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COMMON LAW DUTIES AND LIABILITIES OF DIRECTORS IN FUNDRAISING

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A. INTRODUCTION

Generally speaking, most directors and officers of charities, as well as non-profit organizations when such organizations are involved in raising funds for a charitable purpose, consider the legal responsibility for fundraising to lie either with the professional fundraisers who are retained as independent contractors or employed by the charity, or with the management of the charity. Board evaluations of the charity's fundraising efforts may often be based upon monetary performance instead of exercising the necessary due diligence required of them at common law to review the appropriateness of the various fundraising vehicles that are utilized to achieve the monetary goals set by the boards of directors.

Directors and officers can face serious legal consequences if they allow a charity to become involved in an improper fundraising practice. It is therefore essential that the board of directors and officers of charities understand their legal obligations to ensure that the fundraising programs undertaken by a charity are carefully scrutinized in order to document that the board has exercised the due diligence required of it in its fiduciary capacity to manage and protect the charitable property that has been entrusted to the board members. This *Charity Law Bulletin*[1] provides a brief overview of the common law duties and liabilities of directors and officers of charities in relation to fundraising.

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[1] This *Charity Law Bulletin* is based in part on an excerpt from a manual by Jane Burke-Robertson, Terrance S. Carter, & Theresa L.M. Man titled *Corporate and Practice Manual for Charities and Not-for-Profit Corporations*, (Toronto: Carswell 2013).

B. COMMON LAW DUTIES

The following is a selection of key decisions from the last 15 years that help to articulate what the common law duties and liabilities of directors and officers of a charity are in relation to fundraising:

1. *Ontario (Public Guardian & Trustee) v. AIDS Society for Children (Ontario)*

The seminal 2001 decision of *Ontario (Public Guardian & Trustee) v. AIDS Society for Children (Ontario)*[2] ("AIDS Society for Children") underscores the high fiduciary duty that is placed upon directors of charities with regard to fundraising programs. The Court ultimately found the AIDS Society for Children and its three directors personally liable for unreasonable fundraising costs of $736,915.71, and imposed a further $50,000.00 penalty on the directors of the charity.

The decision followed complaints that the AIDS Society was not applying its funds for its stated charitable purposes. It was discovered that despite raising $921,440 through public donations, no funds had been expended on charitable programs and the Society was in debt. In a motion by the Office of the Public Guardian and Trustee ("OPGT") to have certain questions of law determined prior to 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 AIDS Society and its directors were required to account for "the gross amount received from the public and not for a net balance received under some agreement with a third party," as well as to utilize such monies to further the objects of the charity. While the AIDS Society had the power to require the fundraising company to account for the monies raised, any accounting between the AIDS Society and the fundraising company did not derogate from the AIDS Society's "obligation to account fully to the public to whom it stands in a fiduciary relationship."

As well, the Court held that a fiduciary relationship can be breached whether or not a loss occurs. As a result, the mere 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.

[2] [2001] OJ No 2170 (SCJ). For a discussion of the AIDS Society for Children case, see Terrance S. Carter and Jacqueline M. Connor, "Fiduciary Relationships in Fundraising: The Impact of the AIDS Society for Children Decision" in *Charity Law Bulletin* No. 9 (September 29, 2001), online: <http://www.carters.ca/pub/bulletin/charity/2001/chylb09.htm>.

The Court also considered whether the fundraising contracts were void *ab initio* or voidable by declaration of the Court at the behest of the OPGT. In the case at hand, more than 76% of the monies raised had been paid to the fundraising companies for fees. The Court held that the fundraising contracts were voidable as being contrary to public interest. The voidability of the contracts was based upon breach of public policy, as well as misrepresentation to donors concerning the amount of money raised that was actually going to fulfill the charitable purposes of the charity.

2. *Ontario (Public Guardian & Trustee) v. National Society for Abused Women and Children*

In another third-party fundraising contract decision, *Ontario (Public Guardian & Trustee) v. National Society for Abused Women and Children*[3] ("National Society for Abused Women and Children"), the Court came to many of the same conclusions as in the AIDS Society for Children case. In the National Society for Abused Women and Children decision, the directors of the charity entered into fundraising contracts with businesses 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. Although the fundraising efforts raised close to $1 million, only $1,365.00 made its way to charitable work.

The Court found that the contracts between the fundraising companies and the charity were improper and void *ab initio*, as the amount of compensation paid to the fundraising companies was unconscionable. The profit earned by the fundraising companies had to be paid by the directors to the OPGT. Each director was required to repay all monies received from the National Society if demanded by the OPGT, and once the monies had been paid over, then the directors could seek compensation only if such claims for compensation were properly documented and received, subject to approval by the Court.

The Court found that the three directors of the National Society were in a clear conflict of interest when they arranged for the National Society to enter into the contracts with fundraising companies that they either owned or by whom they were employed. The Court held that by entering into these contracts, the directors breached their fiduciary duty as directors of the National Society. Requiring the directors to repay the monies received from the charity in this case reinforces the principle that where directors of a charity are found to be in breach of their fiduciary duties, the directors will be personally liable to repay the monies to the charity

[3] [2002] OJ No 607 (Sup Ct).

that they had received from a breach of their fiduciary duty, whether such monies had been received directly or indirectly, including monies received through fundraising contracts.

The Court in the National Society for Abused Women and Children decision was particularly critical of the fundraising arrangement that allowed a fundraising company to "speak for the charity" and receive 75% to 80% of the gross receipts but failed to disclose what those costs were to donors and as such what the charity was actually receiving. This aspect of the decision emphasizes that directors and officers of a charity have a fiduciary obligation to ensure that fundraising expenses are kept within the reasonable expectations of donors or alternatively that donors are advised what those fundraising expenses are before being asked to donate. What the reasonable expectations concerning fundraising expenses are was not identified by the Court. However, what is clear from the decision is that fundraising costs of 75% to 80% of gross receipts is much higher than what the Court was prepared to consider as reasonable in the circumstances.

3. *Public Guardian and Trustee v. Canadians Against Child Abuse Society*

Charities must also remember that if they are fundraising in another province, they will likely become subject to the jurisdiction of regulating authorities in that province concerning the affairs of the charity in the province. In *Public Guardian and Trustee v. Canadians Against Child Abuse Society*,[4] the OPGT obtained a restraining order against a Nova Scotia charity operating in Ontario. The OPGT was successful in effectively shutting down the charity's operations in Ontario. The charity argued that the Court did not have jurisdiction to make such an order because the organization was incorporated and had its head office outside of Ontario. The Court, though, rejected that argument. The decision effectively expands the OPGT's role in Ontario in protecting charitable interests so that even out-of-province charities operating in the province will be subject to its jurisdiction.

C. CONCLUSION

All three of the cases referred to above underscore the need for charities and their board of directors to carefully review contracts with third-party fundraising companies to ensure that the contracts comply with the courts' expectations with regard to compensation and the need to provide disclosure to potential donors concerning the cost of fundraising. The need for public disclosure found under the common law is also set

[4] *Public Guardian and Trustee v. Canadians Against Child Abuse Society*, (18 November 2005), Toronto 02-049/04 (Ont. Sup. Ct. J.).[unreported].

out in the CRA's *Fundraising by Registered Charities Guidance*,[5] which outlines the CRA's understanding of the legal principles that relate to fundraising under the *Income Tax Act* and at common law. Consequently, there needs to be caution exercised by directors and officers of charities with regard to fundraising, particularly since directors, as well as officers, could be faced with personal liability for having permitted unreasonable fundraising costs or having failed to have properly disclosed excessive fundraising costs to the public. As well, charities should consult with their legal counsel to monitor both new and existing fundraising programs and particularly the use of third-party fundraisers that may be retained by the charity.

[5] Canada Revenue Agency, *Fundraising by Registered Charities Guidance*: CG-013 (20 April 2012) online: Canada Revenue Agency <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/fndrsng-eng.html>. For further information on the *Fundraising by Registered Charities Guidance*, see Terrance S. Carter, "Practical Considerations Involving the CRA Guidance on Fundraising" in *Charity Law Bulletin* No. 296 (November 29, 2012), online: <http://www.carters.ca/pub/bulletin/charity/2012/chylb296.htm>.