

1995

**Report on
Conflicts of Interest:
Directors and Societies**

Volume I

MINISTRY OF ATTORNEY GENERAL

**LAW REFORM COMMISSION
OF BRITISH COLUMBIA**

REPORT ON

CONFLICTS OF INTEREST:

DIRECTORS AND SOCIETIES

(VOLUME I)

“The Commission is to take and keep under review all the law of the Province, including statute law, common law and judicial decisions, with a view to its systematic development and reform, including the codification, elimination of anomalies, repeal of obsolete and unnecessary enactments, reduction in the number of separate enactments and generally the simplification and modernization of the law....”

Law Reform Commission Act
Statutes of British Columbia, 1969

This Report and the Consultation Paper

This Report is divided into two volumes:

- Volume I: describes how the project was carried out and contains the Commission's recommendations for changing the law, in the form of draft legislation. This document is Volume I.
- Volume II: is a detailed discussion of (a) the comments received on the Consultation Paper and (b) the substantive issues.

Only limited numbers of Volume II have been printed and most of these have been made available to public libraries and law libraries. Volume II and the Consultation Paper that preceded this Report, however, are both available on disk (MSDOS). Both volumes of the Report and the Consultation Paper may also be read or downloaded from the Queen's Printer's computer bulletin board.¹

1. See Appendix C for more information.

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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**TO THE HONOURABLE UJJAL DOSANJH, Q.C.
ATTORNEY GENERAL OF THE PROVINCE OF BRITISH COLUMBIA:**

The Law Reform Commission of British Columbia has the honour to present the following:

**REPORT ON CONFLICTS OF INTEREST:
DIRECTORS AND SOCIETIES**

This Report brings forward recommendations arising out of a project referred to the Law Reform Commission in 1993. The reference emanated from an inquiry, held by the Honourable E.N. (Ted) Hughes, into aspects of the operation of the Victoria Commonwealth Games Society. Mr. Hughes questioned whether the general rules that govern conflicts of interest in relation to societies and their officers continue to meet public expectations and concluded that the possibility of developing revised rules should be referred to the Law Reform Commission.

Currently, a director of a society may enter into a transaction with the society so long as the director's interest is disclosed and the transaction is approved by the other directors. The rules permit a director to profit personally from the connection with the society. Many people have doubted the appropriateness of such a result, particularly when the society is funded by what is, in substance, public money.

After extensive research and consultation, we have concluded that existing conflict of interest rules are largely ineffective for all societies and inappropriate for societies that are publicly funded. We recommend changing the law so that in almost all cases a director may not enter into a business transaction with the society or otherwise receive money from it. This prohibition would extend to family members and business associates of a director. The only exceptions to the prohibition would be a very few carefully defined cases where the transaction would result in a significant benefit to the society.

The focus of our study has been societies, but the issues and the responses to them are not strictly confined to those bodies. We have therefore proposed that any reforming legislation should allow cabinet to make regulations extending the application of the legislation to governmental and non-governmental agencies analogous to societies.

We also recommend that a commissioner be appointed to advise societies about conflicts of interest, and make rulings concerning whether particular societies should be exempt from all or part of the rules. Our preference would be to see the mandate of the Commissioner of Conflicts under the *Members' Conflicts of Interest Act* expanded to include this jurisdiction.

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A. The Issue

The Honourable E.N. (Ted) Hughes, Commissioner of Conflicts of Interest, was asked by the Victoria Commonwealth Games Society to inquire into its rules for awarding contracts. One of the recommendations Mr. Hughes made to the Attorney General and the Minister of Recreation was to ask the Law Reform Commission to consider whether there was a need to revise the conflicts of interest rules that apply to directors of societies:¹

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.

B. Importance of Societies

Incorporation as a society is probably the most familiar form organizations in the nonprofit sector will take.² The rise of the nonprofit sector represents a major shift in structure and approach for delivering community services:³

The scope and scale of this phenomenon are immense. Indeed, we are in the midst of a global "associational revolution" that may prove to be as significant to the latter twentieth century as the rise of the nation-state was to the latter nineteenth. The upshot is a global third sector: a massive array of self-governing private organizations, not dedicated to distributing profits to shareholders or directors, pursuing public purposes outside the formal apparatus of the state. The proliferation of these groups may be permanently altering the relationship between states and citizens, with an impact extending far beyond the material services they provide.

To name just a few of their activities, nonprofit agencies raise funds for health care or deliver the services directly; create and promote tourism; help recent immigrants adjust to Canadian society; restore historic buildings; help troubled youth and provide boys and girls with stable, adult friends; assist parents in providing home care for developmentally disabled children; promote the film industry; and lobby for political change. Even matters traditionally regarded as public sector responsibilities are being placed in the hands of private organizations.⁴ Some of these have become commercial enterprises, but the majority

1. The Hon. E.N.(Ted) Hughes, Q.C., Commissioner of Conflicts, *Report to the Victoria Commonwealth Games Society* (March, 1992) 23.

2. There are different legal structures organizations can adopt. Incorporation as a society is the most common. It is not even necessary for organizations, however, to have a legal personality. They will often incorporate in order to register as a charity and obtain a tax number, or to meet a requirement of a funding body. In this project, we will speak of the nonprofit sector and societies as synonymous but, strictly speaking, they are not.

3. Lester M. Salamon, "The Rise of the Nonprofit Sector," (1994) 73 *For. Aff.* 109.

4. *See, e.g.*, D. Bramham, "Cull eyes privatization in budget battle," *Vancouver Sun*, Jan. 5, 1995 D1, which reports that the B.C. Ministry of Finance is considering alternatives to government funding for services. Some options may lead to more privately owned hospitals, schools, toll bridges and roads. There are three basic methods of privatizing services once solely delivered by government: (1) government simply withdraws services and funding, (2) government caps the level of services delivered, (3) government continues to fund the services but they are now delivered by private agencies: K. Bowlby, P. McMahon, P. Bradshaw, V. Murray, "Privatization and the Delivery of Personal Social Services: Is the Voluntary Board of Directors Up to the Task?" (1994) 12 *Philanth.* 21.

are being carried out by the nonprofit sector. The transition is occurring for a number of reasons perhaps the most important of which is that nonprofit agencies have proved they can use public resources more efficiently than government.⁵ A commentator provides a useful view on the dimensions of the part of Canada's nonprofit sector that consists of registered charities:⁶

Canada's 70,000 registered charities employ twice as many Canadians as the construction industry, and account for as much of Canada's economy as the entire province of British Columbia. It's almost impossible to imagine life in Canada without them: the social-service agencies, health organizations, hospitals, arts and culture groups, churches and religious charities, international-development agencies, service clubs, recreation groups, museums, universities and public foundations....They serve all the collective needs of Canadians that aren't met by either business or government.

Many people who wrote to us wished to make sure the Commission understood the crucial role played by societies today. They worried that legal change might somehow interfere with the valuable work entrusted to societies. Here is a sampling of comments we received:

- Our society cannot afford to have its volunteer organizations supplanted by arms of a government because the administrative costs imposed by having civil servants do anything as paid employees are far too great. Society generally would not be able to afford its recreation groups, minor sports leagues and smaller special purpose societies if they were not run by volunteers. The community would be poorer (and not only financially) as a result.
- Our province's health care system is undergoing considerable strategic reforms. Non-governmental organizations are serving quasi-governmental roles, providing government services, and proliferating to serve a multitude of public interests. The availability of community leaders to provide strategic direction is essential to the public interest.

The nonprofit sector is vast. It faces problems as complex as any government office or commercial enterprise. Its boards consist of volunteers, typically people who are not expert in the work of the agency. The agencies are underfunded and usually unable to afford professional advice. The people involved in these enterprises do the best they can with the limited resources available to them. In many cases their efforts can best be described as heroic.

Community services are being provided according to three entirely separate models. Two of these models are familiar: they are government and commerce. Both of these models of delivery are well developed and, compared to the nonprofit sector, satisfactorily funded. The relationship between government and commerce has been carefully worked out over the years and is generally understood. Each has developed the structures and support services essential for performing at acceptable levels.

The third model, the nonprofit sector, is familiar enough but changing almost from day to day. It has grown tremendously over the past decade. The array of services provided by this sector is astonishing, as is the amount of money that is being placed in its hands. But the rules for nonprofit agencies, and the relationship among the nonprofit sector, government and commerce has yet to be clearly delineated. Nor are all of the structures and support services that government and commerce regard as essential for their purposes yet present for the nonprofit sector, although they are being developed.

For example, employee/management relations represents an area of issues and problems that must be addressed by each of the three sectors, but nonprofit boards usually lack the experience and resources to deal with these matters. The British Columbia government has now set up, in response to a

5. Those non-governmental organizations whose work is carried out by dedicated, unpaid volunteers, *e.g.*, have an economic advantage over government delivery of the same services. There is also a marked public perception in favour of transferring public responsibilities to nonprofit agencies: *see, e.g.*, Editorial, "More bureaucrats no help to human rights," *Vancouver Sun*, Dec. 16, 1994 A16, which argues that human rights would be more capably protected by better funded nonprofit organizations than a revitalized government commission.

6. M. Connell, "How will Canada pay for its charities," *Globe and Mail*, Nov. 29, 1994 A21.

recommendation of the Korbin Commission, the Community Social Services Employer's Association. That Association's mandate is to provide labour management services to nonprofit employers.

Many questions concerning conflicts of interest rules for government and for business have been worked out. In contrast, the rules for the nonprofit sector are largely amorphous. Work in devising appropriate conflicts rules for nonprofit organizations should be regarded as part of the necessary process of (a) defining relationships within the nonprofit sector, (b) defining relationships among the nonprofit sector, government and business, and (c) developing support services for the nonprofit sector. This work must be carried out if the nonprofit sector is to be expected to fulfil the mandate entrusted to it.

C. Volunteers

The remarks quoted above sound two themes: (1) societies do important work, and (2) it is important not to discourage volunteers from taking part in societies. Rules that are too onerous might discourage participation and interfere with society work.

We share our correspondents' concerns. The work carried out by societies is too valuable to place in jeopardy. But, because it is so valuable, and because so much money is being handled by societies, it is equally important to ensure that appropriate conflicts of interest rules are in place.

D. Consultation

In preparing this Report, the Commission consulted extensively with people involved with societies operating in British Columbia. More than 16,000 societies have been incorporated in B.C. that are still active. We prepared a database that allowed us to determine which of these societies:⁷

- receive substantial grants (more than \$10,000) from the provincial government
- have been allowed to raise funds through gaming
- are allowed to issue tax receipts for donations.

We mailed brochures describing the Consultation Paper (the "CP") and the suggestions made in it for changing the law to more than 7,000 societies. Press releases were circulated to the media. Notices about the CP were posted at various sites on the internet, and the paper itself was placed on the Queen's Printer's Bulletin Board so that it could be downloaded free of charge by anyone. Requests for the CP soon exhausted supplies and a second print run was necessary. The CP generated numerous comments from people across Canada and in the United States. Not surprisingly, most of the comments we received were from people involved in societies in B.C.

The comments were very helpful and led to some re-thinking of directions for reform. They are summarized in this Volume of the Report and described in detail in Volume II.

7. The data matching process is described in an Appendix to the Consultation Paper.

A. Introduction

This Chapter examines the basic duties and responsibilities placed on directors of societies and then considers examples of conflict of interest situations in which directors find themselves. It then discusses the current rules for dealing with conflicts of interest.

B. Duties

1. THE DUTY OF LOYALTY

A director of a society has what is described as a “duty of loyalty” to the society. This duty arises at common law. A director is considered to be a trustee for the corporation. This idea is explored in more detail below.

The duty of loyalty is considered to be so important that it is expressly set out in a section of the *Society Act*:

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)...
- in exercising his powers and performing his functions as a director.

Subsection (a) confirms that one aspect of the duty of loyalty is to promote the interests of the society. It is the duty of loyalty that prohibits a director from acting while in a conflict of interest. By definition, a conflict of interest occurs when a person who is under a duty to promote another's interests allows personal interests to intervene.¹

2. THE DUTY OF CARE

A director of a society also owes the society a “duty of care.” This is another duty that arises at common law, but is also set out in the *Society Act*:

25. (1) A director of a society shall
- ...
 - (b) exercise the care, diligence and skill of a reasonably prudent person,
- in exercising his powers and performing his functions as a director.

1. A person is also in a conflict of interest when the person is under a duty to promote the interests of A, and a separate duty to promote the interests of B, and the interests of A and B come into conflict. In the absence of a conflict of duty and duty, or of duty and personal interest, there is no conflict of interest. Even so, many people tend to use the phrase indiscriminately, and draw in just about anything meeting their personal disapproval: D. Ward, “Conflict law being used as 'political terrorism',” *Vancouver Sun*, March 17, 1995 A1. The idea of conflict of interest has been extended, however, to include situations where there is the “appearance” of a conflict and situations where a person directly “and indirectly” benefits. The CP took a wide view concerning matters relevant to this inquiry and examined issues that, strictly speaking, went beyond conflicts of interest. This Report also examines a number of issues relating to the standards of conduct that should be expected of a director, but which technically do not come within the compass of “conflicts of interest.”

A director must not be negligent in making decisions or carrying out duties on behalf of the society. A director who is negligent and causes the society loss may be personally responsible for making good the loss.

3. DIRECTOR AS TRUSTEE

The first model for determining legal rules that applied to directors was that of the trustee administering a trust on behalf of a beneficiary. The model is an imperfect fit for directors of societies and corporations. Special rules that depart from the trustee model have now been developed that apply to directors of incorporated bodies:²

...A significant difference between the trustee and the corporate director is that historically the primary role of the trustee was to preserve the trust, to be cautious, and to avoid risk, whereas the role of a director of a business corporation was, and still is, to take risks to ensure that earnings continue and grow in the future. The role of a director of a non-profit corporation encompasses elements of both the trustee and corporate director models.

It is well established that trustees must exercise an independent judgment, and put the interests of the persons they protect before their own.³ Trustees (in this case, directors) cannot compete with the beneficiary (corporation) for business opportunities.⁴ Board members with knowledge of a breach of trust are considered to participate in and share personal liability for the breach.⁵

4. STATUTORY LIABILITY

Directors are also responsible in other ways. It has been decided, for example, that where a corporate entity fails to remit taxes, or fails to pay wages, in some cases directors will be personally responsible for making up all or part of any shortfall.

Some rules are aimed at making sure that there is a functioning society, and not simply a vehicle behind which directors can hide. Where, for whatever reason, a society has less than 3 members for more

2. James J. Fishman, "Standards of Conduct for Directors of Nonprofit Organizations," (1987) *Pace Law Rev.* 389, 402.

3. Even non-trustees may, in the circumstances, be regarded as fiduciaries and owe a duty of loyalty (one example of a fiduciary obligation): *see, e.g., Hodgkinson v. Simms*, [1994] 3 S.C.R. 377 where an accountant advised a client to purchase a MURB but did not disclose a personal financial interest in the project. The accountant was liable to the client for money lost on the investment, but not because it was a bad investment or because the client paid too much for it. Liability stemmed solely from the breach of the duty of loyalty owed to the client which required, in the circumstances, disclosure of the accountant's personal interest in the investment. *See also 347518 B.C. Ltd. v. 347202 B.C. Ltd.*, [1994] B.C.D. Civ. 3304-04 (S.C.) which dealt with the responsibilities of joint venturers involved in hotel management and whether one of them could enter into a contract with a hotel that had just cancelled its contract with the joint venture; *Chi v. Chun*, [1994] B.C.D. Civ. 3794-01 (S.C.) which involved a real estate agent who arranged a sale of the vendor's property and then took over as purchaser when the original purchaser decided not to proceed.

4. *Keech v. Sandford*, (1726) 2 Eq. Ca. Abr. 741, 22 E.R. 629. Equity may now allow some relaxation of the rule which, in its strictest form, forbids a trustee from benefiting even in circumstances where the beneficiary suffers no loss: *see, e.g., In re Drexel Burnham Lambert U.K. Pension Plan*, [1995] 1 W.L.R. 32 (Ch. Div.).

5. *Valliant v. Air Canada*, [1993] 3 S.C.R. 787.

than 6 months, each director becomes personally liable to pay society debts incurred after the expiration of the 6 months and for so long as the number of members continues to be less than 3.⁶

C. Dealing With a Conflict of Interest: What Must a Director Do?

Some people asked us for recommendations on reference works that would help them identify conflicts and provide advice for dealing with those that arise.⁷ This section should help these people. It describes in some detail how the *Society Act* applies to conflicts of interest:

The *Society Act* requires a director to disclose a conflict of interest:

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.

The *Company Act* sets out similar rules for directors of companies, but the disclosure requirement is a little different. Under the *Company Act*, the interested director is under an obligation to disclose at a meeting of directors: that is, the disclosure is made to the *board*. Under the *Society Act*, the obligation is to make sure “each other director” is informed.⁸

The old rule used to be that a director who became aware of a conflict had to do everything possible to remove the conflict. The board did not have power to approve the transaction. The *Society Act* takes the same approach as modern company legislation. It allows a board to authorize a transaction despite a director's personal interest in it.

The *Society Act* procedure, which requires a director to disclose and request the board to specifically authorize the transaction before it may be regarded as valid, does not remove the conflict. It is a system that is supposed to improve the likelihood that the conflict of interest will not hurt the society's interests.

6. S. 24 (8). See W. I. Innes, “Liability of Directors and Officers of Charitable and Non-Profit Corporations,” (1993) 13 E.&Tr. J. 151. See also G. Shaw, “Volunteers must be wary in non-profit scenarios,” *Vancouver Sun*, Feb. 3, 1995 D2 which provides some examples where directors may be personally liable under the *Income Tax Act* for unremitted employee deductions, or for injuries suffered by people in society activities; J. Sheppard, “Frightening consequences feared in new prosecution rules,” *Vancouver Sun*, Jan 3, 1995 D1 concerning recent amendments to the *Criminal Code* which allow directors of corporations to be prosecuted for fraud, theft or criminal negligence committed by officers of a corporation on behalf of the corporation where a “corporate culture” exists allowing the acts or omissions to occur.

7. The literature dealing with nonprofit organizations, though relatively recent, is substantial. Surprisingly little of it deals with conflicts of interest issues. For the most part books about nonprofit organizations are concerned with the role of nonprofit agencies, their relationship with government and commercial entities, management issues and fundraising techniques. There are, however, a number of texts dealing with the duties and responsibilities of directors of *companies*: see, e.g., J.M. Wainberg and M.I. Wainberg, *Duties and Responsibilities of Directors in Canada* (1987); J. Millard, *The Responsible Director* (1989).

8. The *Society Act* approach has some merit, although may present practical difficulties. The requirement that everyone know about the conflict ensures that approval cannot be obtained by disclosing to a sympathetic faction of a divided board. On the other hand, in some cases the impossibility of locating one of many directors may mean nothing can be done even if all of the others agree that the conflict is not a serious one.

This idea was first adopted to allow corporations to enter into genuinely beneficial transactions. Perhaps everyone believed that directors would, as an ethical matter, simply not ask for authorization where the transaction was not in the corporation's best interests. Whatever the original intention that led to the introduction of the procedure, our research discloses that it is sometimes being used to authorize transactions that are not always in the best interests of societies. We also discovered that the disclosure requirement is often ignored, either because people involved in societies do not always have access to legal advice, or because they do not always recognize a conflict of interest when it arises.

D. The Role of the Board

Section 28 of the *Society Act* provides:

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;...

The section provides that a director will be accountable to the society for profit made under a transaction with the society unless the director first discloses the personal interest in the transaction to the board and the board votes to approve the transaction.⁹

During our consultation period, some people expressed the view that board approval was unnecessary if the decision to contract was being made by officers of the society. The question simply would not come before the board. This view is incorrect. *An important feature of section 28 is that board approval is required in any case that a director has a conflict, not just in those cases where the board is for other reasons involved in the decision.*

What should the board do after a director discloses a potential conflict of interest in a proposed transaction? The board has a completely unfettered discretion. It can decide that a trivial conflict is, nevertheless, reason enough not to enter into the transaction. Or, it can decide to proceed with the transaction even if everyone is agreed that the conflict is a serious one. The *Society Act* provides no guidance on the issue at all. The only check would be the duty of care each director owes the society. If the transaction is imprudent, the directors may find themselves personally liable to the society for not exercising the "care, diligence and skill of a reasonably prudent person" as required under section 25(b). But if the transaction is a sensible one from a business perspective, the directors would have little cause to worry on this head.

The board must formally vote on the matter before the transaction takes place, and must agree by a majority. The interested director cannot vote and cannot be counted as part of the quorum,¹⁰ although nothing in the Act prevents the director from taking part in the meeting. A cautious lawyer might advise an interested director to leave the meeting to avoid any suspicion of impropriety or undue influence in the board's decision.

9. If a director fails to disclose and obtain the board's prior approval, the only recourse then is to seek ratification of the transaction by the membership: s. 28(1)(b). A similar rule applies to directors of companies: *Company Act*, R.S.B.C. 1979, c. 59, s. 145. *See, e.g., Shulus Cattle Co. v. Lower Nicola Indian Band*, (1995) 52 A.C.W.S. (3d) 540 (B.C.S.C.).

10. S. 28(2). But that subsection also provides that the society may adopt bylaws that allow a director to be counted as part of the quorum.

There are no guiding rules for boards about whether or not particular kinds of transactions should be authorized.

E. What Happens if the Rules are Followed?

If the procedure is followed, there is usually no recourse against either the interested director or the board. The decision to authorize must be a pretty bad one in order to bring about repercussions.

An unanswered question is the significance of the director's duty of loyalty. Can a director who personally profits from society business be said to have satisfied the duty? Our courts long ago decided that one aspect of the duty of loyalty was an obligation to put the interests of the protected person first. This means, basically, that in almost no situation will a court allow a person who is under this duty to personally benefit from any decision made on behalf of the protected person.

It is difficult to see how the *Society Act* procedure for authorizing conflicts of interest is to work with the duty of loyalty. These two sections of the Act are fundamentally inconsistent.

F. What Happens if the Rules are Not Followed?

The procedure for authorizing a transaction in which a director has a personal interest is straightforward but not always followed.

Example

The society must buy stationery from someone. It chooses to buy from a director. The transaction is concluded without disclosure, discussion or vote.

What are the consequences of not following the procedure? Technically, the director must account for (or pay back to the society) any profit made from the transaction.¹¹ As a practical matter, no one is likely to complain if the transaction is fair. Everyone might simply ignore a technical, inconsequential breach. No one will want to incur substantial legal costs when it is clear enough that no one has done anything particularly blameworthy. Even more serious transgressions will not necessarily end up in court. The director might voluntarily compensate the society. Many problems are resolved by simply not re-electing the director.

Here are a few possible scenarios in which the required procedure might not be observed. It is useful to explore them and consider the legal position in each case:

The director does not disclose before the society enters into the transaction:

Technically, the director is under a duty to pay back any profit, and may be liable in other ways for breaching the duties of loyalty and of care owed the society. The director may ask the membership to ratify the transaction, and is protected if the vote passes by a 3/4 majority.

11. S. 28. Many people would regard this consequence as unfair, or an overreaction, where the director's actions were truly innocent. Nevertheless, the board cannot ratify the transaction after the fact, although the membership can: s. 28(1)(b). So can the court.

The director abstains from the vote without disclosing:

The transaction is not protected unless the board is informed about the conflict of interest.

The director discloses, but some material facts were not revealed:

Disclosure means full disclosure. It does not qualify as disclosure if the board does not have enough information to assess the significance of the conflict of interest. Of course, what qualifies as full disclosure will sometimes be a very close judgment call. A director seeking authorization is well advised to be as informative as possible, or risk having the transaction attacked at a later date.

The director discloses, but after the transaction has taken place:

The Society Act requires disclosure in advance. But the Act gives a director reason to disclose even if it is late, because the membership may ratify the transaction. The membership will probably want to know why the director did not disclose in advance. A membership convinced that the transaction is fair, and the director's failure to notify was innocent, will be inclined to ratify.

Not every director was informed:

The Society Act requires disclosure be made to every director. Failing to notify even one of the directors, technically, invalidates the authorization. But we can find no case where this issue has arisen.

The director didn't disclose to the board because the decision was made by staff:

It does not matter who is charged with making the decision to contract. If the director has a conflict, disclosure must be made to board directors. If the board does not authorize the transaction, the director will be under a duty to account to the society for profit made under the contract.

There was no quorum:

A board has no power if not enough impartial directors are present to make the decision. There must be a quorum.¹² A decision to authorize has no validity in the absence of a quorum. The director is no better off than had there been no disclosure.

12. The society's by-laws determine the number of directors who must be present to form a quorum. The scheduled by-laws to the Society Act, e.g., provide that where the board has not fixed the quorum necessary to transact business, it shall be a majority of the directors: By-law 31(2).

The director took part in the debate and witnessed the vote:

The Society Act is silent about whether a director can take part in the portion of the meeting where the decision to authorize is made. It provides that the director must disclose, cannot vote and cannot be counted as part of the quorum. Even so, if the director remains at the meeting there may be an appearance or the suspicion that the director was able to influence the vote. The director's presence might stifle free debate on the issue. The director is well advised to be absent during this part of the meeting.¹³

The director took part in the vote:

The Society Act says that the director may not vote. But what happens if more than enough other directors voted in favour, so that it is unnecessary to count the interested director's vote? It does not matter.

The only protection the Society Act offers is a procedural one. If the procedure is not followed, the transaction is not authorized. The interested director's vote may have affected the final result. For example, other directors, unaware of the Society Act requirements, may mistakenly believe that the vote will pass (because the interested director voted) and find little reason in stirring up ill will by voting against the motion.

The board conspired:

Conspiracy is a violation of the duty of loyalty all the directors owe the society. Conspiracy is usually difficult to prove. We have been told of some situations where the board followed the statutory procedure under discussion for the benefit of the directors, all of whom wished to profit from a particular arrangement. Each director disclosed, and did not take part in the vote regarding personal interests, but all were agreed in advance to approve the transactions. That is a conspiracy that will void the authorization.

The board consisted of members related to the interested director:

No board member who has a close business or family relationship with an interested director is allowed to take part in the decision. The Society Act does not spell this out with a list of prohibited degrees. What it does instead is disqualify a person who has a direct interest or an indirect interest in the transaction. A director who stands to profit from the transaction is considered to have a direct interest in it. An indirect interest is one where a person related to the director profits. Participation by a person related to the director will probably void the authorization.

The decision to authorize was a bad one:

Nothing in the Act says the board has to make a good decision. It is only required to follow the statutory procedure and make an honest decision.

The decision to authorize cannot be proved:

A director is not assisted by a favourable vote that cannot be proved. The interested director should insist on some written record, such as a note in the minutes, or a letter from the board, so that if the issue arises (perhaps years) later, it is easily settled.

13. S.L. Ward, *Tort Liability of Nonprofit Governing Boards* (1993) 78; W. Innes, *supra* n. 6, 156.

A. Introduction

The Consultation Paper (“CP”) was published late in 1993. Six months were reserved for consultation.¹ We heard from a great many people and groups, which led to an extension of the consultation period. The comments we received prompted a reconsideration of many aspects of the suggestions made in the CP.

This Chapter discusses the comments the CP attracted in only very general terms. Volume II contains a detailed examination of the points raised in consultation.

B. Summary of the CP Suggestions

The purpose of the CP was to stimulate public discussion on the Commission's tentative proposals for new conflicts of interest rules for directors of societies. Comments were invited to assist the Law Reform Commission in developing final recommendations. The CP was very successful in attracting responses.

The CP suggested that existing conflict of interest rules are not effective in protecting societies and similar nonprofit bodies. As described in the last chapter, the current law permits a director of a society to enter into a transaction with the society so long as the director's interest is disclosed and the transaction is approved by the other directors. Those rules permit a director to profit personally from the connection with the society. Even before the Commission began its work, many people had begun to express doubts about whether this procedure led to appropriate results, particularly for societies funded by what is, in substance, public money.

The CP suggested that the law should be changed so that in almost all cases a director would not be permitted to enter into a business transaction with the society, or be entitled to receive benefits that differ in kind or extent to those enjoyed by all who participate in the society. The prohibition would extend to family members and business associates of a director. The only exceptions to the prohibition would be a very few carefully defined cases where the transaction would result in a significant benefit to the society. These transactions would be permitted.

In addition to proposing rules that apply expressly to society directors, the CP considered the position of other people involved with societies, such as members and volunteers, who may also face a conflict of interest. It suggested that a more flexible set of guidelines should regulate their conduct.

C. Comment: Main Themes

A short summary cannot possibly replace close study of the correspondence we received. This section highlights the main themes at a very general level.

While most people favoured the initiative to restate the conflicts rules that apply to directors of societies, some were opposed. There were two general reasons for opposing legal change in this context:

- (a) some felt there is no problem. The current rules are entirely satisfactory.
- (b) some felt that there is a problem, but alternatives to the existing law are unworkable.

We remain convinced that there is a need to change the rules that apply to directors of societies. As discussed at length in Volume II of this Report, the current rules fail to effectively screen conflicts of interest.

We found, however, the points raised by correspondents (particularly those who fell into the second camp) very helpful. People who feared that new law might interfere with the functioning of nonprofit agencies expressed concern about whether different rules would be flexible enough; whether they would allow transactions that were regarded as essential to the operation of some societies; whether they would

1. For information on obtaining a copy of the CP see Appendix C.

discourage participation; whether they would increase the liability of volunteers; whether they would add layers of bureaucratic complexity interfering with the efficiency of organizations that were overworked and underfunded in any event. Many concrete examples were raised for our consideration.

We have responded by introducing innovations and refinements aimed at eliminating or reducing the risks foreseen by some of our correspondents. For example, instead of expressing the conflicts rules in legislation, as suggested in the CP, we recommend the new rules take the form of guidelines scheduled to the legislation. The purpose of these rules would be to guide the board in the exercise of its discretion to approve arrangements and transactions where a conflict of interest might arise. The approach recommended builds, essentially, on the existing law, although the rules suggested would restrict the kinds of transactions that a board may regard as acceptable.

Moving from legislation to guidelines reduces the complexity of the approach by allowing the rules to be expressed in relatively plain language (even so far as incorporating examples to demonstrate particularly difficult points). Where legislation requires, for the most part, the expression of rules in tightly phrased legal language, guidelines accommodate the statement of rules in terms of general principle. We think this approach goes some distance in allaying the concerns expressed by those who cited unworkability as an argument against changing the law.

Even apart from this major shift in approach, a comparison with the CP draft legislation will reveal many changes and refinements in detail adopted in response to suggestions made to us in the process of consultation. For example, many correspondents were concerned about conflicts that arise when a society requires people with special qualifications to be on the board (discussed in Volume II, Chapter VI). Another issue that raised a great deal of comment was whether a chief executive officer of the society could also be a voting board member (discussed in Volume II, paras 3.9.1 to 3.10.3). Some people argued that no single set of rules could be appropriate for all kinds of societies. Many characteristics were suggested as being distinguishing one society from another. However, in our view, the key factor is the distinction between those societies that receive public funds and those that are entirely funded by donations from their members. Volume II provides more detail on how, and why, we have responded to the comments and suggestions for change.

A. Introduction

This Chapter sets out our recommendations for revising the conflicts rules that apply to people involved in societies. Sample legislation based on these recommendations, which addresses many points of detail, is set out in Appendix A.

B. Conclusions and Recommendations

1. The conflicts of interest rules that apply to directors of societies must be revised.
2. It is not feasible for law to prohibit directors from having any conflicts of interest. Some conflicts of interest produce good results (such as those we describe as arising from “stakeholder representation”). (See recommendation 5)
3. The law should restrict the range of conflicts of interest that a board may consider to be acceptable.
4. Boards and their directors usually do not have enough information about the criteria for assessing the seriousness of a conflict of interest in a proposed transaction. A board should be provided with rules about what it may approve and what it must not approve. An outline of the kinds of rules that should apply is set out in the next section. The *Director Transaction Rules* set out in Schedule B to the draft *Standards of Conduct Act* (see Appendix A) are based on this outline.
5. Special rules are necessary for conflicts of interest that arise when a director is a stakeholder representative. (By “stakeholder representative” we mean a director who has special expertise or credentials or who is a member of a group whose viewpoint should be represented in board deliberations, where the expertise, credentials or membership
 - (a) is a requirement of the society for directors, or the director, or
 - (b) enhances the director's ability to serve the society, promote its interests and carry out public obligations it has by reason of its mandate or sources of funding.)

Conflicts that arise by reason of the stakeholder's representative status should not necessarily disqualify the director from participating in board decisions.

6. The members of a society should be able to choose whether or not the society's chief executive officer can be a member of its board by making suitable amendments to the society's by-laws.
7. While it would be possible to confine reform to the narrow issue of conflicts of interests affecting directors of *societies*, these problems are shared by all nonprofit agencies whether or not they are incorporated as societies. For this reason, we favour a broader approach for revising this part of the law. The sample legislation set out in Appendix A is drafted so that the conflicts of interest rules can be extended to all non-profit agencies. The structure could also be applied to municipalities.
8. Any nonprofit agency should be free to select stricter rules for its directors.
9. In special cases, some nonprofit agencies should be permitted to be exempted from the statutory rules. Three situations where this would be appropriate are (a) where the society is funded entirely from private sources, (b) where the society has detailed alternative conflicts rules that are satisfactory for its purposes, and (c) where the society is set up as a “private foundation” within the meaning of the *Income Tax Act*. The privately funded society should be able to decide for itself about the rules to apply to its directors. In all other cases, the society would have to apply for an exemption.
10. In conjunction with revised conflicts of interest rules, nonprofit agencies require assistance from a person (a “commissioner”)

- (a) qualified to provide advice and rulings about conflicts of interest, and
- (b) empowered to exempt societies from the application of all or part of the statutory rules (generally or for limited purposes) in appropriate circumstances.

Our preference would be to see the mandate of the Commissioner of Conflicts under the *Members Conflicts of Interest Act* expanded to serve this function.

11. In addition to duties listed in recommendation 10, the commissioner should be charged with responsibility for providing society participants with sources of information about duties they owe the society, and encouraging societies to adopt standards of conduct suitable for their activities. A sample Policy Statement that might serve to deliver basic information to society participants is set out in Appendix B to this Report.

C. Director Transaction Rules

This section summarizes what we consider to be the main features of the *Director Transaction Rules* board members should consult when asked to approve a transaction that would confer a personal, private benefit on a director:

- in most cases, the board should not accept or authorize a transaction in which a director has a conflict of interest.
- legislation, however, should recognize exceptions to the general rule.
- there are three groups of exceptions where it would usually be permissible for a board to authorize a transaction that will benefit a director:
 - (a) a conflict exists, but it provides no benefit, or only a minimal benefit, to a director
 - (b) a conflict exists, but the benefit to the society is such that the conflict should be tolerated, or
 - (c) a conflict exists, but there is an overriding policy reason for tolerating the conflict.
- even if one of these exceptions should apply, the board must not approve the transaction unless
 - (a) it is fair and reasonable and unquestionably in the society's best interests.
 - (b) carrying out the transaction will be consistent with any public obligation placed on the society by reason of its mandate or funding.
 - (c) there is no reasonable alternative for accomplishing the objects of the transaction.
 - (d) carrying out the transaction will not impair public confidence in the society and the way it manages its affairs.
- *Director Transaction Rules* should be annotated with explanatory comments and examples.
- *Director Transaction Rules* should list factors, the presence of which should serve as a warning to a board that the transaction must not be approved, such as:
 - (a) society resources will not be applied sensibly, efficiently or economically.
 - (b) a significant motivating factor for the transaction is to accommodate, or prefer the interests of, a director.

(c) the transaction is of a kind that other people have in the past, or probably would in the future, perform gratuitously.

(e) the transaction will raise questions about the director's ability to act impartially on behalf of the society.

(f) the transaction may diminish public confidence in the society's ability to carry out its mandate.

D. Acknowledgments

We are grateful to Simon Thompson, Michael Donaldson, Tom Zworski, Tom Jurkovic and Lois Patterson, all of whom assisted in carrying out parts of the research for this project.

We would like to express our appreciation to Mark Hiltz, who coordinated the databases that were created to (a) track conflicts rules adopted by government boards and agencies, and (b) identify B.C. societies that receive provincial and federal grants, raise funds through the operation of licensed gaming, or operate as registered charities.

We would also like to record our indebtedness to the many individuals and groups who considered the CP and took the time to make formal submissions and meet with us to discuss directions for revising the law. Our work owes much to the thoughtful advice, comments and constructive criticism we received through this process.

APPENDIX A
THE STANDARDS OF CONDUCT ACT

A. Introduction

New legislation will be necessary to provide the substantive structure for the new conflicts of interest rules that we recommend should apply to directors of societies. This Appendix sets out an example of legislation that addresses what we see as the fundamental issues in this respect. Paragraph number references in [brackets] are to the portion of Volume I or II where the specific issue is discussed (e.g., **[Discussed at Vol.II, para. 7.4.4]**). For the most part, sections of the draft legislation are not followed by references because they represent policy explained in the CP.

These references should not form part of the legislation. The *Director Transaction Rules*, in Schedule B to the draft legislation, on the other hand, are annotated with *Examples* and with *Comments*. The *Examples* and *Comments* should form part of the Schedule.

B. The Standards of Conduct Act

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of the Province of British Columbia, enacts as follows:

1. The following be enacted as the *Standards of Conduct Act*:

Contents

Section 1	Definitions.
Section 2	Application.
Section 3	Authorization
Section 4	Board Decisions.
Section 5	Continuing Obligation to Disclose.
Section 6	Ratification.
Section 7	Validity of Transactions.
Section 8	Commissioner
Section 9	Annual Report
Section 10	Public Disclosure Statement
Section 11	Advice
Section 12	Protection of Commissioner
Section 13	Regulations
Schedule A	Organizations Designated to be a Society for the Purposes of this Act.
Schedule B	Director Transaction Rules.

Definitions

1. In this Act

“benefit” means a direct or indirect pecuniary or non-pecuniary advantage and includes the avoidance of a detriment, but does not include the prestige associated with the position of director nor participation in the activities or program of the society in which all members have an opportunity to participate,

“board” means the board of directors of a society, or a similar group responsible for conducting the activities of a society,

“commissioner” means the person appointed under section 8,

“Director Transaction Rules” means the Director Transaction Rules in Schedule B to this Act or, subject to section 2(5), where a society has selected other Director Transaction Rules in accordance with this Act, the selected Director Transaction Rules,

“director” means a director of a society, or a person in a similar position,
[Discussed at Vol. II, para. 7.4.9]

“public funds” means financial support in the form of money or money's worth derived from

(a) a municipal or provincial government or agency or the federal government or a federal agency, whether by contract for services, loan, loan guarantee, subsidy, grant, transfer of public property at less than fair market value, permission to use public property at a rent less than fair market value or tax concession,

[Discussed at Vol. II, para. 2.10.5-6; 4.4.2 - 4.4.3]

(b) donations made by persons who are not members of the society, or
[Discussed at Vol. II, para. 2.10.3 - 2.10.4]

(c) licensed gaming.

[Discussed at Vol. II, para. 2.10.7 - 2.10.11; 4.4.2-5]

“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 has the potential to affect, or give the appearance of affecting, the director's ability to act impartially on behalf of the society,

[Comment: “person” includes a corporation: see Interpretation Act, R.S.B.C. 1979, c. 206, s. 29.]

“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,

[Discussed at Vol. II, para. 4.8]

“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,

[Discussed at Vol. II, Ch.VI]

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

“tax concession” includes

(a) the privilege enjoyed by a society of issuing tax receipts under the *Income Tax Act* for charitable donations made to the society, or

(b) an exemption from, or reduction in liability to pay, any form of taxation afforded a **society**,

[Discussed at Vol. II, para 2.10.12-18; 4.4.2.2-3]

“transaction” means an arrangement, other than a gift, under which
[Discussed at Vol. II, para. 3.12]

- (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.

Director Transaction Rules

2. (1) The Schedule B Director Transaction Rules apply unless

- (a) the members formally change the society's bylaws as authorized in subsection (2) and (3) to adopt different Director Transaction Rules, or
- (b) the commissioner exempts the society from the application of the Schedule B Director Transaction Rules under s. 11(2).

(2) A society may adopt stricter standards of Director Transaction Rules than those set out in Schedule B, including Director Transaction Rules which prohibit a society from entering into any transaction that will benefit a director.

(3) A society that receives no public funds may adopt any Director Transaction Rules it wishes, including Director Transaction Rules that allow a board to authorize any transaction that will benefit a director.

[Discussed at Vol. II, para. 4.4.3]

(4) A person who is subject to Director Transaction Rules under this or another Act or under rules adopted by the society must comply with the strictest standard.

(5) Where a society adopts Director Transaction Rules under subsection (3) and subsequently receives public funds, then the operation of any part of the adopted Director Transaction Rules that sets a less strict standard than that required under the Director Transaction Rules in Schedule B is suspended and replaced by the Director Transaction Rules in Schedule B until the later of

- (a) the expiration of one year from the date the public funds are received, and
- (b) the date the public funds are exhausted.

[Discussed at Vol. II, para. 4.4.3.6]

Authorization

3. (1) A society may not enter into a transaction that will benefit a director unless the board authorizes it in accordance with this section.

[Discussed at Vol. II, para. 7.4.5]

(2) The board may authorize a transaction that will benefit a director where:

[Restates s. 28(1) of the Society Act]

- (a) the director has disclosed the benefit in the transaction to the board,
- (b) a quorum of the board is present for the decision,
[Restates s. 27 of the Society Act]

(c) 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, and

[Discussed at Vol. II, para. 7.4.7]

(d) the transaction satisfies the society's Director Transaction Rules.

(3) A failure by a director to disclose fully the nature of a benefit in a transaction under subsection (2) 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 the Director Transaction Rules relied upon for the authorization.

[Discussed at Vol. II, para 7.2.1]

(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 public confidence in the conduct of the society's activities.

[Discussed at Vol. II, para. 6.9]

(6) A board decision authorizing or refusing to authorize a transaction under this section may not be set aside by a court if

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

(b) the board had enough information about the transaction to assess the nature of the benefit to be derived from it by a director or a related person, and

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

[Discussed at Vol. II, para. 7.4.11]

(7) Where

(a) the transaction is one that could not be authorized under the Director Transaction Rules,

(b) subsection (6) does not apply, and

(c) the director who benefited by the transaction is liable to the society

the court may order that all directors who were present and voted in favour of authorizing the transaction are jointly and severally liable with the director who benefited.

[Comment: even where s. 3(7) applies, s. 7(2) allows a court to relieve a director of liability if the director acted honestly and reasonably. Factors that will influence a court's decision in this respect would include whether the board attempted to impose reasonable, even if ultimately unsuccessful, safeguards to confine the conflict. One situation where a board would not be exposed to liability is where the authorization was based upon an incomplete or misleading disclosure: Discussed at Vol. I, Chapter II.]

Board Decisions

4. (1) A director must not take part in a board decision about a transaction between the society and

(a) the director, or

(b) a person who is a related person to a director, or

(c) any other person if the director or related person might derive a benefit from the transaction.

[Restates s. 28(2) of the Society Act]

(2) Where subsection (1) applies, the director must not be counted as part of the quorum making the decision, unless

(a) it would be impossible due to the resignation, death or disability 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.

(3) Subsection (1) does not apply to a director whose conflict arises solely because the director is a member of a special group whose interests should be represented on the board, unless the board otherwise decides.

[Discussed at Vol. II, Ch.VI]

Continuing Obligation to Disclose

5.(1) Subject to a court order under section 7, a director who benefits from a transaction with a society of which he or she is a director, but failed to seek in advance the authorization of the board, as required under section 3, remains under an obligation to disclose fully and promptly the nature and extent of the benefit to the board, supplying enough information to assess the nature of the benefit.

(2) Where subsection (1) applies, a director must also provide the commissioner with the same information given to the board.

[Comment: a director who discloses in advance is not under an obligation to also disclose to the commissioner. The commissioner would be swamped with material if the legislation so provided. But where the director fails to disclose in advance, disclosure is not considered complete under the draft legislation until the commissioner is notified. The commissioner is given the responsibility of determining whether the matter is something that can be handled by the board or whether in the circumstances other interested parties, such as government or a funding body, should also be apprised of these matters. See s. 10(2).]

Ratification

6.(1) Following disclosure under section 5, the members of the society may, by special resolution, ratify the transaction if

[Restates s. 28(1)(b) of the Society Act.]

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

(b) the transaction was one that could have been authorized by the board of directors.

(2) Ratification under subsection (1) does not prevent an application under section 7 nor relieve a director of 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.

[Restates s. 26 of the Society Act.]

(3) The secretary of the society must file a certified copy of the special resolution under subsection (1) with the commissioner within 14 days after it is passed.

Validity of Transactions

7. (1) Where authorization for a transaction or proposed transaction has not

been sought under this Act, or authorization has been granted in circumstances where it should have been withheld, the potential for a director or a related person to benefit from the transaction does not make the transaction void but the court may, on the application of the society, the commissioner 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 to carry out the objects of this legislation.

[Discussed at Vol. II, para. 7.4.10; Restates s. 29 of the Society Act.]

(2) Where authorization for a transaction or proposed transaction has not been sought under this Act, or authorization has been granted in circumstances where it should have been withheld, the director must reimburse the society for any benefit received under the transaction by the director or a related person.

(3) Despite subsection (1) and (2), 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.

(4) Before exercising its discretion under subsection (3), a court must have regard to whether the director sought ratification of the transaction within a reasonable time, and whether it was ratified, under section 6.

Commissioner

8. **[A section will be needed to allow for the appointment of a commissioner, determine the commissioner's term of office and whether further appointments can be made, identify the situations where a commissioner may be removed or suspended from office before the expiration of the term, and provide for payment of compensation and other administrative issues concerning the commissioner and running the commissioner's office. Many precedents exist, such as the *Ombudsman Act*, the *Auditor General Act*, and the *Members Conflicts of Interest Act*. The Commission recommends broadening the role of the current Conflicts Commissioner to fulfil this office. The Conflicts Commissioner should be consulted on this point. Such a step would require devoting additional resources to that office.]**
[Discussed at Vol. II, para. 7.3]

Annual Report

9. The commissioner must report annually upon the affairs of the commissioner's office to the Speaker of the Assembly who shall cause the report to be laid before the Assembly.

Disclosure Statements

10. (1) The commissioner must
- (a) retain a file of all disclosure statements received from directors under section 5,
 - (b) make the statements available to any person for inspection without charge and during normal business hours, and
 - (c) provide a copy of the statement on payment of a reasonable copying charge.

(2) Where the commissioner receives a disclosure statement from a director under section 5, the commissioner may require

- (a) the society to disclose the identities of persons who may have an interest in the activities and administration of the society, such as directors, members and funding bodies,
- (b) the society to provide minutes, documents and other material in its possession that relate to the transaction, and
- (c) the director or the society to deliver copies of the disclosure statements and other relevant materials to such persons as the commissioner directs.

Advice and Exemptions

11.(1) The commissioner, upon receiving a written request, may provide information or advice

- (a) to societies, boards, directors, members and funding bodies
 - (i) concerning whether particular circumstances may have the potential to violate a requirement of this Act,
 - (ii) about by-laws, special rules or systems a society might consider adopting to safeguard against violating a requirement of this Act, and
 - (iii) about resolving problems that arise when transactions take place without observing the requirements of this Act, and
- (b) to the legislature concerning whether particular organizations should be subject to, or exempt from, this Act.

(2) The commissioner may, upon receiving a written request, exempt a society from the application of all or part of this Act and may make the exemption subject to a limited period of time and the satisfaction of conditions where

- (a) the commissioner is satisfied the society has selected appropriate alternative rules, or established appropriate alternative arrangements for conflicts of interest, or
- (b) the society is a “private foundation” under the *Income Tax Act*.

[Comment: an example of a condition the commissioner may impose would be a requirement to adopt special procedures, like a “Chinese wall,” to confine the conflict. An exemption would not be granted unless the commissioner were satisfied with the alternative arrangements or rules the society wished to govern conflicts of interest issues.][Discussed at Vol. II, para. 4.5 - 4.8]

(3) A list of all societies wholly or partly exempted under subsection (2) during the year must be published in the commissioner's annual report for that year.

(4) The commissioner does not have to act on a written request under subsection (1) or (2) and, without limiting the generality of the forgoing, may decline to act where in the commissioner's view

- (a) the request is not within the purview of this Act,
- (b) the request is frivolous and vexatious, or
- (c) the request relates to the subject matter of legal proceedings that have been commenced or are likely to be commenced.

Regulations

12. The Lieutenant Governor in Council may make regulations:
 - (a) exempting a society from the application of this Act,
 - (b) exempting a member, 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 by adding it to Schedule A 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 public funds.

[Discussed at Vol. II, para. 4.9]

(f) **[regulations in connection with the commissioner.]**

2. Section 24 of the *Society Act*, R.S.B.C. 1979, c. 390, is amended by adding the following subsections:

(4.1) Subject to subsections (4.2) and (4.3), a director may not be a paid officer of a society.

(4.2) A society may enact by-laws allowing one member of its board, but no more than one, to be a paid officer of the society.

(4.3) A society incorporated before [date legislation comes into force] may, without amending its by-laws as required under s. (4.2), allow one member of its board, but no more than one member, to be a paid officer of the society, unless its by-laws specifically prohibit the arrangement. **[Discussed at Vol. II, para 3.5 - 3.10]**

3. Sections 27, 28, 29 and 30(1) are repealed.

4. Section 30(2) is amended by adding at the beginning of the section the words, "Despite the *Standards of Conduct Act*".

5. Subsection 30(5) is amended by striking out "sections 27, 28 and 29 do" and substituting "the *Standards of Conduct Act* does".

Schedule A

Organizations Designated to be a Society for the Purposes of this Act

Each of the following is a society:

[Comment: No decision has been made to designate specific organizations to be societies for the purposes of the draft legislation.]

Schedule B

Director Transaction Rules

Contents

Para 1	Guidelines For Authorizing a Transaction From Which a Director May Derive a Benefit
Para 2	Examples of a Conflict But No Benefit to the Director
Para 3	Examples of a Conflict, Benefit to Director, But Overriding Economic or Practical Benefit to Society
Para 4	Warning Factors
Para 5	Transactions That Do Not Require Board Approval Because There Is No Conflict

Guidelines for Authorizing a Transaction From Which a Director May Derive a Benefit

1.1 As a general rule, the board should not accept or authorize transactions from which a director may derive a benefit. In all but a very few cases, a transaction with a society which will benefit a director will violate the duty of loyalty the director owes the society. Unless there are very good reasons for authorizing the transaction, the members of the board who participate in the decision to do so may be in breach of the duty of care all directors owe the society and may find themselves liable for losses experienced by the society that flow from the transaction.

1.2 There are, however, three groups of exceptions where it is permissible for a board to authorize a transaction that will benefit a director:

- (a) a conflict exists, but it provides no benefit, or only a minimal benefit, to a director (see paragraph 2.1 for more information and examples)
- (b) a conflict exists, but the benefit to the society is such that the conflict should be tolerated (see paragraph 3.1 for more information and examples), and
- (c) a conflict exists, but there is an overriding policy reason for tolerating the conflict, namely the conflict arises
 - (i) because the director is a member of a special group, and
 - (ii) the society needs that special group to be represented on the board or requires the advice or perspective that a member of that special group can give.

[Comment: in many cases, a society will want to have representation from people who will be involved in its activities or affected by its programs. There will be a need to have stakeholders directly involved with the board of the society. The importance of the policy of having stakeholders participate will usually outweigh the policy against allowing transactions with a society from which a director will derive a benefit. However, in these cases the society should develop special rules to limit those conflicts that arise. See the definition of "special group" in the definitions to the *Standards of Conduct Act* and s. 4(3).] [Discussed at Vol. II, Chap. VI]

1.3 The fact that a transaction falls into one of the groups listed in paragraph 1.2 does not mean that the board must approve it or should approve it. The transaction must not be approved unless

- (a) overall, the transaction is fair and reasonable and unquestionably in the society's best interests,
- (b) the transaction is in keeping with public expectations about the conduct

of the society's activities,
[Discussed at Vol. II, para. 7.4.6]

(c) the board has made reasonable inquiries which confirm there is no reasonable alternative for accomplishing the objects of the transaction which is not coloured by a conflict of interest, and

(d) tolerating the conflict will not impair public confidence in the administration of the society or the application of public funds.

1.4 Paragraph 4.1 lists further factors which, if present, suggest the board should not authorize the transaction, even if the transaction otherwise would satisfy the requirements of paragraphs 1.2 and 1.3.

Examples of a Conflict But No Benefit to the Director

2.1 Examples of transactions referred to in paragraph 1.2 (a):

(a) transactions where the director assists the society in obtaining credit.

Example

The director guarantees repayment of a loan made to the society.

Example

The director assumes liability to repay a loan made to the society.

(b) transactions where the conflict arises because the director is also a director or member of another society.

[Discussed at Vol. II, para 3.11]

Example

Society A wishes to enter into a contract with Society B. Director C is on the boards of both societies.

(c) transactions between the society and the director which are a normal or necessary part of the relationship between them.

Example

The director posts security to ensure the faithful fulfilment of the director's duties to the society.

Example

**The society agrees to indemnify or reimburse the director for expenses and liabilities incurred by reason of being a director.
[Discussed at Vol. II, para. 3.5 - 3.10]**

Example

The society arranges insurance to protect a director against liabilities incurred by reason of being a director.

Example

The society agrees to pay reasonable remuneration for services performed by the director as a director. The services are properly rendered to the society, and the arrangement is one that is allowed under the society's by-laws.

[Comment: even though all of these transactions are allowed, the society should ensure that systems are in place to safeguard against abuse. The relationship between a director and any employee of the society is virtually one of employer and employee. Employees are not able to supervise the conduct of their employers. Consequently a society should ensure that any of the transactions listed above between a director and the society are brought to the attention of other directors. For example, societies should require reimbursement claims submitted by directors to be vetted by or reported to the board or a delegate of the board.]

Example of Transaction Not Allowable

The director requests reimbursement for income not earned during time devoted to society business.

[Comment: the society must refuse this request. Income lost or foregone is not a reimbursable expense.]
[Discussed at Vol. II, para. 3.7]

(d) transactions with no economic significance.

[Comment: sensitivity to conflicts issues must be tempered by practical considerations. Nothing is gained by prohibiting transactions coloured by a conflict by which no real or palpable advantage is obtained by a director, which is the case where the transaction involves little money, prestige or other identifiable collateral advantage to the director.]

(e) transactions with a person related to the director that provide no financial advantage to the director and there is no cause to believe the director intervened to confer a benefit on the person.

[Comment: it is possible for a director to derive a benefit from a transaction that benefits a person related to the director. Whether a transaction that benefits a director indirectly at best should be authorized is also subject to the factors set out in subparagraphs 1.2(b) and (c).]

(f) transactions in which a director redeems, repurchases or otherwise acquires for fair market value property previously sold or donated to the society by the director or a related person.

[Comment: Ordinarily, directors would not be permitted to purchase society property. An exception is made where the director, or a person related to the director, previously owned the property and the purchase is for fair market value.]
[Discussed at Vol. II, para. 3.13]

Examples of a Conflict, Benefit to Director, But Overriding Economic or Practical Benefit to Society

3.1 Before a transaction benefiting a director may be authorized under paragraph 1.2(b) on the ground that there is an overriding benefit to the society, the board must be satisfied that either:

(a) the transaction is so advantageous to the society that no other decision makes economic sense, or

(b) for practical reasons only the director or a person related to the director can carry out the transaction.

Example

The director offers to sell property to a society at a price which

makes the transaction, in substance, a gift.

Example

The director provides legal services to the society at a fraction of their true cost.

Example

Only the director can complete the work within the necessary time frame.

Example

The chief executive officer, who is paid for services, is elected to the board. The society's by-laws allow one director to be a paid employee of the society.

[Comment: this arrangement is a recognized exception to the general rule: see the recommendation to amend s. 24 of the *Society Act*. The exception is based on the efficiencies that can be realized by allowing a CEO to participate in board decisions.]

Example

The director is the only person prepared to loan money to the society.

Warning Factors

4.1 The presence of any of the following factors suggest the transaction is not in the society's best interests:

- (a) the transaction wastes society resources.
- (b) the sole reason for authorizing the transaction is to accommodate a director, or to confer an unjustified advantage or preference on a director.
- (c) the transaction is for economic reward and is of a kind that other people have in the past, or probably would in the future, perform gratuitously.
- (d) the transaction favours or appears to favour the personal interests of the director over those of the society, members of the society, or members of the public.
- (e) the transaction compromises or appears to compromise the director's integrity, independence and ability to act impartially on behalf of the society and in the interests of the society.
- (f) the transaction compromises or appears to compromise the reputation of the society.
- (g) the transaction is to engage a person, such as an auditor, to scrutinize the affairs of the society.

**Transactions That Do Not Require
Board Approval Because There Is No Conflict**

5.1 Transactions that do not require board approval:

(a) an unconditional gift from the member or director.

[Comment: these guidelines only apply to “transactions.” The definition of transaction in the *Standards of Conduct Act* does not include gifts.]

(b) transactions which relate to the participation by the director or a member of the director's family in activities the society regularly makes available to its members.

[Comment: these guidelines only apply when a director “benefits” from the transaction. The definition of “benefit” in the *Standards of Conduct Act* does not include general participation in society activities. Usually, directors and their families should be allowed to take part in programs run by the society. A distinction must be drawn, however, between participating in activities available to all, and competing for privileges made available by the society to only a few. Where a competition is involved a director's conflict of interest should not be authorized.]

APPENDIX B

PARTICIPATING IN A SOCIETY: POLICY STATEMENT

In addition to legislation, people involved in nonprofit organizations will benefit from having general information about legal rules that apply to them. This Appendix sets out an example of a statement of those rules which might be distributed in the form of a brochure to society members, etc. During the Commission's consultation, it very quickly became clear that most people want this kind of information and have no ready source for it.

Conduct Policy Statement For Society Participants

Contents

Para 1	Definition
Para 2	General Duties
Para 3	More About Avoiding a Conflict of Interest
Para 4	Using Society Property and Society Information
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Advice to the Society

- *All people involved in a society--its members, directors, officers and employees--have duties they owe the society.*
- *This is a general statement of the legal principles that apply. It should be made readily available to society participants.*
- *While everyone in a society is subject to these duties, some people, like directors and officers, are subject to higher duties, such as those set out in the [Standards of Conduct Act.]*

Definition

1.1 A “conflict of interest” is any situation where

- (a) your personal interests, or
- (b) those 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

could influence your decisions and impair your ability to

- (c) act in the society's best interests, or
- (d) represent the society fairly, impartially and without bias.

General duties

2.1 Unless authorized to do so by the board, or by a person the board designates, 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 paragraph

1.1(b).

2.2 The “appearance of a conflict of interest” occurs when a reasonably well informed person properly could have a reasonable perception that you are making decisions on behalf of the society that promote your personal interests or those of a person described in paragraph 1.1(b).

2.3 If you are a director, you must immediately disclose a conflict of interest in writing to the board of directors. It is important to make the disclosure when the conflict first becomes known. If you do not become aware of the conflict until after a transaction is concluded, nevertheless you must still make disclosure immediately.

2.4 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.

2.5 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

3.1 If you are a director,

(a) you must not use your relationship with the society to confer a benefit on a person described in paragraph 1.1(b). This duty does not prevent you or anyone else from transacting business with other people connected with the society.

(b) you must not personally benefit from any transaction involving the society except in unique situations, authorized by the board.

(c) you must not indirectly benefit from any transaction involving the society except in unique situations, authorized by the board.

3.2 An “indirect benefit” is

(a) a benefit derived by a close friend, family member, business associate, or a 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.

Using Society Property and Society Information

4.1 You must have authorization from the board, or from a person the board designates,

(a) to use property owned by the society for personal purposes, or

(b) to purchase society property unless it is through usual channels of disposition equally available to the public. Even then, you may not purchase the property without authorization if you are involved in some aspect of the sale.

4.2 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.

4.3 You may not use your position with the society to solicit a society's clients for a personal business or one operated by a close friend, family member, business associate or a corporation or partnership in which you hold a significant interest. This duty does not prevent you or anyone else from transacting business with other people connected with the society.

4.4 "Society information" is information that is acquired solely by reason of involvement with the society and which the society is under an obligation to keep confidential.

4.5 You may use society information only for society purposes.

4.6 You must not use society information for your personal benefit.

4.7 You must protect society information from improper disclosure.

4.8 You must report to the board, or to a person the board designates, any incident of abuse of society information.

4.9 You may divulge society information if

(a) you are authorized by the board or by a person designated by the board to release it, and

(b) it is to a person who has a lawful right to the information.

4.10 If you are in doubt about whether society information may be released, you must request advice from the board or from a person the board designates.

Rules About Gifts

5.1 You may accept a gift made to you because of your involvement in the society 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) the gift 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.

Guidelines for Authorizing a Transaction From Which a Member May Derive a Benefit

6.1 Even if you are not a director, if you are in a position to influence decisions made on behalf of the society, the board must treat you as if you are a director.

APPENDIX C

THE ELECTRONIC VERSION OF THIS REPORT AND OF THE CONSULTATION PAPER

The full text of both Volumes of this Report and of the Consultation Paper that preceded it have been posted to the Queen's Printer Bulletin Board System (QPBBBS) where they are available for downloading in Wordperfect 5.1 format. The filename of the Report is LRC144.EXE. The filename of the Consultation Paper is CP71.EXE. These are self-extracting compressed files.

Access to the Queen's Printer Bulletin Board and Internet Facility

The following information was current at the time this Report was settled but some particulars are subject to change as the system is refined over time.

Dial-in Access

The QPBBS supports the following for dial access on lines capable of 14,400 baud (V.32/V.32bis). The telephone number is:

(604) 953-4013

After log-on, a logical series of menus will take the user to the law reform documents. Long distance charges will apply to calls originating outside the Victoria area.

Internet Access

The QPBBS supports internet access in any of 4 modes: TELNET, FTP, Gopher and WWW. All forms of internet access require the user to specify an address or "resource locator" that will consist wholly or partly of the QPBBS domain address:

bbs.qp.gov.bc.ca

World Wide Web (WWW)

The QPBBS supports WWW access. This is the preferred mode as it supports the greatest range of access options and the most logical structure for convenient use. The Internet address of the Commission's "home page" for WWW access is:

<http://bbs.qp.gov.bc.ca/lrc/lrhome.htm>

Telnet

Users can Telnet to the Queen's Printer Bulletin Board at the domain address. All of the normal Bulletin Board functions are available except for file downloading.

FTP

Users can FTP to the QPBBS at the domain address. Log in as ANONYMOUS, and use your e-mail address as the password. Once connected look for the Law Reform Commission documents in the following path:

[/govtinfo/lawrefor](#)

Documents may be downloaded by FTP.

Gopher

The QPBBS offers a Gopher server. Access is through the domain address. Documents may be downloaded through gopher.

The Law Reform Commission can be reached directly through Internet at the following E-mail address:

arthur_close@mindlink.bc.ca