

# Agenda Gems: Legal Duties of the Board of Directors

**A Discussion Paper on Legal Liability, Risk Management and the Role of Directors in Non-Profit Organizations** informs board members about their legal responsibilities and provides practical suggestions for managing risks and minimizing personal liability.

- Developed by Volunteer Canada (2002)
- Full document available at <http://www.volunteer.ca/volunteer/pdf/LiabilityEng.pdf>

## ***What is a board?***

Some organizations are governed by administrative or 'hands-on' boards while others are led by policy-governing boards. Both boards may be called a board of directors, a board of governors or a board of trustees. The responsibility of an organization's board is to:

- Provide leadership and direction to the organization; and
- Govern the affairs of the organization on behalf of its stakeholders or members

## ***What is a director?***

A director is an individual who is a member of a governing board of an organization.

Directors of non-profit organizations are volunteers and are rarely paid for their services. As a rule, directors are elected or appointed to their positions on the board. They may also be officers, where an officer fulfills certain corporate roles and functions (such as those duties of a 'president,' 'treasurer' or 'secretary' of the organization). Officers can also be senior staff persons, and in rare circumstances, staff persons can also be directors.

Regardless of the name, size, or type of organization, the role of the director remains fairly constant. Directors and officers of non-profit organizations are responsible for governing the affairs of the organization on behalf of its members. Directors and officers have a relationship of 'trust' with the members of the organization, and it is from this trust relationship that certain important legal duties arise.

## ***What are the legal duties of a director?***

The basic responsibility of directors is to represent the interest of the members in directing the affairs of the organization, and to do so within the confines of the law. This legal duty is described in statutes and has been expanded and interpreted in the common law.

In representing the members of the organization and acting as their 'trustee,' directors have three basic duties: **Diligence, Loyalty, and Obedience** (See next page for more detail).

## ***What are the liability implications of these duties to directors?***

A director who fails to fulfill his or her duties as outlined above may be liable. The term 'liability' refers to the responsibility of directors and organizations for the consequences of conduct that fails to meet a pre-determined legal standard.

### ***Indemnification***

Clearly, volunteer directors take on a range of legal responsibilities and face many potential liabilities. Non-profit organizations recognize that this can be quite daunting. As a result, it is almost universal practice for these organizations to 'indemnify' their directors for liabilities that they might incur in carrying out their duties as directors.

### ***Avoiding liability through risk management***

There is risk inherent in everything we do. Directors of organizations must always be mindful of risks—this means examining situations cautiously and thinking ahead to the potential consequences of decisions and actions. Most people manage risks most of the time, and they do so instinctively. However, it is always a good idea to take steps ourselves, and to encourage others to think about risks and risk management more systematically.

## **THREE LEGAL DUTIES OF A DIRECTOR**

### **THE DUTY OF DILIGENCE**

To act reasonably, prudently, in good faith and with a view to the best interests of the organization and its members;

Diligent directors always **act prudently and in the best interests of the organization**. When performing their duties as directors, they are expected to exercise the same level of care that a reasonable person with similar abilities, skills and experience would exercise in similar circumstances. If a director has a special skill or area of expertise, such as an accountant or lawyer would have, he or she has a duty to achieve a standard of care that corresponds to his or her professional abilities.

Directors have a **responsibility to act cautiously** and to try to anticipate the consequences of their decisions and actions before they undertake them. They are to be honest and forthright in their dealings with members, with the public and with each other. Diligent directors are also **well-informed about the activities and finances** of the organization. They have an obligation to foresee potential risks inherent in a situation and to take reasonable steps to manage those risks.

### **THE DUTY OF LOYALTY**

To place the interests of the organization first, and to not use one's position as a director to further private interests;

Directors are required to **put the interests of the organization first**. These interests will always take precedence over any other interest, including a director's personal interests. Loyal directors will avoid putting themselves in a conflict of interest. When this is unavoidable, they will act appropriately in disclosing the conflict and ensure that they play no part in discussing, influencing or making decisions relating to that interest.

**Confidentiality** is also an important aspect of the duty of loyalty. Directors have an obligation to keep organizational business private, and to not discuss certain matters with people outside the organization.

**A board acts as one entity.** Loyal directors support the decisions of the board, even if they might not personally agree with the decisions and might not have voted to support the decisions in the board meeting.

## THE DUTY OF OBEDIENCE

To act within the scope of the governing policies of the organization and within the scope of other laws, rules and regulations that apply to the organization.

Nearly all non-profit organizations have contractual relationships defined in their governing documents, which includes its constitution, bylaws, policies and rules and regulations.

Directors have a duty to **comply with the organization's governing documents**, and to ensure that staff and committees of the organization do as well. Obedient directors ensure that governing documents remain current and accurate, and oversee the process that is used to amend and update governing documents. Directors also have a **duty to obey external laws, statutes and rules** that are imposed upon organizations, corporations and individuals.