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comes under some scrutiny only at annual general or at special meetings.” (emphasis added)

- At common law, corporate fiduciaries are prohibited from dealing with their corporation. They may not have an interest in any contract or transaction with the corporation. The prohibition is absolute. It is not conditioned on whether the contract is prejudicial to the corporation. Contracts entered into in violation of this prohibition are voidable at the option of the corporation and the fiduciary is accountable to the corporation for any profit received in the transaction.
- The basic elements of the law are set out clearly in the leading 19th century House of Lords decision, *Aberdeen Railway v. Blaikie Brothers* ((1884) ([1843-60] All E.R. Rep. 249 (U.K.H.L.)). In that case, John Blaikie was a director of Aberdeen Railway and a partner of Blaikie Brothers. Blaikie Brothers had entered into a contract with Aberdeen Railway to supply it with iron chairs. In describing the obligations of a director, the House of Lords stated as follows (at 252-53):

“This, therefore, brings us to the general question, whether a director of a railway company is or is not precluded from dealing on behalf of the company with himself or with a firm in which he is a partner. The directors are a body to whom is delegated the duty of managing the general affairs of the company. A corporate body can only act by agents, and it is, of course, the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such an agent has duties to discharge of a fiduciary character towards his principal, and it is *a rule of universal application that no one having such duties to discharge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect. So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into.* It obviously is, or may be, impossible to demonstrate how far in any particular case the terms of such a contract have been the best for the *cestui que trust* which it was impossible to obtain. It may sometimes happen that the terms on which a trustee has dealt or attempted to deal with the estate or interests of those for whom he is a trustee have been as good as could have been obtained from any other person; they may even at the time have been better. But still so inflexible is the rule that no inquiry on that subject is permitted.” (emphasis added)

It does not matter that the relevant director is only one of several directors. Each director owes a fiduciary duty to provide the full benefit of his or her knowledge and skill on the subject matter of the contract. In *Aberdeen Railway*, Lord Cranbrook stated (at 253):

“It was Mr. Blaikie’s duty to give to his co-directors and through them to the company, the full benefit of all the knowledge and skill which he could bring to bear on the subject. He was bound to assist them in getting the articles contracted for at the cheapest possible rate. As far as related to the advice he should give them, he put his interest in conflict with his duty, and *whether he was the sole director, or only one of many, can*

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make no difference in principle. The same observation applies to the fact that he was not the sole person trading with the company. He was one of the firm of Blaikie Brothers with whom the contract was made, and so was interested in driving as hard a bargain with the company as he could induce them to make.” (emphasis added)

- A series of decisions applicable to memorandum of association corporations demonstrate that this common-law principle can be modified explicitly in the memorandum of association (*Imperial Mercantile Credit Association v. Coleman* (1871), L.R. 6 CH 558 (English Chancery Division); *Boulting v. Association of Cinematograph Television and Allied Technicians* [1963] 1 All E.R. 716 English C.A.). This position is based on the general principle that:

. . . the person entitled to the benefit of the rule may relax it, provided he is of full age and *sui juris* and fully understands not only what he is doing but also what his legal rights are in that he is in part surrendering them. (*Boulting* at 729)

- Case law has also dealt with the effect on fiduciary dealings of subsequent shareholder approval or ratification of the transgressing transaction. There is clear authority to support the efficacy of a shareholder ratification vote in memorandum of association jurisdictions. There is less authority in favour of the efficacy of a shareholder ratification vote in Canadian letters patent jurisdictions.
- There is an extensive case law applying this common law rule to dealings between fiduciaries and their corporation. That case law demonstrates that the interested director may be interested in the relevant transaction directly or indirectly, as a partner in a partnership, or as a director, shareholder or agent of another corporation or as trustee of trust that is a party to the relevant transaction. The fact situations include the following:
 - sales of assets to the corporation;
 - purchases of assets from the corporation;
 - loans by the corporation to the fiduciary;
 - guarantees and/or security interests to guaranty and/or secure obligations owed by the fiduciary;
 - gifts by the corporation to the fiduciary;
 - situations in which the fiduciary provides services, for example, the services of a solicitor, to the corporation.
- There is a limited case law, discussed below in Section C, which addresses the issue of fiduciary conflicts of interest in regard to charitable corporations.

B. Non-Share Capital Corporations Law

These common law rules have been modified by the statutes governing non-share capital and business corporations. As an example of the former, the *Corporations Act* (Canada) provides in section 98 as follows:

Directors

Director interested in a contract with the company

98. (1) Subject to this section, it is the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company to declare his interest at a meeting of directors of the company.

At what meeting declaration to be made

(2) In the case of a proposed contract the declaration required by this section to be made by a director shall be made at the meeting of directors at which the question of entering into the contract is first taken into consideration, or, if the director is not at the date of that meeting interested in the proposed contract, at the next meeting of the directors held after he becomes so interested, and, in a case where the director becomes interested in a contract after it is made, the declaration shall be made at the first meeting of directors held after the director becomes so interested.

What is deemed sufficient declaration

(3) For the purposes of this section, a general notice given to the directors of a company by a director to the effect that he is a shareholder of or otherwise interested in any other company or is a member of a specified firm and is to be regarded as interested in any contract made with such other company or firm shall be deemed to be a sufficient declaration of interest in relation to any contract so made.

Director not to vote if interested

(4) No director shall vote in respect of any contract or proposed contract in which he is so interested as aforesaid and if he does so vote his vote shall not be counted, but this prohibition does not apply:

- (a) in the case of any contract by or on behalf of the company to give to the directors or any of them security for advances or by way of indemnity,
- (b) in the case of a private company, where there is no quorum of directors in office who are not so interested, or
- (c) in the case of any contract between the company and any other company where the interest of the director in the last-mentioned company consists solely in his being a director or officer of such last-mentioned company, and the holder of not more than the number of shares in such last-mentioned company requisite to qualify him as a director.

When director not accountable

(5) A director who has made a declaration of his interest in a contract or proposed contract in compliance with this section and has not voted in respect of such contract contrary to the prohibition contained in subsection (4), if such prohibition applies, is not accountable to the company or any of its shareholders [members, in the case of non-share capital] or creditors by reason only of such director holding that office or of the fiduciary relationship thereby established for any profit realized by such contract.

“Contract” and “meeting of directors”

(6) For the purposes of this section “contract” includes “arrangement” and “meeting of directors” includes a meeting of an executive committee elected in accordance with section 96.

No liability when contract confirmed

(7) Nothing in this section imposes any liability upon a director in respect of the profit realized by any contract that has been confirmed by the vote of shareholders of the company at a special general meeting called for that purpose.

As an example of the latter, Section 202 to 206 of the *Bank Act* (Canada) provide as follows:

Disclosure of interest

202. (1) A director or an officer of a bank who

(a) is a party to a material contract or proposed material contract with the bank,

(b) is a director or an officer of any entity that is a party to a material contract or proposed material contract with the bank, or

(c) has a material interest in any person who is a party to a material contract or proposed material contract with the bank

shall disclose in writing to the bank or request to have entered in the minutes of the meetings of directors the nature and extent of that interest.

Time of disclosure for director

(2) The disclosure required by subsection (1) shall be made, in the case of a director,

(a) at the meeting of directors at which a proposed contract is first considered;

(b) if the director was not then interested in a proposed contract, at the first meeting after the director becomes so interested;

(c) if the director becomes interested after a contract is made, at the first meeting after the director becomes so interested; or

(d) if a person who is interested in a contract later becomes a director, at the first meeting after that person becomes a director.

Time of disclosure for officer

(3) The disclosure required by subsection (1) shall be made, in the case of an officer who is not a director,

(a) forthwith after the officer becomes aware that a proposed contract is to be considered or a contract has been considered at a meeting of directors;

(b) if the officer becomes interested after a contract is made, forthwith after the officer becomes so interested; or

(c) if a person who is interested in a contract later becomes an officer, forthwith after the person becomes an officer.

Time of disclosure for director or officer

(4) If a material contract or proposed material contract is one that, in the ordinary course of business of the bank, would not require approval by the directors or shareholders, a director or an officer referred to in subsection (1) shall disclose in writing to the bank or request to have entered in the minutes of meetings of directors the nature and extent of the director's or officer's interest forthwith after the director or officer becomes aware of the contract or proposed contract.

203. (1) Where subsection 202(1) applies to a director in respect of a contract, the director shall not be present at any meeting of directors while the contract is being considered at the meeting or vote on any resolution to approve the contract unless the contract is

(a) an arrangement by way of security for money lent to or obligations undertaken by the director for the benefit of the bank or a subsidiary of the bank;

(b) a contract relating primarily to the director's remuneration as a director or an officer, employee or agent of the bank or a subsidiary of the bank or an entity

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controlled by the bank or an entity in which the bank has a substantial investment;

(c) a contract for indemnity under section 212 or for insurance under section 213; or

(d) a contract with an affiliate of the bank.

Ineligibility

(2) Any director who knowingly contravenes subsection (1) ceases to hold office as director and is not eligible, for a period of five years after the date on which the contravention occurred, for election or appointment as a director of any financial institution that is incorporated or formed by or under an Act of Parliament.

Validity of acts

(3) An act of the board of directors of a bank, or of a committee of the board of directors, is not invalid because a person acting as a director had ceased under subsection (2) to hold office as a director.

204. For the purposes of subsection 202(1), a general notice to the directors by a director or an officer declaring that the director or officer is a director or officer of an entity, or has a material interest in a person, and is to be regarded as interested in any contract made with that entity or person, is a sufficient declaration of interest in relation to any contract so made.

205. A material contract between a bank and one or more of its directors or officers, or between a bank and another entity of which a director or an officer of the bank is a director or an officer or between a bank and a person in which the director or officer has a material interest, is neither void nor voidable

(a) by reason only of that relationship, or

(b) by reason only that a director with an interest in the contract is present at or is counted to determine the presence of a quorum at the meeting of directors or the committee of directors that authorized the contract,

if the director or officer disclosed the interest in accordance with subsection 202(2), (3) or (4) or section 204 and the contract was approved by the directors or the shareholders and it was reasonable and fair to the bank at the time it was approved.

Conflicts of Interest

Application to court

206. Where a director or an officer of a bank fails to disclose an interest in a material contract in accordance with sections 202 and 204, a court may, on the application of the bank or a shareholder of the bank, set aside the contract on such terms as the court thinks fit.

C. Special Rules in Regard to Charitable Corporations

- It appears that the conflict of interest regime set out in the not-for-profit corporations statutes does not apply to charitable corporations. There is strong support in the case law for the proposition that contracts between fiduciaries and a charity require prior court approval or prior approval of this office of the Public Guardian and Trustee.
- In *Re French Protestant Hospital v. Attorney General* (1951) Vol. 1 Chancery Div., p. 938), the court dealt with a situation where the bylaws of the corporation provided that no person should be eligible to be chosen or to continue as a director who receives any emolument from the corporation. Certain directors of the corporation - a solicitor and a surveyor - received fees from the corporation for providing the corporation with professional advice. The directors of the corporation sought to amend the relevant by-law by adding a proviso as follows:

But this by-law shall not prevent any director holding or continuing to hold office by reason of the fact that the corporation employs in a professional capacity and pays fees to a firm of which such director is a member, either as sole proprietor or a partnership or otherwise.

The issue in the case was whether the board of directors had the power to amend the by-law in this way. The court held that, although technically the directors are not trustees and the corporation's property is not vested in the corporation as trustee, for all intents and purposes, the directors were bound by the rules that affect trustees. The court held that the directors therefore did not have the power to amend the by-law. The reasoning supporting this position is important and is worth quoting in full (emphasis added):

... It is obvious that the corporation is completely controlled by the governor, deputy governor, and directors, and it is, therefore, those persons who, in fact, control the corporation and decide what shall be done. Those persons are as much in a fiduciary position as trustees in regard to any acts which are done in regard to the corporation and its property. It would be entirely illegal if they were simply to put the property, or the proceeds of the property of the corporation, in their pockets and make use of it for their own individual purposes or for their purposes as a whole, and not for the purposes of the charitable trust for which the property is held. *Therefore, it seems to me plain that they are, to all intents and purposes, and for the purposes of this case, bound by the rules which affect trustees.*

...

The duties of persons in such a fiduciary position were expressed by Lord Herschell in *Bray v. Ford* (1). Having held that there was no power in the memorandum of association of the limited company in that case,

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which was a company existing for charitable purposes, entitling the vice-chairman of the Yorkshire College to receive remuneration for his services as solicitor, Lord Herschell said ([1896] A.C. 51):

“It is not now in controversy that if this be so the respondent [the vice-chairman] was not warranted in making a charge for his professional services. *It is an inflexible rule of a court of equity that a person in a fiduciary position, such as the respondent's, is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict.* It does not appear to me that this rule is, as has been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to lay down this positive rule. But I am satisfied that it might be departed from in many cases, without any breach of morality, without any wrong being inflicted, and without any consciousness of wrong-doing. Indeed, it is obvious that it might sometimes be to the advantage of the beneficiaries that their trustee should act for them professionally rather than a stranger, even though the trustee were paid for his services.”

It is clear, therefore, that without some provision in the constitution which controlled the governors and directors in what they did the directors had no right to make any profit or claim any remuneration out of the property of the corporation. The question, however, assuming that such conduct would prima facie be repugnant to law, is whether an alteration of the by-laws which permits these gentlemen to remain directors and yet also to receive payment for their services would be repugnant to law and unreasonable so as not to be validly made under the terms of the charter.

Lord Herschell clearly recognised that in some cases it may not be improper to have a provision, sometimes described as a charging clause, which enables trustees to be paid, and one is familiar with the clauses which are so often inserted in wills and settlements and which enable trustees to be paid for their services, *but, while it is entirely proper for a settlor or testator to insert in his settlement or wills provision enabling the trustees of a trust constituted by him to obtain payment for their services, it seems to me a very different matter for persons who are already in the position of trustees, and, therefore, so far as they exercise their powers at all, bound to exercise them in a fiduciary manner on behalf of the charitable trusts in which they act, to empower themselves to be at the one time trustees and persons who are making a profit.*

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In settling schemes for the administration of charitable trusts the practice of this court has always been to exclude the trustees who administer the trusts from any power to make a profit or obtain remuneration. It seems to me, therefore, that it would be a great change if it were thought proper for such a general provision to be inserted in a document regulating charitable trusts, particularly on the motion of the trustees themselves. Counsel for the applicants said, no doubt with complete accuracy, that in the present case one is dealing with two entirely honourable gentlemen who would not abuse the powers which it is sought to confer on them, but it is plain that the terms of the proposed alteration to the bye-laws are sufficiently wide to enable the full amount of fees to be charged so that the persons in question would make a profit out of their offices for the services rendered by them. It does not seem to me that that is a proper and reasonable provision to insert in the bye-laws relative to a charitable trust at the instance of the trustees themselves or persons who are, to all intents and purposes, in the position of trustees, and, prima facie, any such bye-law would be repugnant to law. If it is said that it is not repugnant to law that there should be a charging clause inserted in the provisions regulating trusts, it seems to me that it is not reasonable to insert such a provision in trusts of the kind which I have to consider in the present case. Accordingly, I come to the conclusion that the proposed alteration to the bye-law is invalid and ineffective.

The upshot of this analysis is that directors of a charitable corporation will be treated as though they are trustees and therefore will be subject to the strict common law rule against self-dealing applicable to trustees. Only the “settlor” can create an exception to this prohibition in the trust instrument itself.

Note that the rule in *French Protestant Hospital* is not substantially different from the rule discussed in section A above. The only new element in it is the view that directors of a charitable corporation are trustees of the corporation’s property. Note also that this view was been criticized in subsequent English discussions.

- In *Re Public Trustee and Toronto Humane Society et al* (1987) 60 O.R. 2nd 236,(Ont S Ct.) the court dealt with a situation in which two directors became paid employees of the corporation at substantial salaries. One of the issues in the case was whether such an arrangement was permissible. In reasoning to its conclusion that it was not, the court approved of and followed the *French Protestant Hospital* as follows (at 247):

While no controlling authority from Ontario or other Canadian judicial sources was cited, I have been much influenced to in my conclusions by the judgment of Danckwerts, J. in *Re French Protestant Hospital* . . .

The court held that the corporation and its directors could not, as a consequence, behave as though the corporation were simply another corporation, subject only to its constitution, letters, patent and incorporating statutes (emphasis added):

Baldly put, that argument was that donations and bequests to the Society (in the absence of evidence of specific directions) were simply gifts to the Society and that the expenditure of money so obtained was not open

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to criticism as long as it was applied to the expressed objects of the corporation as set out in its declaration. This brings me back to the anomalous nature of the charitable corporation. *In the face of the conflict in judgments and learned opinion, I would not be so bold as to venture an opinion as to what a charitable corporation is. I do, however, venture to express an opinion as to what it is not; it is not simply a non-profit corporation such that if due regard be had for the instrument of incorporation, the by-laws, and the provision[s] of the Corporation Act, its activities are immune to criticism. A charitable corporation must be mindful not only of the considerations to which I have just alluded, but also of some if not all of the considerations which attend a trust for charitable purposes. The corporate structure can no more shield its activities from scrutiny than it can shield the acts and omissions of its directors.*

- *French Protestant Hospital* was also followed in the Ontario Supreme Court decision of *Re David Feldman Charitable Foundation* (1987), 58 O.R. (2d) 626. That case dealt with a foundation established by letters patent by David Feldman, of which he, his solicitor and his accountant were the sole directors. The letters patent permitted non-trustee investments. As one of its investments, the foundation loaned the sum of \$175,000 to Feldman's corporation. On the application by the Public Guardian and Trustee to pass, examine and audit the accounts of the foundation, the court held that the foundation was a trustee pursuant to the provisions of the *Charities Accounting Act* and that the directors were also trustees. The court did not refer to the conflict of interest provisions of the relevant incorporating statute.
- The third Ontario decision of note is *R. Harold G. Fox Foundation Fund et al. and Public Trustee* ((1989) 69 O.R. 2nd 742). That decision dealt with the power of a charitable corporation to pay its directors for services provided to the corporation, other than the services of directors. The court made reference to section 126(1) of the *Corporation Act* (Ontario) (which provides that the corporation will be operated on a not-for-profit basis) and section 61 of the *Trustee Act* (Ontario) (which addresses compensation for trustees). The court held that the matter of director's remuneration for non-directorial services was governed by the *Trustees Act* and therefore required prior court approval. The court stated as follows (emphasis added):

The decision in *Re Public Trustee and Toronto Humane Society* (1987), 60 O.R. (2nd) 236, 40 D.L.R. (4th) 111, 27 E.T.R. 40 (H.C.J.), by Anderson J. answered many of the questions about the status of directors of corporate charitable institutions. He held that they were answerable, in certain respects for their activities and the disposition of their property as though they were trustees. *They were not commercial corporations nor simply non-profit corporations.* He was satisfied that they were "amenable to the ancient supervisory equitable jurisdiction of the court" (p.244); intervention was warranted pursuant to the *Trustees Act*, or under section 6(d) of the *Charities Accounting Act*, or under the inherent equitable jurisdiction of the court in charitable matters (p. 245).

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In his opinion the ordinary corporate safeguards were not adequate. When there was “deemed to be sufficient warranty to pay a director a salary as an employee” (p. 247), the opinion of the court must be obtained. He had suggested a mechanism whereby, on notice to the Public Trustee, approval could be given by fiat. It was when this decision was drawn to their attention that the directors of the fund went to the Public Trustee for approval, and then made this application. It was his submission in light of the wording of s. 61 of the Trustee Act that an allowance should be made only after the work has been completed to a director for services other than as a trustee.

In any application to the court for approval before payment the onus should be upon the applicant to show that such payment for services other than as a trustee is in the best interest of the trust in light of the circumstances and the basic rules of equity which affect trustees.

- In Charities Bulletin No. 3 issued by the Public Guardian and Trustee, it is stated as follows:

Generally, a charity cannot pay a director to act in a capacity of director although, in appropriate circumstances, payment for services other than a director may be allowed by court order or by any regulations made under section 5.1 of the *Charities Accounting Act*. Any trustee may be paid by the charity if the amount of compensation is approved in advance either by the court or by an order made under section 13 of the *Charities Accounting Act*. A trustee may also be paid when authorized by the document which creates the trust. The document that creates the trust can also prohibit or restrict payment to trustees. A charity can reimburse a director or trustee for reasonable out-of-pocket expenses.

- The Office Public Guardian and Trustee has on occasion expressed the view that it would not approve letters patent of incorporation which permit payments to directors and that, although a trust document could provide for such a payment, that was acceptable as it was within the settlor’s gift. The case law quoted above, including *French Protestant Hospital*, seems to confirm this viewpoint. While the use of a trust vehicle is not common outside of testamentary charitable trusts, it may become a far more popular entity in light of this issue.
- Under Section 5.1 of the *Charities Accounting Act*, the Attorney General, on the advice of the Public Guardian and Trustee, may make regulations providing that acts or omissions that would otherwise require the approval of the Superior Court of Justice in the exercise of its inherent jurisdiction and charitable matters shall be treated, for all purposes, as though they had been so approved.

CONCLUSION

Although there is room for some doubt, the common law position appears to be that a director may not be remunerated in his or her capacity as a director and may not otherwise deal with the charitable corporation unless there has been a prior authorization by the court or unless the letters

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patent of incorporation provide for such remuneration. As stated at the outset, this common law prohibition may not apply to Charity Bank on the basis that Charity Bank is subject to the exclusive jurisdiction of the federal Parliament.

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