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## The Charity Law & Practice Review

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# ENTER THE COMMERCIAL PARTICIPATOR

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### **The Impact on Charities' Trading Activities of Part II of the Charities Act 1992 (the Act) and the Charitable Institutions Fundraising Regulations 1994 (the Regulations)**

It is a well-known fact that the system by which charities are able to trade in such a way that their trading income is received free of tax is a clumsy and irrational one. It works only because of some judicious blind eye-turning on the part of relevant authorities, and is all the more frustrating because relatively simple legislative changes could enable charities to do what they need to be able to do in the interests of fundraising in a much more straightforward way.

The advent of Part II of the Charities Act 1992 and the Charitable Institutions Fundraising Regulations 1994 which came into force on 1st March 1995, far from assisting with any of these difficulties, have, in fact, added a further layer of complications to be contended with by any charity wishing to carry out trading activities.

This article does not propose to consider the role of the professional fundraiser, which is also covered by Part II of the Charities Act 1992. That individual is concerned primarily with the simple solicitation of funds for the charity and thus plays no role in a charity's trading activities. The thrust of this article is to consider charities' relationships with commercial participators.

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## **I. First Principles**

Let us go back to first principles.

### **A. Who or what is a Commercial Participator?**

The terminology originated in the Charities Act 1992 and the definition is to be found in section 58(1). As originally passed, this read as follows:

"commercial participator", in relation to any charitable institution, means any person who -

- (a) carries on for gain a business other than a fund-raising business, but
- (b) in the course of that business, engages in any promotional venture in the course of which it is represented that charitable contributions are to be given to or applied for the benefit of the institution.

This immediately raised the question of whether or not a charity's trading company was a commercial participator as it quite clearly would fall within the definition set out in section 58(1). The point was resolved by the Deregulation and Contracting Out Act 1994 which amended the definition to exclude from it a company connected with the institution in question. Section 58(5) defines such a connected company as one of which the institution (either alone or with other charitable institutions) exercises the whole of the voting power at a General Meeting.

A commercial participator, then, is an unconnected commercial organisation which, in the course of its business of, say, selling soap powder, makes representations that part of the proceeds of sale of that soap powder will be paid to a particular charity.

### **B. The Underlying Purpose of the Legislation**

To go even further back, it might be helpful to consider the overall purpose of the legislation enacted in 1992 and 1993. Very broadly, it was intended to promote public giving to charities by allaying the public's suspicion of charities and, in particular, whether they actually received money being raised for them and, if they did, how they spent it. The method of achieving this end is to make charities activities more available for public scrutiny. In the context of commercial participators, this means requiring them to make clear, when claiming that a

purchase of a particular item will benefit a charity, by how much, in fact, that charity will actually benefit.

### **C. Methods by which the Legislation seeks to achieve its aim**

How then is this to be done? Again, in very broad terms, the legislation seeks to lay open the activities of commercial participators to public scrutiny in two ways:

- (i) It requires any commercial participator who is claiming to be assisting a charity to have an agreement with the charity in question and to make its claims only in accordance with the terms of that agreement, and
- (ii) It requires representations by such a commercial participator to be accompanied by a statement making clear specified matters relating to the representations.

Clearly, all of this is bound to have an impact on the way in which charities are able to carry out their trading activities when a commercial partner is involved. To consider this impact, this article will look at the agreement and statement in turn, considering the difficulties which arise in the case of each of them.

## **II. The Agreement**

### **A. Requirements - s.59(2) of the Act and Regulation 3**

The section in the Act which requires the agreement to be entered into is section 59(2):

"It shall be unlawful for a commercial participator to represent that charitable contributions are to be given to or applied for the benefit of a charitable institution unless he does so in accordance with an agreement with the institution satisfying the prescribed requirements."

The prescribed requirements are contained in Regulation 3. On the face of it there is nothing very surprising in Regulation 3. The various points which are by that regulation to be covered in the agreement are really only those which common sense would dictate any commercial agreement should contain. Matters such as the date of the agreement, that it should be in writing and that it should show the names and addresses of the parties are elementary in the extreme! There are quite detailed requirements as to how the agreement should show the way in which consideration for goods or services should be divided between the parties but, again, none of it any more than one would need to have in any agreement if it

were to be of any use at all. Perhaps the only surprising requirement is that the agreement should contain a statement of its principal objectives and the methods to be used in pursuit of those objectives. This is perhaps the only point that would not, as a matter of course, appear in any agreement with a commercial participator.

## **B. Problems**

### **1. Tripartite Agreements**

Although thus, on the face of it, the requirements of Regulation 3 may seem very straightforward, they are, in fact, fundamentally flawed because they presuppose that the agreement will be between the charity and the commercial participator. Given that the charity's involvement with the commercial participator will almost certainly be a trading relationship, in 90% of cases it will be the charity's trading company which will be contracting with the commercial participator and not the charity at all. The Home Office Voluntary Service Unit, who are responsible for these Regulations, do not seem fully to have taken this point. One suggestion which has been made is that, since Regulation 3(2) refers to the agreement being signed "on behalf of" the charity, the trading company might, in these circumstances, sign as the charity's agent. This is, however, quite beside the point. There is no difficulty about the actual signing itself. There is no reason why the charity should not sign the agreement itself if it were going to be a principal in the arrangement (as it would have to be if the trading company were to be acting as nothing other than the charity's agent). The whole point is that the charity must not be a principal in the arrangement. If it were to be, then it would be carrying out non-charitable trading activity and would be receiving income which would not be covered by one of the exemptions from income tax set out in section 505 of the Income and Corporation Taxes Act 1988 and would thus have to pay income tax on its trading income. The result of this (quite apart from meaning that the charity would be in breach of charity law) would be that the whole purpose of having a trading company in the first place would be lost.

Clearly, notwithstanding the provisions of the Act and the Regulations, the contractual relationship will still have to be between the trading company and the commercial participator. Following the coming into force of the Act there will now also have to be an agreement between the charity and the commercial participator. The obvious answer, as the VSU point out, is for the agreement to be a tripartite one with the charity joining in as well. It is very important, however, to ensure that the charity's role is not tainted by its joining in the agreement. It must be very clear from the face of the agreement that the charity's sole function is to confirm that it does not object to the agreement between the trading company and the commercial participator. It must not, on the one hand, take any role in the agreement which might suggest that it was itself trading

directly with the commercial participator and, on the other hand, it must not perform any function which could be said to be supplying a service to the trading company. This, in turn, might have the effect of rendering ineffective the covenanted payment from the trading company to the charity because it might then be said to be in consideration for the services so supplied.

## **2. Transitional provisions**

The Act and the Regulations do not provide for transitional provisions covering agreements entered into prior to 1st March 1995. The Home Office reasoning behind this is that the Act has been around since 1992 and the Regulations have been available in draft for quite long enough for transitional provisions to be unnecessary. This does not, in fact, seem an unreasonable position for the Home Office to take.

The result, however, is that, where there were existing agreements in place as at 1st March which continue to cover the period thereafter (as there must be) and where, in the case of those agreements, the charity is not a party to the agreement (as in most cases it would not be), it will be necessary for supplemental agreements to be entered into between the charity and the commercial participator in relation to those existing agreements in order to conform with the provisions of the Act. Again, in executing those supplemental agreements great care is necessary to ensure that they contain nothing which might be classified as trading by the charity.

## **3. Retailer as commercial participator**

A view has been expressed that a retailer might qualify as a commercial participator. In a situation where a charity has entered into an arrangement with a commercial participator who produces, for the sake of argument, soap powder, there is likely to be printed on the packets of soap powder a notice to the effect that some part of the proceeds of sale of each packet will benefit the charity. Quite clearly, the Act and Regulations will apply to the relationship between the charity and the producer of the soap powder. But what about the supermarket in which that soap powder is sold? The definition of a commercial participator refers to "any person...who....in the course of....business, engages in any promotional venture in the course of which it is represented that charitable contributions are to be given to or applied for the benefit of (a charitable institution)". A "promotional venture" is defined as meaning any advertising or sales campaign or any other venture undertaken for promotional purposes.

Is it then a "promotional venture" to display goods for sale on the shelves of a supermarket? There is at least an argument that it is, since there can be no reason, other than to promote them for sale, for displaying the packets of soap powder on

the shelves. If this is right, then supermarkets such as Tesco and Sainsbury's are likely at any one time to find that they are commercial participators in relation to a number of charities without in any way of being aware of it. Strictly speaking, they should in each case have an agreement with the appropriate charity. This is clearly unintended and would be impossible to enforce.

#### **4. Enforceability of the requirements**

The initial difficulty is that the penalties for failing to comply with the requirements attach not to the charity but to the commercial participator. Yet, realistically, it will be the charity and not the commercial participator who is aware of the Act and the Regulations. Clearly, it is not in the interests of the charity as a whole to allow commercial participators generally to transgress through ignorance, but it may not always be easy to prevent this.

The second problem in relation to the enforceability of these provisions relates to the difference between the provisions of the Act and real life. The primary sanction for a commercial participator who acts as such without an agreement complying with the legislative requirements is to be found in sub-sections (4) and (5) of section 58 of the Act. These specify that, without the consent of the Court, such an agreement will not be enforceable against the charity and the commercial participator will not be entitled to receive payment in respect of anything which it has done in accordance with such a defective agreement. Realistically, however, it will be the commercial participator who has the money and the boot will rather be on the other foot. It will be the charity which is looking to recover its share of the proceeds from the commercial participator and the chances of the commercial participator wishing to enforce the agreement against the charity are rather small. The legislation seeks to compensate for this problem by a combination of Regulations 6(2) and 8. Between them, these two Regulations make it a criminal offence, punishable on conviction by a fine of up to £500, if the commercial participator fails to pay to the charity the sums which are due to it under any agreement (presumably whether or not a defective agreement) as soon as reasonably practicable and, in any event, within 28 days of receipt by the commercial participator.

These provisions, however, present a number of difficulties:

- (a) First of all, as we have seen, it is likely that the commercial participator will not be paying the money directly to the charity at all, but to the charity's trading company. If the trading company then sits on the money for the remainder of its financial year (as it usually will), does this mean that the commercial participator is guilty of a criminal offence?
- (b) The wording of Regulation 6 is obscure, to say the least. What it actually says is that "notwithstanding any contrary term in the agreement" the

money which is due to the charity must be paid over as soon as reasonably practicable and not later than 28 days of receipt "or such other period as may be agreed". There are, thus, two directly conflicting provisions, namely that a different period from 28 days may be agreed between the parties, on the one hand, but that the money must be paid over within the period specified notwithstanding any contrary term in the agreement. A different period having been agreed between the parties is clearly a contrary term in the agreement and, accordingly, presumably must be ignored. If, on the other hand, it is acceptable to agree a different period, it is a little difficult in the context of Regulation 6 to see what other contrary terms would possibly be contained in the agreement which, in accordance with this provision, should be ignored.

- (c) Assuming that the gist of these Regulations does mean that monies must be paid over at the very latest 28 days after receipt, this in most cases will be quite unrealistic in commercial terms. The type of agreement which commercial participators enter into with charities' trading companies, which involves the payment of a royalty in respect of items sold, will almost invariably provide for royalties to be calculated and paid over quarterly. Monthly would be more than is commercially realistic, and to provide for less than monthly is, frankly, commercially naive. There are, surely, enough provisions in the Regulations and the Act to make commercial participators think twice, without charities being placed in the position where they are forced by legislation to require commercial participators to conform with uncommercial terms.

### **III. The Statement**

#### **A. Requirements - s.60(3) of the Act**

The provisions related to the statement are contained in section 60(3) of the Act, which says as follows:

Where any representation is made by a commercial participator to the effect that charitable contributions are to be given to or applied for the benefit of one or more particular charitable institutions, the representation shall be accompanied by a statement clearly indicating:

- (a) the name or names of the institution or institutions concerned;
- (b) if there is more than one institution concerned, the proportions in which the institutions are respectively to benefit; and
- (c) *(in general terms) the method by which it is to be determined:*



- (i) what proportion of the consideration given for goods or services sold or supplied by him, or of any other proceeds of a promotional venture undertaken by him, is to be given to or applied for the benefit of the institution or institutions concerned or
- (ii) what sums by way of donations by him in connection with the sale or supply of any such goods or services are to be so given or applied,

as the case may require.

## **B. Problems**

### **1. Home Office Recommendations**

The primary and fundamental problem in relation to the statement is that the conflict between what the Act says and what the Home Office says in its guidelines that the statement should contain. This is quite different from the requirements contained in the Act. The Home Office have produced a booklet on the subject, which makes the point that the terms that the Act require are the minimum the law allows but then goes on to recommend an approach which requires significantly more.

It might be useful at this stage to consider the history of the wording of Section 60(3). In the original Bill, which eventually was enacted as the Charities Act 1992, the initial words of paragraph (c) of that sub-Section, which are in italics in the extract set out above, were not included. In other words, as originally conceived, this requirement would have made it necessary to include in this statement details of what proportion of the proceeds of sale of each item would be paid to the Charity. During the passage of the Bill through Parliament, it was pointed out why this would prove impossible (to which we will come a little later), and the wording accordingly was amended in the final enactment to include the words in italics above.

In the recommendations as to the content of the statement which the Home Office are currently making, however, the change seems to have been ignored. The recommendations are couched in terms which reflect the original wording of the Bill and not the wording as amended. The Home Office recommendations say that the statement should say something like "X% of the purchase price will be paid to Charity Y" or "£X per item sold will be paid to Charity Y". Accepting that sometimes this will be impossible, the Home Office recommended the easier alternative of expressing this as "a minimum of X% of the purchase price or £X per item sold will be paid to Charity Y".



This is all very well in the case of a simple agreement whereby the charity merely allows the commercial participator to use its name in exchange for, say, 5p per item sold. In such cases, depending on the circumstances, it is possible to structure arrangements so that the payments qualify as "annual payments" for the purposes of the Income and Corporation Taxes Act 1988. Thus, such payments would be covered by an exemption from income tax under section 505 of that Act and will also fall within what is permitted "trading" by the Charity Commission. In those circumstances, therefore, it would be possible for the agreement relating to this arrangement to be entered into directly between the charity and the commercial participator and thus it **would** be possible to make the statement in the terms recommended by the Home Office.

But this will only be the case in the most simple of arrangements.

It is far more likely that either it will be clear that the charity is carrying on a business of trading in its name or the deal will be much more complex. In either of these circumstances the charity will have to act through its trading subsidiary. That means that even where the deal does involve a straightforward payment of £ per item sold (and such deals are by no means always that simple) the money will be paid first to the trading company. The trading company will have its own fixed costs which it will have to meet out of its income before the balance is passed up to the charity under the terms of the covenant between the trading company and the charity.

Thus, the more successful the commercial participator is in selling items, and hence the more items sold, the smaller the percentage of the proceeds of each will be needed to meet fixed costs. If 5% of an item costing £1 is paid to a trading company and only half a dozen are sold, then obviously all the money which is paid by the commercial participator to the trading company will be needed to cover the trading company's fixed costs. It will thus not be accurate to say that any percentage of the price of each item is paid to the charity. On the other hand, if 100,000 items are sold, then the percentage of the sale of each which has to be allocated to fixed costs in the trading company will be very small, and almost all the 5p per item paid by the commercial participator to the trading company will eventually find its way up to the charity under the terms of the covenant.

Thus, for most arrangements between a trading company and a commercial participator, if the statement is to be made with any degree of accuracy the best that could be managed would be a statement to the effect that "X% of each item sold will be paid to XYZ Limited, a company which covenants all its profits to Y Charity". This is not exactly snappy but has the merit of being accurate.

Fortunately, regardless of what the Home Office recommendations say, the requirements of the Act will be met by a statement such as that outlined above.

## 2. What is a "representation"?

It is only a "representation" that results in the need for either the agreement or the statement. It is clearly important, therefore, to understand what it is that constitutes such a representation.

Section 58(6) contains the definition as follows:

In this Part:

- (a) "represent" and "solicit" mean respectively represent and solicit in any manner whatever, whether expressly or impliedly and whether done
  - (i) by speaking directly to the person or persons to whom the representation or solicitation is addressed (whether when in his or their presence or not), or
  - (ii) by means of a statement published in any newspaper, film or radio or television programme,or otherwise, and references to a representation or solicitation shall be construed accordingly; and
- (b) .....

The definition is thus extremely wide. It means that any time that any commercial participator says anything about benefiting a charity (presumably even if he or she is simply doing so in casual conversation) he or she must add all the details required by the statement, including the details which we have just been looking at relating to the amount paid to the charity. At best a commercial participator's audience will think him longwinded and at worst downright pedantic!

Worse still, the representation can be made "impliedly". It is a little unclear quite what that means. If a shopkeeper allows his assistant to serve in the shop wearing a Save the Children T-shirt, is he impliedly making a representation that part of the proceeds from the sale of certain items in the shop will be paid to Save the Children? Ought he, therefore, to put up a sign saying "no percentage of the proceeds of sale of anything in the shop will be paid to Save the Children"?

Reduced to that level, it is clearly ludicrous, but, when the definition is drawn as widely as it is, it is quite difficult to know where the line between sense and nonsense is to be drawn.

### **3. The trading company making representations**

What is the position where the trading company itself is the one making the representation? This could occur in a situation where the commercial participator produces the items for sale, but under the terms of the agreement with the trading company they are marketed under the name of the trading company rather than under the name of the commercial participator. The trading company is by definition not a commercial participator and, therefore, it can make whatever representation it likes without being bound to follow the requirements for the statement. The Home Office guidelines recommend that a trading company should conform with those guidelines but the Act and the Regulations themselves make no such requirement on the trading company. Unless, of course, the representation made by the trading company is simply to the effect that proceeds will be used for a particular purpose (e.g., for charity or for cancer research) rather than using the name of the particular charity itself. If this is done, the situation will then fall within the terms of Regulation 7 which expressly relates to bodies who are neither commercial participators nor professional fundraisers. The provisions of Regulation 7 are to the effect that where a particular purpose is described rather than the name of a charity, there is an obligation on the body making the representation (including a trading company for this purpose) to make a statement which gives, to all intents and purposes, the same details as those required under section 60(3) of the Act. Thus, one arrives at a situation where a trading company owned by a charity which is involved with cancer research need say nothing in support of a representation to the effect that proceeds go to the charity by name, but must give all the details required by the statement if the representation is to the effect that proceeds will be used for the purposes of cancer research. This must be illogical in the extreme.

### **4. Penalties for failure to conform**

Again, the commercial participator and not the charity will be the one who suffers and, again, failure to conform to the requirements of the statement amounts to a criminal offence. Conviction could lead to a fine of up to £5,000. This may not be a large sum to some commercial participators but a criminal record is surely another matter. Potential commercial participators may well feel that the risks of entering into arrangements of this sort with charities are beginning to surpass the possible benefits of so doing.

In conclusion, it is clear that Part II of the Charities Act 1992 and its supporting Regulations have added yet another layer of complexity to a charity's trading activities - a field already, surely, sufficiently full of potential traps.

And to what end?

The purpose of the Act was to ensure that it is made clear to the public, when a commercial participator claims to be assisting a charity out of the proceeds of sale of a particular item, whether  $\frac{1}{2}\%$  or 90% of the proceeds of sale would actually go to the charity. The greatest irony of the situation is that, because of the difficulty of legislating for this, the Act itself is unable to lay upon the commercial participator any burden which would have this effect. Whilst the Home Office is seeking to redress the balance by its recommendations, these are, as we have seen, in most cases, likely to be impossible to fulfil.

The spirit of the Act, then, is one with which, with the best will in the world, commercial participators are going to find impossible to comply, and the only thing left to them will be to comply with the letter of the law, which is unlikely to have the effect that the Act was intended to have.