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Consultation Paper on
Conflicts of Interest: Directors and Societies

LAW REFORM COMMISSION OF BRITISH COLUMBIA

MINISTRY OF ATTORNEY GENERAL

Consultation Paper No. 71

Conflicts of Interest:

Directors and Societies

This Consultation Paper is circulated for criticism and comment. It does not represent the final views of the Commission.

It would be appreciated if comments could be submitted by May 31, 1994.

Comments we receive are treated as public documents, although you may request confidentiality.

November, 1993

The Law Reform Commission of British Columbia was established by the *Law Reform Commission Act* in 1969 and began functioning in 1970.

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Introductory Note

This paper discusses ideas and suggestions for changing the law.

Public consultation is an important part of preparing sound recommendations for changing the law. The Commission will not make its final recommendations for changes in the law in the topic under review in this paper until the public has a chance to comment.

We would like to have your views, criticism and advice. If the paper does not address your particular concerns, please tell us.

Public consultation ends May 31, 1994. If you wish to comment, you should do so as soon as possible.

Please direct your comments to the following address:

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OVERVIEW OF THE CONSULTATION PAPER

Purpose of this paper: The suggestions made in this paper are for discussion purposes only. Final recommendations will be made in the light of comment on the paper.

The Current Law: The law currently lets a society's director enter into transactions with the society if the director's interest is disclosed. The transaction must be approved by other board members.

The Problem: Many people have expressed concerns that the rules are not working very well. In a number of well publicized cases, the rules have allowed directors to enter into contracts with societies, or receive money in other ways, raising classic conflict of interest problems.

Our suggestions: The law should be changed. Directors should not be allowed to be in a conflict of interest. Only in a very few cases should transactions with a society in which a director has an interest be allowed.

Who may be Affected?: The problem is not confined to societies. Government will be invited to consider applying our suggestions to a larger group of bodies that have public responsibilities.

Guide to this Paper:

It is not necessary to read all of this paper to learn about suggested changes to the law. But you should at least read the Summary in Chapter VI, the Draft Legislation (in Appendix A) and the Conduct Guidelines (in Appendix B).

1. *The Summary of suggestions in Chapter VI*: The Summary gives the main outlines of proposed legal change. It is, however, only a summary. For complete details, you must read the text or at least study the draft legislation.

2. *The Draft Legislation in Appendix A* (the green pages at the back of this paper): There are two versions of it. One is extensively annotated.

3. *The Text*: is a detailed examination of the current law, how it developed and problems that have arisen with it. If these subjects do not interest you, you can turn directly to either Chapter V, which discusses options for reform and the reasons that led to our suggestions for changing the law, or Chapter VI, which summarizes our suggestions.

4. *The Conduct Guidelines*: The Draft Legislation sets out rules for *directors*. Other people involved with societies may also find themselves in a conflict of interest. The Conduct Guidelines deal with these situations. See Appendix B (also in the green pages at the back of this paper).

All comments should be sent as soon as possible, and no later than May 31, 1994. Write, call or fax:

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Table of Contents

CHAPTER I SOCIETIES AND CONFLICTS OF INTEREST[1]

A. Companies and Societies

Except in special situations, people are ordinarily allowed to act in self-interested ways, promoting their interests or those of their family, friends and associates over the interests of others.

One situation where it is clear that a person must act exclusively in the interests of another arises with incorporated entities. A director of a company or of a society must act in the best interests of the corporation for an obvious reason: the only way a legal entity like a company or society can look after its interests is through the people who are charged with making decisions on its behalf.

B. Rules Governing Representatives

Experience shows that when someone charged with protecting another lets personal interests become involved, a conflict often arises that might prejudice the protected person's interests. To prevent conflicts from happening, courts have developed legal principles that usually require a representative to keep personal interests separate. Transactions between the protector and the protected person, for example, are often forbidden, and other strict rules require the protector to observe the highest standards.

Many of these rules were developed to govern the relationship between a trustee and a beneficiary. They have been adapted to apply in analogous situations – where one person, by having accepted or assumed power over another, is considered to owe the other special duties of care, integrity and fidelity. These duties are usually referred to as "fiduciary

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1. A note about sources:
Newspapers: The best examples of recent conflicts of interest cases are found in newspapers. Consequently, this Consultation Paper makes many references to newspaper articles, mainly the *Vancouver Sun* and the *Province*. These references are not put forward as authority for propositions set forth in the text, but as examples of recurring and emerging problems that the law must deal with.
Cases: Legal thinking about conflicts of interest has been developed in different contexts: company law, municipal law and equity (dealing with trustees and other fiduciaries) to name a few examples. Our research has necessarily adopted a broad focus. But references to cases that do not deal with the directors of societies are put forward only for illustrative purposes. It is important not to lose sight of the fact that this Consultation Paper is concerned with the rules that apply to directors of societies. Proposals for revising the law set out later apply only to societies, although it is suggested that the revised rules could have a broader scope.

duties." They apply to relationships,[2] for example, with doctors,[3] lawyers,[4] bankers,[5] and others.[6]

C. Related Legal Principles

The law in this area is supplemented by other legal principles. Parts of the law of contract, those for example dealing with undue influence and unconscionability, serve a similarly protective function. Legislation also requires some people to protect the interests of others even at the cost of their own personal interests.

Sometimes the requirement is simply a duty to disclose particular information, such as special qualifications or skills a person may have. A person who, over the years, has acquired particular expertise in purchasing land is under no obligation to tell a seller about that expertise, even though the fact may account for a significant inequality in their respective powers of bargaining. A person who is a licensed real estate agent, however, may not purchase property without first disclosing that

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2. Or to some aspects of these relationships.

3. *Norberg* v. *Wynrib*, [1992] 2 S.C.R. 226.

4. *Martin* v. *Gray*, (1990) 77 D.L.R. (4th) 249 (S.C.C.); *Re Manville Canada Inc. and Ladner Downs*, (1993) 76 B.C.L.R. (2d) 273, (1993) 100 D.L.R. (4th) 321 (B.C.C.A.); *Baker* v. *Regional District of Bulkley Nechako*, [1993] B.C.D. Civ. 2401-03 (B.C.C.A.). In response to recent litigation, rules have been formulated to govern lawyers and law firms in particular conflict of interest areas. The Federation of Law Societies has proposed rules to govern the transfer of lawyers between opposing firms. *See also* the *Report of the Canadian Bar Association Task Force on Conflicts of Interest* (February, 1993); *see also* T. Onyshko, "Conflict of Interest," Lawyer's Weekly, Apr. 2, 1993, 1, (discussing the CBA initiatives).

5. *Lloyd's Bank* v. *Bundy,* [1974] All E.R. 757 (C.A.).

6. For other examples, *see Noel* v. *Noel,* (1992) 130 N.B.R. (2d) 328 A.P.R. 350 (N.B.Q.B.) regarding the conflicting interests of parents and their child with respect to managing a personal injury damage award in favour of the child. *See also J.(L.A.)* v. *J.(H.),* (1993) 39 A.C.W.S. (3d) 1226 (Ont. Gen. Div.); and *Carnaby* v. *Millar,* [1993] B.C.D. Civ. 1566.1-01 (S.C.). For more general discussions of the concept of fiduciaries and their obligations in recent cases, *see, e.g., Frame* v. *Smith,* [1987] 2 S.C.R. 99; *Lac Minerals Ltd.* v. *International Corona Resources Ltd.,* [1989] 2 S.C.R. 574; *Canson Enterprises Ltd.* v. *Boughton and Co.,* (1992) 61 B.C.L.R. (2d) 1 (S.C.C.); *Huff* v. *Price,* (1990) 51 B.C.L.R. (2d) 282 (C.A.) leave to appeal dismissed June 27, 1991 (*sub nom Charpentier* v. *Huff)*, 56 B.C.L.R. (2d) xxxviii (S.C.C.); *Knoch Estates* v. *Jon Picken Ltd.,* (1991) 4 O.R. (3d) 385 (Ont. C.A.); *337965* v. *Tackama Forest Products Ltd.,* (1992) 67 B.C.L.R. 1 (C.A.) leave to appeal dismissed March 11, 1993, 75 B.C.L.R. xxxii (S.C.C.); *Baillie* v. *Charman,* [1993] 1 W.W.R. 232 (B.C.C.A.).

fact to the vendor.[7] Similarly, a licensed car dealer must disclose that fact when selling a vehicle.[8]

D. Conflicts of Interest

Someone who allows a personal interest to interfere with duties owed another is said to be in a "conflict of interest."[9] It is a loose

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7. *Real Estate Act*, R.S.B.C. 1979, c. 356, s. 28(1). Conducting business through a company does not avoid a real estate agent's obligation to disclose: *Alert Products of America Corp.* v. *Parksville Apartments Ltd.*, [1993] B.C.D. Civ. 2262-01 (B.C.S.C.).

8. *Motor Dealer Act* Regulation, s. 23-28, B.C. Reg. 447/78. A motor dealer must also disclose other facts, such as whether the vehicle was used as a taxi or police car, or whether it ever sustained serious damage (repairs costing more than 20% of its asking price).

9. *See, e.g.*, K. Kernaghan, *Ethical Conduct: Guidelines for Government Employees* (1975) 13; K. Kernaghan & Langford, *The Responsible Public Servant* (1990) 134. The phrase "conflict of interest" explicitly lists only one of the two factors that must be present to constitute a conflict of interest. The simple fact that the interests of two (or more) people come into conflict does not in itself necessarily raise a legal issue. People in business, *e.g.*, customarily have antithetical interests, but the presence of their competing goals does not usually have any significance except to themselves. The critical condition is that one person must be under a duty to the other. The actual conflict is not between the interests of two people, but between one person's interest, and that person's duty to promote another's interests. A person might also be in a conflict of interest and not have personal interests involved at all. This will occur, *e.g.*, where the person is under a duty to promote the interests of two other people and *their interests* conflict.

At least, legal principles developed with respect to fiduciaries hold that a conflict of duty and duty is a "conflict of interest," but the view is not universally accepted: *see, e.g.*, the Report of the Hon. Mr. Justice P.D. Seaton (July 27, 1993), pursuant to the *Inquiry Act*, R.S.B.C. 1979, c. 198, Part 2. The Report considered the purchase by the B.C. government of shares in MacMillan Bloedel: *see also* M. Farrow, "Games bidding gets thumbs up," *Vancouver Sun*, August 10, 1993, A3. The Report concluded that because no one making the decision to purchase a personal financial stake in the transaction it could not be characterized as a conflict of interest. *Cf.* the principles that apply to lawyers (and other fiduciaries), *supra*, n. 4, where it is at least equally likely that the "conflict of interest" stems from a conflict of duties owed two or more people, such as the common complaint arising when a lawyer who was with a firm that acted for one side to a law suit moves to a firm acting for the other side. Much litigation has taken place to determine the degree of earlier participation in one side's affairs that will disqualify the lawyer from acting for the other: *see, e.g., Kaiser Resources Ltd.* v. *Western Canada Beverage Corp.,* (1992) 71 B.C.L.R. (2d) 236 (S.C.). *See also Canadian Co-operative Leasing Services* v. *Price Waterhouse Ltd.,* (1992) 128 N.B.R. (2d) 1, 322 A.P.R. 1 (N.B.Q.B.) (conflicting duties owed by an accounting firm). In some cases, the fiduciary's activities will necessarily raise a conflict

> description. The Manitoba Law Reform Commission[10] referred to the difficulty of defining a conflict of interest and observed that, like sin, everyone is against it but few can define it. There are several reasons why the concept is imprecise.
>
> One reason is the difficulty that sometimes arises of determining when one person owes these special duties to another. People are not only ordinarily permitted, but expected, to act in self-interested ways. Even if duties are owed, the extent of those duties is not always well marked, particularly since in many cases the question turns on the specific circumstances.
>
> In recent years, moreover, the law relating to fiduciary obligations has been thoroughly revised by the courts and now encompasses much more than anyone ever thought possible, more in fact than many currently think is sensible.[11] A further complicating factor is that this is an area where different parts of the law intersect and overlap. A particular fact pattern, or different parts of it, may be the focus of criminal law as well as equity and also raise issues properly dealt with under the law governing contract, tort or restitution.
>
> This area of the law is unique in one further way. Emphasizing the high ethical standards required in this context, it is often a matter of concern if a person, while not in an actual conflict of interest, appears to be in one. In contrast, appearing to commit a crime is not enough to trigger a penalty under criminal law, nor is appearing to breach a contract

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of duties such that courts are prepared to assume as a feature of the relationship an implied agreement that a measure of conflict is acceptable. *E.g.*, a real estate agent may take a listing from A to sell Blackacre and also represent B who wishes to buy Whiteacre owned by C. If the properties are adjacent, confidential information arising from one transaction might well be material to the other, but the real estate agent is under an obligation not to disclose it: *Kelly* v. *Cooper,* [1993] A.C. 205 (P.C.). Similar arrangements are accepted in other fields of endeavour, such as stock brokerage: *see B.C. Securities Act* Regulation, Part 13.1.

This Consultation Paper adopts a broad view. It addresses (1) matters commonly agreed to constitute serious conflicts of interest, (2) matters commonly agreed to constitute conflicts of interest that for one reason or another are not regarded as serious, and (3) matters upon which there may not be agreement about whether they are conflicts of interest but which, nevertheless, raise related or analogous issues. *See further* the discussion of bias in Chapter IV.

10. *Report on Conflict of Interest of Municipal Councillors* (Report No. 46, 1981) 1. The reference is to a comment made in E.P. Johnson, "Legislative Comments: Conflict of Interest," (1968) 70 W. Virginia L.R. 400.

11. Dr. P.D. Finn, "Commercial Law and Morality," *Fiduciary Obligations* (1989), Continuing Legal Education Society of British Columbia.

enough to support a claim for a remedy. No other area of the law goes so far in an attempt to ensure ethical conduct.

These special circumstances explain why it is natural enough to expect some imprecision about what constitutes a conflict of interest and how to deal with the situation. In fact, it seems that real questions exist among different parts of the community about what is a conflict of interest, or at least what should be considered a serious conflict.[12] A newspaper review we conducted, for example, disclosed that the term is often employed in non-technical ways for the purpose of denoting, simply, disapproval about particular behaviour. A situation involving the hiring of family, friends and associates, for example, may be described as a "conflict of interest" but other terms may be used more or less interchangeably, such as "favouritism to family members," "nepotism," a breach of "integrity and the appearance of integrity," or "pork barrelling." Accepting a collateral benefit may be referred to as a conflict of interest or as "bribery" or "theft." Releasing confidential information may be regarded as a conflict of interest, a "breach of confidentiality," "whistleblowing" or a "scandal." Depending on your perspective, a person may be considered a hero or a villain for acting while in a conflict of interest.

Similarly, people who avoid a conflict of interest might be honoured for their integrity or vilified for "shirking responsibilities" or "dithering." People who require others to avoid conflicts of interest might be seen as doing their duty, or as imposing a "gag rule" or engaging in a "witch hunt."

The terms used may suggest the personal views of the reporter, the political stance of the paper or merely a desire to dramatize or underplay various stories. Whatever words are used, however, it is sometimes difficult to decide what factor makes seemingly similar situations subject

12. Following Chapters will set out concrete examples about conflicts of interest but the reader might find it useful at this point to refer to two Appendices where examples – in one case from recent publicized events, in the other scenarios concerning a fictitious society – are set out. *See* Appendices C and D.

to differing characterizations.[13] Views often seem to fall along partisan lines.

E. Reference

This project concerns conflicts of interest rules that apply to directors of societies. The project was referred to the Commission by the Attorney General on the recommendation of the British Columbia Conflicts of Interest Commissioner, the Hon. E.N. (Ted) Hughes.[14] The concerns arose from an inquiry conducted by Mr. Hughes into the financial dealings of the Victoria Commonwealth Games Society ("VCGS"). Victoria will host the Commonwealth Games in 1994 and VCGS is charged with overseeing them.

The budget of VCGS is measured in millions of dollars.[15] Contracts it has entered into are, and others that will be made in the future will be, financially significant. Some directors of VCGS who provide services in the areas needed by the society were understandably interested in bidding on the contracts. The society's bylaws originally stated "in no case shall the members of the society benefit individually from the assets or incomes of the society." But this was changed in 1989 to provide that a director "shall be at liberty to contract or otherwise deal with the society, but shall absent himself from deliberations and shall not vote on the contract or transaction in which he is interested."

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13. Another factor possibly contributing to unfocused public views about conflicts of interest also stems from imprecise use of language. Very loose language is used to describe whether a conflict of interest actually exists, particularly in media coverage of court decisions and conflicts rulings. The media will often say something is not a conflict of interest in circumstances more aptly described in these terms:

- there is a conflict of interest, in the sense that a person's official actions may affect personal interests, but its significance is controlled by legislation and, under the legislation, it is not considered to be either material or a disqualifying factor. It would be more apt to say that the particular circumstances do not qualify as a conflict of interest within the meaning of the relevant legislation.
- there is a conflict of interest but it is clear that it had no impact on the decision.
- there is a conflict of interest but in the circumstances it is acceptable.

14. Appointed under the *Members' Conflict of Interest Act*, S.B.C. 1990 c. 54, *am.* S.B.C. 1992, c. 64.

15. According to the original financial projections, the games were to cost $160 million dollars and of this $86 million would be contributed by the federal and provincial governments. Municipalities would be responsible for about $6 million. The balance would be made up from such things as marketing, television rights and ticket sales: Byron Postle and John J. Jackson, "Site Unseen," *Policy Options*, Sept. 1992, 16.

VCGS is funded by all levels of government. Its activities have an almost exclusively public dimension. VCGS's interests are difficult to distinguish from the interests of the public generally. Some members of the public were troubled by the idea that directors might profit from personal dealings with VCGS.

VCGS asked Mr. Hughes for guidance on these issues and formulated three questions for consideration. He provided general, non-binding advice about how VCGS, and its directors, should conduct themselves. It was his view, however, that consideration should be given to changing aspects of the law to accord with the perceived public expectations about the ethical standards that should apply:[16]

> I believe that in today's environment the fact that what I have recommended goes beyond the requirements of the *Society Act* is quite academic. The standard set in that statutory enactment should be referred to the Law Reform Commission of British Columbia for study, accompanied by a request for any recommendations for statutory change that are thought to be appropriate. I would suggest that the Minister in charge of Recreation confer with his colleague, the Attorney General, about a reference to that body. I have no criticism of past practices, policies or decisions of the members of the VCGS board. They have been following procedures that were seen to be quite appropriate not many years ago and procedures for which, I acknowledge, statutory support can be found. They are procedures, however, that I judge to be no longer satisfactory if the objectives set for the Games are to be achieved.

The issues addressed by Mr. Hughes are not confined to only those societies that operate large undertakings. A concerned citizen wrote to us separately, outlining additional concerns about societies generally:

> ...There are more and more non-profit societies in this province and many of them are performing essential services in the areas of health and social services, often in a quasi-governmental role. While the vast majority of these organizations are well-run and exceptionally well intentioned, the potential for abuse is inherent in the Act.
>
> I am not suggesting that it is a mistake for government to use non-profit societies to deliver services. In many cases they are doing a better job than government itself could ever do, but the often large amounts of public money that is involved poses a risk of misuse.
>
> I am enclosing some clippings that describe situations that are less than ideal, and in many cases it will be found that they did not directly contravene the Act. The Act allows for a director to continue in spite of a conflict of interest by simply declaring it. What if other directors also have the same conflict of interest, or even a different one? The Act should preclude a paid employee from being a voting director. There is a lack of accountability in the "corporate model" which is not suitable for non-profit societies which cannot use profit or loss statements to evaluate performance. I know of one organization with a large membership and a Board of Directors of four, three of whom hired themselves as employees paid from government grants. (The Act requires only a quorum of three). I know of another large organization whose Executive Director, a voting member of the Board, had an interest free mortgage from the society.

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16. *Report to the Victoria Commonwealth Games Society* by the Honourable E.N. (Ted) Hughes, Q.C. (March, 1992) 23.

While this Consultation Paper considers the law governing conflicts of interests as they apply to directors of societies, the issues examined have a wider dimension. Other people involved with other legal entities will find themselves in situations analogous to those of people involved with societies. Our preliminary conclusions will have some relevance outside the parameters of this study.

This document is intended to provide a platform for public consultation. Our final decisions and recommendations will be formulated in the light of comment and criticism we receive on this Consultation Paper. Please let us have your views as soon as possible.

F. Overview of the Consultation Paper

The next two Chapters discuss the legal structure of societies and the conflicts rules that apply to them, comparing these with the rules that apply to companies and to elected officials. Chapter IV examines the rules in practice. Chapter V deals with options for reform. Our tentative suggestions for changing the law are summarized in Chapter VI.

Much useful information has been placed in Appendices. Please refer to the Table of Contents for a detailed guide to this information.

CHAPTER II SOCIETIES

A. Corporations

People will often wish to associate for specific purposes and it is convenient if the association itself has a legal personality. An association with a legal personality can then enter directly into legally binding arrangements.[1] This personality will continue even as the membership of the association changes. The process of setting up an association with a legal personality is called "incorporation." In British Columbia there are two types of corporations.

Business endeavours are usually pursued through a "company" set up under the (federal) *Canada Business Corporations Act*[2] or under provincial legislation, like the British Columbia *Company Act*.[3]

The British Columbia *Society Act* allows people to incorporate a "society" to conduct non-profit enterprises.

B. Societies

1. ACTIVITIES

The scope of purposes or activities a society might engage in is described in section 2 of the *Society Act*:

> **2.** (1) A society may be incorporated under this Act for any lawful purpose or purposes, such as national, patriotic, religious, philanthropic, charitable, provident, scientific, fraternal, benevolent, artistic, educational, social, professional, agricultural, sporting or other useful purposes.

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1. When an organization is able to do this, it means that the participants need not personally incur those financial obligations. The *Society Act* provides, *e.g.*, that a member of the society is not liable for a debt or liability of the society: s. 5. Of course, a member can assume liability, by co-signing or guaranteeing a loan, *e.g.*, as the lender may require. The *Society Act* also provides that where "a society has less than 3 members for more than 6 months, each director is personally liable for payment of every debt of the society incurred after the expiration of the 6 months and for so long as the number of members continues to be less than 6:" s. 24(8).

2. R.S.C. 1985, c. C-44.

3. R.S.B.C. 1979, c. 59.

The section also sets out specific limits on what can be pursued by a society. The prohibition against "carrying on a business, trade, industry or profession for profit or gain," for example, is in section 2(1)(d).[4]

Once incorporated, a society has "the powers and capacity of a natural person of full capacity as may be required to pursue its purposes." The capacity of a society and its powers are described in the Act:

> **4.** (2) The powers referred to in subsection (1) include but are not limited to the powers to
>
> (a) buy, sell, exchange, develop and mortgage property;
> (b) borrow money and give security for it and secure or purchase money obligations;
> (c) issue negotiable instruments;
> (d) receive and make gifts;
> (e) enter contracts and leases;
> (f) employ persons; and
> (g) belong to other societies or associations, whether or not incorporated, with similar purposes or purposes beneficial to the society.

2. FORMING A SOCIETY

A society is formed by preparing a constitution and bylaws. These documents are filed with the Registrar of Companies.[5] The constitution is a document that sets out the name and purposes of the society. Bylaws provide rules for conducting various aspects of the society's internal business:

> **6.** (1) The bylaws of a society incorporated under this Act shall contain provisions in respect of
>
> (a) admission of members, their rights and obligations and when they cease to be in good standing;
> (b) conditions under which membership ceases and the manner, if any, in which a member may be expelled;
> (c) procedure for calling general meetings;
> (d) rights of voting at general meetings, whether proxy voting is allowed, and if so, provisions for it;
> (e) appointment and removal of directors and officers and their duties, powers and remuneration, if any;
> (f) exercise of borrowing powers; and
> (g) preparation and custody of minutes of meetings of the society and directors.

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4. Some endeavours require government permission. *E.g.*, an orphanage requires the consent of the Superintendent of Family and Child Service; a hospital requires the permission of the Minister of Health; a social club that of the Minister of Financial and Corporate Relations; insurance services that of the Superintendent of Financial Institutions.

5. S. 3(1).

The bylaws may also address issues involving a conflict of interest, and how to handle one when it arises.[6]

A society must have at least 5 members and 3 directors. After incorporation, members select the directors in accordance with the society's bylaws.[7]

3. BOARD OF DIRECTORS

The structure of a society resembles that of a company. Each has a board of directors that is charged with managing or supervising the management of the affairs of the corporation.[8] The board meets periodically to make important decisions on behalf of the corporation.

Officers are responsible for the day-to-day conduct of the society's business. Much of the actual work will be done by employees or volunteers.

Ordinarily, when we refer to a director we mean a person who has been elected to that position, but both the *Company Act* and the *Society Act* actually give the term a more expansive meaning. The *Company Act* provides that a director "includes every person, by whatever name he is designated, who performs functions of a director."[9] The *Society Act* says that a director includes a "trustee, officer, member of an executive committee and a person occupying any such position by whatever name called."[10]

Both the *Company Act* and the *Society Act* set out special rules for directors to follow to deal with actual or potential conflicts of interest. Because of the definitions given to the word "director," these special rules apply to any person elected to the board, and many other people as well. The conflicts of interest rules that apply to directors of corporations are discussed in the next Chapter.

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6. The bylaws cannot adopt a less onerous approach to conflicts than set out under the *Society Act*: see s. 26. But nothing prevents a society from adopting more stringent rules. The *Society Act* sets out standard bylaws (in Schedule B). A society may adopt these bylaws, modify them, or adopt another set altogether: s. 6(2). The Schedule B bylaws do not include special rules relating to conflicts of interest.

7. S. 24.

8. *See, e.g., Society Act*, s. 24(2).

9. S. 1.

10. S. 1.

C. Summary

Companies and societies have similar legal structures and operate in similar ways, although they are incorporated for entirely different purposes.

CHAPTER III THE CONFLICTS RULES

A. The Conflicts Rules

1. Companies and Societies

Although companies and societies are used for different purposes, as explained in the last Chapter, essentially the same conflicts of interest rules apply to each. The *Society Act* conflicts of interest rules are modeled on sections found in the British Columbia *Company Act*.[1]

The rules relate only to those conflicts that arise between the interests of the corporation and its directors, although other people involved with a company or society may find themselves in a conflict of interest.

The reason the rules relate only to directors is because (theoretically) the directors can protect the corporation from conflicts that might arise with the interests of other people. The mind and conscience of a corporation is its board of directors. One defect to this theory is that directors are only capable of protecting the corporation's interests if they are aware of the conflicting interests of an officer, shareholder, member or employee.

The directors make important decisions on behalf of the corporation, but not all of its decisions. Members, for example, will be involved in aspects of society business and the society may have employees who carry out various matters on behalf of the society. Not all matters affecting a society will necessarily come to the attention of its board of directors.[2]

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1. British Columbia's *Society Act* was enacted in 1978. The sections dealing with conflicts of interest are derived almost word for word from the *Company Act*. The legislature expected a procedure that works reasonably well for companies to work equally well for societies. The same conclusion has been reached in other jurisdictions and by other bodies. *See, e.g.,* The 38th Report of the Law Reform Committee of South Australia on *Proposed Amendments to the Industrial and Provident Societies Act, 1923-1974,* at p. 6; Alberta Law Reform Institute, *Proposals for a New Alberta Incorporated Associations Act* (1987, Report 49); The Permanent Law Reform Commission (Malta), Report No. 12, *Law Relating to Foundations* (1992) 39-40; California Law Revision Commission, *Recommendations Relating to Non-Profit Corporation Law,* (vol. 13, 1976) s. 5571.

2. Research into the role of the board and of individual directors reveals a wide gap between reality and widely held assumptions. Typically, non-executive directors perform more advisory than management functions: *see, e.g.*, Myles L. Mace, "Directors: Myth and Reality (1971)" published in Zeigel et al, *Cases and Materials on Partnerships and Canadian Business Corporations* (2nd ed., 1989) vol. 1, 412; Myles L. Mace, "Directors: Myth and Reality – Ten Years Later," (1979) 32 Rutgers L. Rev. 293. *See also* the "Cadbury Report" (*Report of the Committee on the Financial Aspects of Corporate Governance,* Dec. 1992,

This problem is partly addressed by the extended definitions the *Company Act* and the *Society Act* give to the word "director."

2. THE RULES AND HOW THEY EVOLVED

This section discusses the conflict of interest rules that apply to corporations. Because the *Society Act* rules are derived from the B.C. *Company Act*, much can be learned from exploring both the law that applies to the directors of a company, and how that law developed.

(a) The Statutory Rules

The *Society Act* and the *Company Act* adopt as a starting point the proposition that a director is not allowed to act if in a conflict of interest. Where, for example, the director wishes to engage in a business venture with the company or society, there is an obligation on the director to disclose the conflict of interest (because usually a transaction favouring the interests of the director will not represent the best arrangement for the company or society). It is open to the other directors to authorize the transaction notwithstanding the conflict. The view is that a potential conflict of interest is avoided if the director discloses the conflict and takes no part in decisions made on behalf of the corporation about it.

To summarize the rules:[3]

- in addition to acting honestly and in good faith, a director must act in the best interests of the corporation.
- a director must act according to the standards of a reasonably prudent person.

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established by the Financial Reporting Council, the London Stock Exchange and the accountancy profession in the wake of the Maxwell scandals. The Committee was chaired by Sir Adrian Cadbury). The Cadbury Report makes recommendations to bolster the function of non-executive directors to monitor the activities of executive directors (who ordinarily run the company and make most of the corporation's decisions). A committee on corporate governance set up by the Toronto Stock Exchange is considering adopting a code of conduct for directors similar to the one established in Britain following the Cadbury Report: M. Gibb-Clark, "Liability worries corporate directors," *Globe and Mail*, Sept. 29, 1993 B6. An English poll of executive directors suggests that the interests of shareholders are not uppermost in their minds: only 13 per cent thought representing shareholders was one of the top 5 contributions outside directors could make. The percentage rose to 85 per cent when those polled selected their answers from a prepared list: *Economist*, May 8-14, 1993, 88.

3. The rules are set out in ss. 25-29 of the *Society Act* and ss. 141-151 of the *Company Act*. The *Society Act* sections are set out in Appendix F.

- a director who is, directly or indirectly, interested in a proposed contract or transaction with the corporation must advise other directors of the conflict of interest.

- other directors are able to approve the transaction before it is entered into, notwithstanding the conflict.[4]

- if the conflict is not disclosed until after the transaction is entered into with the corporation, then only the members (of a society) or shareholders (of a company) can ratify it, by a special resolution.[5] The transaction must have been fair and reasonable from the corporation's perspective before it can be ratified.

- approval is no good if the director does not disclose fully.

- a director who engages in a transaction that is not approved must account to the corporation for profit made from it. A court may make other appropriate orders (such as setting aside the contract).[6]

(b) The Position At Common Law

The law has always considered a director to be under an obligation to look after the interests of the company. Where there is a conflict between the company and the director, the interests of the company must come first. Before legislation sorted out the conflicts of interest rules that apply to a director of a company, the courts fashioned rules based on the principles that apply to the relationship between a trustee and a beneficiary.

Under these rules a director may not transact business, directly or indirectly, with the company. A director who ignores the rules and enters into the transaction is responsible to the company for any profits and the company is free to elect to set aside the transaction.

Only shareholders, at a general meeting, can ratify the transaction.

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4. The director who is in a conflict cannot vote nor be considered part of the quorum at the meeting. A society may amend the quorum rule in its bylaws: s. 28(2).

5. A "special resolution" requires a 75 per cent majority. There are special rules for how the vote is conducted. *See, e.g.*, the definition of "special resolution" in s. 1 of the *Society Act*.

6. A court application can be brought by the society or an "interested person." An undisclosed conflict does not render a contract void, but a court has broad powers to deal with the contract: *Society Act*, s. 29.

These rules often operated inconveniently. A technical or trivial conflict which in no fashion prevented a director from protecting the company's interests might nevertheless place a transaction in jeopardy. Two different companies who shared a director, for example, could not enter into a contract even though the director would receive no direct or indirect benefit from the contract. Technical conflicts also arose from service contracts between a director and the company, and arrangements where the director was required to guarantee a loan for a company. In these kinds of cases, the conflicts rules harmed rather than protected the company by preventing it from entering into convenient arrangements.

Even where the conflict in question was more substantial, the rules could prevent some contracts clearly of benefit to the company from being made. The existence of a conflict does not always have to pose a threat to the company's interests. Suppose a director is the only one with sufficient expertise to consult on a particular matter arising outside the scope of a director's usual duties. The conflicts rules effectively prevented the company from retaining the director's services.

The rules, consequently, were too arbitrary. And the only method of avoiding them – ratification by the shareholders – was too inefficient and slow a process to represent a practical solution.

(c) Early Techniques for Handling Conflicts of Interest

A general practice arose of providing in the articles of a company (which serve the same function as the bylaws of a society) that directors could, in some cases, transact business with the company. Shareholders, who could ratify particular transactions after the fact could also do so in advance.[7] Company articles usually set out the now familiar practice – described above – of allowing the transaction to be approved by the board (if the director first discloses a personal interest in it and does not take part in the decision).

(d) Legislation

7. Just as documents that establish a trust can be used to amend the equitable rules and authorize a trustee to enter into transactions with the trust in a personal capacity.

Beginning in 1929, these ideas gradually found expression in British Columbia legislation.[8] Our current company legisla-tion, adopted in 1973, completely endorses the disclosure/ authorisation model.[9]

3. How Effective Are the Statutory Rules for Companies?

(a) Criticisms

Legislation has moved the law some distance from the view that no conflict can be tolerated. The change was made to ensure that truly attractive arrangements can be made on behalf of a company.

Doubts may be entertained about whether these rules make sense for companies. It is not clear that the interests of the company are really protected by this procedure.[10]

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8. The B.C. *Companies Act*, S.B.C. 1929, c. 11, s. 105, followed the example of English legislation, which required a director to disclose an interest but was otherwise silent about whether disclosure protected the transaction. The issue was left to the shareholders of companies to address in the articles of the company or on a case-by-case basis.

9. The legislation also provides that particular transactions are unaffected by a director's conflict of interest (subs. 144 (3) and (4)). These are: a transaction with another company or firm in which the director is a member, officer or director, or in which the director has an interest, provided the director gives general notice of the relationship in writing; involvement in a loan to the company; a transaction with an affiliate of the company; a transaction involving an indemnity or insurance respecting director's liability; and a transaction relating to the director's remuneration for acting as a director.

10. *See, e.g.,* David Baines, "Funk's firm flounders with own investments," *Vancouver Sun*, Sept. 11, 1992, D1. Novatel Communications Ltd. provides another useful example: a report by Alberta's Auditor General, Donald Salmon, dated Sept. 25, 1992, estimates the Calgary-based firm, which was involved in cellular telecommunications technology, cost Albertan taxpayers $566 million. The company made large loans to clients so they could purchase licenses to operate small cellular systems in the United States. These systems were caught in the recession and went into bankruptcy. *See further*, Nattalia Lea, "The Novatel Aftermath", *Computing Canada*, v. 19, No. 1, Jan. 4, 1993. "There's the issue of secrecy. The government is not watching. This would not have happened if there was a citizen's group that reported to the press. The problem with the board of the directors is they are part of the old boys' system and they won't do anything:" *ibid.*, at 4. The facts of *Grizzly Ropes Ltd.* v. *Hymax,* [1992] B.C.D. Civ. 752-06 (S.C.), where a closely held company transferred all its assets to another company to prejudice a shareholder, have been repeated many times by other companies. *See also* D. Baines, "Vancouver man linked to VSE firm despite securities ban," *Vancouver Sun*, Apr. 10, 1993, E7, which tells

The rules about companies, however, are not under consideration in this project. They have, in fact, been recently reviewed by government.[11]

(b) A Justification for the Company Law Rules

The common law adopted an overly cautious position. Modern legislation may have gone too far the other way. Even so, there is at least one good reason in favour of the modern approach for companies: those who are directly affected by a transaction that personally benefits a director are also involved in the process of determining whether it should be approved.

In a small, closely held company, for example, the directors are often the majority shareholders. As such, their personal interests are closely allied to those of the company. If one director wishes to enter into a transaction with the company, it can be expected that the other directors will weigh the fairness of the transaction very closely.

Even where the directors are not shareholders, they are accountable to the shareholders. If the board authorizes a transaction that is contrary to the company's best interests, the shareholders are in a position to monitor the position and vote offending directors out of office.[12] It is reasonable to expect that people who are accountable to the shareholders, or whose personal interests are otherwise at stake, will try their best to make sure the company enters into prudent transactions. Those who are not vigilant have only themselves to blame.

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of a company that raised funds on the stock exchange ostensibly for mineral exploration but used them to purchase a pizza enterprise.

11. The Ministry of Finance and Corporate Relations considered changes to the *Company Act* in a Discussion Paper circulated in January 1991. The changes suggested did not depart from the general thrust of the current legislation. It was tentatively proposed that the obligation to disclose should not arise if the contract or the interest of the director in it is not significant ("material"). Some concerns were expressed about whether approval by the board of directors provided an adequate safeguard of the company's interests. Because members do not have access to minutes of directors' meetings, it is possible for directors to act to promote their mutual interests rather than the interests of the members. Even so, no changes to the Act were suggested in this respect. The other significant change proposed was to provide that a contract approved by members could not be set aside even if it is not fair and reasonable, on the view that an innocent third party might otherwise be prejudiced. Remedies are discussed in Chapter IV of this Consultation Paper.

12. In situations where a director holds a disproportionate voting position, there is also the remedy of oppression: *infra*, Chapter V.J.2(c) "Improper Board Approval."

4. HOW EFFECTIVE ARE THE STATUTORY RULES FOR SOCIETIES?

(a) Criticisms

An Example

The "Fraser Valley Musical, Dramatic and Dance Society" (FVMDDS) makes grants to promising amateur actors. The grants are generous and many apply for them. Director B, who is an internationally recognized director of theatre and probably has more experience than anyone else on the board in judging promising actors, advises that her son is one of the applicants. Director B says she will not take part in the decision whether to award her son a grant. Director C suggests that in the circumstances Director B should not take part in deciding about any of the grant applications. Director D disagrees, but Director B thinks that the prudent thing to do is not participate and absents herself during that part of the meeting. The remaining directors decide impartially that Director B's son should be one of the grant recipients.

A number of interesting points arise from the example. First, while everyone recognizes the potential for a conflict of interest to arise from a grant application received from a close relation of a director, there is disagreement about what steps are necessary to remove Director B from the decision. Would any problems arise if Director B participated in deciding about other grant applications? Some might perceive a conflict because a decision in favour of other applicants would tend to minimize the chances of her son receiving a grant. Has FVMDDS been protected? At least in one respect, FVMDDS suffers a loss. The effect of the rules is that the most knowledgable of its directors cannot help carry out an important part of its functions. Moreover, is it clear that FVMDDS has been protected from prejudice arising from Director B's conflict of interest? Did the other directors approve the son's application to keep Director B happy? Were they afraid that Director B, whose prestige is an asset to the society, might resign? Is Director B's son more worthy than the unsuccessful applicants? Even if the son's merits tower above the rest, would the general public be satisfied that matters were carried out fairly, or would there be a suspicion of favouritism? Some might think that public perceptions are of little importance if the society is applying its own money. But what if the source of the money is municipal and provincial grants, or charitable subscriptions?

It must be recognized that the current rules, at least to some extent, operate defectively.

(b) The Company Law Justification Does Not Apply to All Societies

It was mentioned earlier that even if the company law rules operate imperfectly, there is still justification for retaining them. The justification is that the ones affected by the transaction with the corporation will be involved in the process of ratifying it.

This will also be true for some societies. Some societies are financed by, and exist exclusively for the benefit of, their members. Directors who approve a transaction that does not benefit the society will eventually be answerable to its members. These arrangements will often provide a large measure of protection against conflicts of interest for societies that fit this description.

But not all societies will fit this description. Many have a public dimension, because of the purposes they seek to serve or because of their funding sources and fund raising methods.[13]

Where no one's personal financial interests necessarily depend upon the society getting a good deal, directors may be willing to turn a blind eye to the actions of one of their number, or accept minor transgressions in the interests of general peace.

For example:

> *Director A works tirelessly for the society (which operates a jazz club). Director A also has a janitorial business. The jazz club requires janitorial services. Although Director A's business charges a bit more than competitors, the board may still approve the contract, perhaps on the grounds that it's nice to deal with someone they know, and Director A really deserves a little extra for all of the unpaid work Director A has performed for the society in the past.*

The scrutiny of the other directors will not always guarantee the protection of the interests of the society.

People may sometimes rationalize arrangements in which a society's best interests are required to give way to the interests of someone charged with looking after the society's interests. In many cases, the amount of money is small, but it is equally possible for large amounts of money to be involved. And not all of this money will belong, strictly speaking, to the society.

5. SOCIETIES AND PUBLIC SUBSIDY

(a) Societies in British Columbia

The foregoing discussion has adverted at times to a public dimension that some societies have which places them in a position quite different from the one occupied by companies. It is worth spending some time developing this idea.

13. *E.g.*, even those societies which are almost exclusively funded by their members may encourage donations by offering to provide tax receipts, in this way deriving a public subsidy: *infra*, n. 20.

Over 16,000 active societies have been incorporated under the B.C. *Society Act*.[14] Many of these receive public funds in one way or another. Total grants made by the provincial government in 1990-91 to just over 1000 societies, for example, exceeded 2 billion dollars.[15] One problem that arises with societies relates to public funds entrusted to them:[16]

> It is true that government officials are accountable for the grants they hand out. Once the grant is given though, the monitoring of expenditures and internal control appears to be left in the hands of the recipient. If the public feels that its tax dollars are spent inappropriately, it has no recourse. The politician will distance himself/herself from the independent society, and the members of the society, themselves, are not elected and are therefore not directly responsible to the public.

If public funds are used by the society, the community has a stake. Public concern about the activities of societies and their directors

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14. As of April 8, 1993, there were 16,129 active societies in B.C. and 13,796 inactive societies: information from the Societies Registry.

15. This information is derived from the public accounts published for 1990/1991, and is based on grants to societies that exceed a threshold amount of $10,000. Grants were made as follows:

129 grants of $10,000–$20,000
95 grants of $20,001–$30,000
109 grants of $30,001–$50,000
136 grants of $50,001–$100,000
302 grants of $100,001–$500,000
76 grants of $500,001–$1,000,000
94 grants of $1,000,001–$2,000,000
59 grants of $2,000,001–$5,000,000
14 grants of $5,000,001–$10,000,000
14 grants of $10,000,001–$15,000,000
4 grants of $15,000,001–$20,000,000
13 grants of $20,000,001–$50,000,000
5 grants of $50,000,001–$75,000,000
4 grants of $75,000,001–$140,000,000
1 grant of $216,349,397

Virtually all larger grants go to societies operating hospitals. The federal government makes similar grants, details of which are published in *Public Accounts of Canada*, Vol. II, Part II, "Additional Information and Analyses." The B.C. information was kindly made available to us by government in the form of a database, from which we were able to compile this information (*see further* Appendix G). The federal government, however, does not keep this information in a single database and were unable to assist us in identifying more exactly the amounts of federal money received by societies located in B.C.

16. Byron Postle and John J. Jackson, "Site Unseen," *Policy Options*, vol. 13, no. 7 (Sept. 1992) 15. The authors suggest the solution may be to have elected officials more closely involved with societies handling public funds. Preventing some abuses in this way would come at a cost, however. Government often provides funding to various societies to carry out functions that it wishes to be distanced from, and possibly it is legitimate practice to do so. Moreover, having a society apply funds is often more efficient that to do so through government. Increased government monitoring may impair that efficiency.

probably increases in direct proportion to the amount of public funds invested in a society or placed at its disposal.[17]

(b) Public Funds and Societies

In some cases, a society's funds are clearly derived from the public. Other situations of public subsidy may be less obvious.

A direct grant by government is the clearest example of public funding. The grant may have no conditions attached, leaving it open to the society to apply the funds for its purposes as it sees fit. Grants falling into this category are usually, but not always, modest. The larger the grant, the more likely particular conditions will be attached to it concerning its use.

Another good example of public funding arises when government enters into a formal contract with an organization to deliver specific services.[18] In these cases, the society is essentially an instrument for giving effect to government policy. The society may be involved in providing medical care or operating a hospital, for example, or promoting various other worthwhile endeavours, such as helping the homeless, or providing assistance to battered spouses or abused children. Typically, the society will be under an obligation to account for how the funds are used.

Other forms of fund raising may be derived less directly from the public but still confer upon the society a public dimension. At the most basic level, societies may raise funds by selling products such as chocolate bars, flowers or fertilizer, by conducting "free" car washes or by soliciting donations. Funds raised by selling goods or services, or through private donations, are not usually thought of as public subsidy but, nevertheless, these activities tap into a finite supply of money. It is a matter of public concern if the money is misapplied:[19]

> As any parent who has gone door to door flogging chocolate bars for a child's sports team can tell you, this kind of hard-earned cash carries a special trust. Spend it wisely and spend it on the kids.

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17. Similarly, the public will be concerned about who is appointed a director of such a society: *see, e.g.,* S. Bell, "Indo-Canadian group elected ex-smuggler as director," *Vancouver Sun,* Sept. 28, 1993, A3.

18. Such an arrangement is technically different from a grant subject to conditions, but functionally the result is the same. Money is placed in the hands of an organization to accomplish specific public goals.

19. G. Shaw, "Amateur swimming organization's money sinks in risky venture," *Vancouver Sun*, June 19, 1993, D7.

Even these forms of fund raising can have a definite element of public sponsorship or subsidy. Some organizations, for example, are registered with the federal government and authorized to issue tax receipts for donations, so that the donor may deduct the contribution when calculating income taxes. The reduction in tax revenue is born by taxpayers as a whole, so that, in effect, every taxpayer is providing an indirect subsidy to these societies.[20]

Particularly effective forms of fund raising involve games of chance, but the ability to operate a casino or bingo game is carefully regulated by the provincial government.[21] A special license to raise funds through

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20. In British Columbia, 8,330 groups are registered with Revenue Canada as charitable organizations who have tax numbers and are authorized to issue tax receipts. 5,154 of these are located in Vancouver and the surrounding region. 1,629 are located in Victoria. Revenue Canada's records do not reveal how many of these groups are organized as societies. Revenue Canada, however, kindly made available to us a list of these groups in the form of a database and a name comparison with societies incorporated in B.C. suggests that just under a third – 4,805 – are registered as charities (*see* Appendix G). *The Canadian Donor's Guide to Fund Raising Organizations in Canada*, (1991) (6th ed., published by the Canadian Bar Association & the Canadian Centre for Philanthropy) observes (at p. 6) that "[m]any organizations with Revenue Canada Charitable Registration Numbers are not active fund raisers or are supported mainly by their respective members." To the extent they issue tax receipts, however, they are supported by all taxpayers.

21. It is the policy of the B.C. Gaming Commission, *e.g.*, that funds raised through gambling (which must be used for charitable or religious purposes) support programs and services directly benefitting the community in which the licensed gaming events are held. (This information, and other information about funds raised through gambling is derived from the *Annual Report of the Auditor-General* (March, 1993) 27-43. In 1992, 9,700 gaming licenses were issued or renewed. Licensees earned over $105 million, of which $61 million was made from bingo, $27 million from casinos operated for charities by private companies and $13 million from raffle tickets: *ibid.*, 27-43. *See also* Larry Pynn, "B.C. firms pressure Washington to adopt more liberal laws," *Vancouver Sun,* July 20, 1993, A3. About $480 million was spent in licensed gaming in 1991-92 (not including $200 million wagered on horse racing or $676 million on lottery tickets). Auditor-General George Morfitt noted problems in ensuring charities (1) receive their proper share of gambling proceeds, and (2) apply the funds for charitable purposes. An additional concern was to ensure that this method of fund raising was made available to charities on a fair basis. One charity receiving more than it needs of this revenue precludes others from having access to the proceeds. There is much competition for these funds. There is a waiting list for charities wishing to run bingo games. The waiting period for casino events, depending upon the region of the province, is 3 to 10 months. The Public Gaming Board has adopted procedures to monitor the application of funds raised through gaming, but it is an impossibility to expect it to do anything more than spot audit fund use. Quite apart from the sheer number of charities raising funds

gambling represents a public concession. Again, most people would be concerned to learn if money raised in this way were misapplied.[22]

(c) Societies with a Public Dimension

For societies with a public dimension in the sense that they receive a public subsidy, any misapplication of funds affects the public. The statutory rules for ratifying a conflict, however, do not make sure that the people affected by a transaction between a society and a director (*i.e.*, the public) are necessarily part of the process by which it is approved.

Moreover, concerns arise in cases other than the misapplication of funds. If a director of a company, for example, enters into a desirable contract (charging fair market value), competitors cannot claim to have been prejudiced. Outsiders cannot ordinarily complain if the company fails to make various opportunities generally available. The same is not true where a director contracts with a publicly funded society. The director's competitors are unlikely to find much consolation in learning there was, in fact, an approval process and the society's interests were not prejudiced. A society's public dimension suggests that these arrangements are not good enough. While the directors of the society must safeguard the society's interests, they owe additional duties, it may be argued, to the public to act with a fair and even hand.

Company law, consequently, provides only an imperfect analogy. Possibly of more relevance are the ethical standards required of elected officials and public employees.

B. Public Duties

1. INTRODUCTION

People in government occupy positions of trust. An unethical, unscrupulous person in an official position has many opportunities for personal profit. Taking advantage of these opportunities is regarded as unacceptable. Even so, until recently legislation has not provided public officials with much guidance on appropriate ethical conduct.

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through gaming, many transfer the funds between affiliated organizations (a church or a school may establish related organizations, in the form of companies or societies, to carry out specific endeavours). The Public Gaming Board kindly made available to us information about licensees in the form of a database. A name check with societies incorporated in B.C. suggests that about 2,560 societies have raised funds through licensed gaming. But a larger number of societies will also receive funds generated from gambling in the form of donations from affiliated organizations who operated licensed events. Appendix G describes how name matching was carried out.

22. *Annual Report of the Auditor-General, ibid.*

The following discussion reviews aspects of criminal law that deal with the ethical conduct of public officials and then describes the standards set by provincial legislation.

2. *CRIMINAL CODE*

The *Criminal Code* does not address activity involving a conflict of interest in a particularly comprehensive fashion. Only three areas are singled out for special attention.

A person who is employed by the federal government, or a provincial or municipal government, and who holds government property must return it on demand. It is a crime to refuse to do so.[23]

It is also a crime to bribe a public official (or for a public official to ask for or accept a bribe). The *Criminal Code* deals with various forms a bribe may take, including a loan of money, a benefit to a family member and a contribution to an election fund.[24]

Section 122 of the *Criminal Code* comes closest to dealing with conflicts of interest. It is concerned with breaches of trust by public officials:

> **Breach of Trust By Public Officer**
>
> **122.** Every official who, in connection with the duties of his office, commits fraud or a breach of trust is guilty of an indictable offence and liable to imprisonment for a term not exceeding five years, whether or not the fraud or breach of trust would be an offence if it were committed in relation to a private person.

The words "breach of trust" ordinarily suggest misusing trust property, but it is clear that section 122 deals with a broader idea than that. It relates to an abuse of *public trust*.[25] A person may not use a public office to further private ends.[26] At the heart of this section is the policy

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23. S. 337, R.S.C. 1985, c. C-46.

24. S. 121. *See also* s. 123, which deals with influencing a municipal official by bribery, threats, deceit or other unlawful means. While seeking *personal* donations is unlawful, apparently it is acceptable for the *organization* itself to seek donations and corporate sponsorships from those wishing to transact business with it: *see, e.g.*, M. Farrow, "Games bidding gets thumbs up," *Vancouver Sun,* August 10, 1993, A3.

25. *R.* v. *Campbell,* [1967] 3 C.C.C. 250, 50 C.R. 270 (Ont. C.A.), *aff'd* 2 C.R.N.S. 403 (S.C.C.).

26. *R.* v. *Cyr,* (1985) 44 C.R. (3d) 87 (Que. S.C.), which also held that it is possible for a person to further private ends without directly reaping a personal benefit.

that to avoid any possibility of bias, the work of a public servant must not conceal a pecuniary self-interest.[27]

The section may not be very effective. A recent case shows that some kinds of activities which blur the border between public duty and personal benefit are not crimes within the meaning of the section.[28]

Criminal law addresses some kinds of conflicts of interest, but not many. The *Criminal Code* leaves much scope for provincial legislation to define appropriate standards for the conduct of public officials, and to provide remedies where these standards are not met.

3. PROVINCIAL LEGISLATION

(a) Overview

British Columbia's conflict of interest rules for people in government are distributed over several statutes. They have received recent attention, and are subject to an ongoing review.

One set of rules applies to public employees, another to members of the legislative assembly.

(b) Public Servants

Most of the rules that apply to public employees are not found in legislation. They are set out in a *Directive* issued under the *Public Service Act*. The *Directive* is discussed later in this section.

(c) Members of the Legislative Assembly

A member of the legislative assembly is not allowed to transact business with the provincial government,[29] either personally or through a corporate vehicle.[30] The legislation also says that an MLA cannot accept

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27. *R.* v. *McKitka,* (1982) 66 C.C.C. (2d) 164, 35 B.C.L.R. 116 (C.A.); *R.* v. *Power,* (1993) 82 C.C.C. (3d) 73 (N.S.C.A.).

28. *R.* v. *Vander Zalm*, (June 25, 1992) Van. Reg. No. CC920084 (B.C.S.C.).

29. *Constitution Act*, R.S.B.C. 1979, c. 62, s. 25(a).

30. *Ibid.,* s. 25(b). The prohibition applies to a company (or an affiliate of the company) in which the MLA is a director or senior officer or holds shares that carry 30 percent or more of the voting rights for electing directors of the company. Conflicts arising from other relationships are not specifically addressed.

money for any employment with government, but these rules are subject to a number of exceptions.[31]

All members of the legislative assembly (as well as elected municipal officials, non-elected public officials, and designated provincial and municipal employees) must disclose information about financial holdings, whether or not there is an actual conflict.[32] Disclosure makes it possible for others to judge whether people carrying out public responsibilities find themselves in a conflict of interest. A person who fails to disclose as required may be fined as much as $10,000.[33] A court may also order a person who fails to disclose an interest in a transaction with the government to repay financial gain arising from the transaction.[34] The most severe penalty awaits an MLA who ignores the prohibition against dealing with government. The cost of violating the legislation may be the MLA's seat in the legislature.[35]

More conflicts of interest rules were introduced in 1990 by the *Members' Conflict of Interest Act*,[36] which was further fine-tuned in 1992 by the *Members' Conflict of Interest Amendment Act*.[37] The new legislation overlaps to some extent the earlier legislation described above.

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31. S. 26. An MLA may receive, *e.g.*, salary as a member of the legislative assembly and reimburse-ment for expenses properly incurred. Programs of general application are also outside the rule: *e.g.*, a member of the legislature would be entitled to apply for a home owner's grant.

32. *Financial Disclosure Act*, R.S.B.C. 1979, c. 130. The statute was enacted in 1974: S.B.C. 1974, c. 73.

33. *Ibid.,* s. 10.

34. S.12.

35. *Constitution Act*, *supra*, n. 29, s. 27. In some cases, party control may be more effective than legislation. *E.g.*, where an elected official is suspected of unethical conduct, the party may refuse to allow the person to sit as a member of the party or to run for re-election: *see, e.g.,* "PM bans Tory MPS facing charges from being candidates," *Vancouver Sun,* August 3, 1993, A1.

36. S.B.C. 1990, c. 54.

37. S.B.C. 1992, c. 64. A useful summary of these changes is set out in the *Annual Report of the Commissioner of Conflict of Interest 1992-93* at 2-5.

An MLA is not allowed to be in an actual or apparent conflict of interest.[38] "Conflict of interest" is defined in section 2:

> **2.** (1) For the purposes of this Act, a member has a conflict of interest when the member exercises an official power or performs an official duty or function in the execution of his or her office and at the same time knows that in the performance of the duty or function or in the exercise of the power there is the opportunity to further his or her private interest.
>
> (2) For the purposes of this Act, a member has an apparent conflict of interest where there is a reasonable perception, which a reasonably well informed person could properly have, that the member's ability to exercise an official power or perform an official duty or function must have been affected by his or her private interest.

For greater certainty, the legislation specifically prohibits an MLA

- from accepting money or other personal benefit for performing official duties (other than authorized compensation or a small gift as an incident of protocol), and
- from using either insider information[39] or the influence of office[40] for personal benefit.

An even stricter position applies to cabinet members.[41] A cabinet member may not engage in any activity (of a business or social nature) that is likely to conflict with public duties.[42] A cabinet member must resign from office or divest any assets or investments that raise conflicting interests.[43]

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38. S. 2.1. The prohibition against acting when in an apparent conflict of interest was introduced in the 1992 amendments. The definition of "conflict of interest" and "apparent conflict of interest" was considered in some detail in the "Opinion of the Commissioner of Conflict of Interest on a Citizen's Complaint of Alleged Contravention of the *Members' Conflict of Interest Act* by the Honourable Robin Blencoe, Minister of Municipal Affairs, Recreation and Housing," (August 16, 1993).

39. S. 3.

40. S. 4. Nothing, however, prevents a member from engaging in normal activities on behalf of constituents: s. 5.

41. The cabinet member rules also apply to parliamentary secretaries.

42. A cabinet member, *e.g.*, may not hold an office or directorship which is likely to cause a conflict, although exceptions are made for a social club, religious organization or political party: s. 8(1)(c).

43. S. 8(4). One way of satisfying the requirements of s. 8(4) is to transfer the assets to a blind trust. The 1992 amendments also provided tighter controls on the activities of

Cabinet members are also prohibited from engaging in various activities after leaving office. Government contracts must not be awarded to former cabinet members, and a former cabinet member must not lobby on behalf of others. The 1990 legislation set the prohibition to last for 12 months after leaving office. The 1992 amendments raised it to 24 months. A former cabinet member who lobbies within 24 months of leaving office will be subject to a fine of up to $5000.[44]

The Act was originally silent about how a contract was affected by an undisclosed conflict of interest. The 1992 amendments provide that the contract is valid but voidable by government within 2 years of the date the transaction was authorized. The crown, however, may not set aside a contract involving a person or organization that both acted in good faith and lacked actual notice of the member's failure to abide by the statutory requirements.[45] Nevertheless, any person who gains financially by a transaction that involves a violation of the Act may be ordered to repay the profit.[46]

The *Members' Conflict of Interest Act* created the office of the Conflicts of Interest Commissioner (currently held by Mr. Hughes). The Commissioner conducts inquiries into the conduct of members and provides advice on potential conflicts. Originally only an MLA or a member of the Executive Council could request the Commissioner to act. The 1992 amendments allow any member of the public who has reasonable grounds to believe there has been a contravention of the legislation (or of the *Constitution Act*) to apply to the Commissioner to review the matter.[47] After an inquiry, the Commissioner may recommend the Legislative Assembly reprimand, suspend, fine or remove a member who has violated the Act.[48]

The rules are distributed over several statutes. They do not operate seamlessly. Nevertheless, their policy is clear. To borrow a term, people involved in government, particularly those who occupy the most senior and influential posts, are expected to function as "guardians" and observe

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blind trusts.

44. S. 7(7).

45. S. 9.2.

46. S. 9.3.

47. S. 15(1.1). This was the case, *e.g.,* in the Blencoe Inquiry, *supra,* n. 38.

48. S. 17.

the highest ethical standards.[49] The rules for elected members are aimed at completely eliminating any possibility of a conflict. The label "guardian" is an accurate description and emphasizes the contrast with the *Company Act* approach, the "business model," for dealing with conflicts of interest.[50]

(d) The Public Service Act Directive

The *Public Service Act Directive*[51] lists standards of conduct that apply to all government employees.[52] The *Directive* is comprehensive. It sets out policies about conflicts of interest as well as other matters such as competence, confidentiality and sexual harassment. In particular:

> The conduct of public service employees must not bring the employer into disrepute. Accordingly, employees must avoid situations which violate the standards of conduct policies or result in a public perception that a violation has occurred. If an employee finds himself in such a situation, he/she must disclose the matter and remedy it.

The *Directive* sets out policies about accepting gifts, keeping out of compromising situations, using information acquired in the course of employment,[53] and transactions involving the interests of relatives and

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49. Jane Jacobs, *Systems of Survival* (1992) 31 adopts the term to refer to the moral rules that apply to people in government as well as keepers of the peace, like the police and the armed forces. The concept was originally used by Socrates to refer to people in these positions who were responsible for protecting the state from its enemies as well as from corruption.

50. *Systems of Survival, ibid.*, discusses the contrasting moral syndromes that should, and usually do, govern people in commerce and those serving a guardian role, and explains a variety of situations in modern life where unsatisfactory results arise as the product of following the wrong syndrome for the function performed, or by following inconsistent rules, resulting in a unworkable hybrid of the two syndromes. The ideas discussed in *Systems of Survival* seem to apply equally to some of the unfortunate results which have arisen where directors of societies have patterned their behaviour in accordance with the business model rather than the guardian model for identifying and dealing with conflicts of interest.

51. *Public Service Act Directive*, Chapter: General Policies, Section: Standards of Conduct, 02/03/87, s. 1.3.

52. These guidelines also apply to the employees of government boards, agencies and commissions: *Public Service Act Directive*, Chapter: Pay and Benefits, Section: Special Employee Categories, 09/17/ 91.

53. The disclosure of information held by a government agency about driver's records, *e.g.*, would violate the Standards of Conduct.

friends or organizations in which they or the employee have an interest.[54] Public servants must avoid receiving any personal benefit from government transactions over which they have some influence.[55] A public servant is also under an obligation to arrange private affairs to prevent any conflict of interest from arising. Failure to abide by the guidelines can result in disciplinary action up to and including dismissal.

Government employees are expected to abide by comprehensive conflicts guidelines. A public employee must avoid conflicts of interest, disclose any when they become apparent and remedy the situation. The *Directive* does not say that anyone may authorize an employee to allow a conflict of interest to continue.

The standards that apply to public servants, like those that govern elected officials, differ noticeably from those that govern directors and societies. Public servants are also expected to function like guardians.

C. Summary

There are two quite different models for dealing with conflicts of interest. One is a business model. It is based on the idea that those affected by the conflict of interest can ratify it. The second is a guardian model. It is based on the view that public duties require the application of stricter ethical standards.

The business model currently applies to societies, but there are reasons for believing that the second model is the more suitable of the two. The business model has been selected for societies because of surface similarities they have in common with companies. Each is an artificial legal entity and they have similar structures, most particularly a board of directors. But societies, unlike companies, are not used for business purposes, and many societies are supported by public subsidy. For these reasons, the more appropriate analogy would appear to be with those in public service, suggesting that the guardian model for conflicts of interest should apply to the directors of societies.[56]

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54. A "direct relative" is defined as the employee's spouse, common law spouse, parent, grandparent, grandchild, brother, sister, son or daughter and any person married to one of these people who lives in the same household.

55. The *Directive* lists the following transactions as examples: "investments, borrowings, purchases, sales, contracts, grants, regulatory or discretionary approvals and appointments."

56. Practical considerations may limit the extent to which the guardian model can apply to societies. This issue is addressed in Chapter V.

CHAPTER IV THE RULES IN PRACTICE

A. Defects With the Business Model

How well do the *Society Act* conflicts rules work in practice? No empirical method exists for testing them. The best we can do is examine how well the rules apply to some problems that have arisen in the past.

Three general categories of problems can be isolated from recent examples:[1]

- A director, officer or employee of a society (or a third party related to one of these people) receives a (direct or indirect) personal benefit, possibly at the expense of the society;

- A director, officer or employee of a society (or a third party related to one of these people) receives a (direct or indirect) personal benefit, at the expense of not the society but a third party (or at the expense of the general public);[2]

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1. Set out in these generic groups, it is difficult to capture the flavour of the ethical problems that may sometimes arise. A review of two appendices might help sharpen the reader's appreciation for the issues. Appendix D summarizes recent examples that have caught the attention of the media in British Columbia. Appendix C attempts to illuminate the issues by providing examples in the context of a fictitious society.

2. The first two categories are broadly framed, particularly with the use of the phrase "personal benefit." While often tangible, and representing an increase in financial well-being, not all benefits are necessarily measured in money. Even where there is a financial aspect to the benefit, it may not be directly connected to the matter affecting the society. In the simplest example, the director who enters into a contract with the society profits financially from it. But other situations will represent a "benefit." The decision may be to locate society premises to benefit an enterprise operated by the director, or to ensure that a rival does not receive a particular opportunity or honour. For that reason, it is also appropriate to include in these categories cases where a director, etc., is motivated by a personal interest that affects the impartiality of a particular decision. In other words, some cases of bias are properly classified as conflicts of interest. There are, consequently, ways of re-classifying these categories which focus on the effect a personal interest might have on decision making:

- a person who must make a decision on behalf of the society lets a personal interest affect the decision, although the person receives no (direct or indirect) personal benefit, and there is no appearance of being benefited;

- a person who must make a decision on behalf of the society lets a personal interest affect the decision, and in so doing receives a (direct or indirect) personal benefit, or there is the appearance of being benefited;

- a person involved with a society does not take part in the decision on behalf of

the society but nevertheless receives a (direct or indirect) personal benefit from a transaction with the society, or there is the appearance of being benefited.

Category 1 describes bias. Category 3 describes personal benefit. Category 2 involves both of these features.

The legal meaning ascribed to "bias" differs somewhat from its colloquial sense, where it tends to be used in connection with a person who lets personal prejudices interfere with judgment. Used in its legal sense, the term is more neutral. It has long been agreed that even the most fair minded person having a personal interest in the matter to be decided should not act in a judicial or quasi-judicial capacity. Factors which simply raise an appearance of affecting judicial impartiality are encompassed by the idea of "bias:" *see, e.g.*, *Bennet* v. *B.C. (Supt. of Brokers),* (1993) 77 B.C.L.R. (2d) 145 (C.A.).

Although the rules for directors of a society can be characterized as addressing some elements of bias, the concept does not apply quite so broadly as it does in the judicial arena. Only the existence of an interest in a contract or transaction with the society disqualifies the director from taking part in a decision about the contract or transaction. A director may be biased in the more general legal sense of having a personal interest in a particular matter, but because of the way the *Society Act* rules are framed, the interest would not prevent the director from taking part in the decision.

Suppose a society invites bids on a particular contract. The board of directors considers the bids received. One member of the board believes that because woman have long been disadvantaged only bids from businesses run by women should be accepted. Should the rules identify bias as a ground for disqualification so that this board member may not take part in the decision? Aspects of this issue may be considered in a case to be brought before the Supreme Court of Canada: *Queen* v. *Native Women's Association of Canada*, S.C.C. Bulletin of Proceedings, Mar. 12, 1993, p. 497. (Appeal from [1992] 3 F.C. 192 (C.A.).)

While bias is a concern where people perform adjudicative functions, it seems to have less force for people making business decisions. A recent example involves a cabinet minister who made a decision which affected the fortunes of a former, and possibly future, employer. Some people were concerned, fearing a conflict of interest may have affected the decision. Others felt that the breach was only technical, because the person did not receive a direct benefit from the decision. Even if there is general agreement that the person was impartial, and free of any conflict of interest, competitors of the company that benefited by the decision might well be suspicious about whether extraneous considerations affected the decision.

How far can concerns about bias be addressed in the context of societies? A community centre, *e.g.*, catering to a particular ethnic group may not be able to make even handed decisions about contract placement to other ethnic groups if there is a tradition of hostility between them in their country of origin. Conflict of interest rules

- A director, officer or employee commits a crime or perpetrates a fraud on the society.

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do not really deal with these questions. Other legal principles, however, may provide a solution. *See, e.g., Kane* v. *Canadian Ladies' Golf Association,* (1992) 11 C.P.C. (3d) 270 (P.E.I.S.C. (Tr. Div.)). The applicant had been chosen as an alternate for the Association's representatives in a golf tournament. The court held that the selection process was null and void, not by reference to allegations of bias, but because the Association had failed to follow its own rules in selecting its representatives. *See also Lee* v. *The Showmen's Guild of Great Britain,* [1952] 2 Q.B. 329 (C.A.).

The current rules under the *Society Act* deal more completely with the second category. A director may not take part in a board decision about a transaction with the society in which the director is directly or indirectly involved. The Act is silent about what constitutes an indirect involvement, an issue addressed in greater detail in Chapter V. The Act is based on the view that it may be presumed that a person who has a personal financial interest in a matter will act in self-interested ways (in other words, with bias). Even so, the legislative formulation ignores, or attaches no significance to, other factors that may suggest bias. This is true even where the decision may significantly affect the director's financial well-being. *E.g.*, Director A, who operates a restaurant, is a board member of a religious organization that must decide where to locate its cemetery. If Director A votes against a site near the restaurant, there is a financial component, but it is not measured in terms of profit to Director A. This kind of conflict of interest is probably not caught by the current legislation. Another example: if the decision relates to the location of a theatre, locating it near the restaurant may provide Director A with a financial benefit, but the benefit is one-step removed so would not, within the rules, be regarded as a conflict of interest. Another example (from municipal law): a councillor takes part in a vote about removing top soil at the municipality's expense on various properties. The removal will enhance property values. The councillor, who is a real estate agent, does not disclose that the vote concerns a property which the councillor has listed for sale: *Campbell* v. *Dowdall,* (1992) 12 M.P.L.R. (2d) 27 (Ont. Gen. Div.).

The third category applies where the director is not involved with making the decision on behalf of the society (in most cases the director is relieved of voting responsibility by operation of the conflicts rules). In such a case, is there any reason why the director should not be able to benefit, directly or indirectly, from a transaction with the society? The current Act finds this position acceptable, provided the other directors authorize the transaction.

The foregoing addresses questions that arise in identifying particular kinds of conflicts of interest. The *Society Act* adopts a narrow focus on what is considered, for its purposes, to be a conflict of interest. This Chapter, on the other hand, does not deal with the factors or causes that create or contribute to a conflict of interest. It looks instead at the kinds of interests that may come into competition − those of directors of a society, those of the society, and those of members of the public − when a conflict of interest arises. The next Chapter will consider whether current views about what constitutes a conflict of interest should be revised.

The phrase "a director, officer or employee" is cumbersome. A useful term is "insider," which is familiarly used to refer to people who have close connections with the affairs of a company whose shares are publicly traded.[3] It nicely captures the idea of people involved in the society's affairs.

1. INSIDER (OR A RELATED PERSON) V. THE SOCIETY

Some examples of cases where a society's interests appear to have given way to those of a director include directors who set their own salaries; family members who used a society property for personal purposes; and contracts between a director and the society that might very well have been performed by someone else.

Whether the society has actually been prejudiced by the transaction or by any activity related to it is seldom clear and, possibly, beside the point. The behaviour of a person who has a conflicting personal interest may still be impeccable, protecting absolutely the interests of the society. Even so, an arrangement in which an insider (or someone connected with the insider) deals personally with a society invites suspicions.

Most people would accept the proposition that an arms-length transaction is less likely to prejudice a society than one in which insiders, or their friends or relations, are involved. For one reason, it is easier to be business-minded and firm with a stranger than it is with a friend or associate. Directors who are essentially dealing with themselves may find it particularly difficult to be hard-nosed.

The current conflicts rules do not seem to be seriously aimed at avoiding conflicts of interests at all. It should not be surprising, consequently, that from time to time conflicts are allowed to taint various transactions. We believe there is less and less public tolerance for even the appearance of a conflict of interest. To the extent the *Society Act* rules are not aimed at avoiding conflicts of interests, they must be considered to be flawed.

2. INSIDER (OR A RELATED PERSON) V. A THIRD PARTY

The second generic category of problems involves a conflict of interest, not between the society and the insider, but between the insider and a member of the public. Every time an insider transacts business with a society, an opportunity is lost to the general public. Questions have arisen in some cases about whether a society spent its budget fairly

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3. In that context, special rules apply to ensure that a person does not unfairly profit from insider information about the best times to buy or sell the company's shares. This special meaning has no application when used in connection with societies. Nevertheless, to the extent that it refers to a person involved with a corporation in contrast with someone dealing at arms-length with the corporation, it is, for our purposes, a useful term and one which will be employed in the following discussion.

or gave equal opportunities to local businesses to bid on various contracts. Allowing an insider to transact business with a society places third party interests after those of the society and its directors, officers and employees.

The current rules focus solely on the interests of the society. A board of directors is not asked to determine whether ratifying a transaction will affect wider, public interests. Bearing in mind the public dimension of many societies, conflicts rules that allow a society's insiders to ignore third party interests are defective in their operation.

As with conflicts falling into the first category discussed above, even the appearance of a conflict of interest is probably not acceptable. If an insider obtains a desirable contract with a society, many would wonder whether the process was conducted fairly. Did outsiders have a reasonable opportunity to bid? Did personal friendships or business associations shape the decision making process? Did the director, officer or employee have information not generally known to others which provided an advantage?

3. FRAUDULENT AND CRIMINAL BEHAVIOUR

The last of the general categories identified above involves fraudulent and criminal behaviour. An insider who directs funds to a person not entitled to them, submits padded expense accounts, or takes money that is not earned may be in a conflict of interest, but these are not matters for conflict of interest rules. Criminal activity is a matter for criminal law, or civil law dealing with fraud or deceit.[4] These kinds of problems are outside the scope of our inquiry.

B. Additional Defects With the Business Model

The business model (that is, the *Company Act*/*Society Act* model) is based on this theory: a conflict of interest is effectively contained if

(a) a director discloses a personal interest in a proposed transaction, and

(b) the director does not take part in the process by which the society decides whether to enter into the transaction with the director.

4. Financial consequences of criminal activity may often be the subject of a civil suit. *See, e.g., Richmond Raiders Football Club* v. *Richmond Savings Credit Union, Lawyer's Weekly,* Apr. 23, 1993, 15 (B.C.S.C.), where part of the money lost through a director's fraud was recovered from the lending institution.

Scrutiny by the other directors is regarded as a satisfactory method of protecting the society's interests. A number of criticisms can be levelled at the assumptions underlying this theory.

1. LOSING THE DIRECTOR'S EXPERTISE

A board of directors must have people qualified to oversee the activities of the society. Any process that excuses a director from taking part in board decisions diminishes, possibly only in a small way but diminishes nevertheless, the board's ability to carry out its functions:[5]

> It follows from these propositions that, unless the articles confer on a director express powers of contracting with the company, a director's powers of so contracting are extremely limited....[The director] is, like a trustee, disqualified from contracting with the company; and for a good reason: the company is entitled to the collective wisdom of its directors....

The problem is heightened, of course, where the excused director has special expertise. Unsurprisingly, a director who wishes to enter into a transaction with the society is likely to have some expertise in the transaction. The likelihood increases with the value and importance of the transaction. The society's interests must be protected by the remaining, non-expert board members dealing with the excused expert director – a classic situation of inequality of bargaining power. As Conflicts Commissioner Hughes observed:[6]

> That takes me to another concern in instances where a director has been selected for service on the board because of special expertise possessed by him. Is not the Society going to lose a substantial contribution if such a director has to bow out of participation at the board table as and when ramifications growing out of a contract awarded to his company or another corporation of which he is a director arise from time to time? That will be something the Society and the director in that position will want to carefully think through.

The board might replace lost expertise by retaining a qualified adviser. The excused director's abilities will seldom be truly unique. But that does not alter the fact that the director's actions, which the law accommodates, prejudice the society's interests.

2. INCONSISTENT DUTIES

A director owes at least two separate duties to the society that may be violated by authorising a business transaction between the society and the director: (1) to make sure the society gets the best deal; and (2) to serve the interests of the society faithfully. These are clearly set out in the *Society Act*:

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5. Schmitthoff & Curry, *Palmer's Company Law* (1959) 554.

6. *Report to the Victoria Commonwealth Games Society* by the Honourable E.N. (Ted) Hughes, Q.C. (March, 1992) 17.

> **25.** (1) A director of a society shall
> (a) act honestly and in good faith and in the best interests of the society; and
> (b) exercise the care, diligence and skill of a reasonably prudent person, in exercising his powers and performing his functions as a director.
>
> (2) The requirements of this section are in addition to and not in derogation of, an enactment or rule of law or equity relating to the duties or liabilities of directors of a society...

It is doubtful whether a director can carry out either of these duties while negotiating a transaction which carries with it personal benefits. The current rules that allow a conflict to be authorized sit uncomfortably with these duties.

The *Society Act* does not talk about a duty of good faith owed to the public. But, as discussed earlier, there is a public dimension to the operation of many societies. The directors must see to it that the society acts accordingly. Allowing a director to transact business with a society is a practice that may often fail to meet public expectations about fair dealing.

3. THE WRONG PEOPLE ARE SCRUTINIZING THE TRANSACTION

In theory, scrutiny by the board adequately safeguards the society's interests. But this is only true if the members of the board are prepared to scrutinize. What factors motivate board directors to protect a corporation's interests? Directors paid for services might be anxious to serve well so that their income will continue. Directors with a financial stake in a corporation will usually want to make sure that all decisions benefit the company. Directors wishing to retain the prestige of their positions will safeguard the corporation's best interests to win re-election. Without inducements like these, however, the only spur is personal integrity.

Of these reasons, only the last two, prestige and personal integrity, would seem to apply ordinarily to directors of societies. Would these considerations sufficiently motivate a director to protect the society's interests? Possibly not, in a climate where conflicts are winked at, tolerated, sometimes even encouraged.[7] In this climate, where the personal interests of other directors are unaffected, extraneous factors may well take on a disproportionate significance in a board decision.

What kinds of extraneous factors? Perhaps ones like these:

- Director A has done a lot for this society.

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7. Another factor is that directors who ask awkward questions may find themselves isolated or removed from the board: *see, e.g.*, G. Shaw, "Amateur swimming organization's money sinks in risky venture," *Vancouver Sun,* June 19, 1993, D7.

- Director A is powerful, the kind of person I do not want to upset.
- I have a separate business relationship with Director A.
- I really don't want to make waves.
- I'm not affected directly and I trust Director A. There's no real need to look into this very carefully.
- If I vote against this transaction, Director A may vote against a motion I wish to pass or a transaction I want to enter into with the society.

Any of these reasons, or any combination of them, may lead to approving a transaction that is not necessarily in the society's best interests. Even if the transaction is impeccable, suspicions may arise about why it is with Director A rather than someone else. Was everyone treated fairly? Did insider information give Director A an advantage over others? Did Director A shape the bidding process to obtain an unfair advantage?[8] These questions suggest the dimensions of unease and public distrust that may sometimes arise when a director has a personal interest in a transaction with a society.

If the current rules are defective because they depend upon the scrutiny and approval of the wrong people, who is qualified to approve a transaction with a director? The answer, probably, is no one. No process of scrutiny will convince outsiders that the interests of the society and of the public have been protected. It is this state of affairs that led to the suggestion by Commissioner Hughes that nothing less than complete fidelity to a society's interests must be expected of board members.

4. OPPORTUNITIES FOR COLLUSION

Thorpe v. *Tisdale*[9] concerned an arrangement among a company's directors. They agreed to approve each others' proposed transactions with the company. The business model did nothing to protect the company's interests. In later proceedings, a court held that the directors' arrangement was illegal.

Thorpe v. *Tisdale* is an old case, and an extreme example, but less glaring versions of this scenario probably take place from time to time.

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8. *E.g.*, half inch pipe is specified for the contract with the society. Director A's company is a manufacturer of half inch pipe, but 3/8 inch pipe would do the job just as well. 3/8 inch pipe is also cheaper and a number of competitors make it. Did Director A have any influence over setting specifications?

9. (1909) 13 O.W.R. 1044.

The arrangement may arise naturally, without any express agreement. Director B may be tempted to vote in favour of a dubious arrangement in favour of Director A, for example, to curry favour for a personal transaction. Even if the motive is absent, events like these give the appearance of an agreement among directors to sponsor each other.

The most obvious method of avoiding express arrangements, or the appearance that they exist, is to not let directors transact business with their society.

5. THE DIRECTOR'S AWKWARD POSITION

Personally benefiting from a transaction with a society may make the director's role more difficult to carry out when other directors wish to deal with the society. The director who has already benefited may feel an obligation to the other directors and vote in favour of a questionable transaction. Or, feeling uncomfortable about these events and wishing to avoid any appearance of collusion, the director may vote against a transaction, even one undeniably to the society's advantage. Personal dealing with the society will, at least to some extent, affect a director's moral authority to act on behalf of the society. A director who transacts business with a society is in an awkward position.[10]

C. Tentative Conclusion

The current conflicts rules for societies are based on an inappropriate model. A different set of rules, recognizing the public dimension possessed by many societies, needs to be put in place.

The dilemma is that an "all or nothing" position is unlikely to work. A rule prohibiting any transaction coloured by a conflict of interest has obvious disadvantages. Unfortunately, more pragmatic rules that permit arrangements touched by a conflict of interest to be authorized, like those that currently apply to societies, sometimes produce results in which the interests of the society and the community are neglected. Conflicts of interest rules are currently being used to authorize practices that ought not to be allowed. Rules whose object is to detect and prevent conflicts are employed instead to ratify or validate practices that are not clearly in the best interests of the protected agency.

Is there an appropriate middle ground where a tainted transaction can be authorized only where it is in the interests of the society and the

10. How well served is a society by a director who (by virtue of the earlier transaction) is on record as not being unduly worried about conflicts of interest? Jane Jacobs, *Systems of Survival* (1992) develops the argument that those charged with looking after the interests of others ("guardians") cannot carry out their responsibilities if affected by personal business considerations.

public? This question is explored in the next Chapter, which considers options for revising the law.

CHAPTER V REFORM

A. Introduction

The last Chapter explained that current conflicts rules are out of step with contemporary views and needs. This Chapter explores alternative approaches for handling conflicts of interest problems.

B. Application (Part 1): Form v. Function[1]

The Commission was asked for advice about the conflict of interest rules that apply to *societies*. What seems clear, particularly from the results generated by a survey of government agencies,[2] is that the legal structure of an organization has little to do with the kinds of conflict issues that will arise. The controlling factor is the activity carried out by the organization.

The focus on form over function has interfered with the development of legal principles relating to conflicts of interest: false parallels are drawn, so that groups of organisations are treated in similar ways, without recognizing the vast differences that exist among them. This has arisen in at least two respects.

First, because societies and companies resemble each other in form the same rules apply to each. They are both corporations. Both have legal personality. The affairs of each are under the responsibility of a board of directors. But the examination of the different objects, sources of funding and functions carried out by these two kinds of corporations – companies carry out business enterprises while societies pursue non-profit activities – suggests that different rules should apply to them.

Second, even within the set of corporations constituted as "societies" there are wide points of divergence. Focusing on legal form masks the differences that exist. A society with a large budget that enters into many contracts faces quite different conflicts issues from one that has a minimal budget and relies entirely upon the donation of goods and

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1. The title to this section – "Application (Part 1)" – needs some explanation. The initial question is: what organizations should be subject to our inquiry to determine appropriate conflicts of interest rules? We are effectively confined by the terms of our reference to an examination of these issues as they apply to societies. It is reasonably clear, however, that the principles in question are of more general application. Later in this Chapter, "Application (Part 2)" will explore the question: which of the people associated with societies should be subject to conflicts of interest rules? Currently, the *Society Act* mentions only directors. But a great many other people acting on behalf of a society will find themselves in positions where their personal interests conflict with those of the society. Conflicts of interest rules might possibly adopt a broader scope.

2. *See* Appendix E.

services. A society that provides a social outlet for a small membership is entirely different from one that performs public functions or spends public funds and whose operations are, in many respects, expressions of government policy.

When the Street Kids in Distress Society ("SKIDS") lost its funding, the responsible Minister, Lois Boone, was asked whether societies should be subject to more government regulation. The Minister replied that it would be impossible to regulate the 16,000 societies incorporated in British Columbia.[3] The label "society" has muddied the discussion. SKIDS, at least in part, attracted public attention because the society was financed with public funds. Government records show that only about 1100 societies receive sizeable grants.[4] Even this number would probably prove daunting to regulate, although it is a small fraction of all British Columbia societies.

Some of the variations that can exist are suggested by this table of combinations:

We Study...	Operates a social club? Or a public service?	Is self-funded? Or publicly subsidized?	Has a small membership? Or a large membership?	Has a small budget? Or a large budget?

Should a small, self-funded social club be subject to the same rules as a big, publicly funded society carrying out public functions? Should distinctions be drawn between societies with small budgets and those with large budgets?

The label used to describe the legal structure of societies does not make clear the differences that exist among various kinds of societies. Assumptions true for some kinds of societies will not apply to others. The rules that apply to societies must be sensitive to their differences. Although our reference restricts our inquiry to societies, within the bounds of this reference is virtually the entire spectrum of conflicts issues that confront any organization, whatever its technical legal form.

C. Structure of Rules

It is a mistake to think that only one set of conflicts of interest rules applies in any one situation. Directors of a company or of a society are not just subject to the rules set out in the *Company Act* or the *Society Act.* A web of rules set out in provincial and federal legislation and the common law apply, and these are supplemented by ethical and moral standards.

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3. L. Kines, "Street Kids Shut Down, Bank Account Gets Frozen," *Vancouver Sun,* Feb. 25, 1993.

4. The Public Accounts 1991/92 list grants made to societies and foundations that exceeded $10,000. The Office of the Comptroller very kindly made this information available to us in the form of a database. *See supra,* Chapter III.A.5 "Societies and Public Subsidy."

In addition to the rules under the *Society Act*, a director of a society will be subject to rules arising from some (or all) of the following sources:

- common law and equity
- bylaws of the society
- standards of conduct adopted by the board of directors[5]
- business practice guidelines, adopted by the board of directors
- *Criminal Code*
- other provincial legislation[6]
- *Public Service Act Directive* (for a government representative on the board who is appointed from the public service).

Other forces are also at work, such as common sense, professional codes of conduct,[7] convenience (avoiding a conflict of interest may ease a director's tasks), fear of public embarrassment, and career protection or advancement. Any or all of these considerations may motivate the avoidance of a conflict of interest.[8]

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5. In some cases, customs and past practices and procedures will provide a reference point for ethical conduct: *see, e.g., Kane* v. *Canadian Ladies Golf Ass'n.,* (1992) 11 C.P.C. (3rd) 270 (P.E.I.S.C. (Tr. Div.)).

6. *E.g.*, *Real Estate Act*, R.S.B.C. 1979, c. 356; *Securities Act*, S.B.C. 1985, c. 83; *Members' Conflict of Interest Act*, S.B.C. 1990, c. 54, am. S.B.C. 1992, c. 64.

7. Such as the *Code of Ethics* of the Canadian Real Estate Association that governs realtors (*see, e.g.,* Real Estate Board of Greater Vancouver, "Code sets rules for realtors," *Vancouver Sun,* July 29, 1993, E5), or the *Professional Conduct Handbook* published by the Law Society of B.C. that governs lawyers in B.C., or the *Code of Conduct* adopted by the Coaches Association of B.C.: W. Long, "Amateur Sports: Coaches draft rules for their own conduct," *Vancouver Sun,* June 30, 1993, E3.

8. *See further,* David Charny, "Nonlegal Sanctions in Commercial Relationships," (1990) 104 Harv. L. Rev. 373, 392-7, who describes a number of non-legal factors that encourage people to honour contracts and observe ethical behaviour in commerce. Some of these are prompted by business concerns (*e.g.*, a damaged reputation for fair dealing may result in the loss of valuable opportunities for future trade), but the motivations may be more far reaching than that (sharp business practices, *e.g.*, may result in the loss of opportunities for important or pleasurable associations with others; many people act honourably because they like the good opinion of others).

The tangle of formal and ethical rules, together with related considerations, sometimes leads to contrary guidelines. For example, the *Society Act* imposes upon a director the highest of duties to the society to look after its interests. At the same time it allows opportunities for self-dealing. The current situation largely reflects the inability of our community to agree upon what constitutes acceptable and unacceptable conduct, once it emerges beyond the range of activities formally regulated by civil and criminal law.

D. Approach to Reform

1. HIERARCHY OF RULES

Many people, particularly lawyers, ordinarily think of legislation as the best tool for setting out rights and obligations. But legislation has some obvious drawbacks. It really only works well for setting out firm rules. Modern legislation attempting a more flexible approach sometimes sets out a general rule, and then confers upon a particular person or agency, or the court, discretion to make decisions appropriate in the circumstances.[9] One criticism of this approach is that a discretion invites an individual to decide matters according to personal beliefs, leading to some inconsistency among decisions by different people.

The current rules for societies already import an unstructured discretion, with unsatisfactory results.

What seems to be needed are several levels of rules. At the highest level are invariable rules that should apply to all directors of all societies. Because circumstances seem to have such a heavy significance in determining whether there is a conflict and how serious it is, there are not many rules of such universal application.[10]

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9. *E.g.*, *Family Relations Act,* R.S.B.C. 1979, c. 121, s. 51.

10. Examples of problems that arise if the rules do not permit some flexibility: (1) A deputy minister who was about to retire was asked to remain to supervise a construction project. The contract was signed before the deputy minister retired, but covered the period following retirement. The deputy minister was charged and convicted under s. 122 of the *Criminal Code* (discussed above in Chapter III.B.2. *Criminal Code*) because the deputy minister extracted a personal pecuniary advantage while still in office. The conviction was overturned on appeal. The C.A. held that no element of the transaction, viewed in context, could be construed as a breach of trust: *R.* v. *Power,* (1993) 82 C.C.C. (3d) 73 (N.S.C.A.); (2) A superintendent of a company donated materials to a hockey team without filling in the necessary forms. The superintendent derived no personal benefit from the donation and would have been entitled to make the donation simply by filling in the necessary forms. The company discharged the superintendent, but a court held that the matter was an error of judgment that should have been subject to a lesser form of discipline: *Hill* v. *Dow Chemical Canada Inc.*, (1993) 41 A.C.W.S. (3d) 669 (Alta.

At the next level are rules which may allow the board some discretion to determine whether, in the circumstances, a conflict exists and how to deal with it. These rules can also probably apply to all societies.

Eventually, however, the rules must recognize the significant differences that can exist between societies. Some rules must be geared to the particular circumstances of the society (is it a small social club? is it a large society carrying out public functions? does it make grants, purchase property, determine industry standards or professional qualifications, etc. or does it advise those who are responsible for any of these functions?). In some cases, these specific rules can operate in a black and white way. Others must operate more flexibly, in the sense that breaking a rule may not always be considered wrong or, if wrong, may not always be viewed as very serious.

It would be possible to use legislation to set out at least part of this hierarchy of rules, but the more specific to a situation the rules must be, the less appropriate legislation becomes. These considerations suggest that something is needed to supplement legislation.

2. CONDUCT GUIDELINES

Practices adopted by many societies and government agencies suggest the solution. They supplement legislation with conduct guidelines the society or agency drafts itself.

Conduct guidelines have a number of advantages over legislation. They can incorporate more flexibility and cover more areas – such as setting rules that should be observed by people other than directors involved with the society. Conduct guidelines need not use complex drafting (which legislation sometimes must, in order to be precise). Rules set out as general guidelines are more likely to encourage ethical behaviour than principles prescribed in legislation, a point made by the Cadbury Committee when it recommended a code of business ethics for directors of companies:[11]

> Statutory measures would impose minimum standards and there would be a greater risk of boards complying with the letter, rather than the spirit, of their requirements.

Conduct guidelines can even include examples, something which is uncommon in legislation. Finally, the standards can be chosen with specific regard to the needs of the particular society (whereas legislation must ordinarily be of general application). To ensure that there is no

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Q.B.).

11. "Cadbury Report," *Report of the Committee on the Financial Aspects of Corporate Governance,* Dec. 1992, para. 1.10.

vacuum of rules, legislation can set out rules which apply to all societies that do not expressly adopt different conduct guidelines.

We think that this route for reform holds a good deal of promise. In this Chapter, consequently, tentative decisions will be made about what can be addressed in legislation, and what can be dealt with in conduct guidelines. Draft conflicts legislation and draft conduct guidelines are set out later in this Consultation Paper for discussion purposes (see Appendices A and B).

E. What Should Be Included in Conduct Guidelines?

The survey of government agencies[12] reveals that many agencies do not distinguish too rigorously between conflicts of interest and good ethical or business behaviour expected from employees of the agency. Those agencies that addressed conflicts of interest usually took the opportunity to embrace a broad spectrum of other issues, such as the use of agency property and the need for confidentiality as well as more general obligations such as a duty to carry out assigned tasks in a competent manner. Most of the matters addressed were peripheral to issues of conflict of interest.

The information garnered through the survey was used as a basis for draft model "Conduct Guidelines." The reader might wish to refer to Appendix B at this point. It will give some idea about how we propose to demarcate the borders between pure conflicts of interest issues and related matters that we think can be addressed as conduct guidelines.

Advice is welcome on whether this is a reasonable method of dealing with recurring issues, and related but peripheral issues, while still retaining a tight focus on what constitutes a conflict of interest. To what extent can grey areas, where formal rules do not operate well, be dealt with through guidelines? Have too many matters been characterized as issues of conduct? Should some of these standards be incorporated in conflicts of interest legislation? Are there standards which we have failed to include? Would a different format or exposition of these standards be more useful (further explanatory material might be added, for example). Advice is invited on all of these questions.

F. General Rule: A Total Prohibition Model?

Has a consensus emerged in favour of laws which prohibit any conflicts of interest? That certainly seems to be true for elected officials and civil servants, but it is not clear that there is agreement about the ethical standards to be observed by people involved with societies.

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12. *See* Appendix E.

The discussion to this point has dwelt entirely upon the problems that arise from allowing a director to have a personal interest in transactions with a society, giving a one-sided view of the issue. Even if there is public consensus deploring rules which allow directors to sometimes profit from their involvement with societies, changing the law to prohibit any conflicts at all would not be entirely practical.

1. PRACTICAL CONCERNS

Our preliminary view is in favour of adopting conflicts of interest rules which generally prohibit a director of a society from transacting business with the society. But there are reasons for recognizing at least a few exceptions to the general rules. These reasons are explored in this section.

The lessons to be drawn from the current law suggest that exceptions to the general rules must be kept to an absolute minimum. Those times when a conflict may be regarded as acceptable should be rare and exceptional. As such, it should not come as a surprise to find that examples explored in the following discussion sometimes involve unusual situations.

(a) Profit v. Indemnity

Concerns about possible conflicts of interest are most likely in any situation where the director makes a profit, so it might be possible to authorize at least some transactions involving a conflict of interest where the director is providing services for free or for a nominal charge.[13]

Example: The director, a construction contractor, is willing to frame in new rooms for the society's offices at cost.

Example: The director, a stationer, is prepared to let the society buy supplies at cost.

Example: The society sells bags of potatoes to raise funds. The director purchases 10 bags.[14]

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13. Even in those cases where the director makes a profit, the smaller the contract, the smaller the profit, the less concern people are likely to have. The profit factor may not be a reliable indicator in every case. In tough economic times, businesses are sometimes prepared to work at cost on a transaction to retain experienced workers or to keep an effective organization together. Awarding a director a contract that may appear to be uneconomic may nevertheless represent a deprivation to other businesses.

14. Compare, however, the sale of raffle tickets. While no one is probably concerned when directors purchase lottery tickets, views change when an insider wins the raffle. For this reason, many companies that conduct contests prohibit management, staff and their families from entering.

Many people would view a rule preventing these kinds of transactions as being unrealistic.

Some "opportunities" that arise through a society will be so undesirable that no one will vie for them. If a director is prepared to act where no one else will, there is no reason to prevent a society from benefitting from the service. The director will often be only too happy to act without any charge, but there may be other circumstances where some amount of money will be involved.

> *Example: A society office is located in a dangerous part of town, and the office is kept open late. Staff want safe transportation home, but the society cannot afford taxi fares.*

Few would be likely to find anything wrong if the society paid a director an honorarium for driving people home late at night, and reimbursed the director for the cost of gas. This is a reasonable arrangement for a society that operates on a shoestring and that is anxious to economise at every opportunity.

Different considerations arise for a well-funded society operating a world class exposition or international athletic event. The need to economise does not arise in the same way. The society will probably have a large and well paid staff. Many of the contracts and transactions entered into by the society will involve large sums of money. Conversely, the demands on volunteers (directors, members, and assistants) will often be less, simply because the enterprise is more likely to be adequately staffed. What does not seem like a conflict of interest in the underfunded society, or if it does is easily understood and accepted, takes on a different hue. Conflicts of interest rules, it seems to us, must take this factor into account.

(b) The Position of Volunteers

Many societies receiving public funds perform valuable public services. People take part in these societies not with a view to profit but because they care deeply about the objects and aims of the society. The time they devote to society activities may be significant.[15] Not many are wealthy enough to be able to afford making substantial donations (of goods, money or time). Allowing a society in some cases to reimburse a person, even a director, for costs incurred on behalf of the society would seem to recognize the economic realities facing volunteers.

(c) Disincentives to Service

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15. An employer may sponsor the society by giving employees time off to devote to the society's work but, for many, time off is illusory. Missed work must be caught up some other time. A self-employed person must arrange for someone to cover the business during absences.

Because directors are charged with looking after the interests of the society, they are expected to shoulder a great deal of responsibility when things go wrong. A society's insolvency, for example, may leave employees unpaid, and various withholdings required by the provincial and the federal governments unremitted. Directors may find themselves personally responsible for paying wages and making good other defaults.[16]

Any doubt about the solvency of a company or society increases the difficulty of finding people willing to serve as directors.[17] Exposure to personal liability is also a disincentive to service, even when the corporation is clearly solvent.

Stricter rules about conflicts of interest pose increased risks to directors, who may face penalties by unknowingly falling afoul of the rules. It might be expected, consequently, that stricter conflicts of interest rules will increase the difficulty of finding qualified people to serve as directors of societies.

(d) Cost Implications to the Society

Rules that prohibit a director from participating in any transaction with a society in which there is a direct (or indirect) benefit may have other implications for the society. The rules may require the society to follow a more formal tendering process to buy or sell something or to pursue a more expensive alternative.

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16. Directors are responsible for (1) unpaid wages of employees of the corporation: *Employment Standards Act*, R.S.B.C. 1979, c. 107.1, s. 19; *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 114(1); (2) unpaid wages of employees of a closely related corporation: *Remko'B Investment Ltd.* v. *Director of Employment Standards*, [1993] B.C.D. Civ. 730-01 (S.C.); *Employment Standards Act, ibid.*, s. 20; and (3) unpaid source deductions: *see, e.g.*, *Lindthaler* v. *M.N.R.*, (1992) 8 B.L.R. (2d) 159 (Tax Ct. of Canada). The S.C.C. has held that directors are not responsible for damages for wrongful dismissal: *Barrette* v. *Crabtree Estate*, (1993) 101 D.L.R. (4th) 66 (S.C.C.). In *Richmond Raiders Football Club* v. *Richmond Savings Credit Union*, *Lawyer's Weekly*, Apr. 23, 1993, 15 (B.C.S.C.) the club was defrauded, but the directors were found 25 per cent contributorily negligent for failing to perform their duties of supervision and management. It is not clear, however, whether the directors were personally responsible for any portion of the financial loss. *See further,* W.I. Innes, "Liability of Directors and Officers of Charitable and Non-Profit Corporations," (1993) 13 E. & T.J. 1.

17. In England, few people are willing to volunteer to serve as governors in the school system, because of the heavy demands of time and the exposure to personal liability: Jonathan Robinson, "School Governors – A Siren Call?" June 26, 1992, Sol. J. 628. Events closer to home provide further examples. The directors of Westar, a company on the brink of insolvency, resigned rather than risk incurring personal liability from trying to rescue the company: *Re Westar,* (1992) 14 C.B.R. (3d) 95 (B.C.S.C.).

> *Example: A society that promotes music appreciation needs a piano. There are three stores in the community that sell pianos, all operated by directors of the society. If the society cannot deal with a director it must purchase the piano in a neighbouring community. The directors who sell pianos are also the only local businesses that tune pianos. Each time there is a problem, someone will have to be brought in from a neighbouring town resulting in a great deal of additional expense.*

It would have been more economical for the society to buy the piano from one of its directors.

A total prohibition rule is not concerned about whether a particular transaction is in the society's best interests, nor with the prudent application of public money. Such a rule, by being absolute, is intended to ensure no opening exists for other, more suspect, transactions. The rule is an expensive protective measure if fair transactions must be passed over for more expensive alternatives.

A commentator on changes in the law in the United States governing elected officials questioned whether the expense of their new conflicts procedures could be justified. The U.S. developments require, among other things, a process of formal disclosure:[18]

> ...But, at the same time, I am concerned about the cumulative effect of the new ethics laws. In other words, while particular provisions appear to be improvements, the new laws, taken as a whole, add substantially to the regulatory burden borne by government employees and by people on the outside who deal with the government. Unfortunately, this burden will be borne not just by those whose conduct we may agree is corrupt or unfair, but by all sorts of people trying to carry out the business of the government for the public's benefit.
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> It seems to me that we may have overemphasized the value of form-filling and overlooked ways to improve real enforcement against actual conflicts of interest. I wonder whether "sunlight" is always the "best disinfectant." For example, I question whether the proper completion of the financial disclosure and other reporting forms really leads us to a higher level of ethical conduct. Will people feel that the completion of those forms is all there is to government ethics? Will the Office of Government Ethics consider that if you filled out the form right you have it made?

Those prepared to bend a few rules will find ways around any conflicts of interest procedures, even those based on a total prohibition model. There are many examples involving elected officials who ignore the rules altogether.

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18. Marshall J. Breger, "Will the Ethics Reform Act Change the Way the Government Conducts Business in the 1990's?", excerpts from the Administrative Conference of the U.S. Colloquium, Jan. 25, 1990, Federal Bar News & Journal. New ethical procedures may have unexpected defects. Vendor disclosure statements, now widely used in real estate transactions in B.C., may provide some support for unwarranted litigation by purchasers seeking warranties about defects unknown to the vendors: see, *e.g.*, G. Shaw, "Vendor disclosure statements industry answer to sales woes," *Vancouver Sun*, June 8, 1993, D1.

Onerous rules may only result in delay and increased expense. Abiding by procedures that safeguard against conflicts of interest may use up the probably already stretched resources of the society. The rules will be followed by those who would have behaved ethically in a much less policed environment, but may do little to dissuade others from profiting from a conflict of interest.

2. PERMISSIBLE TRANSACTIONS

The points raised in the last section suggest that while generally satisfactory, a prohibition rule must permit some flexibility in its operation. Is it possible to set out rules that will only allow those transactions truly in the society's best interests to be ratified? Or will any model based on this approach return, in some round about way, to the starting point where anything can be authorized? In part, the problem can probably be dealt with by defining allowable transactions with sufficient precision. Provided the board of directors can be given enough guidance on this point, we believe its collective wisdom and integrity is the surest and safest method of selecting among transactions which may be authorized and those which may not.

Legislation in British Columbia and other places already recognizes some kinds of transactions where the involvement of a director's personal interest is viewed as being acceptable or as not raising a conflict of interest. These are:[19]

(a) remuneration for the position,

(b) contracts for the benefit of the society, and

(c) contracts for the benefit of the director as director.

The following discussion examines these exceptions to determine whether they are acceptable for directors of societies in British Columbia.[20]

(a) Remuneration for Position

Someone engaged at a certain salary to carry out certain duties is not placed in a conflict of interest by accepting the salary. The *Company Act*

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19. Ordinarily the legislation provides that for these transactions the director need not disclose, nor follow any special procedure to obtain the approval of the board of directors.

20. It is important to recognize that our concern is with exceptional transactions. A director should not be considered to be in a conflict of interest by participating in the regular activities of the society. Legislation setting out rules to deal with conflicts of interest should probably say so expressly.

recognizes the payment of remuneration as an exception to the conflicts rules:

> **144.** (4) A director of a company shall be deemed not to be interested or not to have been interested at any time in a proposed contract or transaction by reason only,
>
> ...
>
> (d) that the proposed contract or transaction relates to the remuneration of a director in his capacity as a director.

This provision is common in legislation dealing with conflicts of interest in different contexts.[21]

The section is concerned with remuneration for services rendered by a director in the capacity as a director. It does not address issues surrounding the payment of money to a person who is a director for services that are additional to those expected of a director. Payment for collateral services would be a matter for the general conflicts of interest rules.[22]

Directors of societies usually serve on a voluntary basis. This exception is unlikely to be relied upon very often but should still be part of revising legislation.

Legislation that provides that a director may accept a salary without being in a conflict of interest does not immunize from scrutiny how salaries (and other perquisites) are set. A number of recent situations have raised public concern about salary levels, trips financed from public funds, and various benefits and opportunities made available to such people as municipal councillors, parks board members, school trustees and so on.[23]

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21. *See, e.g.,* the *Members' Conflict of Interest Act*, s. 1, definition of "private interest."

22. In this respect, *see* Dona Campbell, "Case Comment: Remuneration of Directors," (1989) 9 Philanthrop. 36, which refers to recent cases addressing the issue.

23. *See, e.g.*, H. Munro, "Whistle blower on expenses gets colleagues steamed up," *Vancouver Sun,* April 7, 1993, B2 (use of charge cards by school trustees); "Save the Money" (ed.), *Vancouver Sun,* Mar. 18, 1993, A18 (Taxpayer funded cultural exchange trips to Zhuhai, China, for municipal councillors); P. Boisseau, "Squandermania: For angry taxpayers, political perks rhymes with insensitive jerks," *Vancouver Sun,* July 29, 1993, A4; K. Morgan, "Process problem at centre of fiasco," *Province*, June 9, 1993, A57 (B.C. Transit free family pass); H. Munro, "Government bean counters get taste of good life on ferry cruise," *Vancouver Sun,* May 5, 1993, A3; H. Munro, "B.C. taxpayers sending six people to 10-day Mediterranean meeting," *Vancouver Sun*, August 13, 1993, A1; H. Munro, "Councillors fear break-ins if travel itineraries published," *Vancouver Sun,* Apr. 21, 1993, B9; H. Munro, "Administrators hire lawyer in perks probe," *Vancouver Sun,* April 21, 1993, A3.

It may be that those charged with setting remuneration and other benefits should follow additional steps to reassure the public. To begin with, it should remain a conflict for people to set their own salaries.[24] Moreover, decisions about remuneration should possibly be given some publicity.[25] Decisions made in secret may not fully cater to public concerns nor serve public interests.[26]

Control might also be exerted by those who provide funding, such as government. Most funding bodies probably already inquire about arrangements made by various agencies to pay directors and staff when determining whether a grant should be made. An organization that makes unjustifiable decisions about how it remunerates its staff might well find its funding in jeopardy.

(b) Contracts for the Benefit of the Society

The *Company Act* and the *Society Act* set out three examples of contracts so clearly of benefit to a corporation that they should not be affected by the normal conflict of interest rules:

- a guarantee of a corporate obligation,
- a contract between the corporation and a related corporation, and
- security posted by the director.

(i) Guaranteeing a Corporate Obligation

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24. *E.g.*, the concerns raised about teachers sitting as school board trustees taking part in salary negotiations for other teachers: L. Still, "Curb stands on teachers on boards," *Vancouver Sun*, May 4, 1993, A1; *Wynja* v. *Halsey-Brandt*, (1993) 78 B.C.L.R. (2d) 72 (C.A.); The Cadbury Committee, *supra,* n. 10, recommended that corporate director salaries should be established by the recommendation of a remuneration committee consisting of wholly or mainly non-executive directors, and that all of a director's emoluments should be disclosed: para 3.3 and 2.1. Companies traded on the Toronto Stock Exchange will, as of Oct. 31, 1993, have to disclose compensation paid to top executives: "Show us your pay stubs," *Vancouver Sun,* Oct. 20, 1993, A14.

25. Some, however, resist this position: H. Munro, "Councillors fear break-ins...," *supra*, n. 21.

26. The example on public disclosure set by the provincial government is largely a good one. *The Public Accounts*, published annually, lists the amounts paid by government in the form of grants, salaries and benefits. Apparently, salaries for high level appointments to government-related agencies are not given the same publicity, a factor which has attracted some criticism: *Report of the Auditor-General* (March 1993) 65-75; J. Hunter & K. Baldrey, "Auditor flays government over salary-reporting system," *Vancouver Sun,* April 30, 1993; K. Bolan, "New HLRA boss hopes to restore confidence," *Vancouver Sun,* Oct. 20, 1993, B1.

Few lenders are prepared to advance credit to a small corporation solely on the strength of its assets or ability to pay. Lenders will usually want a co-signer or guarantor. The *Company Act* recognizes this as a fact of business life:

> **144.** (4) A director of a company shall be deemed not to be interested or not to have been interested at any time in a proposed contract or transaction by reason only,
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> (a) where the proposed contract or transaction relates to a loan to the company, that he or a specified corporation or specified firm in which he has an interest has guaranteed or joined in guaranteeing the repayment of the loan or any part of the loan;...

Directors of a society should also be free to support a society's activities in this way.[27]

(ii) Contracts Between the Corporation and a Related Corporation

Companies associated with each other often do business together. These companies, typically, have been started up by the same people and have similar patterns of shareholding as well as similar representation on the boards of directors.[28] Where business is conducted between two or more related companies, the fact that they share directors is not viewed as prejudicing the contractual arrangements between them. The *Company Act* provides:

> **144.** (4) A director of a company shall be deemed not to be interested or not to have been interested at any time in a proposed contract or transaction by reason only,
>
> ...
>
> (b) where the proposed contract or transaction has been or will be made with or for the benefit of an affiliated corporation, that he is a director or officer of that corporation;...

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27. Of course, the director would still be considered to have a personal interest in decisions relating to the guaranteed loan sufficient to bar the director from taking part in board decisions about the loan.

28. *See, e.g.,* E. Blake Bromley, "Parallel Foundations and Crown Foundations," (1993) 11 Philanthrop. 37; and Cynthia Orr, "CICA Exposure Draft: Non-Profit Organizations," (1992) 11 Philanthrop. 35, 38, (the second article reviews rules suggested to deal with accounting questions that arise as a result of relationships an organization might have with, *e.g.*, a foundation the organization establishes, or national, provincial and local chapters or agencies.)

The *Company Act* devotes a number of sections to defining what is meant by an affiliated corporation.[29] Societies can set up subsidiaries,[30] so these kinds of situations may arise equally with societies.[31] Is there any reason why the *Company Act* approach should not be followed in the *Society Act*?

Conflicts of interest rules are based on the idea that where an insider reaps a personal advantage, a third party whose interests are involved may often lose out. In the situations outlined above, however, essentially the corporation is dealing with itself. Conflicts of interest rules are not concerned with protecting a person from being harmed by that person's self-dealing.

At a minimum, legislation should clarify that no conflict of interest arises simply because a director of a society is also a director of the society's subsidiary and a transaction is contemplated between the two societies. In our view, having regard to the fact that societies operate on a non-profit basis, it would also be safe to go a step further and provide in legislation that no transaction between two societies, even ones that are not formally related, should be considered to be affected by a conflict of interest simply because they share the same director.

We have more difficulty with the situation that arises when people involved in a society set up a company to handle various matters related to the society's activities. Directors of a weightlifting club, for example, might conclude that some services and products can be provided more

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29. *See* Section G.2 "Relatives and Associates," below, which discusses family and business relationships.

30. S. 34. A society may also set up branch societies: *see* ss. 18-9. Or it may join other societies or associations: s. 4(2)(g).

31. The *Society Act* defines "subsidiary" as having the same meaning as in the *Company Act*. The *Company Act* provides:

> **1.** (3) For the purposes of this Act, a corporation is a subsidiary of another corporation where
> (a) it is controlled by
> (i) that other corporation;
> (ii) that other corporation and one or more corporations, each of which is controlled by that other corporation; or
> (iii) 2 or more corporations, each of which is controlled by that other corporation; or
> (b) it is a subsidiary of a subsidiary of that other corporation.

The *Company Act* also defines what is meant by "control" (subs. 1(4)), a definition which requires setting out a number of further defined terms.

efficiently to its members through a loosely associated company than by dealing with a number of different commercial enterprises. As added bonuses, the arrangement will save members money at the same time it provides the club with additional funds.

Allowing a society to transact business with a related company (in the sense that it has directors in common), however, may invite disaster.[32] It is no different from a transaction between a society and one of its directors and should be subject to the same principles.

(iii) Requiring A Director to Post Security

A person who occupies a position of trust will often be under an obligation to provide some form of security to ensure that duties are performed faithfully. A court may require a deceased's personal representative, for example, to post security before the personal representative is allowed to administer the estate. The *Society Act* provides for a similar arrangement with a director:

> **30.** (1) A society may require a director or officer to give the security it considers sufficient for the faithful discharge of his duties.

Conflict of interest rules should not prohibit a transaction so clearly of benefit to the society.

Probably because of the difficulty of attracting volunteers, societies seldom require directors to post security. It is more common to find transactions between a society and a director with entirely the opposite object: to protect the director from personal liability for breaching duties owed the society and others. Some of these arrangements are discussed in the next section.

(c) Contracts for the Benefit of a Director as Director

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32. *See, e.g.,* G. Shaw, "Amateur swimming organization's money sinks in risky venture," *Vancouver Sun,* June 19, 1993, D7, (recounting events by which an organization promoting amateur swimming lost $123,000 by dealing with two companies it set up to provide "sport specific products and services to the amateur sport community and helping these groups access the corporate sector.") The problem arises from mixing the two models – the guardian model and the business model – for dealing with conflicts of interest. J. Jacobs, *Systems of Survival* (1992) discusses problems that arise when inconsistent ethical systems are mixed to produce a hybrid. A transaction between related *companies* is acceptable, notwithstanding the many risks that arise from such a relationship – evidenced in many cases over the years – because it is an efficient commercial arrangement, and each company is subject to the same conflicts of interest rules. Allowing a society to conduct some of its business through a related company, however, would permit it to evade the protective strictures of the conflicts of interest rules we think should govern its activities.

A director of a society may attract personal liability in any number of ways. Director's insurance is available to offset some of these risks. Some corporations pay for the insurance. Both the *Company Act*[33] and the *Society Act* endorse these transactions. The *Society Act* provides:[34]

> **30.** (5) A society may purchase and maintain insurance for the benefit of a director against personal liability incurred by him as a director and sections 27, 28 and 29 do not apply in respect of the purchase or maintenance of that insurance.

A corporation may also reimburse a director for expenses incurred in litigation, provided the court approves. The *Company Act* provisions are substantially the same as these from the *Society Act*:[35]

> **30.** (2) A society may, with the approval of the court, indemnify a director or former director of the society or a director or former director of a subsidiary of the society, and his heirs and personal representatives, against all costs, charges and expenses, including an amount paid to settle an action or satisfy a judgment, actually and reasonably incurred by him, in a civil, criminal or administrative action or proceeding to which he is made a party by reason of being or having been a director, including an action brought by the society or subsidiary, if
>
> (a) he acted honestly and in good faith with a view to the best interests of the society or subsidiary of which he is or was a director; and
>
> (b) in the case of a criminal or administrative action or proceeding, he had reasonable grounds for believing that his conduct was lawful.
>
> (3) The court may, on application of a society, a director or former director of the society, or a director or former director of a subsidiary of the society, make an order approving an indemnity under this section, and the court may make any further order it considers appropriate.

Notice that the indemnity is not available if the director acts dishonestly or without reasonable grounds.

These kinds of arrangements ostensibly benefit directors, but the society also derives an advantage. These arrangements operate as

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33. Ss. 144(4)(c) and 152(4).

34. This is a discretionary matter and may prove to be more controversial for societies than corporations, as are similar questions that have arisen in relation to holders of (elected and non-elected) public offices: *e.g.*, (1) the reaction to the request for reimbursement of legal fees by two school board trustees who challenged a ruling that because they were teachers they were in a conflict of interest: J. Lamb, *Vancouver Sun*, May 10, 1993, A3; (2) the government's agreement to pay the legal costs of the province's Conflict of Interest Commissioner in a defamation suit he brought against a broadcaster: V. Palmer, "Poking the Premier...," *Vancouver Sun*, May 18, 1993, A14; (3) the payment of the legal fees of 4 federal members of parliament charged with criminal offences: *Vancouver Sun*, Aug. 12, 1993, A6.

35. The *Company Act* provisions are in s. 152.

incentives for directors to serve. Without them, a society might be unable to attract qualified people to act on its behalf.

(d) Summary

Some transactions involving a director so clearly benefit the corporation that legislation allows them to take place. In our tentative view, it is appropriate to carry this policy forward in new legislation.

3. TRANSACTIONS THAT MAY BE AUTHORIZED

(a) Overview

As the foregoing discussion suggests, not many transactions are, or for that matter should be, allowable by definition. Other kinds of transactions may be unobjectionable in particular circumstances. Because they depend upon the circumstances, however, decisions must be made on a case-by-case basis about whether to authorise them. To what extent is it possible to provide guidelines for deciding whether to authorise particular transactions?

The law currently allows fair and reasonable transactions to be authorized by the board of directors. As we see it, the requirement that a transaction be fair and reasonable is only one of three tests that should be satisfied before a decision to enter into it with a director may be considered acceptable. An equally important factor is that the transaction must clearly meet community expectations about ethical conduct.[36]

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36. Clear ground rules probably cannot be set up for identifying "community expectations." We have considered a number of different methods of describing the concept, both for the purposes of the text, and in the draft legislation in Appendix A. Some alternatives:

1. the transaction must not harm a public interest.
2. the transaction must fulfill the trust reposed by the public in directors of a society administering public funds.
3. the transaction must be fair and reasonable to the public.

Our tentative preference is for the formulation set out in the text and it is incorporated in the draft legislation in Appendix A, but views are invited on the other options, as well as suggestions for other formulations that might be more precise. Even if clear ground rules are unavailable, it should not be very difficult for a board to abide by this condition. In most cases anticipating how people would view particular transactions, should they become matters of public knowledge, will be a straightforward exercise. Transactions where public funds are funnelled to friends and family, *e.g.*, must certainly be suspect. Applying funds in partisan ways or for transactions not clearly within the objects of the society must be regarded as equally suspicious. A board of directors should not find it difficult to anticipate the public perceptions about particular transactions.

Even before these questions are raised, however, a reason must be identified for letting a particular transaction proceed. There must be some justification for allowing an exception to the prohibition rule.

We think the kinds of justifications for approving a transaction fall into three categories:

- transactions involving trivial conflicts;
- transactions where the economic benefit to the society outweighs the need to eliminate the conflict of interest;
- transactions where a conflict, by reasons of necessity, must be accommodated.

This section describes these categories of exceptions and how they should apply to determine whether the something extra is present which provides a reason for tolerating a conflict of interest. As will become clear in the following discussion, it is our view that acceptable departures from the prohibition model are very few indeed.

(b) The Three Categories

(i) Trivial Conflicts

The law is not generally concerned with trifles, although some trivial-seeming things have a disproportionate significance for symbolic reasons. Few people are likely to be concerned if a director enters into a transaction with a society that involves little or no money,[37] even fewer where the personal interest of the director is tenuous or remote. For example, a transaction not with the director but the director's cousin is unlikely to raise serious concerns about a conflict of interest. The more distant the family relationship, the less likely there is to be any perception of a conflict.

Another example would be where a director owns a few shares in a publicly traded company that has issued millions of shares. The director's investment should not interfere with a proposed transaction between the society and the company. Any portion of the profit from the transaction that the director's share holdings will earn will be insignificant.

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37. Barring transactions with a symbolic dimension or which, even if not of significant value, are sought after for other reasons. Suppose the board of directors must nominate a representative of the society to receive a visiting member of the monarchy, and a small amount of money is involved for travel arrangements and hotel accommodation. In the circumstances, the selection of a director over other members of the society may represent a significant breach of duties owed.

It is our tentative view that the board of directors should be able to authorize transactions where either the conflict of interest is slight or, even where it is more serious, very little turns on it. As a practical matter, transactions falling into this category may very well be ignored entirely. No one would think it necessary to convene a board meeting to decide whether a society that occupies a small store front office should engage a director's brother-in-law to vacuum the premises.[38] There will be a natural balance struck between the importance of the matter and the cost and inconvenience of invoking the formal procedure for authorizing the transaction.

Sometimes, to avoid any potential for public embarrassment or to ensure that the propriety of a transaction is not later questioned, a director will want to have the transaction authorized in advance. In other cases, the society will insist upon a formal process of scrutiny to reassure members of the society as well as the public that everything is in order. It may be expected that as the two factors – the proximity of interest and the monetary value of the transaction – increase, the more natural it will be to bring the issue before the board of directors and the more likely it will be that the transaction is one that ought not to be authorized.[39]

For some transactions falling into this category, the board of directors may be able to set down guidelines as part of formal standards of conduct. A good example is when directors may accept gifts from third parties. The exchange of gifts and hospitality is expected in most forms of social interaction as well as being an accepted part of business culture. A director will encounter situations where it is not only socially desirable, but necessary, to deliver or accept a token of appreciation in the form of a gift or hospitality. Some government agencies,[40] for

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38. In contrast, where the society provides medical services in a number of buildings, *e.g.*, the janitorial contract will represent a large financial transaction that raises significant conflicts of interest issues.

39. One of a series of transactions, viewed in isolation, may appear to be trivial but, in aggregate, represent substantial sums of money. For this reason, transactions must be examined in context.

40. For guidelines on the acceptance of gifts, *see* Appendix B "Model Standards of Conduct." Concerns about remuneration and other benefits (*see, supra,* F.2(a) "Remuneration for Position") are increased when benefits are conferred or financed (in whole or in part) by third parties, making a gift seem to border on a bribe. Concern has been raised about corporate gifts to (1) government finance officers (*supra,* n. 21 "Government bean counters..."); (2) hospitals (W. Boei, "Maternity Hospitals: Free baby formula offer weighed," *Vancouver Sun,* June 30, 1993, B6); (3) teachers (H. Munro, "Weekend trade show for top educators draws just 1 publisher," *Vancouver Sun,* May 10, 1993, A3; "Conflict of Interest – A School Primer," *Vancouver Sun,* May 10, 1993, A10). While inappropriate if given directly to a director, the gift may be acceptable if filtered through the organization instead, although even here, concerns arise about the propriety

example, have set dollar figures to ensure that these exchanges remain token or nominal.

(ii) Economic Benefit to the Society

The second category of reasons again turns on financial considerations. It embraces situations where the monetary value involved exceeds the threshold defined by the first category. Any legitimate transaction for an amount so significantly less than the value anyone else would charge, so as to in substance amount to a gift, should be capable of being authorized by the board of directors. In these cases, the society should be able to make a token payment, recognize the director's contribution with a symbolic honorarium, or at least make sure that the director is indemnified for expenses incurred on behalf of the society.

Example: The director supplies the society with needed equipment or services for a fraction of true value.

Example: The society produces a play which it wishes to perform in communities throughout the province. A moving van will cost $5000 but Director A has a suitable vehicle which needs repairs. Director A lets the society use the van on the basis that the society will make it roadworthy (at an estimated cost of $1500).

In our view, there are two alternative tests for determining whether a transaction falls into this category and may be authorized by the board of directors:

(1) Taking the transaction as a whole, is it a gift, or does it in substance amount to a gift, to the society?[41]

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of the transaction: *e.g.*, "Maternity Hospitals..." *supra*; M. Farrow, "Track contract queried," *Vancouver Sun,* July 21, 1993, B3 (the Victoria Commonwealth Games Society solicited corporate donations and sponsorships from companies bidding on contracts with the Society). In some cases, the gift is disguised. The organization may sell a service, such as a trade-show booth, at an exaggerated price: "Weekend trade show...", *supra*. If acceptable as a gift, there is no reason why it should not be acceptable characterized as a business transaction. If unacceptable as a gift, however, disguising its nature cannot legitimize the transaction.

41. Even if this condition is satisfied, a society may find the gift to be unacceptable for other reasons. The motive for the gift may present ethical problems for the society. Suppose a society whose purpose is to encourage breast feeding of new born children receives a generous gift of formula from a national manufacturer who hopes the society will also provide new mothers with information about the advantages of alternative prepared baby foods. The obvious conflict with the society's stated aims may make the gift unacceptable.

(2) Even if not effectively a gift, are the benefits to the society manifestly so substantial that no other decision makes economic sense?

These conditions will only be satisfied in very rare cases. They have been framed in very strict terms. Condition (2), for example, would not be satisfied by a director offering a 10% or 20% discount on the best price the society can get elsewhere. Similarly, contracts where a large portion of the expense is derived from extras, or measured on a "cost plus" basis, would ordinarily be unacceptable by operation of these conditions.

(iii) Necessity

"Necessity," the last of the categories, recognizes that sometimes there will be competing policies, and these policies may possibly be of more importance than the policy to avoid a conflict of interest. When competing policies cannot be reconciled, and one must give way to the other, the board must be able to weigh the relative advantages and disadvantages of available options. This conflict might arise in one of three ways:

- no one else is capable of carrying out the transaction,
- others may be capable of carrying out the transaction, but no one else is willing to do so (except, possibly, at a substantial premium), or
- it is more important to the society for the director to participate in the transaction than to avoid the conflict of interest.[42]

Some examples will help explain these ideas.

- No one else is capable of carrying out the transaction:

Example: the electrical wiring in the society's premises is defective and shorts out one evening. Director A is an electrician. The wiring presents a fire hazard and must be dealt with immediately. There is no time to send for another electrician.

In the example, others are capable of performing the work, but no one can do so in the time frame called for by circumstances.

- No one else is willing to carry out the transaction:

Example: The society provides general legal information and runs legal education courses. It also develops a radio call-in program to provide advice about legal problems. The program is popular and the radio station is successful in selling advertising time in connection with it, paying a portion of the proceeds to the society.

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42. *See, e.g.,* s. 7 of the draft legislation in Appendix A.

Director B owns the radio station. Other radio stations were not interested in developing, or carrying, the program. Other options, such as a community cable television show or a newspaper column are available, but will not provide as large an audience.

- The director's participation is important to the society:

This idea is probably best demonstrated by examples involving government agencies. Some government agencies are required to regulate industries, or administer programs which will affect an industry or profession. In order to possess the expertise necessary to carry out its functions these boards usually have directors who are involved in the particular endeavour in question. Marketing boards are a good example, as is the Legal Services Society, which administers legal aid in the province. In cases where the source of a director's conflict arises from participation in a class affected by the organization's activities, it is usual to find agreement that the conflict must be tolerated.[43] Nothing is gained

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43. *E.g.*, Commissioner Matkin established an advisory committee to assist in the inquiry into the activities of the Vancouver Stock Exchange. Most of its members, naturally enough, are involved in that sector: D. Baines, "Matkin inquiry makes right move with VSE post mortems," *Vancouver Sun,* June 18, 1993, C1. Even so, striking appropriate representation (balancing impartiality with expertise) is usually difficult and controversial. The Racing Commission, seeking industry representation, added to its board people involved in horse racing, a decision which proved to be controversial. The Worker's Compensation Board, *e.g.*, consists of appointees from different sectors and under governing legislation, each is expected to represent the views of the sector that made the appointment, *i.e.,* to act in biased ways. Bylaw No. 2 (Oct. 7, 1991) provides that "[t]he Board of Governors is not a typical "corporate board of directors." Rather, the representative governors' primary duty and responsibility is to represent the interests of their constituencies." The board of the Legal Services Society is composed of an equal number of lawyers and non-lawyers and, on some issues, the vote splits along those lines, resulting in an impasse: *see, e.g.,* Minutes of the Vancouver Criminal Justice Section, Canadian Bar Association, March 17, 1993. Many school boards have trustees who are teachers, a perspective which would be invaluable for many board decisions, but not all (*see, e.g.,* L. Still, "Curb stands on teachers on boards," *Vancouver Sun,* May 4, 1993, A1. *Wynja, supra,* n. 22. Peer review arrangements have also proved to be controversial, because of a natural suspicion that people protect their own, however their class is defined, along gender, family, ethnic, religious, national, social, educational, career or other lines. *See, e.g.,* the concerns raised about (1) peer review of doctors for competence (R. Wigod, "Doctor disciplined for spurning peer review," *Vancouver Sun,* July 14, 1993, B7); (2) peer review of doctors for sexual misconduct complaints (Wigod, *ibid.*; "Physician, heal thyself," *Vancouver Sun,* June 4, 1993, A16; J. Hunter, N. Hall, "Victoria promises doctors greater power," *Vancouver Sun,* June 4, 1993, B7; "Physicians can't heal themselves," *Vancouver Sun,* July 20, 1993, A12); K. Bolan, "Withholding of doctors' names criticized by victim," *Vancouver Sun,* August 18, 1993, B2; L. Still, "Take a new look at doctor's case, B.C. Supreme Court tells college," *Vancouver Sun,* August 18, 1993, B1; K.

by requiring the director to resign. In fact, much is lost, because the board then loses the expertise it requires to make an appropriate decision. As a matter of necessity, the conflict must be accommodated, or dealt with in different ways.[44] It is important, however, to ensure that expedience is not mistaken for necessity.[45]

In these cases, while the conflict must be accepted, there are techniques for ensuring that appropriate decisions are made. Sometimes it is sufficient to ensure that the decision is given publicity, so there is public scrutiny. In other cases, the director might observe procedures to limit involvement in particular respects. Where, for example, a director is an employee of a television network, and the society wishes to sell the broadcasting rights for an event it is holding, the director may be able to take part in board decisions by limiting activity in the commercial venture so that there is no involvement in the network's bid for the broadcasting rights. The various techniques available for controlling, limiting or

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Bolan, "Women turn to courts in battles with doctors," *Vancouver Sun,* August 17, 1993, A1, B10-11; (3) police disciplinary decisions (B.C. Civil Liberties Association, (1993) 27 The Democratic Commitment 4; K. Bolan, "Civilian watchdog for police urged," *Vancouver Sun,* May 10, 1993, A3; N. Hall, "Independent probes of police urged," *Vancouver Sun,* May 18, 1993, A1); (4) media assessment of media, "Media should report on themselves, meeting told," *Vancouver Sun,* May 10, 1993, A5; (5) peer review of lawyers: the B.C. Law Society received 1400 complaints about its 7600 members in 1992, most of which were dealt with informally ("Law society fines member $5000," *Vancouver Sun,* August 19, 1993, B4.)

An absence of representation, however, may be equally questionable. *See, e.g.,* concerns raised about the appointments to committees considering employment standards: K. Bolan, "Lack of people of color on panel upsets groups," *Vancouver Sun,* May 20, 1993, B5.

A survey concerning the handling of complaints against lawyers conducted in New South Wales, Australia, in Nov. 1992 (See N.S.W. Law Reform Commission, Report 70, *Scrutiny of the Legal Profession – Complaints Against Lawyers* (1993) 33) found that the public was generally unaware that complaints were handled largely by peer review and most (80 per cent of those surveyed) wanted regulation by a public authority independent of the legal profession. 80 per cent also thought this new body should consist of equal numbers of lawyers and non-lawyers.

44. K. Baldry, "Conflict policy means ministers fleeing meetings," *Vancouver Sun,* May 29, 1993, B10.

45. *E.g.*, the amateur swimming organization that set up a company to provide services and solicit corporate sponsorships (*supra*, n. 32) engaged in an expedient device, possibly one with some profit potential. But convenience and profit are not factors that would support a finding that the arrangement was one of necessity, something which would only arise if the services, product or sponsorship could be obtained in no other way.

isolating a conflict – public tender,[46] Chinese walls,[47] cones of silence,[48]

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46. If bids are invited from the general public, there is some guarantee the society will receive the best price – even so, there may be a perception of a conflict of interest. An insider may have access to information which helped fine-tune the bid: an issue addressed in *Martselos Services Limited* v. *Arctic College,* (1992) 5 B.L.R. (2d) 204 (N.T.S.C.).

47. "Chinese walls" is a term coined in the financial district in London ("The City"), prompted by the formidable walls typically surrounding ancient Chinese cities: "Chinese Walls," (1993) 137 Sol. J. 280. The term refers to the establishment of information exchange barriers within an office. Rules and procedures that result in partitioning an office allow different parts of the office to work on potentially conflicting matters as if they were separate entities. The practice is recognized by the (U.K.) *Financial Services Act, 1986*: *see, e.g.,* F. Benson, *Conflict of Interest Tools of the Trade: Chinese Walls, Cones of Silence and Glass Houses* (1991) 5; R. Tomasic, "Chinese Walls, Legal Principles and Commercial Reality in Multi-Service Professional Firms," (1991) 14 U.N.S.W.L.J. 46; J.S. Ziegel, "Bankers' Fiduciary Obligations and Chinese Walls: A Further Comment on *Standard Investments Ltd.* v. *Canadian Imperial Bank of Commerce,*" (1986-87) 12 Can. Bus. L.J. 211; Law Commission, *Fiduciary Duties and Regulatory Rules: A Summary of a Consultation Paper* (Consultation Paper No. 124, 1992) 12. Some methods of installing Chinese walls:

- physically separating different departments,
- educating employees about the importance of maintaining confidentiality,
- carefully defining when and how the wall may be crossed (and maintaining records of these events),
- monitoring the wall's effectiveness, and
- imposing penalties for improperly breaching the wall.

See further the guidelines proposed in the *Report of the Canadian Bar Association Task Force on Conflicts of Interest* (Feb. 1993).

48. "Cones of silence" resemble chinese walls. Rather than separating departments, however, a cone of silence establishes an informal information barrier around one individual or subject.

glass walls,[49] and dilution[50] – all have roles to play. The focus in these cases must be on controlling or minimizing the conflict.[51]

(c) Procedure

Currently, a director who has an interest in a transaction is obliged to disclose it and may not take part in the portion of the board meeting that considers whether to enter the transaction. The director may not vote on the matter nor be counted for the purposes of determining whether a quorum is present.

A simple majority of the board can now authorize a transaction coloured by a conflict of interest, but legislation could easily set a higher standard, such as a special majority (75 per cent of the directors). Should this be the standard for authorizing a transaction affected by a conflict of interest?

A special majority requirement would reinforce the exceptional nature of any departure from the prohibition model for dealing with conflicts of interest. On the other hand, the requirement may be superfluous, if the grounds for approval are as narrowly defined as we have suggested above. A special majority requirement may also prove to be largely unworkable. Such a requirement would effectively place a power of veto in the hands of a disproportionately small number, although possibly too much should not be made of this concern. Experience suggests that decisions made by the boards of small societies are frequently unanimous.

We welcome views on this issue but on balance prefer the higher standard. The unease of even one board member about the transaction is probably enough evidence that it should not be condoned.

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49. "Glass walls" refers to activity conducted in an overtly public fashion. It is an approach which is particularly effective if the sole concern is the *appearance* of a conflict of interest.

50. "Dilution" is a term we have coined to refer to adding additional directors to the board, or adopting various procedures to offset any danger that a decision might be affected by a conflict of interest. Other forms of dilution would include the board permitting a director to take part in board decisions, but arranging to test the director's advice by retaining an expert or referee, or consulting a specially established advisory panel, or seeking the advice of its membership. The Racing Commission, *e.g.*, when it added industry representatives to its board also created additional positions to ensure that board representation remained balanced.

51. Further examples are set out in annotations to the draft legislation. *See* Appendix A, particularly subs. 7(2), dealing with relationships with a "special group."

(d) Summary

Our tentative view is that it is necessary to change the principles upon which a board of directors may decide to authorize a transaction in which a director has an interest. Unless the reason for the transaction falls within an identified category, the society should not enter into the transaction. Even if one of these principles applies, however, the board may not necessarily authorize the transaction. If the board does consent, it may also require additional steps to be taken to minimize the conflict. This procedure best protects the interests of a society and the public. No transaction with a director which serves purely the director's interests will be allowed to proceed.

These are the steps we suggest should be followed to determine whether a transaction can be authorized:

(a) The reason for allowing the transaction must fall into one of these categories:

(i) the nature of the conflict, or the transaction itself, is trivial,

(ii) the transaction is an unconditional gift or represents, in substance, a gift from the director to the society,

(iii) the transaction, while not effectively a gift, represents benefits to the society manifestly so substantial that no other decision makes economic sense, or

(iv) it is more important to the society for the director to participate in the transaction than to avoid the conflict of interest.[52]

(b) If there is a satisfactory reason for allowing the transaction, the board of directors may do so provided

(i) the transaction is a fair and reasonable one from the society's perspective, and

(ii) the transaction meets community expectations about fair dealing.

Most proposed transactions where the personal interests of a director are involved should not be approved. A director does not have a right to deal with the society. These suggested changes to the law are based on the right of the society not to be barred from entering into a transaction which, in the circum-stances, is in its best interests. When all

52. For a detailed discussion of the concept dealt with in this paragraph, refer to the text in Chapter V.F.3.(b)(iii) "Necessity." *See also* s. 7 of the draft legislation in Appendix A.

else is said, this is really the only reason for approving any transaction raising a conflict of interest.

Legislation incorporating this revised approach will signal a decided change in the way societies and their directors operate and think. People take part in a society because of sympathy with the society's objects as well as for business reasons. These motivations are shared by those acting on behalf of the society. Balanced representation on the board of directors is usually seen as desirable for two reasons: (1) members of particular professions and disciplines may be able to help with fund raising (a doctor for the medical community, a lawyer for the bar, a teacher for educators and so on); and (2) the society may get a break on the cost of particular services the director can render.

Most arrangements between a society and a director permitted under the new principles will be entirely altruistic. True business relationships will only rarely be acceptable, and then only when they are clearly for the benefit of the society.

4. NON-AUTHORIZABLE TRANSACTIONS?

Having listed transactions which, by their very nature, may proceed without any formal authorisation, and provided guidance on how to determine whether other kinds of transactions may be authorised, it is useful to consider whether some kinds of transactions are, by their very nature, of a kind that should not be capable of authorization. The examples that spring to mind usually involve civil wrongs or criminal offenses and, as such, are not legitimate transactions in any event. There is no need to set out a special conflicts of interest rule to provide that a board of directors may not, for example, authorize a transaction with a director that involves tax evasion, destruction of public property, or the acceptance of a bribe.

But there are transactions, although not illegal, which it is pretty clear should not be authorizable. These seem to fall within a definable category: transactions where a third party is engaged to scrutinize the affairs of the society. Suppose, for example, that there is a need to audit a society's books. The aim of an audit is to ensure that accounts are properly kept. An audit must be conducted by an impartial third party. Authorizing a transaction by an accounting firm in which a director is a principal or employee would be entirely inappropriate.

Is there a need for a specific prohibition, or can a board of directors deal with the issue by applying the principles identified before? Formally adopting a rule about these kinds of transactions would probably be useful, but we welcome comment on the question.

G. Application (Part 2)

1. WHICH PEOPLE SHOULD BE SUBJECT

TO THE CONFLICTS RULES?

An earlier part of this discussion dealt with whether the conflicts rules under review should apply only to societies, or whether they might have a wider scope. This section considers a related question of application. Which people associated with a society should be subject to conflicts of interest rules?

The *Society Act* only addresses the position of directors, but conflicts issues are not so neatly compartmentalized. Officers, members, staff, volunteers and others involved with a society will find personal interests competing with those of the society and of the public. To what extent can legislation that addresses one genus of conflicts, but fails to consider any others, be regarded as satisfactory?

The rules might be revised to deal with all people who are involved with a society and who may be considered, at least from time-to-time, as acting on behalf of the society. It may be that the rules discussed above would work well for most of these cases.[53]

The two main problems with extending the ambit of the rules is that (1) each further step carries with it potential disincentives to participate in the society's activities,[54] and (2) restrictions on what the society can do often prevent a society from doing some things that are not objectionable at all.

The current approach is based on an important aspect of the role performed by a board of directors with respect to others associated with the society. All are expected to behave ethically but, because the directors are the conscience and directing mind of the enterprise, it is the board that is responsible for overseeing the behaviour of others. Because no one is well placed to oversee the behaviour of the board itself, however, its members must abide by stricter formal rules than apply to the rest. Under our proposals, new legislation would apply to directors. More flexible conduct guidelines would apply to other people involved with societies.

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53. The board of directors might be given more latitude to endorse transactions coloured by the conflicting interests of someone other than a director to take into account the fact that the kinds of conflicts that will arise will often be much less serious than those involving directors.

54. *E.g.*, experience has shown that increasing the potential liability of directors is a disincentive to service: *supra,* Ch.V.F.1(c) "Disincentives to Service." Similarly, the risk of exposure to liability for accidentally violating a conflict of interest rule might also limit those willing to participate in a society's activities.

It is an imperfect model, but it is a realistic one. In the final analysis, the only reliable assurance against wrongdoing or unscrupulous behaviour is the personal integrity of those placed in positions of trust.[55]

2. RELATIVES AND ASSOCIATES (WHO IS AN INSIDER?)

An important area of concern involves relationships between an insider of the society and others outside the society. A director prohibited from dealing with a society directly should not be able to do so indirectly through a surrogate (such as a corporation operated by the director).

What people have relationships so close that they should be subject to the same rules that apply to directors? An employer? An employee? A partner? A creditor? A debtor? Many commercial relationships with a director may raise questions about conflicts of interest.[56]

Family relationships also have this potential. Questions may arise if the transaction involves not the director but the director's spouse or child or a financial enterprise in which a family member has a significant holding or interest.

The following list is compiled from our survey of government agencies.[57] It suggests the kinds of relationships where there is some suspicion that an identity of interest may exist with a director. For convenience, the list is divided into two groups: one for family relationships, the other for business relationships.

(a) Family Relationships

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55. An earlier part of this Consultation Paper considered the role of conduct guidelines. Particular societies may wish to set out detailed conflicts rules to apply to members and staff. They can do this through conduct guidelines. As a general rule, it is likely that the larger the society, the more rigid its conflicts structure should be. For one reason, the larger the society, the less able directors are to oversee the actions of others. For another, a large society will usually administer significant amounts of money and will wish to reduce potential for publicly embarrassing situations by limiting the scope members and others have for personally profiting from taking part in the society. Moreover, the larger the society the more likely it is to have a formal corporate structure delineating the hierarchy of particular offices and their authority and responsibilities. Such a formal structure lends itself to more formal conflicts of interest rules.

56. *See, e.g., Harbord Insurance Services Limited* v. *I.C.B.C.,* [1993] B.C.D. Civ. 1930-01 (S.C.), which concerned an identity of interest between two companies sharing the same director; *Levy* v. *Geary,* (1993) 38 A.C.W.S. (3rd) 204 (Ont. Gen Div.) involved a trustee of a bankrupt company who was related to a director of the company.

57. *See* Appendix E.

- spouse
- common law spouse
- parent
- grandparent
- grandchild
- brother
- sister
- brother-in-law
- sister-in-law
- son-in-law
- daughter-in-law
- child, including an adopted child (sometimes restricted to a minor or dependent child)
- any spouse or common law spouse of a listed person
- any relation (of the director or the director's spouse) or spouse of such a relation (sometimes restricted to those who reside with the director).

(b) Business Relationships

- a corporation of which the director (or the director's associate) beneficially owns, directly or indirectly, shares carrying more than [10] per cent of the voting rights attached to the issued shares of the corporation
- a partner
- a trust or estate in which the director has a substantial beneficial interest or for which the director serves as a trustee or adviser
- a joint venture (or those involved in the joint venture)
- a colleague or member of a research team or department
- an employer
- a business associate of a person listed in the Family Relationship Group or the Business Relationship Group
- an enterprise in which the director has equity
- an enterprise which owes the director money (whether or not secured)
- an enterprise to which the director owes money
- an applicant, co-applicant or co-signor

The two groups are extensive, but not necessarily comprehensive. Even given the attention to detail, there are ambiguities. The test for a relation who resides with a director is clear enough but does a family member reside with the director by occupying a self-contained basement suite? by living somewhere on the director's property? or by renting an apartment in a building owned by the director?[58] Should the list include

58. *E.g.*, in British Columbia, a person injured in a motor vehicle accident can recover the costs of home nursing services on a "no-fault" basis, provided the services are not rendered by a family member. In *Cherry (Guardian ad litem of)* v. *Borsman,* (1992) 12 C.C.L.T. (2d) 137, 70 B.C.L.R. (2d) 173 (C.A.), the mother of the injured person provided the nursing services. It was held that she was not a "family member." Because she lived 3

a director's step children or nieces and nephews who reside with the director? Some friendships are as close as any family relationship. Should these be included? What about businesses run by, or which employ, people who are in a listed family relationship to a director?

The difficulty in defining relationships is well demonstrated by provisions of the *Company Act* which deal with the concept of an "affiliated corporation." To define an "affiliated corporation", the *Company Act* must also define, in the course of 5 subsections, a number of further concepts including a "subsidiary," and corporate "control."[59] Defining relationships is difficult. This is only partly because of the scope for diversity and variation the law makes available in corporate structures. A corporation may be little more than the alter ego of a natural person. An interlocking series of companies may really consist of people dealing with themselves.[60]

The law has long recognized that people in close family and business relationships deal with themselves in quite a different fashion from people who are strangers negotiating at arms-length. This fact suggests a need for special rules to deal with extended relationships. But here difficulties are quickly encountered. Legislation attempting to define relationships from which may arise a kind of vicarious conflict of interest is necessarily technical, as the *Company Act* attempt demonstrates. However comprehensive its drafters try to make it, no list can cover off every eventuality. A director intent upon evading the rules can simply

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miles away, the family relationship did not exclude the claim.

59. *See* subs. 1(3)-(7).

60. On the other hand, a close business relationship may not raise a conflict of interest. In *Re Manville Canada Inc. and Ladner Downs,* (1993) 76 B.C.L.R. (2d) 273, 100 D.L.R. (4th) 321 (C.A.) the court concluded that an international partnership agreement between a B.C. law firm (that represented a number of plaintiffs in the action) with a law firm outside the province (that represented a defendant) did not raise a conflict of interest. The court had regard to the structure of the partnership which emphasized the independence of the partner law firms. *See further Carleton Condominium Corp. 347* v. *Trendsetter Developments,* (1992) 25 R.P.R. (2d) 157 (Ont. C.A.). Ontario legislation prohibits a condominium developer from retaining a majority interest in the development. In this case, the developer sold off more than 50 per cent of the units, but then purchased units through a related corporation. It also held mortgages on other units. A familiar mortgage provision gives the lender the right to vote on behalf of the unit against which the security is registered. In this way the developer controlled a majority of votes in the condominium development, which were used to make decisions in the developer's best interests. The Ontario Court of Appeal held that there was no conflict of interest under the legislation, because nothing in the legislation prevented a third party from acquiring a majority position.

select a unlisted surrogate. If a list can be so easily evaded, is there any point in having one at all?

The *Society Act* (and the *Company Act*, apart from the attempt to deal with subsidiary companies) addresses the issue in a different way. It speaks of conflicts involving a director who is "directly or indirectly interested in a proposed contract or transaction." What is contemplated by these words is left undefined. It is a minimalistic approach to the problem that seems to work fairly well. The approach works because the words used manage to capture the idea that a director is not allowed to benefit. The words "directly or indirectly" sweep in transactions with a person in any relationship with the director that actually benefits, or has the potential of benefitting, a director.

One possible criticism of a minimalistic approach is that it does not allow effective policing against conflicts in the same way as firm rules, which admit no doubt about whether a particular person is within the contemplation of the legislation. But the ethical issues involved in conflicts of interest are not really amenable to resolution by inflexible rules. The aim must necessarily be not to provide systems for detecting and avoiding conflicts but guidance for those charged with identifying and dealing with them.

The minimalistic approach requires the exercise of common sense. Initially, it is the director who must judge whether a conflict is serious enough to require disclosure. As a matter of prudence, the conflict would have to be very remote and technical before a director would be justified in declining to disclose it. Upon disclosure, the board of directors must determine whether the transaction is acceptable, and for this task they too must exercise a discretion in determining what is meant by a "direct or indirect interest."

An additional reason for dealing with relationships in this way is the significance of the circumstances in deciding whether an actual conflict of interest, or an apparent or potential conflict, is serious enough to address. The proximity of relationship with a director is really only one among many factors that has some significance in resolving this question.[61] For this reason, the weight to attach to a relationship with a

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61. Events from the 1993 teachers' strike offer a good example. In accordance with high ethical standards, members of the cabinet who have a real, apparent or potential conflict of interest in a particular matter absent themselves from the portion of the meeting in which the matter is discussed. With respect to the strike, those whose spouses are teachers (including the premier) felt they were in a conflict of interest and followed this procedure. The practice, normally an accepted one that the community expects of elected officials and others, was in this instance criticized because of the appearance of abdication of responsibility by the most senior elected officials. The Conflict of Interest Commissioner was asked to rule on the issue, and decided that these cabinet members were not in a conflict of interest within the meaning of the *Members'*

director is best dealt with as part of a general inquiry, rather than by reference to an immutable list of forbidden degrees of connection.

H. The Role of an Adviser

Views will differ about whether factors raise a conflict of interest. In many cases, a director will not be certain about whether a particular course of conduct poses a conflict.

An adviser can perform a number of useful functions, from the perspective of a society, society insiders, and members of the public. For example:

- an adviser can

Conflict of Interest Act and could participate (Decision dated May 30, 1993). In part, the decision is a reflection of the principle of necessity: the community is prepared to accept and tolerate a conflict of interest arising from a very close relationship where to otherwise deal with the conflict results in decision-making paralysis: *see* K. Baldrey, "Conflict policy means ministers fleeing meetings," *Vancouver Sun,* May 29, 1993, B10; V. Palmer, "Right move, but why the dithering?" *Vancouver Sun,* May 31, 1993, A10; "An education for the future," *Vancouver Sun,* June 1, 1993, A12; V. Palmer, "A holy writ as wrought by Ted Hughes," *Vancouver Sun,* June 2, 1993, A12. In contrast, a scathing editorial in the same newspaper published only 30 days earlier criticised proposed federal legislation because it allowed cabinet ministers to vote on issues in which their families have a financial interest. It said that prohibiting ministers from making decisions affecting their immediate families "...seemed like the sort of straightforward stuff that even a corrupt Third World dictator would have trouble not defending...,": "Evading Conflict," *Vancouver Sun,* April 30, 1993. What was the reason given in support of the policy which the press apparently rejected? The Bill accepted that such conflicts are unavoidable: "Conflict of Interest law called full of holes," *Vancouver Sun,* Apr. 29, 1993, A4. The inconsistent editorial perspective suggested by these examples underscores the way attitudes about conflicts of interest tend to shift, depending upon the background circumstances (in this case, apparently, views formed in the abstract change when applied to real events). Compare these events with, *e.g.*, the differing views respecting teachers taking part on a board of trustees, Gudlanjson and Halsey-Brandt, "Conflict ruling no reflection on integrity of trustees," *Vancouver Sun,* May 27, 1993, A13; finally resolved by the decision of the B.C. Court of Appeal decision in *Wynja, supra,* n. 22; and the criticism of I.C.B.C. executives whose spouses received promotions, "Wife promoted on own merit, manager says," *Vancouver Sun,* Nov. 18, 1992, B5. It is not altogether clear that cabinet members were being unduly cautious by absenting themselves from the portion of the meeting that considered these matters. These issues arise fairly often in small communities where councillors are frequently in a conflict of interest. Because conflict of interest is virtually unavoidable, it is tolerated in many situations that would be unacceptable in larger communities where alternatives are available: *Hilton* v. *Norgaard,* (1992) 11 M.P.L.R. (2d) 259.

- act on a complaint and decide whether a director is in a conflict of interest;
- respond to a director's inquiry about whether engaging in a proposed activity, etc., will raise a conflict of interest;
- establish procedures for
  - avoiding conflicts of interest;
  - detecting conflicts of interest; and
  - handling conflicts of interest.

Particularly because circumstances can have such a definite impact on views about whether or not a conflict of interest exists, there will probably be many cases where a director will wish advice on the question in advance.

The Conflicts Commissioner provides this service to members of the legislative assembly, under the *Members' Conflict of Interest Act*. Apparently, the Commissioner receives similar inquiries from many people not affected by the *Members' Conflict of Interest Act*, and sees providing this kind of advice as an important function:[62]

> ...I perceive a very real need for the availability of an officer where [those involved in municipal councils, school boards, hospital boards and the public service] could go for advice and guidance and that is particularly so for politicians at the municipal level. Land development and zoning decisions that members of municipal councils face, from time to time, often contain seeds of

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62. Annual Report 1992-93 at 11. Some examples of issues the Conflicts Commissioner has had to consider in relation to elected officials (*ibid.* at 14-21):

- when may a member use official letterhead for personal purposes?
- may a member accept funds raised by friends?
- may members take a trip paid by a forest company to familiarize members with forestry issues?
- may members use "air miles" for personal purposes?
- may members accept free cable services to their offices?
- may a member accept a prize awarded to the seat occupant where travel has been paid by the public treasury?
- may a member's spouse apply for a government job?
- may a member continue to work for a university?
- may a spouse of a member serve in a paid position in the member's constituency office?
- may members purchase B.C. Savings Bonds?
- may a member accept a free membership in a professional association?
- may a member accept free passes or tickets to use a faculty or club or for recreation?

> conflict of interest. Few municipalities, if any, could finance conflict of interest departments within their municipal structures.

The comments are probably equally apt for directors of societies, particularly those societies managing large budgets that are derived from public funds.

Should legislation create an office like the Conflicts Commissioner to advise directors of societies?

Because there are a great many societies in British Columbia, a government-financed adviser might be justified. Having one person fill this office would ensure some consistency in the kinds of rulings made. Clear guidelines would emerge to assist directors and societies in detecting and handling conflicts of interest.

On the other hand, the rules we tentatively propose are based on the view that most conflicts of interest should not be tolerated. Directors and societies should err on the side of caution, avoiding any situation where there is even a hint of a conflict of interest. An independent adviser's role would probably be minimal.

Some of the larger government agencies designate a particular staff member, often one with legal training, to provide advice. Letting societies decide for themselves whether to provide such a service is an approach that makes sense. Large societies are more likely than small societies to encounter conflicts of interest issues in more serious forms. Large societies are also more likely to have the budget to deal with them in more formal ways. If this decision is left to societies on an individual basis, the majority of societies in British Columbia, which are very small, could elect to do without the luxury. But we should emphasize that our views are tentative and we particularly welcome comment on this issue.

I. The Need For an Appeal Structure

Sometimes a board's decision about approving a transaction with a director may be a close one, while the financial consequences of the board's decision may be significant. What should happen if a director feels that a decision to not approve a transaction is unfair? What rights should other directors of the society, and its members, have to challenge a decision to approve a transaction? Many people, particularly lawyers, feel comfortable with a procedure that allows for review, to make sure that a fair decision has been reached.

On the other hand, an appellate process is often costly and leads to delay, factors that may make it difficult for a society to conduct its regular

business.[63] Moreover, there is no evidence under the current law of a need to review specific decisions made by the board of directors.

It was observed earlier, when we tentatively concluded that most transactions involving a director should not be approved, that a director does not have a right to deal with the society. The only reason for allowing any transaction to be approved is based on the right of the society to not be barred from entering into an arrangement which, in the circumstances, is in its best interests. If the board of directors says no, that should end the matter.

What if a member of the society is concerned about a decision by the board of directors to approve a transaction? An appeal process to deal with this situation would protect the interests of the society, by allowing an inquiry into the wisdom of the board's decision. Against this must be balanced the costs of a formal review process, in terms of delay, expense and the disruption of day-to-day business.[64]

In our tentative view, societies will be best served by a simple structure with clear, straightforward rules. Each society must depend upon the wisdom and integrity of its board of directors. From time to time, a bad decision will be made, but that is not reason enough for trying to construct a fail-safe system. In the end, virtually every aspect of our society depends upon the personal integrity and competence of people.

That is not to say that there will be no recourse whatsoever. Suppose a majority of the board consistently makes questionable decisions. The remedy for those concerned about the board's behaviour is to keep the membership fully informed, and sponsor a different slate at the next annual general meeting. In extreme cases, the remedy of oppression is available.[65] We think these are adequate safeguards.

J. Remedies

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63. An appeal procedure may also introduce scope for further concerns about bias or conflict of interest, such as occurred with appeals to cabinet of land commission decisions about taking land out of the agricultural reserve. Those concerns led to a proposal to remove appeals from cabinet to another body to be established under the proposed *Environmental Assessment Act* (Bill 32, 2nd Reading June 14, 1993, 2nd Sess., 35th Parl.; K. Baldrey, "Cabinet to lose ability to overrule decisions of land commission," *Vancouver Sun,* June 22, 1993, A9.

64. One defect to an appellate structure that should not be overlooked is the potential for it to be abused. Where there is a marked division of opinion among members of a society an appeal procedure may be used by a few to hector a board serving the interests of the majority.

65. The remedy is described below. *See* n. 77.

1. RIGHTS AND REMEDIES

This section examines legal remedies available where a director acts while in a conflict of interest and the functions these remedies perform. Ordinarily, legal remedies answer one or more of three objectives:

- *compensating the innocent party*: a wrongdoer should make good a loss suffered by an innocent party;
- *inducing people to obey the law*: requiring a person to answer for wrongful actions provides a reason for obeying the law; and
- *penalizing the wrongdoer*: sometimes it is important to go beyond the first two objectives and provide a remedy designed as a penalty. In this way, the community can register its extreme disapproval for particular kinds of behaviour.

One or more of these objectives is served by the remedies the law currently makes available when a director acts while in a conflict of interest.

Some of these remedies are authorized by the *Society Act*. Others are derived from common law and equity. After examining the existing remedies, the discussion will turn to consider whether the law should be revised to provide additional remedies.

2. CURRENT REMEDIES

(a) Account

As mentioned earlier, the *Society Act* provides that a director who directly or indirectly benefits from a transaction with the society must repay profit earned on the transaction:[66]

> **28.** (1) A director...shall account to the society for profit made as a consequence of the society entering or performing the proposed contract or transaction...

A director can avoid this obligation by advising the board about the conflict and obtaining its prior approval of the transaction. If the director fails to disclose an interest, or discloses after the society enters into the transaction, only the members of the society (by a 75 per cent majority) can excuse the director from the obligation to account.

This section of the *Society Act* mirrors a provision in the *Company Act*. Both seem to have been inspired by an equitable principle relating to the

66. The equivalent ss. in the *Company Act*, R.S.B.C. 1979, c. 59, are ss. 144-5. *See, e.g., Brian Mountford & Associates Ltd.* v. *Lucero Resource Corp.,* [1991] B.C.J. No. 194 (S.C.); *Redekop* v. *Robco Constr. Ltd.,* (1978) 7 B.C.L.R. 268 (S.C.).

misuse of a beneficiary's property, although the equitable principle is more elaborate than this:[67]

> It is often asserted quite uncritically that a fiduciary who misuses property entrusted to him, must account to his beneficiary for all profit he has made. Such assertions have done much to obscure what is already a quite complicated area of the law for they suggest a liability which is markedly at variance with the principles actually applied by the courts. In those simple but uncommon cases where a fiduciary misapplies trust moneys alone to purchase, say land or shares which he resells at a profit, it is doubtless correct to say that "...for every farthing of profit he may make he shall be accountable..." There his actual gain happens to correspond with Equity's measure of his liability. But it need not necessarily do so. His actual gain may be more or it may be less than the "profit" for which he is liable.

Where, for example, profit is derived from both use of a beneficiary's property and from the fiduciary's own skill, the equitable principle provides for return of only the portion attributable to the property.[68] Where there is no profit at all, a fiduciary may still be required in equity[69] to compensate for depriving the beneficiary of the use of the money by paying interest.[70]

Section 28, which allows the members to excuse a director from the obligation to account unfortunately speaks only of "profits." Suppose a director is found liable in equity to compensate the society based on these

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67. Finn, *Fiduciary Obligations* (1977) para. 241.

68. *Ibid.* Suppose that a society owns a car in need of repair. Director A fixes the car and sells it at a profit, pocketing the proceeds. The society's remedy would probably be confined to the value of the unrepaired car. The courts are vigilant about characterizing the portion which is attributable to skill. Where a person wrongfully uses another's money to purchase property which is then sold at a profit, *e.g.*, the courts are unlikely to find any portion of the profit attributable to the wrongdoer's skill: *Boardman* v. *Phipps,* [1966] 3 All E.R. 721 (H.L.). Equitable remedies are not operating in isolation. The past decade has seen the rapid evolution of principles of restitution. A number of techniques – such as waiver of tort – are available to courts to ensure that a director does not profit from breaching duties owed the society.

69. And now by statute: *Court Order Interest Act*, R.S.B.C. 1979, c. 76.

70. Before the enactment in British Columbia in 1974 of the forerunner of the *Court Order Interest Act*, situations where courts could award interest to a litigant for having been deprived of the use of money were limited: *See Report on Prejudgment Interest* (LRC 12, 1973); *Report on the Court Order Interest Act* (LRC 90, 1987). Equity would award interest in some cases involving a breach of a fiduciary duty. That remedy has been overtaken, but not entirely replaced, by the *Court Order Interest Act.* The *Court Order Interest Act* prohibits an order of interest on interest (compounding). An order for compound interest in suitable cases would still be available in equity.

principles, but the measure of recovery is not determined as profits.[71] The members would not be able to excuse a director in these circumstances, even one whose actions were completely innocent.

An equally surprising feature of the law is that while members may sometimes relieve a director of some portion of responsibility, the court has no power to do so.[72] In contrast, the *Trustee Act* allows a court to relieve a trustee of personal liability where the trustee has acted honestly and reasonably:[73]

> **Jurisdiction of court to relieve trustee of breach of trust**
>
> **98.** If it appears to the court that a trustee, however appointed, is or may be personally liable for a breach of trust, whenever the transaction alleged to be a breach of trust occurred, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the court in the matter in which he committed the breach, then the court may relieve the trustee either wholly or partly from that personal liability.

The responsibility of a director to a society is derived from the law that applies to trustees. Courts should probably enjoy a similar ability to relieve a director from personal liability incurred as a result of breaching duties owed the society where the director has nevertheless acted honestly and reasonably. The closest the *Society Act* comes to this, however, is to allow a society to indemnify a director for loss, provided the court approves.[74]

(b) Dealing with the Contract or Transaction

The *Society Act* provides courts with a sweeping power to deal with transactions involving directors' personal interests:

> **29.** The fact that a director is, in any way, directly or indirectly, interested in a proposed contract or transaction, or a contract or transaction, with the

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71. The director may make no profit on the transaction, but still be under an obligation to compensate the society. It may be established, *e.g.*, that the same transaction with a competitor of the director would have cost the society less, and the director is required, for breaching fiduciary obligations, to compensate the society for the difference.

72. S. 86 of the *Society Act* (like s. 230 of the *Company Act*) empowers the court to remedy irregularities, but the s. is ordinarily relied upon to address problems that arise when procedural requirements are not completely met: *e.g.*, the inadequate giving of notice or a technical defect in a proxy form: *U.S. Gold Corp.* v. *Atlanta Gold Corp.,* (1989) 43 B.C.L.R. (2d) 71 (C.A.).

73. *Trustee Act*, R.S.B.C. 1979, c. 414.

74. S. 30.

> society does not make the contract or transaction void, but, if the matters referred to in section 28 (1) (a) or (b) have not occurred, the court may, on the application of the society or an interested person,
>
> (a) prohibit the society from entering the proposed contract or transaction;
> (b) set aside the contract or transaction; or
> (c) make any order that it considers appropriate.

There does not appear to be any authority on this section. Anything we can say about its operation is speculative. Paragraph (a) seems clear. If action is taken quickly enough, preventing a contract from being signed is unlikely to cause much prejudice.[75]

If the contract has been made, particularly if there has been some performance under it, the consequences of setting it aside might be serious. Courts are likely to be hesitant about making an order under paragraph (b).

Paragraph (c) contains the most intriguing of the powers conferred by section 29. Conceivably, it empowers a court to rewrite the contract, or restructure the terms of a transaction, to ensure that it is fair to the society.

Although untested, it would seem that section 29 empowers the court to make a suitable order to deal with transactions whenever a conflict of interest is eventually discovered.

(c) Improper Board Approval

Under the current law, a decision by the board authorizing a transaction in which a director has an interest may only be challenged if the director did not fully disclose the nature of the interest.[76] No one can attack the transaction on the basis that the board arrived at an incorrect decision.[77] The matter is left entirely to the discretion of the board.

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75. In these circumstances, it may be unnecessary to involve the court. The board, upon learning of the conflict, may decline to enter into the transaction: *see, e.g., Cornwallis (Municipality)* v. *Evans,* (1992) 80 Man. R. (2d) 238 (Q.B.).

76. Assuming the decision is validly made: *e.g.*, that a quorum was present, and that the members were not conspiring against the interests of the society: *see, e.g., Thorpe* v. *Tisdale,* (1909) 13 O.W.R. 1044.

77. One exception: corporate actions that oppress the interests of a minority are subject to court review. This remedy is more familiar in company law. The B.C. *Company Act* provides:

> **224.** (1) A member of a company may apply to the court for an order on the ground
>
> (a) that the affairs of the company are being conducted, or the powers of the

Should this position be carried forward if the changes suggested above are adopted? We have tentatively proposed that the board be permitted to authorize only a limited number of transactions. If the board mistakenly authorizes a transaction that does not fall within the list of those it may authorize, should the transaction be considered a nullity? Should a member, for example, be permitted to challenge the arrangement in court on the ground that the board exceeded its jurisdiction?

The discussion above was at pains to explain that arriving at the "correct" decision about a conflict of interest depends very much upon the particular circumstances. The structure described for authorizing particular transactions affected by a conflict of interest consists of guidelines, carefully framed but simply guidelines nevertheless and not hard and fast rules. The system still depends upon the integrity of the board and its discretion. Moreover, third parties dealing with the society and its directors must be able to rely upon the enforceability of agreements. For these reasons, it is our tentative conclusion that a board decision, however misguided, should not be open to challenge, provided

(a) the decision is validly made (in the sense that the required procedures as to convening a meeting were faithfully followed),

(b) the board had enough information about the nature of the conflict of interest to assess it, and

(c) the board acted in good faith.

(d) Disclosure After the Fact

(i) Where the Conflict Exists Before the Transaction is Made

A director must disclose a personal interest in a transaction before the society enters into it. What should happen if the director fails to disclose in advance?

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directors are being exercised, in a manner oppressive to one or more of the members, including himself; or

(b) that some act of the company has been done, or is threatened, or that some resolution of the members or any class of members has been passed or is proposed, that is unfairly prejudicial to one or more of the members, including himself.

The oppression remedy, however, is also available when the corporation is a society: *Buckley* v. *B.C.T.F.,* (1992) 65 B.C.L.R. (2d) 155 (C.A.) *aff'g* (1990) 44 B.C.L.R. (2d) 31 (S.C.). As a matter of procedure, to clothe the court with jurisdiction so that it can grant specific remedies for oppression, the application will probably have to request an order winding up the society: *see Society Act*, s. 71 and *Company Act*, s. 296.

There are, possibly, three scenarios:

(a) the director knew of the competing interest and chose not to reveal it;

(b) the director knew of the interest but failed to appreciate its significance; or

(c) the director did not learn of the interest until after the fact.[78]

Whatever the reason for the non-disclosure, the director continues to be under an obligation to disclose and must pay to the society profit made from the transaction.[79] The *Society Act* gives the court wide powers to deal with transactions made by a society unaware of a director's conflicting interest.[80]

If the transaction was fair and reasonable to the society when it was made, the membership may approve it at a later date when full disclosure is finally made. The membership's approval requires a 75 per cent majority.[81] Presumably, the membership's decision to ratify a transaction, and a court's treatment of the transaction where the membership decides not to ratify, will turn at least in part on whether the director's actions are regarded as innocent or culpable in the circumstances.

The members' power to ratify is derived from company law and the similar power enjoyed by shareholders. The flaw in the model, as mentioned earlier, is that the membership of a publicly subsidized society is not necessarily qualified to rule on the director's liability. Moreover, particularly where a society is small and its membership tight-knit, the public may see ratification as a whitewash, attributing the decision to club collegiality.

Rules for dealing with these special problems might be recast to conform with the suggested directions for change outlined above. New legislation could provide, for example, that the membership can ratify a transaction only where, had there been timely disclosure, a board of directors could have approved the transaction. As we contemplate restricting the range of transactions that can be approved by the board,

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78. Perhaps the transaction is with a person who is related to the director (perhaps through marriage) but for a number of reasons the director was unaware of the relationship. Or perhaps the director has corporate holdings, one arm of which, without the director's knowledge, makes an investment that raises a conflict.

79. S. 28 sets out the obligation to account for profit.

80. S. 29.

81. *See* s. 28 (b) and the definition of "special resolution" in s. 1.

this would substantially limit the kinds of transactions that can be ratified by the membership.

It might be argued that limiting the power to ratify, while theoretically attractive, may produce unwanted results. The more limited the power to ratify, the more cause a director has to continue to conceal a conflict of interest discovered after the fact. A broad power to ratify, on the other hand, might encourage prompt disclosure, something which is undoubtedly in the public interest. Moreover, if a director has acted in complete innocence, fetters on the ability of the membership to relieve the director of responsibility may result in a penalty out of all proportion to the mistake that was made, particularly where the conflict derives from a remote relationship.

These reasons argue in favour of retaining the current approach, or one based on it. The membership, for example, might be given a wide power to ratify in those circumstances where it is convinced that the director acted innocently.

(ii) Where the Conflict of Interest Arises After the Transaction is Made

When a director's conflicting interest exists before the transaction is made, there are few situations where the director can establish that the failure to disclose an interest was innocent, although there are some.[82] Innocent non-disclosure is a significant factor. An unsuspected conflict

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82. *See, e.g., Hilton* v. *Norgaard, supra*, n. 61, (a municipal council case where a shareholder of a company transacting business with city was later elected mayor). It is important to distinguish between not knowing about a conflict and failing to appreciate that a personal interest, of which the director was aware, raised a conflict. To be truly innocent, the director would probably have to be entirely unaware of the personal interest at the relevant time. Many recent examples of conflicts of interest that have attracted media attention consist of decisions made by people who did not recognize that the involvement of their personal interests was wrong: *see, e.g., Scorgie* v. *Morin,* (1993) 40 A.C.W.S. (3d) 171 (Sask. Q.B.) where a mayor did not appreciate that a conflict arose from voting on a resolution affecting taxes levied on the mayor's business or on land owned by the mayor's common law spouse; *Campbell* v. *Dowdall,* (1992) 12 M.P.L.R. (2d) 27 (Ont. Gen. Div.), where the councillor didn't realise it was wrong to take part in a vote affecting the value of property the councillor had been engaged to sell. Possibly the only way of bringing home the idea that conflicts of interest will not be tolerated is to ensure that people accept responsibility for knowingly acting while in a conflict of interest even where they did not appreciate the significance of their actions. Criminal law is also based on this principle. It is not an adequate explanation that a perpetrator did not know particular actions were against the law. But *cf.* teachers as school board trustees, where the issue was far from straightforward: P. Gudlanjson and S. Halsey-Brandt, "Conflict ruling no reflection on integrity of trustees," *Vancouver Sun,* May 27, 1993, A13.

is unlikely to have affected the director's actions. Provided the transaction was fair and reasonable when it was made, there may be little or no reason to penalize the director, and less to interfere with the transaction, penalizing other parties to it.

The same is probably true in any case where the conflict of interest arose after the transaction was approved and the director had no reason to suspect that it would arise. How might this happen? The director might marry into a conflict, or acquire an interest in a business that is dealing with the society.

> *Example: A society sponsors a large soccer league. Company B makes soccer uniforms. It enters into a contract with the society to provide soccer uniforms for the next two years. The contract is a good one for both parties. A director of the society, impressed with Company B's performance of the contract, later buys Company B. The contract still has one more year to run.*

Unless there is some suspicion that the director contemplated buying Company B when the transaction was first being considered, there is no reason to intervene to protect the society's interests in this transaction. In most cases, however, it would be prudent for the director to resign from the board before purchasing the company.

> *Example: Several businesses compete for a lucrative advertising contract with a society. Director A votes in favour of Advertising Agency B, which is awarded the contract. A year later, Director A takes a senior position with Advertising Agency B.*

There would be no doubt that Director A would be in a conflict of interest if employed by Agency B at the time the contract was voted on. Many would be equally troubled by the events of this example. Was the offer to Director A made at an earlier time, expressly or tacitly?[83]

Should special rules be developed to deal with conflicts of interest that arise after the fact? The current legislation does not have such rules. On the whole, it would appear that the element of discretion that exists, in the membership to ratify a transaction and the courts with respect to policing the transaction, provides sufficient protection. But we welcome advice on this issue.

(e) Remedies at Common Law and Equity

The statutory measures discussed above complement common law and equitable remedies that are available in appropriate circumstances.

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83. In B.C., special rules apply to elected officials that restrict the extent to which they can deal with government agencies after they leave office. But no rules are in place to deal with situations that look like delayed bribes. For one reason, notwithstanding appearances, it would be very difficult to establish that anything wrong had occurred at all.

The law relating to fiduciaries, for example, applies equally to the directors of a society.[84] The court has broad powers to deal with situations that arise where fiduciary obligations are not faithfully discharged. If a director misuses society property, for example, or takes personal advantage of a society's corporate opportunities, the society may seek a suitable equitable remedy.[85]

Common law remedies are also useful. A director who misuses society property, for example, may be liable in detinue, trespass to chattels or conversion.[86] The *Society Act* ensures that its measures enhance, and do not limit or replace, the existing law:

> **26.** Nothing in a contract, the constitution or the bylaws, or the circumstances of his appointment, relieves a director
>
> ...
>
> (b) from a liability that by virtue of a rule of law would otherwise attach to him in respect of negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the society.

Paragraph (b) is comprehensive in preserving the existing non-statutory law. It is a policy that we think should be carried forward in revising legislation.

(f) Removing a Director

Serious unethical behaviour is usually regarded as sufficient reason to reprimand or discharge an employee, but it does not qualify as a ground for removing a director. The members of a society, nevertheless, may be understandably concerned about allowing a person who has acted unethically to continue as a director.

The *Society Act* provides a general procedure whereby the membership can remove a director. The decision requires a 75 per cent majority:

> **Removal of Directors**
>
> **31.** A director may be removed from office by special resolution and another director may be elected, or by ordinary resolution appointed, to serve during the balance of the term.

As mentioned earlier, "special resolution" is defined in the *Society Act*. It is useful at this point to examine the definition a little more closely:

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84. The equitable principles relating to directors, and their status as fiduciaries, at least for directors of companies, has been cast into some doubt by the decision of the B.C. Court of Appeal in *337965* v. *Tackama Forest Products Ltd.,* (1992) 67 B.C.L.R. 1 (C.A.); leave to appeal dismissed Mar. 11, 1993, 75 B.C.L.R. xxxii (S.C.C.).

85. *Canadian Aero Service Ltd.* v. *O'Malley*, [1974] S.C.R. 592, 40 D.L.R. (3d) 371.

86. *See Report on Wrongful Interference With Goods* (LRC 127, 1992).

"special resolution" means

(a) a resolution passed in general meeting by a majority of not less than 75 % of the votes of those members of a society who, being entitled to do so, vote in person or, where proxies are allowed, by proxy
  (i) of which the notice that the bylaws provide and not being less than 14 days' notice specifying the intention to propose the resolution as a special resolution has been given; or
  (ii) if every member entitled to attend and vote at the meeting so agrees, at a meeting of which less than 14 days' notice has been given;
(b) a resolution consented to in writing by every member of a society who would have been entitled to vote on it in person or, where proxies are allowed, by proxy at a general meeting of the society; and a resolution so consented to shall be deemed to be a special resolution passed at a general meeting of the society;
(c) where a society has adopted a system of indirect or delegate voting or voting by mail, a resolution passed at least 75 % of the votes cast in respect of the resolution; or
(d) an extraordinary resolution passed before January 5, 1978.

The requirement for a special resolution strikes us as a satisfactory method of dealing with the problem. The removal of a director for whatever ground should be regarded as a serious question.[87] The procedures required for a special resolution are appropriate for resolving this question. Moreover, where the issues are so straightforward that the unanimous consent of the membership can be obtained, subparagraph (ii) allows a very quick response.

(g) Tentative Conclusion

From both a technical and a theoretical perspective it is sensible to suggest that if courts are to deal adequately with the kinds of issues that arise, they must be suitably empowered. Gaps in their jurisdiction should be filled in. This is an argument in favour of increasing statutory remedies available to courts to deal with conflicts of interest issues.

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87. For one reason, removing a director may result in a significant alteration in the power balance of the board. Consider, *e.g.*, the consequences of removing the 4 teacher trustees from the school board in the midst of the teachers' 1993 strike. Of the remaining 5 trustees, an agreement to end the labour dispute was voted down by a 3-2 majority. The results might have been quite different if the 4 disqualified trustees had been able to participate: *see, e.g.*, S. Balcom, "Now in hands of 5 trustees – 3 could carry vote affecting 54,000 students," *Vancouver Sun*, May 5, 1993, A1. It is difficult to say whether the public is better served by placing power in a minority of the board, or by allowing people with a disclosed personal interest to participate in these decisions. Compare this with the views relating to participation in cabinet decisions relating to the strike by members whose spouses are teachers: *supra,* n. 56. For cases dealing with the removal of directors, *see: Wieder* v. *Students' Assn. Wascana Campus, SLAST Inc.*, (1993) 41 A.C.W.S. (3d) 641 (Sask. Q.B.); *C.M.H.C.* v. *Society for the Christian Care of the Elderly,* [1993] B.C.D. Civ. 3963-02 (B.C.); *Singh* v. *Sikh Cultural Society,* [1993] B.C.D. Civ. 3963-01 (S.C.).

But in practice there is little if any resort to the remedies currently available. There are no reported cases dealing with the relevant sections of the *Society Act*. Perhaps increasing the array of remedies is less important than other avenues for reform. Much might be achieved by simply providing clearer guidelines about the boundaries of acceptable ethical behaviour.

We suspect that most people are prepared to act honestly and honourably. The imprecision of the current rules, which are somewhat vague, may act as an invitation to test their boundaries. One reason for crediting this view is the fact that so much of recently questioned activity has been carried out with no attempt at secrecy, the traditional companion of a person whose motives are questionable. Directors are often surprised when the public reacts negatively. That was certainly the case with the Victoria Commonwealth Games Society and the contemplated transactions that motivated the reference of this project to the Commission.[88]

Where there is serious doubt concerning the acceptability of particular kinds of behaviour, it should not be surprising to find courts reluctant to intervene and grant remedies. Stating the rules with more precision should enhance the utility of existing remedies.

Remedies currently available operate largely behind the *Society Act*, and apply to directors and societies through the power of the common law and equity. Usually a suitable remedy can be found. Even if this were not true, the absence of a remedy or the inability to penalize is not an invitation for directors to act unethically.

We are tempted to conclude that our efforts should be aimed at setting out clear conflict of interest rules rather than fashioning new remedies. With respect to revising the law to provide additional

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88. Representatives of VCGS voiced surprise that anyone could question directors of societies entering into what were accepted business practices for directors of companies. The justification of "accepted business practice" failed in connection with transactions between directors and the society but apparently was accepted with respect to VCGS's practice of soliciting donations from companies bidding on contracts with the society. Initial concerns (see M. Farrow, "Track contract queried," *Vancouver Sun,* July 21, 1993, B3) were dismissed on the basis that the bidding process "follows established practices for international games projects" M. Farrow, "Games bidding gets thumbs up," *Vancouver Sun,* August 10, 1993, A3, quoting a press release from Municipal Affairs Minister Robin Blencoe. This is an area where procedural safeguards can ensure that legitimate fundraising practices do not suggest a conflict of interest. Corporate donations, *e.g.*, should be acceptable if they are made separately from a tender and without strings attached (*e.g.*, the donation will be made whether or not a particular contract is awarded). In contrast, a bid framed in terms of an overall dollar figure for the contract, less a donation, resembles very much a kickback, a practice once prevalent among some industries but now widely rejected.

remedies, we tentatively propose only that courts be allowed to relieve a director who acts honestly and reasonably from personal liability that arises from overlooking a conflict of interest. Of course, new legislation should be closely monitored so that appropriate steps can be taken if events prove that courts require further powers.

CHAPTER VI SUMMARY

A. Overview

This Consultation Paper has explored the rules that determine whether a director of a society has a conflict of interest and, if so, how to deal with it. We tentatively conclude that the current rules must be revised. The law could totally prohibit a director from acting while in a conflict of interest, but it is our considered opinion that a more pragmatic approach must be adopted.

This Chapter sets out a summary of our suggestions for changing the law. The summary is in general terms. For concrete details, the reader should refer to previous chapters, particularly Chapter V, as well as the annotated draft *Standards of Conduct Act* in Appendix A and the draft *Conduct Guidelines* in Appendix B.

A word about vocabulary is in order. As the text has discussed, the term "conflict of interest" is, in some respects, a misleading one. It lacks precision. There is little agreement about what is and what is not a conflict of interest. We have used the term for convenience in our discussion and in the following summary of tentative conclusions, but not in the draft legislation set out in Appendix A. It is our tentative view that, for the sake of precision, legislation must state accurately what kinds of conduct it applies to.

The Conduct Guidelines, however, use the term "conflict of interest." The Guidelines are intended to provide a flexible framework for dealing with these kinds of problems and, consequently, can afford to use the more familiar term, even if the cost is some loss of precision.

We welcome comment on this approach to drafting. Should the term "conflict of interest" also be avoided in the Conduct Guidelines?

B. Tentative Conclusions

We have arrived at the following tentative conclusions:

Generally

1. As a general rule, a director must not act while in a conflict of interest.

2. As a general rule, a society must not enter into

(a) a transaction with a director, or

(b) any transaction in which a director has a direct or indirect interest.

3. Even so, some transactions may take place, notwithstanding the director's direct or indirect interest in the transactions, where the purpose is not to benefit the director but rather to permit the society to enter into transactions which are in its best interests.

Acceptable Transactions

4. A transaction in which the director has a direct or indirect interest is acceptable, and does not need to be authorized by the board of directors under paragraph 5, if the transaction is

(a) accepting remuneration for the director's services as director,[1]

(b) a loan to the society guaranteed by the director,

(c) a transaction between two societies in which the conflict of interest arises solely because the societies have a director in common,

(d) the posting of security by a director to ensure the faithful fulfilment of the director's duties,

(e) insurance for the director against personal liability incurred by virtue of the directorship,

(f) an agreement by the society to reimburse a director for expenses and liabilities incurred by virtue of the directorship, or

(g) participation in the activities the society regularly makes available to its members.

Transactions that May be Authorized

5. (1) The board of directors may authorize the transactions listed in paragraph 5 (2), provided the director first discloses the conflict of interest and establishes that

(a) the transaction is fair and reasonable to the society, and

(b) the transaction meets community expectations about the conduct of the society's activities.

(2) If the conditions in paragraph (1) are satisfied, the board of directors may authorize the following transactions:

(a) Transactions where the conflict of interest is slight or, where it is more serious, the financial consequences of the transaction are minimal.

(b) A transaction which

(i) is an unconditional gift,

(ii) in aggregate, substantially amounts to a gift, or

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1. *This position may appear to be contentious unless it is first realized that the exception has a limited scope. Directors' remuneration is an area that has generated a great deal of controversy. The policy in subpara. (a) is not to relieve the society or its board of its responsibilities in setting appropriate levels for salary and benefits. But once these are set, there should be no impediment to a director accepting the remuneration.*

(iii) represents benefits to the society so substantial that no other decision makes economic sense.

(c) A transaction

(i) which no one else is capable of carrying out;

(ii) which others may be capable of carrying out, but no one else is willing to do;

(iii) in which it is more important to the society for the director to participate in the transaction than to avoid the conflict of interest.[2]

(3) A director who is in a conflict of interest can neither vote on whether the transaction should be authorized nor be considered part of the quorum for the meeting dealing with that issue.[3]

(4) If the board of directors authorizes a transaction, it must record in the minutes of the meeting at which it is authorized the exception relied upon.

(5) If a board of directors authorizes a transaction notwithstanding a conflict of interest, it must consider whether special steps are necessary to insulate or confine the conflict of interest for the protection of the society, or to safeguard public trust in the conduct of the society's affairs.

Transactions that May Not be Authorized

6. A transaction where a third party is engaged to scrutinize the affairs of the society may not be authorized by the board of directors if a director has a direct or indirect interest in the transaction.

Review of a Board Decision

7. A board decision authorizing or refusing to authorize a transaction should not be reviewable on application to the court if

(a) procedures required for arriving at a valid decision were faithfully observed,

(b) the board had enough information about the nature of the conflict of interest to assess it, and

(c) the board acted honestly and in good faith.

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2. *For a detailed discussion of the concept dealt with in para. 5(2)(c)(iii), refer to the text in Chapter V.F.3.(b)(iii) "Necessity." See also* s. 7 of the draft legislation in Appendix A.

3. *See, however,* s. 5(3) of the draft legislation in Appendix A.

Conduct Guidelines

8. (1) Legislation setting out conflicts of interest rules should apply only to directors of a society.[4] It is the responsibility of the directors to ensure that other transactions with the society are not affected by a conflict of interest with an officer, member, employee, volunteer or other person involved with the society.

(2) People involved in societies should be subject to conduct guidelines. A society should consider preparing standards appropriate for its activities. Legislation should set out the standards that apply if a society does not do so.

(3) Government (and other funding bodies) should consider making it a condition of receiving or raising funds that a society

(a) have in place particular conduct guidelines appropriate for its activities, and

(b) take steps to ensure that people involved with the society observe these standards.

(4) Societies may define in advance for themselves transactions that constitute a conflict of interest. They may also define specific transactions which do not qualify as conflicts of interest, although such a definition cannot authorize a transaction which is unacceptable under the new legislation.

Direct and Indirect Interests

9. Legislation setting out conflicts of interest rules should not define what is meant by a direct or indirect interest, because the characterization depends heavily upon the particular circumstances.

A Director's Personal Liability

10. Revising legislation should empower courts to relieve a director from personal liability where the director acted honestly and reasonably, on the same principles that apply to the similar jurisdiction with respect to trustees.

Bodies Analogous to Societies

11. Legislation should allow cabinet to make regulations extending the application of the legislation to governmental and non-governmental agencies that are analogous to societies.

Role of Adviser

12. It is not proposed that legislation establish an office that would provide societies with rulings on whether particular matters raise conflicts of interest and, if so, how to handle them. We would particularly welcome comment, however, on whether an adviser would be useful and should be provided for in new legislation.

C. Draft Legislation For Comment

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4. *Note, however, that "directors" has an expanded meaning under the Society Act.*

We have prepared a draft statute to show how these principles might be embodied in legislation. It is set out in Appendix A. We would appreciate comments on both the proposals listed above, and methods of implementing the proposals. The draft legislation is annotated.

In addition to the proposals and the draft legislation, a draft entitled "Conduct Guidelines" has been prepared. The draft is set out in Appendix B. We welcome comment on

(a) whether the ethical issues pursued in this Consultation Paper can be dealt with by dividing conflicts of interest issues (to be dealt with in legislation) from other ethical issues (which would be dealt with by conduct guidelines),

(b) whether additional matters should be dealt with in the model conduct guidelines (and whether some included items might be omitted, or handled in alternative ways), and

(c) whether different drafting approaches might make the information easier to deal with.

D. Invitation for Comment

This Consultation Paper is being circulated for criticism and comment. We welcome your views on our tentative conclusions, and other issues that you feel need to be addressed. Our final views will be arrived at only after we have had an opportunity to consult. Please let us have your views as soon as possible.

It is important that people involved with societies consider how the suggested changes will affect them and their organisa-tions. This information will help us formulate new laws that will benefit everyone.

Appendices

APPENDIX A

DRAFT LEGISLATION

This Appendix sets out draft legislation. The legislation is based on the suggestions for changing the law set out in the body of this Consultation Paper and summarized in Chapter VI. The Commission welcomes comment on both the policy decisions that we have tentatively reached, and methods of giving them force. Appendix B sets out draft *Model Conduct Guidelines*.

Immediately following the draft legislation is an annotated version of it.

A. The *Standards of Conduct Act*

Contents

Definitions

1. In this Act

"**benefit**" means a direct or indirect pecuniary or non-pecuniary advantage, other than the prestige associated with the position of **director**, and includes the avoidance of a detriment,

"**board**" means the **board** of **directors** of a **society**, or a similar group responsible for conducting the activities of a **society**,

"**director**" means a **director** of a **society**, or a person in a similar position,

"**related person**" means a person who has a family connection or business association with a **director** such that

(a) a **transaction** between a **society** and the person would confer a **benefit** upon the **director**, or
(b) the relationship might affect, or give the appearance of affecting, the **director**'s ability to act impartially on behalf of the **society**,

"**society**" means

(a) a body created under the *Society Act*,
(b) a body described in Schedule "A,"
(c) a body declared in a regulation under this Act, or under another enactment to be a **society** to which this Act applies.

"**special group**" means a group of people having in common particular expertise or qualifications, or experience with or involvement in a particular business, endeavour or activity,

"**special resolution**" has the same meaning it has under the *Society Act*,

"**transaction**" means an arrangement under which

(a) a **society** and another person agree to exchange value or services,
(b) a **society** confers a **benefit** on another person, or
(c) a **society** receives a **benefit** from another person.

Application

2. (1) The Schedule B Model Conduct Guidelines apply to all members, employees, volunteers and other people involved in the activities of a **society** unless the **board** formally adopts another form of Conduct Guidelines.

(2) A **society** may provide that the Schedule B Model Conduct Guidelines governs the conduct of its **director**s or adopt stricter standards of conduct.

(3) A **director** who is subject to standards of conduct under this or another Act or under rules adopted by the **society** must comply with the strictest standard.

Standards of Conduct: Directors' Duties

3. (1) A **director** must not allow personal interests to
- (a) compete with those of the **society**, or
- (b) come into consideration in any matter in which the interests of the **society** are involved.

(2) A **director** must avoid any situation which would compromise the **director**'s integrity, independence and ability to act impartially on behalf of the **society** and in the interests of the **society**.

(3) A **director** must not enter into a **transaction** with the **society**.

(4) A **director** must not use the position of **director** to derive a **benefit**.

(5) A **director** must not disclose or **benefit** from the use of confidential information obtained by participating in the **society**.

(6) A **director** must avoid any situation that could result in the appearance of a breach of subsections (1) to (5).

The Society's Duties

4. (1) A **society** must not enter into a **transaction** with a **related person**.

(2) A **society** must not enter into a **transaction** with any person if a **director** or a **related person** might derive a **benefit** from it.

Board Decisions

5. (1) A **director** must not take part in a **board** decision about a **transaction** between the **society** and
- (a) the **director**,
- (b) a person who is a **related person** because of a relationship or association with the **director**, or
- (c) any other person if the **director** or **related person** might derive a **benefit** from the **transaction**.

(2) A **director** who must not participate in a **board** decision must
- (a) disclose the reason to the **board**, and
- (b) not be counted as part of the quorum at the meeting in which a **board** decision is made relating to a **transaction** referred to in subsection (1).

(3) Despite subsection (2)(b), a **director** may be counted part of the quorum if
- (a) it would be impossible due to the resignation, death or incompetence of other **directors** to assemble a quorum even if all other **directors** of the **society** were present, and
- (b) the other **directors** present at the meeting unanimously agree to allow the **director** to be counted as part of the quorum.

Acceptable Transactions

6. (1) Despite sections 3 and 4, a **director** may accept hospitality or a gift that is not of excessive value if

(a) it is disclosed to the **board**, and

(b) its acceptance would not compromise or give the appearance of compromising the **director**'s integrity or independence nor impugn the reputation of the **society**.

(2) The following **transactions** do not contravene sections 3 or 4:

(a) the **director** receives

(i) reasonable remuneration for services performed by the **director** and properly rendered to the **society**, and

(ii) reimbursement for expenses reasonably incurred in performing those services,

(b) the **director** guarantees repayment of, or otherwise assumes liability to repay, a loan made to the **society**,

(c) the **transaction** is with another **society** and the **director** is also a **director** or member of that **society**,

(d) the **director** posts security to ensure the faithful fulfilment of the **director**'s duties to the **society**,

(e) the **society** agrees to indemnify or reimburse the **director** for expenses and liabilities incurred by reason of being a **director**, or arrange for insurance against these risks, or

(f) the **transaction** relates to participation in activities the **society** regularly makes available to its members.

Authorization

7. (1) Despite sections 3 and 4, the **board** may authorize a **transaction** listed in subsection (2) where

(a) a **director** who must not participate in the **board** decision has disclosed the reason to the **board**,

(b) the **transaction** is fair and reasonable to the **society**,

(c) the **transaction** is in keeping with community expectations about the conduct of the **society**'s activities,

(d) a quorum of the **board** is present for the decision, and

(e) the resolution authorizing the **transaction** is passed by a majority of not less than 75 per cent of those on the **board** present and entitled to vote at the meeting.

(2) The following **transaction**s may be authorized:

(a) a **transaction** with a third party which confers a **benefit** on a **director** or **related person**, or any **transaction** with a **director** or **related person**,

(i) by which the **society** receives an unconditional gift, or what is in substance a gift,

(ii) which only the **director**, **related person** or third party can complete within a reasonable time and according to reasonable standards pertaining to quality of work or the qualifications or accreditation of the person who will carry out the work,

(iii) which only the **director**, **related person** or third party is willing to carry out,

(iv) which manifestly represents **benefits** to the **society** so substantial that no other decision makes economic sense, or

(v) the financial consequences of which are minimal.

(b) a **transaction** with a third party that might benefit a **director** or a **related person** as a member of a **special group** in circumstances where the **board** needed representation from the **special group**, or

(c) a **transaction** with a **related person**, if

(i) the **transaction** provides no financial advantage to the **director**, or

(ii) the **director** is a member of a **special group**, the **board** needs representation from the **special group**, and the **director**'s membership in the **special group** is inextricably linked with the **director**'s relationship to the **related person**

provided that

(iii) a **related person** does not have access to information unavailable to others with whom the society could enter into a similar transaction, and

(iv) the **director** did not intervene to confer a benefit on a **related person**.

(3) A failure by a **director** to provide the **board** with enough information to assess the nature of an interest in a **transaction** invalidates an authorization under this section.

(4) A **board** that authorizes a **transaction** under this section must record in the minutes of the meeting the item in subsection (2) relied upon for the authorization.

(5) A **board** that authorizes a **transaction** under this section may make the authorization contingent upon the **director** taking steps or observing procedures that may be necessary in the circumstances to protect the **society** or to safeguard the public trust in the conduct of the **society**'s activities.

(6) A proposed **transaction** by which a third party is engaged to scrutinize the affairs of the **society** and which contravenes section 3 or 4 may not be authorized by the **board** under this section.

(7) A **board** decision authorizing or refusing to authorize a **transaction** under this section is not reviewable if

(a) procedures required for arriving at the decision were faithfully observed,

(b) the **board** had enough information about the **transaction** to assess the nature of the interest of a **director** or a **related person** in it, and

(c) the **board** acted honestly and in good faith.

Remedies

8. (1) A **director** must account to the **society** for **benefit**s received by the **director** or a **related person** as a consequence of the **society** entering or performing a **transaction** that violates section 3 or 4 and that is not validly approved under section 7 unless

(a) the **transaction** was reasonable and fair to the **society** at the time it was entered into, and

(b) after full disclosure of the nature and extent of the **director**'s interest in the **transaction** the members approve it by **special resolution**.

(2) If a **transaction** is entered into in contravention of this Act, it is not void but the court may, on the application of the **society** or an interested person,

(a) prohibit the **society** from entering the proposed **transaction**,

(b) set aside the **transaction**, or

(c) make any order that it considers appropriate.

(3) No liability attaches to a **society** for contravening section 4.

(4) Nothing in this Act relieves a **director** from a liability that by virtue of a rule of law would otherwise attach to the **director** in respect of negligence, default, breach of duty or breach of trust of which the **director** may be liable in relation to the **society**.

(5) Despite subsection (4), a court may relieve a **director**, either wholly or partly, of any liability that arises from a breach of duties owed the **society**, including responsibility arising from a breach of duties under this Act, where the **director** acted honestly and reasonably.

Regulations

9. The Lieutenant Governor in Council may make regulations:

(a) exempting a **society** from the application of this Act,

(b) exempting a **director** or **related person** from the application of this Act,

(c) stipulating special rules of conduct for a person or **society** subject to this Act,

(d) declaring a person or a class of people to be **directors** for the purposes of this Act,
(e) declaring a person or entity to be a **society** for the purposes of this Act if it
  (i) is created by an enactment,
  (ii) is created by an agreement to which the province is a party,
  (iii) has a **board**, the majority of whose members are nominated or appointed by the province,
  (iv) carries out activities that are funded in whole or in part by the province whether by loan, subsidy, tax concession, grant or payment under a contract to deliver services,
  (v) has indebtedness the repayment of which is guaranteed by the province, or
  (vi) is financially supported in whole or in part by public subscription or donation.

Schedule A

Each of the following is a **society**:

[*E.g.*,
The Law Foundation
The Vancouver Foundation
The Victoria Foundation[1] ...]

Schedule B

[See Appendix B]

1. No decision has been made to make these specific organizations subject to the suggested legislation. They are included only for the sake of example.

B. The Annotated Version of the *Standards of Conduct Act*

Standards of Conduct Act

Contents

A decision has been made to move away from the terminology of "conflict of interest." It is not a precise term. It carries with it vague associations and connotations, raising expectations and misconceptions about exactly what standards are contemplated by the description. The draft legislation refers instead to "standards of conduct," and defines these with some precision. The draft legislation deals with three basic situations: (a) transactions with a society that directly or indirectly benefit a director; (b) transactions with a society that directly or indirectly benefit a person with a family relationship or business association with a director; and (c) decisions made by a director on behalf of a society, where a director's personal views or interests are involved.

Definitions

1. In this Act

S. 1 sets out definitions. Defined terms in the legislation are signified by **bold type face**.

The draft is set up as a separate Act. In its current form, it applies to societies but contemplates allowing regulations to be passed which would make other agencies subject to the same standards of conduct: see the definition of "society" and s. 9(e).

If the focus of this legislation is confined to societies, however, it could form part of the *Society Act*. Whichever route is adopted, the draft legislation is intended to replace the current sections of the *Society Act* that deal with conflicts of interest. Those sections would be repealed.

"**benefit**" means a direct or indirect pecuniary or non-pecuniary advantage, other than the prestige associated with the position of **director**, and includes the avoidance of a detriment,

To simplify drafting, "benefit" is defined. It embraces financial and non-financial benefits. A director is considered to benefit whenever the director reaps an advantage or avoids suffering a personal setback or financial loss. The benefit may be actually received by the director (a "direct" benefit, received immediately, or by a more circuitous route) or received by someone else whose relationship with the director suggests that its receipt "indirectly" benefits the director. Benefits of nominal value are dealt with in s. 6(1).

"**board**" means the **board** of **directors** of a **society**, or a similar group responsible for conducting the activities of a **society**,

Because cabinet may designate other bodies to be "societies" within the meaning of the Act, the definitions of "board," "director" and "society" have been given extended meanings.

"**director**" means a **director** of a **society**, or a person in a similar position,

Another extended definition. See the annotation to "board." Under the *Society Act*, a "director" includes a "trustee, officer, member of an executive committee and a person occupying any such position by whatever name called."

"**related person**" means a person who has a family connection or business association with a **director** such that

The presence of a family or business relationship between a person and a director provides a reason to look for a conflict of interest that might harm the interests of the society. Obvious problems arise in any attempt to define in advance what will constitute a close or distant relationship. The answer to this question will almost always depend upon the circumstances.

(a) a **transaction** between a **society** and the person would confer a **benefit** upon the **director**, or

Paragraph (a) contemplates, for the most part, a financial benefit to the director, but other kinds of personal advantages are also relevant. The transaction, *e.g.*, may consist of a particular honour or privilege which, by being conferred on a relation, reflects well upon the director.

(b) the relationship might affect, or give the appearance of affecting, the **director**'s ability to act impartially on behalf of the **society**,

Paragraph (b) is concerned with issues of bias or favouritism.

"**society**" means

Another extended definition. See the annotation to "board."

(a) a body created under the *Society Act*,

(b) a body described in Schedule "A,"

See Schedule A.

(c) a body declared in a regulation under this Act, or under another enactment to be a **society** to which this Act applies.

S. 9 sets out the regulation-making power.

"**special group**" means a group of people having in common particular expertise or qualifications, or experience with or involvement in a particular business, endeavour or activity,

The term "special group" is used in s. 7(2)(b) and (c). For a society to obtain the necessary expertise, there will be circumstances where the board of directors must have one or more members who are from a particular class that will be affected by, or involved in, transactions with the society. There must be a method of authorizing these kinds of transactions despite the apparent conflict of interest.

"**special resolution**" has the same meaning it has under the *Society Act*,

A special resolution must be passed by a 75 per cent majority.

"**transaction**" means an arrangement under which

(a) a **society** and another person agree to exchange value or services,

A society may enter into a contract with another person, or the arrangement may be less formal, but still involve the exchange of benefits between the society and another person.

(b) a **society** confers a **benefit** on another person, or

A society may confer a benefit on another in circumstances where nothing is received in exchange. The society, *e.g.*,

may make a grant or provide funding, services or goods.

(c) a **society** receives a **benefit** from another person.

A society may receive a benefit from another in circumstances where nothing is given in exchange. Essentially the term "transaction" includes contracts and the making or receiving of a gift. The nature of the transaction determines the standards of conduct a director must observe. As a general rule, a director cannot enter into a contract with the society, make a gift to it, or receive one from it, although there are exceptions to this rule (particularly for transactions by which the society receives what is in substance a gift). See ss. 4 and 7.

Application

2. (1) The Schedule B Model Conduct Guidelines apply to all members, employees, volunteers and other people involved in the activities of a **society** unless the **board** formally adopts another form of Conduct Guidelines.

This draft legislation applies to directors (although it would be possible for cabinet to extend its application in appropriate circumstances: see the definition of "director" and the regulation making power in s.9). Other people involved in a society must still act ethically but, instead of legislated rules, Conduct Guidelines have been selected as the method of setting out the rules governing their behaviour: see Schedule B. If a society does nothing, Schedule B will apply. The board of directors, however, may modify the Schedule B Model Conduct Guidelines, or adopt another form altogether.

(2) A **society** may provide that the Schedule B Model Conduct Guidelines governs the conduct of its **director**s or adopt stricter standards of conduct.

A society may set out more precise guidelines for its directors. Standards set out in Schedule B will be appropriate, but do not really go very much further than the rules set out in this draft legislation. Where the society adopts Conduct Guidelines drafted with its particular functions in mind, however, the more precisely tailored rules should probably also apply to its directors. S. 2(2) allows a society to so stipulate. What should happen if a society adopts inappropriate guidelines? For directors, subs. (3) answers the question.

(3) A **director** who is subject to standards of conduct under this or another Act or under rules adopted by the **society** must comply with the stricter standard.

Conduct Guidelines adopted by a society cannot reduce the ethical standards the draft legislation requires of directors. In the event of a conflict between different ethical rules or guidelines, the director must abide by the most rigorous of them. For other people involved in a society, sole responsibility for setting appropriate conduct guidelines is left with the board of directors. Funding organizations, however, can informally supervise conduct guidelines by refusing to support societies that set inappropriate standards. See Proposal 8(3) in this respect.

Standards of Conduct: Directors' Duties

The draft legislation deals with two branches of conflicts of interest: (a) those that arise in transactions whereby a

director might derive a benefit; and (b) those that arise when a director must make a decision on behalf of the society. S. 3 deals with the first group of issues. The second − bias issues − are addressed in s. 3(2) and in s. 5.

3. (1) A **director** must not allow personal interests to

(a) compete with those of the **society**, or

(b) come into consideration in any matter in which the interests of the **society** are involved.

S. 3(1) sets out the director's obligation in the most general terms. In order to make sure the society's interests come first, a director is under a duty to not allow personal interests to come into consideration in any case.

(2) A **director** must avoid any situation which would compromise the **director**'s ability to act impartially on behalf of the **society** and in the interests of the **society**.

To repeat points made earlier, the draft legislation is concerned with three situations: (a) situations where a director directly or indirectly benefits from a transaction with a society; (b) situations where a person related to the director directly or indirectly benefits from a transaction with a society; and (c) situations where the director's personal views or interests affect decisions made by the director on behalf of the society. The last of these is concerned, essentially, with issues of bias. S.3(2) requires a director to act impartially. Not all cases of bias are attributable to a conflict of interest. A person who holds one-sided views and who is prepared to prejudge a situation is equally guilty of bias as one who makes a decision which promotes self interests. It would be possible, consequently to: (a) regard bias issues as a wholly separate subject that need not be addressed in the legislation; (b) only address bias issues that arise from a conflict between the interests of the society and those of a director (or a person related to the director); or (c) deal with all issues of bias comprehensively in the legislation. The draft legislation adopts the third course.

(3) A **director** must not enter into a **transaction** with the **society**.

See the definition of "transaction." As a general rule, a director cannot enter into a contract with the society, make a gift to it, or receive one from it, although there are exceptions to this rule (particularly for transactions by which the society receives what is in substance a gift): see ss. 4 and 7. In contrast, under the current law a director may enter into a transaction with a society provided the director's personal inter-ests are disclosed to fellow directors and the board authorizes the transaction.

(4) A **director** must not use the position of **director** to derive a **benefit**.

A director may have opportunities to use the office for personal advantage. The draft legislation prohibits such conduct. The language of the section is neutral. Basically, accepting any collateral benefit, except as otherwise authorized under this Act, qualifies as unethical behaviour. The benefit might more colloquially be characterized as a bribe. A director may not accept, or extract, a collateral benefit

or advantage in connection with the office of director. The definition of "benefit" specifically excludes advantages associated with the prestige of being a director. See, however, s. 6(1) and the provisions in the Model Conduct Guidelines relating to the acceptance of gifts (Appendix B).

(5) A **director** must not disclose or **benefit** from the use of confidential information obtained by participating in the **society**.

Insider information must not be used for personal advantage. Confidential information is a form of property. For other rules relating to the use of society property, see the Schedule B Conduct Guidelines. The use of confidential information is really outside the kinds of behaviour generally considered to be a conflict of interest, but the obligation set out in subs. (5) is consistent with fiduciary duties expected of a director.

(6) A **director** must avoid any situation that could result in the appearance of a breach of subsections (1) to (5).

In some cases, even the appearance of profiting from a conflict of interest may damage the credibility of the director, the board and the society. A director, consequently, is under a duty to avoid not only actual conflicts of interest but the appearance of acting while in a conflict of interest.

The Society's Duties

4. (1) A **society** must not enter into a **transaction** with a **related person**.

"Related person" is defined and refers to a person related to a director of the society.

Where a person who is related to a director deals with the society, a suspicion arises that a conflict of interest may have coloured the transaction in one of several ways. Possibly the related person is the director's surrogate so that, while the names have been changed, essentially the director is deriving a personal advantage. S. 3 provides that it is unacceptable conduct for a director to benefit personally. S. 4(1) provides that it is equally unacceptable for a director to do so indirectly through a related person: see limb (a) of the definition of "related person."

The other danger that arises when a related person wishes to transact business with a society is the possibility that the director, through natural ties of love and affection or the anticipation of an indirect financial benefit, may give greater weight to the interests of the related person than to those of the society, or of other people wishing to do business with the society.

The potential participation of a related person raises concerns similar to those that arise when a director is involved in the transaction, so similar rules apply. As a general rule, a society may not enter into a transaction with a related person (by, *e.g.*, entering into a contract with, or conferring a benefit upon, the related person), except in unique circumstances

set out in s. 7. While the society is under a duty to not enter into a transaction with a related person, no liability attaches to a society for failing to abide by this section: s. 8(4). This protection is necessary because a society will not always know whether a person is related to a director. Breach of this section protects a society by triggering the remedies available in s. 8.

(2) A **society** must not enter into a **transaction** with any person if a **director** or a **related person** might derive a **benefit** from it.

The draft legislation covers transactions with a director, those with a related person and, completing the range of possibilities, any trans-action whereby the director potentially derives a benefit.

Board Decisions

5. (1) A **director** must not take part in a **board** decision about a **transaction** between the **society** and

This s. is in addition to the director's obligation to act impartially when making decisions on behalf of the society: see s. 3(2). The board of directors must act exclusively in the interests of the society. A director cannot do so if a personal interest is involved in the matter to be decided. The draft legislation attempts to set these situations out comprehensively: any time a director might benefit personally; any time a person related to a director is involved in the issue; and any time the director might benefit indirectly as a result of the involvement of any person.

"Benefit" is a defined term. It includes any financial benefit; any personal benefit; and any situation where a detriment to the director is avoided.

(a) the **director**,

While the general rule is that a director may not transact business with a society, there are exceptions. See ss. 6 and 7. Even if an exception applies, however, the director may not take part in a board decision relating to the transaction.

(b) a person who is a **related person** because of a relationship or association with the **director**, or

"Related person" is defined. It means a person who is in a family relationship or a business association with *any* director. Unless para. (b) makes it clear which director is barred from taking part in a decision because of the involvement of a related person, s. 5(1) would have the ludicrous result of forbidding all directors from taking part.

(c) any other person if the **director** or **related person** might derive a **benefit** from the **transaction**.

(2) A **director** who must not participate in a **board** decision must

Subs. 5(2) follows the procedure required currently under the *Society Act*.

(a) disclose the reason to the **board**, and

The director is under an obligation to make sure other directors are fully informed about the director's conflicting interest.

(b) not be counted as part of the quorum at any meeting in which a **board** decision is

The law recognizes that not all directors may be able to attend every meeting.

made relating to a **transaction** referred to in subsection (1).

Even so, a sufficient number (a "quorum") must be present to make a valid decision. (The requirement for a quorum ensures that a society's interests are not neglected through apathy). A director who is not permitted to participate in the decision cannot be counted as part of the quorum.

This subs. departs from the current law in two respects: (a) the current rule is that a director cannot take part in a decision to *approve* a transaction. The draft legislation refers to any decision relating to the transaction; (b) the current law allows the society in its by-laws to adopt a different quorum rule. The draft legislation does not provide that option. If a quorum is not present, the board must wait until enough directors are available to consider the matter. But see subs. (3).

(3) Despite subsection (2)(b), a **director** may be counted part of the quorum if

Disqualifying a director from participating may make it impossible to assemble a quorum. If so, in many cases the only answer will be to hold an extraordinary general meeting of the society to elect more directors. The legislation allows the board of directors an option of proceeding. The decision, however, requires unanimity: see para. (b).

(a) it would be impossible due to the resignation, death or incompetence of other **directors** to assemble a quorum even if all other **directors** of the **society** were present, and

(b) the other **directors** present at the meeting unanimously agree to allow the **director** to be counted as part of the quorum.

Sometimes it is difficult to assemble a quorum because directors do not choose to attend the meeting or they are out of town. These factors would not satisfy the requirement in para. (a) that it be *impossible* to assemble a quorum.

Acceptable Transactions

6. (1) Despite sections 3 and 4 a **director** may accept hospitality or a gift that is not of excessive value if

Gifts and hospitality are a normal and accepted part of business culture. Provided the value involved is token or nominal, and these matters are dealt with publicly, there should be no objection to a director accepting a gift or hospitality. The Schedule B Conduct Guidelines further develop what is expected of a person participating in a society in connection with the acceptance of gifts.

(a) it is disclosed to the **board**, and

(b) its acceptance would not compromise or give the appearance of compromising the **director**'s integrity or independence nor impugn the reputation of the **society**.

(2) The following **transactions** do not contravene sections 3 or 4:

Some transactions between a director and a society are acceptable by definition.

(a) the **director** receives

These include the payment of remuneration (para. (a)). Few direc-tors

(i) reasonable remuneration for services performed by **the director** and properly rendered to the **society**, and

(ii) reimbursement for expenses reasonably incurred in performing those services,

of societies serve for pay but, where such an arrangement is in place, accepting the remuneration and other employment benefits is not considered a conflict of interest. This does not mean that the public will necessarily find all such arrangements between a society and a director to be acceptable. The subs. refers to *reasonable* remuneration.

(b) the **director** guarantees repayment of, or otherwise assumes liability to repay, a loan made to the **society**,

Other acceptable transactions include: transactions essential for the conduct of the corporation's business (guaranteeing loans) (para. (b)); transactions a society carries out with other societies (para. (c)); transactions whereby a director guarantees the faithful discharge of duties owed the society (para. (d)); and transactions necessary to ensure that people will act as directors (para. (e)).

(c) the **transaction** is with another **society** and the **director** is also a **director** or member of that **society**,

Para. (c) parallels the position adopted for companies. A transaction between two companies that are formally related to each other (*e.g.*, one may be a subsidiary of the other) is not affected by a conflict of interest, even if the two companies share a director. Para. (c) adopts a wider view because societies are engaged in non-profit activities. There may be circumstances where a society should not deal with another society, but they are not governed by this act. A society is not considered to be a related person to one of its directors. Similarly, where a director of one society is a member of another, the second society is not a related person to the director within the meaning of this legislation. A transaction between a society and a company with common directors, however should be viewed with the same suspicion as transactions between a society and any of its directors.

(d) the **director** posts security to ensure the faithful fulfilment of the **director**'s duties to the **society**,

(e) the **society** agrees to indemnify or reimburse the **director** for expenses and liabilities incurred by reason of being a **director**, or arrange for insurance against these risks, or

(f) the **transaction** relates to participation in activities the **society** regularly makes available to its members.

Nothing should prevent a director from taking part in the society. The draft legislation is aimed at business transactions and exceptional arrangements. Suppose, however, that the society arranges for a trip to Hawaii for any member that wishes to go. The member must pay for the trip, but the society has managed to get discounted prices on travel and accommodation. There is no reason for preventing a director from taking part in society activities. A distinction must be drawn, however, where an opportunity is available through the society but it is not

available to all members (such as examples given in the text relating to a society awarding a limited number of grants). In these cases, a director should not be able to benefit unless the transaction can be authorized by the board of directors under one of the exceptions listed in s. 7. Para. (f) draws this distinction be referring only to activities "regularly" made available to members.

Authorization

7. (1) Despite sections 3 and 4, the **board** may authorize a **transaction** listed in subsection (2) where

Transactions involving a director's conflict of interest may be authorized by the board of directors in exceptional circumstances, where the decision to authorize is clearly in the best interests of the society.

(a) a **director** who must not participate in the **board** decision has disclosed the reason to the **board**,

S. 5 sets out the circumstances where a director must not participate in a board decision. The board's authorization is meaningless if it does not have complete information about the director's conflicting interest. See also s. 7(3).

(b) the **transaction** is fair and reasonable to the **society**,

Two fundamental conditions must be satisfied before a transaction can be authorized and, after those hurdles are cleared, a reason for allowing the transaction (set out under subsection (2) must exist.

Condition 1: the transaction must be a fair one from the society's perspective.

(c) the **transaction** is in keeping with community expectations about the conduct of the **society**'s activities,

Condition 2: the transaction must be a fair one from the perspective of the public. The board must be sensitive to the interests of the society as well as the concerns of the community.

(d) a quorum of the **board** is present for the decision, and

See s. 5(3).

(e) the resolution authorizing the **transaction** is passed by a majority of not less than 75 per cent of those on the **board** present and entitled to vote at the meeting.

The *Society Act* currently allows the board to approve a transaction by a simple majority. Emphasizing the extraordinary nature of allowing a transaction touched by a conflict of interest to proceed, the draft legislation provides that approval by a simple majority is insufficient.

(2) The following **transaction**s may be authorized:

(a) a **transaction** with a third party which confers a **benefit** on a **director** or **related person**, or any **transaction** with a **director** or **related person**,

As mentioned before, the legislation deals with three different transactions: between a society and a director; between a society and a person related to a director; and between a society and anyone else, where a director or related person will derive a benefit.

(i) by which the **society** receives an unconditional gift, or what is in substance a gift,

Non-commercial transactions benefiting a society do not carry with them the same concerns as those that are entered into with a view to profit. Even so, not all

such transactions should be authorized. The motive for the gift may place the society in an ethical dilemma. An obvious conflict with a society's stated aims would probably make a gift unacceptable.

(ii) which only the **director**, **related person** or third party can complete within a reasonable time and according to reasonable standards pertaining to quality of work or the qualifications or accreditation of the person who will carry out the work,

In some cases, the conflict of interest must, as a matter of necessity, be accommodated to give effect to a competing, but more important, policy. In these cases, not allowing the transaction to take place will result in more harm to the interests of the society than would flow from tolerating the conflict of interest.

If no one else can complete a *necessary* transaction, nothing is gained by preventing a society from entering into the transaction.

(iii) which only the **director**, **related person** or third party is willing to carry out,

A number of people may be qualified to carry out the transaction, but if they are unwilling to do so, the society faces the same dilemma encountered under para. (ii).

(iv) which manifestly represents **benefits** to the **society** so substantial that no other decision makes economic sense, or

Para. (iv) is related to para. (i). It would be unrealistic to expect a society to pay a hefty premium for avoiding a transaction which is clearly to its benefit to enter.

(v) the financial consequences of which are minimal.

The less money involved in a transaction, the less concern people have about the existence of a conflict of interest. If the financial consequences of a transaction are minimal, the board of directors should be capable of authorizing it. In practice, it is likely that the conflict of interest present in a transaction described in para. (v) will be ignored.

(b) a **transaction** with a third party that might benefit a **director** or a **related person** as a member of a **special group** in circumstances where the **board** needed representation from the **special group**, or

Para. (a) deals with transactions from a financial perspective. Para. (b) concerns circumstances where a transaction with someone other than a director or related person may result in benefiting a director or related person. Where a related person is involved, it is the relationship that raises cause for concern.

Ordinarily, the presence of an indirect benefit to a director would be enough reason for a society not to enter into the transaction (unless the transaction is one described in s. 7(2)(a)). Similarly, an indirect benefit to a related person raises cause for concern, but such a transaction may be authorized if it satisfies the requirements of s. 7(2)(c).

An exception must be made, however, to accommodate circumstances where a society, in order to make informed decisions, must have on its board of directors representatives from particular sectors that will be affected by, or involved in, transactions with the society. See the definition of "special group."

Para. (b) refers to "needed" representation, but does not define what would satisfy that requirement. An argument might be made, *e.g.*, that a society that runs a girls' soccer league needs representation from the special group of people who are parents of female soccer players. We have in mind a stricter threshold than that. The Legal Services Society, *e.g.*, sets tariffs for the payment of lawyers who represent clients under the legal aid program. Some of its directors are lawyers, and some of them participate in the legal aid program. Most people would agree that the society "needs" some representation from people who are lawyers, a "special group" that may be affected by transactions with the society. (Note that the Legal Services Society would not come within the terms of the draft legislation, unless cabinet were to make that decision by regulation.) Should the draft legislation set out a statutory test that must be met to establish the need for representation? Would it be enough if the board of directors or a majority of the members, passes such a resolution? Perhaps a particular agency is authorized to nominate a director to represent its interests. Would the agency's decision be sufficient? We have found the issues dealt with by this part of s. 7 to be particularly difficult and would welcome comment and advice on the methods we suggest.

(c) a **transaction** with a **related person**, if

Para. (c) addresses two problems that arise from the involvement of a related person in a transaction. The first is where there is no reason to expect the director will benefit financially from the transaction (subpara. (i)). The second is where the director has a close relationship with the related person, but it is that very relationship which has motivated placing the director on the board: see subpara. (ii).

(i) the **transaction** provides no financial advantage to the **director**, or

If the transaction has no financial dimension (subpara. (i)), the inquiry shifts to whether the conflict involves bias or insider advantage (see subpara's (iii) and (iv)). These are matters that can be considered by the board. A number of factors may suggest that the transaction is acceptable: the relationship may be distant in terms of blood or marriage, or in fact; or steps may be available to insulate the perceived conflict. In these cases, a board of directors should be able to authorize the transaction. It is unrealistic to try to protect a society by barring all transactions with all related people.

Where the related person is a society (as defined), this category of transaction might also be dealt with under s. 6(2)(c). One society is free to transact business with another despite sharing a director.

(ii) the **director** is a member of a **special group**, the **board** needs representation from the **special group**, and the **director**'s membership in the **special group** is inextricably linked with the **director**'s relationship to the **related person**

See the definition of "special group." The annotation to s. 7(2)(b) is also relevant. Para. (b) addresses *transactions with third parties* that might affect a director or related person. In contrast, para. (c) deals with *transactions with related persons*. *E.g.*, the society will hold events that a number of broadcasting networks wish to televise. The society will need someone versed in the field of broadcasting. It might be impossible to obtain the services of a director with suitable expertise if the director's participation excludes the director's employer from bidding on the telecasting rights.

provided that

(iii) a **related person** does not have access to information unavailable to others with whom the society could enter into a similar transaction, and

Sometimes problems arising from the involvement of a related person can be dealt with by introducing suitable methods of confining the conflict. In many cases, barring access to information not generally available will be enough to ensure the related person does not gain an unfair advantage. In the broadcasting company example, it may be enough simply to adopt procedures which ensure the director is not involved in the company's bidding, in this way ensuring the company does not have access to insider information.

(iv) the **director** did not intervene to confer a benefit on a **related person**.

A director may have available indirect methods of favouring the interests of a related person. The director, *e.g.*, may be able to influence those who are charged with selecting the successful bid, or of shaping the standards called for to conform with the skills or services, etc., the related person makes available. Any of these activities to favour a related person are objectionable and forbidden under the legislation. The board must satisfy itself that the director is not intervening on either side of the transaction to favour the interests of a related person.

(3) A failure by a **director** to provide the **board** with enough information to assess the nature of an interest in a **transaction** invalidates an authorization under this section.

It stands to reason that an authorization based on inadequate information cannot protect a director. The policy must be to encourage full and frank disclosure. The invalidity of the authorization, however, does not affect the validity of the transaction: see s. 8(2).

(4) A **board** that authorizes a **transaction** under this section must record in the minutes of the meeting the item in subsection (2) relied upon for the authorization.

This practice will ensure the board of directors turns its collective mind to the requirements of the legislation.

(5) A **board** that authorizes a **transaction** under this section may make the authorization contingent upon the **director** taking steps or observing procedures that may be necessary in

A number of procedures are available for avoiding or insulating a conflict of interest. Currently, the *Society Act* requires only disclosure. But there are often steps

the circumstances to protect the **society** or to safeguard the public trust in the conduct of the **society**'s activities.

that can be taken before, during, and after the transaction to protect against any prejudice arising from a conflict of interest. A director might be required to provide periodic reports about financial and personal interests, *e.g.*, or special arrangements might be put in place to limit the extent of the conflict.

(6) A proposed **transaction** by which a third party is engaged to scrutinize the affairs of the **society** and which contravenes section 3 or 4 may not be authorized by the **board** under this section.

An example given earlier is engaging an auditor to check the society's books. Someone in a close relation-ship with a director would be in, or give the appearance of being in, a conflict of interest. Such a transaction should not be capable of being authorized.

(7) A **board** decision authorizing or refusing to authorize a **transaction** under this section is not reviewable if

No transaction may be questioned asserting that the board lacked proper jurisdiction to authorize a particular transaction. The board's discretion must be relied upon to apply the guidelines set out in the draft legislation.

(a) procedures required for arriving at the decision were faithfully observed,

(b) the **board** had enough information about the **transaction** to assess the nature of the interest of a **director** or a **related person** in it, and

(c) the **board** acted honestly and in good faith.

Remedies

8. (1) A **director** must account to the **society** for **benefit**s received by the director or a related person as a consequence of the **society** entering or performing a **transaction** that violates section 3 or 4 and that is not validly approved under section 7 unless

S. 8(1) is based on s. 28 of the *Society Act*. It broadens the court's jurisdiction in one particular. The director's liability to account is not confined to "profits" derived from the transaction. The draft legislation is intended to replace the sections in the *Society Act* that address conflicts of interest issues.

(a) the **transaction** was reasonable and fair to the **society** at the time it was entered into, and

S. 8(1) allows members of a society to approve transactions that the board of directors could not have authorized. The reason: to encourage directors to disclose the existence of a conflict whenever it is discovered. Provided the transaction was fair and reasonable when it was made, there is little likelihood the society or the public suffered by the presence of the conflicting interest.

Members may ratify the transaction while still deploring the director's conduct. A director who flagrantly disregards the conflicts rules is unlikely to be returned to office in the next election. This is a more suitable method of dealing with the problem than setting aside the transaction and possibly prejudicing third party interests. But see s. 8(2) which empowers a court to provide such a remedy in suitable circum-stances.

(b) after full disclosure of the nature and extent of the **director**'s interest in the **transaction** the members approve it by **special resolution**.

"Special resolution" is defined as having the same meaning it has under the *Society Act*. Basically, the membership must approve the transaction by no less than a 75 per cent majority.

(2) If a **transaction** is entered into in contravention of this Act, it is not void but the court may, on the application of the **society** or an interested person,

Subs. 8(2) is based on s. 29 of the *Society Act*.

(a) prohibit the **society** from entering the proposed **transaction**,

(b) set aside the **transaction**, or

(c) make any order that it considers appropriate.

(3) No liability attaches to a **society** for contravening section 4.

S. 4 places a duty on a society not to enter into a transaction with a person related to a director, or a person who is not related but through whom a director will derive a benefit as a result of the transaction. S. 8 (3) provides that a society is not liable if it breaches one of these duties. Breach of s. 4, however, triggers other remedies under s. 8.

(4) Nothing in this Act relieves a **director** from a liability that by virtue of a rule of law would otherwise attach to the **director** in respect of negligence, default, breach of duty or breach of trust of which the **director** may be liable in relation to the **society**.

Subs. (4) preserves the common law and equitable principles that apply when a director breaches duties owed the society. It is based on s. 26 of the *Society Act*. But see subs. (5).

(5) Despite subsection (4), a court may relieve a **director**, either wholly or partly, of any liability that arises from a breach of duties owed the **society**, including responsibility arising from a breach of duties under this Act, where the **director** acted honestly and reasonably.

S. 8(5) gives the court a jurisdiction which corresponds to one it enjoys with respect to a trustee who has breached duties owed a beneficiary: see *Trustee Act*, R.S.B.C. 1979, c. 414, s. 98. In some circumstances, particularly where the director has acted innocently, it will be inappropriate to penalize, or penalize too severely, the director. Subs. (5) gives the court jurisdiction to tailor the remedy to the circumstances.

Regulations

9. The Lieutenant Governor in Council may make regulations:

(a) exempting a **society** from the application of this Act,

The draft legislation sets out conflict rules of general application. There may be cases where these rules should not apply. Cabinet can make that decision on a case-by-case basis. There would be few cases where an exemption would be justifiable, but there are some. Perhaps the society or director is subject to separate rules (under, *e.g.*, another Act).

(b) exempting a **director** or **related person** from the application of this Act,

(c) stipulating special rules of conduct for a person or **society** subject to this Act,

(d) declaring a person or a class of people to be **directors** for the purposes of this Act,

Cabinet may decide that people who hold a particular office in the society (such as the chief executive officer) should be subject to the same rules that apply to directors. The draft legislation allows cabinet to make such a designation by regulation. In most cases, the conduct of people other than directors will be suitably guided by the standards of conduct that apply to the society: see, *e.g.*, Schedule B.

(e) declaring a person or entity to be a **society** for the purposes of this Act if it

Similarly, cabinet can decide that these rules should apply to agencies other than societies. *E.g.*, these standards of conduct would be appropriate for government agencies to observe, as well as for various foundations.

(i) is created by an enactment,

The criteria set out in para. (e) operate alternatively. Virtually any agency having some public dimension could be designated to be a "society" within the meaning of the draft legislation.

(ii) is created by an agreement to which the province is a party,

(iii) has a **board**, the majority of whose members are nominated or appointed by the province,

(iv) carries out activities that are funded in whole or in part by the province whether by loan, subsidy, tax concession, grant or payment under a contract to deliver services,

(v) has indebtedness the repayment of which is guaranteed by the province, or

(vi) is financially supported in whole or in part by public subscription or donation.

Schedule A

Each of the following is a **society**:

[*E.g.*
The Law Foundation
The Vancouver Foundation
The Victoria Foundation...]

No decision has been made to make these specific organizations subject to the suggested legislation. They are included only for the sake of example.

Schedule B

[See Appendix B]

APPENDIX B

DRAFT MODEL CONDUCT GUIDELINES

The Commission tentatively proposes that conflicts of interest rules in the *Society Act* relating to directors should be revised. It is also the Commission's tentative conclusion that conflict of interest issues involving other people associated with a society can be dealt with by adopting Conduct Guidelines. This Appendix sets out an example of Conduct Guidelines that a society might consider adopting. It is based on the materials provided to us in our survey of government agencies (see Appendix E). One option is for legislation to set out standards of conduct, such as these, in a schedule and provide that they apply to any society that does not formally adopt a different set (see section 2 of the draft legislation set out in Appendix A).

These conduct guidelines are virtually as strict as the rules we tentatively propose should govern directors, but they allow a much more flexible approach in terms of determining what constitutes a conflict and how to deal with it.

Draft Model Conduct Guidelines

Advice to the Society

- The society must adopt conduct guidelines. The society may formally adopt these conduct guidelines, perhaps in modified form, or adopt an entirely different set of standards. If the society does nothing, these conduct guidelines apply.
- These conduct guidelines are drafted to apply to everyone involved in a society, other than its directors. A society may choose to have these conduct guidelines also apply to its directors.
- The society should customize the guidelines by providing examples that are encountered by the society.
- The society should provide initial training and annual reminders about duties.
- The society should provide rules for special conflict situations if they are relevant to the society.[1]

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1. *Some examples of special rules depending on the particular functions of the society:*

- If the society performs advisory functions to a purchasing agent it might set out the same obligations that apply to the purchasing agent.

- If the society performs adjudicative functions: (a) it should set out rules for handling bias arising from a close relationship or financial interest. [*E.g.*, "You may not take part in a decision affecting your personal interests of those of close friends, family members or business associates."]. (b) the rules might also acknowledge an exception where there is a need for special expertise. [*E.g.*, the rules might recognize an exception where the conflict arises because of the expert's involvement in the industry or activity in question. The rules might also require suitable arrangements to insulate the conflict.]. (c) the standards of conduct should also set out rules about bribes, and the acceptance of gifts and services.

- If the society may make levies the rules should not permit a conflict, except to the

(continued...)

APPENDIX B
DRAFT MODEL CONDUCT GUIDELINES

Definition

1.1 A "conflict of interest" is any situation where
(a) your personal interests, or
(b) the interests of a close friend, family member, business associate, corporation or partnership in which you hold a significant interest, or a person to whom you owe an obligation

may prevent you from acting
(c) in the society's best interests, and
(d) on behalf of the society fairly, impartially and without bias.

General duties

1.2 You must arrange your private affairs and conduct yourself in a manner to avoid
(a) a conflict of interest, or
(b) the appearance of a conflict of interest.

1.3 Unless authorized to do so, you may not
(a) act on behalf of the society, or deal with the society, in any matter where you are in a conflict of interest or appear to be in a conflict of interest, nor
(b) use your position, office or affiliation with the society to pursue or advance your personal interests or those of a person described in s. 1.1(b).

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1. (...continued)

extent that the levy affects a person as a member of a class.

- If the society is an employer the rules should deal with employee/volunteer relationships. [*E.g.*, "You may not use your position with the society to extract services for your personal benefit."]

- If the society makes grants the rules might provide for a total prohibition on certain people receiving grants.

- If the society sets qualifications and training standards: (a) the rules should allow industry representatives to participate, but set out rules to insulate the conflict. (b) special rules might deal with particular issues. [*E.g.*, "You may not extract volunteer work from a trainee, or appropriate a trainee's work for your own."]

- If the society sets standards/tariffs/opportunities the rules might provide for industry representation, but set out special rules to insulate the conflict.

- If the society administers a large purchasing budget: (a) the rules might provide an obligation to set standards generically. (b) the rules might prohibit certain people from buying from, selling to or dealing with the society.

- If the society performs many operational functions it should have rules about hiring, advancement, salaries, etc. [*E.g.*, "If you have influence over a decision to hire, you must act fairly. You must adequately advertise available positions. You must hire the best-qualified applicants."]

1.4 You must immediately disclose a conflict of interest in writing to the board of directors or a person the board designates. It is important to make the disclosure when the conflict first becomes known. If you do not become aware of it until after a transaction is concluded, nevertheless you must still make disclosure immediately.

1.5 If you are in doubt about whether you are or may be in a conflict of interest, you must request the advice of the board of directors or a person the board designates.

1.6 Unless otherwise directed, you must immediately take steps to resolve the conflict or remove the suspicion that it exists.

More About Avoiding a Conflict of Interest

2.1 You must not personally benefit from any transaction involving the society except in unique situations, authorized in accordance with these rules.

2.2 You must not indirectly benefit from any transaction involving the society except in unique situations, authorized in accordance with these rules.

2.3 An "indirect benefit" is
(a) a benefit derived by a close friend, family member, business associate, or corporation or partnership in which you hold a significant interest, or
(b) a benefit which advances or protects your interests although it may not be measurable in money.

2.4 You must not use your relationship with the society to confer an advantage on yourself or on a close friend, family member, business associate, or a corporation or partnership in which you hold a significant interest.

Using Society Property and Society Information

3.1 You must have authorization to
(a) use property owned by the society for personal purposes, or
(b) purchase society property unless it is through usual channels of disposition equally available to the public. Even then, you may not purchase the property if you are involved in some aspect of the sale.

3.2 You may not take personal advantage of an opportunity available to the society unless
(a) it is clear that the society has irrevocably decided against pursuing the opportunity, and
(b) the opportunity is equally available to members of the public.

3.3 You may not use your position with the society to solicit clients for a personal business or one operated by a close friend, family member, business associate or a corporation or partnership in which you have a significant interest. This duty does not prevent you or anyone else from transacting business with other people connected with the society.

3.4 "Society information" is information which is acquired solely by reason of involvement with the society and which the society is under an obligation to keep confidential.

3.5 You may have access to society information only for society purposes.

3.6 You must not use society information for your personal benefit.

3.7 You must protect society information from improper disclosure.

3.8 You must report any incident of abuse of society information.

3.9 You may divulge society information if
(a) you are authorized to release it, and

(b) it is to a person who has a lawful right to the information.

3.10 If you are in doubt about whether society information may be released, you must request advice from the board of directors or a person the board designates.

Transactions That Cannot Be Authorized

4.1 You may not directly or indirectly benefit from a transaction with the society over which you are in a position to influence decisions made on behalf of the society.

Rules About Gifts

5.1 You may accept a gift in the following circumstances:
(a) the gift has no more than token value,
(b) it is the normal exchange of hospitality or a customary gesture of courtesy between persons doing business together,
(c) the exchange is lawful and in accordance with local ethical practice and standards, and
(d) could not be construed by an impartial observer as a bribe, pay off or improper or illegal payment.

5.2 You personally may not use society property to make a gift, charitable donation or political contribution to anyone on behalf of the society. Any gift must have the authorization of the board of directors or a person the board designates.

APPENDIX C

EXAMPLES INVOLVING A FICTITIOUS SOCIETY

Conflicts of interest cases are not easily categorized. Some suggestion of the scope of the problem, and the various gradations between particular classes of conflicts of interests is needed to begin identifying potential solutions. This Appendix attempts to do this through examples.

The examples consist of relatively common situations that involve, or appear to involve, conflicts of interest. The examples are built around a mythical society that promotes opera, theatre and dance: The Fraser Valley Musical, Dramatic and Dance Society ("FVMDDS"). Its revenues are only partly based on membership dues. FVMDDS also conducts "fund raisers" throughout the year, including a lottery and a casino night. It also receives grants from the municipality, the province and the federal government. Money is also made available by foundations which sponsor and promote the arts.

The examples are common enough but the issues raised are of general application. In each case, the question is whether there is an actual or potential conflict of interest (either as defined by law, or which many would agree exists by reference to non-legal ethical standards). If a conflict exists, is it caught by the current legal rules? What conflicts are not caught? How well are the current legal rules working?

These examples give a snap shot of typical problems that might arise in the operation of a society with a medium sized budget. The examples can also be used as a point of comparison with societies with proportionally larger (and smaller) budgets. Increasing the amount of money involved magnifies the seriousness of the conflict. Decreasing it may render it trivial. Can a single set of rules apply to all societies? The stricter the rules, the more costly they will be to administer. What is an acceptable cost for a large society may prove ruinously expensive for a small society operating on limited funds.

Some might be prepared to dismiss many of the examples out of hand on the ground that little money is at stake, or because of a cynical expectation that this is the way people behave. But these examples are based largely on complaints that found their way into the news programs and newspapers of the province and over which there has been some community outrage. A review of summaries of these examples, bearing in mind the public reaction to them, may help the reader judge comfort levels with respect to both the current rules, and possible changes to them. Appendix D sets out synopses of these cases.

Keep in mind that our chief concern is with those agencies that are partly, or entirely, supported by public funds, or whose operation is subject, in some way, to public subsidy. Some examples where a director benefits directly may seem harmless, or reflections of human nature, the kind of matters usually addressed in an informal way (usually by expressions of disapproval). The same situation takes on a different hue if public money is being used for personal purposes.

Various names are used in the examples simply to make the fact patterns clearer. None of them refer to real people or organizations and, if we have in error used your name, please accept our apologies in advance.

(1) T is a member of FVMDDS's board of directors. T also operates a business, Stars Inc., which acts as an agent and impresario, bringing in professional performing artists. FVMDDS wishes to book a particular theatre for its dance extravaganza, "Les Ballets Folklorico de Chilliwack." Stars Inc. wants to book the theatre on the same dates for the "Pounding Tim Canners Farewell Tour." Stars Inc. outbids FVMDDS.

(2) A person whose company sells building supplies sits as a volunteer on a committee advising FVMDDS about acquisitions. The committee recommends purchasing set construction material sold by the volunteer's company although there are many other potential suppliers, all providing similar value and quality for the money.

(3) Stars Inc. has some used office equipment it no longer needs. Director T suggests that FVMDDS buy it. The operating manager of FVMDDS does so, although personally she feels that it is not a good buy. For one thing, FVMDDS can't really use it.

(4) Director H is a doctor. There is a need for a dance trainer. Director H acts in this capacity for no fee, except that where a medical service is called for, the Medical Plan is billed.

(5) Director H has a friend who operates a company that sells theatrical equipment (backdrops, curtains, and lighting equipment) and arranges a 15 per cent discount for FVMDDS.

(6) Bids are invited to supply particular equipment. Two companies submit bids at the same price (each offering a 15 per cent discount). Since there is nothing to choose between them, the board chooses the company run by Director H's friend.

(7) One director operates a company which is the exclusive sales agent for the manufacturer of "Tip Toes" a superior ballet shoe. No other local company provides a similar shoe. "Tip Toes" are more costly than shoes offered by other suppliers because of their high quality. It is generally considered beneficial for amateur performers to use professional quality shoes.

(8) The operating manager of FVMDDS sets up an area exclusively used for mime. Few members of FVMDDS are interested in mime, but the operating manager is a student of the discipline. The manager engages an instructor to teach a class once a week, but only a couple of members join the manager in taking part.

(9) The manager feels that public relations are important and regularly takes various members of the community out for lunch (the mayor, the high school principal, local professional performing artists). The board of directors question whether this is of any use to FVMDDS at all.

(10) The lease on rehearsal space rented by FVMDDS comes up for renewal. FVMDDS cannot afford to renew. An employee takes the lease and sublets at a profit to Stars Inc., which needs additional space.

(11) The directors consider whether it might make sense to buy a theatre (various additional grants might be made available for this purpose, which are not available for the ongoing expenses of FVMDDS). A real estate agent is retained and suggests a few properties that might serve as a theatre. Director Y, acting on the information, buys the best of them and offers to sell it to FVMDDS.

(12) FVMDDS decides not to buy the property. Director Y sells it to Stars Inc.

(13) FVMDDS is upset about Director Y's activities. It seeks legal advice. A firm of lawyers is consulted. Director Z is a partner in the firm.

(14) FVMDDS's books are prepared by an accounting firm run by Director Y's brother-in-law. The accounting firm charges expenses but no fees for these services.

(15) FVMDDS identifies a number of other suitable locations. One director, X, is particularly keen on location A. At a director's meeting, location A is settled on. It is too expensive to buy, so it is leased instead. Everyone feels that location A is pricey, but well worth it. Two years later, Director X takes a position with the Company that owns location A.

(16) The new location creates transportation problems for some performers and crew. Director G agrees to drive those who live near him. After a while, this responsibility becomes burdensome and Director G suggests chauffeuring should be a paid position. The board of directors authorizes a contract with Director G.

(17) FVMDDS receives funds from the government to sponsor a few people to take part in a dance workshop in Winnipeg. Applications are invited from all amateur performing artists in the province, not just members. Some of the directors are also amateur performing artists and apply for grants. One of the director's sons also applies.

(18) FVMDDS has enough funds to send 15 people to Alberta for another workshop. Two years ago, one director accompanied 14 participants. Last year, the directors decided that more supervision was needed. 9 directors accompanied 6 participants.

(19) The decision last year to send so many directors attracted a good deal of negative comment. This year it is resolved that only workshop participants will be funded by FVMDDS. Any director who wishes to attend must do so at personal expense. The directors approve grants to 15 people. Of these, 3 are members of FVMDDS. All 15 are from Vancouver. Coincidentally, all of the directors are from Vancouver and for that reason most familiar with the performing artists from their region. 5 of the successful applicants are students of a former director of FVMDDS.

(20) FVMDDS is casting for a new opera, "Hannibal Lecter." Roles are open to all performing artists, not just members of the society. A member of the society is selected to direct the production. All the lead roles, but one, are cast with members of the society.

(21) FVMDDS productions have a sliding ticket price: for adults, students, and seniors. Members are entitled to a 10 per cent discount. The directors vote that directors are entitled to a 50 per cent discount on all FVMDDS productions.

The examples suggest the kinds of changes that can be rung on conflicts of interest scenarios. In the course of our work, we have considering existing rules, and reform ideas, against these examples, but not a lot would be achieved by setting out this analysis here. The reader, however, should consider whether particular fact patterns raise concerns and give some thought to acceptable ways of resolving them.

These examples are extensive, but not comprehensive. Each example suggests themes into which numerous variations can be introduced. If an example concerns a director's son, should different results follow if it is the son of the director's best friend? If a time element is involved, does it make any difference if subsequent events take place immediately after a particular decision or some years later? If the director benefits from a particular decision, does the kind of benefit alter matters? What should happen if a director doesn't take personal advantage of an opportunity originally available to the society, but tells a friend about it. And so on.

APPENDIX D

RECENT ALLEGED SITUATIONS OF CONFLICTS OF INTEREST

A. Introduction

This Appendix is a companion to Appendix C. Appendix C sets out examples of conflicts of interests against the background of a typical society.[1] In preliminary work, we asked various people to consider the examples and give us their views about which ones they felt were troubling and which were acceptable. We were surprised to find that many people felt that the issues did not present real problems. In part, this may be because the scenarios do not involve large sums of money.

The reaction to this survey was in stark contrast to the high dudgeon expressed in the newspapers of our country in stories which mark falls from ethical grace of people involved in societies, other kinds of agencies and political office. It is useful, consequently, to review actual examples of alleged conflicts of interest as a check against reactions to the examples. Presumably, most people share some of the sense of outrage that found expression in the media coverage of these events. What explanation might account for these different perceptions? Are we as a community prepared to accept ethical lapses from people dealing with some kinds of agencies and not others?

It should be observed that including particular fact patterns in the following list suggests no value judgment on our part. In many cases, the conflict might have been unavoidable, or a practice that has the general approval of the community and is considered entirely acceptable. In some cases, initial perceptions might have been mistaken, and further information, unavailable to us, justified the questioned conduct.

(1) A society is set up to provide a public service. The person who sets up the society is also the operating officer, and takes responsibility for many of the financial decisions that must be made. Clients of the society object to some of the expense accounts the operating officer submits. Directors of the society resign because they are unable to exercise any influence over the operating officer.

(2) The provincial government incorporates a society to operate a tourist-oriented service, which will set up entertainments throughout the province. No external supervision is set up over the society's application of funds, and it goes seriously over budget. Many businesses in the community feel they did not get a fair chance to bid on various contracts the society entered into.

(3) A government office hires an appraisal firm to advise on the purchase of property needed for public purposes. Principals in the appraisal firm purchase adjoining commercial property for their personal purposes.

(4) The chair of a foundation is a partner in a law firm. Legal work required by the foundation is directed to the firm.

(5) Directors of a society operate a newsletter on behalf of the society. They are paid separately (over and above any remuneration for being a director) for the services they provide. Members of the society object to the arrangement.

(6) The director of a society charges a number of personal expenses (such as meals) to the society. The director's son has the use of a car purchased by the society.

(7) A society invites tenders on a number of large contracts. A company owned by one of the directors submits a bid. The director reveals the conflict and does not take

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1. No single society, of course, would ever produce the extraordinary range and amount of conflicts issues set out in the examples.

part in the decision about which bid to accept. The director's company's bid is accepted.

(8) Several directors of a funding body apply personally for grants. Each discloses the conflict and does not take part in the decision respecting their own grant application. All are approved.

(9) Employees of a society take advantage of a loose petty cash arrangement to take sizeable salary advances, but quit their jobs before becoming entitled to the salary.

(10) Former students operate a society for current students of a school, but make decisions in their own best interests.

(11) A director gets an interest-free mortgage from a society.

(12) The directors of a board negotiate salaries with their employees. The salaries of the directors are calculated by a formula based on the salaries of the employees.

(13) Directors of a board set their own salaries.

(14) A person who is a teacher in area A is elected to a school board in area B. The board negotiates contracts with the teachers in area B, knowing that the standards set will be referred to in negotiations in area A.

(15) Directors of a board authorize trips (with their spouses) ostensibly on board business.

(16) Directors on a board authorize interest free loans for directors and the use of "company cars."

(17) Funds received by a society are diverted by a director to non-society purposes, some of which benefit members of a political party in which the director is a member.

(18) A person associated with the motor vehicle branch accepts bribes for arranging driver's licenses.

(19) Doubts are expressed about whether a senior member of the management of I.C.B.C. is capable of carrying out duties in light of a bad driver's record.

(20) Someone associated with I.C.B.C. has unauthorized access to, and discloses, the confidential driver's record of a senior member of management.

(21) A member of Parliament receives a campaign donation from a body who received a government grant sponsored by the member of Parliament.

(22) A court holds that a law firm joined by a lawyer who acted for one party in a dispute cannot represent the other party.

(23) A court holds that a law firm joined by a legal secretary who worked for a law firm that acted for one party in a dispute cannot represent the other party.

(24) The impartiality of an adjudicative panel is challenged on the basis that one of its members is associated with a company that is a business rival of a firm of one of the people appearing before the panel.

(25) A lawyer refuses to take part in a public inquiry commission dealing with forestry issues because clients will be affected by decisions made by the commission.

(26) A government agency works with a private company to develop a new product the agency requires. After the product is developed, an employee of the agency

involved in the process resigns and sets up a competing business manufacturing the same product. The agency buys from the former employee's business.

(27) A board authorizes for its members free lifetime passes to use facilities managed by the board.

(28) Concerns are raised about how money and property owned by a society that helps street kids is being used.

(29) Doubts are expressed about the conduct of a prosecutor of the same faith as the accused.

(30) A cabinet minister makes a decision that affects a company the minister once worked for, and with which the minister still retains seniority rights.

(31) A woman receives a desirable promotion at I.C.B.C. The woman's husband is a senior manager of the corporation.

(32) A former member of the Legislative Assembly is hired under contract as an adviser about native issues by a cabinet minister. At the same time, the former member is also under contract to a ministry-funded group whose task is to promote aboriginal culture.

(33) A councillor makes travel arrangements for official business using a travel agency he owns.

(34) A councillor votes on a resolution to change a residential zoning designation for property owned by the councillor's brother-in-law.

B. Categories

The examples above can be grouped. For our purposes, we have grouped the examples into six categories, although finer distinctions could be made. Placing an example in a particular group does not mean that we think that the example represents an actual conflict. In many cases, only an appearance of a conflict may exist. In some cases, public perceptions about the existence of a possible conflict seem highly dubious. In each of these cases, however, a great deal more information would be needed to determine whether or not there was an actual conflict of interest.

(1) A person or organization receives a (direct or indirect) personal benefit: 1, 4, 5, 6, 7, 8, 10, 11, 12, 13, 14, 15, 16, 21, 27, 30, 33,

(2) A person or organization related to a director, officer, employee, MLA, MP, etc. receives a (direct or indirect) personal benefit: 4, 6, 7, 14, 15, 17, 25, 26, 30, 31, 33, 34.

(3) Third parties do not have equal opportunity to deal with publicly financed body: 2, 5, 8, 33.

(4) Persons associated with an agency misuse agency property or information: 3, 6, 15, 20, 22, 23, 26, 28.

(5) Persons associated with an agency may be biased: 19, 24, 29, 30, 32.

(6) Persons associated with the agency may be guilty of fraud or have committed a crime: 9, 18.

APPENDIX E

SURVEY: CONFLICTS OF INTEREST MODELS ADOPTED BY GOVERNMENT AGENCIES

Early in this project, it was felt that experience acquired by government agencies and boards in dealing with conflicts of interest would be invaluable in devising new rules to apply to societies. We requested information from over 210 boards, agencies and commissions and received replies from 163 of them. Of those that responded, only 51 had formal conflicts of interest rules or guidelines, and the majority of these were very rudimentary. Many agencies that had no formal rules or guidelines, however, adopted what was frequently described as a commonsense approach. When a conflict of interest arose, it was dealt with in a practical way.

Surprisingly, many bodies said the functions they carry out do not give rise to conflicts of interest problems. This was the position, for example, of the majority of marketing boards that replied to our survey. Most had no conflicts of interest guidelines and many advised us that they had no need of them. Yet, typically, a marketing board consists of representatives of the industry being regulated. Any decision about quotas or prices will naturally affect everyone involved in the industry. This is a conflict of interest at the most basic level. In contrast, the conflicts of interest guidelines of one marketing board ranked among the strictest of any agency surveyed. Clearly, views differ significantly over what constitutes a conflict of interest and how to deal with it.

We wish to express our gratitude to all of those who responded to our survey. In some cases, the time required to put together an informative reply was considerable. This project could not have been carried out without the generous cooperation we received.

A. Conflict of Interest Models

1. KINDS OF MODELS

The survey revealed that a number of different models for dealing with conflicts of interest are in current operation among various government agencies and boards. These were the models we identified:

1. "No Formal Rules"
2. "Disclosure Model"
3. "Divestment Model"
4. "Resignation Model"
5. "Variable Model"

Each of these models for dealing with conflicts of interest is described below.[1]

1. These models took various forms. In some cases, legislation establishing the government body set out conflicts of interest rules and procedures. In other cases, by-laws applied. Some agencies have adopted formal guidelines, which those involved with the agency were expected to observe. Such guidelines, (or standards of conduct) usually require each person to sign a document attesting that a copy of the guidelines has been received, and that the guidelines are understood and will be observed.

For the most part, these rules only apply to persons who make policy decisions on behalf of the agency. Employees, for example, are usually not subject to these rules.[2]

(a) Agencies with no Formal Rules

Most agencies have not adopted formal rules.[3] Many of those involved with these agencies saw no need for rules, or dealt with conflicts of interest problems informally. Some described their approach as essentially "moral" or "ethical." A person upon becoming aware of a conflict of interest would deal with it in a sensible fashion. If a decision had to be made about a transaction which involved the personal interests of a board member, for example, the board member might agree to not take part in the decision. If the board served an adjudicative function, a board member might decline to take part in a particular hearing on the ground that the conflict of interest potentially raised a suspicion of bias.

(b) Disclosure Model

The most common formal model used by government agencies was one based on the *Company Act* and *Society Act* rules. A person with a conflict of interest was expected to disclose it and remedy the situation. In most cases, the remedy was to ask other board members to authorize the transaction. Ratification would, essentially, allow the conflict of interest to continue. Board members alerted to the conflict of interest, however, are usually thought to be well placed to protect the interests of the agency and the public.

(c) Divestment Model

The Divestment Model adopts a more rigorous method of dealing with conflicts of interest. Customarily, board members will be required to disclose their various investments, holdings and business relationships, usually on an annual basis. This obligation is in addition to the obligation to disclose any conflict of interest when it arises.

To prevent a conflict of interest from arising, however, board members will also be required to divest themselves of interests that are likely to come into conflict with their obligations to the board and, through the board, to the public. In this way, the likelihood that a member's personal interests will come into conflict with those of the agency is significantly reduced. This model also usually prohibits a member from dealing directly with the agency in any personal capacity.

Divestment may be used to deal with a conflict of interest when it arises. In some cases the conflicts guidelines also allow the other board members to ratify the transaction, allowing the conflict of interest to continue. Again, typically, these rules only apply to board members.

(d) Resignation Model

The Resignation Model is closely related to the Divestment Model. Essentially, each model adopts the view that most kinds of conflicts of interest cannot be authorized or ratified. But the two models adopt different methods of dealing with the conflict. Under the Divestment Model, the board member may continue to serve, but must transfer

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2. For many government boards, however, employees are subject to Standards of Conduct established under the *Public Service Act*.

3. People working for agencies without formal conflicts rules may nevertheless be subject to other rules. A member of the legislature or a minister who is on a board will be subject to the rules that apply to MLA's or the stricter ones that apply to cabinet members. A member of the public service that takes part in the agency's business will be subject to the *Public Service Act* as well as the *Public Service Act Directives*. The effect of these rules is described in Chapter III.

or isolate[4] the interest giving rise to the conflict. Under the Resignation Model, a board member who lets a conflict of interest arise is obliged to resign from the board. It is possible to blend these two models into a single set of guidelines. When that is done, customarily the board member is given a choice of how to put an end to the conflict of interest.

(e) The Variable Method

The Variable Method is based on the view that there are a variety of conflicts of interest problems and situations and no single method will serve in every case.[5] Consequently, a number of different methods are employed, often keyed to different activities or functions. An agency might prohibit a director from dealing directly with the agency in a business transaction, but where the conflict arises from a grant application by a family member, allow the issue to be resolved if the director discloses the interest and abstains from the decision. The Conflicts of Interest Guidelines developed by the University of British Columbia are very sophisticated, in part because of the range of activities at the university – which extends from teaching students, to awarding grants and purchasing equipment. Ethical rules have been developed to deal with many different kinds of situations in which a conflict of interest may arise, including special situations arising in, *e.g.*, a student/teacher relationship, an adviser/ graduate relationship, a researcher/research assistant relationship, and peer review.

We have characterized this model as "variable," but really it is a composite of all of the other models.

B. The Relationship Between An Agency's Activity and the Conflicts Model Employed

While an agency's activities, naturally enough, shape the kinds of conflicts issues that arise, a more useful exercise than grouping them by their specific activities is to categorize them by the kinds of functions they carry out. In this way, points of similarity can be identified between agencies carrying out seemingly quite different activities.

It would seem natural enough to suspect that agencies serving similar functions would adopt similar conflicts of interest rules. An agency that performs an exclusively adjudicative function will usually only be concerned about whether a member's personal interests raise issues of bias, and should adopt rules to ensure that a member does not take part in a hearing that affects the member's personal interests, or those of people closely related to the member by marriage, blood, or business association. An agency that makes grants will be similarly concerned that decisions are not affected by factors unrelated to merit. Where a large portion of an agency's budget is spent on purchasing goods or services, the agency should try to ensure that decision makers are not directly or indirectly involved in transactions with the agency. For some agencies, because of the functions they perform, a disclosure procedure where the person with a conflict does not take part in a particular decision will work well enough. For other agencies, who find it necessary to take extraordinary steps to protect public trust in the way it carries out its duties, it might be necessary to adopt a Divestment or Resignation Model.

In our research, we have found it useful to group agencies into 7 different categories, by reference to the chief functions they perform.

1. THE CATEGORIES

(a) "Adjudicative": the board performs a quasi-judicial function.

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4. Behind, *e.g.*, a blind trust.

5. Even in the discussion above, it is clear that most models provide a few options. Commonly, the disclosure model is combined in some form with the resignation or divestment model (often the relationship between the two is left hazy).

(b) "Advisory": the board advises government about particular issues (*e.g.*, such as heritage matters or public recreation).

(c) "Grants": the board provides funds for education, arts, scientific endeavours, etc. and selects suitable applicants to receive funds in the form of repayable or non-repayable grants.

(d) "Levies": the board sets rates, or is empowered to raise funds through various measures, such as setting membership fees.

(e) "Professional Qualifications": the agency regulates a particular business or profession and is involved in determining levels of competence and how to assess them.

(f) "Industry Regulation/Standards": the agency regulates a trade or industry. It may do such things as set standards and investigate or rule on complaints. Many agencies are charged with regulating particular industries. They provide rules to measure quality, determine prices that will be paid for particular products or goods and determine levels of production. Any marketing board would fall into this category.

(g) "Operational": the agency activities involve a range of functions. At the simplest level, any agency managing a budget which involves selling or purchasing property (such as office or business equipment) would fall into this category. But some agencies, like I.C.B.C., would also perform functions embraced by all of the other categories referred to above.

2. THE RELATIONSHIP BETWEEN AN AGENCY'S FUNCTION AND APPROPRIATE CONFLICTS RULES

We did not find any specific correlation between an agency's function and the conflicts of interest model it adopted. What we found instead was that agencies with only one function often had no conflicts of interest rules at all, while those with several functions (particularly if they were involved in a commercial enterprise or one which affected commerce) had detailed rules. This says more about how people view conflicts of interest than about what are appropriate rules. Members of a board that performed an exclusively advisory function, for example, usually did not see any potential for a conflict of interest. Similarly, members of agencies regulating specific industries usually did not think that their activities were touched at all by conflicts of interest, possibly on the view that their personal integrity was the surest safeguard for ethical practices. Large enterprises, with operational functions, typically had comprehensive rules, enterprises like the University of British Columbia, I.C.B.C., B.C. Buildings Corporation, B.C. Ferry Corporation, B.C. Gaming Commission, B.C. Housing Management Commission, B.C. Railway Company Limited, B.C. Trade Development Commission, B.C. Transit Commission, B.C. Utilities Commission, Credit Union Deposit Insurance Corporation of B.C., Okanagan Valley Tree Fruit Authority, and the Pacific National Exhibition.

C. Kinds of Issues That Arise

1. INTRODUCTION

The foregoing discussion is at a necessarily general level and is designed to provide an overview of the kinds of issues that arise in setting out conflicts of interest guidelines. But the process requires a more detailed and specific approach. It is useful at this point, consequently, to spend some time identifying the kinds of concerns often addressed by conflicts of interest guidelines.

2. ISSUES ADDRESSED IN CONFLICTS OF INTEREST GUIDELINES

This section is based on the survey we conducted and lists issues addressed in conflicts of interest guidelines adopted by government agencies. Which of the following

issues do you think qualifies as a conflict of interest and which are adequately addressed by other areas of the law? The guidelines we reviewed dealt with obligations for directors, commissioners, members, employees, managers and volunteers, among others. For convenience, we have referred only to an "[employee]" but in some cases it is useful to consider the issue or direction from the perspective of people having a different status in the agency.

(a) an [employee] must be loyal to the agency.
(b) an [employee] must be honest.
(c) an [employee] must be competent.
(d) an [employee] must not act or make a decision without adequate information.
(e) an [employee] must act ethically and with integrity.
(f) an [employee] must not be abusive.
(g) an [employee] must not sexually harass a fellow [employee].
(h) an [employee] must not act fraudulently.
(i) an [employee] must not engage in criminal activity.
(j) an [employee] must not seek or accept a bribe.
(k) an [employee] must not seek or accept a gift, favour or service from, or be placed under obligation to, or under the influence of, someone who has, may or will deal with the agency.
(l) an [employee] may not employ personally a person who has, may or will deal with the agency.
(m) an [employee] may not work with a family member.[6]
(n) an [employee] may not use the office, position or affiliation with the agency to lend weight to the expression of personal views or to obtain other advantages or personal benefits.
(o) an [employee] may not purport to speak on behalf of an agency, unless it is the [employee's] job to do so.
(p) an [employee] may not have access to agency information except to the extent that it is necessary to carry out the [employee's] job.
(q) an [employee] may not use agency information for personal purposes/non-agency purposes.
(r) an [employee] may not divulge agency information to an outsider.[7]
(s) an [employee] may not use the agency's premises for personal purposes.
(t) an [employee] may not use the agency's property for personal purposes.[8]
(u) an [employee] may not purchase agency property. [9]
(v) an [employee] may not sell property to the agency.
(w) an [employee] may not enter into a transaction with the agency.
(x) an [employee] may not derive a personal benefit from a transaction between the agency and another.
(y) an [employee] may not take advantage of an opportunity initially offered to the agency.
(z) an [employee] may not solicit clients through the agency for a personal business.

D. Comments

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6. Sometimes this obligation is qualified to exclude only those situations where (a) one spouse would otherwise be required to supervise the other; (b) one spouse would be in a position to make decisions affecting the career advancement or remuneration of the other; or (c) the two, together, would have an opportunity to collude to the detriment of the agency.

7. An exception is often expressly made where the matter involves a contravention of law, waste of funds or assets, or danger to public health or safety.

8. Property is sometimes given an expanded definition: *e.g.*, to include office systems. Note also that information would qualify as property.

9. Exceptions are often made to this obligation. *E.g.*, an employee who is uninvolved in the public sale of agency property may be allowed to purchase the property.

The list above, compiled from our survey of government agencies, is comprehensive. It seems to deal with just about every situation that might arise involving standards of conduct, at the very least in terms of general principle if not in the form of a specific rule. While our list is a composite, some agencies have adopted standards of conduct guidelines that are virtually as comprehensive. Clearly, not all of these forms of misbehaviour qualify as conflicts of interest. How many of these directives really deal with conflicts of interest?

At the most general of levels, any situation where a person's private interests interfere with the agency's there is a conflict of interest, but that is so general a definition as to be virtually unworkable. A close examination of the list suggests that it deals with a number of categories of issues which are not, except in the most non-specific terms, conflicts of interest. The list might be categorized as follows:

1. A duty of competence: items (c) and (d).

2. A duty to act with integrity: items (a), (e) and (f).

3. A duty to not commit a criminal or quasi-criminal offense: items (j), (g), (h), (s) and (t).

4. Related non-criminal activity: items (k), (l) (s) and (t).

5. Issues of confidentiality and privacy: items (p), (q) and (r).

6. Abuse of office: items (n) and (o).

7. Corporate opportunities: item (y).

8. Dealing with the agency: items (u), (v), (w) and (x).

APPENDIX F
SOCIETY ACT: SELECTED SECTIONS

Duties of Directors

25. (1) A director of a society shall
(a) act honestly and in good faith and in the best interests of the society; and
(b) exercise the care, diligence and skill of a reasonably prudent person, in exercising his powers and performing his functions as a director.

(2) The requirements of this section are in addition to and not in derogation of, an enactment or rule of law or equity relating to the duties or liabilities of directors of a society...

Disclosure of Interests

27. A director of a society who is, directly or indirectly, interested in a proposed contract or transaction with the society shall disclose fully and promptly the nature and extent of his interest to each other director.

Accountability

28. (1) A director referred to in section 27 shall account to the society for profit made as a consequence of the society entering or performing the proposed contract or transaction,
(a) unless
  (i) he discloses his interest as required by section 27;
  (ii) after his disclosure the proposed contract or transaction is approved by the directors; and
  (iii) he abstains from voting on the approval of the proposed contract or transaction; or
(b) unless
  (i) the contract or transaction was reasonable and fair to the society at the time it was entered into; and
  (ii) after full disclosure of the nature and extent of his interest in the contract or transaction it is approved by special resolution.

(2) Unless the bylaws otherwise provide, a director referred to in section 27 shall not be counted in the quorum at a meeting of the directors at which the proposed contract or transaction is approved.

Validity of contracts

29. The fact that a director is, in any way, directly or indirectly, interested in a proposed contract or transaction, or a contract or transaction, with the society does not make the contract or transaction void, but, if the matters referred to in section 28(1)(a) or (b) have not occurred, the court may, on the application of the society or interested person,
(a) prohibit the society from entering the proposed contract or transaction;
(b) set aside the contract or transaction; or
(c) make any order that it considers appropriate.

APPENDIX G

DATA MATCHING METHODS FOR THE SOCIETY DATABASE

Some statistical information referred to in this Consultation Paper was derived from a database we developed which consisted of information about organizations in B.C. that

(a) are registered as federal charities,

(b) have received funding from the provincial government, or

(c) have been licensed to operate lotteries and gambling events.

None of the information we received identified whether particular organizations were societies incorporated in B.C. It was necessary, consequently, to adopt data matching methods to compare information about these organizations with information about societies incorporated in B.C.

The data matching was intended to answer three questions:

1. How many registered B.C. societies are registered federal charities?

2. How many registered B.C. societies have received grants from the provincial government?

3. How many registered B.C. societies have received a B.C. gaming permit?

The data was provided by the B.C. Registry of Societies, Revenue Canada, and the Public Gaming Commission. We are grateful for their assistance.

The data they provided was collected in three corresponding fields: BC SOC & FED CHARITY, BC SOC & GRANT, and BC SOC & BC GAMING. In all cases there must be a B.C. society before there could be a match. The matching was done by examining a list (using a table feature available through the database manager) of organization names sorted alphabetically. If a name appeared more than once a match was suspected. The records were examined to verify if similar name forms were a true match. A true match is when the data indicates that the organizations represented in the different records were the same or so similar that there is a high degree of confidence that the organizations are the same. Other fields helpful in matching were addresses, postal codes, city names, and dates. If information in three or more records all seemed to be matches then all records would be considered a match. For example, "XXX registered charity" compared with "XXX society" and "XXX foundation". If all have the same address, then these organizations would all be considered matches. These type of occurrences are very few − less than 100 records.

The name forms of organization were normalized as much as possible to increase the likelihood that records with similar organization names would sort close to each other. Misspelling, spaces, abbreviations and number use caused the majority of problems in matching name forms.

The most troublesome matching involved religious organizations and service organizations. There are probably some missing matches among these groups of organizations.