Recent Legal Developments

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The British Columbia Law Reform Commission has continued to be busy in matters affecting charitable organizations (see (1994), 12 *Philanthrop.*, No. 1, pp. 60-61). Its report, *Consultation Paper No 71*, released in late 1993, deals with conflicts of interest for directors of societies, which obviously includes charitable corporations. The report arose out of concern about the fact that directors of the Victoria Commonwealth Games Society were permitted to bid on contracts with the Society. The provincial Conflicts of Interest Commissioner conducted an inquiry and provided non-binding advice to the Society. He also recommended that the law be changed so as not to permit such activities, and the Law Reform Commission was accordingly asked to report on the matter.

The report provides an excellent overview of the existing conflict of interest rules for societies in British Columbia (chapter 3). These are, essentially, that directors may contract with societies provided that full disclosure is made and that the other directors authorize the conflict in advance of any contract being entered into. *Ex post facto* authorization of a conflict can only be achieved by vote of the members in a special resolution. These rules are the same as those for business corporations. They are based on the rationale that the other directors can adequately protect the interests of a society's members, and that in the final analysis they are accountable to those members. This rationale mirrors the justification for the rules in business corporations—the directors look after the interests of shareholders and are accountable to them.[1]

The Commission argues that these rules are inadequate for societies, principally because, unlike business corporations, societies are frequently not entirely private and a stake in them is not confined to members. They often act as quasi-public entities, sometimes providing services contracted for by government and often, and most importantly, receiving a substantial amount of funding from both government and public subscription. Thus "it is a matter of public concern if the money is misapplied" (p. 23) but the public has no say in transactions which may raise public-interest concerns. In addition, even when neither the public nor the society's members are objectively harmed by a transaction, the perception may be one of dubious practice.

The Commission concludes that this public nature of societies suggests that the business corporation rules should be altered in favour of ones more akin to standards of conduct for public officials, which are considerably stricter. It suggests that function, not form, should govern these matters. That is, until now

the form of the society (like a business corporation) has given rise to corporation-type rules; the better approach is to be guided by function—the carrying out of public activities and purposes. It also brings into the scope of any new rules not just contracts between directors and societies, but other aspects of conflict of interest—apparent nepotism and remuneration of directors.

Having said all this, the Commission also argues that there are advantages to allowing some transactions between a society and its directors. Often such transactions involve the provision of services to the society at cost, or perhaps below real cost, and it would be unreasonable not to allow some remuneration. At other times small societies will incur costs by *not* being able to deal with a particular director. Rules that are overly strict will act as a disincentive to volunteers, especially if they are then exposed to personal liability. Thus the Commission's recommendations represent a compromise between the business corporation model and the public servant model, between making it possible to authorize any transaction and barring all possible conflicts. It refers to this as a "pragmatic approach" (p. 96).

The concrete recommendations begin with a "general rule" that a society should not enter into a transaction with a director or into one in which a director "has a direct or indirect interest". They then delineate a variety of exceptions. Some of these, such as director remuneration, director insurance, and loan guarantees by a director, would not require board approval. Others would require prior approval by the board. They include transactions "where the conflict of interest is slight" or where, though it is "more serious", the "financial consequences of the transaction are minimal". Also, transactions that amount to gifts and those that "represent benefits to the society so substantial that no other decision makes economic sense" can be authorized. Authorization requires the board to decide that the transaction is both "fair and reasonable" and that it "meets community expectations about the conduct of the society's activities".

This is merely a summary of the many recommendations and rationales included in the report. The Commission has also provided draft legislation and a variety of useful appendices, including one comprised of "Examples Involving a Fictitious Society". The report is the most comprehensive recent treatment of the entire subject in Canada and will prove very useful for those with an interest in the area, for that reason alone. But it also represents a substantial contribution to discussion of an issue which is assuming increasing importance. Whether the proposals can be translated into effective legislation, especially terms like "community expectations", "economic sense", "slight" and "more serious" conflicts of interest, is an issue that must await a more detailed analysis and, probably, some practical experience. The difficulty of drawing lines in this area is amply illustrated by the problems the Ontario courts have had in deciding when and how to police the activities of directors of charitable corporations. (See *Re Public*

Trustee and Toronto Humane Society (1987), 40 D.L.R. (4th) 111 (Ont. H.C.) and the *Case Comment* by M. Cullity in (1988), 7 *Philanthrop.* No. 3, p. 12.)

Also with regard to the regulation of charities, in June 1994 the Alberta Court of Appeal handed down a very significant judgment regarding that province's *Public Contributions Act*, R.S.A. 1980, c. P-26. The *Act* makes it an offence to solicit funds, for charitable or other purposes, without government approval—either from a designated Minister or from a municipality when a campaign is to be conducted entirely within a city. It gives government officials broad discretion to grant or withhold such approval. The specific grounds listed in s. 6 of the *Act* include the likelihood of misuse of the funds, the likelihood that little of the money collected would go to the purpose designated, the fact that a "similar" campaign has already been authorized, the government not being satisfied as to the "honesty, integrity or bona fides of the persons conducting...the campaign", and "any other reason considered ... to be sufficient and in the public interest". These provisions date from 1965. In *Epilepsy Canada* v. *Attorney-General for Alberta*, unreported, Appeal No. 14515, Cote J.A., for a unanimous Court, held first that the *Act* restricted the Charter right to freedom of expression. This, it should be said, was a nearly inevitable conclusion given the broad scope given to this Charter right by other judgments of the Supreme Court of Canada involving, *inter alia*, commercial speech and hate literature.

Less inevitably (and reversing the trial judgment), the Court also held that the legislation could not be saved under section 1 of the Charter—as a reasonable limit on a right in a free and democratic society. It was agreed that the legislation's objectives were fourfold: to protect consumers from misleading or fraudulent solicitation; to give credibility to charities which obtained permission to solicit; to promote the efficiency and productivity of charities; and to promote a variety of charitable solicitations. A complete account of why the Court came to this conclusion requires a long analysis of the test to be used under section 1 of the Charter, which cannot be given here. But essentially the Court found that while the legislation did have valid objectives, and that those objectives were rationally connected to the specific provisions of the *Act*, the legislation was a much broader restriction on speech than was necessary for the reasonable regulation of charities. The *Act* covered more than large-scale campaigns, it "stops one from asking a few friends, relatives, neighbours, co-workers, or classmates to donate to some worthwhile cause". Moreover, it required approval for each campaign or solicitation. Perhaps most importantly—a point that "seriously disturb[ed]" Cote J.A.—the legislation gave no *right* to get permission to solicit, "no matter how honest one is, no matter how good are one's auditing controls, and no matter how good is one's track record". The granting and revocation of permission was, on its face, entirely discretionary. The Court observed also that many of the *Act*'s valid objectives could be served by its registration and reporting provisions, and these were not under attack.

The result was that certain sections, including s. 6, of the *Public Contributions Act* were declared constitutionally invalid. However, the whole *Act* will remain in force until 30 April 1995 to give the legislature time to amend it with less intrusive provisions.

The decision in *Epilepsy Canada* v. *Attorney-General* demonstrates that changes to the political and constitutional order will not pass by the charitable sector. But this does not represent a fundamental change, such as the narrowing of donors' ability to select recipients, which was carried out in *Re Canada Trust and Ontario Human Rights Commission* (1990), 69 D.L.R. (4th) 321 (Ont. C.A.). (See (1990), 9 *Philanthrop.*, No. 3, p. 3). Here the Court found that regulation of charities' fund-raising activities was a valid objective and that carefully-tailored legislation which would represent a reasonable limit on the right to freedom of expression could be written. But governments interested in the regulation of charitable activity now have an obligation to do so in a narrower, more direct, manner, not with legislation which potentially sweeps all activities into its path.

FOOTNOTE

1. In Ontario, the *Corporations Act* contains no provision equivalent to that of the *Societies Act* (and Ontario's *Business Corporations Act*) for advance clearance of contracts between directors and the corporation; only the members can approve such contracts.