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LEGAL LIABILITY IN FUNDRAISING: A NEW APPROACH IN RISK MANAGEMENT

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A. INTRODUCTION

There are a number of practical steps that can be taken to avoid legal liability resulting from fundraising programs. This *Charity Law Bulletin* ("*Bulletin*") discusses the need for charities to employ a proactive risk management approach and is directed to fundraisers and senior managers who either work for or on behalf of charities, as well as to lawyers who advise charities or who themselves serve on the boards of charitable organizations. For a more detailed discussion, you are directed to a paper by the author, entitled, "'Looking a Gift Horse in the Mouth': Avoiding Liability in Charitable Fundraising," presented April 16, 2004, to the Canadian Association of Gift Planners, available at http://www.charitylaw.ca.

B. "FOR EVERY UP THERE IS A DOWN"

It has been estimated that more than $41-trillion USD will be transferred to heirs in the next 55 years, $6-trillion of which is expected to go to charities. At the same time, fundraising is increasingly necessary for charities in recent years due to a combination of government cutbacks in support for charities, competition amongst charities for available donations, and an increased demand for services being placed upon charities by the public. With the proliferation of various fundraising programs that are in use, there is an increasing demand for accountability in fundraising from members of the public and government, as well as by umbrella organizations such as the Canadian Centre for Philanthropy. To encourage the boards of charities to be more accountable in fundraising, various codes for ethical fundraising have been developed in recent years, such as the Canadian Centre for Philanthropy's Ethical Fundraising and Financial Accountability Code, the AFP Code of Ethical Principles and Standards of Professional Practice, or A Donor's Bill of Rights.

The risks associated with improper fundraising programs can easily negate any benefit that is realized, and potentially become a major liability. Such negative financial consequences to the charity could expose both directors and officers to personal liability. However, the reality of increased budgetary pressures to achieve and maintain an ongoing source of funds often precludes a charity from having the luxury of time to properly evaluate the legal consequences of the various fundraising programs that it undertakes.

It is important for charities to be informed about initiatives to promote ethical standards in fundraising. It would also be advantageous, from a marketing and public relations standpoint, for a charity adopting a code to publicly advise its supporters. A charity, though, must be careful not to rely solely on codes of ethics. It must, first and foremost, be informed of and adhere to requirements placed upon the charity at law.

C. THE LEGAL RESPONSIBILITY OF DIRECTORS TO OVERSEE FUNDRAISING PROGRAMS

Contrary to popular opinion, the legal responsibility for fundraising lies with the charity and its board of directors, and not simply with the professional fundraisers who are retained by the charity or with the management of the charity. Directors have a fiduciary duty to exercise prudence in overseeing the operations of a charity and protecting its charitable property, which includes protecting the charity's property from undue risk of loss and ensuring that no excessive administrative expenses are incurred.

1. The AIDS Society for Children Case

The high fiduciary duty placed upon directors of charities from fundraising programs was underscored in the case of *Ontario (Public Guardian and Trustee) v. The AIDS Society for Children (Ontario),* [2001] O.J. No. 2170 (Sup. Ct. Jus.) ("AIDS Society case"), which resulted in the court finding the AIDS Society for Children ("AIDS Society") and its three directors liable for the unreasonable fundraising costs in the amount of $736,915.71, and imposing a further $50,000 penalty on the directors of the charity. This followed complaints that the AIDS Society was not applying its funds for its charitable purposes. It was discovered that despite raising $921,440 through public donations, no funds had been expended on charitable programs and the AIDS Society was in debt. In an application by the Public Guardian and Trustee ("PGT") for the passing of accounts, the court held that directors of a charity, although not strictly trustees, have a fiduciary obligation to the charity and the property held by the charity. Further, the charity and its directors are accountable to the public for all monies publicly raised from it, and to utilize such monies to further the objects of the charitable institution. As agents of the charity, fundraising companies have a duty to account for the gross amounts of monies raised from the public and not simply the net amount that was paid to the charity pursuant to the terms of the fundraising contracts.

The court also held that a fiduciary relationship can be breached whether or not a loss occurs. As a result, the fact that a charity and its board of directors may have entered into an improvident fundraising contract may in and of itself be a breach of the fiduciary duty, regardless of whether or not a loss subsequently occurs. In relation to the question of whether the fundraising contracts, which in this case provided for more than 76% of the monies raised going to the fundraising companies for fees, were either void or voidable, the court held that the fundraising contracts could be voidable as being contrary to public interest. The voidability of the contracts would be based upon breach of public policy, as well as misrepresentation to donors concerning the amount of money raised that was actually going to fulfil the charitable purposes of the charity.

2. The *National Society for Abused Women and Children* Case

In another third-party fundraising contract case, the Ontario Public Guardian and Trustee v. National Society for Abused Women and Children, [2002] O.J. No. 607 (Sup. Ct. Jus.) ("National Society for Abused Women and Children"), the Court came to many of the same conclusions as in the Aids Society case. In this case, the directors of the charity entered into fundraising contracts with businesses that they either owned or with whom they were employed, and approved commissions between 75% and 80% of the gross funds raised, together with additional monthly administrative fees. The fundraising efforts for the National Society for Abused Women and Children ("Society") raised close to

$1-million, but only $1,365.00 made its way to charitable work. The court found that the fundraising contracts were void *ab initio*, as the amount of compensation paid to the fundraising companies under the contracts was unconscionable. The court required the directors of the Society to pay all monies that they had received from the Society through the fundraising companies over to the PGT. Once the monies had been paid over to the PGT, the directors could then seek compensation, but only if such claims for compensation were properly documented and received, subject to approval by the court. In this case, the court confirmed that there is a fiduciary obligation of directors to account for all fundraising costs, and that donors are entitled to know about fundraising and administrative costs when making donations.

D. THE DANGER OF THE "FOLLOW THE LEADER SYNDROME" IN FUNDRAISING

Part of the problem associated with the increasing legal liability involved with fundraising programs is the presumption that if one charity has already undertaken a particular fundraising program, then it must be "okay" for another charity to "follow the leader." This trend often extends not only to the second charity adopting the same program as the initial charity, but even to the point of the second charity copying the specifics of the program word for word. The inherent problem with the "follow the leader syndrome" in fundraising is that no one involved with the first charity may have conducted an appropriate "due diligence" review of the legal liability or the appropriateness of the fundraising program in question.

Some of the problems that can occur when a charity simply copies the fundraising program of another charity without conducting its own "due diligence" review may include some, if not all, of the following:

- The fundraising program may have originated in the United States and been adopted without taking into account the differences in the statutory regimes;
- The corporate objects and powers of the charity may be very different;
- Even if a legal opinion has been obtained by the first charity concerning the legality of a fundraising program, the legal opinion will not have application to another charity;
- Even if a fundraising program is determined to comply with all applicable laws, it may not be practical for another charity to undertake the same program due to the inexperience or size of that charity.

Charities should conduct an appropriate "due diligence" review of the legal liability or the suitability of a program prior to adopting another charity's fundraising program.

E. DEVELOPING A PRO-ACTIVE LEGAL RISK MANAGEMENT APPROACH TO FUNDRAISING

Given the increase in legal risks associated with charitable fundraising, it is incumbent upon charities, their boards, staff, and legal counsel to become "pro-active" in identifying and minimizing such legal risks whenever possible. Some things to consider when implementing a "pro-active" legal risk management approach to fundraising are summarized below.

- The charity should stop and evaluate the legal risks involved in a fundraising program before the program is implemented, expanded or continued;
- The charity should be encouraged to obtain appropriate professional, legal and accounting advice as necessary, rather than expecting management, staff or professional fundraisers to provide advice outside their areas of expertise;
- A legal review or "audit" of a new or existing potentially problematic fundraising program should be conducted and an opinion obtained to evidence due diligence by the board and management of the charity;
- The charity should develop and comply with an appropriate standard of conduct for fundraising in accordance with sample codes established by umbrella organizations, such as the Canadian Centre for Philanthropy, the Canadian Association of Gift Planners or the Association of Fundraising Professionals;
- In the event that legal risks are identified through a legal review or audit, those risks should be communicated to the board of directors, who would then need to decide whether or not such legal risks are acceptable and reasonable in the circumstances, bearing in mind the responsibility of the board of directors to exercise a fiduciary duty of prudence in managing the charity's property; and
- The board of directors should be informed of its legal obligations to oversee charitable fundraising and the directors' exposure to personal liability if they do not exercise due diligence in protecting the property of a charity or in ensuring that the rights of a donor have been adequately protected.

F. CONCLUSION

Courts have placed a fiduciary duty on boards of directors to oversee charitable fundraising and ensure that the rights of a donor have been adequately protected. As a consequence, directors of a charity must proactively review, approve and oversee all fundraising activities of a charity, including the terms of contractual relationships with professional fundraisers. This new approach to risk management in fundraising has become essential in order for board members to avoid personal liability.

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