Ontario Superior Court rules fundraising contracts void ab initio

By Terrance Carter

The Ontario courts and the Public Guardian and Trustee of Ontario (PGT) are becoming increasingly proactive in relation to third-party charitable fundraising arrangements. This more proactive approach has most recently been evidenced in the Ontario Superior Court decision *Ontario Public Guardian and Trustee v. National Society for Abused Women and Children,* [2002] O.J. No. 607.

The case involved three individuals who incorporated the National Society for Abused Women and Children in 1999, subsequently arranged for it to obtain charitable status, and then entered into fundraising contracts with businesses that the directors of the Society either owned or were employed by.

The fundraising efforts raised close to $1 million, but only $1,365 made its way to charitable work. The fundraising contracts provided for commissions of 75 to 80 per cent of the funds raised, together with additional monthly administrative fees on one of the contracts of $1,500.

Justice Ernest Loukidelis found that the fundraising contracts were void *ab initio,* as the amount of compensation paid to the fundraising companies under the contracts was ruled unconscionable. This resulted in the court requiring the directors to pay all monies they had received from the Society through the fundraising companies over to the PGT. Once the monies had been paid over, the directors could seek compensation, but only if claims were properly documented and received, subject to approval by the court.

The practical consequences of the decision are summarized as follows:

1. The intensity of the judge's comments reflect the offensive nature of the facts involved in the case. Justice Loukidelis found that the whole *modus operandi* was "a scheme whereby the charity was used as a cover to raise monies for the benefit of the collection agency." However, the decision is not limited to the specific fact situation of this particular charity but has application to any charity that raises funds by using third-party fundraising companies.

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2. The court found that the compensation to third party fundraisers of 75 per cent to 80 per cent of the gross receipts for the donations was unconscionable and would "be bound to shock the conscience of any citizen." These comments were made notwithstanding that legal counsel for the three directors argued that the fundraising practices were similar to those carried out by other new charities and were done for purposes of establishing a database for future contributions. This would suggest that the court will compare fundraising expenses to the gross amount of donations received in the same year, instead of amortizing those expenses over a number of years to reflect the long-term benefit of the fundraising database that was being established.

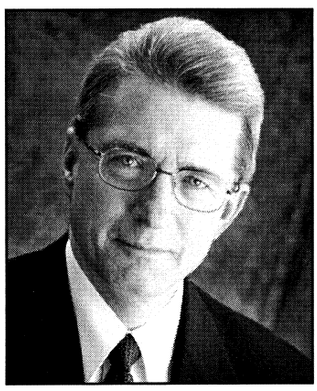
3. The court found that the three directors were in a clear conflict of interest when they arranged for the society to enter into contracts with fundraising companies that were either owned by them or employed by them. It held that by entering into these contracts, the directors breached their fiduciary duty as directors.

The practical difficulty that can arise from conflicts of interest where directors receive, either directly or indirectly, remuneration from a charity is made all the more problematic in extreme fact situations such as the one in this case.

4. Once the court found that the directors were in conflict of interest by directing the society to enter into the fundraising contracts, it went on to require that the directors account for all monies that they had received from the fundraising companies that they owned or were employed by.

This aspect of the decision underscores that where directors of a charity are found to be in breach of their fiduciary duties, the directors will personally be liable to repay the monies that they have received back to the charity, whether such monies have been received directly or indirectly, including monies received through fundraising contracts.

5. The court also confirmed the fiduciary duty directors in



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Ontario have to disclose unreasonable fundraising costs to donors. This decision is similar to the position taken in *Aids Society for Children (Ontario)*, 105 A.C.W.S. (3d) 1044, in which the same court held that directors of a charity have a fiduciary obligation to disclose fundraising costs to donors where such costs exceed 70 per cent of the gross receipts.

Justice Loukidelis was particularly critical of the arrangement that allowed a fundraising company to "speak for the charity" and receive 75 to 80 per cent of the gross receipts without disclosing what those costs were and what the charity was actually receiving.

This aspect of the decision emphasizes that directors of a charity have a fiduciary obligation to ensure that fundraising expenses are kept within the reasonable expectations of donors. What the reasonable expectations on fundraising expenses are was not identified by the court, nor was there any reference to the 80/20 disbursement quota rule required for registered charities under the *Income Tax Act*. However, what is clear from the decision is that fundraising administrative costs of 75 to 80 per cent of gross receipts is much higher than what the court was prepared to consider as reasonable in the circumstances.

6. The common-law fiduciary obligation placed upon directors of a charity would appear to be in addition to the increasing legal obligations imposed upon directors by statute concerning fundraising, such as the requirements under the federal *Competitions Act*, the federal *Personal Information Protection and Electronic Documents Act*, and the proposed Ontario *Privacy of Personal Information Act*.

7. It is possible that Loukidelis's ruling, as well as the earlier decision in *Aids Society for Children (Ontario)*, may become the impetus for fundraising legislation in Ontario similar to what has been put in place in other provinces, such as Alberta. Whether the provincial government, the charitable sector or the third-party fundraising community will take the initiative in this regard remains to be seen.

The National Society for Abused Women and Children decision is important for the numerous observations, findings and conclusions of the court concerning the inappropriateness of fundraising activities carried out by the society, as well as the recognition that the PGT will not hesitate to seek an order for a judicial passing of accounts under the *Charities Accounting Act* (Ontario) where fundraising arrangements are considered to be patently unreasonable.

It will now be more important than ever for charities that are fundraising in Ontario to be diligent in ensuring that they not only comply with statutory requirements involving fundraising, but also comply with common-law fiduciary duties imposed upon directors of charitable corporations in relation to the expectations of donors concerning reasonable administrative expenses involved in fundraising.

It is clearly a new day in Ontario, and possibly across Canada, for charitable fundraising that will need to be closely monitored by charities, their directors, legal counsel who advise them, professional fundraisers, as well as the third-party fundraising community.

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