Selected New Developments in the Liability of Directors and Officers of Charitable and Nonprofit Corporations[1]

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(1) Developments in Respect of the "Director-Trustee Dilemma"

One of the issues that has plagued the area of charitable corporations law in Ontario is whether, and to what extent, the directors of such corporations are "trustees" of corporate assets. In a number of Ontario cases (discussed herein) courts have held that, at least for certain purposes, the directors of a charitable corporation should be treated as "trustees" of the corporation's property. This characterization directly affects the area of directors' liability, since trustees are, in law, held to higher fiduciary standards than "mere" directors (i.e., directors of for-profit corporations). While it is arguable that imposing stricter duties on directors of charitable corporations than on directors of for-profit corporations makes a certain degree of sense (given that, among other things, the actions of directors of charitable corporations are not constantly being scrutinized by shareholders with a direct financial interest in the directors' actions), characterizing the directors of charitable corporations as "trustees" may not be the best way to obtain this result. It would be far better, from the viewpoint of clarity and precision, for the courts simply to say outright that directors of charitable corporations are subject to higher duties (including the duty of loyalty) than those of for-profit corporations. In this regard, the Corporate and Insolvency Law Policy Directorate of Industry Canada has introduced a framework paper setting out its proposals for a new *Not-for-Profit Corporations Act*.[2] Under Part V of the proposed *Act*, a corporation would not be deemed to hold any property in trust unless that property was transferred to the corporation expressly in trust for a specific purpose and no director would be deemed to be a trustee with respect to the corporation or its assets.[3] The adoption of this proposal would certainly resolve the issue and allow those involved with such corporations to operate with more certainty. However, until such proposals are enacted and subsequently construed by our courts, there is a risk (in Ontario at least) of courts continuing to hold that directors act as trustees of underlying corporate assets. (As discussed later, in the opinion of the authors, the better view is that directors are not trustees of corporate assets.)

Re Christian Brothers

There has been a significant development in this area as a result of the reference decided by the Ontario Court of Appeal in *Re Christian Brothers of Ireland in Canada*.[4] (The application for leave to appeal this decision, as well as an application for reconsideration, was dismissed by the Supreme Court of Canada.) The reference dealt with the winding up of the Christian Brothers of Ireland in Canada (CBIC), a charitable corporation incorporated by special Act of Parliament, in order to satisfy claims of victims who suffered sexual and other abuse at Mount Cashel Orphanage, which had been run by the Order. While the reference did not deal with directors' liability, the Ontario Court of Appeal did clarify, to some degree, the extent to which a charitable corporation should be characterized as holding its assets "in trust." This clarification should, in turn, shed some light upon the related question of whether, and to what extent, the directors of a charitable corporation should be held to the standard of a "trustee."

The Facts in Re Christian Brothers of Ireland in Canada

CBIC, a worldwide Roman Catholic religious teaching order, was incorporated by Act of Parliament in 1962, although it had carried on activities in Canada without corporate form since 1876. A number of criminal and civil proceedings within the past few years established that, from the mid-1960s to the mid-1980s, almost 90 boys who resided at Mount Cashel Orphanage in St. John's, Newfoundland, were sexually and physically abused by certain of the Christian Brothers charged with their care. Damage claims in respect of the abuse amounted to approximately $36 million. In October of 1996, CBIC made application to be wound up in order to satisfy the claims for compensation. A winding up order was granted by Houlden J.

The reference – a motion for advice and directions relating to the payouts by the liquidator of CBIC – was not made in a factual vacuum. Indeed, two innocent (i.e., unconnected to any claims of abuse) British Columbia schools, whose ownership was not determined at the time of the reference (since determined in *Rowland* v. *Vancouver College Ltd.*[5]) risked liquidation depending upon how the Court decided the issues before it (discussed later). If all of the assets of CBIC were held to be exigible to help satisfy the compensation claims then, depending upon the resolution of the ownership of the schools, the British Columbia schools risked seizure and sale. On the other hand, if the two British Columbia schools were not lumped in with the assets available for liquidation, the assets available for payment by the liquidator might be reduced by as much as $35 million – leaving only about $4 million to satisfy the victims' claims.

The Issues

Two issues that both the Ontario Court (General Division) and the Ontario Court of Appeal addressed were, in summary, as follows:

(1) Whether, because of its charitable objects, CBIC was immune from liability to persons with tort claims under the purported doctrine of "charitable immunity" (the "charitable immunity" issue); and

(2) Assuming that there was no doctrine of charitable immunity in Canadian jurisprudence, whether certain of CBIC's assets were not exigible for the satisfaction of judgments because of the manner in which they were held (the "exigibility" issue).

Blair J.'s Decision in the (then) Ontario Court (General Division)

Regarding the charitable immunity issue, Blair J. in the Ontario Court (General Division) held that this "doctrine" was never a part of Canadian law.[6] As such, charitable corporations in Canada are not protected from judgments against them for liability by reason of some general charitable immunity.

Blair J., nonetheless, spent considerable time on the exigibility issue. For the sake of brevity, only the key points of his decision on this issue will be considered here. The question, as he put it, was "whether, assuming there is no general charitable immunity shielding the corporation from judgment, some or all of its assets are nonetheless immune from attachment in the face of judgments in favour of persons with tort claims against it."[7] This question, he stated, resolved itself into several subissues. The first was whether charitable corporations hold their assets generally "in trust" for their charitable purposes, as opposed to owning them beneficially. Regarding this point, Blair J. stated:

> A charitable corporation does not hold its assets "as trustee" for charitable purposes, however. 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.
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> The law in this jurisdiction does not support the proposition that all assets received by a charitable corporation...by way of a gift or bequest are presumptively received in trust, and held by the corporation "as trustee" for the charitable purposes of the corporation, as opposed to being held beneficially by the corporation and required by its objects to be used for such purposes.[8]

Against the possibility that he was wrong on this point, Blair J. stated that, "[e]ven assuming, however, that the property of a charitable corporation is held in some sort of 'trust-like' capacity to be used only for the charitable purposes of the corporation...those assets are...exigible at the instance of tort victims who have established legitimate claims against the corporation."[9] Blair J. then considered the subissue of whether some assets held by a charitable corporation were immune from exigibility, or immune for some purposes. Dividing the

ways in which a charitable corporation may acquire or hold property into several branches, he stated that property from outright gifts and bequests and other sources (government grants, etc.) is clearly exigible. The same is the case with property gifted to the charitable corporation generally for its charitable purposes as it is with gifts in the nature of "precatory trusts" (which are not trusts at all, but mere expressions of wishes or hopes). Blair J., though, carved out one category from exigibility: property subject to specific purpose trusts where the wrong asserted by the claimant had no relationship to that property. In Blair J.'s words, "I do not think that tort claims legitimately asserted against one specific charitable purpose property can be asserted against other specific charitable purpose property that may be held by the same charitable corporation."[10]

To summarize Blair J.'s position in respect of the "trusteeship" issue, charitable corporations do not generally hold their property as "trustee" for their charitable objects but rather beneficially, like any other corporation. The exception to this is specific charitable purpose property, which is, in a true sense, held in trust by the charitable corporation. Blair J. noted, however, that this does not change the fact that the directors of charitable corporations are under a duty to ensure that the corporation uses its assets in a manner consistent with its objects.

This approach, it is submitted, is very sensible. It draws no false distinction between the way a charitable corporation holds property and the way a for-profit corporation holds property, except in the case of property subject to a "true" trust (i.e., one that meets each of the three "certainties"). Blair J.'s decision, however, was appealed to the Ontario Court of Appeal. The Court of Appeal allowed the appeal.

The Ontario Court of Appeal's Decision

The Ontario Court of Appeal unanimously held that the appeal from Blair J.'s decision should be allowed. The majority's decision was written by Feldman J. (Abella J. concurring). Feldman J., citing the recent Supreme Court of Canada case of *Bazley* v. *Curry*,[11] agreed with Blair J.'s holding that the doctrine of charitable immunity has never been the law of Canada. She held, however, that Blair J. erred in proceeding to analyze the further question of whether assets held in trust are exigible to pay tort victims' claims after he had already decided that there was no doctrine of charitable immunity. Feldman J. noted that this theory – the "trust fund" theory – is simply the rejected charitable immunity doctrine in different guise. As a result, where the charitable corporation is held liable for the actions of its agents or employees (upon a *Curry* analysis of vicarious liability), then "the trust assets must answer for the wrong done."[12]

Feldman J. was especially clear in rejecting Blair J.'s exemption of "specific charitable purpose trust property" from a charitable corporation's otherwise

exigible property. In analyzing this issue, she made some statements regarding the nature of charitable corporations, which may have important ramifications for the liability of directors of such corporations. She first noted that "[i]t is generally accepted that charitable corporations receive and hold their assets beneficially as all corporations do."[13] Against this proposition, though, must be set the principle that charitable corporations "are obliged to use those assets only to further the charitable purposes of the corporation."[14] She underscored the tension in this area by citing a passage by Slade J. in the British case of *Liverpool and District Hospital for Diseases of the Heart* v. *A.-G.*,[15] which reads in part:

> In a broad sense a corporate body may no doubt aptly be said to hold its assets as a "trustee" for charitable purposes in any case where the terms of its constitution place a legally binding restriction upon it which obliges it to apply its assets for exclusively charitable purposes. In a broad sense, it may even be said...that the company is not the "beneficial owner" of its assets. In my judgment, however, none of the authorities...establish that a company formed under the *Companies Act 1948* for charitable purposes is a trustee in the strict sense of its corporate assets, so that on a winding up these assets do not fall to be dealt with in accordance with the provisions of...that *Act*. They do, in my opinion, clearly establish that such a company is in a position analogous to that of a trustee in relation to its corporate assets, such as ordinarily to give rise to the jurisdiction of the court to intervene in its affairs; but that is quite a different matter.[16]

From this passage, Feldman J. observed that "[b]ecause of the trust-like obligations of the charitable corporation, it is accepted that the court maintains its supervisory scheme-making power whether a charity's legal form is as a charitable trust or a charitable corporation."[17] The explanation she provided for the existence of this supervisory jurisdiction is important. She said that it exists "to continue *to ensure that gifts made with charitable intent will not fail even if the object of the gift is unclear or uncertain, or if the gift is directed to a charitable corporation which is misnamed or the corporation no longer exists*"[18] (the *cy-près* doctrine[19]).

On the specific question of whether a corporate charity with multiple objects that held a gift in trust for a special purpose was able to apply that trust property to pay tort claims that did not arise in connection with that property, Feldman J. held that the property was indeed exigible to pay such claims. One of the reasons provided for this result was:

> [T]he purpose of the reference in recent case law dealing with the disposition of certain charitable gifts, to the concept of a testator leaving a gift as a special purpose trust is not to immunize such gifts from liability to victims of wrongdoing by the charity. *It is to allow a court to apply the doctrine of* cy-près *to such a gift and, rather than have the gift fail* ab initio*, the court may propound a scheme for the funds to be used as closely as possible to the use the testator intended*.[20]

As a result, the Ontario Court of Appeal held that all of the assets of the CBIC, whether owned beneficially or in trust for one or more charitable purposes, were exigible and could be used by the liquidator to pay the claims of tort victims.[21] What conclusions about the general nature of charitable corporations may be drawn from the Ontario Court of Appeal's decision in *Re Christian Brothers*? The key point, for the purposes of our topic, seems to be that the rationale for characterizing a charitable corporation as "trustee" of its assets is to enable a court to ensure – using the *cy-près* doctrine – that gifts made with charitable intent that are unclear or uncertain will not, for that reason alone, fail. It is *not* the case that a charitable corporation should be seen as holding all of its assets "on trust" or "as trustee" for the charitable purposes. If this is correct, then *Re Christian Brothers* would appear to diminish the circumstances under which a charitable corporation can be properly analogized to a trustee. If this is so, it is arguable that the directors of charitable corporations should be treated not as "trustees" of the charitable assets but, instead, simply as directors, in the same way directors of a for-profit corporation are viewed. On this analysis, the directors of charitable corporations are, of course, subject to fiduciary duties, but those duties should be seen as more analogous to (although perhaps more stringent than) the duties imposed on directors of for-profit corporations, instead of the duties imposed on trustees.

It could be objected that this conclusion is too much of a stretch, that it takes the Ontario Court of Appeal's statements in *Re Christian Brothers* too literally, and somewhat out of context (given that the issue of directors' liability was not raised in that reference). That is probably true. Nevertheless, the fact that the Court of Appeal described in a narrow fashion the way in which a charitable corporation can be properly seen as a "trustee" of the corporation's assets (namely, to validate the application of the *cy-près* doctrine), at least provides an important peg on which to hang a future argument that the directors of charitable corporations should not be held to "trustee-like" standards but instead should be subject to standards similar to those imposed on directors of for-profit corporations under the corporations legislation of Canada and the provinces.

On a separate point, in the authors' view, the Ontario Court of Appeal's decision in *Re Christian Brothers* is highly suspect insofar as it concluded that express trust funds maintained by a charitable corporation are subject to tort claims made against that corporation, irrespective of any relationship between the objects of the trusts and the activities out of which the tort claims arose. It seems trite law that where a trust company is sued, for example, for sexual harassment in the work place, the tort claimants could not have recourse to estate assets administered by that trust company; similarly, where an individual trustee is involved in a car accident unrelated to trustee duties, it seems utterly implausible to suggest that injured parties could have recourse to trust assets under that trustee's administration. There seems to be no reason to suggest that

the position of charitable corporations should be different. Despite this logical conclusion, the proposition of Blair J. of the Ontario Court (General Division), now affirmed by the Ontario Court of Appeal, has been cited in *Asian Outreach Canada* v. *Hutchinson.*[22] While this decision did not deal with the exigibility of charitable corporations' assets to satisfy tort claims, but with whether various interlocutory orders should be made in connection with the manner in which affiliated Christian charities were entitled to solicit donations in Canada, Cullity J., relying on *Re Christian Brothers,* stated the following proposition:

> It has been held that the fact that a corporation is established for exclusively charitable purposes does not provide it with immunity from judgments for damages in tort and that its corporate funds, and in certain circumstances even funds that have been designated for specific purposes and of which it is a trustee in the strict sense, may be exigible to satisfy such judgments.[23]

This proposition appears to have been, in essence, confirmed by the Supreme Court of Canada's recent dismissal of the application for reconsideration of its decision to dismiss leave to appeal the Court of Appeal's decision. As a result, it appears that active charities should now establish separate endowment foundations to act as trustees of any express trust funds which they hold; failing that, on the strength of *Re Christian Brothers,* those funds would appear to be in constant danger from tort claims made against the active charity.

Another potentially important new development in the context of how directors of charitable corporations should be characterized, whether as trustees or as directors subject to the fiduciary duties incumbent upon such office, has come in the way of two decisions of the Ontario Superior Court of Justice: *Ontario (Public Guardian and Trustee)* v. *Unity Church of Truth*[24] and *Ontario (Public Guardian and Trustee)* v. *AIDS Society for Children (Ontario).*[25]

Ontario (Public Guardian and Trustee) v. Unity Church of Truth

In this case, the Public Guardian and Trustee (PGT) applied to the then Ontario Court (General Division) pursuant to section 4 of the *Charities Accounting Act* (discussed herein) to require the Unity Church, a charitable corporation incorporated pursuant to the Ontario *Corporations Act*, and the directors of the corporation to provide an accounting of the Church's financial affairs. The application arose, in part, as a result of sexual harassment allegations made by three female parishioners against one of the church's ministers (Sherman) who was also a director. These allegations were the subject of a civil lawsuit. The application also contained allegations that Sherman had used Church monies to fund his legal defence, that he had for many years been paid a salary while acting as a director, and that another director had improperly benefited from acting as a real estate agent on the sale of a Church property.

Sheard J. analyzed the funding of Sherman's legal defence in light of section 80 of the *Corporations Act* (which, as discussed later, authorizes directors to

be indemnified out of the funds of the corporation for acts done by them in the execution of their duties). He concluded that until a decision of the court was made, or the parties settled the dispute, a determination could not be made as to whether the payments on account of legal fees were a proper expense. As such, these payments were held to be inappropriate. On the issue of the real estate commissions received by the other director, Sheard J. found the transactions at issue to have been proper from a financial point of view. He therefore excused these payments.

On the issue of the salary received by Sherman while he was a director, Sheard J. stated the following:

> Invoking the rule that, as a director, he is not entitled to receive a benefit from the corporation...would have the result that any payment to him was contrary to the principles of common law and, unless excused by the court, should be refunded. To approach the matter on the basis that Sherman was a director does not raise the question of whether his salary or benefits were excessive. As a director, any payment or benefit was improper.[26]

As will be discussed in greater detail, this "rule" would seem to have been the law in Ontario (at least until *Unity Church of Truth*) as established by two Ontario cases: *Re David Feldman Charitable Foundation* and *Public Guardian and Trustee* v. *Toronto Humane Society*.[27] The rule is based on the view that directors of charitable corporations are trustees at least in the sense that they cannot, without court approval, be remunerated for their services as directors or as employees or officers of the charitable corporation.

Sheard J., however, rejected this view. He stated that "[s]uch an approach, in my view, should not be implemented or advanced by an order of this court".[28] Citing the 1996 *Ontario Law Reform Commission Report on the Law of Charitie*s, which stated that the passing of accounts is a costly, tedious procedure borrowed from the general law of trusts and estates that has been widely criticized as being unduly intrusive and cumbersome, as well as inappropriate for the accounts of an operating organization,[29] Sheard J. held that, "[w]ithout presuming to pursue" the Ontario Law Reform Commission's comment, "ordering accounts here would not be justified."[30] In the result, he dismissed the PGT's application for the passing of accounts.

The *Unity Church* decision is interesting in many ways, although perhaps the most important aspect is the way in which Sheard J. dealt with the supposed "rule" that directors of a charitable corporation cannot receive any remuneration from the corporation. In effect, he denied the force of this rule, not by excusing the purported "breach of trust" but instead by seeming to deny that there was such a breach in the first place. Also, he cited as support for his decision a report that explicitly stated that the passing of accounts was a concept borrowed from the general law of estates and trusts; the implication being that it had no place in the law of charitable corporations. The court here

would therefore seem to be distancing itself from the characterization of the directors of charitable corporations as trustees. The impact of this could be enormous, since it directly opposes the previously accepted rule that directors of such corporations are trustees, at least to the extent that they cannot receive remuneration from their corporations. *Unity Church* may also serve to limit the circumstances under which the PGT's applications to court pursuant to section 4 of the *Charities Accounting Act* in respect of salary payments to directors of charitable corporations will succeed. While *Unity Church* has not to date been cited in any subsequent court decisions, it will be interesting to see the extent, if any, to which it influences the manner in which directors of charitable corporations are characterized for purposes of determining the fiduciary duties they owe to those corporations.

Ontario (Public Guardian and Trustee) v. AIDS Society for Children (Ontario)

In this case, the PGT applied to the Superior Court of Justice pursuant to section 4 of the *Charities Accounting Act* for a passing of accounts by the AIDS Society. The organization's charitable registration had been revoked by the Canada Customs and Revenue Agency (CCRA) as a result of an investigation by the PGT, which revealed that despite having raised hundreds of thousands of dollars from the public, no funds had been expended on its charitable programs and, in fact, the AIDS Society was in debt. Prior to the passing of accounts hearing, a motion to determine various questions of law was brought. As a result, the passing of accounts was adjourned pending the determination of the motion. Among the issues to be decided was the following: Is the AIDS Society and/or its directors responsible as fiduciaries to the public for all the funds collected from the public, including funds collected on its behalf by various agents?

Haley J. responded to this question in the affirmative, relying on *Re The French Protestant Hospital*.[31] The Court found that the directors of the AIDS Society were responsible as fiduciaries to the public for all funds collected from the public. In reaching this conclusion, however, Haley J. made comments regarding the characterization of directors vis-à-vis the charitable corporation. The Court stated that "[t]he directors stand in a fiduciary relationship to the Society and are therefore required to act in such a way as to support and further the object of the Society as a charitable institution."[32] However, since the Court was asked to decide the nature of the directors' relationship with the public and not that with the charitable corporation, no analysis of this issue was undertaken. Therefore, based on these *obiter* comments by Haley J., it appears that the position taken is that directors of charitable and nonprofit corporations are fiduciaries and not trustees. However, since a different issue was being decided, this decision cannot be likely taken to stand for the proposition that directors of charitable and nonprofit corporations are not trustees. As a result, the

"director-trustee dilemma" continues and it remains unclear how directors of these corporations should be characterized.

(2) Liability of Directors of Nonprofit and Charitable Corporations for Failure to Remit Payroll Deductions Under Subsection 227.1(1) of the *Income Tax Act* (Canada)

One important concern facing directors of nonprofit and charitable corporations is the vicarious liability imposed on them for the corporation's failure to remit federal taxes under subsection 227.1(1) of the *Income Tax Act*[33] (Canada). That subsection states:

> **227.1** (1) Where a corporation has failed to deduct or withhold an amount as required by subsection 135(3) or section 153 or 215, has failed to remit such an amount or has failed to pay an amount of tax for a taxation year as required under Part VII or VIII, the directors of the corporation at the time the corporation was required to deduct, withhold, remit or pay the amount are jointly and severally liable, together with the corporation, to pay that amount and any interest or penalties relating thereto.

A director's liability under subsection 227.1(1), however, is modified by subsections 227.1(3) and (4):

> **227.1(3)** A director is not liable for a failure under subsection (1) where the director exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances.
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> **227.1(4)** No action or proceedings to recover any amount payable by a director of a corporation under subsection 227.1(1) shall be commenced more than two years after the director last ceased to be a director of that corporation.

Thus, unlike the *Corporations Act*, the liability of directors under this provision admits of a defence of due diligence, although the limitation period expires two years, rather than six months, after cessation of office.[34] The issue of the liability of directors of nonprofit corporations under subsection 227.1(1) was recently addressed by the Federal Court of Appeal in the 1999 decision in *Canada* v. *Corsano*.[35] At trial,[36] O'Connor T.C.J. found that the nonprofit corporation in question had indeed failed to remit federal income taxes. As such, the directors would have been liable under subsection 277.1(1) of the *ITA*, unless they could establish, pursuant to subsection 227.1(3), that they exercised the degree of care, diligence and skill to prevent the failure that a reasonably prudent person would have exercised in comparable circumstances. O'Connor T.C.J. considered the phrase "in comparable circumstances" found in subsection 227.1(3) and held that the standard demanded of volunteer directors of nonprofit corporations under section 227.1 "should not be as rigorous as the standard applied to directors of normal corporations run for profit."[37] Applying the "less-rigorous standard,"[38] O'Connor T.C.J. found that the directors had met that standard.

The Federal Court of Appeal overturned the decision on the issue of the applicable standard of care. In this regard, the entire panel concurred with the reasoning set out by Létourneau J., who made the following comments:

> [T]he rationale for subsection 227.1(1) is the ultimate accountability of the directors of a company for the deduction and remittance of employees' taxes and...such accountability cannot depend on whether the company is a profit or not-for-profit company, or I would add whether the directors are paid or not or whether they are nominal but active or merely passive directors. All directors of all companies are liable for their failure if they do not meet the *single standard of care* provided for in subsection 227.1(3) of the *Act*. The flexibility is in the application of the standard since the qualifications, skills and attributes of a director will vary from case to case. So will the circumstances leading to and surrounding the failure to hold and remit the sums due.[39]

The Federal Court of Appeal therefore rejected the notion of a different, lower standard of care under subsection 227.1(3) for directors of nonprofit corporations than for those of for-profit corporations. Although Létourneau J.'s decision leaves some room for applying a flexible test (since the wording of subsection 227.1(3) of the *ITA* demands such flexibility), the flexible test does not take into consideration the fact that the company in question is a nonprofit corporation, or that the directors of the company were not paid for their services. The flexibility appears to exist only in taking into account the qualifications, skills and attributes of the individual directors. Therefore, different standards will result which are commensurate with the varying degrees of qualifications, skills and attributes of the directors in question. As noted previously, the Supreme Court of Canada denied leave to appeal this decision without providing reasons.

The Federal Court of Appeal's decision in *Corsano* is troubling, given that the liability of directors under subsection 227.1(1) of the *ITA* can, from a pecuniary standpoint, be quite serious. Should it really be irrelevant to the determination of the directors' standard of care under subsection 227.1(3) that the corporation in question is a nonprofit or charitable corporation? Arguably, since the directors of a nonprofit or charitable corporation are not paid, and since they are generally benefiting the public in some fashion through their directorships, the bar should be set somewhat lower than the standard for paid, for-profit company directors. At the very least, these should be factors considered under subsection 227.1(3). But *Corsano* operates to remove any *prima facie* distinction between for-profit and nonprofit corporation directors under section 227.1. As a result, directors of nonprofit and charitable corporations should be very careful to understand and ensure compliance with the remittance requirements under the *ITA*, in order to avoid any potential personal liability.

Another troubling aspect of *Corsano* is that even though the *ratio* of that decision is, strictly speaking, limited to the issue of directors' standards of care

for the purposes of subsection 227.1(3) of the *ITA*, the case could be used in future to argue that a single standard of care should be applicable in all instances to directors of a corporation, be that corporation for-profit or non-profit. This might serve as a deterrent to persons who are desirous of serving society by applying their skills and energies as directors of charitable and nonprofit corporations, but are not willing to risk personal liability under the manifold laws that apply to such organizations.

Even more recently, the Federal Court of Appeal, in *Cameron* v. *Canada*,[40] has had an opportunity to consider the standard of care applicable to directors in respect of subsection 227.1(1) of the *ITA*. Linden J.A., for the Court, affirmed that the applicable principles to be applied are those enunciated in *Soper* v. *Canada*,[41] *Smith* v. *Canada*,[42] *Worrell* v. *Canada*[43] and *Corsano*.[44] As a result of the non-distinction between directors of for-profit corporations and those of nonprofit and charitable corporations, the principles established in these cases now apply across the board to all directors. The Court, in *Cameron*, further affirmed that the standard of care applicable is that of "…reasonableness, not perfection."[45]

As a result, it is relatively clear that directors and officers of charitable and nonprofit corporations will not be held to a different, less onerous, standard by virtue of the corporation being either a charitable or nonprofit corporation. Therefore, for directors and officers of charitable and nonprofit corporations, it would seem prudent to take steps to ensure that the corporation's auditors regularly monitor the compliance requirements of the corporation under the *ITA* and be under instructions to advise the directors of any defaults. In addition, it would probably be prudent to have a precise system for recording admission to, and resignation from, the board of directors in order to ensure compliance with the notice requirements under provincial law[46] and to provide any former directors with evidence of such compliance.

(3) Indemnification and Liability Insurance

Section 80 of the *Corporations Act* (which, by subsection 133(1), is specifically applicable to charitable and nonprofit corporations incorporated under or subject to the provisions of Part III of that statute) permits corporations to indemnify directors on much the same basis as indemnities commonly given by business corporations.[47] While some commentators have pointed out that, as a practical matter, this form of indemnity may be of little comfort in the case of charities without a large asset base or endowment, nevertheless, obtaining an indemnity is a generally accepted and prudent step for any person asked to act as a director of a corporation. While the matter was not that straightforward in the case of charitable corporations, it has now been clarified with the passage of Ontario Regulation 4/01 under section 5.1 of the *Charities Accounting Act*, which took effect on July 17, 2001. This regulation allows charities, if the conditions of the regulation are met, to indemnify directors, officers and

trustees against losses that may be incurred through honest and good faith management of the charity without having to obtain a court order.[48] While this is a positive and much awaited change, the requirements for providing an indemnity are much more stringent than under the Ontario *Corporations Act*. It is important to note that the corporation must consider various factors before providing an indemnity, including, for example, the level of risk to the director and other means by which such risk can be eliminated.

In addition, because of the uncertainty associated with unsecured corporate indemnities, corporations often purchase liability insurance to protect their directors. While there is nothing in the *Corporations Act* specifically permitting this, it is generally acknowledged to be within the powers of such corporations. The recent Ontario Regulation 4/01 made under the *Charities Accounting Act* now expressly allows charities to buy liability insurance for directors, officers and trustees without having to first obtain a court order to do so.[49] The same restrictions that apply to providing indemnities, apply to liability insurance.

Section 2 of the Regulation, which is the section that governs the provision of indemnities and the purchase of liability insurance, states:

> 2.(1) In the circumstances and subject to the restrictions set out in this section, an executor or trustee and, if the executor or trustee is a corporation, each director or officer of the corporation may be indemnified for personal liability arising from their acts or omissions in performing their duties as executor, trustee, director or officer.
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> (2) An executor, trustee, director or officer cannot be indemnified for liability that relates to their failure to act honestly and in good faith in performing their duties.
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> (3) In the circumstances and subject to the restrictions set out in this section, insurance may be purchased to indemnify the executor, trustee, director or officer for the personal liability described in subsection (1).
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> (4) The terms of the indemnity or insurance policy must not impair a person's right to bring an action against the executor, trustee or director or officer.
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> (5) The executor or trustee or, if the executor or trustee is a corporation, the board of directors of the corporation shall consider the following factors before giving an indemnity or purchasing insurance:
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> 1. The degree of risk to which the executor, trustee, director or officer is or may be exposed.
> 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.

(6) The purchase of insurance must not, at the time of the purchase, unduly impair the carrying out of the religious, educational, charitable or public purpose for which the executor or trustee holds the property.

(7) No indemnity shall be paid or insurance purchased if doing so would result in the amount of the debts and liabilities exceeding the value of the property or, if the executor or trustee is a corporation, render the corporation insolvent.

(8) The indemnity may be paid or the insurance purchased from the property to which the personal liability relates and not from any other charitable property.

(9) If the executor, trustee, director or officer is deceased, the indemnity or the proceeds of the insurance may be paid to his or her estate.

In addition, charities that indemnify or purchase liability insurance for their directors, officers or trustees are responsible for ensuring that all of the requirements of the regulation are met. They must also keep records showing that the requirements of the regulation have been met.[50]

As can be noted, therefore, charities cannot as a matter of course provide indemnities or purchase liability insurance for their directors, officers or trustees; the matter must be considered taking into account the factors outlined in subsection 2(5) of the Regulation. Nonetheless, it is the authors' view that the passage of this regulation has clarified the matter and may provide individuals, who might otherwise not be willing to act as directors due to the risks associated with the position, with the incentive to consent to act as directors, officers or trustees of charitable corporations. Similarly, it is the author's view that such regulation was necessary in order to attract individuals with the requisite skills, knowledge and expertise to successfully manage charities.

NOTES

1. The authors wish to thank Paola Calce, Fraser Milner Casgrain LLP, Student-at-Law, for her research work and contributions in updating this article, and Kristi Kasper, Fraser Milner Casgrain LLP, summer student, for creating a summary of the article. An earlier version of this article was published in two parts in the *Estates and Trusts Journal*: William I. Innes, "Liability of Directors and Officers of Charitable and Non-Profit Corporations," Vol. 1 (1993) 13 E. & T.J. 1 and 151.

2. Industry Canada, Corporate and Insolvency Law Policy Directorate, "Reform of the Canada *Corporations Act*, Draft Framework for a New *Not-for-Profit Corporations Act*" (March 2002) [hereinafter Reform Draft Framework]. See also Industry Canada, Corporate and Insolvency Law Policy Directorate, "A Supplement to the Draft Framework for a New

Not-for-Profit Corporations Act" (March 2002) [hereinafter Reform Draft Framework Supplement].

3. *Ibid.* at 17.
4. (2000), 47 O.R. (3d) 674 (C.A.), rev'g (1998), 37 O.R. (3d) 367 (Gen. Div.). Application for leave to appeal to the Supreme Court of Canada was dismissed without reasons on November 16, 2000. Application for reconsideration was dismissed without reasons on May 23, 2002 ([2000] S.C.C.A. No. 277].
5. (2000), 34 E.T.R. (2d) 60 (B.C.S.C.), aff'd (2001), 41 E.T.R. (2d) 77 (B.C.C.A.). Leave to appeal to the Supreme Court of Canada was refused on May 23, 2002, [2001] S.C.C.A. No. 652.
6. *Supra* note 4 (Ont. Gen. Div.) at 386.
7. *Ibid.* at 389.
8. *Ibid.* at 390–91.
9. *Ibid.* at 392.
10. *Ibid.* at 400.
11. [1999] 2 S.C.R. 534 [hereinafter *Curry*].
12. *Supra* note 4 (C.A.) at 694.
13. *Ibid.* at 701.
14. *Ibid.* at 702.
15. [1981] 1 Ch. 193, [1981] 1 All E.R. 944.
16. *Supra* note 4 (C.A) at 702.
17. *Ibid.*
18. *Ibid.* [emphasis added].
19. *Ibid*.
20. *Ibid.* at 707 [emphasis added].
21. *Ibid.* at 709.
22. (1998), 28 E.T.R. (2d) 275, [1999] O.J. No. 2060 (S.C.J.), online: QL(OJ) [hereinafter *Asian Outreach* cited to O.J.].
23. *Ibid.* at para. 3.
24. (1998), 59 O.T.C. 120, [1998] O.J. No. 1291 (Gen. Div.), online: QL (OJ) [hereinafter *Unity Church* cited to O.J.].
25. (2001), 39 E.T.R. (2d) 96, [2001] O.J. No. 2170 (S.C.J.), online: QL (OJ) [hereinafter *Aids Society* cited to O.J.].
26. *Supra* note 24 at para. 33.
27. *David Feldman Charitable Foundation (Re)* (1987), 58 O.R. (2d) 626, 26 E.T.R. 86 (Surr. Ct.); *Public Guardian and Trustee* v. *Toronto Humane Society* (1987), 40 D.L.R. (4th) 111, 60 O.R. (2d) 236 (H.C.J.). See also *Harold G. Fox Education Fund* v. *Ontario (Public Guardian and Trustee)*, (1989) 69 O.R. (2d) 742 (H.C.) where the Court held that payments to directors required court approval, but without any significant analysis of the issue of

whether directors of a charitable or nonprofit corporation were trustees of the funds held by the corporation.

28. *Supra* note 24 at para. 33.
29. Ontario Law Reform Commission, "Report on the Law of Charities" (1996) at 454.
30. *Supra* note 24 at para. 35.
31. *French Protestant Hospital v. Attorney-General* (1951), 1 All E.P. 938 (Ch. D.). A very early decision on the point, *Charitable Corporation v. Sutton* (1742), 2 Atk. 26 E.R. 642, is subject to the infirmities pointed out by Sealy.
32. *Supra* note 25 at para. 29.
33. R.S.C. 1985 (5th Supp.), c.1 [hereinafter *ITA*].
34. Similar provisions are found in the following statutes: *Income Tax Act*, R.S.O. 1990, c. I.2, s. 38; *Canada Pension Plan*, R.S.C. 1985, c. C-8 (as amended by R.S.C. 1985, c. 6 (1st Supp.), s. 22), s. 21.1; *Employment Insurance Act*, R.S.C. 1985, c. E-5.6, ss. 83(1); *Retail Sales Tax Act*, R.S.O. 1990, c. R.31, ss. 43(1), (2), and (3).
35. [1999] 3 F.C. 173 (C.A.) [hereinafter *Corsano*]. Application for leave to appeal dismissed without reasons on April 20, 2000 ([1999] S.C.C.A. No. 260).
36. [1998] 1 C.T.C. 2021 (T.C.C.).
37. *Ibid.* at 2040-41, (citing William I. Innes, "Liability of Directors and Officers of Charitable and Non-Profit Corporations", Vol. 1 (1993) 13 E. & T. J. 1, p. 17).
38. *Ibid.* at 2041.
39. *Supra* note 35 at 188 [emphasis added].
40. [2001] F.C.J. No. 1019 (F.C.A.), online: QL (FCJ) [hereinafter *Cameron*].
41. [1998] 1 F.C. 124 (F.C.A.).
42. [2001] F.C.J. 448 (F.C.A.), online: QL (FCJ).
43. [2000] F.C.J. 1730 (F.C.A.), online: QL (FCJ).
44. *Supra* note 35.
45. *Supra* note 40 at para. 3.
46. *Corporations Information Act*, R.S.O. 1990, c. C.39, s. 4.
47. It should be noted, however, that since the tax status of payments under such indemnities is unclear and it is possible that they might be taxable in the hands of a director or former director, care should be taken to provide for a gross-up of payments in the event, and to the extent, that such receipts are found to be taxable.
48. O.Reg. 4/01.
49. O.Reg. 4/01, s. 2(3).
50. O.Reg. 4/01, s. 1(3). That section states as follows: An executor or trustee must maintain records demonstrating that he, she or it has complied with the requirements of this Regulation when engaging in an act that is authorized under subsection (1).