

New Ruling on Conflict of Interest and Participation of Elected Officials on the Boards of Not for Profit Organizations – Court of Appeal finds an Indirect Pecuniary Interest

On January 11, 2013, the Court of Appeal overturned the B.C. Supreme Court decision in *Schlenker v. Torgrimson*, which had been a decision alleging that members of the Salt Spring Island Local Trust Committee were in conflict because of their participation on the boards of directors of not for profit organizations. Not only did the Court find that there was in fact a conflict of interest, but the Court found that it was in fact a pecuniary interest which would result in disqualification of an elected official from public office; although not the outcome in this case as the local trustees had not run for office in 2011.

The two members of the Salt Spring Island Local Trust Committee were active in environmental issues and participated in the incorporation of the Salt Spring Island Water Council Society and the Salt Spring Island Climate Action Council Society and sat on the board of directors of those organizations.

In September 2011, one of the elected officials moved and voted in favour of a resolution to dedicate \$4,000.00 to fund a project by which the Salt Spring Island Water Council Society would organize and run a workshop to raise awareness of water issues on Salt Spring Island. The other Committee trustee was present and voted in favour of the resolution, along with a third trustee.

A similar motion was adopted the following month to dedicate \$4,000.00 to the Salt Spring Island Climate Action Council Society for the purpose of providing a progress report on greenhouse gases.

During both meetings neither trustee disclosed that he or she was a

director of the newly incorporated societies. A court application was brought against the trustees for a declaration that they had contravened the relevant provisions of the *Community Charter* that protected against participation in votes in which an elected official has a pecuniary interest. The respondents were successful in the B.C. Supreme Court and, as they did not run in the 2011 election, on the appeal they argued in the Court hearing the appeal that they were no longer office holders.

The Court of Appeal found, however, that a resolution of the issue would have practical utility as elected officials often seek legal guidance on whether they are in a conflict of interest and the clarification of the rules affecting councillors who hold directorships with not for profit societies would be invaluable.

The Court of Appeal noted that the object of the conflict of interest provisions in the *Community Charter* were to “prevent elected officials from having divided loyalties in deciding how to spend the public’s money. One’s own financial advantage can be a powerful motive for putting the public interest second but the same could also be said for the advancement of the cause of the non-profit entity, especially by committed believers in the cause, like the respondents, who as directors were under a legal obligation to put the entity first.”

The Court of Appeal ruled that “by limiting the interest to a personal financial gain, the chambers judge’s interpretation missed an indirect interest, pecuniary in nature, in the fulfillment of the respondents’ fiduciary duty as directors.” The Court of Appeal found this defeated the purpose and object of the conflict of interest legislation.

The Court adopted the test as that of the reasonably well-informed elector and concluded that a “reasonably well-informed elector on Salt Spring Island would conclude that the respondents’ interest as directors would influence their decision to authorize and pay for contracts with their societies.”

The Court noted that “the respondents themselves initiated the resolutions that directly benefited their Societies and then voted in favour of those resolutions, without disclosing that they were directors of the very Societies that were obtaining the benefit.”

The Court of Appeal rejected an argument that the conflict of interest provisions of the *Community Charter* should be interpreted narrowly, in favour of elected officials, because of the serious penalties that arise from engaging in conduct that involves a conflict of interest.

The Court analyzed the fiduciary duty that is attributed to directors of societies and concluded that directors of societies:

“have a fiduciary duty of loyalty to ‘act honestly and in good faith and in the best interests of the society’: s. 25(1)(a) of the Society Act. This fiduciary duty is the same duty that directors owe to corporations under the Business Corporations Act at s. 142(1)(a), which provides that directors of a company (defined as a corporation recognized as a company under that Act), when exercising the powers and performing the functions of a director of the company must act honestly and in good faith with a view to the best interests of the company, as well as the federal Canada Business Corporations Act under s. 122(1)(a), which provides that every director of a corporation in exercising their powers and discharging their duties shall act honestly and in good faith with a view to the best interests of the corporation.”

On the point that the respondents themselves were not benefited by their decisions, the Court noted as follows at paragraph 49:

“In several ways in the course of these reasons, I have endeavoured to make the point that so long as the ‘matter’ involves the expenditure of public funds and the respondents have ‘an interest’ in the matter which a well-informed elector would conclude conflicts with their duty as councillors, it makes no difference that they put no money into their own pockets.”

and at paragraph 50:

“As directors of the Societies, the respondents were under a fiduciary duty to put the Society’s interests first. Directors of societies, by virtue of their position, have an indirect interest in any contract a society is awarded. When the respondents moved and voted in favour of resolutions that benefitted their Societies through the granting of contracts, arguably contracts the Societies might not have been awarded had the councillors not also been directors, their duties as directors to put the Society’s interests first were in direct conflict with their duties as councillors to put the public’s interests first. These circumstances encompass the mischief the legislation was aimed at, namely, a conflict of interest in deciding money resolutions. The public is disadvantaged by the conflict, whether the respondents derived any personal gain or not, because the public did not have the undivided loyalty of their elected officials.”

The Court found that in the case of the Salt Spring Island trustees, the pecuniary conflict did not depend on a remote or tenuous connection or on speculation as in other previously decided cases “but on the solid

footing of a fiduciary duty as discussed.” The Court allowed the appeal and issued a declaration that “the respondents voted on questions contrary to s. 101 of the *Community Charter*.”

S. 101 of the *Community Charter* involves situations where there is a direct or indirect pecuniary interest in a matter. The Court did not deal with the question of a non-pecuniary “common law” conflict of interest which had been dealt with at length by the chambers judge.

This decision should be a cause of concern to elected officials who are also directors of not for profit societies that serve the broader community interest. As a result of this ruling, a decision that involves the financial interests of the not for profit society may be found to give rise to an indirect pecuniary conflict of interest on the part of an elected official and, accordingly, to create grounds for disqualification from office under s. 101(3) of the *Community Charter*. The Court did not address the question of mere membership in a society, but was concerned with persons who occupy roles as directors of the corporation. A situation that involved mere membership in the not for profit organization would have to be examined on its own facts to determine whether there was any basis for finding that the elected official owed any type of fiduciary duty to the society.

Also of concern is the finding that the phrase “a direct or indirect pecuniary interest” may mean more than “personal financial gain”. In this case, the financial gain accrued to two separate third parties.

The Court did not address the issues of contravention of s. 101 of the *Community Charter* as a result of inadvertence or because of an error of judgment made in good faith.

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