trust funds or endowment funds, the corporation and its directors may be considered to be or treated as trustees of those assets. Their overriding duty is to carry out the restrictions attached to this special purpose charitable trust. In other words, they must make sure that the gift is used for the purpose for which it was given and for no other purpose.

If a charitable corporation fails to comply with the terms of a special purpose trust, all of the directors of the charitable corporation will be in breach of trust. In their personal capacity, individually and as a group, they will be liable with the corporation for the full amount of the loss suffered by the trust fund as a result of the failure to comply with the terms of [Footnote 5]

Some instances in which directors may be found liable for breach of trust are:

- The charitable corporation uses a fund that the donor gifted for use in a particular charitable program to cover the charitable corporation's operating or administrative expenses.
- The charitable corporation uses money from a public fundraising appeal for different charitable purposes from those communicated to the public without obtaining court authorization.
- The charitable corporation places funds into a perpetual endowment fund when all of the monies were intended by the donor to be spent on a current program of the charitable corporation.
- The charitable corporation encroaches on the capital of an endowment fund that was intended by the donor to be held in perpetuity.
- The charitable corporation borrows from a donor-restricted charitable trust fund even where there is a *bona fide* intent to repay those monies together with interest.

Not all conditions placed on gifts by donors will turn a gift into a special purpose trust or another type of restricted gift, however. Each situation must be analysed to determine whether the restriction is sufficient to constitute a special purpose trust. Where there is any uncertainty about whether a special purpose trust or restricted gift has been created, appropriate legal advice should be sought.

Practical implications
The higher duty of care for directors of charities has a number of practical implications. Directors of charities should play an active role in managing their corporations' assets in order to meet this higher duty of care. This means that directors should, at a minimum:

- actively oversee the operations of the corporation and ensure that all programs are permitted by the corporation's charitable objects;
- oversee the corporation's fundraising program so that they are aware of the fundraising methods being employed by staff or professional fundraisers that may result in a special purpose trust fund being created;
- be aware of the terms of any special purpose trust funds and comply with those terms;
- apply for a court order to modify the terms of the trust if the terms of any special purpose trust are no longer capable of being fulfilled by the charitable corporation;
- ensure that all charitable donations, particularly special purpose trusts, which are not to be used for immediate purposes, are properly invested;
- invest property from donations in accordance with the letters patent of the charitable corporation and if the letters patent are silent, then in accordance with the applicable provincial trust legislation (e.g., in Ontario, *Trustee Act*[Footnote 6]);
- comply with their duty to protect and conserve the trust property under their administration;
- keep proper books of accounts with respect to the affairs of the charitable corporation, including donor restricted charitable trust [Footnote 7]; and,
- never allow himself/herself to be in a position that results in a conflict of interest in the duties owed by the directors to the corporation.

Duty of Loyalty

Synopsis
Directors must act with honesty and in good faith in what they reasonably believe to be the best interests of the corporation.

As noted above, the position of a director with respect to the not-for-profit corporation is that of a fiduciary. As a result, a director is considered to be acting for the corporation's benefit, and must subordinate his or her personal interests to the best interests of the corporation. In Québec, directors must by law "act with honesty and loyalty in the best interest of the legal [Footnote 8] which is the civil law codification of the common law fiduciary duties.

This duty of loyalty involves good faith, trust and special confidence, and is the same whether the corporation is a business corporation or a not-for-profit corporation. It requires high standards of honesty and good faith in the exercise of a director's powers and discretions. It means that a director must always use his or her powers in the best interests of the corporation. The director may not delegate his or her duty, except under certain circumstances and with adequate supervision; the director must not profit from his or her position and must always disclose the entire truth in his or her dealings with the corporation; and, the director must avoid all conflicts of interest.

A director will never be able to discharge his or her obligations in meeting the duty of care if the director has acted in bad faith. Intentional dishonesty, incomplete or misleading representations, and acting from an improper motive can all be characterised as bad faith. The 'good faith' requirement is the core of the fiduciary relationship and requires a director to act with pure intentions and with a view to serving the best interests of the corporation.

Directors may not abuse their powers by exercising them for an improper purpose, - i.e., in order to give themselves an advantage or to confer an advantage to someone else, or in order to unduly discriminate against a person - without their act being justifiable by the best interests of the corporation.

For instance, they may not use their power by admitting only members sympathetic to them and refusing to admit or expelling members because they are not.

Not only could such improper actions be set aside by a Court, but they may also result in the personal liability of the directors towards the corporation and the injured persons.

Practical implications
The duty of honesty and good faith has various practical implications. Directors must:

- disclose the entire truth in their dealings with the corporation and actively avoid any impropriety or dishonesty;
- have full allegiance to the corporation's mission and further its cause;
- resign as a director where the director has any personal prejudices or beliefs that are inconsistent with the corporation's mission and that might interfere with the duties owed to the corporation;
- place the interests of the corporation above personal self-interest in all dealings with the corporation and actively avoid all potential conflicts of interest;
- fulfill all of the corporation's reporting obligations with honesty and good faith, and accurately represent the corporation's financial or other position;
- maintain adequate and accurate books of account, records and minutes of the corporation;
- ensure that all corporate decisions are implemented in accordance with the applicable board resolution;
- accurately portray the corporation's programs and objectives to the general public and to any requesting government authority;
- not disclose any information acquired in connection with their position as directors that might be harmful to the interests of the corporation and that is not already available to the public; and,
- fulfill the terms and restrictions of any special purpose trust fund maintained by the corporation, honestly and in good faith.

Non-delegation

Synopsis
A director must not delegate his or her general responsibility for governing the corporation. In certain circumstances it is permissible to delegate particular tasks related to management of the corporation, provided there is proper supervision of the party to which the task is delegated.

Directors are entitled to delegate some of their responsibilities to committees, officers, or members of the corporation. In Québec, directors of *CompaniesAct* corporations may not delegate powers to any committee other than an executive committee composed exclusively of directors and created by a bylaw adopted by 2/3 of the members present at a special meeting. In other jursidictions delegation powers are not so prescribed, however wholesale delegation - most obviously, where a director purports to give over all his or her responsibilities as a director to another person - is never permitted. Such an action would usurp the role of the corporation's members in electing directors.

The fact that directors have delegated a particular task does not relieve them from responsibility, and they should always supervise the carrying out of the task. Directors should remember that they are ultimately accountable for the overall management of the organization.

Delegation of core responsibilities, such as giving an executive committee authority to bind the corporation, should be contemplated in the bylaws. If such delegation is not addressed in the bylaws, or alternatively in an explicit resolution of the full board setting out the terms of the delegation, actions or decisions taken by the body to whom the delegation was made may be subject to challenge. Generally, the broader the delegation, the stronger the argument to be made that it needs to be contemplated in the bylaws.

The line between governance and operational matters is often unclear. As a general rule, it is best to limit delegation of core functions to board commit-tees authorized by the bylaws. Other matters may be delegated by way of board resolution.

The terms of reference of any delegation, whether found in the bylaws, resolutions or both should set out the scope and duration of the delegation, the requirements for reporting back to the full board, and the relationship between the board and the body to which the matter is delegated. (See chapter 5 for further information on the relationship between boards and various types of committees.)

Non-delegation by directors of charities
Where directors of charitable corporations may be considered to be trustees, their ability to delegate decisions with respect to treatment of charitable property may be even more constrained. At common law, trustees may not delegate any such decisions. In certain jurisdictions, delegation by trustees of some aspects of their responsibility is permitted, subject to prescribed restrictions, under provincial trust legislation or regulations.

The No-profit rule and the No-conflict rule

Synopsis
Directors must act with loyalty at all times. The duty of loyalty requires directors to stringently avoid conflicts of interest. Directors may not profit in any way from the irrelationship with the corporation. If they do, they must account to the corporation for the profit. Directors cannot place themselves in a situation where their duty as a director conflicts with their interest or with their duty to others.

A director must give undivided loyalty to the corporation he or she serves. Directors should not put them-selves in a position that would create a conflict between their duty to act in the best interests of the corporation and their own personal [Footnote 9] In general terms, this means that a director should not have any personal interest in any proposed contracts with the corporation. Nor should a director take personal advantage of opportunities that arise because of his or her association with the corporation.

While a conflict of interest can result from many circumstances, there are two general ways in which a director can find himself or herself in a conflict of interest:

- There can be a personal conflict between a director's duty to act in the best interest of the corporation and his or her own self-interest, such as where a director stands to gain financially from a proposed contract between the director (or his/her company or firm) and the corporation;
- There can also be conflict in duties owed to another, where a director's duties to the corporation he or she serves conflict with duties that the director owes to another person or corporation. This can happen when the director is a director of two corporations, or is the director of one corporation and serves the other in another capacity, and the two corporations are involved in one or more transactions.

Personal self-interest conflicts
Directors should not put themselves in a position that would create a conflict between their duty to act in the best interests of the corporation and their own personal [Footnote 10]

The courts have shown very little flexibility on this point by insisting that directors avoid not only actual conflict but also the appearance of conflict. The common law principle with respect to directors' conflicts is straightforward - directors may not have an interest in a contract or transaction being entered into by the corporation.

Personal self-interest can include a situation in which the director stands to gain personally, either directly or indirectly, through a business or corporation involved in the transaction.

Example
A director applying, or being recruited, for a staff position or contract work of a corporation of which he or she is a director is in a personal conflict of interest.

This restriction may extend to a situation in which relatives or friends of the director stand to receive a benefit. It can also include corporate opportunities that the director learns of in advance of others and that the director takes advantage of to the detriment of the corporation.

Example
A director setting up his or her own corporation to tap a potential market identified through the research conducted by the corporation of which he or she is a director is in a personal conflict of interest.

In some cases - but not in the case of charitable corporations or where directors could be considered trustees - an otherwise improper benefit gained by a director may be permitted. The legislation under which the corporation was incorporated may provide for a means of 'ratifying' contracts in which the director has an interest. This generally requires the director to declare his interest and to abstain from voting. The contract can then generally proceed and the director can retain any profit realized.

If the not-for-profit corporation's governing statute does not provide a means of 'ratifying' the contract and a director has an interest in a contract with the corporation, the corporation may recover from the director the profits that the director gained from the contract. Where the corporation is a charity or where directors could be considered trustees, trust legislation precludes 'ratification' of this type of transaction.

In Ontario, directors of charitable corporations are prohibited by common law from realizing any benefits, either directly or indirectly, from their position as a director or otherwise. This means that a director of such a corporation carrying on activities in Ontario would typically not be able to take advantage of ratification of contracts in which he or she has an interest if this would result in a direct or indirect benefit to the director.

Where a director has a conflict of interest and he or she fails to act properly (i.e., by declaring the conflict and following the procedure in the incorporating legislation), the director must repay any benefit resulting from the transaction to the corporation.

Conflict in duties owed to another person or organization
A conflict of interest can arise where a director's duties to the corporation which he or she serves conflict with duties that the director owes to another person or organization.

Where an individual is a director of two corporations, or is a director of one corporation and serves as staff or in another capacity with another organization, that have dealings with each other, the individual's duty to both entities can lead to a conflict of interest. This can arise if the interests of the two entities are not in harmony and the director cannot discharge his or her obligations to one without acting against the interests of the other.

Example
A director of a corporation who is also a staff member of an organization that is a funder of that corporation may face a conflict of interest where he or she wants to direct use of funding in a particular way that might not be in the best interest of the corporation.

A conflict of interest may also arise from conflicting duties owed by the director to two corporations of which he or she is a director, or where he or she is a director of one corporation and serves as staff or in another capacity with another organization (as opposed to a conflict that is based on a particular transaction or contract).

Example
This may happen when an affiliated organization is represented on a corporation's board of directors. As the mandate of the two organizations evolve over time, one organization may want to move away from providing support or complementary services to being the exclusive service provider. So the question of merging the two organization or folding one of them may arise. Once this has been contemplated, it may be impossible for the individual to continue to hold both positions.

When an organizational conflict of interest becomes apparent at a meeting of the board of directors, the director should declare the conflict. He or she should then leave the room for the discussion and abstain from voting on any matter that affects the other corporation of which he or she is a director or employee. If the conflict is insurmountable, the director may have to resign from one or both corporations.

Both the corporation and the directors should have a clearly defined policy to follow in the event of a conflict of interest. However, the legal validity of any policy that allowed a board to disregard a conflict of interest in breach of its fiduciary obligations is doubtful.

Relief of conflicts of interest in incorporation statutes
For federally incorporated organizations, conflicts of interest resulting from a particular transaction can be dealt with under the remedial provisions of the governing statute. Some provincial corporation statutes, as well as the *Civil Code of Québec*,[Footnote 11]also provide procedures to cure such conflicts of interest. Non-contractual conflicts of interest must be dealt with in other ways.

Under section 98 of the *Canada Corporations Act*, a director has a duty to declare his or her direct or indirect interest in a contract or proposed contract with the corporation at a meeting of the board of directors. The Act sets out certain minimum requirements to address the conflict. The procedure outlined in the Act can be used in situations where a director:

- has a personal interest in a proposed contract with the corporation;
- has an interest in a contract with the corporation because he or she serves as an employee, or in another capacity, in another corporation with which the corporation is contracting; or,
- has an interest in a contract with the corporation as a result of being a director in another corporation with which the corporation is contracting.

In the last circumstance, even if the procedure is followed, the contract may not be legally valid where the overlap between the two organizations is such that the majority of directors on the board of the contracting corporation are directors of the other corporation.

Where a not-for-profit corporation incorporated under the *Canada Corporations Act* wishes to enter into a contract with another corporation or firm in which one of its directors has a direct or indirect interest, the following applies:

- In the case of a proposed contract, the director must declare his or her interest at the meeting of directors at which the question of entering into the contract is first considered.
- Where a director becomes interested in a contract after it is made, the declaration must be made at the first meeting of directors held after the director becomes interested.
- The director's declaration of interest can take the form of a general notice to the directors of the corporation to the effect that he or she is a shareholder of or is otherwise interested in the other company or firm, or is a member of a specified firm, and is to be regarded as 'interested' in any contract made by the corporation with that company or firm.
- The director who has declared a conflict should not vote on any contract in which he or she is interested.
- The prohibition against voting in these circumstances does not apply (1) in the case of any contract by the corporation to give to the directors any security for advances or by way of indemnity (e.g., where the board approves the purchase of directors and officers liability insurance); (2) where there isn't a quorum of directors in office who are not interested in the particular contract (see above: such a contract may be held not legally valid); or (3) if the director is a director or officer in the other company and holds only that number of shares which is required to qualify him or her as a director (e.g., if the director's interest in the other corporation is limited to the minimum mandatory amount that must be held by any director).

Relief of conflict of interest by courts (in the case of charities)
In Ontario, a director of a charitable corporation who stands to profit as a result of a contract in which he or she has an interest may not continue to serve the corporation as a director without court authorization.

Under the *Charities Accounting Act*, a procedure is provided for court authorization of trustee conflicts of interest. As the *Act* deems directors of Ontario public benefit corporations to be trustees, they are eligible for this court-authorized relief.

Receiving any personal benefit from a charitable corporation while sitting as one of its directors is considered to be a conflict of interest. Therefore, for a public benefit not-for-profit corporation carrying on activities in Ontario:

- a director may not receive any payment for services as a director or receive any benefit or payment from the charity, directly or indirectly in any other capacity, without court approval; and
- the corporation may only provide an indemnity and purchase directors and officers liability insurance on behalf of its directors provided that they meet the requirements set forth in Ontario Regulation 4/01 under the *Charities Accounting Act*. (For more on this, see Chapter 6.)

This position is enforced at least in part through the supervision of the Office of the Public Guardian and Trustee of Ontario.

A director of a charitable corporation in another province, who may potentially be deemed a trustee owing to the nature of a corporate dealing, may in some cases be able obtain court relief from the conflict by making an application based on trust law.

Practical implications
The duty of loyalty and duty to avoid conflicts of interest have a number of practical implications. Directors should:

- demonstrate full allegiance to the corporation's mission and further its cause;
- approve a conflict of interest policy which includes guidelines on the circumstances in which directors will be considered to be in conflict and the appropriate remedies for failing to disclose a conflict;
- not disclose any information acquired in connection with their position as directors that might be harmful to the interests of the corporation;
- not disclose or use any information relating the affairs of the corporation for personal profit or advantage;
- place the interests of the corporation above personal self-interest in all dealings with the corporation;
- carry out all of their duties in the best interests of the corporation;
- actively avoid all conflicts of interest and immediately disclose any actual or potential conflict, real or perceived, to the board of directors;
- ensure that minutes of any meeting at which a decision involving a potential conflict of interest is discussed accurately reflect the views of all conflicted and non-conflicted directors;
- obtain a legal opinion where there is uncertainty as to whether a conflict of interest exists;
- resign where a director is a director of two corporations, or serves as a director of one corporation and in another capacity in the other corporation, where the interests of the two entities are in conflict and it is apparent that the director cannot act in the interests of one corporation without acting against the interests of the other.

Duties Towards Members[**]

Directors have certain duties to the members of the corporation. They must ensure that the corporation and its directors abide by the terms of its letter patent and bylaws, which have been considered by the courts as akin to a contract between the corporation and its [Footnote 12]

Directors must also treat all members equally (for instance, by fixing or collecting dues or enacting rules or bylaws), unless the best interests of the corporation clearly require otherwise.

Directors must tread especially carefully in the sensitive and litigation-rich area of members' discipline.

Before suspending, fining, expelling or refusing to readmit a member, directors must make sure that the bylaws of the corporation clearly empower them to do so, and that all the internal procedural steps they set out (notices, delays, inquest and recommendation by a committee, hearing, internal appeal, etc.) have been strictly adhered to.

The proceedings must afford a reasonable degree of procedural fairness - i.e., fair play and good faith. The disciplined member should be given fair notice, and an opportunity be to be heard (and have counsel present) in his own defence by board members open to [Footnote 13] Otherwise, the board's decision will be subject to review by a Court. Directors must be careful not to impinge on the member's reputation, for example by publicising at large his expulsion and the motives thereof, or by having a general meeting of members ratify it when a board resolution is sufficient according to the bylaws. They stand to be personally sued for damages if they do.

Sample Questions For Prospective or Current Directors To Ask the Organization

1. Does the board of directors meet regularly? How often does it meet?

2. What notice and preparation (e.g., agendas, reports, etc.) does the corporation give to directors in advance of board meetings?
3. Does the corporation have written policies such as a conflict of interest policy and an investment policy?
4. Does the corporation maintain the proper books of account, records and minutes of meetings?
5. Does the corporation provide board members with ongoing operational and program information?
6. How does the board monitor and supervise the chief staff person? Does it do an annual performance appraisal of this person?

Sample Questions For Directors To Ask Themselves

1. Do I understand the duties of a director of a not-for-profit corporation?
2. Do I attend board meetings regularly? Do I prepare adequately for them? Do I read materials and consider them carefully?
3. Do I exercise independent judgement when voting on corporate matters?
4. If I am serving on the board of a charitable corporation, do I understand the specific fiduciary responsibilities that I have?
5. Am I alert to any potential conflicts of interest or appearance of personal gain?
6. If I sit on the board owing to my affiliation with a stakeholder group, do I understand that my affiliation with that group cannot determine my vote on any board decision? Am I prepared to declare a conflict of interest, and in some cases resign, if I am unable to reconcile my role with the stakeholder group and my position as a director?
7. Have I read and do I understand the corporation's policies on matters such as investment and conflict of interest?

Duties Checklist

Duties Checklist

Subject	To Be Conducted By	How Often	Comment
1. Procedures for distribution of material	Chair and executive director	Annually	A benchmark should be established that enables board members adequate time to consider material; limitation of the volume of material should also be considered, where the amount of material prevents directors from giving it adequate attention.
2. Director attendance record	Chair and individual board member	Annually	Does the director attend frequently enough to make a reasonable contribution to board deliberations?
3. Director performance re: preparation and familiarity with distributed materials	Chair and individual board member	Annually	Does the director regularly participate in board deliberations, and is this participation based on an informed understanding of the issues and materials relating to the matter being considered?
4. Is the director aware of, and discharging, his or her duties?	Chair and individual board member	Upon selection for the board, and annually after that	Is the director aware of, and discharging, his or her legal requirements vis-à-vis skill and diligence, loyalty, honesty and good faith, and avoiding conflict of interest?
5. Are there any additional duties placed on the director by the nature of the corporation	Chair and individual board member	Upon selection for the board, and annually after that	Is the director aware of the extra requirements that may arise, for instance, from the corporation being a charity?

Duties Checklist

Subject	To Be Conducted By	How Often	Comment
or the activities it engages in?			
6. Is there a formal process in place for director performance review or removal?	Chair, executive director and/or nominating committee	Annually, in advance of the nomination and election process	Director performance review can be established by resolution, policy or other means. A process for removal of directors should be specified in the bylaws.
7. Is board business being fully discussed and completed?	Full board and the executive director	Annually	Feedback should be sought from directors both as individuals and as a group. It may be helpful to provide a means to share comments anonymously.
8. Is there a need to adopt specific policies that will assist board members in fulfilling their duties?	Full board	Annually	Directors should review their duties and consider any measures that will facilitate full and informed compliance with what is required of them. Is there a conflict of interest policy? Is there a screening policy?

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