

Case Comment: Remuneration of Directors

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Should directors of charitable organizations be permitted to pay themselves for services rendered to the organization which are not related to their duties as directors?

The propriety of such actions as well as the necessary procedures to guard against any abuse of authority relating to such payments have been carefully considered by Ontario courts on several occasions recently.

Re Toronto Humane Society

In the decision in *Re Toronto Humane Society*¹, released in June 1987, Anderson J. addressed this issue among several matters raised before him.

The Toronto Humane Society had been incorporated as a charitable corporation under the *Benevolent and Provident Societies Act*² and is now subject to Part III of the *Ontario Corporations Act*³.

The case arose through separate applications brought by the Public Trustee and by one of the directors of the Society in which the validity of certain actions of the directors of the Society was contested. These included the payment of “substantial” salaries to two directors in their capacity as employees of the Society.

Anderson J. found that he had jurisdiction to review the actions of the directors of the Society on several grounds:

1. He stated that Section 6d(1) of the *Charities Accounting Act*⁴ gave him jurisdiction not only over the charitable organization, but over the directors themselves.
2. Although he was not prepared to find that the directors were trustees in all respects, he found the character of their office was such as to make them subject to the direction of the court under the *Trustee Act*⁵.
3. He referred to the inherent equitable jurisdiction of the court in charitable matters.

In examining the propriety of the payment of the directors of the Society, Anderson J. compared a charitable corporation to other corporations. A charitable corporation is not subject to the same “braking” mechanism as a commercial corporation whose activities are scrutinized by

shareholders with a financial interest in controlling both the actions of the directors and their payment. While members of a charitable corporation may also review the actions of directors, the implication is that without financial motivation the members may not take the same time and trouble to intervene to prevent abuse of authority.

Anderson J. was particularly concerned about this danger where payment was the issue. He stated at page 246:

Charitable institutions, or indeed non-profit corporations of any kind, are reasonably easy victims for any small determined group with the intention of taking control. That in itself is a sufficient potential evil. When one couples with it the capacity to pay a substantial remuneration there arises a situation which all human experience indicates should be avoided.

Anderson J. had no doubt that the directors owed a fiduciary obligation to the Society. Payment would therefore put them in a position of conflict between interest and duty. He concluded that if directors of a charitable corporation are to be permitted to pay themselves at all, payment must be upon the same terms as those upon which a trustee receives remuneration, that is, either by express provision in the trust agreement or by court order. Since there will be no trust document in these situations, he stated that a court order is really the only practical mechanism for payment of such directors.

However, having carefully considered the circumstances of payment of directors of the Toronto Humane Society, Anderson J. issued a declaration prohibiting payment of any remuneration whatsoever to a director of the Society. He appears to have based his decision on the special circumstances of the case where a very small group of directors exerted a great deal of control and where they had already made inappropriate payments. Furthermore, the salaries given had apparently been “substantial”. At page 247 of the decision, Anderson J. states:

I have no doubt that a mechanism could be worked out whereby on notice to the Public Trustee approval [of payment of directors] could be given by fiat.

Re Faith Haven Bible Training Centre

The issue of reimbursement was re-examined in *Re Faith Haven Bible Training Centre*⁶ by Judge Misener of the Surrogate Court.

The proceeding was commenced by notice of the Public Trustee, pursuant to Section 3 of the *Charities Accounting Act*, to the Faith Haven Bible Training Centre to pass its accounts before a Judge of the Surrogate Court of the County of Oxford. The Centre had been incorporated under Part

III of the *Corporations Act* in 1977 for the purpose of religious education and was registered as a charitable organization in 1978.

For several years prior to the application the by-laws of the Corporation had been ignored by the officers and directors. Annual meetings were no longer held, directors continued in office without re-election and new directors were simply appointed by existing directors.

In 1984 the corporation closed its school and began to distribute its assets.

Among the actions of the directors being questioned was the decision to give the Centre's car to two directors, as well as to pay both staff and directors for past services.

Judge Misener found that the monetary payments, as well as the transfer of the automobile, were breaches of duty by the directors. He was willing to excuse payment to staff pursuant to Section 35 of the *Trustee Act* since the payments made were fair, reasonable and morally justified. Nevertheless, the payments and transfer of the property to directors were breaches of trust so blatant, given the context of conflict of interest and trust, that he found that he had no jurisdiction to excuse these breaches of trust pursuant to Section 35. With respect to the gift of the automobile, the Judge was not persuaded by the fact that the directors receiving the property had not taken part in the decision to make the transfer.

However, Judge Misener was prepared to exercise his power pursuant to Section 61(3) of the *Trustee Act* to permit the directors *as trustees* a fair and reasonable allowance for their care, pains, and trouble and time expended. The solicitor for the Centre was permitted to amend his application to include a claim for compensation of the directors in their capacity as trustees. Since he was satisfied that the remuneration already paid was fair in each case, Judge Misener exercised his jurisdiction to permit the directors to retain property paid or transferred as compensation.

Harold G. Fox Education Fund v. Public Trustee

Madam Justice Van Camp again considered the issue of remuneration of directors in the *Harold G. Fox Education Fund*⁷ decision. This decision was originally released June 30, 1989 and was reissued October 11, 1989. The amended version included an interesting Addendum, wherein Madam Justice Van Camp examined the factors she took into account in considering the question of costs.

The Fund was established by Dr. Harold Fox for educational purposes in July 1966 and was incorporated under Part III of the *Ontario Corporations Act*. The Fund had been a charitable foundation and, at the time of

application, was a charitable organization, both as defined under the *Income Tax Act*.

From 1972 until 1986 the directors of the Fund had approved payments to one of the directors for services rendered as Fund administrator. After the release of the *Toronto Humane Society* decision, the directors became concerned about the propriety of the payments and consulted with the Public Trustee. The Public Trustee did not feel he had jurisdiction to approve payments already made and an application was brought by two of the directors of the Fund under Section 6d of the *Charities Accounting Act* to seek the direction of the court with respect to the propriety of two separate acts of the directors, i.e., the payments already made and the resolution to continue to pay \$1,000 per month to the director for services as Fund administrator. (The director in question had not voted on this resolution.)

Madam Justice Van Camp accepted as fact that the services rendered by the director in question had been valuable; had he not performed them, it would have been necessary to have hired an administrator.

In examining the authority to pay this director, Madam Justice Van Camp first reviewed Section 126(2) of the *Corporation Act* which makes it clear that a director may receive “reasonable remuneration and expenses” for services rendered to a corporation incorporated under the *Act*, both as a director and in any other capacity, unless the Letters Patent or By-laws of the corporation in question provide otherwise.

The Letters Patent of the Harold G. Fox Education Fund provide as follows:

... the directors shall serve without remuneration, and no director shall, *directly or indirectly*, receive any profits from his position as such ...

Nevertheless, Madam Justice Van Camp found that the restriction in the Letters Patent applied only to remuneration as a director.

She then considered Section 61 of the *Trustee Act* in light of the statements in the *Toronto Humane Society* decision as to the fiduciary status of directors of a charitable organization. Based on her review, Madam Justice Van Camp was prepared to approve the past payments. The only impropriety she found concerning these payments was that approval of the court should have been obtained before payment. Nevertheless, because of the uncertainty of the law with respect to payment of such directors she was prepared to relieve against this breach. This is, however, a warning that, in future, directors who make such payments first and then seek approval of their action may do so at their peril.

With respect to approval of the resolution to continue to pay the director in the future, counsel for the Public Trustee submitted that section 61 of the *Trustee Act* only permits compensation for “time expended”, that is, an allowance under the section should only be made *after* work has been completed. Madam Justice Van Camp approved the future payments, however, relying on an 1887 English decision⁸ in which it was held that in certain circumstances the court has the power to authorize both retrospective and prospective payments.

In relying on this case and approving prospective payment, Madam Justice Van Camp is apparently invoking the inherent equitable jurisdiction of the court in charitable matters.

Madam Justice Van Camp found that in the particular circumstances of this Fund, it was appropriate to approve compensation for future service to enable the fund to continue its work. She was satisfied that sufficient safeguards were in place to prevent abuse of such approval. Firstly, the Fund would continue to be subject to account under the *Charities Accounting Act* and secondly, should circumstance change, either the Public Trustee or the Corporation could apply to the court for further direction.

Certain remarks of Madam Justice Van Camp made in the Addendum to the decision are worth noting. Firstly, she appears sympathetic to the situation of a charitable organization and states that the resources of a charity should not be diminished in litigation arising with respect to its administration⁹. Secondly, she states that after investigation of the circumstances of the payments in this case, the Public Trustee could have approved the payments. She does not specify whether she is referring to the past payment only or to both the past and the future payments. Her remarks are somewhat surprising since the procedure had apparently been set down in *Toronto Humane Society* (and followed in this case) that for approval of payment to such directors an application should be made to court upon notice to the Public Trustee. Is Madam Justice Van Camp suggesting that one can by-pass this procedure by obtaining the approval of the Public Trustee? She makes no reference to any statute which gives the basis of authority for obtaining approval at the level of the Public Trustee.

There is obvious appeal in Madam Justice Van Camp’s suggestion. If payments to such directors are to be permitted at all there must be an arbiter as to the appropriate circumstances in which to permit payment. The court procedure is time-consuming and expensive. Perhaps the Public Trustee, then, in his role as watchdog of such institutions, is, as she

suggests, the proper authority to assess the appropriate circumstances for payment, at least in the first instance.

The Court in *Fox* gives no guidance on the criteria to be applied by the Public Trustee. Should the Public Trustee consider whether the services, or goods, are offered at fair market value? Should the director offer them at cost, or less than fair market value? The Court also does not address the process to be followed by the charity in arriving at the decision to purchase services or goods from the director. In *Faith Haven*, the usual corporate procedures of withdrawal and abstention from voting were held insufficient to protect the charity from a conflict of duties, at least when assessing the propriety of payments to a director.

It is clear from the *Fox* judgment that the payment may only be made for services separate from those which arise from acting as a director. It is, however, not easy to define the limits of one's "capacity as a director" in such cases. Many directors are appointed to charitable boards because of their professional expertise, from which the charities may hope to benefit without charge. Many smaller charities use their directors in general administration, and the directors of such charities might be surprised at the notion that this work should be compensated as if it were separate from their duties as directors.¹⁰

Conclusion

The question of payment of directors of charitable organizations has been an obvious issue for judicial consideration. How much control the court will wish to exert over these directors is unclear. The answer will depend, in part, upon the extent to which it is determined that the *Trustee Act* applies to such directors.¹¹

In *Toronto Humane Society*, Anderson J. was not prepared to find that the directors of a charitable organization were trustees for all purposes. With respect to paying themselves, he found that they had breached their fiduciary duty and that was sufficient to permit the court to intervene. In the *Faith Haven Bible Training Centre* decision, however, the Surrogate Court judge is not so cautious and uses "trustee" and "director" interchangeably. In that case this benefited the directors since the breaches of duty could be excused under the *Trustee Act*. Nevertheless, the extent to which the same *Act* will be used by the court to exercise judicial control over directors of charitable organizations remains to be seen.

In *Re Toronto Humane Society*, Anderson J. was asked to appoint a trustee to take over the affairs of the Society. He refused to do so on the basis that no long-term purpose would be served by such an appointment. He

was satisfied that the board of directors had been put on notice of its fiduciary duty and would take care in future in management of the Society. He was, however, prepared to nominate a neutral party to preside over the next annual meeting of the Society.

Madam Justice Van Camp suggests in the Addendum to her decision in *Fox* that the Public Trustee should increase his role in reviewing the actions of directors. In doing so, the Public Trustee has no express remedies against actions of which he disapproves except to bring his complaint before the court. Once the court does review the application, presumably it would have the power to replace a director, if necessary. Nevertheless, the *Fox* decision suggests that the court will avoid its interventionist role if it can find a way to do so.

However, except in situations where compensation is clearly merited, referring the question of payment to the Public Trustee with no guidelines on how to determine the propriety of payment may not prove helpful in practice either to the regulator or to the charity. One may safely predict further litigation on compensation of directors.

FOOTNOTES

1. *Re Toronto Humane Society* (1987), 60 O.R. (2d) 236. [See also an earlier Case Comment by Maurice C. Cullity (1988), 7 *Philanthrop.* No. 3, p. 12.]
2. *Benevolent and Provident Societies Act* 1877 c. 167 (Repeated by s. 211 (Sch. E) of, and replaced by, the *Ontario Companies Act*, 1907, c. 34, s.1.)
3. *Corporations Act*, R.S.O. 1980 c. 95.
4. *Charities Accounting Act*, R.S.O. 1980, c.65, s.6d, enacted 1981, c. 11, s. 1.
5. *The Trustee Act*, R.S.O. 1980 c. 512.
6. *Re Faith Haven Bible Training Centre* (1988), 29 E.T.R. 198.
7. *Harold G. Fox Education Fund v. Public Trustee* (1989), 69 O.R. (2d) 742.
8. *Re Freeman's Settlement Trusts* (1887), 37 Ch.D., 148.
9. Note that in a recent Case Comment in *The Philanthropist*, L.A. Vandor commented that increasing judicial control or intervention is a definite burden on charities. Furthermore, he stated, it may be difficult for a charity to obtain dynamic board members if the charity is unable to compensate directors for services rendered beyond those required as directors. ("Case Comment: *In Re the French Protestant Hospital*" (1989), 8 *Philanthrop.* No. 2, p. 10.)
10. See, however, the comments of Blake Bromley who is critical of such donations of professional services (1986), 6 *Philanthrop.* No. 2, p. 30. Mr. Bromley does not, however, recommend payment to directors for these services.
11. See J. Hodgson and A. McNeely, "Trusteeship and the Charitable Corporation" (1985), 4 *Philanthrop.* No. 2, p. 26.