



Councillor's Conflicting Duties and Obligations

By John C. McDonnell, Partner

SUMMARY: Significant challenges may arise for inter-municipal organizations that appoint municipal councillors as directors of these organizations. The primary issue pertains to which master each councillor/director serves and how to address conflicts when they occur.

PROBLEM/SCENARIO: Three municipalities (the "Municipal Members") have come together to form a new legal entity, such as a Corporation, Commission, Society, etc. to govern their Regional relationship in the joint provision of services (ex. water, waste management, landfill, emergency services). Let's call this entity the "Regional Entity".

Municipality A has decided to appoint two of its Councillors to sit as directors of the Regional Entity (we'll call them the "Councillor-Directors"). Everyone is generally aware of the concept of "fiduciary duty" and that Councillor-Directors owe a fiduciary duty to the Regional Entity. That is, each Councillor-Director is supposed to act in the best interests of the Regional Entity.

However, the real expectation of Municipality A is that the Councillor-Directors will be representatives of their Council and will strictly follow Council's instructions. On its face, this may appear to be a good way to represent Municipality A's interests on the Regional Entity.

Somewhere down the road, Municipality A has a problem with what the Regional Entity wishes to do. The Regional Entity has a good regional rationale for doing what it is doing, but it is contrary to what Municipality A wants. Municipality A's Council directs the Councillor-Directors to "do as we say", even though the Councillor-Directors know that doing so is not in the Regional Entity's best interests. The Councillor-Directors have a real problem because they know they have a fiduciary duty to the Regional Entity. However, they cannot necessarily ignore their Council's directions. Further, how does the Regional Entity move forward? The functioning of the Regional Entity could break down.

So, how to resolve this problem?

LAW GOVERNING DIRECTORS

The law respecting fiduciary duty dictates that the following duties are owed by the Councillor-Directors to the Regional Entity (this list is not exhaustive):

- Act in the best interests of the Regional Entity;
- Do not favour the interests of Municipality A, that appointed the Councillor-Director, if Municipality A's interests are different from the Regional Entity;
- Do not disclose confidential information about the Regional Entity to Municipality A;
- Disclose information about the Regional Entity, as is discussed by Municipality A, that is relevant to the Regional Entity.

Although the intention of Municipality A may be that Councillor-Directors are to be delegates of Municipality A, the law does not fully support this methodology. Obviously when the best interests of Municipality A conflict with the best interests of the Regional Entity, there is a significant issue for the Councillor-Directors. They are, in effect, trying to serve two masters. Each Councillor-Director owes a fiduciary duty to the Regional Entity, which arises due to his/her position of being a director. At the same time, each Councillor-Director is still a councillor of Municipality A. As a Councillor, each has statutory obligations to Municipality A, as imposed by the *Municipal Government Act*. Just some of these Councillor obligations include:

- considering the welfare and interests of the municipality as a whole and bringing to Council's attention anything that would promote the welfare or interests of the municipality; and
- performing any other duty or function imposed on Councillors by statute or by the Council.

How will the Councillor-Directors act? When can they make an appropriate decision?

WHY IS THIS A PROBLEM?

Firstly, residents have commenced litigation on this type of issue in the past to prevent the Councillors from participating in Council discussions. Litigation was commenced in 2010 to prevent a Councillor from considering and participating in a Council decision to sell land to another organization because this Councillor sat as a director of the other organization. Obviously, municipalities do not wish to open themselves up to such challenges.

Secondly, the Councillor-Director may be exposed to other types of legal and ethical challenges, such as:

- Stakeholders who may try to litigate the legitimacy of decisions; or
- A third party who has suffered damages as a result of a decision by the Regional Entity may sue the Councillor-Director for any damages alleging breach of fiduciary duty.

SOLUTION

Fortunately, there are a few ways that prudent municipal entities and their municipal members can minimize this problem. Not all of the following need to be implemented. It is possible to just pick and choose which one of the following works best in this particular situation. They are:

1. **Contracting Out of the Problem.** Depending on the type of legal entity that the Regional Entity is and depending upon its governing statute, it might be possible to implement an agreement that states that certain decisions can be made by the Municipal Members themselves and not by the Councillor-Director at the board level (each Municipal Council will vote as a single Member of the Regional Entity). Some legislation permits certain decisions to be made, not by the board of directors (which is when the fiduciary duty arises), but rather by the Municipal Members themselves. The members themselves have no fiduciary duty to the Regional Entity and they can act solely within their own best interest. Therefore, actions taken by the Council cannot be challenged, like actions taken by Councillor-Directors can be.
2. **Permit Non-Councillors to Sit as Directors.** Most types of legislation permit non-councillors to be directors of the Regional Entity. These individuals will not have divided interests like the Councillors-Directors do. When they make a decision, they will do so in serving the best interests of the Regional Entity.
3. **Have Good Conflict of Interest Policies in Place.** Strong conflict of interest policies will be important to establish the parameters of what constitutes a conflict of interest and how both the Regional Entity and the Councillor-Director should deal with the conflict of interest. Being prepared in advance will help to alleviate some of the issues occurring after the fact.
4. **Have Confidentiality Policies in Place.** The Municipal Members and the Regional Entity should implement policies that will dictate how confidential information is to be disclosed by the Regional Entity to the municipalities and vice versa, to minimize the potential for conflict.
5. **Regular Communication Between Entity and Members.** When clear and regularly followed communication protocols are created regarding:
 - a. when information is to be provided by the Regional Entity to the Municipal Members;
 - b. what information is to be provided by the Regional Entity to the Municipal Members; and
 - c. who provides the information to the Municipal Members by the Regional Entity;

these protocols help to minimize conflict. When consistent, regular and full information is provided by the Regional Entity to the Municipal Members, the Municipal Members are less likely to involve themselves with the operations of the Regional Entity. Quite frequently, the issues arise when Municipal Members are not provided with complete and timely information concerning the operations of the Regional Entity. Once council is aware of all factors pertaining to issues the Regional Entity is facing, they may be less inclined to involve themselves and direct their Councillor-Directors accordingly.

6. **Provide Training and Educate Both Directors and Members.** It is likely that at the time of the creation of the Regional Entity, everyone will be aware of this issue and sensitivities thereto and will know how to deal with these issues. However, as the Regional Entity ages and people at both the municipal level and the organizational level change, the successor individuals may be unaware of the problems and how to implement the solutions. Providing ongoing education and training to all affected parties will help to prevent problems from occurring.

SUMMARY

There are significant issues surrounding a Councillor acting as a director on a Regional Entity, including ethical conflicts of interest, conflicts of duty and potential legal liability if the director breaches his or her fiduciary duty. This is not to say that Councillors can never act as directors for such corporations that are formed through the association of municipalities. However, when there is potential for such conflicting duties and obligations, arrangements should be constructed and legal advice should be considered to avoid potential liability.

HELP?

Should you have any questions regarding the above or require any assistance in developing arrangements to assist in such dual loyalty issues, please contact John C. McDonnell at 780-497-4801 or at jmcdonnell@brownleelaw.com or any of the following members of the Brownlee LLP Corporate Governance Team: Rodd Thorkelsson, Jill Swainson, or Glen Scott.