

Unit 5

Legal Duties of Directors

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BECAUSE
WE'VE
ALWAYS
DONE IT
THIS WAY,
THAT'S WHY.

Goff



Legal Duties of Directors

The basic responsibility of directors is to represent the interest of the members in directing the affairs of the association, and to do so within the law. A board member must meet certain standards of conduct and attention in carrying out his or her responsibilities. These standards are described as the duty of diligence, the duty of loyalty and the duty of obedience.

- 1. The duty of diligence:** is the duty to act reasonably, prudently, in good faith and act in the best interests of the association and its members. This means that a board member owes the duty to exercise reasonable care when he or she makes a decision as a director of the association.
- 2. The duty of loyalty:** is the duty to place the interest of the association first and to not use one's position as a director to further one's own interests. The duty of loyalty is a standard of faithfulness. A board member must give undivided allegiance when making decisions affecting the association.
- 3. The duty of obedience:** is the duty to act within the scope of the governing bylaws and policies of the association and within the scope of other laws, rules and regulations that apply to the association. The duty of obedience also requires that board members be faithful to the association's mission.

5.1

Source: Director's Liability: A Discussion Paper on Legal Liability, Risk Management and the Role of Directors in Non-Profit Organizations and www.boardsource.org

Liability of Directors

A director who fails to fulfill his or her duties, as listed on the previous page may be held personally liable as a director. Liability refers to the responsibility of directors for the consequences of their action that fail to meet a pre-determined legal standard. Liability arises when a law is broken, when a contract is breached or when an act or failure to act intentionally or unintentionally causes injury or damage.

Directors need to take steps to minimize their liability:

1. As a director, it is your responsibility to ensure that the association complies with applicable laws, its letters patent and its bylaws. If you disagree with a proposed action or decision of the board, you should protect yourself by voting against a motion and making sure that your vote is recorded in the minutes of the board meeting.
2. As a director you must ensure that the association's contractual agreements are fulfilled. This includes contracts with employees and independent contractors.
3. As a director, you are responsible to ensure that you, as well as association employees and volunteers do not act negligently. You have a duty to ensure that all persons involved in your programs and activities are in a safe environment. You must be diligent and safety conscious to ensure that participants will not face unreasonable harm. Be proactive and develop a risk management program to identify any potential risks before a problem occurs.

Source: *Director's Liability: A Discussion Paper on Legal Liability, Risk Management and the Role of Directors in Non-Profit Organizations*

Did you know? In Canada, 30% of all injuries to adults result from sport and recreational activities. This figure rises to 40% for injuries in the 15-25 age group.



5.2

Why Risk Management?

Risk management is a discipline for dealing with uncertainty. It is defined as “reducing the chances of injury, damage or loss by taking steps to identify, measure and control risks.”

Why manage risk?

- The threat of litigation is increasing. Our society is more litigation-orientated and the public is expecting nonprofit organizations to be more accountable and business-like in managing their business.
- The risk of client/participant harm. Causing harm to a client/participant, however unintentional, undermines your purpose and jeopardizes your mission.
- For your own safety and security. Sound risk management will help create a sense of confidence and safety.

5.3

The risk management process

The process of risk management is a three-part activity. It involves:

1. First, look at the situation and ask what can go wrong and what harm could result?
2. Second, identify practical measures that can be taken to keep such harm from occurring.
3. Third, if harm does occur, identify practical measures that can be taken to mitigate its impact and pay for any resulting damages or losses.

The practical measures that can be used to manage risks fall into four categories:

- **Assume the risk** – decide that the risk is minor and do nothing.
- **Reduce the risk** – find ways to change or modify an activity or environment so that the degree of risk is reduced. Policies and procedures regarding programs are examples of risk management.
- **Avoid the risk** – choose not to do something. If your organization cannot offer a service/program while ensuring a high degree of safety, it should choose not to provide the program.
- **Transfer the risk** – accept the risk but transfer the liability associated with it to someone else through a written contract. Liability insurance and insurance contracts are some examples of this.

Source: www.nonprofitrisk.org

FAQ: What is indemnification?

One way that a board can protect its directors against personal liability is to have an indemnification clause in their bylaws. Indemnification means that the association relies on its own financial resources to pay board members' legal costs for claims that result from being a board member.

FAQ: Why is Directors' and Officers' liability insurance important?

Directors' and officers' liability insurance is a common risk management measure that is important in minimizing directors liability. Directors' and officers' liability insurance covers losses arising from a director's own "wrongful acts." The purpose of this insurance is to provide the financials backing for the indemnity that the organization provides to its directors. These types of insurance policies vary, and there is no standard level of coverage. When seeking to purchase directors' and officers' insurance, you should sit down with your lawyer or insurance representative so that you understand the full extent of your coverage.

5.4



How do you measure up?

Tool #9

A Board Member Liability Checklist

Review this checklist with your board to minimize your liability.

In order to minimize liability, each board member must:

- Know and support the organization's beliefs, vision, mission, target and aims statements
- Attend all board meetings and assigned committee meetings
- Read pre-meeting material before each meeting
- Be familiar with the board's policies
- Be familiar with the minutes of the board and assigned committees
- Know the responsibilities and functions of the board and its committees
- Know who is authorized to sign cheques, and for what amounts
- Monitor the community's response to the organization's programs and services
- Participate in approving the annual budget, audit, annual financial report, and periodic financial statements

5.5

A Board Liability Checklist

Review this checklist with your board to minimize your liability.

In order to minimize liability, every board must:

- Give the required notification for the annual general meeting
- Notify the membership of proposed bylaw changes
- Complete the annual incorporation filing requirements
- Approve, and annually review personnel policies
- Maintain up-to-date contracts with the Executive Director and staff
- Develop and implement an evaluation process for the Executive Director
- Maintain receipts and disbursements, according to financial and business policies
- Make sure that the membership approves the annual audited financial statements
- Purchase adequate insurance
- Make sure that committee reports are submitted in writing
- Develop written job descriptions for board members

*Source: Board Development, Roles and Responsibilities of Not-for-Profit Board.
Produced by: Board Development Program Libraries, Community & Voluntary Sector Services Branch*

5.6