Law Commission

Technical Issues in Charity Law

Consultation Paper No 220

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Law Commission
Reforming the law

Technical Issues in Charity Law
A Consultation Paper

50 YEARS

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TECHNICAL ISSUES IN CHARITY LAW

A Consultation Paper

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Topic of this consultation: Technical issues in charity law: changing purposes, amending governing documents and applying property cy-près; regulating charity land transactions and the use of permanent endowment; payments to charity trustees and other non-beneficiaries; incorporation, merger and insolvency; Charity Commission powers; the Charity Tribunal and the courts.

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THE LAW COMMISSION

TECHNICAL ISSUES IN CHARITY LAW
A CONSULTATION PAPER

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PART I

INTRODUCTION

CHAPTER 1
INTRODUCTION

1.1 This Consultation Paper analyses various issues in charity law and makes provisional proposals that the law should be reformed.

1.2 We seek views from consultees on the questions raised in the Consultation Paper by 3 July 2015. Replies should be sent to the address on page iii.

CHARITIES

What is a charity?

1.3 Charities occupy a special place in society and in law. They exist for the benefit of the public.[1] Each has a purpose, ranging from the relief of poverty to the promotion of the arts to the advancement of environmental protection.[2] Charities come in all shapes and sizes, and their aims range from focusing on local issues to a nationwide or global sphere of interest.

1.4 It is a fundamental principle that, for an institution to be a charity, its purposes must be exclusively charitable.[3] A charity must exist for the benefit of the public generally, not for the benefit of private individuals or entities.

1.5 Charities are registered and regulated by the Charity Commission for England and Wales.

The size of the charity sector

1.6 There are approximately 180,000 charities in England and Wales registered with the Charity Commission,[4] with a combined annual income of nearly £65 billion.[5] In 2012, it was estimated that there were a further 191,000 unregistered charities with a combined income of £57.7 billion.[6]

1.7 There are nearly 950,000 trustees of registered charities, and registered charities employ over 900,000 people and are supported by over 3.7 million volunteers.[7]

1 Charities Act 2011, ss 2(1)(b) and 4.

2 Section 3(1) of the Charities Act 2011 contains a list of charitable purposes.

3 Charities Act 2011, s 1(1)(a).

4 Charity Commission, "Charities in England and Wales – 30 September 2014", available at http://apps.charitycommission.gov.uk/Showcharity/RegisterOfCharities/SectorData/SectorOverview.aspx. This comprises 164,000 main charities and 16,000 linked charities.

5 Charity Commission, "Charities in England and Wales – 30 September 2014". The figure comprises voluntary income (£19.8bn), trading to raise funds (£6.2bn), investment income (£3.6bn), charitable activities income (£33.2bn) and other sources (£2.0bn).

6 National Audit Office, *Regulating charities: a landscape review* (July 2012) para 1.18, available at http://www.nao.org.uk/wp-content/uploads/2012/07/Regulating_charities.pdf. The National Audit Office included exempt and excepted charities, but did not include charities that are unregistered because their income is below £5,000 (see paras 1.25 to 1.28 below). When small unregistered charities are included, these figures will increase.

7 Charity Commission, "Charities in England and Wales – 30 September 2014".

Public trust and confidence

1.8 The Charity Commission's first statutory objective is to increase public trust and confidence in charities.[8] Research suggests that public trust and confidence in charities is high. Ipsos MORI research in June 2014 found that just 3% of the population say that the role of charities in society is not very important, or not important at all, and that 71% of people consider that charities are trustworthy and act in the public interest.[9] The importance of charities is reflected by the significant donations made to them each year; charitable giving by individuals in the United Kingdom in the financial year 2012/13 was estimated to have been £10.4 billion.[10]

1.9 Charities have an important role and the law should both protect and properly regulate them. Our project is intended to further these objectives by removing unnecessary regulation while safeguarding the public interest in ensuring that charities are properly run.

THE BACKGROUND TO THE PROJECT

1.10 The project originated from our Eleventh Programme of Law Reform.[11] The Charity Commission had suggested a review of certain issues affecting charities established by statute and by Royal Charter. We were also mindful of the forthcoming statutory review[12] of the Charities Act 2006 by Lord Hodgson of Astley Abbotts, which might raise further legal issues that were ripe for reform. Lord Hodgson's report, published in 2012, made over 100 recommendations.[13] Amongst those recommendations, he highlighted various technical legal problems faced by charities and suggested that they be given further consideration by the Law Commission. We agreed to include many of those issues within our project.

1.11 We have divided the project into two parts. The first part concerned social investment by charities. We published a Consultation Paper in April 2014[14] and a

8 Charities Act 2011, s 14.

9 Ipsos MORI, *Public trust and confidence in charities: Research study conducted by Ipsos MORI on behalf of the Charity Commission* (June 2014) pp 34 and 39, available at https://www.ipsos-mori.com/researchpublications/publications/1679/Public-Trust-and-Confidence-in-Charities-2014.aspx.

10 Charities Aid Foundation, *UK Giving 2012/3 – an update* (March 2014) p 6, available at https://www.cafonline.org/pdf/UK%20Giving%202012-13.pdf. Total donations from individuals and companies in the United Kingdom on which Gift Aid was reclaimed in 2012/2013 were £4.13 billion: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/324131/Table_10_3.pdf (this does not include donations made outside the Gift Aid scheme).

11 Eleventh Programme of Law Reform (2011) Law Com No 330, available to download from the Law Commission website www.lawcom.gov.uk (Publications > Programmes of law reform).

12 See Charities Act 2006, s 73.

13 Lord Hodgson of Astley Abbotts, *Trusted and Independent: Giving charity back to charities – Review of the Charities Act 2006* (July 2012), available at https://www.gov.uk/government/consultations/charities-act-2006-review. We refer to the Report as the "Hodgson Report".

14 Social Investment by Charities (2014) Law Commission Consultation Paper No 216, available to download from the Law Commission's website (A-Z of Projects > Charity Law).

paper setting out our recommendations in September 2014.[15] We are awaiting a response from Government to our recommendations. Our conclusions on social investment led us to expand our terms of reference for the remainder of the project to include a review of the law relating to the use of permanent endowment.

1.12 The second part of our project covers all remaining issues in our terms of reference, including a review of permanent endowment. In this Consultation Paper, we explain those issues and make provisional proposals for reform. This is not a full review of charity law. Rather, it is a consultation on selected technical issues, many of which arose from the Hodgson Report. In formulating our proposals for reform, we have carefully considered Lord Hodgson's recommendations. Our review is not, however, limited to an assessment of his recommendations and we have looked afresh at the various issues in our terms of reference.

THE DIFFERENT LEGAL FORMS OF CHARITIES

1.13 Charities take many different legal forms. Several of the technical issues raised in this Consultation Paper turn on the legal form of the charity, particularly whether it is incorporated (and therefore has a legal personality separate from its trustees or members) or unincorporated (and therefore has no separate legal personality). Whilst the Charities Act 2011 applies to all charities regardless of their legal form,[16] particular legal forms of charities are subject to overlapping or additional regulation under other legislation.

Incorporated charities

Companies

1.14 Charities can be incorporated as companies. They are governed by the Companies Act 2006 and must be registered at Companies House (as well as being registered by the Charity Commission[17]). Charitable companies are usually limited by guarantee, rather than by shares. A charitable company's governing document is called its articles of association. The Charity Commission publishes model articles of association for charitable companies.[18]

Charitable incorporated organisations

1.15 The charitable incorporated organisation ("CIO") is a new form of incorporated charity that was introduced by the Charities Act 2006 as an alternative to the limited company. It provides the benefits of incorporation without requiring dual registration with both the Charity Commission and with Companies House. The membership of a CIO may be limited to its trustees (the "foundation" model), or it

[15] Social Investment by Charities: The Law Commission's Recommendations (September 2014), also available to download from the Law Commission's website.

[16] Although some provisions do not apply to certain categories of charity: see para 1.26 and following below.

[17] Unless they are not required to register with the Charity Commission: see para 1.25 below.

[18] Charity Commission, *Model articles of association for a charitable company* (March 2012), available at https://www.gov.uk/government/publications/setting-up-a-charity-model-governing-documents.

may have members who are not trustees (the "association" model). A CIO's governing document is called its constitution. The Charity Commission publishes a model constitution for CIOs.[19]

Charities incorporated by Act of Parliament

1.16 A small number of charities have been incorporated by Act of Parliament. The incorporating Act will often contain the provisions regulating the purposes and administration of the charity, but some of these provisions may be found in a later Act or Acts (or indeed in another instrument). We discuss charities incorporated by Act of Parliament, which we refer to as "statutory charities", in Chapters 3 and 4.

Charities incorporated by Royal Charter

1.17 A charity may be incorporated by a Royal Charter granted by the Sovereign.[20] Charters are granted on the advice of the Privy Council, which advises on the exercise of the Sovereign's duties and common law powers. Like other corporate bodies, Royal Charter corporations are legal persons distinct from their individual members.[21] The governing documents of charities incorporated by Royal Charter typically comprise the incorporating Charter (and any supplemental Charters), bye-laws and regulations. We discuss Royal Charter charities in Chapters 3 and 4.

Community benefit societies

1.18 Community benefit societies, previously known as industrial and provident societies, are governed primarily by the Co-operative and Community Benefit Societies Act 2014.

Other incorporated charities

1.19 Charities have occasionally been incorporated by grant of letters patent, by persons acting under Royal licence, by prescription, by a lost Charter being presumed, and by custom.[22]

Unincorporated charities

1.20 An unincorporated charity will either be a trust or an unincorporated association.

[19] Charity Commission, *Model constitution for CIO with voting members other than its charity trustees* (August 2014) and *Model constitution for CIO whose only voting members are its charity trustees* (August 2014), available at https://www.gov.uk/government/publications/setting-up-a-charity-model-governing-documents.

[20] At common law, the Sovereign has the power to incorporate by Royal Charter any number of persons assenting to be so incorporated: see *Sutton's Hospital Case* (1612) 10 Co Rep 23a, 31a and 33b, by Sir Edward Coke CJ; and *Elve v Boynton* [1891] 1 Ch 501, 507, by Lindley LJ.

[21] *Re Sheffield and South Yorkshire Permanent Building Society* (1889) QBD 470, 476, by Cave J.

[22] See J Warburton, *Tudor on Charities* (9th ed 2003) ch 3; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) ch 18; *Re Free Fishermen of Faversham (Company or Fraternity)* (1877) 36 ChD 329; *Byrd v Wilsford* (1596) Cro Eliz 464.

Trusts

1.21 A charitable trust involves one or more trustees holding property on trust for charitable purposes. The charity has no members. The governing document is the trust deed. The Charity Commission publishes a model trust deed for charitable trusts.[23]

Unincorporated associations

1.22 An unincorporated association has been described as "an association of persons bound together by identifiable rules and having an identifiable membership".[24] The rules of the association contain the contractual rights and obligations enforceable by the members against one another. They usually provide for the management of the affairs of the charity to be the responsibility of a committee elected from the members.[25] The governing document is called a constitution. The Charity Commission publishes a model constitution for unincorporated associations.[26]

The statutory definition of a charity

1.23 Section 1(1) of the Charities Act 2011 defines "charity" as an institution that is established for charitable purposes only, and falls to be subject to the control of the High Court in the exercise of its jurisdiction with respect to charities. This definition does not distinguish between the different legal forms of charities set out above.[27] Similarly, references to a charity in this Consultation Paper are references to any institutions within the section 1 definition, unless we expressly refer to a particular legal form of charity.

DIFFERENT CATEGORIES OF CHARITY UNDER THE CHARITIES ACT 2011

1.24 There are four categories of charity under the Charities Act 2011, and the application of the Act to any given charity depends on the category into which it falls. The legal form of a charity (see paragraphs 1.14 to 1.22 above) has no bearing on its categorisation under the Act.

Registered charities

1.25 Every charity must register with the Charity Commission, unless it is:

(1) an exempt charity (see paragraph 1.26 below);

(2) an excepted charity with an annual income of £100,000 or less (see paragraph 1.27 below); or

[23] Charity Commission, *Model trust deed for a charitable trust* (November 2013), available at https://www.gov.uk/government/publications/setting-up-a-charity-model-governing-documents.

[24] *Re Koeppler's Will Trusts* [1985] 2 All ER 869, 874, by Slade LJ.

[25] J Warburton, *Tudor on Charities* (9th ed 2003) para 3-037.

[26] Charity Commission, *Model constitution for an unincorporated charity* (November 2013), available at https://www.gov.uk/government/publications/setting-up-a-charity-model-governing-documents.

[27] See Charities Act 2011, s 9(3).

(3) a charity with an annual income of £5,000 or less.[28]

Exempt charities

1.26 Certain charities are exempt from the requirement to register with the Charity Commission, and from other (but not all) provisions of the Charities Act 2011.[29] They are usually regulated by another body (the "principal regulator") whose functions overlap with those of the Commission. Exempt charities are listed in Schedule 3 to the Charities Act 2011.[30] They include:

(1) most English universities;[31]

(2) other educational bodies, such as higher and further education corporations, academies, and foundation and voluntary schools;[32] and

(3) various museums and galleries, such as the Victoria and Albert Museum, the Science Museum and the British Museum.[33]

Excepted charities

1.27 Charities may be excepted by an order of the Minister or of the Charity Commission, and are known as "excepted charities".[34] They include:

(1) some churches and chapels;

(2) some charities that provide premises for schools;

(3) Scout and Guide groups; and

(4) certain armed forces charities.[35]

[28] Charities Act 2011, s 30(2). CIOs, however, must register regardless of their income level.

[29] Those provisions have been extended to certain exempt charities, referred to as "specified exempt charities": see Appendix A.

[30] See also Charity Commission, *Exempt Charities* (CC23) (September 2013) para B6, available at https://www.gov.uk/government/publications/exempt-charities-cc23.

[31] Charities Act 2011, Sch 3, paras 2 to 5. The principal regulator of these charities is the Higher Education Funding Council for England. Welsh universities are not exempt and are therefore regulated by the Charity Commission: see Charity Commission, *Exempt Charities* (CC23) (September 2013) para B6.

[32] Charities Act 2011, Sch 3, paras 5 to 11. The principal regulator of these charities is the Department for Education, the Department for Business, Innovation and Skills or the Welsh Government.

[33] Charities Act 2011, Sch 3, paras 12 to 25. The principal regulator of these charities is the Department for Culture, Media and Sport, save for the Royal Botanic Gardens, Kew, for which the principal regulator is the Department for the Environment, Food and Rural Affairs.

[34] There are restrictions on the creation of new excepted charities: Charities Act 2011, s 31.

[35] See Charity Commission, *Excepted Charities* (June 2013), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/351491/Excepted_charities.pdf.

Other unregistered charities

1.28 Charities with an annual income of £5,000 or less are not required to register with the Charity Commission.[36]

TERMINOLOGY

Charities

1.29 We have explained that references to "charities" in this paper are to all charities falling within section 1 of the Charities Act 2011, unless we expressly refer to a particular legal form of charity.

Trustees

1.30 Section 177 of the Charities Act 2011 defines those responsible for the control and management of charities as "charity trustees". We refer to them as "charity trustees" or just "trustees". Strictly speaking, not all of those who control and manage charities are trustees; for example, charitable companies are run by directors, not trustees. Nevertheless, the terms "charity trustee" and "trustee" are widely accepted as covering all those who run charities, including directors. We use the term "trustee" in that sense, save where we make clear that we are referring specifically to the trustees of a trust.

Governing documents

1.31 A charity's governing document sets out (amongst other things) its purposes, the powers and duties of those responsible for its management and administration, and the procedures to be followed in exercising those powers. We use this as a generic term for the rulebook of all charities, whatever their legal form.

REFERENCES

Charity Commission guidance

1.32 We make frequent reference to guidance published by the Charity Commission. The guidance is available on the Charity Commission's website.[37]

1.33 The Charity Commission also publishes operational guidance, which is intended for internal use but which gives further details about the Commission's approach to many of the issues that we discuss in this consultation paper. Much of the operational guidance is available on the Charity Commission's website.[38]

THE STRUCTURE OF THIS PAPER

1.34 In Part 2, we discuss the amendment of charities' purposes and other provisions in their governing documents. We provisionally propose the creation of a new

[36] Indeed, they are not yet permitted to be registered: s 30(3)(b) of the Charities Act 2011, which would permit such charities to register voluntarily, has not yet been brought into force.

[37] See https://www.gov.uk/government/organisations/charity-commission, or search for guidance at https://www.gov.uk/government/publications?keywords=&publication_filter_option=guidance&topics%5B%5D=all&departments%5B%5D=charity-commission.

[38] See http://ogs.charitycommission.gov.uk/.

power for statutory and Royal Charter charities to make minor amendments to their governing documents (Chapter 4), and then consider the power of other charities to change their purposes and amend their governing documents, including the use of cy-près schemes (Chapter 5 and 6). Finally, we examine the rules governing the distribution of the proceeds of failed fundraising appeals (Chapter 7).

1.35 In Part 3, we discuss the regime that applies to charities when they dispose of land, and make provisional proposals for its simplification (Chapter 8). We then turn to the law governing the use of permanent endowment (Chapter 9); we evaluate the procedures by which charities can release the restrictions on spending their permanent endowment and consider whether a new regime should be created that would seek to ensure the permanence of a fund whilst giving trustees greater flexibility as to how it can be used.

1.36 Part 4 addresses three issues: the payment of trustees for the provision of goods to their charity; empowering the Charity Commission to award an equitable allowance to a trustee who has made an unauthorised profit in breach of his or her fiduciary duties to the charity (Chapter 10); and the circumstances in which ex gratia payments (payments to third parties who have a moral, but not a legal, claim to the charity's property) can be made by a charity (Chapter 11).

1.37 In Part 5, we provisionally propose changes to the regimes that govern the incorporation and merger of charities (Chapter 12). We then look at the insolvency treatment of property held on charitable trust, including permanent endowment and special trust property (Chapter 13).

1.38 Part 6 concerns two discrete powers of the Charity Commission: the power to require a charity to change its name and to refuse to register a charity unless it changes its name (Chapter 14); and the power to determine the identity of the charity's trustees and members (Chapter 15). We provisionally propose that these powers should be expanded.

1.39 In Part 7, we discuss particular issues that have arisen since the Charity Tribunal was established by the Charities Act 2006 and make provisional proposals for reform (Chapter 16).

1.40 Finally, in Part 8, we list all our consultation questions and provisional proposals for reform (Chapter 17).

ACKNOWLEDGEMENTS

1.41 We are grateful to those with whom we have met to discuss the issues in this Consultation Paper: Stephen Roberts and Adrian Broomfield, Charity Commission; Alison McKenna, Principal Judge of the First-tier Tribunal (Charity); officials from the Cabinet Office, Attorney General's Office and the Privy Council Office; Lord Hodgson of Astley Abbotts; the Charities' Property Association; Alison Talbot, Blake Morgan; the Association of University Legal Practitioners; Saira Salimi, Church Commissioners; and the Institute of Legacy Management. We would like to thank Blake Morgan for organising two seminars, one in Oxford on 20 October 2014 and the other in London on 3 November 2014, to discuss the amendment of Royal Charter and statutory charities' governing documents. We are grateful to those who have commented on earlier drafts of this paper:

Stephen Roberts and Adrian Broomfield; Alison McKenna; Saira Salimi; Matthew Smith, Maitland Chambers; Valerie James, Wrigleys Solicitors LLP; Serena Hedley-Dent, Eton College; and Steven Little, Winchester College. We are particularly grateful to Rebecca Fry of Farrer & Co, who worked on the sections of this paper dealing with Royal Charter charities during an unpaid placement with the Law Commission, and to Con Alexander, Rachel Tonkin and the members of the charities team at Veale Wasbrough Vizards LLP for sharing their expert views on the issues in this paper.

PART 2

CHANGING PURPOSES, AMENDING GOVERNING DOCUMENTS AND APPLYING PROPERTY CY-PRÈS

CHAPTER 2
INTRODUCTION

INTRODUCTION

2.1 This Part examines the ways in which charities can change their purposes and amend their governing documents. In the course of our analysis we cover five issues regarded by Lord Hodgson as being ripe for reform, namely:

(1) the ability of charities founded or governed by Royal Charter or Act of Parliament to amend their governing documents;[1]

(2) the statutory power for small unincorporated charities to amend their purposes, which Lord Hodgson said should be available to some larger charities;[2]

(3) whether charity trustees themselves should have power to make cy-près schemes[3] to change their charity's purposes;[4]

(4) making minor, non-substantive amendments to charities' governing documents without Charity Commission consent;[5] and

(5) the administration of the proceeds of fundraising appeals where either too much or too little is raised.[6]

2.2 It is not possible to consider these recommendations in isolation. Our analysis of them has inevitably raised other related difficulties under the current law. Before we ask how a charity's purposes and governing document may be amended, we pause to consider why there might be a need for such a change.

THE NEED TO AMEND GOVERNING DOCUMENTS TO CHANGE PURPOSES AND ADMINISTRATIVE PROVISIONS

2.3 The founders of a charity will aim to ensure that its governing document serves the charity well for the foreseeable future. With the passage of time, however, new needs will arise and unforeseen eventualities will occur, requiring charities to amend their governing documents to ensure their continuing effectiveness. Indeed, charity trustees are encouraged by the Charity Commission to keep their governing documents under review and consider whether they need to be amended.[7] Amendments must be considered carefully, particularly when they change the basis on which donors might have decided to support the charity.

1 Hodgson Report, Appendix A, paras 1 and 2.

2 Hodgson Report, Appendix A, para 26.

3 We explain cy-près schemes in para 3.20 and following below.

4 Hodgson Report, Appendix A, para 3.

5 Hodgson Report, Appendix A, para 13.

6 Hodgson Report, Appendix A, para 4.

7 Charity Commission, *Changing your Charity's Governing Document* (CC36) (August 2011) section C1.

2.4 Charities may need to amend their governing documents for various reasons, which can range from minor technical changes to fundamental changes to the way a charity is run or the charitable objects it pursues. We give some examples in Figure 1.

Figure 1: circumstances in which a charity may need to amend its governing document

(1) *To change the administrative procedures of the charity.* A charity may wish to change the process by which its trustees are appointed or by which members are admitted. Or a charity may prefer to communicate with its members and arrange general meetings by email to avoid the time and expense involved with postal communications, and may need to amend a provision in its governing document – for example, requiring first class post – in order to do so.

(2) *To expand or limit the charity trustees' powers.* A charity's governing document may need to be amended to permit the trustees to borrow money, to purchase or lease property, to make a social investment,[8] or to employ staff. Conversely, an amendment may restrict trustees' powers, such as the default investment power under section 3 of the Trustee Act 2000.

(3) *To update the governing document following legislative changes.* For example, a charity's governing document may need to be amended to reflect changes in equality or employment law.

(4) *To remove anachronistic or offensive provisions.* Historic governing documents may contain provisions that are now out of date or are offensive.

(5) *To change the charity's name.*

(6) *To change the charity's objects.* The Charity Commission gives various examples of circumstances in which a charity may wish to change its objects.[9] For example, the objects of a charity established to care for people with disabilities may require the charity to provide institutions in which beneficiaries can be housed. The trustees may consider that its objects should be amended so the charity can provide support for beneficiaries living in their own homes.

2.5 It is important that changes can be made as quickly and efficiently as possible, whilst retaining safeguards to ensure that proposed amendments are appropriate. Unnecessary bureaucracy in the process can reduce the time available to the charity's trustees and staff for the pursuit of the charity's mission. It can delay beneficial changes coming into effect (particularly as trustee meetings can be infrequent, so even a little bureaucracy can cause a significant delay), and it can impose burdens on third parties. Increased expense in the process reduces the funds available for the charity to spend directly in the furtherance of its objects.

DIFFERENT REGIMES FOR AMENDMENT

2.6 This Part has a number of chapters because there are several different ways in which a charity's purposes and governing document might be changed. The ability of charities to change their purposes, and amend other provisions in their

[8] See the first stage of our charity law project, and our recommendations in Social Investment by Charities: The Law Commission's Recommendations (September 2014).

[9] Charity Commission, *OG2 A1 Application of property cy-près* (March 2012) section 1.1.

governing documents, depends on their legal form. The most common forms (charitable companies, charitable incorporated organisations ("CIOs"), trusts and unincorporated associations)[10] have broad powers to change their purposes and amend other provisions, and in the absence of sufficient powers they have a useful fall-back position of seeking a scheme from the Charity Commission to effect a change. In Chapters 5 and 6, we consider whether these powers could be further improved.

2.7 Some charities, however, are incorporated by an Act of Parliament (which we refer to as "statutory charities") or by a Royal Charter (which we refer to as "Royal Charter charities"). Whilst these legal forms of charity are relatively rare, many well-known charities are incorporated by statute or Royal Charter. Statutory charities include the National Trust[11] and the People's Dispensary for Sick Animals.[12] Charities incorporated by Royal Charter include the National Society for the Prevention of Cruelty to Children, the Royal Society for the Protection of Birds, the British Red Cross Society, the Royal College of Music, the Royal Ballet, the Royal National Institute of Blind People, and the Royal National Lifeboat Institution.

2.8 These charities face particular difficulties in amending their governing documents as amendments require the oversight of the Privy Council or Parliament. They do not have the same fall-back position as other charities (see paragraph 2.6 above) since any scheme from the Charity Commission to effect a change must still be approved by the Privy Council or by Parliament.[13] In Chapter 4, we consider whether the current procedures remain appropriate or whether they could be improved.

THE PROCEEDS OF FUNDRAISING APPEALS

2.9 This Part also addresses a related issue, namely the law governing the distribution of the proceeds of fundraising appeals. Where a charity appeals for donations for a particular charitable purpose but fails to raise sufficient funds, the charity will often have to trace donors to offer the repayment of their donations before the fund can be applied for other charitable purposes. In Chapter 7, we consider whether the requirements that apply before the proceeds can be applied for other charitable purposes should be reformed.

[10] See Chapter 1 above.

[11] The National Trust, incorporated by the National Trust Act 1907, is established for the preservation of lands of beauty or historic interest, and the preservation of furniture, pictures and chattels having national and historic or artistic interest.

[12] Founded in 1917 and now governed primarily by the People's Dispensary for Sick Animals Acts 1949 and 1956, the People's Dispensary for Sick Animals promotes animal health and welfare and provides free medical or surgical treatment, or such treatment at reduced charges, to animals belonging to persons who are unable to afford the services of a veterinary surgeon.

[13] Compare Charities Act 2011, s 69 with s 68 (Royal Charter charities) and s 73 (statutory charities).

CHAPTER 3
THE CURRENT LAW

INTRODUCTION

3.1 In this Chapter, we summarise the current law governing the change of charities' purposes, including by way of cy-près schemes, and the amendment of other provisions in charities' governing documents, including by way of administrative schemes.

EXISTING MEANS TO CHANGE PURPOSES AND OTHER PROVISIONS IN GOVERNING DOCUMENTS

3.2 The ability of a charity to amend its governing document depends on the nature of the proposed amendment, the terms of the charity's governing document, and the legal form and size of the charity. The governing documents of the most common forms of charity generally contain a power of amendment exercisable by a resolution of the trustees or members of the charity. Even in the absence of such a power, many such charities have a power under the Companies Act 2006 or the Charities Act 2011 to amend their governing documents.

3.3 For statutory and Royal Charter charities, however, the position is less straightforward. Any amendment to the governing document of a statutory charity must be sanctioned by Parliament and the process of amendment requires the involvement of the Charity Commission and the Cabinet Office. When a Royal Charter charity seeks an amendment to its Charter, it needs the consent of the Privy Council and is also usually required to engage the Charity Commission and the Cabinet Office, amongst other interested bodies. This can be a long and complicated process.

Charitable companies and charitable incorporated organisations

3.4 The articles of association of a company (whether or not it is charitable) and the constitution of a CIO can be amended by a resolution of its members at a general meeting.[1] Companies' articles and CIOs' constitutions may provide for more restrictive conditions to be satisfied before they can be amended (for example, obtaining the consent of a particular person or the Charity Commission), known as "entrenchment", but such provision cannot prevent amendment with the unanimous agreement of the charity's members.[2]

[1] Companies Act 2006, s 21 (charitable companies), and Charities Act 2011, s 224 (CIOs). A resolution must be passed by at least 75% of the members voting or, in the case of a resolution of the members of a CIO otherwise than at a general meeting, by unanimous agreement of the members: Companies Act 2006, s 283; Charities Act 2011, s 224(2).

[2] Companies Act 2006, s 22; and Charitable Incorporated Organisations (General) Regulations 2012 (SI 2012 No 3012), reg 15(3). We refer to the Regulations as the "2012 Regulations".

3.5 If the amendment that a charitable company or CIO wishes to make is a "regulated alteration", then it must obtain the Charity Commission's prior consent to the change.[3] A "regulated alteration" is:

(1) an amendment to the charity's objects;

(2) an alteration to the provisions concerning the distribution of the charity's property in the event of dissolution; or

(3) any alteration that would authorise a benefit to be obtained by the charity's directors or members (or connected persons), unless that benefit is authorised by section 185 of the Charities Act 2011.[4]

3.6 In addition, a CIO cannot amend its constitution in such a way that would result in it ceasing to be a charity.[5]

3.7 Once a resolution has been passed:

(1) A charitable company must give notice of the amendment to the Registrar of Companies and provide a copy of the articles as amended, the resolution giving effect to the amendment, and (in the case of a regulated alteration) a copy of the Charity Commission's consent, all within 15 days of the resolution.[6] Where the amendment is to the charity's objects, the amendment is not effective until it is recorded on the register at Companies House.[7] If the charitable company is registered with the Charity Commission, the trustees must notify the Commission of the amendment so that the particulars of the charity in the register can be updated.[8]

(2) A CIO must send a copy of the constitution as amended and the special resolution to the Charity Commission.[9] An amendment takes effect once it is registered by the Charity Commission, and the Commission will refuse to register an amendment in certain circumstances.[10]

[3] Charities Act 2011, ss 198(1), 226, 248 and 249.

[4] Charities Act 2011, s 198(2). The meaning of "benefit" is set out in s 199 and of "connected person" in s 200. Authorised benefits under s 185 are considered in Chapter 10 below.

[5] Charities Act 2011, s 225.

[6] Companies Act 2006, ss 26(1) and 30(1), and Charities Act 2011, s 198(3).

[7] Companies Act 2006, s 31(2)(c). A failure to notify Companies House of other amendments can lead to criminal liability on the part of the company and its directors, but does not prevent the amendment from being effective: Companies Act 2006, ss 26(3), 27 and 30(2); Charities Act 2011, s 198(5).

[8] Charities Act 2011, s 35(3).

[9] Charities Act 2011, s 227(1).

[10] Charities Act 2011, s 227(2), (3) and (4).

3.8 In the rare case where a charitable company's articles or a CIO's constitution cannot be amended,[11] the charity can ask the Charity Commission to make a scheme to amend the articles (on which see below).[12]

Trusts and unincorporated associations

3.9 Often the trust deed of a charitable trust will permit the trustees to amend it by passing a resolution to that effect.[13] Similarly, the constitution of an unincorporated association will often permit amendment by the charity trustees and/or the members passing a resolution.[14] The governing document may only permit certain amendments (for example, amendments that do not change the charity's objects) or it may require certain conditions to be satisfied (for example, obtaining the consent of the Charity Commission) before the amendment can take effect.

3.10 The Charities Act 2011 contains a power for certain small unincorporated charities to amend their objects, and a power for all unincorporated charities to amend administrative provisions in their governing document. These powers apply even if the governing document does not contain a power of amendment. If the governing document does contain a power of amendment, the charity can exercise the power under the governing document (in which case any conditions in the governing document must be complied with) or it can exercise the statutory power instead (in which case any conditions in the governing document will not apply).

Statutory power to change a small unincorporated charity's purposes

3.11 Under section 275(2) of the Charities Act 2011, the objects of certain small unincorporated charities can be changed by a resolution of the charity trustees.[15] The power applies to unincorporated charities that both (a) have an income of £10,000 or less per annum and (b) do not hold "designated land", namely land held on trusts stipulating it must be used for the purposes of the charity.[16]

3.12 To exercise the power, the charity trustees must be satisfied (1) that it is expedient in the interests of the charity for the purposes in question to be replaced, and (2) that, so far as is reasonably practicable, the new purposes

[11] This would be either (a) because a 75% majority of members cannot be obtained or (b) if the articles or constitution contain more restrictive conditions (see para 3.4 above), because the more restrictive conditions cannot be satisfied or unanimous agreement of the members cannot be obtained under s 22(4) of the Companies Act 2006 or reg 15(3) of the 2012 Regulations.

[12] Its power to do so is preserved by Companies Act 2006, s 22(3) and (4).

[13] For example, cl 31 of the Charity Commission's model trust deed permits the charity trustees to amend the document.

[14] For example, cl 7 of the Charity Commission's model constitution for a charitable unincorporated association permits the members to amend it by resolution at a general meeting.

[15] Charities Act 2011, s 275(2). The resolution must be passed by at least two-thirds of the charity trustees who vote on it: Charities Act 2011, s 275(5). Unlike the power to amend administrative provisions in s 280 (see paras 3.16 to 3.18 below), there is no separate requirement for the charity's members (if separate from the trustees) to approve the resolution.

[16] Charities Act 2011, s 275(1). For example, a village hall may be held as "designated land".

consist of or include purposes that are similar in character to those that are to be replaced.[17]

3.13 A copy of the resolution, together with the trustees' reasons for passing it, must be given to the Charity Commission.[18] The Commission can require the trustees to provide further information, or to publicise the resolution.[19] Otherwise, the resolution will take effect 60 days after it is received by the Commission,[20] unless the Commission objects to the resolution.[21]

3.14 A charity with an income of over £10,000, or which has designated land, and whose governing document does not contain an express power of amendment, can only change its objects by seeking a scheme from the Charity Commission (on which see below).

3.15 We consider reform to the section 275 power in Chapter 5.

Statutory power to amend administrative provisions in an unincorporated charity's governing document

3.16 Under section 280(2) of the Charities Act 2011, the charity trustees of an unincorporated charity (regardless of its size or of whether it holds designated land) may pass a resolution to modify any provision in its governing document "(a) relating to any of the powers exercisable by the charity trustees in the administration of the charity, or (b) regulating the procedure to be followed in any respect in connection with its administration".[22] If the charity has a body of members distinct from the charity trustees, the amendment must also be approved by at least two-thirds of the members at a general meeting.[23] In the case of a registered charity, the Charity Commission must be notified of the resolution so that it can update the register.[24]

3.17 The Charity Commission's guidance includes various examples of changes that this statutory provision would allow, including changes to the charity's name, the method of appointing trustees, the number of trustee meetings each year, the method of appointing the chair, the criteria for charity membership, the month in which the charity's annual general meeting takes place, and the quorum

[17] Charities Act 2011, s 275(4).

[18] Charities Act 2011, s 275(6).

[19] Charities act 2011, s 276(1) and (2).

[20] Charities Act 2011, s 277. If the Commission requires the trustees to provide further information or publicise the resolution, the 60-day period is suspended until those requests have been complied with: s 278(4) and (5). If the 60-day period of time is suspended for more than 120 days, the resolution is automatically annulled: s 278(6) and (7).

[21] Charities Act 2011, s 278.

[22] This power originally applied only to small charities (with an income of less than £5,000) that did not hold designated land: Charities Act 1993, s 74. It was amended by the Charities Act 2006, s 42, to apply to all unincorporated charities, regardless of size and regardless of whether they held designated land.

[23] Charities Act 2011, s 280(3) and (4).

[24] Charities Act 2011, s 35(3).

provisions.[25] If the charity is registered with the Charity Commission, the trustees must notify the Commission of the amendment so that the particulars of the charity in the register can be updated.[26]

3.18 If a proposed change does not fall within the two categories of provisions in section 280(2) of the Charities Act 2011, and if the governing document does not contain an express power of amendment, then the charity must seek a scheme from the Charity Commission to amend provisions in the charity's governing document (on which see below).

3.19 We consider reform to the section 280 power in Chapter 6.

Charity Commission schemes to change purposes and amend other provisions in a governing document

3.20 If a charitable company, CIO, unincorporated association or trust wishes to amend its governing document but does not have the power to do so by exercising the powers outlined above, then it can apply to the Charity Commission for a scheme to make the amendment sought.[27] Schemes are legal arrangements that change or supplement the provisions that would otherwise apply in respect of a charity or a gift to charity.

3.21 The Commission will make schemes at the request of the trustees, although it will only do so where the trustees' own powers are insufficient to achieve the desired result. In deciding whether to make a scheme, the Commission will have regard to any entitlement of the members of a charity to vote on a proposed amendment in accordance with the procedure in the charity's governing document; the trustees are therefore unlikely to be able to obtain a scheme as an easy alternative to obtaining the charity's members' agreement to an amendment.

[25] Charity Commission Operational Guidance, *OG 519 Unincorporated Charities: Changes to Governing Documents and Transfer of Property (Charities Act sections 268, 275 and 280)* (February 2014) sections B5.3 to 5.4 and E5.1.

[26] Charities Act 2011, s 35(3).

[27] For a detailed explanation of the scheme-making powers of the Charity Commission and the court, see J Warburton, *Tudor on Charities* (9th ed 2003) para 10.04 and following; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) Part III; Charity Commission, *OG500 Schemes* (June 2014) and *OG2 A1 Application of property cy-près* (March 2012). Various sections of the Charities Act 2011 govern the power to make schemes, including s 69 which gives the Commission a broad power – concurrent with the court – to establish a scheme for the administration of a charity; s 67 which governs the court's and Commission's power to make a cy-près scheme where (amongst other things) the purposes of the charity have failed or too much money has been raised following an appeal (on which see ch 7 below); and ss 63 to 66 which governs schemes where insufficient funds have been raised following an appeal (on which see ch 7 below). The Commission's scheme-making powers in respect of statutory and Royal Charter charities under ss 68 and 73 are considered in ch 4 below. If the charity trustees are seeking authorisation to do something that is not permitted by the governing document, it may be possible for the Charity Commission to permit it by making an order under s 105 of the Charities Act 2011, rather than going through the formal procedure of making a scheme.

The historical context

3.22 The Court of Chancery, now the High Court, has for many years exercised an inherent jurisdiction over charities.[28] It deals with both gifts made to charity and the administration of charities, and in doing so can make schemes. Schemes are made to respond to a number of different situations. Case law generally concerns schemes that are made when there is some difficulty in carrying out a testator's directions in his or her will. But the use of schemes is not limited to dealing with the disposal of a testator's estate and can be made as part of the ongoing operation of a charity.

3.23 The Charity Commissioners (now the Charity Commission) were granted a concurrent jurisdiction with the court to make schemes by the Charitable Trusts Act 1860.[29] In practice, most schemes are now made by the Charity Commission and even where the court directs a scheme, it will often ask the Commission to draft the scheme.[30]

Classification of schemes

3.24 There are two categories of scheme.

(1) "Cy-près schemes" alter the objects of a charity. "Cy-près" means "as near as possible" or "near to this", and involves funds being applied for charitable purposes which are similar to the original purposes.

(2) "Administrative schemes" alter any other provisions of a charity's governing document.

3.25 In turn, cy-près schemes can be subdivided into those that deal with "initial failure" of a charitable purpose, and those that address "subsequent failure".

3.26 Initial failure tends to arise in the administration of wills.[31] Cy-près schemes may be made, for example, where a testator has:

(1) left insufficient funds to carry out the stated charitable purpose;

(2) imposed impossible or impracticable conditions on a gift; or

[28] Originally, it depended on the existence of a trust, but now extends to corporate charities, even if they are not trusts: *Construction Industry Training Board v Attorney General* [1973] Ch 173; J Warburton, *Tudor on Charities* (9th ed 2003) para 10.03 and following. The existence of a trust is still relevant to the application of charitable property. Where there is a gift to charity generally, but no trust is created, jurisdiction to deal with the fund rests with the Crown. The Attorney General administers such funds on behalf of the Crown. See *Tudor on Charities*, para 10-002. Where a trust is created, the court has jurisdiction to make a cy-près scheme.

[29] See now Charities Act 2011, s 69.

[30] Charities Act 2011, s 69(3).

[31] There will often be a prior question concerning the proper interpretation of a will. A testator may, for example, have misdescribed a legatee in his or her will, and the court may interpret the will as directing the legacy to the institution that appears to have been intended by the testator. We are not considering scheme-making in the context of the administration of wills.

(3) made a gift to an institution which has ceased to exist or never existed, or whose operations have been transferred to another organisation.[32]

3.27 Subsequent failure tends to concern the work of existing charities. Cy-près schemes may be made, for example, where:

(1) a charity has been deprived of its objects, as where the funds of a charity founded to assist prisoners for debt were applied cy-près when imprisonment for debt was abolished;[33]

(2) a charity's original purpose is to relieve poverty by providing certain items, such as food or fuel, but that is no longer the most practical way to relieve hardship; or

(3) a charity originally established to provide accommodation for people with disabilities considers that it would best serve its beneficiaries by supporting them in their own homes.[34]

Cy-près schemes

SITUATIONS IN WHICH A CY-PRÈS SCHEME MAY BE MADE

3.28 Originally, the power to make cy-près schemes could only be exercised where the original purposes of the charity had become impossible or impracticable.[35] The circumstances in which the court and the Charity Commission can make a cy-près scheme are now set out in statute, which consolidates the common law and expands the circumstances in which property can be applied cy-près.[36] Section 62 of the Charities Act 2011 provides that property may be applied cy-près in the following situations ("cy-près occasions"):

[32] J Warburton, *Tudor on Charities* (9th ed 2003) para 11-005 and following. We consider the particular problem that arises when a charity has ceased to exist following a merger in ch 12 below.

[33] *Attorney General v Hankey* (1867) LR 16 Eq 140; *Re Prison Charities* (1873) LR 16 Eq 129.

[34] Examples 2 and 3 are taken from the Charity Commission's guidance, *OG2 A1 Application of property cy-près* (March 2012) section 1.1. Cy-près schemes can be made in these situations following the expansion of the jurisdiction by the Charities Act 1960 (on which see below).

[35] *Philpott v St George's Hospital* (1859) 27 Beav 107, 111 to 112. For example, *Attorney General v Glyn* (1841) 12 Simons 84 concerned a school for the education of poor children within a certain district; the district had been converted into a dock under a local Act and there were no children to attend the school, so a cy-près scheme was ordered. In *Biscoe v Jackson* (1866) 35 Ch D 460 a gift to establish a soup kitchen and cottage hospital in Shoreditch was impossible as it was not possible to obtain suitable land in Shoreditch; the gift was applied cy-près for the benefit of the poor. The gift in *Re Robinson* [1923] 2 Ch 332 imposed a condition that a black gown should be worn in the pulpit of the evangelical church to be endowed. There was evidence that this would alienate the congregation, and the trust was modified to dispense with the black gown condition.

[36] The circumstances in which property could be applied cy-près at common law were expanded by the Charities Act 1960. The Charities Act 2006 further relaxed the requirements for making a cy-près scheme.

(1) where the original purposes, in whole or in part, have been fulfilled;[37]

(2) where the original purposes, in whole or in part, cannot be carried out (or not according to the directions given and to the spirit of the gift);[38]

(3) where the original purposes provide a use for only part of the property;[39]

(4) where (i) the property, and (ii) other property applicable for similar purposes, can be more effectively used together and, regard being had to the "appropriate considerations", can suitably be used for common purposes.[40] The "appropriate considerations" are:

  (a) (on the one hand) the spirit of the gift concerned, and

  (b) (on the other) the social and economic circumstances prevailing at the time of the proposed alteration of the original purposes;[41]

(5) where the original purposes were laid down by reference to an area that has ceased to be readily identifiable;[42]

(6) where the original purposes were laid down by reference to a class of persons or an area which has ceased to be suitable, regard being had to the appropriate considerations (see above), or to be practical in administering the gift;[43]

(7) where the original purposes, in whole or in part, have been adequately provided for by other means;[44]

[37] Charities Act 2011, s 62(1)(a)(i). For example, a charity for the redemption of slaves in Turkey, as in *Attorney General v Ironmongers' Co* (1834) 2 My & K 576, (1840) 2 Beav 313.

[38] Charities Act 2011, s 62(1)(a)(ii). For example, *Attorney General v Glyn* and *Biscoe v Jackson*: see n 35 above.

[39] Charities Act 2011, s 62(1)(b). This restated the jurisdiction to make cy-près schemes in respect of surplus funds.

[40] Charities Act 2011, s 62(1)(c). A scheme might be made to combine the operations of various small charities working in one area. We discuss the merger of charities in ch 12 below.

[41] Charities Act 2011, s 62(2). Before the Charities Act 2006, the only consideration was "the spirit of the gift". The Charities Act 2006, s 15, amended the Charities Act 1993, s 13, to include the opposing consideration, the social and economic circumstances.

[42] Charities Act 2011, s 62(1)(d)(i). For example, where an area is difficult to identify owing to local government area boundary changes: H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) p 456.

[43] Charities Act 2011, s 62(1)(d)(ii). This replaces the strict common law requirement of impossible or impracticable with "unsuitable". As well as these circumstances, a scheme can be made enlarging a charity's area of benefit by reference to the table in Schedule 4 to the Charities Act 2011: Charities Act 2011, s 62(5). For example, if the area of benefit is a district, it can be enlarged to "any area which includes the district": Sch 4, para 3. See also *OG2 A1 Application of property cy-près* (March 2012) section 1.2.

[44] Charities Act 2011, s 62(1)(e)(i). This provision is used when a charity's purposes become the statutory responsibility of a public authority, such as the maintenance of a road or bridge.

(8) where the original purposes, in whole or in part, have ceased to be charitable;[45] and

(9) where the original purposes, in whole or in part, have ceased in any other way to provide a suitable and effective method of using the property, regard being had to the appropriate considerations (see above).[46]

3.29 Situations (7) and (9) were the significant relaxations to the cy-près doctrine introduced by the Charities Act 1960.

GENERAL CHARITABLE INTENTION

3.30 Section 62 does not change the common law insofar as it imposes other preconditions for the making of cy-près schemes.[47] In the case of initial failure, the donor must have demonstrated a "general charitable intention".[48] The same does not apply to subsequent failure; if the gift was given outright to a charity, or for a particular charitable purpose, then a cy-près scheme can be made on subsequent failure without having to demonstrate an initial general charitable intention on the part of the donor.[49]

3.31 Whether a donor had a general, or paramount,[50] charitable intention is a question of construction of the gift. There is some debate as to the meaning of "general charitable intention",[51] and it will always be a question of degree that depends on the particular circumstances. The authors of *Tudor on Charities* suggest that a general charitable intention will be found if (a) the donor intends his or her gift to be devoted to any charitable object, or (b) the donor intends "to promote a particular form of charity … if possible by carrying into effect the actual wishes expressed by the donor, as to the mode of application of the gift, but if full compliance with his wishes be impossible, by promoting the particular form of

[45] Charities Act 2011, s 62(1)(e)(ii).

[46] Charities Act 2011, s 62(1)(e)(iii). This was the most significant relaxation of the common law requirements for cy-près: J Warburton, *Tudor on Charities* (9th ed 2003) para 11-049. This power was used in *Varsani v Jesani* [1999] Ch 219 where, following a schism within a religious sect, the charity's funds were divided between the two rival factions.

[47] Charities Act 2011, s 62(3).

[48] J Warburton, *Tudor on Charities* (9th ed 2003) paras 11-001 and 11-027 and following; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) p 460.

[49] *Re Wright* [1954] Ch 347, 364, by Romer J; *Re Wokingham Fire Brigade Trusts* [1951] Ch 373, 377, by Danckwerts J; J Warburton, *Tudor on Charities* (9th ed 2003) paras 11-027, 11-051 and following and 11.043; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 460 to 465. If the gift is limited in some way, either for a limited period or with an express gift over clause, the property will not be applicable cy-près: see *Tudor on Charities* para 11-054.

[50] This is the term preferred by the authors of *Tudor on Charities*, since there is no need for the donor to intend to benefit charity generally; the courts can find a general charitable intention even where the donor has attached specific and detailed conditions to his or her gift: J Warburton, *Tudor on Charities* (9th ed 2003), para 11-028. The same view is expressed in H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) p 466.

[51] See J Warburton, *Tudor on Charities* (9th ed 2003) paras 11-027 to 11-033; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 466 to 470.

charity in some way which will give effect as nearly as possible to his expressed wishes as to the mode of application of the gift".[52]

3.32 As noted above,[53] initial failure tends to occur in the context of the administration of wills. As our focus is on cy-près schemes that are made in respect of existing charities, the requirement for a general charitable intention does not generally arise. The main exception to this is the initial failure of specific fundraising appeals, when the existence of a general charitable intention will be relevant (on which, see Chapter 7 below).

CONSIDERATIONS WHEN MAKING A CY-PRÈS SCHEME

3.33 The case law concerning the directions to be made in a cy-près scheme is summarised by the authors of *Tudor on Charities* as follows:

> The main principle to be observed in determining the new purposes for the charity property after a cy-près occasion has arisen is that the property can only be applied for purposes as near as possible to the original purposes. The intention of the donor must be ascertained and the new purposes should be those which can most nearly give effect to that intention.[54]

3.34 Following the Charities Act 2006, the court and Charity Commission are required when making a cy-près scheme to have regard to:

> (a) the spirit of the original gift,
>
> (b) the desirability of securing that the property is applied for charitable purposes that are close to the original purposes, and
>
> (c) the need for the relevant charity to have purposes which are suitable and effective in the light of current social and economic circumstances.[55]

3.35 The Charities Act 2006 also provided that, where a scheme provides for property to be transferred to another charity, the scheme may impose on the trustees of the transferee charity "a duty to see that the property is applied for purposes which are, so far as is reasonably practicable, similar in character to the original purposes".[56] This provision was introduced to cater for situations "where the original purposes are still useful but the court or the Commission believes that the property can be more effectively used in conjunction with other property".[57]

[52] J Warburton, *Tudor on Charities* (9th ed 2003) para 11-030.

[53] See para 3.26 above.

[54] J Warburton, *Tudor on Charities* (9th ed 2003) para 11-066.

[55] Charities Act 2011, s 67(1) to (3), first introduced by the Charities Act 2006, s 18, inserting a new s 14B into the Charities Act 1993.

[56] Charities Act 2011, s 67(4), first introduced by the Charities Act 2006, s 18, inserting a new s 14B into the Charities Act 1993.

[57] Explanatory Notes to the Charities Act 2006, para 74.

Administrative schemes

3.36 Administrative schemes can be made to alter any provisions of a charity's governing document, save for the charity's purposes. The power is wide, and can be exercised if it is expedient in the interest of the charity to do so.[58] Figure 2 provides some examples of administrative schemes.

Figure 2: administrative schemes

Administrative schemes can be made:

(1) where the machinery for carrying out the charity's purposes is inadequate or has failed, as where the named trustees have died;[59]

(2) in the case of a schism within a religious sect, to divide a charity's funds between the two rival factions;[60]

(3) to appoint a trustee and transfer the charity's property to that trustee;[61] or

(4) to confer on the trustees a power to sell charity land.[62]

Publicising schemes

3.37 The Charity Commission must give public notice of a proposed scheme where it appoints, discharges or removes a trustee. In all other cases, public notice must be given unless the Charity Commission considers it unnecessary.[63] This will depend on whether the change is controversial. The Commission will usually expect the trustees to carry out their own consultation, which will assist the Commission in deciding whether the scheme is controversial and that public notice is therefore required.[64]

Conclusion

3.38 When a charitable company, CIO, trust or unincorporated association wishes to change its purposes, but cannot rely on its express or statutory powers of amendment, it can seek a cy-près scheme. Where such a charity wishes to amend any other provision in its governing document, it can apply for an administrative scheme. The Charity Commission (or court) has a wide power to make such schemes if it considers it appropriate to do so. But in respect of cy-près schemes, whilst the law has been relaxed over time, certain restrictions remain, principally concerning the threshold requirements before a cy-près scheme can be made.

[58] *Re J W Laing Trust* [1984] Ch 143.

[59] H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 512 to 513.

[60] *Varsani v Jesani* [1999] Ch 219.

[61] For example, the Charity Commission's scheme of 20 November 2014 in respect of the Fitzwilliam Old People's Centre Miners Welfare Scheme, available at http://apps.charitycommission.gov.uk/Schemes/402725.pdf.

[62] For example, the Charity Commission's scheme of 21 November 2014 in respect of the Wicken Mission Hall, available at http://apps.charitycommission.gov.uk/Schemes/402436.pdf.

[63] Charities Act 2011, ss 88 and 89.

[64] Charity Commission, *OG500 Schemes* (June 2014) sections B8 and E6.1.

3.39 Lord Hodgson recommended that charity trustees should be given the power to make cy-près schemes. We consider that suggestion in Chapter 5.

Statutory charities

3.40 Where a charity is established or governed by statute, its governing document (or one of its governing documents) is an Act of Parliament. Some statutory charities were established by Act of Parliament;[65] others that were not established by statute are nevertheless governed by an Act which was passed in respect of the charity.[66]

3.41 In the absence of any express power to amend a statute (whether in the statute itself or in another statute), the governing document can only be amended by a further Act of Parliament.[67] That requires Parliamentary time and can be a long and expensive process for the statutory charity wishing to make the amendment.

3.42 Section 73 of the Charities Act 2011 provides a mechanism by which a statute establishing or regulating a charity can be amended by secondary legislation ("the section 73 procedure").[68] The procedure requires the Charity Commission to prepare a scheme – in much the same way that it prepares schemes for other charities[69] – that alters the provision made by an Act establishing or regulating a charity. The scheme is then given effect by order of the Minister.[70] If the statute establishing the charity is a public general Act, the order must be approved by a resolution of both Houses of Parliament ("the affirmative procedure").[71] If it is a private Act, the order must be laid before both Houses of Parliament and is subject to annulment by a resolution of either House ("the negative procedure").[72]

[65] The Act may incorporate a new charity, as with the National Trust, or it may transform one or more existing charities into a single corporation. The Church Commissioners, for example, were established under the Church Commissioners Measure 1947 (1947 No 2 (10 & 11 Geo 6)), merging the Governors of the Bounty of Queen Anne for the Augmentation of the Poor Clergy (originally established by the Queen Anne's Bounty Act 1703) and the Ecclesiastical Commissioners (originally established by the Ecclesiastical Commissioners Act 1836).

[66] An example is the Corporation of the Hall of Arts and Sciences, the charity responsible for the maintenance of the Royal Albert Hall. It was initially incorporated in 1866 by Royal Charter, but most of its constitution is now set out in the Royal Albert Hall Act 1966. Similarly, the Bridge House Estates was established by Royal Charter in 1282 but is now largely governed by a series of 19th and 20th century Acts.

[67] For example, the Royal Medical Foundation of Epsom College was governed by the Royal Medical Benevolent College Act 1855, which was later amended by the Royal Medical College Act 1894. The powers to change purposes under Charities Act 2011, s 275, and to amend administrative provisions under Charities Act 2011, s 280, do not apply to a corporate body, so are of no assistance to charities incorporated by statute. Nor can the court or Charity Commission make a scheme to amend provision made by an Act of Parliament (unless Parliament provides express authorisation, on which see below), since Parliament is sovereign over the courts and the Charity Commission.

[68] The power was introduced by the Charities Act 1960, s 19, and then appeared in the Charities Act 1993, s 17.

[69] See para 3.20 and following above.

[70] Charities Act 2011, s 73(1) and (2).

[71] Charities Act 2011, s 73(4).

[72] Charities Act 2011, s 73(3).

A proposed scheme must be publicised, unless the Charity Commission considers this to be unnecessary.[73]

3.43 Where a scheme is given effect by an order under the negative procedure (that is, where it is made in respect of a private Act), the Charity Commission or court can amend that scheme as if it were a scheme brought into effect by order of the Commission under section 69.[74] The same applies to a scheme given effect by an order under the positive procedure (that is, it is made in respect of a public general Act) unless the scheme requires any further amendment to be by way of the positive procedure.[75] In effect, therefore, once a scheme amending a statute has been made and given effect by order, further amendments to that scheme do not require Parliamentary oversight.[76]

3.44 Whilst the section 73 procedure appears relatively straightforward, in practice there are numerous steps to be taken and various parties are involved: they are set out in Figure 3.

Figure 3: statutory charities – the section 73 procedure[77]

(1) *The pre-application phase*

After discussions with the charity, the Charity Commission is satisfied that there is a need for a scheme, but no invitation to submit a formal application for a scheme is made.

The responsible Commission lawyer submits a proposal to draft a scheme to the Director of Legal Services, who considers whether the scheme should be brought to the attention of the Legal Board or to two legally-qualified members of the Board and whether the proposal is exceptional such that it should be brought to the attention of the Office for Civil Society at the Cabinet Office at an early stage.

Once the proposal to draft a scheme has been approved, a formal application for a scheme is invited from the charity.

(2) *The application*

The charity submits an application for a scheme with a copy of the resolution of the trustees. The Commission must be informed of any charity trustees who are not party or privy to the decision because it is under a statutory obligation to notify them of its intention to settle a scheme.[78]

(3) *The drafting phase*

The provisional text of the scheme is drafted by the Commission lawyer (unless the charity asks to provide its own draft) and is sent to the charity and to the Office for Civil Society for comment.

[73] Charities Act 2011, s 88.

[74] Charities Act 2011, s 73(5).

[75] Charities Act 2011, s 73(6).

[76] The further amendment must be an amendment of the scheme, and not the original Act. Accordingly, if the scheme is limited to certain issues and parts of the original Act remain, only the issues addressed in the scheme can be amended by further scheme without the usual s 73 procedure.

[77] This summary is based on s 73 itself, Charity Commission guidance, and our discussions with the Charity Commission and Cabinet Office.

[78] Charities Act 2011, ss 71(1) and 73(7).

The Office for Civil Society considers and comments on whether there are any matters that might cause problems during the Parliamentary process.

The parties agree on the wording of the draft scheme. The Office for Civil Society is asked to draft the Order that will give effect to the scheme.

(4) *The publicity and modification phase*

The Commission considers whether the draft scheme should be published by the charity.[79] This entails giving public notice of the scheme and inviting representations to be made within a period specified in the notice. Only the draft scheme should be published and not the draft Order.

Any representations made within the notice period must be taken into account. The Commission then decides whether to settle the scheme either without modifications or with such modifications as it thinks desirable.[80] Any modifications must be agreed with the charity and the Office for Civil Society.

(5) *Final internal approval*

The revised scheme and draft Order are submitted to the Director of Legal Services for scrutiny and comment. He may refer it to either the entire Board or to two legally-qualified members of the Board at this stage. The scheme is approved but it is not settled.

(6) *Submission to the Minister*

On approval, the scheme and draft Order are submitted by the Chair of the Commission to the Minister for Civil Society in an agreed form. The Commission provisionally settles the scheme subject to the Minister's approval.

(7) *Ministerial approval and settlement*

When approval is received from the Minister, the scheme is settled and can be signed by the Director of Legal Services from the date of approval.

(8) *Parliamentary phase*

The Office for Civil Society is asked to table the draft Order before both Houses of Parliament.

Affirmative procedure. Where the Act in question is a public general Act, the draft Order must be approved by a resolution of each House.[81] Once approved, the Order comes into force.

Negative procedure. Where the Act in question is a private Act, the Order is made by the Minister and laid before Parliament. The Order will come into force on its specified commencement date, which will usually be at least 21 days after it is laid. The order will, however, be revoked if either House passes an annulment resolution within 40 days of it being laid.[82]

3.45 There is no distinction between amendments to the charity's purposes and other amendments; any amendment to the governing document, no matter how significant, must follow the same procedure.

3.46 We set out some recent orders made under the section 73 procedure in Figure 4.

[79] Charities Act 2011, s 88.

[80] Charities Act 2011, s 88(5).

[81] Charities Act 2011, s 73(4). Before being laid in Parliament, the draft Order will also be submitted to the Chair of the Joint Committee on Statutory Instruments.

[82] Charities Act 2011, s 73(3); Statutory Instruments Act 1946, s 6(1).

Figure 4: recent orders under the section 73 procedure

(1) The Charities (People's Dispensary for Sick Animals) Order 2015[83] replaced provisions of the People's Dispensary for Sick Animals Acts 1949 and 1956 to alter the objects of the charity and extend its investment powers.

(2) The Charities (Incorporated Church Building Society) (England and Wales) Order 2013,[84] which altered the governing document of the Incorporated Church Building Society as set out in the Church Building Society Act 1828.

(3) The Charities (Bridge House Estates) Order 2007,[85] which inserted a new section 32(3A) into the City of London (Various Powers) Act 1963, an Act governing the Bridge House Estates charity. The new section conferred a power to divert or block an elevated footway.

(4) The Charities (Cheadle Royal Hospital, Manchester) Order 2006[86] amended all but one of the provisions of the Manchester Royal Infirmary Acts of 1842.

(5) The Charities (National Trust) Order 2005[87] rewrote large parts of the National Trust Act 1971.

(6) The Charities (Alexandra Park and Palace) Order 2004,[88] which replaced section 6(3) of the Alexandra Park and Palace Act 1985 and introduced a power for the trustees to grant a lease of the whole or part or parts of the Palace building and the immediate surrounding area for a term not exceeding 125 years.

(7) The Charities (The Shrubbery) Order 2003[89] altered section 86 of the Essex Act 1987 by permitting the application of available income of the Shrubbery in the maintenance of certain charitable recreation grounds in the Borough of Southend-on-Sea.

3.47 Most orders under section 73 follow the negative procedure. Of the seven most recent orders in Figure 4 above, all followed the negative procedure, save for the order concerning the Incorporated Church Building Society which followed the affirmative procedure. Officials from the Cabinet Office and Charity Commission have told us that the process – both under the affirmative and negative resolution procedure – can take several years.

Royal Charter charities

3.48 Royal Charter charities' governing documents typically comprise:

(1) the Royal Charter, and any supplemental Charters;

(2) bye-laws (sometimes known as rules or statutes); and

(3) regulations.

[83] SI 2015 No 198.

[84] SI 2013 No 641.

[85] SI 2007 No 550.

[86] SI 2006 No 921.

[87] SI 2005 No 712.

[88] SI 2004 No 160.

[89] SI 2003 No 1688.

3.49 There is no clear delineation between the matters that are set out in Charters, bye-laws and regulations. The Charter will often formally incorporate the charity and set out its purposes and powers; the bye-laws might set out the charity's governance structure; and the regulations tend to concern internal procedures.

(1) Amending a charity's Royal Charter

3.50 A charity's Royal Charter may be amended:

(1) pursuant to a power of amendment in the Charter ("the express power procedure");

(2) by the grant and acceptance of a supplemental Charter ("the supplemental Charter procedure");

(3) by Order of the Queen in Council giving effect to a scheme made under section 68 of the Charities Act 2011 ("the section 68 procedure"); and

(4) by Act of Parliament.

Each is considered below.

3.51 Royal Charters that have been confirmed by an Act of Parliament can only be amended by the first three procedures insofar as the amendment is not inconsistent with the confirming Act.[90] Any amendment that would run counter to the Act must be made in accordance with the methods for statutory charities (see paragraph 3.40 and following above).

3.52 As with statutory charities, the relevant procedure must be followed irrespective of the amendment sought though, as noted above,[91] provisions of minor importance will not usually appear in the Charter.

(A) THE EXPRESS POWER PROCEDURE

3.53 Many Royal Charters contain a power of amendment. This can typically be exercised by resolution of the charity trustees or members of the charity, subject always to the approval of the Queen in Council. For example, the Royal Charter of the Royal National Institute of Blind People provides that:

> The Board [of trustees] may alter, amend or add to the original Charter or this Our Supplemental Charter after consultation with the Members or with such Membership bodies of the Institute as determined by the Board by a resolution passed by not less than a two-thirds majority of the Board present and voting at a Special Meeting convened for the purpose, and any such alteration, amendment or addition shall when approved by Us, Our Heirs or Successors in Council become effectual so that the original Charter and this Our Supplemental Charter shall thenceforth continue and

[90] *R v Miller* (1795) 6 Term Rep 268, 277, by Lord Kenyon CJ; *Halsbury's Laws of England* (5th ed 2010) Vol 24 para 341.

[91] See para 3.49 and following above.

operate as though they had been originally granted and made accordingly.[92]

3.54 The procedure that charities must follow to exercise such a power of amendment is set by the Privy Council and has been set out in guidance issued by the Privy Council Office. We summarise the procedure in Figure 5.

Figure 5: Royal Charter charities – the express power procedure

(1) *Initial contact with the Privy Council Office*

Royal Charter charities are advised to consult with the Privy Council Office before any amendment resolution is passed, as this "allows the Privy Council's advisers to provide informal comments and help shape proposed amendments before they are put to the members for approval".[93] A failure to do so increases the risk of the Privy Council refusing to approve a proposed amendment, which can result in delay and expense for the charity.

(2) *Consultation between the Privy Council Office and interested bodies*

The Privy Council Office will consult Government Departments with a policy interest in the Royal Charter body. It will also consult the Charity Commission where the proposed amendments will make "material changes" to the objects of the charity, the name of the charity, the payment of the trustees (other than out-of-pocket expenses) or the dissolution clause.[94]

(3) *Informal response from the Privy Council Office*

The Privy Council Office will give an informal response to the charity indicating that the proposed amendment is likely to be approved (with or without modifications) or rejected.

(4) *Charity trustees pass resolution*[95]

(5) *Submission of resolution to the Privy Council Office*

The charity trustees submit the resolution together with a certificate confirming that it has been passed in accordance with the Royal Charter.

The resolution will then be put before the Privy Council for approval by the Queen in Council at one of the nine Privy Council meetings held each year.

[92] Royal Charter of the Royal National Institute of Blind People, art 10, available at http://www.rnib.org.uk/about-rnib-who-we-are/how-we-are-governed. For other examples of similar powers see: the Royal Charter of the Royal British Legion, art 20; the Royal Charter of the British Red Cross Society, art 15; the Royal Charter of the National Society for the Prevention of Cruelty to Children ("the NSPCC"), art 21; and the Royal Charter of the Royal Society for the Protection of Birds ("the RSPB"), art 9.

[93] Privy Council Office, *Amending a Royal Charter,* available at http://privycouncil.independent.gov.uk/Royal-Charters/amending-a-Royal-Charter/.

[94] Charity Commission, *Royal Charter Charities*, Scenarios 4 and 5, available at http://webarchive.nationalarchives.gov.uk/20140713184835/http:/www.charitycommission.gov.uk/detailed-guidance/specialist-guidance/royal-charter-charities/.

[95] The Privy Council Office recommends that resolutions should contain a latitude clause – for example "subject to such changes as the Privy Council may require and which are agreed by the [charity]" – to enable textual amendments to be agreed without the need to repeat the formalities set out in the charity's Royal Charter: Privy Council Office, *Amending a Royal Charter*.

3.55 We have been told by the Privy Council Office that it responds to enquiries and requests within 15 working days. That means that the express power procedure could take as little as six to eight weeks. In some cases, however, the reality is that the process can take up to one year, given the need to discuss and negotiate amendments with the various parties, many of which have infrequent meetings.[96] The Privy Council does not require any payment from the charity for this process.

(B) THE SUPPLEMENTAL CHARTER PROCEDURE

3.56 If a Royal Charter does not itself make provision for its amendment, it can be varied by the grant and acceptance of a supplemental Charter.[97] Charities wishing to amend their Royal Charters in this way may petition the Queen in Council for a supplemental Charter. Supplemental Charters are granted by the Queen in Council at common law[98] in much the same way as a first Royal Charter. A supplemental Charter may add to, remove from, or amend, provisions in the original Charter, or it may entirely replace the original Charter: see Figure 6.

Figure 6: Royal Charter charities – the supplemental Charter procedure

(1) *Initial contact with the Privy Council Office and other interested bodies*

Royal Charter charities are advised to consult with the Privy Council Office, and other interested bodies, before making a formal petition for a new or supplemental Charter.[99]

(2) *Submission of formal petition*

The charity submits a formal petition for a supplemental Charter to the Privy Council Office.

(3) *Publication of the formal petition*

The Privy Council Office publishes the formal petition in the London Gazette for eight weeks, inviting interested bodies to comment.

(4) *Other consultation*

The Privy Council Office will also consult Government Departments and the Charity Commission in the circumstances outlined in Figure 5 above.

(5) *Consideration of comments and counter-petitions*

The Privy Council Office will consider comments and counter-petitions received by interested bodies. The guidance states that "any proposal which is rendered controversial by a counter-petition is unlikely to succeed".

[96] For example, the Privy Council meets nine times each year. Trustees may meet more frequently than this, but when an amendment requires a resolution of the charity's members, the resolution may have to await the charity's annual general meeting (or an extraordinary general meeting).

[97] *Ware v The Grand Junction Water Works Co* (1831) 2 Russ & M 470, 484, by Lord Brougham LC.

[98] See para 1.17 above.

[99] Privy Council Office, *Applying for a Royal Charter*, available at http://privycouncil.independent.gov.uk/Royal-Charters/applying-for-a-Royal-Charter/.

(6) *Approval by the Queen in Council*

If the petition is uncontroversial, or any controversies are resolved, a supplemental Charter will be granted by the Queen in Council.

3.57 This process would normally take up to a year, but it can take up to two years. In addition, if the supplemental Charter will replace all or most of the existing Charter, the charity is required by the Privy Council to pay to print the Charter on vellum. There is anecdotal evidence that this will cost the charity around £5,000.

(C) THE SECTION 68 PROCEDURE

3.58 Section 68 of the Charities Act 2011 provides an alternative mechanism for amendment of a charity's Royal Charter by Order of the Queen in Council giving effect to a scheme.

3.59 It applies where the Royal Charter "is amendable by the grant and acceptance of a further Charter".[100] The court or Charity Commission[101] drafts a scheme that "does not purport to come into operation unless or until Her Majesty thinks fit to amend the Charter in such manner as will permit the scheme or that part of it to have effect".[102] A proposed scheme must be publicised, unless the Charity Commission considers this to be unnecessary.[103] It will then be submitted to the Privy Council.

3.60 On receipt of the scheme, the Queen may amend the charity's Royal Charter by Order in Council in any way in which the Charter could be amended by the grant and acceptance of a further Charter. Any such Order in Council may be revoked or varied in the same manner as the Charter it amends.[104]

3.61 We understand from the Privy Council Office and the Charity Commission that this means of amending a Royal Charter is rarely used. A recent example was a scheme made by the Charity Commission in March 2011 and approved by the Queen in Council in April 2011 in respect of the Royal Institution of Great Britain.

(D) AMENDMENT BY ACT OF PARLIAMENT

3.62 Any Royal Charter may be amended or revoked by an Act of Parliament.[105] An Act that amends a Royal Charter could itself be amended using the section 73 procedure, but we are not aware of this ever having occurred.

[100] This would exclude Royal Charters which have been confirmed by an Act of Parliament: see para 3.51 above.

[101] The Charities Act 2011, s 68(2)(a) and (3)(a), refers only to the court, but the Charity Commission has concurrent jurisdiction with the court under s 69(1).

[102] Charities Act 2011, s 68(2)(b).

[103] Charities Act 2011, s 88.

[104] Charities Act 2011, s 68(3) and (4).

[105] *Re Islington Market Bill* (1835) 3 Cl & Fin 513.

(2) Amending bye-laws

3.63 Bye-laws can be made or amended pursuant to an express power in the Royal Charter or pursuant to the common law power for corporations to make bye-laws for carrying out their purposes.[106]

3.64 Where the Royal Charter contains an express power to make bye-laws, the charity must comply with any conditions concerning the exercise of that power.[107] The Privy Council's guidance suggests that amendments to bye-laws always require the approval of the Privy Council.[108] That is correct where – as in most cases – the power to make bye-laws is contained in the Royal Charter and expressly requires the charity to obtain the Privy Council's consent. But where the Royal Charter confers a power to make bye-laws without imposing conditions, or where it is silent on the power to make bye-laws and so the charity must rely on its common law power, it is our view that the charity can make and amend bye-laws without the Privy Council's consent.[109] We make a provisional proposal below that the guidance be amended to reflect this.

(3) Amending regulations

3.65 The power to make and amend regulations is generally set out in the charity's Royal Charter or bye-laws. Privy Council approval is not normally required.[110]

The basis on which Royal Charter charities hold their property

3.66 We have been told that there can be uncertainty as to whether property is held by Royal Charter charities as corporate property, or whether it is held on trust for charitable purposes. The question is considered to be particularly important when

[106] *Norris v Staps* (1616) Hob 210 by Hobart CJ; *R v Westwood* (1830) 4 Bli NS 213, 225 (Parker J), 251 (Gaselee J) and 263 (Littledale J).

[107] The Charter will often state that the Privy Council Office must consent to any amendment to the bye-laws: see for example the Royal Charter of the British Red Cross Society, art 16; the Royal Charter of the NSPCC, art 16; the Royal Charter of the Royal National Institute of Blind People ("the RNIB"), art 7(1) and bye-law 44 of its bye-laws; and the Royal Charter of the RSPB, art 8.

[108] "Amendments to Charters can be made only with the agreement of The Queen in Council, and amendments to the body's by-laws require the approval of the Council (though not normally of Her Majesty)": Privy Council, *Chartered bodies*, available at http://privycouncil.independent.gov.uk/Royal-Charters/Chartered-bodies/.

[109] For example, art 17 of the Royal Charter of the Royal British Legion provides that the Rules (the bye-laws) can be amended by special resolution of the Annual Conference which has been approved by a special resolution of the trustees, and art 18 provides that the Governing Regulations (the regulations) can be amended by special resolution of the trustees. The validity of amendments to the bye-laws of a Royal Charter charity was considered by the Court of Appeal in *Knowles v Zoological Society of London* [1959] 1 WLR 823. The case concerned the meaning of the words "majority of fellows entitled to vote" on an amendment to the bye-laws of the Zoological Society of London, rather than whether any such amendment required the approval of the Privy Council. However, there was nothing in the Society's Royal Charter, or in any of the judgments of the members of the Court of Appeal, to suggest that amendments to the bye-laws of the Society had to be approved by the Privy Council. By contrast, the judgment of Lord Evershed MR is clear that amendments to the Society's Charter would be "subject to the approval of His Majesty in Council of the amendment": [1959] 1 WLR 823, 826. The Master of the Rolls expressed no such qualification in respect of the bye-laws.

[110] See for example art 18 of the Royal Charter of the British Red Cross Society, bye-law 65 of the bye-laws of the NSPCC, and bye-law 43 of the bye-laws of the RNIB.

Royal Charter charities amend their purposes; if the property is held beneficially (that is, it is owned outright as corporate property), it can be used for the Royal Charter charity's amended purposes, but if it is held on trust for the original charitable purposes, there is a need for a cy-près scheme to ensure that the property is applicable to those new purposes.

3.67 The same issue would arise if a charitable company held property on trust. An amendment to the company's objects would not automatically change the purposes of the underlying trust. Problems do not, however, tend to arise in the context of companies since (a) it is generally accepted that charitable companies usually hold their property beneficially, so their property can be applied to their amended purposes,[111] and (b) even if property is held on trust, it can be applied to the company's new purposes by the Charity Commission making a cy-près scheme.

3.68 As for (a), there is no reason, in principle, why Royal Charter charities cannot hold property beneficially (so the property can be used for the amended purposes). The reasoning that applies to charitable companies applies equally to Royal Charter charities. But the basis on which Royal Charter charities hold their property will depend on the circumstances of their creation.

(1) If a charity held property on trust prior to the grant of the Charter, the new Royal Charter body may have become a trustee of that charity (in which case the property will continue to be held on trust), or the property may have transferred to the Royal Charter charity (in which case the property will be owned by the Royal Charter charity beneficially).

(2) After the grant of a Charter, or if the Charter creates the charity, the incorporated body can own property beneficially. The basis on which the charity holds its subsequently-acquired property would be no different from the basis on which a charitable company holds its property, and would depend on the circumstances in which it was acquired.

3.69 Turning to (b), if property is held on trust, it can only be applied to a Royal Charter charity's amended purposes pursuant to a scheme. We understand that the difficulty is seen to be that the unpopular section 68 procedure must be followed to make such a scheme. Our view, however, is that a cy-près scheme could be made by the Charity Commission in the usual way (see paragraphs 3.28 to 3.35 above), without having to follow the section 68 procedure. Whilst section 68 applies to "a scheme relating to the body corporate or to the administration of property held by the body (including a scheme for the cy-près application of any such property)", the Queen's consent is only required in respect of "such part of [the scheme] as cannot take effect without the alteration of the Charter".[112] If the Royal Charter charity holds property on trust, an amendment to that trust would not require an alteration of the Charter, so could be made by a standard cy-près

[111] *Liverpool and District Hospital for Diseases of the Heart v Attorney General* [1981] Ch 193, 209, by Slade J. This would not, however, be the case in respect of permanent endowment which we conclude in paras 13.22 to 13.28 below can only ever be held by a charitable company on trust.

[112] Charities Act 2011, s 68(2).

scheme; the fact that the Royal Charter charity is a trustee does not prevent the trust from being subject to a standard cy-près scheme.

3.70 We do not believe that it is possible, nor would it be helpful, to say that all Royal Charter charities hold their property on a particular basis.[113] In practice, if a Royal Charter charity holds its property beneficially, then an amendment to the charity's purposes presents no difficulties as its property will automatically be applicable to those new purposes. And if the charity holds its property on trust such that an amendment to the Charter does not automatically change the purposes of the underlying trust, then a cy-près scheme can be made to apply the property to the new purposes in the usual way. Moreover, in the case of many historic Royal Charter charities, the reality is that there will often be no records of any pre-existing trusts, or whether the current assets of the charity represent any pre-existing trust funds. Our understanding is that, in the absence of evidence to the contrary, charities and the Charity Commission tend to assume that property is held beneficially by the Royal Charter body, so that an amendment to a Royal Charter charity's purposes does not need to be accompanied by a cy-près scheme.

3.71 We have not heard that the basis on which Royal Charter charities hold their property causes significant difficulties in practice.[114] Nor have we received any suggestions as to how the law could be improved or clarified. We are cautious about making general statements, or proposals for reform, that would upset settled understandings and practices, particularly in the absence of a strong call for reform.

Summary

3.72 The table below summarises the procedures by which charities can amend their governing documents.

[113] Subject to n 111 above in respect of permanent endowment.

[114] We have heard that uncertainty as to how a Royal Charter charity holds is property can cause practical difficulties when the charity wishes to exercise the power in ss 281 and 282 of the Charities Act 2011 to spend permanent endowment. The difficulty only arises, however, because ss 281 and 282 do not apply to corporate charities. In ch 9, we provisionally propose extending the ss 281 and 282 power to incorporated charities. This practical difficulty (arising from the basis on which Royal Charter charities hold property) would therefore disappear.

Type of charity	Changing purposes	Amending provisions concerning the distribution of property on dissolution and authorising benefits to trustees or members	Other amendments
Charitable company	Statutory power to amend by resolution of the members, subject to more restrictive conditions in the articles As a "regulated alteration", this requires the Charity Commission's consent If power of amendment cannot be exercised, apply to the Charity Commission for a cy-près scheme	Statutory power to amend by resolution of the members, subject to more restrictive conditions in the articles As a "regulated alteration", this requires the Charity Commission's consent If power of amendment cannot be exercised, apply to the Charity Commission for a scheme[115]	Statutory power to amend by resolution of the members, subject to more restrictive conditions in the articles No requirement for Charity Commission consent If power of amendment cannot be exercised, apply to Charity Commission for an administrative scheme
CIO	Statutory power to amend by resolution of the members, subject to more restrictive conditions in the constitution As a "regulated alteration", this requires the Charity Commission's consent If power of amendment cannot be exercised, apply to the Charity Commission for a cy-près scheme	Statutory power to amend by resolution of the members, subject to more restrictive conditions in the constitution As a "regulated alteration", this requires the Charity Commission's consent If power of amendment cannot be exercised, apply to the Charity Commission for a scheme[115]	Statutory power to amend by resolution of the members, subject to more restrictive conditions in the constitution No requirement for Charity Commission consent If power of amendment cannot be exercised, apply to the Charity Commission for an administrative scheme
Trust or unincorporated association	Express power in governing document Alternatively, statutory power for certain small charities to change their purposes by passing a resolution and giving notice to the Charity Commission If there is no express or statutory power, apply to the Charity Commission for a cy-près scheme	Express power in governing document If there is no express power, apply to the Charity Commission for a scheme[115]	Express power in governing document Alternatively, statutory power for all charities to make certain administrative amendments If there is no express or statutory power, apply to the Charity Commission for an administrative scheme
Statutory charity	Express power in the statute Alternatively, section 73 procedure Alternatively, seek primary legislation		
Royal Charter charity	Express power in the Charter, usually requiring Privy Council's consent Alternatively, petition for a supplemental Charter Alternatively, section 68 procedure		

[115] This might be a cy-près scheme or an administrative scheme. Altering the provisions concerning the distribution of property on dissolution may, for example, involve a change to the charity's purposes, in which case a cy-près scheme would be necessary.

CHAPTER 4
CHARITIES INCORPORATED BY STATUTE OR BY ROYAL CHARTER: CHANGING PURPOSES AND AMENDING GOVERNING DOCUMENTS

INTRODUCTION

4.1 In this Chapter, we consider the ability of charities established or governed by statute or Royal Charter to amend their governing documents, including changing their purposes.[1] There are well-established and relatively simple procedures by which the most common forms of charity (charitable companies, CIOs, trusts and unincorporated associations) can amend their governing documents.[2] Statutory and Royal Charter charities, however, must satisfy different requirements and engage with a complex procedure to amend their governing documents.

4.2 There are three principal differences between the process by which statutory and Royal Charter charities amend their governing documents and the process by which other charities amend their governing documents.

4.3 First, charity trustees of statutory and Royal Charter charities are given less autonomy. Amendments are subject to the oversight of three different bodies: the Charity Commission, the Office for Civil Society in the Cabinet Office, and (in the case of statutory charities) Parliament or (in the case of Royal Charter charities) the Privy Council.

4.4 Second, there is a single procedure for all amendments, whereas the processes for other charities distinguish between major and minor amendments, the former requiring more scrutiny than the latter.

4.5 Third, most charities can seek a Charity Commission scheme to make an amendment if no other power is available to them. Whilst that involves some additional time and expense, it is a familiar and straightforward process. Where a statutory or Royal Charter charity seeks a scheme for the amendment of its governing document, it must comply with the additional requirement for the scheme to be approved by Parliament or by the Privy Council (as the case may be).

4.6 In this Chapter, we summarise the criticisms that have been levelled at the procedures that statutory and Royal Charter charities must follow and we make provisional proposals for their reform. We conclude by asking consultees about the impact of reform.

[1] A charity's governing document may comprise multiple documents, such as a Royal Charter, supplemental Royal Charters, bye-laws and regulations. References to a charity's "governing document" are to all of its governing documents, unless we expressly distinguish between different categories of governing document.

[2] See paras 3.4 to 3.39 above.

CRITICISMS OF THE LAW

Statutory charities

4.7 We were first asked to review the use of section 73 schemes[3] to amend statutory governing documents during our consultation on our Eleventh Programme of Law Reform.[4] The Charity Commission said:

> The procedure is complicated and takes an inordinate amount of time. It is also very frustrating for the charities concerned who are waiting for the changes to be made.

4.8 The Charity Commission noted that the procedure has to be followed even to implement very minor changes to the governing document and suggested that a more proportionate system would save charities time and money.

4.9 We have since been informed by the Charity Commission that it has received complaints from charities about the complexity of the section 73 procedure. Many do not understand why it has to take so long. In some cases charities have decided not to proceed with an amendment.

Royal Charter charities

4.10 Respondents to Lord Hodgson's call for evidence said that the existing means of amending Royal Charters are time-consuming and unclear. In response to the consultation on our Eleventh Programme, the Charity Commission noted difficulties with the procedures. In addition, we have heard that charities find the process to be expensive.

4.11 The amendment of a charity's Royal Charter is often carried out by the exercise of a power of amendment in the Charter itself (the express power procedure).[5] In the absence of such a power, charities tend to make amendments by petitioning for the grant of a supplemental Charter (the supplemental Charter procedure).[6] Whilst both procedures require the Privy Council's consent, the express power procedure does not require a supplemental Charter, with the associated delay caused by more extensive advertising and the costs of printing on vellum.

4.12 The Privy Council Office has told us that most amendments it deals with are made under the express power procedure, and that charities are encouraged by the Privy Council Office to incorporate into their Charter an express amendment power if they do not already have one. However, charity advisers have told us that many Royal Charter charities do not have an express amendment power and that, given the time and expense involved under the supplemental Charter procedure, they often decide not to proceed with an amendment. They are therefore left with inconvenient, inappropriate and out-of-date governing documents.

[3] See para 3.42 above.

[4] Eleventh Programme of Law Reform (2011) Law Com No 330.

[5] See paras 3.53 to 3.55 above.

[6] See paras 3.56 to 3.57 above.

4.13 Amendment by means of the section 68 procedure[7] is rare. That is perhaps unsurprising, for two reasons. First, there may be a very practical reason, namely that the Privy Council Office and Charity Commission have provided guidance on the use of the express power procedure and the supplemental Charter procedure, but not on the section 68 procedure. Second, the express power procedure and supplemental Charter procedure may be less bureaucratic than the section 68 procedure since they remove one step from the process, namely obtaining a Charity Commission scheme.[8]

4.14 The section 68 procedure does, however, enjoy some advantages over the other procedures. The charity can utilise the Charity Commission's expertise to draft a scheme rather than having to prepare its own proposed amendments for consideration by the Privy Council. In addition, if the charity holds property on trust rather than beneficially and wishes to change its purposes, a section 68 scheme can resolve doubts about whether its property can be applied to those new purposes.[9] Nevertheless, charities rarely use the section 68 procedure to amend their governing documents.

4.15 The amendment of a Royal Charter charity's bye-laws usually requires the Privy Council's consent.[10] Whilst this can be a quicker process than amending the Charter itself, we have been told that it can still take a long time.

Lord Hodgson's recommendations

4.16 Respondents to Lord Hodgson's call for evidence were in general agreement that the procedures for amendment of statutory and Royal Charter charities' governing documents were overly burdensome.[11] Lord Hodgson recommended that, to reduce the regulatory burden:

> The Queen in Council could be invited to consider the following changes:
>
> > a. Power to approve changes to the constitutions of Royal Charter charities should be delegated to the Charity Commission, with a requirement that notice of the change is given to the Privy Council;
> >
> > b. Powers to approve changes to bye-laws should be delegated to the trustees of the charity, with a requirement to notify the Charity Commission and Privy Council;
> >
> > c. Power to move administrative provisions from a charity's constitution into its byelaws should be given to the trustees in order to reduce the burden of making administrative changes;

7 See paras 3.58 to 3.61 above.

8 By contrast, the Charities Act 2011 procedure for statutory charities under s 73 has a significant advantage over the only other alternative (seeking an amendment by primary legislation) because it requires only secondary legislation.

9 See paras 3.66 to 3.71 above, where we discuss this issue in more detail.

10 See paras 3.63 to 3.64 above.

11 Hodgson Report, para 10.33.

d. The need for a scheme to be made under section 68 of the Charities Act 2011 where objects are being changed on a cy-près basis should be clarified;

e. Whether property is held by Royal Charter charities on trust, or as corporate property for charitable purposes, should be clarified to make administration and transactions easier (particularly as regards permanent endowment).

Parliament could be invited to consider similar changes to the rules applied to statutory corporations, in order to maintain regulatory oversight while minimising the burden on Parliamentary time.[12]

Conclusions

4.17 There is dissatisfaction among many charities about the current procedures to amend the governing documents of statutory and Royal Charter charities. It is felt that the procedures take too long, that they are bureaucratic in requiring the involvement of various public bodies (however efficient they are), and that they involve unnecessary expense both for the charities (in terms of staff time, legal advice and printing amended Charters) and the public bodies concerned. Some charities, however, have told us that they see no difficulties with the process.

4.18 The principal concern, it seems to us, is not with the level of service provided by the Privy Council Office,[13] but rather as to whether the extent of their involvement is necessary, or could be limited to situations where their expertise and regulatory function would be more valuable.

4.19 It appears that the level of oversight involved in the procedures is not tailored to the importance of a proposed amendment; an amendment to a governing document to increase or decrease the number of trustees must go through the same process as an amendment to the charity's objects. We do not think that minor amendments to statutory or Royal Charter charities' governing documents should occupy Parliament's or the Privy Council's time; nor do they need that level of scrutiny.

4.20 Additionally, there are inconsistencies in the treatment of these charities. For statutory charities, an amendment might be straightforward if a section 73 scheme has already been made in relation to the provision in question, since the amendment can be effected by way of alteration of the scheme, which does not require Parliamentary approval.[14] First-time amendments, however, require Parliamentary approval. The ease by which statutory charities can make an amendment might therefore turn, by chance, on whether a section 73 scheme is already in operation in relation to the provision to be amended. Royal Charter charities can amend more easily if they have an express power of amendment, but face a longer and more complicated process in the absence of such a power (as they must instead use the supplemental Charter procedure or the section 68

[12] Hodgson Report, Appendix A, paras 1 and 2.

[13] The Privy Council Office has explained to us its procedures, and its timetable for responding to enquiries and requests, which seem reasonable.

[14] See para 3.43 above.

procedure). The ease of making an amendment will depend on whether the provision is contained in the Royal Charter, the bye-laws or in regulations, yet the same issue may be addressed in one charity's Charter, another's bye-laws and another's regulations.[15]

4.21 We therefore take the provisional view that the procedures for the amendment of statutory and Royal Charter charities' governing documents should be reformed.

PROVISIONAL PROPOSALS FOR REFORM

The aims of reform

4.22 We suggest that reforms to the procedures should:

(1) minimise the bureaucracy, time and expense involved in making amendments to governing documents, both for the charity and for the public bodies involved in the process;

(2) distinguish between major and minor amendments, imposing less stringent requirements for minor amendments;

(3) retain some level of oversight by Parliament or the Privy Council (as the case may be) in respect of major amendments; and

(4) align Charity Commission involvement closer to that for amending the governing documents of charitable companies, CIOs, trusts and unincorporated associations.

4.23 These aims have guided the formulation of our provisional proposals for reform. There follows discussion of three sets of provisional proposals: first, some proposals specific to Royal Charter charities; second, our proposal for both statutory and Royal Charter charities to have power to make minor amendments; and third, the potential for the reform of existing procedures. Finally we look at the special position of Parochial Church Councils and certain educational charities.

Royal Charter charities

A default amendment power exercisable subject to the Privy Council's consent

4.24 A Royal Charter charity whose Charter does not contain an express power of amendment will usually amend the Charter by using the supplemental Charter procedure.[16] The express power procedure requires less formal consultation with external parties, it is quicker, and it is less expensive for the charity.[17] Royal Charter charities without an express power of amendment are therefore at a disadvantage when it comes to effecting Charter amendments. One option for

[15] See para 3.49 above. For example, provisions concerning the number of trustees are set out in the Royal Charter of the Royal College of Music, in the bye-laws of the NSPCC, and in the regulations of the British Red Cross Society (referred to as "standing orders" in its Royal Charter).

[16] See paras 3.56 to 3.57 and Fig 6 above.

[17] See paras 3.53 to 3.55 and Fig 5 above.

reform is for statute to provide that the Royal Charter of every Royal Charter charity is to be treated as containing a power of amendment exercisable by the trustees passing a resolution, with any such amendment taking effect once approved by the Privy Council.

4.25 We do not envisage such a reform being controversial since any amendment will still be subject to the Privy Council's consent. It would confer universally a power that is already commonplace in Royal Charters.[18]

4.26 We take the view that the power of amendment should require a resolution to be passed by at least two-thirds of the charity trustees who vote on the resolution.[19] If the charity has a separate body of members, the trustees' resolution should be approved by a resolution passed by at least two-thirds of the members who vote on the resolution at a general meeting.[20]

4.27 The power should be available to make any amendment, whether it is to the charity's purposes or to minor administrative provisions, since concerns about the appropriateness of a proposed amendment would be considered by the Privy Council, or the Charity Commission with whom the Privy Council would continue to consult. Further, we do not think that the power should distinguish between amendment of the Royal Charter and amendment of the bye-laws. It is likely to be of most use in respect of Charters as bye-laws already usually permit amendment with Privy Council consent. But in the unlikely event that a desired amendment is to the charity's bye-laws and there is no express power to amend the bye-laws, the default statutory amendment power should still apply.

4.28 It is necessary to consider the relationship between any such default power of amendment and existing powers of amendment in a charity's Royal Charter or bye-laws. There are three options:

(1) the default power could replace existing powers of amendment, so pre-existing powers of amendment can no longer be exercised;

(2) the default power could supplement existing powers of amendment, so charity trustees have a choice as to which power to use; or

(3) the default power could apply only to charities that do not already have an existing power of amendment.

[18] We have been told by the Privy Council Office that new and supplemental Royal Charters granted since the 1950s have generally contained express amendment clauses.

[19] This mirrors the requirements of express amendment clauses in many, but not all, existing Royal Charters (for example, the NSPCC, the British Red Cross Society, and the Royal British Legion). It also mirrors the requirements for resolutions amending small charities' purposes under s 275 of the Charities Act 2011: see para 3.11 above. It would be possible to require a 75% majority instead, which would reflect resolutions made by charitable companies under the Companies Act 2006 and by CIOs under the Charities Act 2011: see para 3.4 above.

[20] This mirrors the requirements for resolutions amending the administrative provisions of unincorporated charities' governing documents under s 280 of the Charities Act 2011: see para 3.16 above. As with the trustees' resolution, it would be possible to require a 75% majority instead.

4.29 Existing powers of amendment may require certain conditions to be satisfied, for example, giving advance notice to members or requiring a particular majority of trustees or members to approve the resolution. Those provisions are likely to have been carefully framed to suit the charity. They would be overridden if the default power replaced the existing amendment powers. They would also be overridden if the default power supplemented existing powers, but had less onerous conditions for its exercise. The particular problem that we are seeking to address by this proposal is the position of Royal Charter charities without any existing power of amendment to their Charter (or bye-laws), not charities that already have an express power of amendment and that can therefore already use the express power procedure.[21] In our view, therefore, the new default power should only apply to Royal Charters or bye-laws that are not already amendable pursuant to an express power in the Charter or bye-laws.

4.30 **We provisionally propose that, subject to paragraphs 4.31 and 4.32 below, the Royal Charter and bye-laws of Royal Charter charities should be deemed by statute to include a power for any provision of the Royal Charter or bye-laws to be amended, subject to any amendment being approved by the Privy Council.**

Do consultees agree?

4.31 **We provisionally propose that the power of amendment should be exercisable:**

(1) **by a resolution of at least two-thirds of the trustees who vote on the resolution; and**

(2) **if the charity has a separate body of members, by a further resolution of at least two-thirds of the members who vote on the resolution at a general meeting.**

Do consultees agree?

4.32 **We provisionally propose that the power of amendment should not apply to a charity's Royal Charter or bye-laws if those documents already make express provision for their amendment.**

Do consultees agree?

Reallocating provisions between the Royal Charter, bye-laws and regulations

4.33 The Privy Council Office has told us that when it is approached by a Royal Charter charity seeking to amend its Charter or bye-laws, it will often encourage the charity to use the opportunity to reallocate the different provisions of the charity's constitution between the Charter, bye-laws and regulations. Accordingly, if provisions concerning internal governance feature in the Charter, it may be appropriate to move them to the bye-laws so that they can be amended more easily. Similarly, it may be appropriate for more minor provisions to be moved

[21] See paras 4.11 and 4.12 above.

from bye-laws to regulations, so that they can be amended by the trustees without Privy Council oversight.

4.34 We encourage this approach, and we suggest that it could be used to greater effect. At present, it is reactive; it applies to charities that seek the Privy Council's consent to an amendment, and the charity is encouraged to use the opportunity to consider other provisions in its governing documents. The approach could be more proactive; rather than waiting for charities to approach the Privy Council to request an amendment, the Privy Council – in conjunction with the Charity Commission – could issue guidance setting out the types of provision that it would normally expect to see in a charity's Charter, bye-laws and regulations. Whether a provision ought to be set out in a charity's Charter, its bye-laws or its regulations may depend on the nature of the charity; a professional body should, perhaps, be treated differently from an animal welfare charity. The guidance could therefore be tailored to different categories of charity.

4.35 Such guidance could provide Royal Charter charities with a template for an overhaul of their governing documents, which would seek to ensure that there was an appropriate level of scrutiny over different types of amendment in the future. Any overhaul would still be considered by the charity trustees and Privy Council on a case-by-case basis and it might be appropriate to depart from the guidance where it is thought that amendments in a particular case would require a greater or lesser degree of oversight.

4.36 The utility of any such guidance would depend on the categories of provision that the Privy Council and the Charity Commission considered to be suitable for the Charter, bye-laws and regulations. In addition, this approach would still require the charity to follow the amendment procedures outlined above.[22] If our proposal above concerning a default amendment power[23] is implemented, then all Royal Charter charities would at least be able to use the express power procedure to make the changes. But the existence of guidance from the Privy Council might encourage Royal Charter charities to reconsider their governing documents, and to contact the Privy Council about any proposed changes. And once the process is complete, the charities' governance arrangements would be improved, and future amendment should be easier and have an appropriate level of oversight.

4.37 **We invite the views of consultees as to whether Royal Charter charities would find it helpful for the Privy Council and Charity Commission to issue guidance concerning the types of provision that they consider to be appropriate for the Royal Charter, bye-laws and regulations, to form a basis for Royal Charter charities to seek amendments to their governing documents.**

Statutory and Royal Charter charities: a new power to make minor amendments

4.38 We take the provisional view that statutory charities should be able to make certain minor amendments to their governing documents without the oversight of Parliament.

[22] See paras 3.50 to 3.65 above.

[23] See para 4.30 above.

4.39 In relation to Royal Charter charities, we have already proposed a default power of amendment, exercisable with the Privy Council's consent.[24] That power would be of use to Royal Charter charities that do not currently have such a power. We have also discussed the possibility of the Privy Council issuing guidance concerning the level of oversight that would usually be expected of amendments to different provisions in governing documents. However, that would not provide a complete solution to the difficulties faced by Royal Charter charities; some might remain reluctant to institute the Privy Council's amendment process.[25] We believe that Royal Charter charities should have a power to make certain minor amendments to their governing documents without the oversight of the Privy Council. We would expect this to be an alternative to the guidance approach, but we consider whether both could work together below.[26]

4.40 There are arguments against permitting Royal Charter charities and statutory charities to make any amendments without the oversight of the Privy Council or Parliament.

(1) A Royal Charter (or statute) can be seen as a quality guarantee for those dealing with the charity, which is preserved by the Privy Council's (or Parliament's) control over amendments.

(2) A Royal Charter is granted by the Queen exercising her common law power;[27] amendments to it should be in her gift.

(3) Charities might be established by Royal Charter or statute because their activities are such that a greater degree of governmental or Parliamentary oversight is warranted; if the body were not established by Charter or by statute then there might be a desire to regulate them in another way.

(4) It may be argued that there is something special about statutory and Royal Charter charities, for example their historic origins and traditions, which makes them worthy of a higher degree of scrutiny, oversight and protection.

4.41 Many statutory and Royal Charter charities are respected and well-known. But so are many other charities which take different legal forms. Some statutory and Royal Charter charities are small institutions that are not well known to the public. The particular legal form a charity takes can, in some cases, be no more than an historical accident, and it is unlikely to be a significant factor in the public's eye in terms of support for the charity's work. Our current view, therefore, is that there is no reason for statutory and Royal Charter charities to face higher degrees of regulation and protection than other forms of charity; what is important to protect is the reputation and work of charities generally, not specifically the minority of charities with this particular legal form.

[24] See para 4.30 above.

[25] See paras 4.35 and 4.36 above.

[26] See paras 4.70 to 4.72 below.

[27] See para 1.16 above.

4.42 A suggestion that the trustees of certain charities should be subject to more onerous requirements might also imply that those trustees are considered to be at greater risk of being imprudent in carrying out their functions. There is no reason for any such belief. Trustees ought to be cautious before making any amendment, given their legal duties and the need to protect the work and reputation of the charity, but there is much to be said for trusting their judgement, regardless of the legal form of their charity.

4.43 As for special protection of Royal Charter and statutory charities, we would suggest that such an argument makes an inappropriate generalisation about Royal Charter and statutory charities, and also ignores the fact that many other charities have historic origins that are worthy of protection. Moreover, if a charity's governing document prevents it from pursuing its objects in the best way possible, it is hampered in its work and its valuable funds are not being put to most efficient use. That is in nobody's interests.

4.44 In light of the difficulties faced by statutory and Royal Charter charities in amending their governing documents, and provided significant amendments would remain subject to Privy Council or Parliamentary oversight, our provisional view is that a new amendment power is appropriate.

The form of the new power

4.45 There would be two main considerations in formulating a power for statutory and Royal Charter charities to make minor amendments to their governing documents. First, what types of amendment should fall within the power? Second, should the power be exercised by the charity trustees alone or by the Charity Commission? We examine both questions separately, but they are inextricably linked; the wider the range of permitted amendments, the stronger the argument for Charity Commission oversight.

(1) Permitted amendments

4.46 We start by considering the types of amendment that could be made without Parliamentary or Privy Council oversight. Amendments to a charity's objects should not be permitted without Parliamentary or Privy Council agreement. Conversely, changing the date or frequency of trustee meetings should not require Parliamentary or Privy Council agreement. Where should the line between those extremes be drawn?

4.47 Charity legislation already distinguishes between major and minor amendments in two places, namely the power for unincorporated charities to make administrative amendments under section 280 of the Charities Act 2011,[28] and the additional requirements imposed on charitable companies (and CIOs) making "regulated alterations" under section 198 of the Charities Act 2011 (section 226 for CIOs).[29] Thus section 280 lists what can be done, while section 198 provides a list of things that cannot be done without oversight.

[28] See paras 3.16 to 3.18 above.

[29] See para 3.5 above.

4.48 We think that the latter approach – listing amendments that would always require Parliamentary or Privy Council consent – would give rise to difficulties. The charities with which we are concerned are diverse and have unique governing documents, and it would be difficult to ensure that a list of regulated alterations covered all provisions that required Parliamentary or Privy Council oversight.

4.49 Section 280 may provide a better approach in setting out a broad description of the amendments that are permitted without that oversight. The distinction it employs between major and administrative amendments could be suitable in the context of amendments to statutory and Royal Charter charities' governing documents.

4.50 However, as we discuss in Chapter 6, there is some uncertainty as to the types of amendment that fall within the wording of section 280. In any event, simply copying the wording of section 280 would not necessarily yield the right list for this purpose. So at this stage it would be helpful to identify the amendments that could properly be made without Parliamentary or Privy Council oversight. The way in which those amendments should be described (whether by a list or a general description) in future legislation will be a drafting question, and will inevitably depend on the types of amendment that we conclude should fall within and outside the amendment power.

4.51 As a starting point we suggest that Parliamentary or Privy Council oversight should not be required in relation to amendments to provisions governing:[30]

(1) the number of charity trustees;

(2) the method of appointing and removing charity trustees;

(3) a power for a third party to appoint charity trustees (where the third party has ceased to exist or has consented to the change);

(4) the conditions that charity trustees must satisfy for appointment, such as area of residence, beliefs, or age;

(5) charity trustee and member meetings, such as the number of meetings each year, the time at which they must take place, quorum provisions, voting, the method of appointing the chair, dealing with conflicts of interest, and provisions concerning casting votes by the chair;

(6) the appointment of officers, such as a treasurer or secretary;

(7) accounting and reporting requirements;

(8) the criteria for charity membership; and

(9) the trustees' powers to carry out the charity's purposes, such as to employ staff, to borrow, to invest, to fundraise, to acquire property, to merge, to create committees, and to delegate their functions.

[30] Many of these categories are set out in Charity Commission, *OG519 Unincorporated Charities: Changes to Governing Documents and Transfer of Property (Charities Act sections 268, 275 and 280* (February 2014) section E5.1.

4.52 Conversely, Parliamentary or Privy Council agreement should be required before making amendments to:

(1) the charity's objects;

(2) the charity's name;

(3) the purposes for which the charity's property must be used on dissolution;

(4) provisions permitting trustees to receive any benefits, save for reasonable out-of-pocket expenses;

(5) powers for a third party to appoint trustees (where that third party does not consent to the change);

(6) any change to the duties imposed on the trustees (for example, a duty of care); and

(7) any existing powers of amendment so as to permit the trustees to make any of amendments (1) to (6) above.

4.53 If the new power were to set out a list of the types of provision that can be amended under the power, it would be possible for that list to be subject to amendment by secondary legislation.

4.54 **We provisionally propose that charities established or governed by statute or Royal Charter should have a statutory power to make minor amendments to their governing documents.**

Do consultees agree?

4.55 **We invite the views of consultees as to the types of amendment that should fall within, and outside, the amendment power.**

4.56 **We invite the views of consultees as to whether the Secretary of State should have power to alter any list of permitted amendments by secondary legislation.**

(2) Should the power be exercisable by the charity trustees or the Charity Commission?

4.57 As noted above, the question of who exercises the amendment power depends on the breadth of amendments that are permitted. In light of the types of amendment that we suggest should be included within the power above,[31] we think that charity trustees should be permitted to exercise the power. Similar amendments to the governing documents of all other charities can be made by the charity trustees (or, where appropriate, the members), and statutory and Royal Charter charities should be more closely aligned with this approach rather than requiring Charity Commission approval for all changes. Similarly, if it is unnecessary for Parliament or the Privy Council to be occupied by minor

[31] See para 4.51 above.

amendments, it is difficult to see why the Charity Commission ought to be troubled by those minor amendments instead. We also note the continuing pressure on the Charity Commission's budget; it cannot be expected to take on the role of Parliament or the Privy Council in this process without additional resources.

4.58 We have therefore taken the provisional view that the power to make minor amendments to statutory and Royal Charter charities' governing documents should be conferred on the trustees of the charity (subject to the approval of the members of the charity, if any; see further below) rather than the Charity Commission. Such a regime would ensure that minor amendments can be dealt with quickly and inexpensively by the charity trustees, whilst significant amendments continue to require approval from Parliament or the Privy Council. It will also more closely align the amendment procedures for statutory and Royal Charter charities with those for other types of charity.

4.59 **We provisionally propose that the power to make minor amendments to statutory and Royal Charter charities' governing documents should be exercisable by the trustees of the charity rather than by the Charity Commission.**

Do consultees agree?

Exercising the new power

4.60 We suggest that the power to make minor amendments should require a resolution to be passed by the charity trustees. If the charity has a separate body of members, the trustees' resolution should be approved by a further resolution passed by at least two-thirds of the members who vote on the resolution at a general meeting.[32]

4.61 The power of amendment may need to be exercised in relation to a provision contained in primary or secondary legislation (in the case of statutory charities) or in a Royal Charter, bye-laws or regulations (in the case of Royal Charter charities). The location of the provision should be irrelevant;[33] what is important is the substance of the proposed amendment. A minor provision appearing in the Charter of a Royal Charter charity should be capable of amendment in the same way as an equally minor provision in the regulations of the charity. There is no reason for the amendment power to specify different requirements or procedures depending on which of the different types of governing document is to be amended. Accordingly, the power should apply to all of a statutory or Royal Charter charity's governing documents.[34]

[32] This mirrors the requirements under s 280 of the Charities Act 2011; see n 20 above.

[33] Lord Hodgson recommended that charity trustees should be able to make changes to bye-laws, and should be able to move administrative provisions from their Royal Charters into the bye-laws so that they can be amended by the trustees alone. We disagree; the availability of the amendment power should depend instead on the substance of the provision in question, not on its location in the governing documents.

[34] Where the amendment is to the Royal Charter charity's regulations, there would generally be no need to rely on the new power since the trustees can usually amend regulations without obtaining the Privy Council's consent.

4.62 The amendment power should supplement any other power that is available to effect the same amendment.[35] The amendment power in section 280 of the Charities Act 2011 supplements other amendment powers, so charity trustees can choose whether to use the statutory power or an express amendment power in their governing document. The utility of the power would be significantly undermined in relation to Royal Charter charities if it only applied where the governing document did not already provide a procedure for amendment. This is because existing amendment powers are likely to impose more onerous requirements, such as Privy Council consent.

4.63 In our view, a resolution passed under the proposed amendment power should take effect immediately, in the same way as a resolution to amend the articles of a charitable company[36] or a resolution passed under section 280 of the Charities Act 2011. We see no reason to delay such a resolution coming into effect, for example in order to give the Charity Commission an opportunity to object to the amendment, where only a minor change is concerned.

4.64 Registered charities will have to notify the Charity Commission of the amendments under their general obligation to inform the Charity Commission of any changes to their governing documents in section 35(3)(a) of the Charities Act 2011. There is no need to single out amendments to statutory and Royal Charter charities' governing documents and specify a time limit within which notification must be given.[37] Nor is it necessary to create a criminal offence of failing to notify the Charity Commission.[38]

4.65 As well as notifying the Charity Commission, Royal Charter charities could be required to notify the Privy Council of any amendment under the new power and statutory charities could be required to notify Parliament by laying the amendments before Parliament. We would expect notification to be quick, but we would not expect a time limit to be specified, nor should a criminal offence of failing to notify be created.

4.66 **We provisionally propose that the power should be exercisable by a resolution of the trustees and, if the charity has a separate body of members, by a further resolution of at least two-thirds of the members who vote on the resolution at a general meeting.**

Do consultees agree?

[35] In contrast to the default amendment power proposed in para 4.30 above.

[36] Save for amendments to the objects; see para 3.7(1) above.

[37] Charities companies must notify the Registrar of Companies within 15 days: see para 3.7(1) above. There is no express time limit under s 35(3)(a) of the Charities Act 2011.

[38] Again, charitable companies are subject to criminal liability for failing to notify the Registrar of Companies: see para 3.7(1), n 7 above. No such criminal offence is set out in the Charities Act 2011 for charities that are not companies.

4.67 **We provisionally propose that the power should apply to provisions in a charity's governing document, whether those provisions are contained in a statute, regulations made pursuant to a statute, a Royal Charter, or bye-laws or regulations made pursuant to a Royal Charter.**

Do consultees agree?

4.68 **We provisionally propose that amendments should take effect once the necessary resolutions have been passed.**

Do consultees agree?

4.69 **We invite the views of consultees as to whether charities that exercise the power should be required to notify the Privy Council or lay the amendments in Parliament (as the case may be).**

Royal Charter charities: combining the guidance approach with a new power to make minor amendments

4.70 In paragraphs 4.33 to 4.37 we discussed the possibility of the Privy Council and Charity Commission providing guidance concerning the types of provision that they consider to be appropriate for a charity's Royal Charter, bye-laws and regulations ("the guidance approach"). In paragraphs 4.38 to 4.69 we discussed and provisionally proposed the creation of a new power for Royal Charter charities to make minor amendments to their governing documents ("the amendment power").

4.71 We expect that the amendment power would be an alternative to the guidance approach, but it might instead be possible for the two to work together. This would depend on the scope of the amendment power. If it is wide then there will be a reduced need for the guidance approach as trustees will less often need to reallocate provisions in order to effect amendments to those provisions without Privy Council oversight. But if the amendment power is narrow then there will be a greater need for guidance from the Privy Council on the provisions that are beyond the scope of the amendment power but which charities would usually be permitted to move from their Charter or bye-laws into their regulations (subject to the approval of the Privy Council).

4.72 **We invite the views of consultees as to whether the power of amendment (see paragraph 4.54 above) should operate (a) alongside, or (b) instead of, guidance from the Privy Council concerning the reallocation of provisions in governing documents (see paragraph 4.37 above).**

Reform of existing amendment procedures

4.73 The existing amendment procedures would remain available in respect of amendments that cannot be made under the proposed statutory power of amendment (and for those that the trustees would prefer to make using existing procedures). We now consider whether those procedures could be improved.

Increasing the involvement of the Charity Commission?

4.74 It would be possible for the regulation of significant amendments to statutory and Royal Charter charities' governing documents to be removed from Parliament

and the Privy Council, and instead be subject to the oversight of the Charity Commission. This was suggested by Lord Hodgson.[39] The Charity Commission would have the power to make a scheme to amend the charity's governing document without having to involve Parliament or the Privy Council in the same way that it can currently make schemes in respect of all other charities. Such an approach would bring consistency between the different forms of charity.

4.75 In our provisional view, however, Parliament and the Privy Council ought to retain some control over major amendments to the governing documents of statutory and Royal Charter charities. These charities enjoy a certain status by reason of being established by statute or Royal Charter. It is appropriate that that status brings with it a requirement that the charities are answerable to Parliament or to the Privy Council in respect of the significant aspects of their structure and governance.

4.76 Moreover, in the case of Royal Charter charities the Privy Council is well-placed to consult with the various bodies that have an interest in the particular charity in question, and sometimes has to negotiate with various parties as part of that process. The Charity Commission cannot in our view be expected to carry out that role. The Privy Council would retain its role for non-charitable Royal Charter bodies in any event and it would be preferable for one body to retain oversight of significant amendments to all Royal Charters regardless of whether the institution seeking the amendment is charitable or non-charitable.

4.77 In our view, therefore, Parliament and the Privy Council – rather than the Charity Commission (or the charity trustees) – should retain control over significant amendments to statutory and Royal Charter charities' governing documents.

Reducing the involvement of the Charity Commission?

4.78 The Charity Commission is currently involved in the process of amending statutory and Royal Charter charities' governing documents. If – as we suggest above – Parliamentary or Privy Council involvement is to be retained in respect of significant amendments, it is arguable that reducing the involvement of the Charity Commission would help to reduce the bureaucracy and time involved in making amendments (see the aims of reform in paragraph 4.22 above).

4.79 For statutory charities, it would be possible for the section 73 procedure to be operated without the Charity Commission's involvement, with the charity trustees or the Office for Civil Society drafting the scheme, to which effect is given by Ministerial order; alternatively, the amendment could be given effect directly by order without the need for a scheme. Any consultation with the Charity Commission could be limited to certain major amendments (just as the Privy Council's consultation with the Charity Commission in respect of Royal Charter charities is limited to circumstances where the proposed amendment would be a "regulated alteration" were it made by a company or CIO).[40] This approach would place the onus of drafting an amendment to primary legislation on the Office for Civil Society or on the charity trustees. Whilst removing the Charity Commission from the picture might reduce the number of organisations involved, in our view it

[39] Hodgson Report, Appendix A, para 1(a); see para 4.16 above.

[40] See Fig 5(2) and para 3.5 above.

would not necessarily save time and expense for the charities, not least because the Commission's expertise and experience in advising on and drafting schemes would be lost.

4.80 For Royal Charter charities, the involvement of the Charity Commission is already limited to cases where the proposed amendment would amount to a "regulated alteration" were it made by a company or CIO.[41] We consider that it is appropriate for the Charity Commission to retain this role; it provides a consistent approach across incorporated charities and ensures that the Charity Commission is aware of amendments by Royal Charter charities in respect of which it has a regulatory interest.

4.81 We do not therefore see that there is much to be gained from reducing or removing the Charity Commission's existing involvement in the process of amending statutory and Royal Charter charities' governing documents.

Statutory charities: affirmative and negative resolutions

4.82 The section 73 mechanism for statutory charities imposes different requirements depending on whether the charity is established (or governed) by a public general Act, or by a private Act. The former requires the affirmative procedure; the latter requires the negative procedure.[42] The affirmative procedure has a greater degree of oversight, since both Houses of Parliament must actively consider and approve the statutory instrument. Section 73 therefore requires greater Parliamentary scrutiny in respect of charities founded by a public general Act than those founded by a private Act. It might be thought that charities founded by public general Act are more well-known, or larger, and amendments should therefore be subject to greater scrutiny. But that is not necessarily the case. The National Trust, for example, was founded by a private Act, the amendment of which is subject to the negative procedure.[43] The Incorporated Church Building Society, by contrast, is perhaps less well known than the National Trust but was incorporated by a public general Act such that amendments are subject to the affirmative procedure.[44] We do not think that the mere fact that a statutory charity is governed by a public general Act, rather than a private Act, justifies a greater degree of scrutiny in respect of amendments.

4.83 The affirmative procedure may be more time-consuming and prone to failure, since it requires a positive resolution from both Houses of Parliament, rather than simply giving each House a limited time in which to object. Additionally, the very existence of a distinction between the two means that consideration must be given to which procedure applies, which can take additional time or result in further expense if advice is sought on the issue.[45]

[41] See Fig 5(2) and para 3.5 above.

[42] See para 3.42 above.

[43] See, most recently, the Charities (National Trust) Order 2005 (SI 2005 No 712).

[44] See the Charities (Incorporated Church Building Society) (England and Wales) Order 2013 (SI 2013 No 641).

[45] We have heard that there was uncertainty as to whether the Church Building Society Act 1828, governing the Incorporated Church Building Society, was a public general Act, which delayed the process of making the amending scheme under s 73.

4.84 We can see merit in statutory charities having to follow the same procedure regardless of whether the Act that is being amended is a public general Act or private Act. If a single procedure is to be adopted, in our view it should be the negative procedure. It is the negative procedure that is followed in respect of the majority of section 73 amendments as most statutory charities are governed by a private Act. Further, we consider that the negative procedure provides a sufficient degree of Parliamentary oversight for amendments to statutory charities' governing documents.

Internal procedures and guidance

4.85 We noted in paragraph 3.64 above that amendments to bye-laws only require the Privy Council's consent when the Charter so provides, but that the Privy Council's guidance suggests that such amendments always require consent. The guidance on this point should be clarified.

4.86 The Office for Civil Society has not issued any guidance on the operation of the section 73 procedure; the Privy Council's guidance on the amendment of Royal Charters is brief; and the Charity Commission has no specific guidance on the section 73 procedure. Given that the procedures involve various public bodies, we can see the benefit of joint guidance issued by the Office for Civil Society and Charity Commission in respect of statutory charities, and by the Privy Council and Charity Commission in respect of Royal Charter charities. We invite consultees' views as to whether such guidance would be helpful.

Other improvements to the procedures

4.87 We invite consultees' views as to whether any other reforms could be made to improve the existing procedures for amending statutory and Royal Charter charities' governing documents.

4.88 **We invite the views of consultees as to whether, and if so how, the involvement of the Charity Commission in making amendments to statutory and Royal Charter charities' governing documents should be increased or reduced.**

4.89 **We provisionally propose that all section 73 schemes should be subject to the negative procedure, regardless of whether the governing document is contained in a private Act or a public general Act.**

Do consultees agree?

4.90 **We provisionally propose that the Privy Council Office amend its guidance to make clear that amendments to bye-laws only require approval when that is expressly required by the Royal Charter itself.**

Do consultees agree?

4.91 **We invite the views of consultees as to whether it would be helpful for the Office for Civil Society and Charity Commission to issue joint guidance in respect of the amendment of statutory charities' governing documents, and for the Privy Council and Charity Commission to issue joint guidance in respect of the amendment of Royal Charter charities' governing documents.**

4.92 **We invite the views of consultees as to whether any further amendments could be made to the existing procedures for amending the governing documents of statutory and Royal Charter charities.**

Special provision for certain statutory and Royal Charter charities

4.93 The position of Parochial Church Councils and various educational bodies has been brought to our attention, and it is necessary to consider how far – if at all – the provisional proposals above should apply to these charities.

Parochial Church Councils

4.94 Parochial Church Councils ("PCCs") are Church of England bodies, established in 1921 by the Parochial Church Councils (Powers) Measure 1921. They are now governed by the Parochial Church Councils (Powers) Measure 1956 and Schedule 3 to the Synodical Government Measure 1969 (No 2). All Measures were passed in accordance with the procedure set out in the Church of England Assembly (Powers) Act 1919. In outline, the 1919 Act allows the General Synod of the Church of England[46] to pass a measure, which is then considered and reported upon by two committees before being laid before Parliament.[47] If the measure is approved by a resolution of both Houses of Parliament and receives Royal Assent, it has the same force and effect as an Act of Parliament.[48] Measures can be amended following the same procedure.

4.95 It is arguable that the section 73 power can already be exercised by PCCs in respect of the 1956 and 1969 Measures insofar as those Measures apply to them, but there has never been an attempt to use the section 73 power in this way. We have been told that the Church of England does not regard section 73 as being available to make such amendments, and concerns have been expressed that PCCs should not have a power to amend their governing documents without General Synod oversight in order to maintain consistency across all PCCs.

4.96 We have been told that there are over 16,000 PCCs and we can see the advantage of retaining consistency in their governing documents. The 1919 Act already sets out particular procedures for the amendment of those governing documents. We consider that those procedures should continue, and we do not propose to supplement them by the statutory amendment power that we provisionally propose above for statutory charities.

4.97 **We provisionally propose that the new power of amendment should not apply to the governing documents of Parochial Church Councils.**

Do consultees agree?

[46] Originally the National Assembly of the Church of England, until renamed by the Synodical Government Measure 1969, s 2.

[47] Church of England Assembly (Powers) Act 1919, ss 2 and 3.

[48] Church of England Assembly (Powers) Act 1919, s 4.

Higher education institutions

UNIVERSITIES GOVERNED BY ROYAL CHARTER AND INDIVIDUAL ACTS OF PARLIAMENT

4.98 Many universities are incorporated by Royal Charter. Amendments to their Charter and bye-laws (referred to in this context as their statutes) require the Privy Council's consent in the usual way.[49]

4.99 Other universities, which may or may not be established by Royal Charter, are governed by individual Acts of Parliament which set out the procedure for the amendment of the university's statutes. We set out some examples in Figure 7.

Figure 7: amendment procedures under Acts of Parliament governing universities

The University of London. The University of London was incorporated by Royal Charter in 1836. Various Acts of Parliament have conferred statute-making power on the university. The procedure is now governed by the University of London Act 1994. It involves:

- consultation with various bodies;[50]

- the passing of a resolution by the Council of the University followed by confirmation of that resolution at a subsequent meeting of the Council between one and six months later;[51]

- submission of the resolution to the Privy Council for approval;[52] and

- publication of the resolution in the London Gazette.[53]

Durham University and Newcastle University. The universities have a complex history.[54] Both are now governed by the Universities of Durham and Newcastle upon Tyne Act 1963 which sets out the universities' statutes and the procedure for their amendment, which includes consultation and approval by the Privy Council.[55]

Royal Holloway and Bedford New College. The Royal Holloway and Bedford New College Act 1985 provided for the merger of Bedford New College, established in 1849, and Royal Holloway College, established in 1879. The 1985 Act sets out the procedure for the amendment of the statutes, which includes consultation and approval by the Privy Council.[56]

[49] See paras 3.48 to 3.65 above.

[50] University of London Act 1994, s 3(2) to (4).

[51] University of London Act 1994, s 3(7) to (10).

[52] University of London Act 1994, s 4(1).

[53] University of London Act 1994, s 4(2).

[54] The history of Newcastle University is set out in detail at http://www.ncl.ac.uk/about/history/. See https://www.dur.ac.uk/about/governance/ for information about the governance of Durham University.

[55] For Durham University, see the Universities of Durham and Newcastle upon Tyne Act 1963, Sch 1, para 45, now para 42 of its statutes as approved in 2011, available at https://www.dur.ac.uk/resources/university.calendar/StatutesUniversityofDurham2011.pdf. For Newcastle University, see the 1963 Act, Sch 3, para 75, now para 58 of its statutes as approved in 2011, available at http://www.ncl.ac.uk/regulations/docs/statutes.pdf.

[56] Royal Holloway and Bedford New College Act 1985, s 7.

The Universities of Oxford and Cambridge and the colleges.[57] The Universities of Oxford and Cambridge were formally incorporated by statute and are statutory charities.[58] Most of the colleges, by contrast, are incorporated by Royal Charter. The powers of the Universities and the colleges to issue statutes was subject to statutory intervention over time, and is now governed by the Universities of Oxford and Cambridge Act 1923 ("the 1923 Act")[59] which requires amendments to statutes to be approved by the Privy Council. This is a complicated procedure involving:

- colleges obtaining the University's consent to an amendment if it "affects the university";[60]

- submission of the amendment to the Privy Council and publication of a notice of the amendment in the London Gazette;[61]

- the consideration of petitions against the amendment by the Universities Committee, a committee of the Privy Council,[62] which can disallow the amendment or remit it for reconsideration;[63] and

- laying the amendment before Parliament, after which either House can present an address praying the Queen to withhold consent to the amendment.[64]

The Universities have overhauled their statutes over time. In doing so, they have adopted the approach that we endorse above of reallocating provisions between statutes (which can only be amended with the Privy Council's consent) and ordinances (which can be amended without the Privy Council's consent).[65] We have not heard that the universities face difficulties in amending their statutes. Our discussions with stakeholders suggest that amendment of the colleges' statutes has been more sporadic and that the colleges have faced difficulties in making amendments using the 1923 Act procedure.

[57] The governing documents of the Universities of Oxford and Cambridge and the colleges have a complex history, and what follows is a brief summary. For a fuller account of Oxford University's governance, see the Preface to its Statutes and Regulations ("the Preface"), available at http://www.admin.ox.ac.uk/statutes/.

[58] Incorporation of Both Universities Act 1571.

[59] The Schedule to which preserved the amendment procedure set out in the Universities of Oxford and Cambridge Act 1877 ("the 1877 Act").

[60] 1923 Act, s 7(2). There is a separate, but overlapping, requirement under the 1877 Act requiring the college, one month before adopting a final resolution, to communicate the proposed amendment to the Vice-Chancellor of the university and the Visitor of the college. The Vice-Chancellor must give public notice of the proposed amendment in the university within seven days. If the proposed amendment affects the interests of the university then it must also be communicated to the Council of the university to enable the Council to make representations: 1877 Act, ss 31 and 32 (preserved by the Sch to the 1923 Act).

[61] 1877 Act, s 45 (preserved by the Sch to the 1923 Act).

[62] See 1877 Act, s 44 (preserved by the Sch to the 1923 Act).

[63] 1877 Act, ss 47 and 48 (preserved by the Sch to the 1923 Act).

[64] 1877 Act, ss 49 and 50 (preserved by the Sch to the 1923 Act).

[65] The statutes of the University of Oxford were significantly amended in the late 1960s and again in 2002: Preface, paras 8 and 10. The statutes of the University of Cambridge were significantly amended following the Report of the Council on the Technical Review of the Statutes of 28 June 2012 (available at http://www.admin.cam.ac.uk/reporter/2011-12/weekly/6272/section1.shtml), which moved various provisions out of the statutes so that they could be amended without the Privy Council's involvement.

4.100 In 2006, the Government wrote to university Vice Chancellors setting out the categories of provision that it considered could properly be moved away from those bodies' statutes into ordinances which could then be amended by the trustees without Privy Council oversight.[66] This was an example of the process that we endorse above; provisions in governing documents are reallocated so that their amendment is subject to an appropriate level of oversight.[67] A few universities took this opportunity to overhaul their governing documents. But we have heard criticisms that deregulation did not go far enough; in particular, amendments to the "Model Statute" (concerning employment matters) were to remain subject to Privy Council control.

4.101 More recently, concerns about amendment procedures for higher education institutions ("HEIs") have been raised in Government consultations and the Government has agreed that improvements could be made.[68]

HIGHER EDUCATION CORPORATIONS

4.102 Higher education corporations ("HEC") are bodies corporate established under section 122 of the Education Reform Act 1988[69] for the purpose of providing higher education services. The powers of an HEC are set out by section 124 of the Education Reform Act 1988. HECs are charities with statutory governing documents.[70]

4.103 An HEC's constitution comprises:

(1) Its "instrument of government", prepared by way of an order of the Privy Council.[71] It can be amended only by an order of the Privy Council.[72]

[66] This followed the Government's White Paper, The Future of Higher Education (2003) Cm 5735, para 7.10, available at http://www.cgee.org.br/atividades/redirKori/2909.

[67] See paras 4.33 and 4.34 above.

[68] Students at the Heart of the System (June 2011) Cm 8122, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31384/11-944-higher-education-students-at-heart-of-system.pdf; Department for Business, Innovation and Skills, *A new, fit for purpose regulatory framework for the higher education sector* (August 2011), ch 5, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31382/11-1114-new-regulatory-framework-for-higher-education-consultation.pdf; *Government response to 'Students at the heart of the system' and 'A new regulatory framework for the higher education sector'* (June 2012), para 3.9, and summary of responses to question 22, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209212/12-890-government-response-students-and-regulatory-framework-higher-education.pdf.

[69] As amended by the Further and Higher Education Act 1992. Strictly speaking, s 122 does not itself create an HEC; rather, it confers on the Secretary of State a power to make an order establishing an HEC: s 122(1) and (6). However it is usual to refer to an HEC as being established under s 122: see, for example, the wording of s 123(4).

[70] Some HECs which are "designated institutions" under s 129 of the Education Reform Act 1988 are not charities.

[71] 1988 Act, s 124A(2). Sch 7A to the Education Reform Act 1988 sets out the matters for which provision must be made and those for which provision may be made.

[72] Education Reform Act 1988, ss 124A(3)(b) and 124D(2).

(2) Its "articles of government", prepared by the HEC itself and approved by the Privy Council.[73] The articles may be varied or revoked by the HEC with the approval of the Privy Council.[74]

(3) Its rules and bye-laws, which the articles empower the HEC to make and which are not subject to Privy Council consent.

SHOULD THE NEW AMENDMENT POWER APPLY TO HIGHER EDUCATION INSTITUTIONS?

4.104 Special provision is currently made for the amendment of HEIs' governing documents. HECs' governing documents are amended following the statutory procedure under the Education Reform Act 1988; the governing documents of the universities and colleges in Figure 7 above are amended under particular statutory procedures. We have heard that there are difficulties with those procedures, and an unnecessary degree of oversight, but we are cautious about adding our proposed amendment power to those existing amendment procedures. The relationship between the two procedures could be difficult to delineate, and the new amendment power would have the potential to undermine the balance created by the legislation governing those institutions.

4.105 Similarly, whilst Royal Charter universities do not have a statutory amendment procedure, they were provided with guidance in 2006 as to the matters considered by Government to deserve Privy Council oversight, and those that did not. Amendments that are permitted by the new power we propose may all fall within the list of matters that the Privy Council is currently willing to move from statutes to ordinances.[75] Certain amendments may, however, fall outside the 2006 list, but fall within the new power of amendment. That may upset the balance that was struck in 2006 between provisions that required Privy Council oversight and those that did not.

4.106 Our intention is that the type of amendments that are permitted by the new amendment power would be suitable for all statutory and Royal Charter charities, regardless of their charitable purposes. But we can see that the special position of HEIs might justify separate tailored treatment.

4.107 If the new amendment power is not appropriate for HEIs, the Government and Privy Council could instead reconsider the 2006 list with a view to increasing the category of provisions that can be moved from statutes into ordinances. And as the 2006 list was drafted for Royal Charter universities (and the universities in Figure 7), a similar approach could be adopted for HECs, setting out the categories of provision that the Privy Council will permit to be moved from the

[73] The matters to be addressed in the articles of government are set out in s 125 of the Education Reform Act 1988.

[74] Education Reform Act 1988, s 125(5). The Privy Council can also direct an HEC to (a) amend its articles of government or (b) secure that any rules or bye-laws made in pursuance of the articles of government are amended by the board of governors in any manner so specified: Education Reform Act 1988, s 125(6) and (7).

[75] In those circumstances, for universities that have already overhauled their governing documents, the new amendment power would be of little practical use. For universities that have not overhauled their governing documents, the new amendment power would be helpful since amendments could be made immediately by the trustees, without having to obtain the Privy Council's consent to moving the provision from statutes into ordinances.

instrument and articles (which require Privy Council consent to amendment) into rules (which do not).

4.108 Alternatively, if the basic structure of the new amendment power would be helpful, the matters that fall within the power could be tailored for HEIs. The Secretary of State and Welsh Ministers[76] could be given power to make regulations setting out the matters that trustees can amend under the power without Privy Council consent.

4.109 We invite consultees' views as to whether, and if so how, the new amendment power should apply to HEIs. In addition, whether or not the new power applies to HEIs, some amendments would still fall to be made under the existing statutory procedures (namely the Education Reform Act 1988 for HECs and the various Acts set out in Figure 7 for those universities and colleges), and we therefore ask whether those procedures could be improved.

4.110 **We invite the views of consultees as to:**

(1) **whether the new amendment power should apply to higher education institutions without modification;**

(2) **whether the new amendment power should apply to higher education institutions in accordance with regulations made by the Secretary of State and Welsh Ministers setting out the provisions that can be amended without Privy Council oversight;**

(3) **whether, and if so how, the 2006 list for universities should be revised;**

(4) **whether, and if so how, that approach should be extended to higher education corporations;**

(5) **whether, and if so how, the amendment procedure for higher education corporations under the Education Reform Act 1988 could be improved; and**

(6) **whether, and if so how, the amendment procedures for the universities and colleges set out in Figure 7 could be improved.**

Other categories of charities established by statute or Royal Charter

4.111 We have discussed whether the new amendment power should apply to PCCs and HEIs. It might be that there are other categories of charities for which special provision should be made when creating any new power of amendment.

4.112 **We invite the views of consultees as to whether there are any other categories of charities established by statute or Royal Charter for which special provision should be made when creating any new amendment power.**

[76] Higher education is devolved to Wales: Government of Wales Act 2006, s 108 and Sch 7, Pt 1, para 5.

THE IMPACT OF REFORM

4.113 In assessing the desirability of and need for reform of the procedures for amending statutory and Royal Charter charities' governing documents, we would be assisted by hearing of consultees' experiences of the current procedures, including details of what the procedures involved, the time taken by the charity trustees and staff, and the costs involved.

4.114 **We invite consultees to share with us their experiences of amending statutory or Royal Charter charities' governing documents, in particular the work, time and expense that have been involved.**

CHAPTER 5
OTHER CHARITIES: CHANGING PURPOSES AND CY-PRÈS SCHEMES

INTRODUCTION

5.1 Having addressed amendments to the governing documents of statutory and Royal Charter charities, we now turn to amendments to other charities' governing documents. In this Chapter we consider charities' power to change their purposes and the power to make cy-près schemes.[1] In Chapter 6 we consider the amendment of other provisions in charities' governing documents.

5.2 Broadly speaking, charities have three ways to change their purposes.[2]

(1) *Express power*. Many unincorporated charities have an express power to change their purposes in their governing documents.[3]

(2) *Statutory power*. Charitable companies and CIOs can generally change their purposes by passing a resolution, provided they obtain the consent of the Charity Commission.[4] Unincorporated charities have a statutory power to amend their purposes under section 275 of the Charities Act 2011 if they have an income of £10,000 or less and do not hold designated land, and provided that the Charity Commission does not object.[5]

(3) *Cy-près scheme*. In the absence of an express power or a statutory power, charities can seek a cy-près scheme from the Charity Commission to change the charity's purposes.

5.3 In this Chapter, we consider two issues. First, are the statutory powers to change charities' purposes, and the restrictions on their doing so, satisfactory? Lord Hodgson recommended that the power under section 275 for unincorporated charities to amend their purposes should be made available to larger charities. He said the threshold should be raised to £25,000 to allow more charities to use the procedure and to reduce the number of schemes that have to be made by the Charity Commission.[6]

5.4 Second, should charity trustees be empowered to make cy-près schemes? As has been seen, the law governing cy-près schemes has been relaxed over time. It started as a narrow power exercisable by the courts and has become a broad

[1] We are here considering cy-près schemes that are made in respect of existing charities, rather than as part of the administration of wills: see paras 3.26 and 3.27 above.

[2] See paras 3.4 to 3.39 above.

[3] Charitable companies and CIOs do not generally have such an express power. If they do, they must obtain the Charity Commission's consent before exercising it as the amendment would be a "regulated alteration" under s 198 (charitable companies) or s 226 (CIOs) of the Charities Act 2011.

[4] See paras 3.4 and 3.5 above. The amendment would be a regulated alteration.

[5] See paras 3.11 to 3.14 above.

power exercisable both by the courts and (now principally) by the Charity Commission. Lord Hodgson recommended that "charities themselves should be able to apply property cy-près in most cases without the need for Charity Commission approval".[7]

5.5 The two issues are linked so we consider them together.

STATUTORY POWERS TO CHANGE, AND RESTRICTIONS ON CHANGING, CHARITIES' PURPOSES

Differences between incorporated and unincorporated charities

5.6 There are notable differences between the ability of charitable companies and CIOs to change their purposes when compared with unincorporated charities.

5.7 Unincorporated charities that change their purposes pursuant to an express power in their governing document need only satisfy the requirements set out in the governing document with respect to the exercise of that power. Companies and CIOs must, in addition to satisfying any requirements in their governing document, obtain the consent of the Charity Commission to the change since it falls within the definition of a "regulated alteration" under the Charities Act 2011.[8]

5.8 In the absence of an express power, companies and CIOs have wide powers to change their purposes by passing a resolution, provided they obtain the Commission's consent. By contrast, unincorporated charities can either:

(1) change their purposes under section 275 by notifying the Charity Commission, provided that:

(a) their income is less than £10,000;

(b) they do not hold designated land;

(c) they are satisfied that, so far as is reasonably practicable, one or more of the new purposes is "similar in character" to the original purposes; and

(d) the Charity Commission does not object; or

(2) if section 275 is not available, change their purposes by seeking a cy-près scheme from the Charity Commission.

5.9 In considering whether to give consent to companies and CIOs under sections 198 or 226, the Charity Commission asks three questions:[9]

(1) are the new objects exclusively charitable?

[6] Hodgson Report, Appendix A, para 26.

[7] Hodgson Report, Appendix A, para 3.

[8] Charities Act 2011, s 198 (charitable companies) and s 226 (CIOs).

[9] Charity Commission, *OG518 Alterations to Governing Documents: Charitable Companies* (May 2014) section B5.1.

(2) is the trustees' decision to make the change a rational one in the circumstances of the charity? and

(3) do the new objects undermine the previous objects?

5.10 Crucially, as long as the trustees provide a "convincing explanation as to why their proposed changes are in the charity's best interests", the amended purposes can be "significantly different from the existing objects".[10]

5.11 By contrast, section 275 is, in effect, a mini-cy-près regime, carved out from the general law of cy-près. It allows trustees of certain small charities to change their charity's purposes, broadly following cy-près principles. If the power cannot be exercised, the charity must instead seek a formal cy-près scheme.

5.12 Accordingly, companies and CIOs always require the Charity Commission's consent to an amendment, but significant changes can be permitted. By contrast, whilst unincorporated charities might only need to notify the Commission (under section 275),[11] there must generally be a similarity between the original purposes and at least one of the new purposes. In short, companies and CIOs always need consent but the test is easier to satisfy; unincorporated charities can sometimes just notify (rather than obtain consent) but the test is harder to satisfy.

Should the requirements for incorporated and unincorporated charities be aligned?

5.13 It is arguable that the powers and restrictions on changing purposes should be aligned, rather than distinguishing between incorporated and unincorporated charities. If the regime for one were applied to the other, it would be more relaxed in some respects but stricter in others. So, for example, if the regime for companies was applied to unincorporated charities, unincorporated charities would not have to satisfy the stricter tests regarding similarity of purposes, but they would not be able simply to notify the Commission of changes; they would require consent instead.

5.14 It is important to consider the position of existing charities and future charities separately. For charities created in the future we think that, in principle, the powers should be the same, regardless of whether they are incorporated or unincorporated. But any alignment of the powers of incorporated and unincorporated charities should not apply to existing charities. Governing documents are drafted against the backdrop of the legal rules that exist at the time of drafting. So a company's articles might have been "entrenched"[12] to restrict their amendment. Conversely, a trust deed might not include any

[10] Charity Commission, *OG518 Alterations to Governing Documents: Charitable Companies* (May 2014) section B5.1. The Commission will consider the following factors: (1) Taking into account modern social and economic conditions, do the proposals seem broadly consistent with what the charity was set up to do? (2) Have the trustees considered how the objects will be carried out? (3) Have the trustees taken into account the implications of the proposed change for the charity's members and beneficiaries? and (4) Have the consequences for the charity's beneficial class (future as well as current beneficiaries) been fully considered?: section B5.3.

[11] Subject to the right of the Charity Commission to object to the resolution.

[12] See para 3.4 above.

entrenchment provisions because that would have been unnecessary at the time. Indeed, it is possible that a particular legal structure has been chosen for the strict (or relaxed) rules concerning amendment that it entails. It would in our view be unacceptable to ignore this historical context and apply the amendment regime for incorporated charities to existing unincorporated charities, or *vice versa*.

5.15 If aligned amendment powers are not going to apply to charities already in existence, should they be aligned for charities established in the future? As already noted, in principle we think that they should. But that would create a dual regime for amendment, depending on when a charity was established. This would be unprecedented; no other provisions of the Charities Act 2011 treat charities differently depending on when they were established. The effects of such a dual regime should not be underestimated:

(1) having two regimes would add to the complexity of the law; and

(2) it would not be a minor inconvenience for a short transitional period; a dual regime would continue for so long as any existing charity continues to exist.[13]

5.16 New charities have the benefit of guidance from the Charity Commission as to the legal structure that they should choose and the amendment powers that exist in respect of those different legal structures.[14] They also have access to the Charity Commission's model governing documents, which reflect these differences. We would hope, therefore, that the governing documents of new charities are drafted carefully with these differences in mind.

5.17 The distinction between incorporated and unincorporated charities is long-standing, and the two regimes governing amendment generally cater for two different types of charity. Whilst a uniform amendment regime is an attractive concept, our provisional view is that its utility would be limited because it should not apply to charities already in existence.

5.18 Our analysis above applies equally to amendments to other provisions in charities' governing documents, and we discuss the differences between incorporated and unincorporated charities' powers to make such amendments in Chapter 6.

5.19 **We invite the views of consultees as to whether, and if so how, the powers to amend charities' purposes (and other provisions in their governing documents) should be aligned between incorporated and unincorporated charities established in the future.**

[13] Unless charities were forced to review their governing documents over a certain period so that the old procedures could be phased out. We are not minded to impose on charities the administrative (and legal) expense that this would involve.

[14] Charity Commission, *Charity types: how to choose a structure* (CC22a) (May 2014), and *Changing your charity's governing document* (CC36) (August 2011). We explain the different legal forms that a charity can take in paras 1.14 to 1.22 above.

Incorporated charities

5.20 We do not think that the procedure for incorporated charities to change their purposes should be relaxed any further. Arguably, if unincorporated charities with an income below £10,000 only have to notify the Charity Commission, so should charitable companies or CIOs with an income below £10,000. But notification by unincorporated charities can generally only be given if the trustees are satisfied that the new purposes are similar. No such requirement applies to companies and CIOs, so it remains appropriate for them to obtain Charity Commission consent.

Unincorporated charities

5.21 An unincorporated charity's purposes can be amended using the section 275 power. That power could be amended in various ways:

(1) The income threshold of £10,000 for charities to be able to use the section 275 power can be increased by secondary legislation.[15] Lord Hodgson suggested that it should be increased to £25,000. That would allow more charities to use the power. It may be considered appropriate to increase the income threshold.

(2) The power cannot be used if a charity holds designated land.[16] It is arguable that land deserves no greater degree of protection than other assets; why should a requirement that land be used for particular purposes preclude the section 275 power, but a requirement that other assets be used for particular purposes not do so?

(3) The requirement to notify the Charity Commission of a section 275 resolution, and the Commission's power to object to such a resolution, could be removed. This would simplify the procedure, but it would remove the oversight of the Commission which might be seen as a valuable safeguard.

(4) If a charity has a separate body of members, they are not required by section 275 to approve a resolution passed by the trustees to amend the charity's purposes. The members have an opportunity to make representations to the Charity Commission during the 60-day period, if they become aware of the trustees' resolution. This contrasts with the power to make administrative amendments to an unincorporated charity's governing document under section 280, which requires a resolution of both the trustees and (if separate) the members of the charity.[17] Section 275 could be reformed to incorporate a requirement that the members of the charity (if any) approve the trustees' resolution.

[15] Charities Act 2011, s 285.

[16] "Designated land" is "land held on trusts which stipulate that it is to be used for the purposes, or any particular purposes, of the charity": Charities Act 2011, s 275(1). When charity trustees wish to dispose of designated land, Part 7 of the Charities Act 2011 imposes additional requirements requiring publicity and consultation. We provisionally propose the repeal of those additional requirements in ch 8 below.

[17] Charities Act 2011, s 280(2), (3) and (4).

5.22 There are arguments against any extension of the section 275 power. Purposes are fundamental to a charity, and facilitating their amendment should be carefully scrutinised. If there are difficulties in achieving a charity's purposes, a Charity Commission cy-près scheme should be sought – with the oversight that that entails – regardless of the size of the charity. Indeed, the potential for the power to be used incorrectly is greater with small charities, since they are less likely to have access to legal advice.

5.23 Our provisional view is that section 275 should be extended to charities with a larger income and to charities with designated land. It incorporates safeguards to ensure that changes to a charity's purposes are similar to its original purposes (adopting, in simpler terms, the cy-près occasions). It can reduce costs for small charities that would otherwise have to obtain a cy-près scheme, which is a proportionate approach.[18]

EXTENDING THE POWER TO MAKE CY-PRÈS SCHEMES TO CHARITY TRUSTEES

5.24 Given the broad powers of companies and CIOs to amend their purposes, cy-près schemes are generally only made in respect of unincorporated charities. If charities (in particular, unincorporated charities) are to be given greater powers to amend their purposes, this could be done by:

(1) expanding the scope of section 275;

(2) conferring on charity trustees the power to make cy-près schemes; or

(3) a combination of both.

5.25 Lord Hodgson recommended that charity trustees be given the power to make cy-près schemes, but that would be unnecessary if a similar result were achieved by expanding the scope of section 275. As a statutory power to amend unincorporated charities' purposes already exists, we think that it would be appropriate to consider broadening that power, rather than to create a supplementary and overlapping power for charity trustees to make cy-près schemes. Moreover, the Charity Commission's role in making schemes is important and should be preserved.

5.26 The vast majority of cy-près schemes are uncontroversial, and the Charity Commission makes numerous schemes each year.[19] But cy-près schemes can be controversial, both within the charity and with third parties. It is sensible for the Charity Commission to be involved in resolving these issues, rather than the charity trustees.

5.27 The Charity Commission's expertise and experience in drafting schemes is helpful for charities. The preparation of schemes by trustees alone would be difficult and time consuming, and would be likely to require legal advice. The involvement of the Charity Commission also adds an important safeguard in the

[18] It has, however, been pointed out to us that it can be cheaper for small charities to obtain a cy-près scheme rather than obtain legal advice on the s 275 resolution procedure.

[19] The Commission publicises schemes that have been made recently, and draft schemes, on its website: http://apps.charitycommission.gov.uk/schemesdefault.aspx.

process of making cy-près schemes. It ensures that schemes are only made when cy-près occasions have arisen.

5.28 The extent, and value, of Charity Commission involvement in making cy-près schemes can be seen from a recent example of such a scheme.

Figure 8: case study – cy-près scheme made by the Charity Commission[20]

Brilley School Charity ("the School Charity") owned land in Brilley, Herefordshire, from which a school was run. The school closed in 2007 and the trustees of the School Charity wanted to dissolve the charity. The trustees wanted to transfer the land to the adjacent Brilley and Michaelchurch Village Hall ("the Hall Charity"), whose objects were to provide recreational facilities for local residents. The objects of the two charities were different, so the School Charity could not give the land to the Hall Charity.

The Charity Commission's involvement in the process ensured that there was proper consideration of:

(1) whether the legal test for a cy-près occasion had arisen;

(2) the arguments of the School Charity's trustees as to whether the land should be sold, or given to the Hall Charity;

(3) the extent to which the Hall Charity organised educational activities and its future plans for the recreational and educational use of the land;

(4) the extent and outcome of local consultation about the proposal that had been undertaken by the trustees; and

(5) the extent and outcome of consultation by the trustees with other bodies, including the Department of Education and the Diocesan Board of Finance.

The Charity Commission was satisfied that a scheme to carry the proposal into effect was appropriate. It drafted a scheme for both charities which (a) widened the Hall Charity's objects to include the advancement of education in the parish, and (b) transferred the land from the School Charity to the Hall Charity. After giving local public notice of the scheme, to which no objections were made, the scheme was brought into effect.

5.29 In general, we see the power to make cy-près schemes as one for the Charity Commission (or court) rather than charity trustees. The Commission can ensure that cy-près schemes are only made in appropriate cases following proper procedures.

5.30 We can, however, see merit in reducing the regulatory burden for small charities; given their resources and structures, a tailored statutory procedure could be preferable to having to apply for a cy-près scheme. We therefore see a place for section 275, and provisionally propose that the power should be extended to charities with a larger income, including those with designated land.

[20] This summary is taken from the Charity Commission's Operational Compliance Report, *Brilley School Charity and Brilley and Michaelchurch Village Hall* (October 2014), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/373282/ocr_brilley_school_charity_and_brilley_and_michaelchurch_village_hall.pdf.

5.31 In addition, we can see a potential lacuna under section 275 because it does not require a separate resolution of the members. Changes to a governing document under section 280 require the approval of the charity's members. Section 275 permits a far more significant amendment, namely a change to the charity's purposes. If members must approve amendments under section 280, arguably they should also approve a change of purposes under section 275 and the absence of such a requirement removes a valuable safeguard. Conversely, however, the fact that section 275 is only available to small unincorporated charities, whereas section 280 is available to all unincorporated charities, might justify an increased level of oversight under section 280. We invite consultees' views as to whether the additional safeguard of a members' resolution (as under section 280) should be introduced into the section 275 procedure.

5.32 **We provisionally propose that the power of unincorporated charities to amend their purposes under section 275 of the Charities Act 2011 should be extended to charities with a larger income.**

Do consultees agree?

5.33 **We invite the views of consultees as to the appropriate income threshold.**

5.34 **We provisionally propose that the power of unincorporated charities to amend their purposes under section 275 should be extended to charities that hold designated land.**

Do consultees agree?

5.35 **We invite the views of consultees as to whether trustees should continue to be required to notify the Charity Commission of a section 275 resolution and whether the Charity Commission should retain its power to object to the resolution.**

5.36 **We invite the views of consultees as to whether the power of unincorporated charities to amend their purposes under section 275 should be subject to a requirement that the members of the charity (if any) agree to the trustees' resolution.**

5.37 **We invite the views of consultees as to whether trustees should be given the power to make cy-près schemes in light of the availability of the section 275 power and the loss of Charity Commission oversight that would be involved.**

THE IMPACT OF REFORM

5.38 In assessing the desirability of and need for reform to section 275 and the power to make cy-près schemes, we would be assisted by hearing of consultees' experiences of the current procedures and any difficulties encountered, including details of what the procedures involved, the time taken by the charity trustees and staff, and the costs involved.

5.39 **We invite consultees to share with us their experiences of changing charities' purposes under section 275 of the Charities Act 2011 and under**

cy-près schemes, in particular the work, time and expense that have been involved.

CHAPTER 6
OTHER CHARITIES: AMENDING GOVERNING DOCUMENTS

INTRODUCTION

6.1 In this Chapter, we consider the power of charities which are not governed by statute or Royal Charter to amend their governing documents, excluding changes to their purposes. We focus on the statutory power of unincorporated charities to make administrative changes to their governing documents under section 280 of the Charities Act 2011. We have already considered whether the amendment powers should be aligned as between incorporated and unincorporated charities; our provisional view is that they should not: see paragraphs 5.13 to 5.19 above.

CHARITABLE COMPANIES AND CHARITABLE INCORPORATED ORGANISATIONS

6.2 Charitable companies and CIOs have broad statutory powers to make amendments to their governing documents.[1] The vast majority of amendments are not "regulated alterations" and so do not require the Charity Commission's consent. Our view is that the power of charitable companies and CIOs to make amendments to their governing documents is adequate, and we have not heard complaints that the powers are inadequate.

UNINCORPORATED CHARITIES

6.3 Unincorporated charities will often also have express powers of amendment. In the absence of an express power, they will be able to rely on the power in section 280 of the Charities Act 2011 to make certain amendments.[2] If a proposed amendment falls outside the scope of that power then they must instead seek an administrative scheme from the Charity Commission.[3]

Amendment of administrative provisions under section 280 of the Charities Act 2011

6.4 Section 280(2) of the Charities Act 2011 provides that:

> The charity trustees of [an unincorporated] charity may resolve for the purposes of this section that any provision of the trusts of the charity—
>
> (a) relating to any of the powers exercisable by the charity trustees in the administration of the charity, or
>
> (b) regulating the procedure to be followed in any respect in connection with its administration,

[1] See paras 3.4 and 3.5 above.

[2] See paras 3.16 to 3.18 above.

[3] See paras 3.20 and 3.36 above.

should be modified in such manner as is specified in the resolution.

6.5 We noted potential uncertainty as to the meaning of this wording in our first consultation paper in this project.[4] Our consideration of section 280 in the context of statutory and Royal Charter charities in paragraphs 4.47 to 4.52 above also led us to conclude that the scope of the power was uncertain. For example:

(1) Does a power to "modify" provisions permit trustees to add entirely new provisions concerning an issue on which the governing document was previously silent? The Charity Commission's view is that this is permitted by section 280, but that is not clear from the wording.[5]

(2) The meaning of the phrase "in the administration of the charity" is unclear. By permitting changes to the powers of the trustees "in the administration of the charity", section 280 could be reflecting the distinction between administrative powers and dispositive powers in trust law,[6] but it could have a wider meaning. The phrase is used throughout the Charities Act 2011. In the context of orders under section 105, the phrase has been described as "very broad".[7]

Is section 280 too wide?

6.6 The Charity Commission's view is that section 280 cannot be used to make amendments to:

(1) the charity's objects;

(2) the purposes for which the charity's property must be used on dissolution;

(3) provisions for land to be held by the Official Custodian;[8]

(4) provisions permitting trustees to receive any benefits, save for reasonable out-of-pocket expenses;

4 Social Investment by Charities (2014) Law Commission Consultation Paper No 216, p 31 n 56.

5 Charity Commission, *OG519 Unincorporated Charities: Changes to Governing Documents and Transfer of Property (Charities Act sections 268, 275 and 280)* (February 2014) section E5.1. Compare Charity Law Association Working Party, *Response to the Charity Commission's letter on whether charities can create permanent endowment from their expendable assets* (January 2014) para 40 noting the converse argument (available at http://charitylawassociation.org.uk/api/attachment/528?_output=binary).

6 L Tucker, N Le Poidevin QC and J Brightwell, *Lewin on Trusts* (19th ed 2014) chs 29 to 36. Dispositive powers are the powers for the trustees to distribute trust property for the purposes of the trust (in the case of a purpose trust).

7 *Seray-Wurie v Charity Commissioners for England and Wales* [2006] EWHC 3181 (Ch), [2007] 1 WLR 3242, [29], by David Richards J. The Charity Commission also considers it to have a wide scope: see Charity Commission Operational Guidance, *OG545-1 Identifying and Spending Permanent Endowment* (December 2012) section E1.2.

8 The Official Custodian can hold legal title to land for charities; see generally ss 90 and 91 of the Charities Act 2011 and Charity Commission, *The Official Custodian for Charities' Land Holding Service* (CC13) (September 2004), available at http://forms.charitycommission.gov.uk/media/93851/cc13text.pdf.

(5) the trustees' powers to spend permanent endowment;[9] and

(6) any existing powers of amendment, so as to permit changes that could not themselves be made under section 280.[10]

6.7 We are not convinced that all such amendments are necessarily excluded by the wording of section 280; it is arguable that amendments (4), (5) and (6) would be permitted. For example, modifying a power so as to permit the trustees to authorise payments to themselves, or conferring a power to spend permanent endowment, arguably relates to "the powers exercisable by the charity trustees in the administration of the charity" under section 280.[11]

6.8 So, whilst we agree with the Charity Commission that amendments (1), (2), (4) and (6) ought not to fall within the section 280 power,[12] that result is not necessarily achieved by the current wording.[13]

Is section 280 too narrow?

6.9 As well as potentially permitting inappropriate amendments, section 280 may not be broad enough to permit some appropriate amendments. Taking the amendments considered in the context of statutory and Royal Charter charities in paragraph 4.51 above, it is arguable that amendments to the following provisions would not – but should – fall within the section 280 power:

(1) a power for a third party to appoint charity trustees (where the third party has ceased to exist or consented to the change);

(2) the conditions that charity trustees must satisfy for appointment, such as area of residence, beliefs, or age;

(3) accounting and reporting requirements; and

9 We explain the meaning of permanent endowment in para 9.9 and following below.

10 Charity Commission, *OG519 Unincorporated Charities: Changes to Governing Documents and Transfer of Property (Charities Act sections 268, 275 and 280* (February 2014) section E5.1. That is consistent with the Charity Commission's model trust deed, cl 31 of which permits the trustees to amend any provision of the trust deed, except for provisions concerning these listed matters.

11 The Charity Commission is empowered to appoint an interim manager if it is satisfied that there has been misconduct or mismanagement "in the administration of the charity": Charities Act 2011, s 76(1)(a). That power can be exercised in numerous circumstances when the Charity Commission has concerns about the actions of the charity trustees in performing their functions. If charity trustees exercised a power of amendment to confer a benefit on themselves, and the Charity Commission had cause for concern, we would expect this conduct potentially to fall within s 76 as being "in the administration of the charity"; it is therefore arguable that that amendment would have fallen within s 280 as being "in the administration of the charity". The only difference in the wording is that s 280 refers to *powers exercisable by the trustees* in the administration of the charity, but arguably conferring benefits on trustees does concern a power exercisable by the trustees.

12 We discuss (5) – the expenditure of permanent endowment – in ch 9 below; it might be that this should fall outside the s 280 power because the Act makes express provision for the expenditure of permanent endowment in s 281 and following. We do not agree that provisions concerning land being held by the Official Custodian are so significant that they should not be amended by the trustees.

13 See also F Quint, "Quis Custodiet? The use of a Protector in a charity context" [2013] *Private Client Business* 334, 334 to 335, commenting on the broad scope of s 280.

(4) the criteria for charity membership.

Inconsistency between incorporated and unincorporated charities

6.10 Section 198 of the Charities Act 2011 sets out the particular amendments to charitable companies' articles and CIOs' constitutions that are "regulated alterations" and require Charity Commission consent. It might be expected that amendments that cannot be made by unincorporated charities under section 280 would also be "regulated alterations" if they were made by charitable companies or CIOs.[14] But that is not the case; an amendment might not be permitted by section 280 (and therefore require the Charity Commission's consent under an administrative scheme), yet the same amendment would not be a "regulated alteration" (and could therefore be made by a charitable company without consent).

6.11 Taking the amendments in paragraph 6.6 above that, in the Charity Commission's view, fall outside section 280, amendments (1), (2) and (4) would be "regulated alterations" and require Charity Commission consent if the charity were a company or CIO. But amendments (3) and (6) would not require Charity Commission consent if the charity were a company or CIO. Conversely, amendment (4) would be a regulated alteration for companies and CIOs (requiring Charity Commission consent), but it is arguable that it would be permitted under section 280 (without Charity Commission consent).

6.12 So whilst there is some overlap between permitted amendments under section 280 and non-regulated alterations under section 198, the two regimes are not entirely consistent.

Conclusion

6.13 Section 280 performs a difficult task, since it is impossible to identify and categorise every conceivable provision that might be found in charities' governing documents. Accordingly, a list of permitted amendments would be incomplete, but a general description (such as that currently in section 280) might be too wide or too narrow. Similarly, a list of excluded amendments (as with regulated alterations) might be incomplete, but a general description too wide or too narrow.

6.14 Lord Hodgson did not report hearing that section 280 caused problems in practice. In light of the discussion above, however, section 280 might benefit from reform to clarify its scope.

6.15 **We invite the views of consultees as to whether the power to make administrative amendments to unincorporated charities' governing documents under section 280 of the Charities Act 2011 is helpful and whether its scope is sufficiently clear.**

6.16 **We invite the views of consultees as to the types of provision that should be included within, or excluded from, the section 280 amendment power.**

[14] See para 3.5 above.

THE IMPACT OF REFORM

6.17 In assessing the desirability of and need for reform to section 280, we would be assisted by hearing of consultees' experiences of the current procedure and any difficulties that they have encountered, including details of the time taken by the charity trustees and staff, and the costs involved.

6.18 **We invite consultees to share with us their experiences of amending administrative provisions under section 280 of the Charities Act 2011, in particular the work, time and expense that have been involved.**

CHAPTER 7
CY-PRÈS SCHEMES AND THE PROCEEDS OF FUNDRAISING APPEALS

INTRODUCTION

7.1 Charities often undertake fundraising appeals for a particular purpose, for example, to fund repairs to the charity's land, to purchase an item of equipment, or to assist the victims of a natural disaster. It can be difficult to predict how much money will be needed for the purpose, and even harder to estimate how much will be raised by the appeal. Sometimes, that will not matter; the money raised by the appeal can be applied to the particular purpose and what the charity can do will depend on the amount raised. But where a broadly predictable sum is required (for example, to rebuild a church hall), the appeal may not raise enough money, or it may raise more than is needed. We refer to appeals that do not raise enough money as failed appeals, and appeals which raise more than is needed as surplus cases.

7.2 Both kinds of fund can, in some circumstances, be applied to other purposes under a cy-près scheme. Lord Hodgson recommended that "proceeds of a failed appeal should be applied for the charity's general purposes unless the donor expressly requests otherwise…".[1] This Chapter arises from that recommendation.

7.3 In this Chapter, we summarise the current law before considering whether the situations in which funds can be applied cy-près should be changed, and whether trustees should be given the power to apply the funds cy-près without requiring a Charity Commission scheme. We conclude by asking consultees about the likely impact of reform.

THE CURRENT LAW

Surplus funds

7.4 When an appeal raises more money than is needed, it is generally accepted that this is a case of subsequent failure of the particular charitable purpose as regards the surplus.[2] As long as the donation was an outright gift,[3] there is no need for

[1] Hodgson Report, Appendix A, para 4.

[2] Charity Commission, *OG53 A1 Charitable appeals: avoiding and dealing with failure* (November 2014) para 1.4. This is the view expressed in H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 505 to 506, though the author also suggests that a surplus arising from a written instrument of gift, as opposed to a fundraising appeal, is an initial failure and a general charitable intention is required: p 493. The authors of *Tudor on Charities* prefer the view that all gifts leaving a surplus are cases of subsequent failure, and that a cy-près scheme can be made if there has been an outright gift: J Warburton, *Tudor on Charities* (9th ed 2003) paras 11-056 to 11-058 and 11-034 to 11-043.

[3] That is, there were no conditions attached to the gift; see J Warburton, *Tudor on Charities* (9th ed 2003) paras 11-051 to 11-058; compare H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 462 to 465, 471 to 472 and 505, where the author questions whether even an outright gift is necessary.

the donors to have had a general charitable intention for the surplus funds to be applicable cy-près.[4]

7.5 The Charity Commission can make a cy-près scheme in the circumstances set out in section 62 of the Charities Act 2011 directing that the surplus funds be used for other charitable purposes.[5]

Failed appeals

7.6 When insufficient funds are raised to carry out a particular purpose, it is generally considered to be a case of initial failure.[6] Depending on the terms of the fundraising literature, it may be possible to find a general charitable intention on the part of the donors, in which case a cy-près scheme can be made. But, generally, when a donation has been made to a particular appeal, there will be no general charitable intention on the part of donors.

Identifiable donors

7.7 Historically, where donations were made by identifiable donors without a general charitable intention, a cy-près scheme could not be made in respect of those donations. Instead, the charity trustees held the funds on resulting trust for the donors and had to return the funds to them.[7] If the donors could not be found, the money had to be paid into court.[8]

7.8 Special provision was made by the Charities Act 1960 for the Charity Commission to make cy-près schemes in these circumstances if the charity trustees had reasonably attempted, but failed, to find the donors to offer them a refund.[9]

Unidentifiable donors

7.9 The historical treatment of donations from unidentifiable donors was more difficult. It was unclear whether a general charitable intention ought to be imputed to unidentifiable donors, and hence whether a cy-près scheme could be made.[10]

7.10 The Charities Act 1960 provided that proceeds of cash collections and money raised from lotteries and competitions were presumed to be given by donors who

[4] See para 3.25 and following above for the meaning of "subsequent failure", and para 3.30 and following for the meaning of "general charitable intention".

[5] See para 3.28 above.

[6] Charity Commission, *OG53 A1 Charitable appeals: avoiding and dealing with failure* (November 2014) section 1.4; J Warburton, *Tudor on Charities* (9th ed 2003) para 11-038; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 497 to 498.

[7] *Re Ulverston and District New Hospital Building Trusts* [1956] Ch 622; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) p 498.

[8] Under s 63 of the Trustee Act 1925.

[9] Charities Act 1960, s 14(1).

[10] *Re Hillier's Trusts* [1954] 1 WLR 700; *Re Ulverston and District New Hospital Building Trusts* [1956] Ch 622, 637 to 641; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 498 to 500; J Warburton, *Tudor on Charities* (9th ed 2003) para 11-041.

cannot be identified.[11] Those donations could therefore be subject to cy-près schemes in the same way as cy-près schemes could be made in respect of proceeds from identifiable donors who cannot be found.[12] The authors of *Tudor on Charities* describe this as "in effect, a statutory presumption that unidentified donors have a general charitable intention".[13]

Avoiding the difficulties of failed appeals

7.11 The difficulties faced by charities when appeals fail arise from the fact that gifts are given for a specific charitable purpose. The Charity Commission recommends that charity trustees should consider phrasing their fundraising literature in such a way that would prevent the initiative from being limited to a specific charitable purpose.[14] The example given by the Charity Commission is a fundraising appeal stating:

> We are raising funds to buy a scanner for the hospital. If for any reason we can't buy the scanner, or there are surplus funds left over following the purchase of the scanner, we will use the money to buy other equipment that the hospital could not otherwise have.[15]

7.12 If insufficient funds are raised for a scanner, the charity trustees will be able to use the funds for the other specified purposes (the purchase of other equipment) without having to contact donors or obtain a cy-près scheme. The terms of the fundraising appeal could even state that in the event that the primary purpose (here the purchase of the scanner) fails, the trustees will be able to use the money raised to support the charity's work generally.

The current regime

7.13 If a fundraising appeal informs donors that the funds will be used for other purposes in the event that the principal purpose cannot be achieved, the charity trustees are free to use the funds for those other purposes. Otherwise, the situation is one where funds have been donated for a specific charitable purpose which has failed and so the charity trustees must invoke the provisions of sections 63 to 66 of the Charities Act 2011 and, where relevant, comply with the detailed requirement set out in the Charities (Failed Appeals) Regulations 2008 ("the 2008 Regulations").[16]

7.14 The Charities Act 2011 provides that the purpose of an appeal fails if any difficulty in applying the proceeds of the appeal to that purpose makes them available to be returned to the donors.[17] Sections 63 to 66 of the Charities Act

[11] Charities Act 1960, s 14(2).

[12] Charities Act 1960, s 14(1).

[13] J Warburton, *Tudor on Charities* (9th ed 2003) para 11-041.

[14] Charity Commission, *OG53 A1 Charitable appeals: avoiding and dealing with failure* (November 2014) section 1.2.

[15] Charity Commission, *OG53 A1 Charitable appeals: avoiding and dealing with failure* (November 2014) section 1.2.

[16] The 2008 Regulations were made by the Charity Commission under the powers conferred on it by ss 14(8) and (9) and 14A(9) of the Charities Act 1993.

[17] Charities Act 2011, s 66(1).

2011 permit the Charity Commission to make a cy-près scheme in relation to the proceeds of a failed appeal in any of five situations.

(1) DONORS WHO CANNOT BE IDENTIFIED OR FOUND

7.15 First, a cy-près scheme can be made in respect of funds given by a donor who cannot be identified, or cannot be found, after certain advertisements are published and inquiries are made.[18]

7.16 Advertisements must be in the form set out in Schedule 1 to the 2008 Regulations and must be published in a newspaper or periodical which is sold or distributed throughout the area in which the appeal was made. Where the appeal was for the benefit of an area within a local authority district or London Borough, the advertisement must be affixed to two public notice boards in the area.

7.17 Inquiries must be sent by post to each donor recorded in the trustees' records and must contain specified information, including a warning that failure to respond within three months may result in the donation being applied cy-près.

7.18 If a donor has not responded to the advertisements and inquiries within three months, a cy-près scheme may be made.[19] If a donor makes a claim within six months of the date of the scheme for the return of his or her donation, the trustees must repay the donation to the donor, less any expenses incurred by the trustees after the date of the scheme in administering the claim.[20] After six months, the donor loses any entitlement to repayment.

(2) DONORS DISCLAIMING

7.19 Second, a cy-près scheme can be made in respect of funds given by donors who have disclaimed their right to have the funds returned using the prescribed form.[21]

(3) DONORS TREATED AS DISCLAIMING

7.20 Third, a cy-près scheme can be made in respect of funds given by a donor where the donor is treated as having disclaimed any right to the return of the donation.[22] This applies where:

(1) the appeal or request informs donors that their donations will be applied for similar charitable purposes in the event that the specific purposes fail; and

[18] Charities Act 2011, s 63(1)(a). The detailed requirements for advertisements and inquiries are set out in the 2008 Regulations, regs 3 to 8 and Schs 1 to 3.

[19] Charities Act 2011, s 63(2); 2008 Regulations, reg 7.

[20] Charities Act 2011, s 63(4) to (5). If the total sum set aside to meet such claims is insufficient, the Charity Commission may direct that the donors shall receive a proportionate share of that fund: s 63(6) to (7).

[21] Charities Act 2011, s 63(1)(b). The form of the disclaimer is prescribed by the 2008 Regulations, reg 8 and Sch 4.

[22] Charities Act 2011, s 65(1) to (3) and (7). The provision was introduced by the Charities Act 2006, s 17, inserting s 14A of the Charities Act 1993.

(2) the donor does not make a written declaration at the time of making the donation that, in the event that the specific purposes fail, he or she wishes the charity trustees to give him or her the opportunity to request the return of the donation.

7.21 If the donor does make such a declaration, then a cy-près scheme can still be made if:

(1) the charity trustees have written to the donor[23] notifying him or her that the specific purposes have failed, enquiring whether the donor wishes to request the return of the donation, and advising the donor that he or she has three months to make such a request failing which a cy-près scheme may be made; and

(2) the donor has not been found or does not request the return of the donation within three months.[24]

(4) CASH COLLECTIONS AND THE PROCEEDS OF CERTAIN FUNDRAISING ACTIVITIES

7.22 Fourth, a cy-près scheme can be made in respect of funds given by a donor through (a) a cash collection, either by means of a collecting box or by other means "not adapted for distinguishing one gift from another", or (b) "the proceeds of any lottery, competition, entertainment, sale or similar money-raising activity".[25]

(5) RETURN OF THE DONATIONS WOULD BE UNREASONABLE

7.23 Fifth, a cy-près scheme can be made in respect of funds given by a donor where the court or Charity Commission[26] considers:

(1) that it would be unreasonable, having regard to the amounts likely to be returned to the donors, to incur expense with a view to returning the property; or

(2) that it would be unreasonable, having regard to the nature, circumstances and amounts of the gifts, and to the lapse of time since the gifts were made, for the donors to expect the property to be returned.[27]

7.24 In its guidance, the Charity Commission states that, if the total funds raised were less than £1,000 and all came from unidentifiable donors, the Commission "may

[23] The trustees are required to maintain a written record of donors' declarations and of their addresses, including any change of address notified to them by donors: 2008 Regulations, regs 9 and 10.

[24] Charities Act 2011, s 65(4) to (6); 2008 Regulations, regs 11 to 13.

[25] Charities Act 2011, s 64(1).

[26] Originally, such an order could only be made by the court. The power was extended to the Charity Commission by the Charities Act 2006, s 16, which amended Charities Act 1993, s 14(4). See now Charities Act 2011, s 64(2).

[27] Charities Act 2011, s 64(2).

decide that the trustees can automatically apply the funds for purposes similar to those of the original appeal, without any legal authority from us".[28]

ANALYSIS

7.25 Failed appeals concern initial failure, so at common law the funds could not be applied cy-près unless the donors had a general charitable intention. Sections 63 to 66 relax that position by setting out circumstances in which funds from failed appeals can be applied cy-près, despite the absence of a general charitable intention.[29]

7.26 Our consideration of failed appeals raises three issues.

(1) Should the precondition to a cy-près scheme, namely the requirement for a general charitable intention, be removed in respect of failed appeals? That would remove with it the need for sections 63 to 66.

(2) If not, can the procedures under sections 63 to 66 be improved?

(3) If a cy-près scheme can be made (either because the requirement for a general charitable intention is removed, or because the sections 63 to 66 conditions have been satisfied), should the trustees be permitted to apply the funds cy-près without the involvement of the Charity Commission?

7.27 Issues (1) and (2) do not arise in relation to surplus cases since there is no requirement for there to be a general charitable intention on the part of the donors;[30] the sections 63 to 66 procedures are therefore unnecessary. Surplus cases do, however, raise Issue (3): should trustees have the power to apply the surplus cy-près without the involvement of the Charity Commission?

National Health Service charities

7.28 The National Health Service Act 2006 makes special provision for National Health Service ("NHS") charities. In the case of failed appeals, the trustees are permitted to apply the proceeds to other similar purposes of the charity.[31] A similar power exists in respect of surplus funds.[32]

7.29 In summary, therefore:

(1) for failed appeals:

(a) the requirement for a general charitable intention is overridden ("issue (1)"),

[28] Charity Commission, *OG53 A1 Charitable appeals: avoiding and dealing with failure* (November 2014) section 2.4(d).

[29] See para 7.6 and following above.

[30] See paras 7.4 and 7.5 above.

[31] National Health Service Act 2006, s 222(10).

[32] National Health Service Act 2006, s 222(7). When exercising these powers the trustees must have regard to the desirability of applying the funds for a purpose similar to that for which they were given: s 222(11).

(b) there is no need to use the sections 63 to 66 procedures ("issue (2)"), and

(c) the trustees can decide how the funds are to be used without the Charity Commission's involvement ("issue (3)").

(2) for surplus cases:

(a) issues (1) and (2) would not arise; but

(b) the trustees can decide how the funds are to be used without the Charity Commission's involvement (issue (3)).

The difficulties with the sections 63 to 66 procedures

7.30 The Charity Commission recommends that, as a matter of good practice, fundraising literature should be carefully drafted and should set out secondary purposes, in order to avoid the risk of the appeal failing and having to invoke the sections 63 to 66 procedures. We endorse that approach. If it is followed, it would be unusual for trustees to have to rely on sections 63 to 66.

7.31 Some aspects of the sections 63 to 66 procedures are helpful and easy to operate. The provisions concerning collection boxes (and similar proceeds) are helpful since they automatically provide for the funds to be applicable cy-près. So too are the provisions allowing the Charity Commission to dispense with the advertisement and inquiry processes on the basis that it would be disproportionate, unnecessary or unreasonable. But the first default procedure – requiring advertisements and inquiries, then offering refunds – is cumbersome. The remaining two procedures requiring a disclaimer or declaration from donors appear to be unrealistic; we expect that they are rarely, if ever, used.

Issue (1): failed appeals – the requirement for a general charitable intention

7.32 In light of the difficulties with the sections 63 to 66 procedures, it is arguable that the requirement, in the case of failed appeals, for a general charitable intention should be removed. There would then be no need for trustees to follow the sections 63 to 66 procedures. That would allow the proceeds of failed appeals to be applied cy-près more easily.

7.33 The requirement for a general charitable intention, however, applies in all cases of initial failure of a charitable gift, whether it is the proceeds of a failed fundraising appeal or the administration of a gift by will. The law relating to general charitable intention has evolved over time to reflect, and protect, donor autonomy. We have not heard criticisms of the legal principle. Nor do we think that the requirement for a general charitable intention should be removed for one instance of initial failure (failed fundraising appeals) but retained for other instances of initial failure (such as gifts by will which are impossible).

7.34 If funds have been donated to a particular appeal, it is important to respect the donors' wishes. Subject to the points of detail that we discuss below, we think that the circumstances in which the requirement for a general charitable intention can be overridden under sections 63 to 66 strike a fair balance between donor autonomy and ensuring effective use of charitable funds. The power of the

Charity Commission to dispense with the advertisement and inquiry procedure is particularly important;[33] it allows the Charity Commission to consider, on a case-by-case basis, whether the absence of a general charitable intention should be ignored.

7.35 Whilst the requirement for a general charitable intention has been overridden in respect of failed appeals by NHS charities, our provisional view is that this special treatment should not be extended to all charities.

7.36 Having said that, there might be scope for deregulation – similarly to NHS charities – in relation to small funds or small donations. If an appeal fails, and only a small amount (say £1,000 or £5,000) has been raised, statute could provide that that fund is applicable cy-près, despite the absence of a general charitable intention, and without the need to follow the procedures in sections 63 to 66. Similarly, if an appeal fails and small donations have been made by individual donors (say £100 or £500), statute could provide that those donations are applicable cy-près, despite the absence of a general charitable intention. Arguably, donors' wishes should be protected in the same way regardless of the size of the fund or the size of their donations. But when the fund or donation is small, the costs of administering it in accordance with the sections 63 to 66 procedures will often be disproportionate, and donors of small amounts are perhaps less likely to object to their donations being used for different purposes than donors of large sums.

7.37 Whilst the same result can often already be achieved by seeking an order from the Charity Commission,[34] a tailored statutory procedure for applying small funds and small donations to similar purposes might be attractive to trustees. If small funds and small donations are to be released from the requirement for a general charitable intention, we consider below whether the Charity Commission should nevertheless be required to make the cy-près scheme directing the fund to other purposes.

7.38 **We invite the views of consultees as to whether the requirement for a general charitable intention, as a precondition for a cy-près scheme in respect of the proceeds of a failed appeal, should be removed:**

(1) **generally; or**

(2) **in respect of small funds or small donations and, if so, what size of fund or donation.**

Issue (2): failed appeals – the sections 63 to 66 procedures

7.39 We set out some difficulties with the sections 63 to 66 procedures above.[35]

[33] See para 7.23 above.

[34] See para 7.23 above.

[35] See para 7.31 above.

Advertisement and inquiry

7.40 The advertisement and inquiry procedure could be seen as cumbersome. Under the original regime in the Charities Act 1960, the steps to be taken were not set out in statute. That led to an application for directions in *Re Henry Wood National Memorial Trust*[36] in which the Judge directed that reasonable steps in that case required adverts to be placed in two editions of each of three national newspapers, as well as notices being sent to the recorded addresses of donors. The requirements in the 2008 Regulations are less onerous. Other jurisdictions only require the trustees to take reasonable steps to contact donors, as under the Charities Act 1960, rather than setting out detailed requirements in secondary legislation.[37]

7.41 It would be possible to revert to a regime that does not prescribe the detailed steps to be taken. Trustees could be given guidance by the Charity Commission as to the steps that it considers to be reasonable. The Charity Commission would then decide whether reasonable steps had been taken before it would make a cy-près scheme.

7.42 Alternatively, the requirement to advertise (in a newspaper and on public notice boards) could be removed, leaving only a requirement to make inquiries of recorded donors.

Disclaimer and declarations

7.43 The disclaimer procedure requires the donor actively to waive his or her right to have a donation returned. The declaration procedure requires the donor actively to request the return of the donation. We think that neither is likely to be used in practice, particularly in light of the administrative costs to the charity of obtaining and recording the documentation. If trustees are aware of these procedures, they are likely at the same time to discover the Charity Commission's recommended practice concerning the drafting of fundraising literature. If they follow that practice, neither process is likely to be necessary. We do not know whether these procedures are used in practice, but if they are not then they should be removed.

7.44 **We invite the views of consultees as to whether the procedures governing the distribution of the proceeds of failed appeals under sections 63 to 66 of the Charities Act 2011 could be improved, and in particular whether:**

(1) **the advertisement and inquiry procedure could be simplified; and**

(2) **the disclaimer and declaration procedures remain of use.**

Issue (3): failed appeals and surplus funds – Charity Commission involvement

7.45 Just as the trustees of NHS charities are empowered to decide how proceeds of failed appeals, and surplus proceeds, can be applied, it is arguable that trustees of all charities ought similarly to be permitted to do so (once a cy-près scheme becomes available, on which see issues (1) and (2) above).

[36] [1966] 1 WLR 1601.

7.46 We have already discussed the merits of removing the Charity Commission's involvement in the process of making cy-près schemes.[38] Our provisional view is that, in general, cy-près schemes should continue to be made by the Charity Commission. That view applies equally to cy-près schemes in respect of the proceeds of failed appeals and surplus funds. We do, however, see the advantage of the similar power in section 275 of the Charities Act 2011 which can be operated by small charities; the Charity Commission is simply notified of the resolution and has a power to object.[39]

Failed appeals: small funds

7.47 In paragraph 7.36 above, we suggested that the need for a general charitable intention could be removed (and therefore a cy-près scheme could be made without having to follow the sections 63 to 66 procedures) for the proceeds of failed appeals where the value of the fund or the donations is small. If that approach were followed, we think that the trustees should have the power to redirect the funds to different charitable purposes without the involvement of the Charity Commission.[40] Statute would have to provide trustees with a clear framework for the exercise of the power,[41] to ensure that funds were redirected in accordance with cy-près principles.

Small surplus funds

7.48 In cases where an appeal generates a small surplus, the trustees could be given a similar power to redirect the surplus to different charitable purposes in accordance with cy-près principles but without requiring the Charity Commission's involvement.

7.49 **We invite the view of consultees as to whether trustees should be given the power – in place of the Charity Commission – to apply small funds or small donations (from a failed appeal or a surplus case) cy-près, and the size of fund or donation for which the power should be available.**

7.50 **We invite the views of consultees as to whether trustees should be given any broader power – in place of the Charity Commission – to apply funds (from a failed appeal or a surplus case) cy-près.**

[37] See H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 502 to 503, discussing the positions in the Republic of Ireland, Northern Ireland and Singapore.

[38] See paras 5.24 to 5.29 above.

[39] See paras 3.11 to 3.14 and ch 5 above.

[40] If no exception is made for small funds and donations then our view is that trustees should not have this power. Trustees would be required to comply with ss 63 to 66 before property was applicable cy-près, and the involvement of the Charity Commission in making a cy-près scheme would continue to ensure that the ss 63 to 66 procedures have been properly followed.

[41] See, for example, s 275(4) of the Charities Act 2011 (see para 3.12 above), and s 222(11) of the National Health Service Act 2006 (see para 7.28 above).

THE IMPACT OF REFORM

7.51 In assessing the desirability of reform, we would be assisted by hearing of consultees' experiences of administering the proceeds of failed fundraising appeals including details of the time taken by the trustees and staff, and the costs involved.

7.52 **We invite consultees to share with us their experiences of administering the proceeds of failed fundraising appeals, including the procedures under sections 63 to 66 of the Charities Act 2011, in particular the work, time and expense that have been involved.**

PART 3

REGULATING CHARITY LAND TRANSACTIONS AND THE USE OF PERMANENT ENDOWMENT

CHAPTER 8
ACQUISITIONS, DISPOSALS AND MORTGAGES OF CHARITY LAND

INTRODUCTION

8.1 In this Chapter we consider the restrictions on charity trustees disposing of, or granting mortgages over, charity land. By "charity land", we mean any land in England or Wales which is held by, or on trust for, a charity.[1] The regime is generally considered to be complex and burdensome for charities, although it is in fact the result of deregulation over time. We start by articulating the concepts of powers and restrictions; we then look briefly at the historical background to transactions involving charity land before explaining the current regime. We describe and discuss the current regime and make provisional proposals for its reform. We then note briefly the provisions of the current law that protect purchasers from the risk of transactions being void or voidable as a result of the current law; the extent to which those protections would be needed following reform would depend upon the substance of reform. We consider the special position of charities governed by the University and College Estates Acts. Finally, we ask consultees about the likely impact of reform.

POWERS AND RESTRICTIONS

8.2 In looking at the ability of charity trustees to acquire and dispose of land, we have to distinguish between trustees' powers to do so – without which, attempts to buy, sell or otherwise deal with land would be void – and restrictions upon the exercise of those powers. Such restrictions may be in the trust deed,[2] articles of association or other governing document of the charity, and are therefore particular to that charity; or they may be in statute and therefore of general application. Absent those restrictions, all dealings that are within the trustees' powers would be valid.[3] Where there are restrictions, failure to comply with them may – depending on their construction – make a purported disposition void or voidable, or it may have no effect at all upon the validity of the disposition but may make the trustees liable for breach of trust.[4] If a disposition is void, it is of no effect. If it is voidable, it takes effect unless and until it is set aside, also known as being "avoided".

[1] Charities Act 2011, ss 117(1), 124(1) and 129(1). The definition therefore includes, for example, land owned beneficially by a charitable company, as well as land held on trust by the trustees of an unincorporated charity.

[2] The power of trustees (in the strict sense) to dispose of land under s 6(1) of the Trusts of Land and Appointment of Trustees Act 1996 cannot be restricted by the trust deed in the case of charitable trusts: s 8(1) and (3). It can, however, be made subject to a condition that the trustees obtain consent to a disposition: s 8(2).

[3] Unless vitiated by anything within the general law, such as fraud or mistake.

[4] See Fiduciary Duties of Investment Intermediaries (2013) Law Com Consultation Paper No 215, ch 6; *Donaldson v Smith* [2006] EWHC 1290 (Ch), [2007] WTLR 421, [54] and [55]; J McGhee, *Snell's Equity* (33rd ed 2014) ch 10; Companies Act 2006, ss 39 to 42 (charitable companies); *Rosemary Simmons Memorial Housing Association Ltd v United Dominions Trust Ltd* [1986] 1 WLR 1440 (industrial and provident societies).

8.3 However, restrictions may cut back those general powers by defining their scope. They may be particular to the charity or they may be statutory. The evolution of statutory restrictions is interesting and we present a brief account here as an aid to understanding the present position.

THE HISTORICAL BACKGROUND[5]

8.4 Case law before the middle of the nineteenth century demonstrated a developing jurisprudence about charity trustees' powers to dispose of land and restrictions on those powers. The position that evolved was summarised in *Bayoumi v Women's Total Abstinence Educational Union Ltd*:

> Subject to the terms on which the land had been conveyed to them, charitable corporations and charity trustees had power to sell, lease or mortgage charity land. But the transaction was liable to be set aside in equity unless it was shown to be beneficial to the charity.[6]

8.5 From 1855 onwards the position was made clearer by statute. The Charitable Trusts Amendment Act 1855 prohibited charity trustees from disposing of land that formed part of the charity's endowment without the consent of Parliament, the court or the Charity Commissioners.[7] The restriction was introduced owing to concerns about trustees entering into land transactions that were not in the charity's interests.[8]

8.6 The restriction imposed by the 1855 Act remained unchanged for over a century. The Charities Act 1960 modified it so that it applied only to "permanent endowment" and "functional land", rather than to the entirety of a charity's endowment.[9] As a result, the requirement to obtain consent from the court or Charity Commission no longer applied to the disposal of land which had been purchased using expendable funds and which was not occupied by the charity. Accordingly, the 1960 Act was a relatively modest relaxation of the 1855 Act restriction.

[5] For a detailed history of the power to dispose of, and restrictions on disposing of, charity land, see J Warburton, "Restrictions on Dispositions of Charity Property – Protection or Undue Burden?" in M Dixon (ed), *Modern Studies in Property Law* (2009) Vol 5 pp 125 to 145; and D Dennis, "Dispositions of charitable land" (2006) 70 *Conveyancer and Property Lawyer* 219.

[6] [2003] EWCA Civ 1548, [2004] Ch 46, 54, by Chadwick LJ.

[7] Charitable Trusts Amendment Act 1855, s 29. The restriction did not apply to exempt charities, which included certain universities and cathedrals, nor to what came to be called "plain charities" which were charities maintained by voluntary contributions and not by endowment income. Special provision was made for "mixed charities", which had both income from endowment and income from voluntary contributions.

[8] *Re Mason's Orphanage and London and North Western Railway Co* [1896] 1 Ch 596, 605, by Kay LJ.

[9] Charities Act 1960, s 29. Permanent endowment was first defined in the Charities Act 1960, s 45(3), and the definition remains almost unchanged today: Charities Act 2011, s 353(3); see further ch 9 below. "Functional land" was defined by s 29(2) of the Charities Act 1960 as land held by, or in trust for, a charity which "has at any time been occupied for the purposes of the charity".

8.7 More significant, however, was the Charities Act 1992, which extended but also relaxed the restriction in the 1960 Act.[10] The 1992 Act extended the restriction to all land held by, or on trust for, a charity; it was no longer limited to permanent endowment and functional land. It relaxed the restriction by introducing certain procedures that charity trustees could follow to avoid having to obtain the consent of the Charity Commission or court to disposals of, or mortgages over, charity land. In the case of disposals or long leases of charity land, the procedure required the charity trustees to obtain advice from a qualified surveyor.[11] For mortgages or short leases, the procedure involved less stringent requirements to obtain advice. The provisions of the 1992 Act concerning charity land were re-enacted in the Charities Act 1993,[12] were subject to minor amendments in the Charities Act 2006, and were consolidated in the Charities Act 2011.[13] Broadly speaking, the provisions introduced by the 1992 Act still apply today, and are explained in detail below.

THE CURRENT REGIME: LIMITATIONS ON DISPOSALS AND MORTGAGES

8.8 The current regime concerning charity land is set out in Part 7, sections 117 to 129, of the Charities Act 2011. There are separate provisions for disposals of charity land and for mortgages of charity land. The regime applies to both incorporated and unincorporated charities. Failure to comply with the regime, where it applies, renders a disposition void.[14]

Transactions to which the regime applies

8.9 Any disposal[15] of charity land[16] falls within the regime unless it is:

(1) a disposal authorised by a statutory provision or scheme;[17]

[10] For the background to the provisions of the Charities Act 1992 concerning land, see the Report of the Charity Commissioners for England and Wales for the year 1986 (6 May 1987) paras 30 and 31; Sir Philip Woodfield, *Efficiency Scrutiny of the Supervision of Charities* (1987), part 9; the Report of the Charity Commissioners for England and Wales for the year 1987 (18 May 1988) paras 51 to 55, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/235847/0427.pdf; and Charities: A Framework for the Future White Paper (1988/89) Cm 694, ch 7.

[11] These were the procedures that the Charity Commission required charity trustees to follow before granting consent under the Charities Act 1960.

[12] Charities Act 1993, s 36 and following.

[13] Charities Act 2011, s 117 and following.

[14] *Bayoumi v Women's Total Abstinence Educational Union Ltd* [2003] EWCA Civ 1548 [2004] Ch 46, [28], [29] and [43].

[15] Section 117(1) refers to a transaction under which land is to be "conveyed, transferred, leased or otherwise disposed of". Examples include: sale; the grant of a lease over charity land; the grant, transfer or surrender of an easement; the release of a restrictive covenant; the surrender of a lease; and an exchange of land.

[16] See para 8.1 above. It is generally accepted that the land must be held by or in trust *exclusively* for a charity or charities so the regime does not apply where land is held jointly by a charity and a non-charity: T Dumont and F Wilson, "When is a Charity Trustee not a Charity Trustee? Part V of the Charities Act 1993 and Sales of Land by Executors" [2004] *Private Client Business* 118, 122.

[17] Charities Act 2011, s 117(3)(a). For example, a disposal pursuant to a compulsory purchase order, a sale by a liquidator, or a sale by a mortgagee under its statutory power.

(2) a disposal for which the authorisation of the Secretary of State is required under the Universities and College Estates Act 1925;[18]

(3) a disposal to another charity "otherwise than for the best price that can reasonably be obtained" which is authorised by the transferor charity's trusts;[19]

(4) a lease to a beneficiary of the charity "granted otherwise than for the best rent that can reasonably be obtained" and intended to enable the premises to be occupied for the charity's purposes;[20]

(5) a disposal of land held by or in trust for an exempt charity;[21]

(6) a disposal of an advowson;[22]

(7) the release of certain rentcharges;[23] or

(8) a disposal of glebe land or certain other ecclesiastical property.[24]

8.10 Any mortgage or other security over charity land falls within the regime unless it is:

(1) authorised by a statutory provision or scheme;

(2) a mortgage for which the authorisation of the Secretary of State is required under the Universities and College Estates Act 1925;

(3) a mortgage granted by an exempt charity;[25] or

(4) a mortgage of glebe land or certain other ecclesiastical property.[26]

[18] Charities Act 2011, s 117(3)(b). The Universities and College Estates Act 1925 applies to the Universities of Oxford, Cambridge and Durham, their constituent colleges and halls, Winchester College and Eton College. The 1925 Act includes powers for them to dispose of land. We consider the 1925 Act in more detail in para 8.113 and following below.

[19] Charities Act 2011, s 117(3)(c). A disposal to another charity will not fall within this exception if it is at open market value.

[20] Charities Act 2011, s 117(3)(d).

[21] Charities Act 2011, s 117(4)(a). For the meaning of "exempt charity" see s 22 and Sch 3, which we discuss in para 1.26 above.

[22] Charities Act 2011, s 117(4)(c). An advowson is "the perpetual right of presentation to an ecclesiastical living": C Harpum, S Bridge and M Dixon, *Megarry & Wade, The Law of Real Property* (8th ed 2012) para 31-007.

[23] Charities Act 2011, s 127. A rentcharge is "an annuity secured on some specified land": C Harpum, S Bridge and M Dixon, *Megarry & Wade, The Law of Real Property* (8th ed 2012) para 31-005.

[24] Charities Act 2011, s 10(2).

[25] Charities Act 2011, s 124(9) and (10). For the meaning of "exempt charity" see s 22 and Sch 3, which we discuss in para 1.26 above.

[26] Charities Act 2011, s 10(2).

8.11 Accordingly, transactions by exempt charities do not fall within the provisions of Part 7. This is because they are regulated by other bodies. We give some examples of exempt charities in paragraph 1.26 above.

The default rule: no transaction without the consent of the court or the Charity Commission

8.12 The default rule is that charity trustees cannot proceed with a transaction that falls within the regime unless they have obtained an order from the court or the Charity Commission authorising them to do so.[27] But the default rule does not apply if certain requirements are met. The requirements differ depending on whether or not the proposed transaction is a mortgage.

(A) Permitted dispositions other than mortgages

8.13 Where the transaction is not a mortgage, charity trustees[28] are not required to obtain an order from the court or the Charity Commission if the disposal of land satisfies two conditions,[29] namely:

(1) the disposition is not made to a "connected person", or a trustee or nominee for a connected person; and

(2) the charity trustees obtain and consider advice on the disposition. The advice required differs depending on whether the disposition is a lease for a term of seven years or less which is not granted in consideration of a premium ("a short lease") or any other disposition;[30] less stringent requirements apply to the former than the latter.

8.14 There are further requirements where the disposal is of "designated land". In the text that follows we discuss connected persons, the advice requirement, and the additional rules for designated land.

Condition (1): connected persons

8.15 A connected person is someone who falls into the following list at the time of the disposition itself, or any contract for the disposition:[31]

(1) a charity trustee;[32]

(2) a person who is the donor of any land to the charity (whether on or after the establishment of the charity);

[27] Charities Act 2011, ss 117(1) and 124(1). This is the restriction that was first introduced by the 1855 Act.

[28] Note that the requirements remain the same where the land has been vested in the Official Custodian for Charities; see generally ss 90 and 91 of the Charities Act 2011.

[29] Charities Act 2011, s 117(2).

[30] Charities Act 2011, ss 119 and 120.

[31] Charities Act 2011, s 118(2).

[32] Or "a trustee for the charity". This would include a holding trustee who would not fall within the definition of "charity trustee" since a holding trustee does not have general control and management of the charity: Charities Act 2011, s 177.

(3) a child,[33] parent, grandchild, grandparent, brother or sister of any such trustee or donor;

(4) an officer, agent or employee of the charity;

(5) the spouse or civil partner of any person falling within (1) to (4);[34]

(6) a person carrying on business in partnership with any person within (1) to (5);

(7) an institution controlled by anyone within (1) to (6), or by two or more of them;[35]

(8) a body corporate in which a substantial interest is held by anyone within (1) to (7), or by two or more of them.[36]

Condition (2): advice requirements

8.16 The second condition under section 117(2) is that the charity trustees have obtained advice. The advice requirements are set out in sections 119 and 120.

SECTION 119: DISPOSITIONS OTHER THAN SHORT LEASES

8.17 Section 119(1) applies to dispositions other than the grant of a short lease,[37] and requires that, before entering into an agreement for the sale, lease or disposal of the land, the charity trustees must:

(1) obtain and consider a written report on the proposed disposition from a qualified surveyor instructed by the trustees and acting exclusively for the charity;

(2) advertise the proposed disposition for such period and in such manner as is advised in the surveyor's report, unless the report advises that it would not be in the best interests of the charity to advertise it; and

[33] This includes a stepchild: Charities Act 2011, s 350(1).

[34] Cohabitants are treated as spouses or civil partners for the purposes of this provision under Charities Act 2011, s 350(2).

[35] See Charities Act 2011, s 351: "a person controls an institution if the person is able to secure that the affairs of the institution are conducted in accordance with the person's wishes".

[36] A "substantial interest" in a body corporate is held by a person who "(a) is interested in shares comprised in the equity share capital of that body of a nominal value of more than one-fifth of that share capital, or (b) is entitled to exercise, or control the exercise of, more than one-fifth of the voting power at any general meeting of that body": Charities Act 2011, s 352(1). The rules for interpretation (for example, of the concept of being interested in shares) set out in Sch 1 to the Companies Act 2006 also apply: Charities Act 2011, s 352(2).

[37] See para 8.13(2) above.

(3) decide that they are satisfied, having considered the surveyor's report, that the terms on which the disposition is proposed to be made are the best that can reasonably be obtained for the charity.[38]

8.18 A qualified surveyor is "a fellow or professional associate of the Royal Institution of Chartered Surveyors" who is "reasonably believed by the charity trustees to have ability in, and experience of, the valuation of land of the particular kind, and in the particular area, in question".[39]

8.19 The qualified surveyor's report must comply with the Charities (Qualified Surveyors' Reports) Regulations 1992 ("the 1992 Regulations"),[40] which require numerous matters to be addressed: see Figure 9.

Figure 9: the Charities (Qualified Surveyors' Reports) Regulations 1992

A qualified surveyor's report must address the following points:

(1) a description of the land and its location, to include measurements, current use, number of buildings included, measurements of buildings, number of rooms in buildings and their measurements; a plan (not necessarily to scale) may be used;

(2) whether the land or part of it is leased by or from the charity trustees, and details of any lease (length, period outstanding, rent, service charge, rent or service charge review provisions, liability for rent and dilapidations, any other lease provision affecting value);

(3) whether the land is burdened or benefited by any easement or restrictive covenant, or is subject to any annual or other periodic sum charged on or issuing out of the land except rent reserved by a lease or tenancy;

(4) whether any buildings are in good repair, and if not the surveyor's advice as to whether it would be in the charity's best interests to repair them, what the repairs should be and the estimated cost;

(5) if the surveyor considers that it would be in the charity's best interests to alter buildings before disposition, a note of that opinion and an estimate of the cost;

(6) advice as to the manner of disposing of the land so that the terms on which it is disposed of are the best that can reasonably be obtained for the charity, including the possibility of dividing the land, advertising period and manner or reasons why the surveyor does not think it would be in the charity's best interests to advertise, and any view on whether it would be best to delay the disposition or not;

(7) VAT advice, if relevant and the surveyor feels able to give it (and if not, a statement to that effect);

[38] Non-financial considerations might be relevant. For example, if a cancer research charity receives the highest offer from a tobacco company which plans to build a cigarette factory on the site, it might be better for the charity to refuse the offer: see P Luxton, *The Law of Charities* (2001) paras 17.57 to 17.60, suggesting that it would be prudent to obtain an order of the Charity Commission to authorise the sale on the second-highest offer.

[39] Charities Act 2011, s 119(3). The RICS has members as well as fellows and professional associates. The Charity Commission states that members of RICS also fall within this definition: CC28, section 4.3. The Minister has power under s 119(3)(a) to make regulations to widen this group beyond RICS. Whilst there has been a consultation on widening the group (discussed in para 8.60 below), no regulations have been made.

[40] SI 1992 No 2980.

(8) the current value of the land in present circumstances, or possible rent under a lease, and its value if advice, opinions and recommendations given are followed; and

(9) if the surveyor considers that the proposed disposition is not in the best interests of the charity because it does not make the best use of the land, his opinion to that effect and reasons, plus advice on which disposition would constitute best use.

SECTION 120: SHORT LEASES

8.20 Section 120 applies when the proposed disposition is a short lease,[41] and requires that, before entering into an agreement for the lease, the charity trustees must:

(1) obtain and consider advice on the proposed lease from a person who is reasonably believed by the trustees to have the requisite ability and practical experience to provide them with competent advice on the proposed lease; and

(2) decide that they are satisfied, having considered the advice, that the terms of the proposed lease are the best that can reasonably be obtained for the charity.[42]

DIFFERENCES BETWEEN THE REQUIREMENTS OF SECTIONS 119 AND 120

8.21 The main differences between the advice requirements for dispositions under section 119 and for short leases under section 120 are therefore:

(1) section 119 requires a qualified surveyor, section 120 does not – for example, an estate agent may suffice;

(2) section 119 requires advertising (unless the surveyor advises it is not in the best interests of the charity), section 120 does not; and

(3) section 119 requires a written report with specified content, section 120 does not.

Designated land: additional restrictions

8.22 Section 121 of the Charities Act 2011 imposes additional requirements where land is held by or in trust for a charity, and "the trusts on which it is held stipulate that it is to be used for the purposes, or any particular purposes, of the charity". This is known as "designated land"[43] or "specie land".[44]

[41] See para 8.13(2) above.

[42] Charities Act 2011, s 120(2).

[43] "Designated land" is also defined in s 275 of the Charities Act 2011 for the purposes of that section (resolution to replace the purposes of an unincorporated charity); for a discussion of s 275, see paras 3.11 to 3.14 and ch 5 above. The definition in s 275 is, in substance, the same as that in s 121.

[44] Charity Commission, *Sales, leases, transfers or mortgages: What trustees need to know about disposing of charity land* (CC28) (March 2012) section 1.6, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/396345/cc28.pdf. We refer to the guidance as "CC28". The Charity Commission distinguishes designated or specie land from "functional property", which is property "used by the charity

8.23 Section 121(2) requires the charity trustees to invite representations before the disposition is made, by taking the following steps:

(1) they must give public notice of the proposed disposition, inviting representations to be made within a time specified in the notice (not less than one month from the date of the notice); and

(2) they must take into consideration any representations made to them within that time about the proposed disposition.[45]

8.24 The additional requirements in section 121 do not apply where:

(1) the disposition is made with a view to acquiring replacement property to be held on the relevant trusts;[46] or

(2) the disposition is the granting of a lease for a term ending not more than two years after it is granted, and not granted wholly or partly in consideration of a premium.[47]

8.25 The Charity Commission can make directions granting exemption from the designated land restrictions in section 121. This may apply to a specific disposition, or to dispositions (generally, or by reference to a specific class) by a charity or class of charity.[48] An application for a direction must be made by the charity or charities in question, and the Charity Commission must be satisfied that giving a direction would be in the interests of the charity or charities.[49] As Luxton notes:

> The aim of this saving is to make life less difficult for charities which make many dispositions of functional land each year. The paradigm case is the National Trust, which has some 10,000 properties leased out on relatively short leases … . The sub-section enables the Charity Commissioners to make appropriate directions to relieve it, or charities in a similar position, of the burden of having to serve thousands of public notices each year.[50]

8.26 Disposing of designated land with no intention to replace it, with the result that it will not be possible to carry on the purposes for which the land was held after the

to further its charitable objects but is not *required* to be used in this way by the trusts of the charity" (emphasis in original): Charity Commission, *OG54 B3 Disposals of Charity Interests in Property* (March 2012) section 1.1, now archived and available at http://webarchive.nationalarchives.gov.uk/+/http://www.charitycommission.gov.uk/about_us/ogs/g054b003.aspx.

45 Charities Act 2011, s 121(2). These steps must precede "the relevant time", that is the time when the charity trustees enter into the agreement for the disposition, or if they do not do so, the time of the disposition: Charities Act 2011, s 121(2) and (4).

46 The Charity Commission provides guidance on replacing designated land in section 5.9 of CC28.

47 Charities Act 2011, s 121(5).

48 Charities Act 2011, s 121(6).

49 Charities Act 2011, s 121(7).

50 P Luxton, *The Law of Charities* (2001) para 17.73.

disposal, will require a cy-près scheme from the Charity Commission. The Charity Commission gives the example of an almshouse charity wishing to sell its almshouses and to use the proceeds to relieve poverty in other ways.[51] A cy-près scheme is not required for a small disposal which has no impact on the charity's ability to further its objects; but if ownership of the land is central to fulfilling the charity's purposes, or if there is a surplus left over, the charity will require a cy-près scheme to apply those funds to some other purpose. We consider cy-près schemes in Chapters 3 and 5 above.

(B) Permitted mortgages

8.27 Charity trustees are not required to obtain an order from the court or the Charity Commission if the mortgage is executed after the charity trustees have obtained and considered written advice on the mortgage.[52]

8.28 There is no separate condition that the mortgagee must not be a connected person. However, the charity trustees' fiduciary duties (see Chapter 10 below) would be likely to prevent them from granting a mortgage to a connected person.

Matters on which the charity trustees must obtain advice

8.29 Where the mortgage is to secure the repayment of a proposed loan or grant, the trustees must be advised on:

(1) whether the loan or grant is necessary in order for the charity trustees to be able to pursue the particular course of action in connection with which they are seeking the loan or grant;

(2) whether the terms of the loan or grant are reasonable having regard to the status of the charity as its prospective recipient; and

(3) the ability of the charity to repay on those terms the sum proposed to be paid by way of loan or grant.

8.30 If the mortgage is to secure the discharge of any other proposed obligation, the trustees must be advised as to whether it is reasonable for the charity trustees to undertake to discharge the obligation, having regard to the charity's purposes.[53]

8.31 The person who advises on the above matters must:

(1) be someone reasonably believed by the charity trustees to be qualified by ability in and practical experience of financial matters; and

(2) not have any financial interest in relation to the loan, grant or other transaction in question.

[51] CC28, p 17.

[52] Charities Act 2011, s 124(2).

[53] Charities Act 2011, s 124(3) and (4). Advice on these matters must also be taken if, after the mortgage has been entered into, the trustees are to enter into any transaction for payment of further sums or undertaking further obligations, whose repayment or discharge is also secured by the mortgage

8.32 The person may be someone giving the advice in the course of their employment as an officer or employee of the charity or of the charity trustees.[54]

Obtaining a Charity Commission order to authorise a disposal or mortgage

8.33 We have set out the requirements that must be met if the trustees are to be exempt from the requirement to obtain a Charity Commission order[55] permitting a disposition or mortgage. Sometimes those requirements cannot be met, for example where the proposed disposition is a sale to be made to a connected person, and so an order will be needed.

8.34 In a few cases the Charity Commission will consider making an order authorising a disposition even though the charity could use the surveyor's report procedure.[56] The guidance suggests that this will be possible in three cases:

(1) the cost of obtaining a surveyor's report is disproportionate to the value of the land, and the value of the transaction is genuinely low; for example, disposals of wayleaves[57] similar to other such disposals recently certified to be of low value;

(2) "the land is in a remote area where it may be difficult to find a qualified surveyor with sufficient knowledge of local land values"; the Charity Commission would look for an estate agent's report to be obtained instead; and

(3) transactions at an undervalue which do not fall within the relevant exemption; for example, to a public authority rather than a charity.[58]

Failure to comply with the requirements of the current regime

8.35 As we mentioned above, failure to comply with the requirements of Part 7 of the Charities Act 2011 renders the disposition – be it a transfer, lease, mortgage or any other arrangement – void.[59] If a disposition is void, it is of no effect. That would have serious consequences for purchasers from charities. There are therefore special conveyancing rules designed to protect purchasers. We discuss these later in this Chapter. Whether those conveyancing procedures change depends upon whether we recommend, after consultation, the maintenance of requirements such that non-compliance makes the transaction void.

[54] Charities Act 2011, s 124(8).

[55] In theory, a charity could obtain an order from the court instead, but the restrictions in the Charities Act 2011, s 115, on charities taking court proceedings where a matter can be dealt with by the Charity Commission effectively prevent such a course: see generally ch 16 below.

[56] See P Luxton, *The Law of Charities* (2001) para 17.26, explaining that since the procedure was introduced to shift regulatory resources away from these transactions, charities are expected to use it rather than making unnecessary applications.

[57] A wayleave is a licence, or permission, to do something or keep something on land.

[58] The Charity Commission will ask for information about: (1) the value of the land and how it has been assessed; (2) advertising; and (3) why the charity needs an order. The Commission will also request minutes of the meetings at which decisions about the disposal were taken: CC28, section 5.5 and following.

[59] We explain the effect of a transaction being void in para 8.2 above.

8.36 Our provisional proposal, below, is for a procedure that would not have this effect; non-compliance would be a matter for the trustees personally because it might be a breach of trust, but it would not impugn the transaction so far as a purchaser is concerned. The special conveyancing rules would become unnecessary, although they might be retained in order to safeguard purchasers when the limitation on the trustees' powers arises not from Part 7 of the Charities Act 2011 but from the trust deed or other governing document. We consider this further below.

EVALUATION OF THE CURRENT LAW

Advantages of the current law

8.37 The principal purpose behind the limitations in Part 7 of the Charities Act 2011 is to protect charities from imprudent (or even reckless or dishonest) decisions of the charity trustees. The limitations seek to ensure that charities obtain the best price when they dispose of land, and that they can afford the obligations undertaken in mortgages.

8.38 The limitations in Part 7 have various secondary purposes.

8.39 First, they create a helpful framework for charity trustees, some of whom may be cautious about entering into high-value transactions. Given a detailed statutory structure for the decision-making process, nervous trustees might feel reassured that they are unlikely to be found to have breached their duties as trustees (though see paragraph 8.45 below).

8.40 Second, the limitation on making a disposal to a connected person provides a statutory scheme to manage conflicts of interest; charities are protected from abuse as the Charity Commission will seek to ensure that the disposal is for full value. Equally, it ensures that charity trustees are not prevented from entering into a transaction with a connected person where that would be in the charity's interests.

8.41 Third, the additional limitations in respect of designated land seek to ensure that local public opinion is taken into account by charity trustees before they dispose of such land.

Problems with the current law

Connected persons

8.42 Part 7 begins with a safeguard to prevent trustees from disposing of charity land to connected persons, unless the charity trustees have obtained the consent of the Charity Commission or court. However, this requirement does not apply to mortgages.

8.43 The general law already prevents charity trustees from entering into transactions with connected persons.[60] That is why there is no similar regime for disposals of other assets (such as personal property, shares, or intellectual property) to connected persons. Such disposals are prevented by the general law. Disposals

[60] To do so would amount to a breach of the trustees' fiduciary duties; for a discussion of the duties, see generally ch 10 below.

in breach of that prohibition are not void, but could be avoided – like any other disposal in breach of trust – if made at an undervalue or otherwise not in the interests of the charity.

8.44 Even so, and despite the general prohibition, if trustees wish to dispose of land to a connected person, in what would otherwise be a breach of their fiduciary duties, they might be able to rely on the express terms of their governing documents, but if not they can seek authorisation from the Charity Commission under section 105 of the Charities Act 2011.[61] A transaction thus authorised would not put the trustees at risk and is unlikely to be avoided.

8.45 The provisions about connected persons in Part 7 are thus, arguably, unnecessary. They may also be unhelpful. They may encourage a belief on the part of trustees that they are safe to dispose of property to someone with whom they are associated but who does not fall within the statutory definition of "connected person". But just because a disposal is not to a "connected person" does not mean that trustees are safe to make the disposal if there would otherwise be a potential conflict of interest. For example, if the disponee is an aunt or uncle, or a person in negotiations with a trustee for a proposed business venture, they would not be a "connected person" but a disposal to such a person may be a breach of fiduciary duty.

8.46 Two points of definition also arise within the current provisions. First, where a charity makes a disposal to a wholly-owned trading subsidiary,[62] the disponee will be a "connected person" and the Charity Commission's consent to the disposal is therefore required. This seems unnecessary, given that any benefit to the disponee will be enjoyed by the charity as the owner of the subsidiary.[63]

8.47 Second, the definition includes "a charity trustee or trustee for the charity".[64] The charity trustees should, of course, be included, but it is unclear whether a "trustee for the charity" who is not a "charity trustee" should be included.[65] This wording includes a holding trustee and others who hold legal title to property, subject to the direction of others and without any control over such decisions. The decision to make a disposal is taken by the charity trustees. It is connection with them that is likely to give rise to conflicts of interest. Where a third party holds legal title for a charity subject to the direction of the charity trustees, the risk is minimal.

Costs and delay

8.48 Where the disposition is not to a connected person, Part 7 requires the trustees to take advice; the requirements differ for mortgages and other disposals. For dispositions other than mortgages, when a transaction falls within the regime, charities must pay for a qualified surveyor to produce a report, and the 1992 Regulations require the reports to address numerous matters. The reports are therefore expensive and the costs can be disproportionate to the value of the

[61] See para 10.17 below.

[62] This could occur during a restructuring process.

[63] This point was raised in para 10.18 of the Hodgson Report.

[64] Charities Act 2011, s 118(2)(a).

transaction. We have been told that a surveyor's report usually costs between £400 and £1,800. Cancer Research UK is reported to have annual compliance costs of £100,000.[66]

8.49 Reports must be provided by members of the Royal Institution of Chartered Surveyors ("RICS"), who are experts in land management and development.[67] That may not always be necessary or even ideal; for example, if the charity is selling a residential property, a local estate agent may be best placed to advise on value and a marketing strategy.

8.50 Strictly speaking, Part 7 requires the qualified surveyor to advise on how to dispose of the property and on the terms of the proposed disposition. The Charity Law Association has pointed out that "if trustees were to follow the legislation slavishly, they would seek advice at an early stage on the wisdom of making the disposition and how to do so, followed up by more advice once the terms of the disposition had been negotiated, leading to increased costs for the charity. In practice, trustees often adopt the more pragmatic approach of instructing surveyors only at the later stage".[68]

8.51 The costs can be particularly burdensome for charities that make numerous disposals each year. And the costs can increase where multiple charities have an interest in land (as where, for example, property is left by will to various charities) since the regime arguably requires each charity to obtain a separate report from a surveyor.[69]

8.52 If the surveyor's report procedure is not used, or if the charity trustees disagree with the surveyor's advice, they must seek the Charity Commission's consent to the disposal. That will add to the charity's costs and will delay the transaction.

8.53 The delays in the process – in obtaining a surveyor's report, or obtaining Charity Commission consent – can jeopardise transactions; buyers may walk away from deals if they are kept waiting, with charities losing out on potentially lucrative disposals.

[65] "Charity trustees" means the persons having the general control and management of the administration of a charity: Charities Act 2011, s 177.

[66] J Rigg, "Tough Terrain" (March 2007) *STEP Journal* 28, 29.

[67] See para 8.18 above.

[68] Charity Law Association Working Party Submission to Lord Hodgson's review, pp 9 and 10.

[69] The Act requires the surveyor to be "acting exclusively for the charity": s 119(1)(a). There are differing views as to whether one surveyor can act for all charities in this situation: see the Institute of Legacy Management Approved Factsheet on Section 117 Charities Act 2011 (August 2012), available at http://legacymanagement.org.uk/wp-content/uploads/Section-117-Charities-Act-2011.pdf, and the Charity Law Association's evidence to the Joint Committee on the Draft Charities Bill (July 2004), available at http://www.publications.parliament.uk/pa/jt200304/jtselect/jtchar/167/4061624.htm, para 139. See also para 8.55(3) below.

Indiscriminate application of the requirements

8.54 The detailed requirements for surveyors' reports in the 1992 Regulations apply to any disposal of charity land that falls within the regime; they are not nuanced to suit different types of property transaction. Self-evidently, the matters to be considered when disposing of a one-bedroom flat will be different from those to be considered when disposing of a 100-acre field with development potential. It is arguable that the surveyor should be left to address the matters that he or she considers to be relevant to the charity in considering how to obtain the best price for the land.

Inconsistencies

8.55 The Part 7 regime gives rise to various inconsistencies:

(1) *Acquisition and disposal.* Whilst Part 7 does impose formality requirements when charities acquire land, the substance of the regime does not apply to the acquisition of land.[70] Arguably the risk to charity funds is similar when charities are acquiring land and disposing of land; just as they may sell land at an undervalue, they may pay too much when purchasing land. As a result, the Charity Commission "strongly recommends" that trustees follow the Part 7 procedure when acquiring land to ensure compliance with their duties.[71]

(2) *Different types of asset.* Part 7 imposes detailed requirements on the disposal of charity land, but there is no equivalent regime for the disposal of other charity assets, such as shares, artwork, jewellery, or intellectual property.[72] And whilst it is probably sensible that there are no special requirements for purely contractual arrangements over land that do not create property rights – for example, a grazing licence – it may be anomalous that some major contractual arrangements not involving land are equally unregulated. If the charity enters into a contract and then defaults on its obligations, the outcome could well be a charging order over charity land.

(3) *Property left by will.* When land forms part of the residue of an estate and the residue has been left to a charity, it can be sold by the personal representatives without having to comply with Part 7. By contrast, if the land has been specifically devised to the charity, or appropriated to the charity by the personal representatives (which will often be the case for tax reasons), the land will be held on trust for the charity. Part 7 will therefore apply to any disposal and the charity trustees must comply with

[70] Where trustees are acquiring land as an investment, they will be required to comply with the investment duties under the Trustee Act 2000, most notably the requirement to obtain advice unless they reasonably consider it unnecessary to do so. We discuss the investment duties in more detail in Social Investment by Charities (2014) Law Commission Consultation Paper No 216, para 3.68 and following.

[71] Charity Commission, *Acquiring Land* (CC33) (April 2001), para 18.

[72] Save that assets which are held as an investment are subject to the investment duties under the Trustee Act 2000.

the regime.[73] Rather confusingly, however, if the land has been specifically devised to, or appropriated to, more than one charity, it has been suggested that the statutory requirements fall not on the charity trustees of the individual charities, but instead on the personal representatives.[74] Dumont and Wilson argue that "the practical problems which flow from these statutory requirements need urgent clarification so as to ensure that they serve the purpose for which they were originally intended".[75]

Compliance in practice

8.56 The Institute of Legacy Management suggests that legal advice on Part 7 is inconsistent, that many charities are unaware of Part 7 and that Part 7 is sometimes ignored because it is too complicated.[76] Julian Smith has suggested that there is confusion as to when it applies and that Part 7 is "often honoured in the breach".[77] In addition, there can be uncertainty as to whether land falls within the definition of charity land such that the Part 7 limitations apply.[78]

Adding value

8.57 We have heard that, for all its disadvantages, the procedure does not often improve the price that the trustees obtain for charity land. The surveyor's report is often obtained as an afterthought, once heads of terms have been agreed through a selling agent. The trustees then incur the expense and delay of instructing a surveyor to endorse the terms that have already been agreed.

Conclusion

8.58 The requirements of Part 7 concerning disposals of charity land are complex, costly, and inconsistent. The requirements concerning mortgages are less

[73] S Roberts and E Millington, "Disposals of Land by Charities" (2006) 9 *Charity Law and Practice Review* 1, 2, n 8; T Dumont and F Wilson, "When is a Charity Trustee not a Charity Trustee? Part V of the Charities Act 1993 and Sales of Land by Executors" [2004] *Private Client Business* 118, 121 to 122.

[74] This is the Charity Commission's view: S Roberts and E Millington, "Disposals of Land by Charities" (2006) 9 *Charity Law and Practice Review* 1, 2, n 8. Dumont and Wilson have argued the contrary, but acknowledge that the Charity Commission's approach is more practical: T Dumont and F Wilson, "When is a Charity Trustee not a Charity Trustee? Part V of the Charities Act 1993 and Sales of Land by Executors" [2004] *Private Client Business* 118, 122 to 124.

[75] T Dumont and F Wilson, "When is a Charity Trustee not a Charity Trustee? Part V of the Charities Act 1993 and Sales of Land by Executors" [2004] *Private Client Business* 118, 125. The Charity Law Association raised a similar concern in its evidence to the Joint Committee on the Draft Charities Bill (July 2004) paras 135 to 137. See also J Warburton, "Restrictions on Dispositions of Charity Property – Protection or Undue Burden?" in M Dixon (ed), *Modern Studies in Property Law* (2009) Vol 5 p 131.

[76] ILM Submission to Lord Hodgson's review.

[77] J Smith, "Disposals of property and Section 36" (November 2010), available at http://www.farrer.co.uk/Global/Briefings/09.%20Higher%20Education/Disposals%20of%20property%20and%20Section%2036.pdf.

[78] For example, in *Maidment and Ryan v Charity Commission for England and Wales* [2006] UKFTT 377 (GRC), both the solicitors acting for the vendor and the solicitors acting for the purchaser had concluded – incorrectly – that the land was not held on a charitable trust, and that the statutory limitations did not apply.

problematic than those for other dispositions, but do suffer from some inconsistencies. We take the view that the requirements, taken together, are in need of reform.

PROVISIONAL PROPOSALS FOR REFORM

Recent examinations of Part 7 of the Charities Act 2011 and suggestions for reform

8.59 The Better Regulation Task Force 2005 Report referred to three proposals by the Charity Commission to reduce regulatory burdens on trustees in relation to charity land.

(1) Trustees should be permitted to make disposals for £1,000 or less without obtaining a qualified surveyor's report, provided they obtain advice from a competent person. This would be closer to the requirements for short leases.

(2) The regulations concerning the definition of "qualified surveyor" should allow different definitions to be adopted for different types of disposal.

(3) The regime currently excludes disposals to other charities for less than the best price that could be obtained which are made in furtherance of the disposing charity's objects. This exclusion should be extended to any disposal in furtherance of the charity's objects, whether or not the disponee is a charity.[79]

8.60 Those proposals were not mentioned in the Government's response to the Report.[80] However, the second proposal was taken further in March 2010 when Government consulted on extending the definition of "qualified surveyor" under the regime to include fellows of the National Association of Estate Agents ("the NAEA").[81] The consultation gave rise to mixed responses, and raised wider concerns about the statutory framework. The Government concluded that fellows of the NAEA should be included,[82] and stated that it was willing to consider further extension of the definition to include, for examples, fellows of the Central

[79] Better Regulation Task Force, *Better Regulation for Civil Society: Making life easier for those who help others* (November 2005) Annex D, available at http://webarchive.nationalarchives.gov.uk/20100807034701/http://archive.cabinetoffice.gov.uk/brc/upload/assets/www.brc.gov.uk/betregforcivil.pdf.

[80] Cabinet Office, *'Better Regulation for Civil Society', The Government's Response: Response to the Better Regulation Commission Report Recommendations and areas for further work* (November 2006).

[81] Cabinet Office, *Making it easier for charities to sell and make other disposals of land: Consultation on extending the definition of 'qualified surveyor' in section 36(4) of the Charities Act 1993* (March 2010), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/79216/charity_disposal_consultation-document.pdf.

[82] Cabinet Office, *Making it easier for charities to sell and make other disposals of land: Consultation on extending the definition of 'qualified surveyor' in section 36(4) of the Charities Act 1993: Government Response* (September 2010) ("2010 Response") p 8, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/79219/charity-disposal-land-response.pdf.

Association of Agricultural Valuers.[83] However, it decided that the wider statutory framework should first be considered as part of Lord Hodgson's review.

8.61 Lord Hodgson highlighted many of the problems identified in paragraphs 8.42 to 8.57 above. He recommended that the regime be removed for all cases other than disposals to connected persons.[84] He said that "trustees are already under a legal duty to act in the best interests of their charity, which includes seeking advice when appropriate, and this applies to disposal of land as much as any other aspect of their work", stressing that trustees ought to exercise their judgement as to what level of process is appropriate according to the property and the transaction envisaged.[85] He suggested that the Charity Commission should produce guidance in consultation with appropriate professional bodies to clarify how trustees should act in relation to both acquisition and disposal of land. He concluded that mortgages should be treated in the same way, and that the "connected persons" provisions should therefore be extended to mortgages.[86] He also recommended that charities' wholly owned subsidiary trading companies should be excluded from the definition of "connected person".[87]

Our provisional proposals

8.62 We agree with Lord Hodgson that, under a reformed regime, trustees should focus on how best to pursue their charity's purposes when deciding to dispose of or mortgage land, just as when they make other decisions.[88] More difficult is the question whether procedures should remain in place with a view to ensuring that trustees comply with their duties when disposing of charity land, and what should be the consequences of non-compliance with those procedures.

8.63 In the text that follows we consider first the requirement related to connected persons, which currently applies to transactions other than mortgages; we provisionally propose the removal of the Part 7 provisions about connected persons. Then we look at the requirement to take advice, for all dispositions including mortgages. We make a provisional proposal for a new requirement for the trustees to take advice where they consider it reasonable to do so. Failure to observe that requirement would not vitiate the transaction but could make the trustees liable for breach of trust. We then discuss the additional requirements for designated land. Finally we ask whether the requirements (reformed or not) should be extended to the acquisition of land and to exempt charities.

Connected persons

8.64 Part 7 requires that where a disposition other than a mortgage is to a connected person, an order of the Charity Commission or the court be obtained. There is no procedure that can be substituted for that requirement, and without an order the disposition is void.

[83] 2010 Response, p 11.

[84] Hodgson Report, paras 10.16, and ch 10, recommendations (1) to (3).

[85] Hodgson Report, paras 10.16 to 10.17.

[86] Hodgson Report, para 10.20 to 10.21, recommendations (1) to (3).

[87] Hodgson Report, para 10.18.

8.65 We explained above that the provisions about connected persons are, arguably, unnecessary. The general law already polices disposals to connected persons – including mortgages; they are prohibited, but the Charity Commission is able under section 105 of the Charities Act 2011 to authorise the transaction. We are at present convinced by that argument.

8.66 Repeal of the relevant provisions of Part 7 would mean that a sale of the charity's land to, for example, a child of one of the trustees would be a breach of fiduciary duty by the trustee; it would not be void. It would be voidable, in the sense that if made at an undervalue it could be avoided,[89] but a purchaser in good faith who gave full value would always be safe from that possibility and indeed it seems unnecessary to have an invariable rule that such transactions are void.

8.67 The argument against repeal is that it can be helpful for statute to set out an express limitation on disposals to connected persons, and a special procedure for seeking Charity Commission authorisation for such disposals. The express limitation is clear on the face of the statute, rather than being buried away in case law concerning fiduciary duties. It also provides trustees with clear categories of persons to whom they must not dispose of land without consent. However, we doubt that most charity trustees are any more familiar with the text of the statute than they are with case law; realistically they are guided by Charity Commission guidance.[90] The Charity Commission already publishes guidance concerning conflicts of interest and payments to trustees.[91] We take the view that the specific provisions about connected persons in Part 7 are far less helpful than the general law, interpreted for trustees by Charity Commission guidance, and that the procedure for authorisation under section 105 of the Charities Act 2011 is entirely appropriate for transactions of this kind.

8.68 **We provisionally propose that the provisions of Part 7 of the Charities Act 2011 relating to dispositions to connected persons be repealed.**

Do consultees agree?

8.69 If consultees disagree, we ask about the current definition of connected persons, which we discussed above. We agree with Lord Hodgson that the risk of inappropriate depletion of charity assets is minimal when land is disposed of to a wholly-owned subsidiary company. Further, we do not think that a trustee for a charity, as opposed to a charity trustee, should fall within the prohibition.[92]

8.70 **If, contrary to our proposal in paragraph 8.68 above, the provisions concerning connected persons are retained, we provisionally propose that the definition of "connected person" should exclude:**

[88] See also J Warburton, "Restrictions on Dispositions of Charity Property – Protection or Undue Burden?" in M Dixon (ed), *Modern Studies in Property Law* (2009) Vol 5 p 142.

[89] See para 8.2 above.

[90] See, for example, A Dunn, "Regulatory shifts: developing sector participation in regulation for charities in England and Wales" (2014) 34(4) *Legal Studies* 660, 667.

[91] Charity Commission, *Conflicts of interest: a guide for charity trustees* (CC29) (May 2014) and *Trustee expenses and payments* (CC11) (March 2012).

[92] See para 8.46 and 8.47 above.

(1) **a charity's wholly-owned subsidiary company; and**

(2) **a trustee for a charity who is not also a "charity trustee", as defined by the Charities Act 2011.**

Do consultees agree?

The requirement to obtain advice

8.71 For dispositions that are not to connected persons, Part 7 still requires an order of the Charity Commission or the court unless the trustees have taken advice. We noted above that the principal purpose behind the advice and consent requirements in Part 7, for disposals and mortgages, was to protect charities' assets. It may be that there is still a need for this protection. In *Bayoumi,*[93] for example, the trustees contracted to sell charity land for £3.2m, and the purchaser assigned the benefit of that contract to a third party just 10 days later for £450,000, an additional 14% of the original purchase price. The original contract for sale by the charity trustees therefore seems to have been at an undervalue. The charity trustees had not complied with sections 117 to 121.[94] We can only speculate as to whether compliance would have prevented the trustees from entering into the original contract, but the facts of *Bayoumi* suggest that there is a need to protect charities from imprudent land transactions.

8.72 We can see the benefit in retaining a statutory regime that seeks to protect charities' assets from inappropriate dispositions or mortgages. But it is important to strike a sensible balance between protecting charities' assets and avoiding unnecessary expense and bureaucracy.

8.73 We also noted above that the advice requirements serve a secondary purpose, namely to give reassurance to trustees, and we consider this reassurance to be important. However, if and insofar as trustees treat the current procedure as a "tick-box" exercise, in the belief that following it automatically ensures that they have complied with their duties, their confidence would be misplaced and the current regime may be unhelpful in that regard.[95] Moreover responses to our earlier consultation on social investment by charities indicated that charity trustees will often be as reassured by Charity Commission guidance as by express statutory provision. Charity Commission guidance has the benefit of being more accessible, and easier to amend, than the words of statute.

8.74 Lord Hodgson recommended that the requirement to obtain Charity Commission

[93] *Bayoumi v Women's Total Abstinence Educational Union Ltd* [2003] EWCA Civ 1548, [2004] Ch 46.

[94] The trustees had obtained the advice of surveyors but none of the surveyors' reports in evidence complied with s 36(3)(a) of the Charities Act 1993 nor did they address the question of how the disposal should be advertised: *Bayoumi v Women's Total Abstinence Educational Union Ltd* [2003] EWHC 212 (Ch), [2003] Ch 283, [28], by Simon Berry QC (sitting as a Deputy Judge of the High Court).

[95] Trustees must still exercise their judgement and take such steps that they consider to be necessary to ensure that a proposed transaction is in the charity's interests. See T Dumont and F Wilson, "When is a Charity Trustee not a Charity Trustee? Part V of the Charities Act 1993 and Sales of Land by Executors" [2004] *Private Client Business* 118, 120; J Warburton, "Restrictions on Dispositions of Charity Property – Protection or Undue Burden?" in M Dixon (ed), *Modern Studies in Property Law* (2009) Vol 5 p 141.

consent or obtain a surveyor's report should be abolished, except in the case of a disposal to a connected person. We can see the attraction of that approach, since it would place charity trustees on the same footing as other people or organisations disposing of land. But our provisional view is that removing the requirement to obtain advice altogether would be a step too far.

8.75 In order to protect charities' assets, and provide trustees with reassurance, we think that a better approach to the regulation of disposals of charity land (including mortgages) would be to require trustees to obtain advice, but to leave to them the decision as to what advice would be appropriate for a particular transaction. This would give the trustees the flexibility to decide:

(1) at what stage the advice is required (advice on a marketing strategy, advice on the proposed sale price, or both);

(2) the level of detail that is required (it may be a detailed formal report, or it may be oral advice); and

(3) who should give the advice (it may be a qualified surveyor, an estate agent, or another professional).

8.76 Once the trustees have decided the stage at which advice would be appropriate, and the nature of the advice that would be appropriate, they should consider and be satisfied that the person they appoint to provide advice has suitable ability and experience to provide them with that advice.

8.77 Given the flexibility concerning the nature of the advice to be sought, we do not think the requirement to obtain it should be absolute. If, for example, the trustees themselves have sufficient knowledge and skills to make an informed decision, it would be pointless for them to obtain – and pay for – brief notional advice simply to pay lip-service to the advice requirement. So trustees should be given the power to dispense with the requirement to obtain advice if they reasonably consider that it is unnecessary to do so. This mirrors trustees' duty under the Trustee Act 2000 to obtain advice on investments unless they reasonably consider that it is unnecessary or inappropriate to do so.[96]

8.78 We expect trustees would usually want to obtain advice both on marketing strategy and on the adequacy of the proposed disposal price, perhaps from different people. But we do not see the need for formal requirements as to how the advice is to be given, in what format, and by whom, nor an absolute requirement that trustees must always obtain advice no matter what the circumstances of the proposed disposal.

8.79 This flexible requirement to obtain advice would go a long way to ensuring that charities' assets are protected from disposal at an undervalue, though the protection would perhaps not be as extensive as that under the current regime. It would avoid the straightjacket, and unnecessary costs, of the current regime, whilst acknowledging that the law should defer to trustees' good judgement.

[96] Trustee Act 2000, s 5(3).

8.80 Trustees would continue to be reassured by the provision of advice. That reassurance would be further bolstered by guidance from the Charity Commission. The Charity Commission already publishes very helpful guidance on land disposal,[97] which would have to be revised following any change in the law. We envisage revised guidance addressing the considerations to be taken into account by trustees in deciding whether to obtain advice, from whom, and what the advice should cover. The focus of decisions concerning land disposals should be on the trustees' general duties, rather than formulaic statutory requirements, and this should be prominent in the guidance. The Charity Commission provides trustees with a useful summary of their general duties in the context of land acquisition,[98] and this could suitably be included in revised guidance concerning land disposal.

8.81 The new advice requirements that we provisionally propose should apply to all land disposals, including short leases for which there are currently less onerous advice requirements, and including mortgages. As to mortgages, section 124 requires trustees to obtain advice on:

(1) whether the loan or grant is necessary for a course of action they are pursuing;

(2) whether its terms are reasonable; and

(3) the ability of the charity to repay on those terms the sum proposed to be paid by way of loan or grant.[99]

8.82 To some extent, therefore, the subject matter of the advice relates to the internal workings of the charity. Whilst section 124 anticipates advice from just one person,[100] it is arguable that different people are best placed to advise on these three matters; (1) from someone who can advise the trustees on how to achieve the charity's purposes, (2) from someone who understands the lending market, and (3) from the charity's accountant or the charity's fundraising and finance staff. Arguably, the first issue – whether the mortgage is necessary – is something the charity trustees themselves are best placed to consider.

8.83 Whilst we consider that section 124 provides a helpful summary of the matters on which trustees should consider obtaining advice, we can see that it may impose an unnecessary straightjacket on trustees. The better course, in our provisional view, would be to leave to trustees the decision as to what type of advice to obtain in relation to a proposed mortgage, with more detailed assistance from Charity Commission guidance, similarly to our proposals concerning disposals. Accordingly our provisional proposal about advice requirements applies equally to mortgages as to other transactions, and should continue to apply also to decisions about drawing down further sums under an existing mortgage.

[97] Contained in CC28.

[98] Charity Commission, *Acquiring Land* (CC33) (April 2001), paras 9 to 11.

[99] Charities Act 2011, s 124(3); see paras 8.29 to 8.32 above.

[100] Charities Act 2011, s 124(8).

8.84 Charity trustees are currently prohibited from disposing of land without (a) following the advice requirements, or (b) obtaining an order from the Charity Commission. Is there any continuing need for that general prohibition, or for the alternative route of obtaining Charity Commission consent? We think not. If the advice requirements were reduced to the extent we propose, there would be little continuing need for the alternative procedure of obtaining consent to a disposal from the Charity Commission or court.[101] Nor should the advice requirements be framed as an exception to a general prohibition; rather they should be stand-alone duties that apply to trustees, breach of which may render the trustees personally liable for breach of trust, but would not render the transaction void. We explain below the consequences of this for conveyancing and the protection of purchasers.

8.85 **We provisionally propose that:**

(1) **the general prohibition on trustees disposing of charity land should be removed; and**

(2) **in its place should be a duty on trustees, before disposing of charity land, to obtain and consider advice in respect of the disposition from a person who they reasonably believe has the ability and experience to provide them with advice in respect of the disposal; but**

(3) **the duty to obtain advice should not apply if the trustees reasonably believe that it is unnecessary to do so.**

Do consultees agree?

8.86 Our intention is that "disposition" should cover the transfer or creation of any interest in charity land, including the grant of a mortgage.

Designated land

8.87 We noted above that the additional limitations in Part 7 in respect of designated land seek to ensure that local public opinion is taken into account by charity trustees before they dispose of such land. It perhaps also ensures that there is some transparency in trustees' dealings with designated land. It is arguable that this is unnecessary, since a charity should be considering how its land can best be used to serve its charitable purposes, rather than public opinion about how it should deal with its land (although, of course, the latter may be relevant to the former). In any event:

(1) we have heard that section 121 advertising rarely results in objections being received;

(2) the consultation requirements in Part 7 only apply to designated land in specific circumstances, namely when the land is not to be replaced with similar land; and

[101] And, in any event, in an unusual case where the trustees could not comply with the advice requirement, they could still seek Charity Commission authorisation to proceed with a disposal under s 105 of the Charities Act 2011.

(3) some disposals of designated land will require a cy-près scheme (for example, where it is held for a particular purpose, or where a charity's purposes cannot be pursued without it holding that land[102]), in which case a local consultation exercise is likely to be required by the Charity Commission in any event.

8.88 We acknowledge that the disposal of designated land can be controversial,[103] and advertisement and consultation can therefore have a valuable role to play. We would expect trustees to consider consultation – both with beneficiaries and perhaps with the local community – as part of their decision-making process in any event. But our provisional view is that statute should not require trustees to do so in all cases.

8.89 **We provisionally propose that the requirements in section 121 of the Charities Act 2011 concerning advertising proposed disposals of designated land and considering any responses received should be abolished.**

Do consultees agree?

Extending the regime to exempt charities

8.90 Certain transactions fall outside the current regime concerning disposals in Part 7 of the Charities Act 2011: see paragraph 8.9 above. We consider that those transactions should continue to fall outside the regime, save that the more flexible advice requirements that we propose above might usefully be applied to exempt charities.[104] The purpose of the restrictions – namely the protection of charities' assets – applies equally to exempt charities, and there is no particular reason why exempt charities should be trusted more than non-exempt charities to make land disposals. The new requirement proposed for non-exempt charities is that they obtain advice on the proposed disposal. That is something that exempt charities would be likely to do in any event, but we invite consultees' views as to whether statute should extend this requirement to exempt charities.

8.91 **We invite the views of consultees as to whether the advice requirements that we propose governing dispositions by non-exempt charities should be extended to dispositions by exempt charities.**

Extending the regime to the acquisition of land by a charity

8.92 The current regime applies to disposals and mortgages of charity land, but not to the acquisition of land by charities. The potential risk to charities' assets is similar, whether a charity is disposing of, or acquiring, land; just as the trustees may imprudently dispose of land at an undervalue, so too may they imprudently

[102] See para 8.26 above.

[103] See, for example, *Maidment and Ryan v Charity Commission for England and Wales* [2009] UKFTT 377 (GRC), concerning part of Central Park in Dartford; and *Morris and Mason v Charity Commission for England and Wales* (26 March 2010) First-tier Tribunal (GRC) (Charity), concerning Romsey Public Walk and Pleasure Ground in Hampshire.

[104] The regime should not apply in so far as another regime applies to them, for example, a requirement to obtain the Secretary of State's consent under the Universities and College Estates Act 1925, on which see para 8.113 and following below.

acquire land at an overvalue. In order to protect charities against that risk, it would be possible to require trustees to obtain advice when acquiring, as well as when disposing of, land. This would create consistency across land transactions. Whilst this would appear to increase the regulatory burden on trustees, it should be noted that the Charity Commission already strongly recommends that charity trustees comply with the existing requirements in Part 7 of the Charities Act 2011 when acquiring land as a matter of good practice. It would therefore be bringing the law into line with current practice recommended by the Charity Commission and, by relaxing the requirements concerning appropriate advice, it would reduce the burden on charity trustees who currently follow the Charity Commission's recommended practice.

8.93 Applying the new regime to acquisitions as well as disposals may, however, present some problems. Any increased delay in the process may be more acutely felt with acquisitions than disposals, since a charity's bid may be declined if the transaction will take longer to complete. Our proposed requirements for disposals, however, seek to eliminate the problems associated with delay by making the advice requirements more flexible; charity trustees will not have to wait for a detailed written report from a qualified surveyor. The advice may come in other forms, and the trustees may even decide that they do not need advice at all.

8.94 Whilst including acquisitions would bring consistency across all land transactions, it would not eliminate inconsistencies in the law. Most notably, there would remain no advice requirements when trustees dispose of, or acquire, other assets.[105] So it may do no harm to continue to single out one particular type of transaction – disposals of charity land – for special treatment as compared with all other transactions, rather than applying that special treatment to all transactions involving land (both disposals and acquisitions).

8.95 **We invite the views of consultees as to whether the new advice requirements that apply to disposals of charity land should also apply to the acquisition of land by charities.**

FORMALITIES AND LAND REGISTRATION

8.96 Where the current requirements of Part 7 of the Charities Act 2011 apply to a transaction, and the charity trustees proceed without complying with those requirements, the transaction will be void. The Charities Act 2011 contains provisions designed to safeguard purchasers of land from charities against that risk. The same provisions also protect purchasers from the risk that the transaction will be rendered void or voidable because of non-compliance with any other restrictions on the trustees' powers, in the trust deed or other governing document of the charity.

The conveyancing procedure

8.97 Sections 122 and 123 of the Charities Act 2011 ensure that those who need to know whether Part 7 applies to the transaction are informed of the position; more importantly, they provide that any restrictions on the trustees' powers – not only in Part 7 but also elsewhere – are deemed to have been complied with when the

trustees so certify. The workings of the conveyancing provisions are best understood if we begin with acquisition.

8.98 When land is acquired by a charity – whether by purchase, gift or assent – the transfer or other document is required to state that the land is going to be held by a charity as a result of the disposition, whether the charity is an exempt charity, and (if it is not exempt) whether the requirements of Part 7 will apply to the land.[106] The result of that statement is that when the acquisition is registered (whether or not that is a first registration[107]) the registrar will enter a restriction on the register of title if Part 7 applies. The effect of the restriction is that no disposition of the land will be registered unless the requirements of Part 7 have been met.[108]

8.99 Accordingly, a disposition of charity land to which Part 7 applies – whether a sale, a mortgage, or any other relevant disposition – will be controlled by the restriction. The restriction alerts a future purchaser to the requirements of the statute and to the need to ensure that the transfer, lease or other instrument is in a form that he or she can rely on. However, the purchaser is not required to check that an order of the Charity Commission or of the court has been made, or that advice has in fact been given in accordance with the requirements of sections 119, 120 or 124.

8.100 Instead, the transfer, mortgage or other disposition that triggers Part 7, and any contract for such a disposition, must state that the land is charity land, whether the charity is an exempt charity, and whether the Part 7 requirements apply.[109] If they do, the trustees must certify in the transfer, mortgage or other deed (but not in a contract) that they have power under the trusts of the charity to effect the disposition and that the requirements of Part 7 have been complied with.[110]

[105] Save where they acquire investments, on which see n 70 above.

[106] Charities Act 2011, s 122(7) and (8); if the acquisition is of registered land or will trigger first registration the statement must be in the form prescribed by Land Registration Rules 2003: Charities Act s 123(1).

[107] It is difficult to conceive of situations today where the acquisition of unregistered land by a charity for a freehold or leasehold estate – save for leases of seven years or less – will not trigger first registration: Land Registration Act 2002, s 4.

[108] If a charity, after being registered as the proprietor of land, becomes an exempt charity, or an exempt charity ceases to be such, the charity trustees must apply for an appropriate alteration to the register. They must also apply for a restriction if a landowner declares a trust over registered land in favour of a charity. See Charities Act 2011, s 123 (3), (4) and (5).

[109] Charities Act 2011, ss 122(2) and 125(1). Note that this means that although exempt charities do not have to comply with the requirements of Part 7, they must comply with the requirement to make this statement. In registered land the statement is technically unnecessary because the same information can be found by checking whether there is a restriction on the trustees' title. If there is no restriction on the title, the registered proprietor's "right to exercise owner's powers in relation to a registered estate or charge is to be taken to be free from any limitation affecting the validity of a disposition": Land Registration Act 2002, s 26. So in the absence of a restriction the purchaser of registered land need not be concerned about Part 7 of the 2011 Act.

[110] Whether by an order of the court or the Charity Commission, or by compliance with the advice requirements: Charities Act 2011, ss 122(3) and 125(2).

Where that certificate is given it is conclusively presumed, in favour of a purchaser,[111] to be true.[112]

8.101 That presumption means that when the disposition is registered, the registrar can be satisfied that the restriction has been complied with and will register the disposition; it also protects the purchaser from any later finding that the disposition was void.

8.102 Where the charity is disposing of unregistered land, of course, the mechanism of the restriction is absent. Instead, the purchaser on examining the charity's title deeds (prior to buying the land or taking a mortgage) will often be aware of the need for the trustees to comply with the requirements of Part 7;[113] again, if a certificate is given in the transfer[114] (or mortgage, lease, or other deed) then the purchaser is protected.

8.103 Section 122(6) adds a further protection: if the certificate is not given the requirements of Part 7 are nevertheless deemed to have been complied with in favour of a purchaser in good faith. This is most likely to be relevant where the charity is disposing of unregistered land. It is unlikely to be relevant in registered land because the restriction ensures that the transaction will not be registered unless the certificate is given, and accordingly the purchaser will not enter into a contract to purchase the land unless the certificate is given in the contract.[115] If the registered title does not contain a restriction, a purchaser is already protected since he or she is entitled to assume that there is no limitation on the registered proprietor's powers.[116]

8.104 The system is thus designed to protect purchasers while at the same time, because of the form of the protection – given by the making of statements and certificates – alerting charity trustees to their duties. It does not in fact ensure compliance with those duties; the purchaser is protected even if the certificate is false. And, as noted above, the protection given to purchasers encompasses not only compliance with Part 7 but also compliance with any other restrictions on the

[111] Anyone who acquires an interest in the land for money or money's worth: see Charities Act 2011, ss 123(4) and 125(3).

[112] Charities Act 2011, ss 122(4) and 125(3). Section 125(6) and (7) contains corresponding provision concerning the certificate given in respect of further advances under an existing mortgage.

[113] Either (a) by noting the statement made on acquisition (see para 8.98 above, but such a statement will only have been made in the case of acquisitions that post-dated the Charities Act 1992) or (b) by noting any declaration of charitable trust on the face of the conveyance to the charity. If the purchaser is not aware, and so does not obtain a certificate from the trustees, he or she may still be protected: see para 8.103 below.

[114] We say "transfer" rather than conveyance because the disposal will trigger first registration and so the form used will be a transfer.

[115] If the transfer itself, in which the certificate is given, is forged then the disposition will be void at common law but will confer a good title upon the purchaser once registered: Land Registration Act 2002, s 58, subject to the provisions for alteration and rectification in Sch 4 to the Land Registration Act 2002. The purchaser may lose title because of the forgery but will not necessarily do so; at any rate, that will be as a result of the forgery of the disposition and not related to the requirements of Part 7.

[116] Land Registration Act 2002, s 26; see n 109 above.

trustees' powers. This is because the certificate has to state that the trustees have power under the trusts of the charity to effect the disposition.

The effect of reform upon conveyancing procedure

Reform of the statement and certificate requirements in Part 7 of the Charities Act 2011

8.105 Whether any change is needed to the provisions described above depends entirely upon whether any change is made to the requirements with which charity trustees must comply when dealing with land. If Part 7 of the Charities Act 2011 remains unamended, or is replaced by provisions non-compliance with which would render the transaction void, then protection for purchasers would still be needed. Sections 122 and 125 achieve that protection without difficulty.[117]

8.106 Equally, if Part 7 is replaced by provisions having the effect that we have provisionally proposed above,[118] or by any provision non-compliance with which does not render the transaction void (or voidable), then there will be no need for the provisions as to statements and certificates so far as statutory restrictions upon the trustees' powers are concerned.

*The "*Bayoumi *gap"*

8.107 The issue in *Bayoumi v Women's Total Abstinence Educational Union Ltd,*[119] in brief, was whether a purchaser in good faith under a contract had the benefit of the protection in section 122(6) (see paragraph 8.103 above) when the charity trustees had not complied with the statutory requirements. The answer was that the purchaser was not protected. So whilst purchasers are protected in the case of *dispositions*,[120] the effect of the decision in *Bayoumi* is that there is no equivalent protection for *contracts*.[121]

8.108 The precise facts in *Bayoumi* cannot arise again because the relevant statutory provisions (which made a contract unenforceable) have been amended. But the fact remains that if the requirements of Part 7 have not been complied with by the time a contract is made, a purchaser will not be able to enforce it. Essentially it will be frustrated because of the failure to comply with the Part 7 requirements. The statute does not provide for a certificate to be given in the contract and any such certificate is not deemed to be correct. Accordingly purchasers who contract to buy, or to take a lease of, land from a charity have to check that the statutory requirements have been complied with. This is onerous, and causes delay and expense.

[117] It might be that some tidying could be achieved; we noted above that the statements required by s 122(2) and s 125(1) are strictly unnecessary where title to the land is registered, because the requisite information is conveyed entirely by the presence or absence of a restriction on the register; see n 109 above.

[118] See paras 8,84 and 8.85 above.

[119] [2003] EWCA Civ 1548, [2004] Ch 46.

[120] Either because (a) the trustees' certificate in the transfer or other document effecting a disposition is conclusively presumed to be correct (s 122(4)) or (b) in the absence of such a certificate, a purchaser in good faith is nevertheless protected (s 122(6)).

[121] We discuss *Bayoumi* in para 8.71 above.

8.109 **We provisionally propose that if the Part 7 requirements are not amended, or are replaced with other requirements non-compliance with which will render the transaction void, then a purchaser should be protected by a certificate, deemed conclusively to be correct, in the contract that the statutory requirements have been complied with.**

Do consultees agree?

Other limitations upon trustees' powers

8.110 If the Part 7 conveyancing provisions are repealed, the purchaser would be left without any special protection so far as concerns limitations upon the trustees' powers in the trust deed or other governing documents. Such limitations do not take effect in registered land in the absence of a restriction on the register;[122] and we think that for such limitations the restriction provisions do all that is needed in this context as they do in other cases – for example where land is held on a non-charitable trust and cannot be disposed of without the consent of a named person. In that case it is the purchaser's responsibility to see that the condition in the restriction is complied with and to produce evidence of that compliance that is satisfactory to the registrar. We do not think that that would generally be problematic.[123] Accordingly we take the view that the special protections found in Part 7 of the Charities Act 2011 would be unnecessary to protect purchasers from the sort of limitation on their powers that might be found in a trust deed. Such limitations are likely to be matters like consent that are easy for the purchaser to check.

8.111 In the case of unregistered land, the purchaser is protected by the normal rules of equity that would protect a purchaser in good faith without notice of a restriction upon the trustees' powers in the trust deed.

8.112 Accordingly we think that there would be no need for the provisions of sections 122 and 125 to remain in the absence of the Part 7 requirements for orders and advice.

THE UNIVERSITIES AND COLLEGE ESTATES ACTS

8.113 The regime in Part 7 of the Charities Act 2011 does not apply to dispositions and mortgages "for which the authorisation of the Secretary of State is required under the Universities and College Estates Act 1925".[124] We refer to this as "the UCEA exception".

Historical background to the Universities and College Estates Acts 1925 and 1964

8.114 The Universities and College Estates Act 1925 ("the UCEA 1925") applies to:

(1) the Universities of Oxford, Cambridge and Durham ("the universities");

[122] Land Registration Act 2002, s 26; see n109 above.

[123] Transitional provisions would be necessary to ensure that existing restrictions in the register that reflect both Part 7 limitations and limitations in the trust deed are not simply ignored when the Part 7 limitations are removed.

[124] Charities Act 2011, ss 117(3)(b) and 124(9)(b).

(2) the colleges and halls of Oxford, Cambridge and Durham ("the colleges");

(3) Winchester College; and

(4) Eton College.[125]

8.115 The UCEA 1925 was a power-conferring Act.[126] A series of "disabling statutes" had prevented the colleges (but not the universities), Winchester College and Eton College from disposing of land.[127] The UCEA 1925 conferred on them numerous powers to deal with land subject to conditions and, in respect of some powers, subject to the Minister's consent ("the Listed Powers").[128] Section 21 conferred a general power to enter into any other unlisted transaction provided they obtained the Minister's consent ("the General Power").

8.116 The Universities and College Estates Act 1964 ("the UCEA 1964"):

(1) repealed the "disabling statutes", but only in respect of the colleges;

(2) removed the requirement for Ministerial consent to the exercise of the Listed Powers, but only in respect of the colleges and universities;

(3) left unchanged the need for Ministerial consent to the exercise of the General Power; and

(4) left the UCEA 1925 unchanged in respect of Winchester College and Eton College.

The universities and colleges

8.117 Although the matter is not free from doubt, it seems that the UCEA 1925 supplemented the existing powers of the universities and colleges.[129] Following the repeal of the disabling statutes by the UCEA 1964, the colleges could exercise the UCEA 1925 powers or the powers in their governing documents. And the universities were never subject to the disabling statutes, so could always exercise the UCEA 1925 powers or the powers in their governing documents.

8.118 The universities and colleges, therefore, only need the Minister's consent to a disposal of land if they need to rely on the General Power. If they have the necessary power in their governing documents, or if the transaction falls within

[125] UCEA 1925, s 1. The universities are exempt charities, but the colleges are not: Charities Act 2011, Sch 3, paras 2 and 4(2). Following the Charities Act 2006, Winchester College and Eton College ceased to be exempt charities.

[126] It consolidated the Universities and College Estates Acts 1858 to 1898. For a historical summary, see *Hansard* (HC) 13 March 1964, vol 691, cols 939 to 949.

[127] The Ecclesiastical Leases Acts 1571, 1572, 1575 and 1836.

[128] Powers had also been conferred on Eton College by a scheme made in 1904 which overrode the disabling statutes: *Eton College v Minister of Agriculture, Fisheries and Food* [1964] 1 Ch 274.

[129] UCEA 1925, ss 25(2) and 42. See, also, the view of Jesus College's historians: http://www.jesus.cam.ac.uk/about-jesus-college/old-library-archives/estates-finances/legal-restrictions/.

the Listed Powers, they do not need Ministerial consent, and the UCEA exception will not apply.[130]

Winchester College and Eton College

8.119 As with the universities and colleges, it seems that the UCEA 1925 supplemented any existing powers of Winchester College and Eton College. Whilst the UCEA 1964 did not repeal the disabling statutes as far as the Winchester College and Eton College were concerned, the Statute Law (Repeals) Act 1998 did. Winchester and Eton can therefore now rely on the UCEA 1925 powers and the powers in their governing documents.[131] The exercise of some of the Listed Powers under the UCEA 1925 remains subject to Ministerial consent, since the UCEA 1964 did not remove that requirement for Winchester and Eton.

8.120 Winchester and Eton, therefore, only need the Minister's consent to a disposal of land if they need to rely on the General Power or certain Listed Powers. If they have the necessary power in their governing documents, or if the Listed Power does not require the Minister's consent, they do not need Ministerial consent, and the UCEA exception will not apply.[132]

Application of Part 7 of the Charities Act 2011

8.121 Part 7 does not apply if a transaction must be authorised under the UCEA 1925.[133] As far as the universities and colleges are concerned, the requirements in Part 7 will apply unless they are using the General Power.[134] As far as Winchester and Eton are concerned, the requirements in Part 7 will apply unless they are using the General Power or certain Listed Powers.[135]

8.122 The Minister might require the trustees to obtain advice as a condition of granting consent under the UCEA 1925. But in our view trustees should be under the same obligation to obtain advice whether or not they are obtaining Ministerial consent to the disposition, particularly if the advice requirements are relaxed as we propose above. The advice requirements would be appropriate when the institutions are using the General Power just as much as when they are using other powers that do not require Ministerial consent. We think that the UCEA exception is complicated and unnecessary, and we see no reason for its continuation under the new regime.

[130] The universities would still not be required to comply with the Part 7 requirements because they are exempt; the colleges would have to comply because they are not.

[131] As noted in n 130 above, Eton College enjoyed certain powers under a scheme made in 1904. Eton College has also told us that its statutes were amended under the Public Schools Act 1868 to include supplemental powers. Winchester College, by contrast, has told us that its powers are limited to those under the UCEA 1925.

[132] Until the Charities Act 2006, Winchester College and Eton College would not have had to comply with Part 7 in any event by reason of being exempt charities, but their exempt status was removed by the Charities Act 2006, s 11(3). We have been told by Eton College that transactions it enters into using powers conferred under the Public Schools Act 1868 are exempt under Charities Act 2011, s 117(3)(a) (see para 8.9(1) above).

[133] See para 8.113 above.

[134] Unless they are otherwise exempt from the Part 7 requirements, for example, by reason of being an exempt charity.

[135] Unless they are otherwise exempt from the Part 7 requirements: see n 132 above.

8.123 **We provisionally propose that the advice requirements under the new regime should apply even if the transaction must be authorised by the Secretary of State under the Universities and College Estates Act 1925.**

Do consultees agree?

Replacing the UCEA 1925 with general statutory powers

8.124 Our consideration of the UCEA 1925 has led us to question whether the UCEA 1925 is helpful to the institutions to which it applies. When they need to rely on the UCEA 1925 powers,[136] they must sometimes obtain Ministerial consent to enter into transactions that other charities can enter without restriction. Many charities will enjoy the benefit of the default powers conferred by the Trusts of Land and Appointment of Trustees Act 1996 and by the Trustee Act 2000, but those powers appear not to apply to the universities, the colleges, Winchester College and Eton College.[137] The UCEA 1925 could be repealed and replaced by general powers which are not subject to Ministerial consent.

8.125 **We invite the views of consultees as to whether the Universities and College Estates Act 1925 should be repealed and the institutions to which it applies given the general powers of an owner similarly to trustees under the Trusts of Land and Appointment of Trustees Act 1996 and the Trustee Act 2000.**

THE IMPACT OF REFORM

8.126 In considering the potential benefits of reform, we would be assisted by consultees' experiences of complying with Part 7 of the Charities Act 2011, in particular:

(1) delays caused by the requirements to obtain advice on disposals or mortgages, or to obtain Charity Commission consent, and their consequences;

(2) costs incurred, including surveyor's costs and legal costs, in complying with the statutory requirements;

(3) staff and trustee time that has been taken up in seeking to comply with Part 7;

(4) any additional costs caused by the "*Bayoumi* gap"; and

(5) whether the Part 7 requirements have been of benefit to charities, for example, by preventing charities from entering into transactions at an undervalue.

[136] Rather than on their governing document.

[137] Section 1(3) of the Trusts of Land and Appointment of Trustees Act 1996 and s 10(1)(b) of the Trustee Act 2000 provide that the default powers do not apply to land (or a trust) "to which [the UCEA 1925] applies". This wording is ambiguous, since the UCEA 1925 applies to named institutions, rather than their "land" or "trusts". Nevertheless, these provisions would appear to be intended to exclude the named institutions from the default powers.

8.127 **We invite consultees to share with us their experiences, including any delays and costs incurred, in seeking to comply with Part 7 of the Charities Act 2011 when disposing of or granting mortgages over charity land.**

CHAPTER 9
PERMANENT ENDOWMENT

INTRODUCTION

9.1 This Chapter considers the law relating to the use of permanent endowment. Permanent endowment is property belonging to a charity that the charity cannot spend. In many cases, permanent endowment will be a fund of assets such as shares or government bonds that produce an income to fund the charity's activities. Although the charity might be able to sell an investment in the fund to purchase another investment, it cannot sell an investment and spend the proceeds to further its purposes. It is also possible for a charity to hold as permanent endowment property that does not produce an income but is used by the charity to pursue its purposes, for example a village hall or a recreational ground. Again, the charity might be able to sell it and purchase other property that performs the same function,[1] but it cannot spend the proceeds of any sale on its day-to-day activities.

9.2 The inability to dispose of permanent endowment can offer long-term financial security and enable donors to provide lasting benefits to particular causes. On the other hand, charities cannot rely on permanent endowment to meet their spending needs. This can cause difficulties for a charity facing an income shortage or wanting to use its resources in a more flexible way. And whilst the restriction on spending permanent endowment protects the capital of the charity, it does not in itself protect capital value in real terms, with the result that over time the relative value of the endowment may diminish.[2]

9.3 The Charities Act 2006 introduced major reforms to enable charities to override the restrictions on spending their permanent endowment. Prior to these reforms, only very small charities[3] could release the spending restrictions, and only where the permanent endowment was too small for any useful purpose to be achieved by the expenditure of income alone. In all other cases, the charity had to apply to the court or the Charity Commission for authorisation. There is now a general power for charity trustees to resolve to release the spending restrictions where this would enable the charity more effectively to carry out the purposes for which the permanent endowment is held, though in some cases the resolution must be approved by the Charity Commission.[4]

9.4 These reforms were broadly welcomed as providing charities with greater flexibility in their dealings with permanent endowment, but we have heard that certain problems remain. In this Chapter we examine the law that governs how a charity can release the restrictions on spending its permanent endowment, and

[1] See for example *Oldham Borough Council v Attorney General* [1993] Ch 210, discussed in paras 9.26 and 9.27 below.

[2] See para 9.22 and n 27 below where we give the example of a permanent endowment of £2,000 that has not grown in capital value over time. £2,000 would have been a significant fund 100 years ago, whereas that amount would be considered much more modest today.

[3] With a gross income of not more than £5 under the Charities Act 1985, and not more than £1,000 under the Charities Act 1993. See paras 9.31 to 9.35 below.

[4] See paras 9.37 to 9.41 below.

we make provisional proposals for its reform. We go on to consider whether charities should be permitted to opt into a new regime that would seek to ensure the permanence of a fund whilst removing the technical restrictions that currently apply to permanent endowment.

9.5 We are not consulting on whether it should remain possible to give or create permanent endowment. We acknowledge, however, that there are some who advocate its abolition on the basis that the limitations on its use, and the administrative and accounting burdens it can impose on the charity, outweigh its benefits.

BACKGROUND

9.6 This Chapter follows our earlier review of social investment by charities,[5] in which we gave detailed consideration to the social investment of permanent endowment. We concluded that, all other things being equal, charities are permitted to use permanent endowment to make social investments, other than social investments that are expected to generate a negative financial return, since this would amount to spending the permanent endowment.[6] If a charity wished to make such a social investment then it would first have to release the spending restrictions that applied to the relevant portion of its permanent endowment.

9.7 Several consultees expressed dissatisfaction with the current procedures for releasing the spending restrictions. Some felt uncomfortable with the connotations of releasing the spending restrictions, likening it to "selling the family silver". They questioned whether it ought to be necessary to take this step where all that is being sought is to "borrow" from permanent endowment, or to make a social investment that will exist within a portfolio structured in such a way that any capital losses from the investment are expected to be offset by gains elsewhere.[7]

9.8 We declined to recommend a specific power for charities to use permanent endowment to make social investments with an expected negative financial return.[8] Such a power would be complex,[9] and we were not satisfied that it would necessarily represent an improvement to the law. Moreover, we considered that the problems identified by consultees would be better addressed in a general review of the law relating to the use of permanent endowment.

[5] Social Investment by Charities: The Law Commission's Recommendations (September 2014) ("Social Investment Recommendations Paper"); Social Investment by Charities (2014) Law Commission Consultation Paper No 216 ("Social Investment Consultation Paper").

[6] Social Investment Consultation Paper, paras 5.11 to 5.15.

[7] Social Investment by Charities: Analysis of Responses (September 2014), para 3.255 and following.

[8] Social Investment Recommendations Paper, paras 1.62 to 1.80.

WHAT IS PERMANENT ENDOWMENT?

9.9 In this section we briefly discuss the statutory definition of permanent endowment, the distinction between "investment" and "functional" permanent endowment, how permanent endowment differs from other forms of charity property, and the way in which permanent endowment is held.

Statutory definition of permanent endowment

9.10 The current definition of permanent endowment appears in section 353(3) of the Charities Act 2011.

> A charity is to be treated for the purposes of this Act as having a permanent endowment unless all property held for the purposes of the charity may be expended for those purposes without distinction between—
>
> (a) capital, and
>
> (b) income;
>
> and in this Act "permanent endowment" means, in relation to any charity, property held subject to a restriction on its being expended for the purposes of the charity.

9.11 Whether such a restriction exists is a matter of construction of the governing document and, where relevant, other documents such as conveyances and wills and even historical evidence of how the property in question has been used. The Charity Commission has indicated that:

> It is not necessary for there to be a clear power to spend capital in order to support the view that the charity's assets are all expendable and consequently not subject to a permanent endowment restriction.[10]

9.12 Equally, however, it is not necessary for there to be an express restriction on spending capital in order to show that the charity holds permanent endowment. An express power to spend income in the absence of a power to spend capital might indicate that the charity has permanent endowment.[11]

[9] There would be complexity, for example, in ensuring that investments that play a recoupment or offsetting role are kept (without being too prescriptive and petrifying the portfolio); in addressing the regular changes that are made to an investment portfolio over time; in setting appropriate limits on the period over which recoupment or offsetting must take place; in setting appropriate limits on the proportion of the endowment fund that could be invested in social investments; and in addressing how recoupment or offsetting should function when there are general market failures. See Social Investment Recommendations Paper, n 55.

[10] Charity Commission, *OG545-1 Identifying and Spending Permanent Endowment* (updated 28 May 2014) ("OG545-1"), para E1.1, available at http://ogs.charitycommission.gov.uk/g545a001.aspx.

[11] OG545-1, para E1.1. Where the intention is not to create permanent endowment, the Charity Commission suggests including the following clause in the governing document, for

9.13 A person who donates property to a charity subject to the condition that it is held "forever" or "in perpetuity" is, in the view of the Charity Commission, likely to have created permanent endowment.[12] So too is a person who gives land and buildings to a charity upon trust specifically to provide homes for the elderly, with no express power for them to be sold.[13] Conversely, if money is donated to a charity to be invested, but the charity trustees are given absolute discretion to spend it if they see fit, then it will not be permanent endowment.[14]

Figure 10: examples of permanent endowment

In its operational guidance the Charity Commission gives several examples of what may be found in a charity's governing document or other instrument to indicate that property is permanent endowment or that it is expendable.[15]

The following are examples of property that is likely to be permanent endowment:

(1) land and buildings held for a specific charitable purpose with no power for them to be sold;

(2) money donated on the condition that it is to be invested and the income received from the investment is to be spent on the purposes of the charity;

(3) property that is to be held "forever" or "in perpetuity"; and

(4) surplus income that is set aside by the trustees pursuant to a power of accumulation and invested to increase the income of the charity.

The following are examples of property that is unlikely to be permanent endowment:

(1) money to be spent by the trustees in furtherance of the purposes of the charity in such manner as they see fit; and

(2) money donated to be invested but which can be spent if the trustees so decide.

"Investment" and "functional" permanent endowment

9.14 We noted above that permanent endowment can consist of investment property that produces income to be spent for the purposes of the charity, or it can be property used directly by the charity to pursue its purposes.[16] The Charity

the avoidance of doubt: "The trustees must apply the income and, at their discretion all or part of the capital, of the charity in furthering the objects." See Charity Commission, *Model trust deed for a charitable trust* (November 2013) cl 4.

12 OG545-1, para D1.3.

13 OG545-1, para D1.1. In this scenario, the charity trustees would have an implied power of sale under s 6(1) of the Trusts of Land and Appointment of Trustees Act 1996, but the absence of an express power would suggest that the donor intended the land and buildings to be retained, without the possibility of their being sold and the proceeds spent. The charity trustees would therefore need to be sure that any sale pursuant to the implied power is consistent with the terms of the trust.

14 OG545-1, para D1.5. The money would be "expendable endowment": see para 9.17 and n 20 below.

15 OG545-1, para D1.

16 See para 9.1 above.

Commission labels the former as "investment" (or "non-functional") permanent endowment and the latter as "functional" permanent endowment.[17]

9.15 Only the income from investment permanent endowment can be spent on the charity's purposes; any capital returns form part of the permanent endowment and so cannot be spent.[18]

9.16 Functional permanent endowment typically comprises land and buildings, but might be works of art or other items of cultural or historical significance.[19] Often functional permanent endowment will be held on trust for a particular charitable purpose within the overall objects of the charity, as in the above example of the charity given land for the specific purpose of providing homes for the elderly. In some cases the purpose will be so specific that it can only be fulfilled by the retention of the original property, for instance a charity established for the purpose of preserving the particular historical building that it owns.

Permanent endowment and other forms of charity property

9.17 The distinguishing feature of permanent endowment is that it cannot be spent on the purposes of the charity. Property that is freely expendable, but which the charity trustees are under no obligation to spend, is commonly referred to as "expendable endowment".[20]

9.18 Permanent endowment must also be distinguished from the income, if any, that it produces. Whereas charity trustees must not spend permanent endowment, they cannot retain income for any longer than is necessary in the performance of the trusts on which that income is held.[21] Charity trustees must carry out the purposes of the trust and in doing so they must act impartially between the charity's current and future beneficiaries.[22] Permanent endowment and income perform different roles in enabling the charity trustees to discharge these duties. Whereas permanent endowment exists to ensure the continued existence of the charity for the benefit of future beneficiaries, income is primarily intended for distribution for the benefit of those in immediate need of the services of the

[17] OG545-1, para E1.2. Land which is functional permanent endowment is also known as "designated land": see para 8.22 above.

[18] Unless the charity invests its permanent endowment on a total return basis, on which see paras 9.45 to 9.48 below.

[19] Had the court in *Re Wedgwood Museum Trust Ltd* [2011] EWHC 3782 (Ch), [2013] BCC 281 (see para 13.71 below) found that the collection of pottery and other artefacts was permanent endowment then it would have been functional permanent endowment.

[20] See, for example, Charity Commission, *Charities and Reserves* (CC19) (June 2010) section A4 and Annex 2, available at http://cc-admin.charitycommission.gov.uk/media/93927/cc19text.pdf. In *Re Gilchrist Educational Trust* [1894] 1 Ch 367, Kekewich J held that property that the trustees were entitled, but not obliged, to apply for charitable purposes was "endowment" within the meaning of s 66 of the Charitable Trusts Act 1853.

[21] See *Attorney General v Alford* (1854) 4 De G M & G 843, 43 ER 737; *Re Peel* [1936] Ch 161; and *Re Gourju's Will Trusts* [1943] Ch 24.

[22] *Learoyd v Whitely* (1886) LR 33 Ch D 347, 350, by Cotton LJ; *Nestle v National Westminster Bank plc* [2000] WTLR 795. See Social Investment Consultation Paper, para 5.12.

charity.[23] This means that income must usually be spent within a reasonable period of receipt.[24] However, in appropriate circumstances, and where authorised by the terms of the trust, income can be added to permanent endowment by way of accumulation.[25]

9.19 A final word should be said about corporate property. The distinctions between permanent endowment, expendable endowment and income apply only in relation to the administration of charitable trusts. No such distinctions apply to the property owned outright by a charitable company. A charitable company is free, subject to its governing document and the rules of company and charity law, to apply any of its corporate property freely in pursuit of its charitable objects. This is why charitable companies cannot hold permanent endowment otherwise than as a corporate trustee, and thus permanent endowment is always held on trust.[26]

SPENDING PERMANENT ENDOWMENT

9.20 We now look at what it means to spend permanent endowment and how this differs from "converting" it into other property to be held subject to the same restriction on capital expenditure. We then consider some of the reasons why a charity might want to spend its permanent endowment.

The meaning of "spending" permanent endowment

9.21 In most cases permanent endowment is valuable property, such as land or shares. Generally, to spend permanent endowment is to spend its liquidated value, in other words the proceeds of any sale of the property. Equally, permanent endowment can be said to be expended when it is invested in such a way that capital value is lost, for the sake of a particularly high income yield.

9.22 The trustees' obligation is to preserve the actual, pound for pound value of the fund.[27] That has two consequences. One is that the trustees are not free to balance or offset losses and gains within the fund; they do not have the freedom to invest permanent endowment in a fund expected to yield high income but to lose capital and offset that with expected capital gains from another investment. The other is that there is no obligation to maintain the *real* value of the permanent

[23] Expendable endowment sits somewhere between the two: it can be used to ensure the continued work of the charity but the charity trustees have a discretion to spend it when they need to; they must exercise this discretion in accordance with their duties to the charity.

[24] Charities can, of course, retain income reserves, on which the Charity Commission publishes specific guidance: see n 20 above.

[25] Statute limits any power to accumulate income to a period of 21 years or until the death of the settlor if so provided in the trust deed: Perpetuities and Accumulations Act 2009, s 14; see also The Rules Against Perpetuities and Excessive Accumulations (1998) Law Com No 251, paras 10.18 to 10.20.

[26] We explain this in detail in paras 13.22 to 13.28 below.

[27] We use the term "actual value" to mean the original sum given to the charity or held by it at any time. The real value of the fund, by contrast, is the actual value adjusted for inflation. According to the Bank of England's inflation calculator, a gift of £2,000 to a charity in 1915, say, would have had a real value in 2014 of approximately £183,600 based on average inflation of 4.6% per year: see http://www.bankofengland.co.uk/education/Pages/resources/inflationtools/calculator/flash/default.aspx.

endowment, allowing for inflation. Generally trustees will of course aim to do so; but if the value of the fund remains nominally the same, without capital growth, that in itself does not amount to spending permanent endowment.[28]

9.23 Releasing the restriction on spending permanent endowment does not change the charitable purposes for which an asset is held. Absent a cy-près scheme, the proceeds of sale can only be spent on the particular charitable purposes for which the permanent endowment was held, which might be more limited than the charity's general purposes.

"Converting" permanent endowment

9.24 Whereas spending permanent endowment is prohibited, selling permanent endowment and using the proceeds to purchase replacement property is generally permissible, subject to the trusts on which the permanent endowment is held. We call this "converting" permanent endowment.

9.25 It may not, however, be possible for the trustees to convert permanent endowment if its retention is necessary to achieve the charitable purpose or purposes for which it is held; in these circumstances the trustees will need a cy-près scheme before they can convert the property.[29] This issue arises more frequently in relation to functional permanent endowment than it does in relation to investment permanent endowment.

9.26 In *Oldham Borough Council v Attorney General*[30] the Council sought to sell a recreational ground that it held as functional permanent endowment on trust for the benefit of the inhabitants of the local area and use the proceeds to acquire other land for the same purpose. It was argued on behalf of the Attorney General that the retention of the land was a purpose of the trust; accordingly, any sale of the land would involve a departure from those purposes and could only be made under a cy-près scheme.[31]

9.27 The Court of Appeal unanimously disagreed. The retention of the land was not a purpose of the trust; consequently, the court could authorise the sale without the use of a cy-près scheme. Lord Justice Dillon explained that there are some cases where the qualities of the property in question are such that any sale would necessitate an alteration of the charitable purposes for which the property is held, for example where there is a trust to retain for the public benefit a house once owned by a historical figure. However, this was "far away from cases such as the present" where the charitable purpose could be carried out on other land.[32]

[28] Depending on the circumstances, the trustees might take the view that their duty of even-handedness requires them to maintain the real value, but the source of that duty is not the permanent endowment restriction. See the discussion at paras 5.11 to 5.16 of the Social Investment Consultation Paper.

[29] See paras 3.28 and following and 9.16 above.

[30] [1993] Ch 210.

[31] The importance of this issue lay in the fact that the court had no jurisdiction to make a cy-près scheme because no cy-près occasion had arisen: see para 3.28 above.

[32] [1993] Ch 210, 222. See also *Sparrow, Carne and Websper v The Charity Commission for England and Wales and the Trustees of the Bath Recreation Ground* (27 March 2014) First-tier Tribunal (GRC) (Charity), [56].

9.28 It is possible for the trust instrument to restrict the conversion of permanent endowment in other ways. For example, a charity might receive money on trust as investment permanent endowment subject to the requirement that it be invested in savings bonds. The trustees might want to redeem the bonds and invest in shares instead. We would expect the Charity Commission or the court to find such a requirement to be an administrative restriction only, and not a purpose of the trust,[33] with the result that it could be removed by an administrative scheme.[34]

Why might charities want to spend their permanent endowment?

9.29 In Figure 11, we set out some reasons why a charity might wish to spend its permanent endowment.

Figure 11: why might charities want to spend their permanent endowment?

(1) The fund might be so small that the costs of administering it are disproportionate to the income it yields, so it would be better to spend the fund or combine it with other funds. This was the purpose behind the original provisions in the Charities Act 1985 permitting trustees to release permanent endowment restrictions.

(2) The charity's overwhelming need might be current, not future, leading the trustees to the view that the charity's purposes would be better served by spending part or all of the permanent endowment on its purposes now.

(3) As part of a total return approach to investment (on which see paragraphs 9.45 to 9.48 below), charities might wish to spend capital in years of low income yield.

(4) Charities might wish to make a social investment that is expected to yield a negative financial return, and to invest the remainder of the permanent endowment in such a way that any loss on the social investment is offset by expected gains elsewhere.

(5) Charity trustees might be advised to invest in an asset or fund offering a high income yield, with dwindling capital value, as part of a balanced portfolio.

(6) A charity might need to carry out major works, such as repairs to a village hall roof, and might wish to use permanent endowment with the intention of replenishing the fund over a period of time afterwards

RELEASING THE RESTRICTIONS ON SPENDING PERMANENT ENDOWMENT: DEVELOPMENT OF THE LAW AND THE CURRENT FRAMEWORK

9.30 In this section we analyse the evolution of the law enabling the release of the restrictions on spending permanent endowment. What began as a power for very small charities to free up small amounts of capital under the Charities Act 1985 eventually became a general code about enabling the expenditure of permanent endowment by unincorporated charities in the Charities Act 2006.

[33] In accordance with the distinction identified by Peter Gibson J in *Re JW Laing Trust* [1984] 1 Ch 143.

[34] Made by the court or the Charity Commission: see para 3.36 above.

The law before 2011

9.31 Originally, a charity could only spend its permanent endowment with the permission of the court or, following the introduction of the Charities Act 1960, by the Charity Commissioner.[35] The court and the Commission are still able to give this permission. Over the years, some charities have been given power to proceed without permission.

9.32 The Charities Act 1985 conferred a very limited power for charities to release the spending restrictions on their permanent endowment. The power was only available to charities with a gross annual income of £5 or less,[36] and only in respect of permanent endowment valued at £25 or less that was not land.[37] The power was exercisable by a unanimous resolution of the charity trustees.[38] The trustees could only pass a resolution if:

(1) they were of the opinion that the property was too small, in relation to the objects of the charity, for any useful purpose to be achieved by the expenditure of income alone; and

(2) they had considered whether any reasonable possibility existed of effecting a transfer of the charity's property to another charity.[39]

9.33 The trustees had to send a copy of the resolution to the Charity Commissioners.[40] The power was available to all charities except industrial and provident societies and friendly societies.[41]

9.34 The 1985 Act power was superseded by section 44 of the Charities Act 1992. This power was available to charities with a gross annual income of up to £1,000;[42] there was no limit on the value of the endowment that could be freed; and the power was exercisable by a resolution passed by a majority of not less than two-thirds of the trustees voting on it.[43] In other respects, however, section

[35] The court could sanction the expenditure of permanent endowment under its inherent jurisdiction to establish a scheme for the administration of a charity (or a cy-près scheme if it involved a change of purposes). This jurisdiction was extended to the Charity Commissioners (now the Charity Commission) by the Charities Act 1960, s 18. Schemes can now be made by the Charity Commission under the Charities Act 2011, s 69(1). In addition, the Charities Act 1960, s 23, enabled the Commissioners by order to sanction the expenditure of permanent endowment if it was "expedient in the interests of the charity". The Commissioners could make an order subject to a requirement that any expenditure was recouped within a specified period. Such orders are now made under the Charities Act 2011, s 105. This power cannot, however, be used to sanction anything that is expressly prohibited by the trusts of the charity: s 105(8).

[36] Charities Act 1985, s 4(1)(b).

[37] Charities Act 1985, s 4(1)(a). Those sums could be changed by statutory instrument: s 5(2).

[38] Charities Act 1985, s 4(3).

[39] Charities Act 1985, s 4(1)(c) and (2).

[40] Charities Act 1985, s 4(4).

[41] Charities Act 1985, s 4(5); Charities Act 1960, Sch 2, para (g).

[42] Charities Act 1992, s 44(1)(b). The sums could be changed by statutory instrument: s 44(9).

[43] Charities Act 1992, s 44(3).

44 was more prescriptive. It was not available to exempt charities and charitable companies,[44] and the trustees' resolution could not take effect until the Charity Commissioners had concurred with it. The trustees had to give public notice of the resolution and provide the Commissioners with a statement of their reasons for passing it.[45] The purpose of the public notice requirement was to enable interested parties to make representations to the Commissioners; any such representations had to be considered by the Commissioners in deciding whether to concur with the resolution.[46] The Commissioners had three months to notify the trustees of their decision.[47]

9.35 As before, the charity trustees could pass a resolution only if they were of the opinion that the property of the charity was too small for any useful purpose to be achieved by spending income alone, and if they had first considered transferring the property to another charity.[48]

9.36 The Charities Act 1993 replicated section 44 of the Charities Act 1992.[49] It was, however, amended significantly by the Charities Act 2006.[50] The provisions introduced by the 2006 Act were reproduced in sections 281 to 285 and 288 to 291 of the Charities Act 2011. We now turn to look at those provisions in detail.

The current law: the Charities Act 2011

9.37 Sections 281 and 282 of the Charities Act 2011 set out two mutually exclusive frameworks for charities to release the restrictions on spending their permanent endowment.[51] Each section allows the trustees of "any available endowment fund of a charity which is not a company or other body corporate"[52] to resolve to

[44] Charities Act 1992, s 44(1).

[45] Charities Act 1992, s 44(5).

[46] Charities Act 1992, s 44(6). The representations had to be made within six weeks of the Commissioners receiving a copy of the resolution from the trustees.

[47] Charities Act 1992, s 44(7). If the Commissioners concurred with the resolution then it would take effect from such date as was specified in the notification: s 44(8).

[48] Charities Act 1992, s 44(2) and (4). The power for a charity to transfer its property to another charity was contained in s 43.

[49] Charities Act 1993, s 75 (as originally enacted).

[50] The reforms implemented the recommendations originating from a review of charity law and regulation by the Prime Minister's Strategy Unit, *Private Action, Public Benefit: A Review of Charities and the Wider Not-for-Profit Sector* (September 2002), available at http://www.uk.coop/sites/storage/public/downloads/strat_data.pdf, which were accepted by Government: *Charities and Not-for-Profits: A Modern Legal Framework* (July 2003), available at http://web.archive.org/web/20030731053149/www.homeoffice.gov.uk/docs2/charitiesnotforprofits.pdf.

[51] In the light of the availability of these specific powers we do not believe that charities can use the power in s 280 of the Charities Act 2011 (see paras 3.16 to 3.18 and ch 6 above) in order to release the restrictions on spending permanent endowment. This is consistent with the view of the Charity Law Association's working group in *Response to the Charity Commission's letter on whether charities can create permanent endowment from their expendable assets* (January 2014) para 28, available at http://charitylawassociation.org.uk/api/attachment/528?_output=binary.

[52] "Available endowment fund" in relation to a charity means (a) the whole of the charity's permanent endowment if it was all subject to the same trusts, or (b) any part of its permanent endowment which was subject to any particular trusts that were different from

release the fund, or any portion of it, from the spending restrictions that apply to it. Before exercising the power, the charity trustees have to be satisfied that the purposes set out in the trusts to which the fund was subject could be carried out more effectively if the capital, or the relevant portion of the capital, could be spent.[53]

9.38 Resolutions can be passed under section 281 if (a) the charity has an income of less than £1,000, or (b) the value of the fund to be released is less than £10,000, or (c) the fund is not entirely given by a person, or two or more persons in pursuit of a common purpose.[54] Resolutions under section 281 take immediate effect and do not require the concurrence of the Charity Commission or any public consultation.[55]

9.39 If a resolution cannot be passed under section 281, the charity must instead follow the procedure in section 282. This will only be the case where:

(1) the charity's income is over £1,000; and

(2) the value of the fund to be released is over £10,000; and

(3) the fund is "entirely given".

9.40 If just one of those conditions does not apply, the trustees can pass the resolution under section 281.

9.41 A resolution passed under section 282 may not be implemented by the trustees unless the Charity Commission has concurred with it.[56] The trustees must send a copy of the resolution to the Charity Commission, which has three months to decide whether to concur with it. The Commission can suspend that period and require the trustees to provide further information or give public notice of the

those to which any other part was subject: Charities Act 2011, s 281(7). The s 281 power applies if such a fund is less than £10,000. Often, all of a charity's permanent endowment will be the "available endowment fund" because it will be subject to the same trusts. But where a charity's permanent endowment is held on different trusts, then each trust is treated separately and the s 281 power can be used for any fund under £10,000, even if the permanent endowment as a whole exceeds £10,000. This might be particularly relevant to school or university prize funds.

53 Charities Act 2011, ss 281(4) and 282(3).

54 Charities Act 2011, ss 281(2) and 282(1). The requirement for the permanent endowment to have been "entirely given" before s 282 will apply distinguishes permanent endowment donated by another from permanent endowment created by the charity itself, for example by the accumulation of income (see OG545-1, para D1.8) or, in the context of total return investment, by the allocation of unapplied total return to the trust for investment (see para 9.46 below). The Charity Law Association's working group takes the view that it might be possible for a charity to "self-endow", that is to say, to create permanent endowment to be held on trust by its trustees (or by the charity itself, in the case of a charitable company): *Response to the Charity Commission's letter on whether charities can create permanent endowment from their expendable assets* (January 2014) para 13 and following.

55 Charities Act 2011, s 281(5).

56 Charities Act 2011, ss 282(4)(b) and 284(5).

resolution. The resolution takes effect when the Commission concurs with it, or if three months pass without the Commission responding.[57]

9.42 The financial thresholds under sections 281 and 282 can be amended by order of the Minister, although that power has not been exercised.[58]

9.43 There is a parallel regime in sections 288 and 289 of the Charities Act 2011 for releasing the spending restrictions on permanent endowment held on "special trust". "Special trust" is defined as property which is held and administered by or on behalf of a charity for any special purposes of the charity, and is so held and administered on separate trusts relating only to that property.[59]

9.44 Sections 288 and 289 apply to the permanent endowment of a special trust which, as the result of a direction under section 12(1) of the Charities Act 2011, is to be treated as a separate charity for the purposes of these sections. Section 288 is the equivalent of section 281: the trustees of permanent endowment held on special trust may resolve to release the spending restrictions that apply to it without needing authorisation from the Charity Commission, but only if the value of the endowment is £10,000 or less or if it has not been entirely given. If the value of the endowment exceeds £10,000 and it is entirely given then the power in section 289 must be used. Section 289 is the equivalent of section 282: any resolution passed under section 289 is only effective with the concurrence of the Charity Commission. Unlike section 281, there is no requirement that the income of the charity (in this context, the special trust) must not exceed a certain sum in order for the trustees to pass a resolution under section 288, which may make it more likely that resolutions have to be passed under the more prescriptive section 289.

Total return investment

9.45 Permanently-endowed charities that adopt a traditional investment approach are constrained by the classification of investment returns (as capital or income) as to how they can apply those receipts. Capital returns have to be added to the endowment; only income returns can be expended on the charity's purposes. The trustees must balance the interests of their present and future beneficiaries by pursuing an investment strategy which balances capital and income returns.[60] Striking this balance has in many cases proved to be difficult and has led to sub-optimal investing (according to the nature of the return rather than its value).[61]

9.46 By contrast, total return investment permits charities to invest with a view to optimising the overall investment return, no matter whether that takes the form of capital or income. All investment returns are designated as "unapplied total

[57] Charities Act 2011, s 284(5).

[58] Charities Act 2011, s 285.

[59] Charities Act 2011, s 287(1). The "special purposes" of a charity are purposes within, but narrower than, the purposes generally for which the charity is established, such as funds raised as a result of an appeal for a particular purpose.

[60] *Nestle v National Westminster Bank plc* [2000] WTLR 795; see Social Investment Consultation Paper, para 5.12.

[61] See Capital and Income in Trusts: Classification and Apportionment (2004) Law Commission Consultation Paper No 175, para 6.11.

return". The charity then decides whether to allocate unapplied total return to the trust for investment (that is, treat it as capital and add it to the endowment fund) or to the trust for application (that is, treat it as income to be expended on its charitable purposes).

9.47 In May 2001, the Charity Commission issued guidance[62] stating that the Commission would authorise individual charities with permanent endowment to undertake total return investment using its power under what is now section 105 of the Charities Act 2011. Importantly, the guidance emphasised that charity trustees would have to obtain separate authority to *spend* any part of the endowment fund; it did not therefore permit trustees to spend endowment capital where there was no unapplied total return.

9.48 The Trusts (Capital and Income) Act 2013[63] and the Charities (Total Return) Regulations 2013 permitted trustees to resolve that their permanent endowment be free from restrictions with respect to expenditure of capital in order to invest on a total return basis, without having to seek authorisation from the Charity Commission. Regulation 4 of the 2013 Regulations[64] enables trustees to spend up to 10% of their permanent endowment, subject to recoupment. The power is intended to facilitate total return investment by permitting charities to spend capital in years when investment returns are low and replenish it later. There is no express provision that this spending power can only be used for this purpose, and therefore nothing that expressly prevents its use for the purposes outlined in Figure 11 above. We appreciate, however, that charities would be reluctant to do so, particularly as the Charity Commission's guidance seems to suggest that regulation 4 cannot be used for such a purpose.[65]

PROBLEMS WITH THE CURRENT LAW

9.49 In this section we discuss the problems with the current powers for trustees to release permanent endowment restrictions and make provisional proposals for their reform.

The unclear role of sections 288 and 289 of the Charities Act 2011

9.50 The regime in sections 281 and 282 is mirrored in section 288 and 289 for "special trusts". The latter provisions appear to be redundant. Any permanent endowment which is a "special trust" would fall within the definition of the "available endowment fund" in sections 281 and 282, so those powers would be available to release the restriction. We are not aware of the powers under

[62] Charity Commission, *OG83 Endowed charities: A total return approach to investment* (May 2001, updated in part March 2012).

[63] Implementing the Law Commission's recommendations in Capital and Income in Trusts: Classification and Apportionment (2009) Law Com No 315.

[64] As authorised by the 2013 Act: see Charities Act 2011, s 104B(3).

[65] Charity Commission, *Total return investment for permanently endowed charities* (November 2013), para E4, available at http://forms.charitycommission.gov.uk/media/585298/total_return_investment_for_permanently_endowed_charities.pdf, which states that the power "can only be used in the context of total return investment … The power does not allow trustees to release permanent endowment for expenditure in any other situation".

sections 288 and 289 ever being used. Their continuing existence causes confusion and their removal would not reduce charities' powers.

9.51 **We provisionally propose that the parallel regime for "special trusts" in sections 288 and 289 of the Charities Act 2011 be repealed.**

Do consultees agree?

Application of the statutory power to incorporated charities

9.52 Sections 281 and 282 provide that the power is only exercisable in relation to the permanent endowment "of a charity which is not a company or other body corporate".

9.53 As we explain in Chapter 13, permanent endowment can only be held by an incorporated charity on trust as a corporate trustee. The Charity Commission's view is that, because an incorporated charity's permanent endowment is held on trust, the permanent endowment is a separate (unincorporated) charity. And if the permanent endowment is an unincorporated charity, the powers under sections 281 and 282 are available in respect of it.

9.54 Conversely, it is arguable that the powers under sections 281 and 282 are not available to incorporated charities. Even if permanent endowment is necessarily held by a corporate charity on trust, it is still permanent endowment "of" the incorporated charity, in which case the powers under sections 281 and 282 would not be available.[66]

9.55 It is unnecessary for us to resolve this point. If the Charity Commission's view is correct, then the words "of a charity which is not a company or other body corporate" are redundant. But even if that view is wrong, we see no reason to exclude incorporated charities from the scope of the powers under sections 281 and 282.

9.56 These words in the statute are, in our view, either redundant or unnecessary, and they serve to cause unnecessary uncertainty in the law.

9.57 **We provisionally propose that sections 281 and 282 of the Charities Act 2011 be amended to make it clear that they apply to permanent endowment held by an incorporated charity.**

Do consultees agree?

The financial thresholds

9.58 Lord Hodgson recommended that the financial thresholds in sections 281 and 282 should be increased, so that more charities fall within the section 281 power and do not need to obtain Charity Commission consent. He suggested that the

[66] If that were the case, the permanent endowment of incorporated charities may still fall within the statutory provisions if the Charity Commission makes a direction under s 12(1) of the Charities Act 2011 that the permanent endowment is to be treated as a separate charity, in which case the ss 288 to 289 powers would be available.

current threshold for the value of the endowment should be raised from £10,000 to £100,000.[67]

9.59 The financial thresholds ensure that the Charity Commission is able to scrutinise the release of the restriction on spending large permanent endowment funds by larger charities. The thresholds ensure that the procedural requirements for releasing permanent endowment (and the associated costs) are proportionate to the value of the permanent endowment in question. We can see the attraction of increasing those thresholds so that more charities fall within section 281 and therefore do not have to obtain Charity Commission consent.

9.60 **We invite the views of consultees as to whether the financial thresholds in sections 281 and 282 should be increased, to what level, and why.**

The time limit for the Charity Commission to consider a section 282 resolution

9.61 Lord Hodgson recommended that the time limit for the Charity Commission to respond to a resolution passed under section 282 should be reduced from three months to 60 days.[68]

9.62 This would bring consistency with the time limit for the Charity Commission to respond to a resolution passed under section 275 of the Charities Act 2011 by an unincorporated charity with a gross income of less than £10,000 to change its purposes,[69] and with the time limit for responding to resolutions concerning the transfer of property to another charity.[70]

9.63 **We invite the views of consultees as to whether the time limit in section 284 of the Charities Act 2011 for the Charity Commission to consider a resolution passed under section 282 should be reduced to 60 days.**

Other problems with the current law

9.64 If consultees consider that the current regimes for the release of permanent endowment restrictions in sections 281 and 282 are deficient in any other respects, we encourage them to tell us.

9.65 There are two aspects of the regime under sections 281 and 282 that we consider to be satisfactory and do not at this stage propose to reform. First, the section 282 procedure should be retained (although if the financial conditions in that section were to be relaxed then fewer cases would fall within its scope). We see merit in the continued existence of the safeguards contained in section 282, in particular the need for the concurrence of the Charity Commission, where larger endowment funds are concerned. Second, the requirement in sections 281 and 282 that trustees must be satisfied, before passing a resolution, that the purposes of the trusts on which the fund is held could be carried out more

[67] And similarly that the income threshold should be raised from £1,000 to £10,000: Hodgson Report, Appendix A, para 27.

[68] Hodgson Report, Appendix A, para 18.

[69] See paras 3.11 to 3.14 above.

[70] Charities Act 2011, ss 268 and 270; see para 12.9 below.

effectively if the capital of the fund could be expended should not be changed. We regard this requirement as providing an appropriate level of flexibility to trustees whilst ensuring that any decision they make is in the best interests of the charity.

9.66 **We invite the views of consultees as to whether the current regime in sections 281 and 282 of the Charities Act 2011 is otherwise satisfactory.**

The impact of reform

9.67 When considering the impact of reform, we would be assisted by hearing of consultees' experiences of releasing the restrictions on the expenditure of permanent endowment and of using the sections 281 and 282 and sections 288 and 289 procedures. We would be interested to hear whether charities would have incurred additional costs, or saved costs, had the powers in sections 281 and 282 been available to incorporated charities and had the financial thresholds under those sections been higher.

9.68 **We invite consultees to share with us their experience of releasing the restrictions on the expenditure of permanent endowment, including the procedures under sections 281 and 282 and sections 288 and 289 of the Charities Act 2011, in particular the time and costs involved.**

A NEW FORM OF PERMANENT ENDOWMENT?

9.69 Trustees who wish to spend some or all of the capital of a fund of permanent endowment have the following options:

(1) pass a resolution under section 281 or 282 of the Charities Act 2011;

(2) apply to the Charity Commission for an order or a scheme authorising the expenditure of the fund; or

(3) pass a resolution to adopt a total return approach to the investment of the fund, following which they will be able to spend up to 10% of the value of the fund, subject to recoupment, under regulation 4 of the 2013 Regulations.

9.70 Are those avenues enough to cater for the various reasons that charities might wish to use permanent endowment which would be prohibited by the spending restriction?[71]

9.71 The permanent endowment restriction is arguably a rather blunt, and perhaps even ineffective, instrument for donors wishing to ensure the perpetual continuation of the charity to which they donate.

9.72 It is blunt because it prevents charities from using its assets in certain ways even where the trustees' intention is to maintain the capital value of the fund in the long term. An example highlighted during our social investment consultation is the use of permanent endowment to make a social investment with an expected negative

[71] See Fig 11 above for examples of why charities might wish to spend permanent endowment.

financial return (or a highly uncertain financial return) which the trustees wish to offset by relying on expected gains elsewhere in the portfolio, so that the overall value of the portfolio is maintained.

9.73 The permanent endowment restriction can be ineffective since, as we noted above,[72] there is no absolute requirement that the trustees maintain the real value of the fund. Although the duty for trustees to act even-handedly between the present and future beneficiaries of the charity will often mean that, in practice, they will seek to maintain the real value of the fund, the permanent endowment restriction only requires the actual value of the fund to be maintained on a pound for pound basis. It is quite conceivable, therefore, that a permanent endowment fund worth £2,000 in 1915 could still be worth £2,000 today, without the trustees having been in breach of trust. The £2,000 fund might have produced a healthy income for the charity's purposes in 1915, but is unlikely to do so today; any desire on the part of donors to ensure the perpetual continuation of the charity by imposing permanent endowment restrictions has therefore failed.

9.74 In addition, when charities wish to use their permanent endowment in a way that is prohibited by the restriction on spending (even if they intend to maintain the value of the fund in the long term), they must pass a resolution under section 281 or section 282 of the Charities Act 2011, or seek a Charity Commission order or scheme, to lift the restriction on expenditure. That can be seen as tantamount to spending the fund, even if the trustees have no intention to deplete the value of the fund in the long term. Trustees, understandably, do not want to be accused of selling the family silver.

9.75 There may be scope for the creation of a new regime that gives trustees greater flexibility in using the capital of a fund while ensuring that the real value of the fund is maintained in the long term. Charities could be given a power to opt into the regime by designating its permanent endowment, or part of its permanent endowment, as a "preserved endowment fund";[73] that decision would place the fund within the new regime whose rules would apply in place of the existing spending restriction.

9.76 The regime would have two main features. First, it would give trustees wide powers as to how they used the fund. There would be no prohibition on spending the capital fund and so no restriction (in principle) on using the fund to make an investment that is expected to make a loss, provided that the trustees devise a suitable plan for replenishing that loss, for example by offsetting short-term losses against long-term gains from other investments. Second, the new regime would impose a duty on trustees to seek to ensure that the real value, and not just the actual value, of the fund is maintained in the long term. Trustees would have to devise a policy setting out how they would seek to achieve this.

9.77 When compared with existing permanent endowment restrictions, such a regime could put substance over form by securing the perpetual continuation of the charity. It would also allow flexible use of permanent endowment assets without the stigma of "spending" it, by placing the emphasis on preserving them. The

[72] See para 9.22 above.

[73] We are open to alternative suggestions for a label. The power would be used in respect of investment (or non-functional) permanent endowment: see paras 9.14 to 9.16 above.

fund would become a more useful asset but its real value would be maintained, in a way that the law relating to permanent endowment, by contrast, does not guarantee.

9.78 Such a regime would not be simple to devise. It would have to address numerous issues, including:

(1) whether there should be any restrictions on the trustees' powers to use the assets, or whether charities should have the power to use the assets in any way (such as borrowing from the fund, or entering into any transaction from an investment through to spending on the charity's purposes);

(2) whether trustees should be subject to a duty to ensure that the real value of the fund is maintained in the long term, or a (less onerous) duty to *seek to ensure* that the real value is maintained;

(3) how "long term" is to be defined;

(4) how "real value" is to be defined and ascertained; for example, it could use inflation indices, the Retail Prices Index or the Consumer Prices Index, or it could be based on indexes of values in certain markets, such as equities, bonds, or land;

(5) how trustees should respond to general market failures and whether there should be a duty to recoup actual losses (which would go beyond the existing permanent endowment requirements which do not require recoupment of actual losses); and

(6) whether powers equivalent to those contained in sections 281 and 282 of the Charities Act 2011 should apply;[74] if they did not, the new regime might be considered to be more prescriptive than the existing regime, and therefore unattractive.

9.79 We hope that raising the possibility of a new regime will stimulate a wide debate about whether such a regime would be helpful, and we encourage consultees to share their views as to whether they would support such a new regime as well as their views on points of detail as to how it would operate.

9.80 **We invite the views of consultees as to whether a new regime should be devised that permits charities to use permanent endowment more flexibly whilst seeking to maintain its real value in the long term. We also invite consultees to comment on how such a scheme might operate.**

The impact of reform

9.81 We would be assisted by hearing of consultees' views as to the likely popularity of such a new regime, and of any additional costs, or any savings, that it would be likely to create for charities.

[74] As explained above, ss 281 to 282 allow permanent endowment to be spent in certain circumstances: see paras 9.37 to 9.42 above.

9.82 **We invite the views of consultees as to whether, and if so how, such a new regime would be likely to increase or decrease the costs incurred by charities in administering permanent endowment.**

PART 4

PAYMENTS TO CHARITY TRUSTEES AND OTHER NON-BENEFICIARIES

CHAPTER 10
REMUNERATION FOR THE SUPPLY OF GOODS AND THE POWER TO AWARD EQUITABLE ALLOWANCES

INTRODUCTION

10.1 This Chapter considers two distinct but related issues. The first is whether a charity should be empowered by statute to pay one of its charity trustees, or a person connected with a charity trustee, for goods supplied to the charity. The second is whether the jurisdiction of the court to award an "equitable allowance" to a charity trustee who has profited from a breach of fiduciary duty should be extended to the Charity Commission. Both are concerned with mitigating the strict rule that a charity trustee, as a fiduciary, must account for (that is to say, hand over to the charity) profits generated by reason of his or her position as charity trustee, or in circumstances involving a conflict of duty and interest.[1]

10.2 This Chapter is divided into three parts. In the first part we examine: the fiduciary duties owed by charity trustees to the charity; the means by which a breach of fiduciary duty can be authorised by the charity, in particular the use of section 185 of the Charities Act 2011 to authorise remuneration for the provision of services by a charity trustee or a connected person; and the court's jurisdiction to award an equitable allowance to a charity trustee in breach of fiduciary duty.

10.3 In the second part we consider whether a provision similar to section 185 of the Charities Act 2011 should be introduced for remuneration for the supply of goods. We agree with Lord Hodgson that there is no reason in principle why, in this context, the supply of goods should be treated differently from the provision of services. We provisionally propose the introduction of a new statutory regime for the supply of goods that mirrors section 185.

10.4 In the third and final part we provisionally propose that the Charity Commission should be empowered to award an equitable allowance to a charity trustee, and ask consultees to share their views as to what circumstances might justify an award.

FIDUCIARY DUTIES, AUTHORISATION OF BREACHES AND EQUITABLE ALLOWANCES

10.5 This part sets out the fiduciary duties owed by charity trustees to the charity, the means by which a breach of fiduciary duty can be authorised by the charity – in particular the use of section 185 of the Charities Act 2011 – and the court's jurisdiction to award an equitable allowance to a charity trustee in breach of fiduciary duty.

[1] For a discussion see M Conaglen, "The extent of fiduciary accounting and the importance of authorisation mechanisms" (2011) 70(3) *Cambridge Law Journal* 548.

The fiduciary duties of charity trustees

10.6 As fiduciaries, trustees must act with "single-minded loyalty" in the interests of the charity.[2] As Lord Herschell explained in *Bray v Ford*:

> It is an inflexible rule of a Court of Equity that a person in a fiduciary position … is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as has been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect.[3]

10.7 The "rule" described by Lord Herschell is more commonly understood as two distinct but overlapping duties.[4] First, a trustee must not profit by reason of his or her position as trustee, or by the use of any opportunity or knowledge resulting from it. Second, a trustee must not enter into a position where his or her personal interest conflicts, or may possibly conflict, with the duties he or she owes to the charity. We shall refer to these duties collectively as the fiduciary duties.

10.8 Liability for breach of fiduciary duty is strict; it is no defence for a charity trustee to say that he or she acted honestly and in good faith.[5] A trustee must account for (that is to say, hand over to the charity) any benefit that he or she has obtained as a result of a breach of fiduciary duty unless the breach has been authorised by the charity.[6]

Authorising breaches of fiduciary duty

10.9 A charity may authorise a transaction that would otherwise amount to a breach of fiduciary duty by one of its charity trustees. We discuss the circumstances in which authorisation may be given below. In deciding whether to give, or seek, authorisation for a breach of fiduciary duty, the trustees must still act in good faith and in the best interests of the charity.[7] Where authorisation is given, the trustee will be entitled to receive or retain any profit obtained as a result of the

[2] *Bristol and West Building Society v Mothew* [1998] Ch 1, 15, by Millett LJ.

[3] [1896] AC 44, 51.

[4] *Chan v Zacharia* [1984] HCA 36, (1983-4) 154 CLR 178, 198 to 199, by Deane J (High Court of Australia).

[5] *Bray v Ford* [1896] AC 44, 48.

[6] *Warman International Ltd v Dwyer* (1995) 182 CLR 544 (High Court of Australia). This is subject to the rule of equity that a fiduciary is entitled to an allowance for the skill and effort employed in obtaining the unauthorised profit where it would be inequitable for the principal to step in and take the profit without paying for that skill and effort: *Boardman v Phipps* [1964] 1 WLR 993, 1018 (HC); see para 10.21 and following below.

[7] For example, if a charity requires legal advice and a trustee is willing to provide that advice for a small fee, it might be in the charity's interests to authorise a breach of fiduciary duty and pay the trustee. By contrast, it would not be in the charity's interests to authorise the payment of charitable funds to a trustee solely for his or her personal gain.

transaction. Authorisation is only effective if the trustee has first made "full and frank disclosure of all material facts" surrounding the transaction.[8]

(1) Authorisation pursuant to an express term in the charity's governing document

10.10 Authorisation may be given pursuant to an express term in the charity's governing document. The governing document may itself authorise the charity trustees to enter into certain transactions, or to receive certain benefits, that would otherwise amount to breaches of fiduciary duty. For example, clause 7(2)(d) of the Charity Commission's model articles of association for charitable companies limited by guarantee provides that:

> A director or connected person may receive interest on money lent to the charity at a reasonable and proper rate which must be not more than the Bank of England bank rate (also known as the base rate).[9]

10.11 The governing document may also confer a power on the trustees to pass a resolution authorising a breach of fiduciary duty by one of their number in specified circumstances.[10] But this is subject, in the case of a charitable company, to the overriding provisions of the Companies Act 2006 that require certain transactions to be authorised by a resolution of the members of the company passed at a general meeting.[11]

10.12 A charity may amend its governing document to include a new power, or to widen an existing power, to authorise a breach of fiduciary duty. The Charity Commission considers that an unincorporated charity may make such an amendment either where its governing document contains a suitable amendment power, or where the amendment has been sanctioned by a scheme.[12] An unincorporated charity cannot use the default power of amendment in section 280 of the Charities Act 2011 for this purpose.[13] A charitable company can

8 *New Zealand Netherlands Society "Oranje" Inc v Kuys* [1973] 1 WLR 1126, 1132, by Lord Wilberforce, delivering the opinion of the Judicial Committee of the Privy Council. The duty of the director of a charitable company to declare his or her personal interest in a proposed transaction or arrangement with the company is enshrined in s 177(1) of the Companies Act 2006.

9 Charity Commission, *Model articles of association for a charitable company* (March 2012).

10 In relation to a charitable company, the charity trustee implicated in the breach, and any other interested charity trustee, will not usually be entitled to vote on the matter, but if they do then their votes will be discounted for the purposes of determining (a) whether any requirement as to the quorum at the meeting at which the matter is considered has been met, and (b) whether the resolution has been passed by a sufficient majority: Companies Act 2006, s 175(6).

11 The transactions are set out in ch 4 of Pt 10 of the Companies Act 2006 and include service contracts longer than two years in duration (s 188), substantial property transactions (s 190; see para 12.25 below), loans (s 197) and payments for loss of office (s 215). Members resolutions approving such transactions are ineffective without the prior written consent of the Charity Commission: Charities Act 2011, s 201.

12 We discuss Charity Commission schemes in para 3.20 and following above.

13 Charity Commission,*Trustee Expenses and Payments* (CC11) (March 2012) section E10. We refer to the guidance as "CC11". We discuss the power under s 280 of the Charities Act 2011 in paras 3.16 to 3.18 above.

amend its articles of association by a resolution of its members.[14] But the amendment will require the prior written consent of the Charity Commission to be effective.[15]

(2) Authorisation pursuant to a statutory power: section 185 of the Charities Act 2011

10.13 Statute may provide for the authorisation of breaches of fiduciary duty. Section 185 of the Charities Act 2011 empowers the trustees of a charity to pay a trustee, or a person connected with a trustee, for the provision of services to the charity.[16] The provision of services in this context includes the supply of goods in connection with the provision of services.[17]

10.14 The section 185 power can only be exercised where the following four conditions are met.

(1) The amount of the remuneration is set out in a written agreement between the charity and the provider of the services ("P") and does not exceed what is reasonable in the circumstances.[18]

(2) The charity trustees are satisfied that it would be in the best interests of the charity for the services to be provided by P on the terms of the agreement.[19]

(3) The agreement does not result in a majority of the trustees of the charity being persons who are:

(a) party to an agreement within (1) above;

(b) entitled to receive remuneration out of the funds of the charity otherwise than by virtue of such an agreement; or

(c) connected with a person falling within (a) or (b) above.[20]

(4) The trusts of the charity do not contain any express provision that prohibits P from receiving the remuneration.[21]

[14] Companies Act 2006, s 21(1). This is unless the charity does not have any members, or enough members who are not charity trustees to form a quorum to consider the amendment: see CC11, section E10.

[15] Charities Act 2011, s 198(1) and (2)(c). The same is true for a CIO.

[16] Section 185 of the Charities Act 2011 consolidated ss 73A and 73B of the Charities Act 1993, as inserted by s 36 of the Charities Act 2006.

[17] Charities Act 2011, s 187.

[18] Charities Act 2011, s 185(2), Condition A.

[19] Charities Act 2011, s 185(2), Condition B. The duty of care in section 1(1) of the Trustee Act 2000 applies to a charity trustee when making this decision: section 185(5).

[20] Charities Act 2011, s 185(2), Condition C.

[21] Charities Act 2011, s 185(2), Condition D. The "trusts" of a charity are "the provisions establishing it as a charity and regulating its purposes and administration, whether those provisions take effect by way of trust or not": Charities Act 2011, s 353(1).

10.15 The Charity Commission has issued detailed guidance on compliance with the above conditions.[22] It suggests that the trustees should consider not only the affordability, price and quality of the service, but also the implications of the payment for the reputation of the charity with its donors, funders, members and supporters, and with the general public.[23] The trustees should also be satisfied that the service is required by the charity and that there is a clear advantage to the charity in using one of its trustees instead of someone else. This may be because the arrangement represents good value for money for the charity, or because the trustee has a special knowledge of the charity and its requirements.[24]

10.16 Section 185 does not apply to remuneration for services provided by a person in the person's capacity as a trustee or under a contract of employment.[25] So, in the case of a trustee who is an accountant by profession, section 185 can be used to pay him or her for preparing the charity's accounts, but not for attending board meetings. Nor does section 185 apply to any remuneration which a person is entitled to receive out of the funds of a charity "by virtue of any provision contained in the trusts of the charity".[26] In its guidance on trustee expenses and payments, the Charity Commission has interpreted this as meaning that where an express provision in the charity's governing document is less restrictive than section 185, the charity need not comply with the requirements of section 185 and may instead rely on its own power. Conversely, where an express power in the charity's governing document is more restrictive than section 185 the charity can rely on the section 185 power (provided that there is no express prohibition of the payment in question).[27]

(3) Authorisation by the Charity Commission

10.17 The Charity Commission may give prior authorisation to a transaction that would otherwise involve a breach of fiduciary duty by making an order to that effect under section 105 of the Charities Act 2011.[28] A section 105 order can only be made if the transaction in question would be "expedient in the interests of the charity".[29]

[22] CC11, section E.

[23] CC11, section E6.

[24] CC11, section E7.

[25] Charities Act 2011, s 185(3)(a).

[26] Charities Act 2011, s 185(3)(b)(i). Similarly, section 185 does not apply to any remuneration which a person is entitled to receive by virtue of any order of the court or the Charity Commission or any other statutory provision: s 185(3)(b)(ii) and (iii).

[27] CC11, section E2. Before entering into a service agreement, the charity trustees must have regard to the guidance: Charities Act 2011, s 185(4).

[28] Section 105(9) of the Charities Act 2011 contemplates the power to make an order being used for this purpose: "In the case of a charitable company, an order under this section may authorise an act even though it involves the breach of a duty imposed on a director of the company under ch 2 of Pt 10 of the Companies Act 2006 (general duties of directors)."

[29] Charities Act 2011, s 105(1). In determining whether the transaction is expedient in the interests of the charity, the Charity Commission will most likely apply the criteria set out in section E7 of CC11.

10.18 A charity is only likely to seek a section 105 order where it has no power to authorise the transaction itself.

(4) Authorisation by the court

10.19 The court can prospectively authorise a breach of fiduciary duty by a trustee of a trust. In *Holder v Holder*,[30] the Court of Appeal indicated that a trustee might, with the leave of the court, bid for trust property at a public auction. In *Re Drexel Burnham Lambert UK Pension Plan*,[31] a case that concerned a pension scheme whose trustees were also members of the scheme, the Judge held that the court had jurisdiction to direct the winding up of the scheme in accordance with proposals submitted by the trustees notwithstanding that the proposals placed the trustees in a position of conflict of interest and duty.

10.20 A charity is only likely to invoke the jurisdiction of the court where it has no power to authorise the breach of fiduciary duty itself. In practice, applications to the court will rarely be made given that the Charity Commission has an equivalent power under section 105 of the Charities Act 2011. Such applications are "charity proceedings" within the meaning of section 115 of the Charities Act 2011, with the result that they cannot be made without authorisation of the Charity Commission.[32] The Commission must not, without special reasons, authorise the taking of charity proceedings where the matter can be dealt with using the Commission's powers, such as the power to make an order under section 105.[33]

The court's jurisdiction to award an equitable allowance

10.21 A charity trustee who is liable to account to the charity for a profit obtained in breach of fiduciary duty may be awarded an allowance for the skill and effort he or she has employed to produce that profit. The basis for the jurisdiction is that it is inequitable for the charity to receive the profit without making some payment to the trustee who produced it.

10.22 Whether an equitable allowance will be awarded, and the amount of any award, will ultimately depend on the circumstances of the case,[34] but the courts have given some indication of the principles that guide the exercise of their discretion. As will be seen from the cases below, the jurisdiction will only be exercised in exceptional circumstances.[35] An award will generally only be made where the trustee has exhibited some special skill in producing the profit and where he or she has acted honestly and in good faith. The courts will be unlikely to make an award where to do so would have the effect of circumventing an express remuneration clause in the charity's governing document.

[30] [1968] 1 Ch 353.

[31] [1995] 1 WLR 32.

[32] Charities Act 2011, s 115(2) and (8)(b).

[33] Charities Act 2011, s 115(3); see ch 16 below.

[34] *Boardman v Phipps* [1965] Ch 992, 1020 to 1021 (CA).

[35] The case law concerns non-charitable trusts but a court would, in our view, adopt the same approach in respect of charities. *Fowler v Fenland Area Community Enterprise Trust* [2010] EWCA Civ 1571 (an application for permission to appeal) did concern a charity, and the court's approach was consistent with the principles discussed below.

Boardman v Phipps[36]

10.23 In *Boardman v Phipps*, a solicitor to a trust was found liable to account to the trust for a profit made in breach of fiduciary duty. The trust owned a minority shareholding in a failing company. The solicitor sought to turn the company around by purchasing the remaining shares on behalf of the trust, and to this end he acquired information about the company. The directors of the company refused to sell their shares to the trust, so the solicitor decided instead to purchase the shares for himself. The solicitor acted throughout in good faith and in the honest belief that he was benefiting the trust. The company made a distribution of capital out of which both the trust and the solicitor made a substantial profit. At trial, Wilberforce J held that the solicitor had placed himself in a position of conflict between his personal interest and his duties to the trust and was liable to account for the profit he made on the distribution. However, the Judge ordered that the solicitor should be given an allowance for his work and skill in producing the profit and directed an inquiry into the amount of the allowance, suggesting that it "should be on a liberal scale".[37] The rationale for awarding such an allowance was that:

> This transaction, ie, the acquisition of a controlling interest in the company, was one of a special character calling for the exercise of a particular kind of professional skill. If Boardman [the solicitor] had not assumed the role of seeing it through, the beneficiaries would have had to employ (and would, had they been well advised, have employed) an expert to do it for them. If the trustees had come to the court asking for liberty to employ such a person, they would in all probability have been authorised to do so, and to remunerate the person in question. It seems to me that it would be inequitable now for the beneficiaries to step in and take the profit without paying for the skill and labour that has produced it.[38]

10.24 The Court of Appeal also concluded that the solicitor was liable to account for his profit, but Lord Denning MR agreed with Wilberforce J that the court should exercise its discretion to award an equitable allowance to the solicitor. The Master of the Rolls remarked that:

> If the defendant has done valuable work in making the profit, then the court in its discretion may allow him a recompense. It depends on the circumstances. If the agent has been guilty of any dishonesty or bad faith, or surreptitious dealing, he might not be allowed any remuneration or reward. But when, as in this case, the agents acted openly and above board, but mistakenly, then it would be only just that they should be allowed remuneration.[39]

[36] [1967] 2 AC 46 (HL); [1965] Ch 992 (CA); [1964] 1 WLR 993 (HC).

[37] [1964] 1 WLR 993, 1018.

[38] [1964] 1 WLR 993, 1018.

[39] [1965] Ch 992, 1020 to 1021.

10.25 A bare majority of the House of Lords upheld the order of an account of profits. The order of Wilberforce J that the solicitor be granted an equitable allowance, and the inquiry into the amount of the allowance, also stood.[40]

Subsequent cases

10.26 In subsequent cases the courts have further clarified the scope of their jurisdiction to award an equitable allowance, and the principles that guide the exercise of their discretion.

GUINNESS PLC V SAUNDERS[41]

10.27 In *Guinness plc v Saunders*, a committee of the board of directors of Guinness purported to agree to pay one of its members, S, £5.2m for his services in connection with a take-over bid. Guinness' articles of association provided that such remuneration could only be paid with the authority of the entire board. Following the successful completion of the bid, the money was paid to S. Guinness sought to recover the money on the basis that S was never entitled to receive it (because it was not paid with the authority of the entire board) and so held the money as constructive trustee.

10.28 The House of Lords unanimously held that S was liable to pay the money back, and that he was not entitled to retain any part of it by way of an equitable allowance, on a quantum meruit,[42] or under section 727 of the Companies Act 1985.[43]

10.29 In dismissing the claim for an equitable allowance, Lord Templeman said that the jurisdiction to award an equitable allowance could not be exercised so as to "usurp the functions conferred on the board by the articles. … Equity has no power to relax its own strict rule further than and inconsistently with the express relaxation contained in the articles of association."[44]

10.30 Lord Goff took a less strict approach. While he agreed that no equitable allowance should be awarded on the facts, he reserved judgement on whether an allowance might ever be awarded in the case of a director of a company.[45] An

[40] Of the majority, Lords Cohen and Hodson expressly agreed with the observations of Wilberforce J regarding the award of an equitable allowance: [1967] 2 AC 46, 104 (Lord Cohen) and 112 (Lord Hodson).

[41] [1990] 2 AC 663.

[42] Quantum meruit, which translates from Latin as "as much as he or she has earned", is a remedy available at common law to a party who has conferred a benefit on another and is entitled to reasonable recompense for that benefit. An action for quantum meruit was once considered to be an action in contract, based on an implied promise to pay: *Sumpter v Hedges* [1898] 1 QB 673. But it is now thought that an action for quantum meruit is founded on a desire to reverse an unjust enrichment: see *Benedetti v Sawiris* [2013] UKSC 50, [2014] AC 938.

[43] Section 727 of the Companies Act 1985, now s 1157 of the Companies Act 2006, provided that in proceedings for a breach of trust or breach of duty against a director the court could relieve the director, either wholly or in part, from liability where the director had acted honestly and reasonably and ought fairly to be excused. The Charity Commission has a similar power under s 191 of the Charities Act 2011: see para 10.51 below.

[44] [1990] 2 AC 663, 691 to 692.

[45] [1990] 2 AC 663, 701.

equitable allowance, he added, could only be awarded "[in] those cases where it cannot have the effect of encouraging trustees in any way to put themselves in a position where their interests conflict with their duties as trustees".[46] *Boardman v Phipps* was one such case, in which the equity underlying the claim was "clear and, indeed, overwhelming".[47]

10.31 *Guinness plc v Saunders* indicates that the courts are unlikely to award an equitable allowance where to do so would have the effect of circumventing an express remuneration clause in the charity's governing document.

O'SULLIVAN V MANAGEMENT AGENCY LTD[48]

10.32 In *O'Sullivan v Management Agency Ltd*, the claimant successfully applied to set aside a series of management contracts he had made with his agent, and companies connected with the agent, on the grounds that the contracts were in restraint of trade and that he had been induced to enter into them by reason of undue influence on the part of the agent. The agent was in a fiduciary relationship with the claimant, and was therefore liable to account for any profits made under the contracts, but was awarded an equitable allowance for the skill and labour employed to promote the claimant's music and to manage his business affairs. Fox LJ said that the power to award an equitable allowance was "clearly necessary [to avoid] substantial injustice".[49] His Lordship continued:

> A hard and fast rule that the beneficiary can demand the whole profit without an allowance for the work without which it could not have been created is unduly severe. Nor do I think that the principle is only applicable in cases where the personal conduct of the fiduciary cannot be criticised. I think that the justice of the individual case must be considered on the facts of that case. Accordingly, where there has been dishonesty or surreptitious dealing or other improper conduct then, as indicated by Lord Denning MR [in *Boardman v Phipps*], it might be appropriate to refuse relief; but that will depend upon the circumstances.[50]

10.33 Accordingly, an equitable allowance might be awarded to a charity trustee even where his or her conduct is not beyond reproach.

BADFINGER MUSIC V EVANS[51]

10.34 In *Badfinger Music v Evans* the claimant, a member of a former music group, created a recording from tapes of a live concert performed by the group which he then released through a record company in exchange for royalties. The claimant warranted that he was the exclusive owner of the rights in the recording, when in fact the other members of the group were entitled to share equally in the royalties with the claimant, and the claimant had not obtained their consent to the release

[46] [1990] 2 AC 663, 701.

[47] [1990] 2 AC 663, 701.

[48] [1985] QB 428.

[49] [1985] QB 428, 468.

[50] [1985] QB 428, 468.

[51] [2002] EMLR 2.

of the recording. It was common ground that the claimant owed fiduciary duties to the other members of the group. The claimant applied for directions that he was entitled to a fee for producing the recording.

10.35 Lord Goldsmith QC (sitting as a Deputy Judge of the High Court) awarded an equitable allowance to the claimant on the basis that the work done by him was of an exceptional and substantial character; without it, the profit to the other members of the group would not have been earned.[52] Although the claimant's conduct was open to serious criticism, it was not so unconscionable as to deprive him of any entitlement to an award.[53] However, it would not have been right to award the claimant the same amount as he would have received if he had agreed with the other members of the group that he should produce the recording.[54]

A STATUTORY POWER TO AUTHORISE REMUNERATION FOR THE SUPPLY OF GOODS?

Analysis

10.36 Charity trustees owe strict duties not to profit from their fiduciary position and to avoid situations where their personal interests conflict with their duties to the charity. A charity trustee must account for any profit made in breach of these duties unless the charity has authorised the breach.

10.37 A trustee who enters into, or who is connected with a person who enters into, a contract for the supply of goods to or on behalf of a charity of which he or she is charity trustee has a personal interest in the contract that conflicts with his or her duties to the charity. The trustee would not be entitled to the benefit of any remuneration under the contract – whether received directly, or indirectly through his or her connection with the person to whom the remuneration is paid – unless authorised to receive it by the charity.

10.38 While section 185 of the Charities Act 2011 gives charities the power to authorise remuneration for the provision of services,[55] there is no equivalent provision made in the Act for the supply of goods. Lord Hodgson saw no principled reason for this omission, and recommended the introduction of a new statutory power.[56]

10.39 There is evidence to suggest that the Charity Commission also supports a general power to authorise remuneration for the supply of goods. In an attempt to work around the absence of such a power in the Charities Act 2011, the Commission has included an express power (in the same terms as section 185) in its model governing documents.[57]

10.40 By contrast, we are unaware of any positive reasons for the exclusion of the supply of goods from the scope of the statutory remuneration power: none

[52] [2002] EMLR 2, [50].

[53] [2002] EMLR 2, [59].

[54] [2002] EMLR 2, [63].

[55] Charities Act 2011, s 187.

[56] Hodgson Report, Appendix A, para 14.

[57] See, for example, Charity Commission, *Model articles of association for a charitable company* (March 2012) cl 7(2)(c) and (3).

appears in the 2002 Cabinet Office Strategy Unit Report[58] that first recommended the introduction of the power[59] or in the Parliamentary debates on the Charities Bill that implemented that recommendation.[60]

10.41 The Cabinet Office Strategy Unit Report recommended the introduction of the statutory power on the basis that:

> Often a trustee can provide such a service on much more favourable terms than the charity could obtain elsewhere. For instance, a village hall trustee who is a plumber might agree to replace the central heating at cost price; or a trustee who is a solicitor might agree to carry out some conveyancing for a nominal fee. We believe that a trustee should be allowed to be paid for a service if the trustee body, as a whole, reasonably believe it to be in the charity's interests that the service should be provided by that trustee.[61]

10.42 In our view, these considerations apply equally to the supply of goods (whether or not in connection with the provision of a service). For example, a charity trustee who supplies office stationery in a trade capacity might agree to supply the charity's offices with stationery at cost price.

10.43 A statutory power to authorise remuneration for the supply of goods would benefit those charities that lack an express power to do so and who would otherwise have to seek an order of the Charity Commission to authorise the remuneration.[62] Having to apply for Charity Commission approval would undoubtedly be more costly and time-consuming than simply relying on a decision of the charity trustees passed in accordance with a statutory procedure.

10.44 It might be argued that a statutory power is not necessary, because charities that lack an express power can acquire one by making a suitable amendment to their governing document.[63] However, some charities may not wish to amend their governing document because the time and expense involved in making the amendment would be disproportionate to the need for the power. This will particularly be the case where the amendment procedure is especially cumbersome, for instance where the charity is incorporated by Royal Charter or

[58] Prime Minister's Strategy Unit, *Private Action, Public Benefit: A Review of Charities and the Wider Not-for-Profit Sector* (September 2002).

[59] The remuneration power in s 185 of the Charities Act 2011 was introduced by s 36 of the Charities Act 2006, which inserted ss 73A and 73B of the Charities Act 1993.

[60] This is despite the fact that the Bill expressly contemplated the supply of goods because it made provision for the authorisation of remuneration for the supply of goods in connection with the provision of services: see Charities Act 1993, s 73B(4) and now Charities Act 2011, s 187.

[61] Prime Minister's Strategy Unit, *Private Action, Public Benefit: A Review of Charities and the Wider Not-for-Profit Sector* (September 2002) para 6.45.

[62] See paras 10.17 and 10.18 above. If a charity's governing document contained an express prohibition on paying trustees, the charity would not be able to exercise the power and would instead have to obtain the Charity Commission's consent: see Condition D is s 185 of the Charities Act 2011 and para 10.14(4) above.

[63] See para 10.12 above.

by Act of Parliament,[64] or where the power is only being sought to sanction a one-off payment rather than regular remuneration.

10.45 Moreover, we suspect that many charities would prefer to rely on a statutory power even though their governing document contains an express power. A statutory power that is clearly framed and accompanied by detailed Charity Commission guidance may, even if it is more prescriptive, be better than an express power in the charity's governing document, particularly where the payment of remuneration to a trustee out of the funds of the charity is concerned. Compliance with the statutory power will remove any doubt about the appropriateness of the payment. As the Charity Commission states in its guidance, section 185 is intended to supplement any existing power in the charity's governing document; it is open to the charity to use either power, even if the express power is the less prescriptive of the two.[65]

Conclusion

10.46 We agree with Lord Hodgson that there is no justifiable reason for distinguishing in this context between remuneration for the provision of services and remuneration for the supply of goods, and that there is a need for reform. We support Lord Hodgson's recommendation for the introduction of a new statutory power to authorise remuneration for the supply of goods, and we make a provisional proposal to that effect below.

10.47 **We provisionally propose the introduction of a new statutory mechanism for the authorisation of remuneration of trustees for the supply of goods that mirrors section 185 of the Charities Act 2011.**

Do consultees agree?

The impact of reform

10.48 In assessing the desirability of reform, we would be assisted by hearing of consultees' experiences of considering whether to authorise, and subsequently authorising, the remuneration of trustees for the supply of services (under section 185 of the Charities Act 2011 or otherwise) and for the supply of goods, including details of the time taken by the trustees and staff, and the costs involved.

10.49 **We invite consultees to share with us their experiences of considering whether to authorise, and subsequently authorising, the remuneration of trustees for the supply of services and for the supply of goods to a charity, in particular the work, time and expense that have been involved.**

THE JURISDICTION TO AWARD AN EQUITABLE ALLOWANCE

10.50 A charity trustee who is liable to account to the charity for a profit obtained in breach of fiduciary duty may be awarded an allowance where it would be inequitable for the charity to take the profit without paying for the skill and labour

[64] We make provisional proposals above to simplify the amendment procedures for these charities: see ch 4 above.

[65] CC11, section E2.

that produced it. At present, the allowance may only be awarded by the court in the exercise of its equitable jurisdiction.

10.51 The Charity Commission has a statutory power to relieve a charity trustee from liability for breach of trust where the trustee has acted honestly and reasonably and ought fairly to be excused from liability.[66] The Commission's view is that this power does not enable it to relieve a trustee from liability to account for a profit made in breach of fiduciary duty.[67] Nor, under this statutory power or otherwise, can it award an equitable allowance. However, the Charity Commission does regard itself as able to give an indication that it is not intending to pursue a trustee for restitution of an unauthorised profit.[68]

10.52 Lord Hodgson recommended that the Charity Commission be given a statutory power to award "small" equitable allowances.[69] The implication is that allowances that do not qualify as "small" (the definition of which was left open by Lord Hodgson) would still have to be sought from the court under its equitable jurisdiction.

10.53 We consider that such a power would benefit charity trustees and charities as it would provide them with a cheaper and less time-consuming alternative to issuing court proceedings. It would also provide certainty as to the outcome, rather than having to rely on an indication by the Charity Commission that formal proceedings will not be taken against the trustee.

10.54 We are mindful of the Charity Commission's burgeoning caseload, and of the drafting difficulties associated with creating a statutory jurisdiction that is based on a broad equitable discretion. But requests for an equitable allowance already come before the Charity Commission and have to be dealt with by other means. A new power would provide the Charity Commission with a simpler, and more reassuring, means of resolving the problems faced by trustees who obtain unauthorised profits in breach of their duties to their charity.

10.55 Such a power is likely to be exercised where the trustee accepts liability for breach of fiduciary duty, and he or she and the charity agree to the retention of some or all of the profit obtained through the breach by way of an equitable allowance. Where the trustee denies liability for breach of fiduciary duty, or where there is a dispute between the parties as to his or her entitlement to an equitable

[66] Charities Act 2011, s 191.

[67] The Charity Commission takes the view that s 191 of the Charities Act 2011 only empowers the Commission to relieve a charity trustee from liability to compensate for a loss suffered by the charity and does not extend to liability to account for an unauthorised profit: Charity Commission, *OG 98 A1 Power of the Commission to relieve trustees, auditors, etc from liability for breach of trust or duty* (14 March 2012) para 1.4. There is conflicting judicial authority on the point: compare *Sinclair v Sinclair* [2009] EWHC 926 (Ch), [76], by Proudman J (interpreting the similar s 61 of the Trustee Act 1925) and *Coleman Taymar v Oakes* [2001] 2 BCLC 749, [82], by HHJ Reid QC (interpreting the similar s 727 of the Companies Act 1985), and see M Conaglen, "The extent of fiduciary accounting and the importance of authorisation mechanisms" (2011) 70(3) *Cambridge Law Journal* 548, n 112.

[68] Charity Commission, *OG 98 A1 Power of the Commission to relieve trustees, auditors, etc from liability for breach of trust or duty* (14 March 2012) para 2.

[69] Hodgson Report, Appendix A, para 6.

allowance, the Charity Commission is unlikely to exercise the power and the matter would have to be resolved in court proceedings.

10.56 In practice, where a trustee is found liable to hand over an unauthorised profit to the charity but the court decides to award an equitable allowance in recognition of the work done to produce that profit, the court will simply subtract the amount of the allowance from the profit to be handed over and order the trustee to pay the balance, if any. For the sake of simplicity, therefore, we suggest that the proposed new power for the Charity Commission to award an equitable allowance should be framed simply as a power to reduce the liability of the trustee.

10.57 We do not consider that the power should be limited to equitable allowances (or a relief from liability to account) of any particular size, but welcome consultees' views.[70]

10.58 We invite consultees' views as to any further conditions on the exercise of the power. The power should not encourage charity trustees to put themselves in a position where their interests conflict with their duties to the charity.[71] In exercising the power, the Charity Commission could be required to apply the same criteria as are applied by the court when considering whether to award an equitable allowance. Alternatively, the criteria could be the same as those that apply to the power in section 191 of the Charities Act 2011, namely whether the charity trustee has acted honestly and reasonably and ought fairly to be relieved from liability.

10.59 **We provisionally propose that the Charity Commission should have a statutory power to relieve a trustee, in whole or in part, from liability to account for a profit (of any size) made in breach of fiduciary duty.**

Do consultees agree?

10.60 **We invite the views of consultees as to whether the criteria that apply to the exercise of the power:**

(1) **should be the same as the criteria applied by the court when considering whether to award an equitable allowance; or**

(2) **should be the same as the criteria that apply to the exercise of the power in section 191 of the Charities Act 2011, namely whether the trustee has acted honestly and reasonably and ought fairly to be relieved from liability.**

The impact of reform

10.61 In assessing the desirability of reform, we would be assisted by hearing of consultees' experiences of seeking to relieve a trustee from liability to account for an unauthorised profit or of seeking to authorise an equitable allowance,

[70] We note that section 191 does not contain any financial limitations on the Charity Commission's power to relieve trustees from liability for breach of duty.

[71] *Guinness plc v Saunders* [1990] 2 AC 663, 701.

including details of the time taken by the trustees and staff, and the costs involved.

10.62 **We invite consultees to share with us their experiences of seeking to authorise an equitable allowance for a trustee, in particular the work, time and expense that have been involved.**

CHAPTER 11
EX GRATIA PAYMENTS OUT OF CHARITY FUNDS

INTRODUCTION

11.1 This Chapter considers whether charity trustees should have greater autonomy, subject to appropriate safeguards, in the making of ex gratia payments out of their charity's funds.

11.2 An ex gratia payment is a payment out of charity funds that the trustees of the charity feel morally obliged to make, but for which there is no legal basis. The ability of the court or the Attorney General to authorise ex gratia payments was established in *Re Snowden*[1] and recently affirmed in *Attorney General v Trustees of the British Museum*.[2] The Charity Commission has an equivalent jurisdiction by virtue of section 106 of the Charities Act 2011.

11.3 Ex gratia payments cannot be made without the prior authorisation of one of these bodies.[3] The Charity Commission's practice, however, is to allow charities to make ex gratia payments of up to £1,000 without authorisation to avoid situations where the cost of seeking authorisation exceeds the value of the payment.[4] Lord Hodgson thought there was a need for further, formal deregulation in this area. He recommended that trustees be given a new statutory power to make small ex gratia payments without the need for prior consent.[5] He further recommended that charity trustees should be permitted by statute to delegate to the chief executive of the charity (1) the power to decide that an ex gratia payment should be made and (2) the power to submit an application to the Charity Commission for authorisation to make an ex gratia payment (in cases where authorisation remained necessary).[6]

11.4 In this Chapter, we analyse the current framework regulating the making of ex gratia payments by charities and evaluate the options for reform. We agree with Lord Hodgson that charities would benefit from a power to make small ex gratia payments and provisionally propose that such a power be introduced. We then ask consultees whether it would be appropriate for charity trustees to be able to delegate the decision whether to make an ex gratia payment to the chief executive of the charity (or other individuals with equivalent responsibilities). Finally, we ask consultees about the likely impact of reform of the law.

1 [1970] Ch 700.

2 [2005] EWHC 1089 (Ch), [2005] Ch 397.

3 However, a charitable company whose business, or subsidiary's business, is being transferred or terminated can make payments (for example compensation for loss of employment) to its employees without the authority of the Charity Commission: Companies Act 2006, s 247. A similar power can be exercised by the liquidator of a charitable company on winding up: Insolvency Act 1986, s 187. See Charity Commission, *OG539 Ex gratia payments by charities* (September 2014) para E1.3. We refer to the operational guidance as "OG539".

4 OG539, para B4.3.

5 Hodgson Report, Appendix A, para 5(b).

EX GRATIA PAYMENTS

11.5 Charities sometimes become legally entitled to receive money or other property to which their trustees believe someone else has a stronger moral claim. This can create a dilemma for the charity concerned because it may have no legal power to pay the money or transfer the property to that other person,[7] or because the payment or transfer would amount to a breach of the charity trustees' duty to act in the best interests of the charity.[8]

Re Snowden[9] and *Attorney General v Trustees of the British Museum*[10]

11.6 In *Re Snowden* an ex gratia payment was described as:

> A payment … out of charity funds which is motivated simply and solely by the belief of the trustees or other persons administering the funds that the charity is under a moral obligation to make the payment.[11]

11.7 *Re Snowden* involved two applications to the court to approve ex gratia payments by charities of money received under a will. In the first application, the testator bequeathed all the shares he might hold at the time of his death in three named companies to three individual legatees in certain proportions. He also named six charities as legatees. The shares were sold during his lifetime with the result that the value of the charities' legacies was much greater, and the value of the legacies to the individuals was much smaller, than the testator could have contemplated. In the second application, the will of the testatrix provided for pecuniary legacies to be given to her niece and nephew and for the rest of her estate to be left to charity. Before she died the testatrix made an alteration to the will that would have increased the gifts to her niece and nephew, but because the alteration did not comply with the requisite formalities it was ineffective.

11.8 In each case approval was sought for a transaction in which the charity would forego money to which it was legally entitled. In the first case the trustees of the

6 Hodgson Report, Appendix A, para 5(a).

7 By "payment" and "transfer" we mean either a waiver of rights to money or property to which the charity is legally entitled but has not yet received, or a payment of money or transfer of property out of the charity's funds; see Charities Act 2011, s 106(2) and Charity Commission, *Ex Gratia Payments by Charities* (CC7) (May 2014) p 2, available at https://www.gov.uk/government/publications/ex-gratia-payments-by-charities-cc7. We refer to the guidance as "CC7".

8 In some cases it may be in the best interests of the charity for the charity trustees to make a voluntary payment out of the charity's funds. "It may, for instance, be good business for a charity to give a member of its staff on retirement a pension in excess of that to which he or she is contractually entitled. Again, one can imagine a case in which the relations subsisting between the charity and the person who is asking that the voluntary payment be made to him are such as to make it expedient for the charity with a view to its future prosperity to comply with the request": *Re Snowden* [1970] Ch 700, 709, by Cross J. Where a voluntary payment would be in the best interests of the charity but the charity trustees have no power to make it they may apply for a Charity Commission order under s 105 of the Charities Act 2011.

9 [1970] Ch 700.

10 [2005] EWHC 1089 (Ch), [2005] Ch 397.

11 [1970] Ch 700, 709.

charities sought to pay money to the individual legatees as if the shares had not been sold. In the second case the trustees asked the court to give effect to the alteration to the will. In each case the trustee made the application to the court because they felt a moral obligation to carry out what they considered were the true intentions of the donor.

11.9 The Judge held that the court had power to give authority to charities to make ex gratia payments out of their funds and sanctioned the payments sought. He emphasised that the power to authorise ex gratia payments:

> … is, however, a power which is not to be exercised lightly or on slender grounds but only in cases where it can be fairly said that if the charity were an individual it would be morally wrong of him to refuse to make the payment.[12]

11.10 The Judge gave four arguments in support of the existence of the jurisdiction of the court to authorise ex gratia payments. First, as a charity depends for its continued existence on the recognition by others of moral obligations to give, it would be odd if a charity could not likewise give effect to its own moral obligations. Second, analogous powers exist in other cases, such as the management of the property of mental health patients and for the benefit of infants. Third, in sanctioning compromises on behalf of charities the court does pay regard to moral obligations. Fourth, the Attorney General has the power to relieve trustees from their strict legal obligations to account in full for breaches of trust committed by them.[13]

11.11 The jurisdiction of the Attorney General to authorise ex gratia payments out of charity funds was recently affirmed in *Attorney General v Trustees of the British Museum,*[14] although it was not available to authorise the particular payment in question. The trustees of the British Museum were incorporated by section 14 of the British Museum Act 1753. Between 1946 and 1949 the trustees acquired four drawings which were added to the collections of the museum. The 1753 Act was superseded by the British Museum Act 1963. Section 3(4) of the 1963 Act provides that:

> Objects vested in the trustees as part of the collections of the museum shall not be disposed of by them otherwise than under section 5 or 9 of this Act or section 6 of the Museum and Galleries Act 1992.

11.12 In 2002 the trustees considered a claim for restitution of the drawings advanced by the heirs of the late Dr Feldmann on the basis that the drawings had been the property of Dr Feldmann in Czechoslovakia and had been stolen from him by the Gestapo in 1939. The trustees sought the Attorney General's permission to accede to the claim under the principle in *Re Snowden*. The Attorney General referred the issue to the court.

[12] [1970] Ch 700, 710.

[13] [1970] Ch 700, 709 to 710. For the Attorney General's power to relieve trustees from liability to account see, for example, *Attorney General v Brettingham* (1840) 3 Beav 91.

[14] [2005] EWHC 1089 (Ch), [2005] Ch 397.

11.13 Sir Andrew Morritt VC affirmed the jurisdiction of the Attorney General to authorise ex gratia payments under the principle in *Re Snowden*, but held that section 3(4) of the 1963 Act prohibited the Attorney General from exercising this jurisdiction in the present case. The Attorney General has no power to dispense with due observance of an Act of Parliament, and the court has no power to direct or approve an action inconsistent with an Act.[15] Any disposition of the drawings could only be justified by reference to one of the statutory exceptions listed in section 3(4), none of which was applicable in the present case.[16] The existence of express exceptions in section 3(4) negatived the recognition of an implied exception for cases falling within the *Re Snowden* principle. Nothing less than statutory authority could permit the making of an ex gratia transfer of the drawings by the trustees; this authority could be obtained either by passing an Act amending section 3(4), or by way of a scheme of the Charity Commission given effect by an order of the Minister under what is now section 73 of the Charities Act 2011.[17]

Ex gratia payments and the settlement of legal claims

11.14 It is important to distinguish between ex gratia payments and payments made in the settlement of a legal claim against the charity.[18] An ex gratia payment is a payment motivated only by a sense of moral obligation; there is nothing in law that empowers (or compels) the charity to make it. By contrast a settlement, while often motivated by moral considerations, is ultimately entered into on the basis of some form of legal authority. Charity trustees will usually have an express power under their charity's governing document to compromise a legal claim,[19] though

[15] *Re Shewsbury Grammar School* (1849) 1 Mac & G 324. In *Attorney General v Trustees of the British Museum*, the Vice Chancellor noted that there is a distinction drawn between cases such as the present where the relevant Act prohibits what is sought to be done, and those where no statutory prohibition is imposed but the charity seeks powers going beyond what is expressly authorised: [2005] EWHC 1089 (Ch), [2005] Ch 397, [28]. An example of the latter was *Re Shipwrecked Fishermen and Mariners' Royal Benevolent Society* [1959] Ch 220, where Danckwerts J approved a scheme conferring wider powers of investment than those authorised by the statute incorporating the charity.

[16] Section 5 authorises the trustees to dispose of duplicates, objects made after 1850 and objects unfit to be retained in the collections of the museum. It also entitles the trustees to destroy useless objects. Section 9 of the 1963 Act and s 6 of the 1992 Act entitle the trustees to transfer objects comprised in the collections to the trustees of any of the other specified national museums.

[17] [2005] EWHC 1089 (Ch), [2005] Ch 397, [42] and [46]. We discuss s 73 in chs 3 and 4 above. Although the making of an ex gratia payment was found to be prohibited by s 3(4), the compromise of a legal claim by the heirs that involved a recognition that the drawings had never been part of the collections would not have infringed s 3(4), since such a recognition would have meant that any disposition of the drawings was not subject to the s 3(4) prohibition: [39].

[18] In this context, a settlement includes an agreement to conclude legal proceedings that have already been commenced, as well as the compromise of a potential claim by way of an agreement not to commence legal proceedings.

[19] Many trustees of charitable trusts and directors of charitable companies will have a specific power to compromise, though their general powers of management of the charity's affairs may also be sufficient. The Charity Commission's model trust deed, for example, contains a power "to do any other lawful thing that is necessary or desirable for the achievement of the [charity's] objects": Charity Commission, *Model trust deed for a charitable trust* (November 2013) cl 5(10). The model articles of association contain a similar power: Charity Commission, *Model articles of association for a charitable company* (March 2012) cl 5. The power to compromise is subject to the general duties, including the duty to

there is also a default power for the trustees of charitable trusts to do so in section 15(f) of the Trustee Act 1925.[20]

11.15 To illustrate this distinction, we can consider the first application in *Re Snowden*, where the individual legatees lost their entitlement under the will owing to the sale of their gifts by the testator during his lifetime. Had the legatees been dependants of the testator (and had the testator died after 1 April 1976), they might have been able to apply to the court for an order that they receive something from the estate on the basis that the will did not make reasonable provision for them.[21] The charities might have decided to settle the claim by giving up some or all of their entitlement to the estate in favour of the individual legatees. This would not be an ex gratia payment, even if the charities were motivated by a sense of moral obligation to make it.

11.16 Other claims exist which might be settled. These include: claims for the rectification of a will;[22] proprietary estoppel claims;[23] constructive trust claims;[24] claims that the testator disposed of any relevant property during his or her lifetime such that it does not form part of his distributable estate; and claims that the will of the testator is invalid for lack of capacity, forgery or undue influence.[25]

exercise reasonable care and skill. See Charity Commission, *OG516 Trustees' power to compromise* (September 2013).

[20] Section 15(f) of the Trustee Act 1925 does not apply to the directors of a charitable company, or the charity trustees of a CIO, except in connection with any property that the company or CIO holds on trust. The statutory power may be modified or excluded by the trust instrument: Trustee Act 1925, s 69(2).

[21] Under the Inheritance (Provision for Family and Dependants) Act 1975, s 1.

[22] The court has a limited jurisdiction, under s 20 of the Administration of Justice Act 1982, to order the rectification of a will. It may only do so where the will is so expressed that it fails to carry out the testator's intentions in consequence of a clerical error or of a failure to understand his instructions. For the meaning of "clerical error" see *Marley v Rawlings* [2014] UKSC 2, [2014] 2 WLR 213, where the Supreme Court held that a mistake by a solicitor which resulted in a husband signing his wife's will and the wife signing her husband's will was a clerical error within the meaning of the Act.

[23] A proprietary estoppel claim may be made where the testator has made a promise or representation to another person that he or she would receive an interest in the testator's property, and that the other person has incurred detriment in reliance on that promise or representation such that the testator's failure to fulfil it would be unconscionable: see *Gillett v Holt* [2001] Ch 210; *Jennings v Rice* [2002] EWCA Civ 159, [2003] 1 FCR 501; and *Thorner v Major* [2009] UKHL 18, [2009] 1 WLR 776.

[24] A constructive trust may arise where the testator and another person have formed a common intention or understanding that the former will hold his or her property on trust for the benefit of the latter, on which the latter has relied, and it would be unconscionable for the testator to resile from this position: see *Gissing v Gissing* [1971] AC 886; *Stack v Dowden* [2007] UKHL 17, [2007] 2 AC 432; and *Jones v Kernott* [2011] UKSC 53, [2012] 1 AC 776. The latter's beneficial interest under the constructive trust does not form part of the testator's estate available for distribution on his or her death.

[25] There is also the possibility that a disappointed beneficiary may sue the solicitor responsible for drafting the will in the tort of negligence: see *White v Jones* [1995] 2 AC 207. The disappointed beneficiary may be determined to pursue a legal remedy against the negligent solicitor, in which case the charity trustees need take no action. Alternatively, the disappointed beneficiary may prefer to approach the charity for an ex gratia payment.

POWER OF THE CHARITY COMMISSION TO AUTHORISE EX GRATIA PAYMENTS

Section 106 of the Charities Act 2011

11.17 The Charities Act 1992 empowered the Charity Commissioners (now the Charity Commission) to exercise the same power as was exercisable by the Attorney General to authorise charity trustees to make an ex gratia payment out of a charity's funds.[26] This power is now contained in section 106 of the Charities Act 2011.

11.18 The power is exercisable under the supervision of, and in accordance with such directions as may be given by, the Attorney General.[27] Any such directions can require the Charity Commission:

(1) to refrain from exercising the power; or

(2) to consult the Attorney General before exercising it.[28]

11.19 The Charity Commission must refer an application to exercise the power to the Attorney General where it considers that this would be desirable.[29]

11.20 If the Charity Commission refuses to make an order under section 106, the charity is permitted either to make a fresh application directly to the Attorney General or to make an application to the court.[30]

Exercising the section 106 power

The need to demonstrate a moral obligation

11.21 In *Re Snowden* it was emphasised that the power to authorise an ex gratia payment "is not to be exercised lightly or on slender grounds".[31] In CC7 the Charity Commission explains that the charity trustees "need to be able to convince us that there are reasonable grounds for them to believe they would be acting immorally by refusing to make the payment".[32]

11.22 The need for "reasonable grounds" is illustrated by an example given by the Charity Commission of a failed application to make an ex gratia payment from property that passed under a will.[33] An individual claimed that the property had in

[26] Charities Act 1992, s 17, which inserted s 23A of the Charities Act 1960.

[27] Charities Act 2011, s 106(3).

[28] Charities Act 2011, s 106(4).

[29] Charities Act 2011, s 106(5).

[30] Charities Act 2011, s 106(6). An application to the court for the approval of an ex gratia payment constitutes "charity proceedings" within the meaning of s 115(1) of the 2011 Act and can therefore only be taken with the approval of the Charity Commission or (if the Commission refuses authorisation) the court. If the Commission has already refused to make an order under s 106 permitting the payment then it is unlikely to sanction the making of a fresh application to the court under s 115.

[31] [1970] Ch 700, 710.

[32] CC7, p 4.

[33] Charity Commission, *Ex gratia payments by charities – case studies* (May 2013) p 1, available at

fact been given to him by the testator before he died. There was no independent corroboration of this claim. The charity trustees decided that the evidence was unconvincing and that they were not legally bound to give the property to him. Instead, they applied to the Commission for authority to make an ex gratia payment to meet this claim. However, the evidence that they relied on to justify a feeling of moral obligation was precisely the evidence which they had rejected as unpersuasive in considering the legal claim. Authorisation was therefore refused. According to the Commission:

> Trustees must decide whether or not they have a moral obligation on the basis of evidence. If they are not convinced by the available evidence, they cannot properly conclude that they have a moral obligation. Section [106] is not a "soft option".[34]

11.23 In CC7 the Charity Commission recommends that a charity making a section 106 application in respect of property left to it under a will provide:

(1) a copy of the will and its probate;

(2) evidence to show that the will does not dispose of the testator's estate in the manner in which he or she really intended; and

(3) evidence to show why the testator was prevented from giving effect to his or her real intention. It will not be enough to indicate that the testator expressed a wish to benefit someone if he or she had the opportunity to give effect to that wish but did nothing about it.[35]

11.24 Cases not connected with wills do not often arise. In CC7 the Charity Commission explains that there is no typical case, but an example might be where a person has made a gift in his or her lifetime to a charity reasonably but mistakenly believing that his or her personal circumstances allowed for the making of a gift of that size at that time. If it later became clear that the donor had, as a consequence of his or her generosity to the charity, reduced him- or herself to poverty, the charity trustees might feel morally obliged to make an ex gratia payment by returning all or part of the gift.[36]

Supervision by the Attorney General

11.25 The Attorney General has asked the Charity Commission to submit a regular return of cases in which the power conferred by section 106 is exercised. He has also indicated that the Commission should consult him on cases involving particular difficulty or political or public interest sensitivity. In practice this is likely to happen only where an application raises a particular point of principle or practice on which the Commission considers it desirable to obtain the Attorney General's guidance.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/396698/Ex_gratia_payments_by_charities___case_studies.pdf.

[34] Charity Commission, *Ex gratia payments by charities – case studies* (May 2013) p 1.

[35] CC7, p 5.

[36] CC7, p 4.

Charity Commission practice

11.26 Historically it has been rare for the Charity Commission to refuse to authorise an ex gratia payment under section 106. We have heard from the Charity Commission that, over the last five years, it has authorised an average of 30, and declined an average of two, ex gratia payments each year under section 106. On the occasions on which it has declined to authorise an ex gratia payment, it has often found some other basis on which the payment could be made.[37]

The decision to make a section 106 application and the making of the application

11.27 The Charity Commission takes the view that a decision to apply under section 106 for authorisation to make an ex gratia payment must be taken by the charity trustees; it cannot be delegated to another individual or body within the charity or to a third party. This is implicit from the requirement in section 106(1)(b) that the *trustees* regard themselves as being under a moral obligation to make the payment.[38]

11.28 Once the decision is made by the trustees, the application may be submitted by the trustees themselves or by anyone with authority to act on behalf of the trustees in this regard, for example the charity's legacy officer or a solicitor.[39] The Charity Commission cannot accept an application from someone who is not acting on behalf of the trustees, for example a disappointed beneficiary or an executor.[40]

Waiving the authorisation requirement for small ex gratia payments

11.29 There is no dispensation under section 106 for small ex gratia payments to be exempt from the requirement for authorisation by an order of the Charity Commission. However, in practice the Commission will be unlikely to challenge a decision by the trustees not to apply for authorisation under section 106 before making an ex gratia payment "where the amount of money involved is relatively small, say, £1,000 or less" such that the trustees "feel it would not be administratively sensible to apply for authority to make the payment".[41] The decision to make the payment must still, however, be made by the trustees.

[37] On one application for authorisation of an ex gratia payment to a trustee for work he had done for the charity the Charity Commission gave an opinion (under s 110 of the Charities Act 2011) that the court would probably have allowed the payment as an equitable allowance and advised the charity that it could make the payment on this basis: Charity Commission, *Ex gratia payments by charities – case studies* (May 2013) p 2. We discuss the power of the court to make equitable allowances in Chapter 10 above.

[38] OG539, para B4.1.

[39] OG539, para F5.

[40] OG539, para F5.

[41] OG539, para B4.3. If, however, the Charity Commission receives an application for authority for a small ex gratia payment then it will consider the application in the same way as any other application.

Limit on exercising the section 106 power in respect of statutory charities

11.30 The Charity Commission cannot authorise charity trustees to make an ex gratia payment which is prohibited by statute.[42] Thus where an Act of Parliament prohibits the disposal of the charity's assets otherwise than in the pursuance of its charitable objectives (that is, where the charity is a statutory corporation), not only does the charity lack the power necessary to make the payment but neither the Attorney General nor the Charity Commission (under section 106) can sanction the payment. In such cases, an ex gratia payment can only be made under the authority of a scheme made under section 73 of the Charities Act 2011,[43] or by an amending Act of Parliament.

REFORM OF THE CURRENT LAW

11.31 Lord Hodgson recommended the deregulation of ex gratia payments. Specifically, he recommended the introduction of a new statutory power for charities to make small ex gratia payments without the prior authorisation of the Charity Commission, the Attorney General or the court.[44] He further recommended that charity trustees should be permitted by statute to delegate to the chief executive of the charity (1) the power to decide that an ex gratia payment should be made and (2) the power to submit an application for authorisation of an ex gratia payment from the Charity Commission (in cases where authorisation remained necessary).[45]

11.32 The Charity Commission emphasises that ex gratia payments should not be viewed as a "soft option" for charities. Both the Commission and the wider public must be confident that any deregulation in this area does not result in charity trustees making ex gratia payments simply to get rid of vexatious claimants. In 1994, Burchfield commented that there had been "many situations where 'try ons' are made by disgruntled beneficiaries in the mistaken belief that charities are 'soft touches' when the reverse should be the case because of the strict duties owed by charity trustees".[46] This should continue to be the case.

11.33 If, however, as Burchfield also suggests,[47] trustees are tempted to dress up ex gratia claims as legal claims to avoid the expense of making an application to the Charity Commission then there might be a stronger case for deregulation. If deregulation is desirable then a second issue arises: how much autonomy should trustees be given? Putting the existing Charity Commission practice in relation to small payments on a statutory footing might be sufficient, or it might not go far enough.

[42] The statutory jurisdiction of the Charity Commission to authorise ex gratia payments is the same as the jurisdiction of the Attorney General: Charities Act 2011, s 106(1). In *Attorney General v Trustees of the British Museum* [2005] EWHC 1089 (Ch), [2005] Ch 397 it was held that the Attorney General had no power to authorise an ex gratia payment prohibited by statute.

[43] See para 3.40 and following above.

[44] Hodgson Report, Appendix A, para 5(b).

[45] Hodgson Report, Appendix A, para 5(a).

[46] J Burchfield, "Ex gratia payments by charities from estates" (1994) 6 *Private Client Business* 416, 419.

[47] J Burchfield, "Ex gratia payments by charities from estates" (1994) 6 *Private Client Business* 416, 419.

A new statutory power to make small ex gratia payments

11.34 The Charity Commission already recognises that the requirement for trustees to seek authorisation to make an ex gratia payment can be disproportionate where the value of the payment is small. In its guidance the Commission indicates that it will usually not object to a failure by the trustees to apply for authorisation where they feel that this would be "administratively sensible"; this will typically be the case where the value of the payment is £1,000 or less.[48] While this might provide some encouragement to trustees, our provisional view is that it would be beneficial for trustees to have the added certainty of a statutory power to make small ex gratia payments, rather than having to rely on the Charity Commission's practice of taking no action in respect of a failure to apply for authorisation under section 106.

11.35 Accordingly, we agree with Lord Hodgson that there should be a new statutory power for charities to make small ex gratia payments without having to seek the prior approval of the Charity Commission (or the Attorney General or the court). Lord Hodgson did not propose a definition of "small" in this context. There are two possible options.

(1) The first is simply to put the practice of the Charity Commission on a statutory footing by permitting charity trustees to make ex gratia payments where the cost of a section 106 application would be "disproportionate" to the value of the payment.

(2) The second option is to introduce a monetary threshold, say £1,000 or £5,000, with a power for the Minister to vary that threshold by secondary legislation.[49]

11.36 We prefer the second of these options. As for the first option, the meaning of "disproportionate" might be ambiguous in some cases, leading to uncertainty as to whether the charity trustees have power to make the payment in question. The second option provides trustees with greater certainty, although it might prove difficult to arrive at an appropriate threshold, at least at the outset. Imposing a monetary limit on the power might stifle legitimate claims, or swell illegitimate claims, given that disappointed beneficiaries will know that payments up to a certain value can be made without Charity Commission approval. Ultimately, however, it will be necessary to rely on trustees to be vigilant and to exercise the power with caution.

11.37 It should be possible for the new statutory power to be excluded or limited by express provision in a charity's governing document. The governing document generally defines the scope of the trustees' powers in applying the charity's property, and that should particularly be the case in relation to the use of property otherwise than in furtherance of the charity's purposes.

[48] OG539, para B4.3.

[49] Akin to the power for the Minister to vary the financial conditions on releasing the restrictions on spending permanent endowment under s 281 of the Charities Act 2011: s 285.

11.38 Any new power should be regarded as enabling, not mandatory. It should remain possible for trustees to continue to obtain formal approval from the Charity Commission for small value payments under section 106 if they wish to do so.

11.39 We consider that the current regulatory regime is satisfactory where larger payments are concerned. The requirement for authorisation is a useful safeguard as a protection against potential abuse of the ex gratia payment jurisdiction by charity trustees.

11.40 **We provisionally propose that a new statutory power be introduced allowing trustees to make small ex gratia payments without having to obtain the prior authorisation of the Charity Commission, the Attorney General or the court.**

Do consultees agree?

11.41 **We invite the views of consultees as to the appropriate financial threshold for the exercise of such a new statutory power.**

11.42 **We provisionally propose that the Minister be given a power to vary the financial threshold by secondary legislation.**

Do consultees agree?

11.43 **We provisionally propose that such a statutory power should be capable of being excluded or limited by a charity's governing document.**

Do consultees agree?

Delegation of decisions and the making of applications

11.44 Charity trustees are generally permitted to delegate the day-to-day management of the charity to other officers. However, as noted above,[50] the Charity Commission's power to authorise an ex gratia payment is only available where the trustees themselves determine that they are morally obliged to make it; that decision cannot be taken by any other officer of the charity. But once the decision has been made by the trustees the section 106 application can be submitted to the Commission by anyone who has been authorised to act on behalf of the trustees in this regard.[51] That authorisation is likely to be given by an express term in the charity's governing document, though there are also default powers of delegation available to the trustees of charitable companies[52] and charitable trusts.[53]

11.45 Lord Hodgson recommended that trustees be given a new statutory power to delegate the making of section 106 applications to the chief executive of the charity. We are not convinced at this stage that such a power is needed since we expect that the vast majority of trustees will already have this power, whether by

[50] See para 11.27 above.

[51] OG539, para B4.1.

[52] Companies (Model Articles) Regulations 2008 (SI 2008 No 3229), Sch 2, Pt 2, para 5.

[53] Trustee Act 2000, s 11.

virtue of their charity's governing document or by virtue of an existing statutory provision.

11.46 The other recommendation made by Lord Hodgson was that trustees should be capable of delegating the decision to make ex gratia payments (whether under any new statutory regime for the making of payments without Charity Commission authorisation, or under section 106) to the chief executive of the charity. The Charity Commission's view is that this is not possible, even in respect of small payments. On the one hand it is possible that the power to delegate decisions could result in greater efficiency in the making of ex gratia payments, but on the other hand there is an issue of principle: should decisions of an entirely moral nature, and which involve the application of the funds of a charity otherwise than in furtherance of its purposes, be capable of being taken by anyone other than the trustees? These are matters on which we would like to hear from consultees.

11.47 If consultees support the introduction of a power for trustees to delegate decisions to make ex gratia payments then two further issues arise.

(1) To whom should the taking of the decision be delegated? Lord Hodgson suggested that it should be the chief executive of the charity, but some charities, particularly small charities, may not have a chief executive, and we can envisage other situations in which it might be more appropriate to delegate to a dedicated legacy officer. Should the trustees be able to appoint a "responsible officer" within the charity for this purpose?

(2) Should the power of delegation be limited to payments of a certain value? If so, should that limit be aligned with the limit on the proposed new statutory power for trustees to make payments without Charity Commission authority,[54] or should it be set at a different value?

11.48 **We invite the views of consultees:**

(1) **as to whether the trustees of a charity should be capable of delegating the taking of a decision to make an ex gratia payment (whether under any new statutory regime for the making of payments without Charity Commission authorisation, or under section 106 of the Charities Act 2011) to another officer of the charity;**

(2) **as to whom the taking of the decision should be delegated; and**

(3) **as to whether such a power should be limited to payments of a certain value and, if so, what that value should be.**

Statutory charities

11.49 The decision in *Attorney General v Trustees of the British Museum*[55] affirmed that the Attorney General, the court and the Charity Commission do not have the power to authorise ex gratia payments that would contravene an Act of

[54] See paras 11.40 and 11.41 above.

Parliament: see paragraph 11.30 above. The jurisdiction to authorise ex gratia payments is narrow, and it is unlikely that Parliament intended, when passing Acts to establish or regulate statutory charities, to exclude this power. We therefore provisionally propose that the existing power to authorise ex gratia payments should be extended to statutory charities even where such a payment would otherwise be prohibited by the provisions of an Act, and that the new power for charity trustees to make small ex gratia payments without authorisation (provisionally proposed above) should also extend to statutory charities.

11.50 **We provisionally propose that the Attorney General, the court and the Charity Commission should have the power to authorise ex gratia payments by statutory charities.**

Do consultees agree?

11.51 **We provisionally propose that the new statutory power for charity trustees to make small ex gratia payments (under paragraph 11.40 above) should be available to the trustees of statutory charities.**

Do consultees agree?

THE IMPACT OF REFORM

11.52 In assessing the desirability of reform, we would be assisted by hearing of consultees' experiences of considering whether to make ex gratia payments and of seeking authorisation from the Charity Commission under section 106 to make such payments, including details of the time taken by the trustees and staff and the costs involved. We also invite consultees' views as to whether the power that we provisionally propose in paragraph 11.40 above would be likely to increase or decrease the costs of making ex gratia payments.

11.53 **We invite consultees to share with us their experiences of considering whether to make, and seeking authorisation to make, ex gratia payments, in particular the work, time and expense that have been involved.**

[55] [2005] EWHC 1089 (Ch), [2005] Ch 397.

PART 5

INCORPORATION, MERGER AND INSOLVENCY

CHAPTER 12
CHARITY INCORPORATIONS AND MERGERS

INTRODUCTION

12.1 Charities change their organisational form for numerous reasons. An unincorporated charity which has grown over time might benefit from incorporation[1] for convenience when entering into contracts and to limit the liability of the trustees. A charity's purposes might be better served by merging with another charity, for example, to achieve efficiencies of scale or if a charity's resources are too small for it to achieve its purposes effectively. The Charity Commission publishes guidance for charities wishing to collaborate with others or formally to merge with other charities.[2]

12.2 An incorporation or merger involves the transfer of one charity's activities to another. This might include the transfer of a charity's employees, contracts, and assets. The transfer of employees is outside the scope of this project and the transfer of contracts will depend on their particular terms. Our focus is on the powers of charities to incorporate and to merge, and on the means by which charities can transfer their assets on incorporation or merger.

12.3 No two incorporations or mergers are the same. They will each raise different legal, accountancy and practical issues. Some will be complicated, time-consuming and expensive; law reform cannot prevent this. The law should, however, facilitate incorporation and merger, and legal obstacles that exist should be removed where possible. We would emphasise that we are not seeking to influence or encourage charities to incorporate or merge, but to improve the legal rules that apply when charities have decided to do so.

12.4 In this Chapter, we summarise the current law governing incorporation and merger and then consider some of the problems that arise,[3] making provisional proposals for their reform. These problems have resulted in the existence of "shell" charities on the register: on incorporation, the original unincorporated charity continues to exist alongside a new charitable company; on merger, the original charity continues to exist following the transfer of its assets to another charity. But the existence of shell charities is inconvenient: it clutters the register with charities that are not in fact operating; those who search the register can be confused or even misled by seeing the formal existence of a charity that had apparently been wound up following incorporation or merger; and the incorporated or merged charity will incur accountancy, administrative and legal costs in maintaining a shell charity on the register. The legal framework for charities should eliminate, as far as possible, the need for shell charities to be retained.

[1] For example, as a charitable company or a CIO; see paras 1.14 and 1.15 above.

[2] Charity Commission, *Collaborative Working and Mergers* (CC34) (November 2009).

[3] The Hodgson Report highlighted some of the difficulties that we address in this Chapter: para 10.1 to 10.8, and Appendix A, paras 16 and 17.

THE CURRENT LAW

Incorporation

12.5 If the trustees of an unincorporated charity wish to operate as an incorporated charity,[4] they must establish a corporate body, which will generally be a charitable company or CIO, and transfer the charity's operations (for example staff, contracts and assets) to the new corporate body.[5] The trustees need legal authority to convert to an incorporated charity. That authority may come from an express power in the charity's governing document; from statute; or from a Charity Commission scheme.

(1) Express powers

12.6 The trustees' powers to transfer the charity's assets to the corporate body will depend on the terms of the governing document; it might cater for the possibility of incorporation or, if not, it is likely to contain a dissolution clause.[6] Even if the governing document makes no provision for incorporation, the trustees are likely to be able to use section 280 of the Charities Act 2011 to introduce provisions to facilitate incorporation.[7]

(2) Statutory powers

12.7 If the trustees' powers under the governing document are insufficient, the trustees might be able to use statutory powers to carry out a proposed incorporation instead. Section 268 of the Charities Act 2011 permits the trustees of an unincorporated charity to resolve that all of the charity's property should be transferred to another charity or charities.[8] The purpose behind section 268 is both to facilitate incorporations and to allow small charities to transfer their assets to another charity before winding up. In order to use this power, the following conditions must be satisfied:

(1) the charity's annual income must not exceed £10,000, unless the transfer is to a CIO in which case there is no financial limit;[9]

(2) the charity must not have any "designated land";[10]

4 We are not here referring to the incorporation of charity trustees under Part 12 of the Charities Act 2011.

5 On the transfer of assets, the trustees will generally seek indemnities from the corporate body in respect of any liabilities they had personally incurred on behalf of the charity. Had the charity's assets remained vested in the trustees as an unincorporated charity, the trustees would have had the benefit of their right to indemnity from those assets for the charity's liabilities (see para 13.35 and following below); the trustees will no longer have access to those assets when they are transferred to the corporate body, so the corporate body should provide them with an indemnity in respect of those liabilities.

6 See for example Charity Commission, *Model trust deed for a charitable trust* (November 2013) cl 32.

7 We discuss s 280 of the Charities Act 2011 in paras 3.16 to 3.18 and ch 6 above. The only limitation on the s 280 power, in this context, is that the Charity Commission states that the trustees cannot use the power to change the purposes for which a charity's property can be used on dissolution.

8 The power is limited to trustees of unincorporated charities by Charities Act 2011, s 267(1)(c).

9 Charities Act 2011, s 267(1)(a) and (2).

(3) the trustees must be satisfied that the transfer is expedient in the interests of furthering the purposes for which the property is held;[11]

(4) the trustees must be satisfied that one or more purposes of the transferee (the corporate body) is "substantially similar" to one or more of the charity's purposes;[12] and

(5) the resolution must be passed by at least two-thirds of the trustees who vote.[13]

12.8 Once the resolution has been passed, it must be sent to the Charity Commission with a statement of the trustees' reasons for passing it.[14] On receipt of the resolution, the Charity Commission has a discretion to require the trustees to give public notice of the resolution, and the Commission must consider any comments made by persons "interested in the charity" within 28 days of public notice being given.[15] The Commission can also direct the trustees to provide further information about the resolution.[16]

12.9 The resolution will take effect 60 days after it is received by the Charity Commission, unless the Commission notifies the trustees within that period that it objects to the resolution.[17] Once the resolution takes effect, the trustees must arrange for the property to be transferred to the new corporate body.[18] The new corporate body must secure, so far as is reasonably practicable, that the property is applied for such of its purposes as are substantially similar to those of the transferor charity, unless compliance would not result in a suitable and effective method of applying the property.[19]

12.10 Where property to be transferred pursuant to a resolution under section 268 is permanent endowment,[20] special provisions apply:

(1) the trustees must be satisfied that *all* of the purposes of the transferee (the corporate body) are "substantially similar" to *all* of the charity's purposes;[21] and

[10] Charities Act 2011, s 267(1)(b). For the meaning of "designated land", see para 8.22 above.

[11] Charities Act 2011, s 268(3)(a).

[12] Charities Act 2011, s 268(3)(b).

[13] Charities Act 2011, s 268(4).

[14] Charities Act 2011, s 268(5).

[15] Charities Act 2011, s 269(1).

[16] Charities Act 2011, s 269(2).

[17] Charities Act 2011, ss 270 and 271(1). The 60-day period is extended where the Commission requires public notice to be given or requires further information from the trustees: s 271(1)(b), (4) and (5). The resolution is deemed never to have been passed if the 60-day period is suspended for more than 120 days: s 271(6) and (7).

[18] Charities Act 2011, s 272(2).

[19] Charities Act 2011, s 272(2)(a) and (3).

[20] Because there are restrictions on its expenditure; see ch 9 above.

(2) the property must be transferred to the new corporate body subject to the permanent endowment restrictions.[22]

(3) Charity Commission scheme

12.11 If the trustees have no power to transfer the charity's property to a new corporate body, whether under the governing document or under section 268, they can instead seek from the Charity Commission a scheme authorising the transfer.[23]

Merger

12.12 If a charity wishes to merge with another charity, it must transfer its operations to the merged charity. A merger is usually structured in one of two ways.[24]

(1) Charity A transfers its assets to Charity B. Charity A will either be dissolved or remain as a shell charity. Charity B might decide to change its name or to amend its governing document following the merger, but it need not do so.[25] We refer to this as a "Type 1 merger".

(2) Charity A and Charity B transfer their assets to a new charity, Charity C. Charities A and B will either be dissolved or remain as shell charities.[26] We refer to this as a "Type 2 merger".

Incorporation as a form of merger

12.13 An unincorporated charity that becomes a corporate charity transfers its assets to a new (corporate) charity. Charity incorporation, discussed above, is therefore an example of a Type 1 merger.

Powers to merge

12.14 The trustees need legal authority to merge with another charity. The powers outlined above concerning incorporation[27] apply equally to mergers. A charity's ability to merge will depend on the terms of its governing document. An unincorporated charity is likely to be able to use the section 280 power to introduce provisions into the governing document to facilitate a merger, and a

[21] Charities Act 2011, s 274(3). Where the transfer is to two or more charities, the trustees must be satisfied that (a) all of the purposes of the transferees, taken together, are substantially similar to all of the purposes of the transferor charity, and (b) all of the purposes of each transferee are substantially similar to one or more of the purposes of the transferor charity. Compare the condition for the transfer of unrestricted property: para 12.7(4) above.

[22] Charities Act 2011, s 272(2)(b); see ch 9 above.

[23] See para 3.36 above on administrative schemes of the Charity Commission.

[24] Based on J Warburton, *The University of Liverpool Charity Law Unit – Mergers: A Legal Good Practice Guide* (January 2001) para 9, available at http://www.liv.ac.uk/media/livacuk/law/cplu/mergersrep.pdf.

[25] As a further alternative, Charity B might become a corporate trustee of Charity A.

[26] As a further alternative, Charities A and B might become subsidiaries of Charity C, a holding company.

[27] See paras 12.6 to 12.11 above.

charitable company or CIO could similarly exercise their powers of amendment to introduce such provisions into their governing documents.[28]

12.15 In addition, the trustees of an unincorporated charity will be able to use the section 268 power to transfer its assets to another charity, subject to the conditions set out in paragraph 12.7 above.[29] The section 268 power is not limited to a transfer to a new corporate body on incorporation. It permits a transfer to an existing charity (whether incorporated or unincorporated) under a Type 1 merger, and a transfer to a new charity (whether incorporated or unincorporated) as a Type 2 merger.

12.16 There are separate statutory provisions governing the merger of CIOs. A CIO is permitted by section 240 of the Charities Act 2011 to transfer its operations to another CIO with the consent of the Charity Commission (a Type 1 merger).[30] Two or more CIOs are permitted by section 235 of the Charities Act 2011 to amalgamate and form a new CIO with the consent of the Charity Commission (a Type 2 merger).[31] Both procedures are similar to those under section 268 applying to unincorporated charities.

12.17 If a charity does not have power to merge, it can instead seek a Charity Commission scheme to authorise the merger.

The purposes of the merged charity

12.18 A proposed merger may raise concerns about the expansion of, or change to, a charity's purposes, as where, for example, a charity that assists homeless people in Birmingham wishes to merge with a charity that assists homeless people nationally. The statutory powers to transfer property under section 268 are fairly broad; it is only necessary that the transferor and transferee charities have one similar purpose (save in respect of permanent endowment), but the merged charity is under a duty to seek to apply the property to the original charity's purposes.[32]

12.19 If a charity wishing to merge is faced with difficulties concerning its limited purposes, it might decide to change its purposes before merging. A charity's purposes can be changed in accordance with the express terms of its governing document, under statutory powers, or by way of a Charity Commission cy-près scheme. We discuss the changing of a charity's purposes in Chapters 3 and 5 above.

The register of mergers

12.20 The Charities Act 2006 established the register of mergers, which is maintained by the Charity Commission. Registration of a merger gives rise to two

[28] See ch 3 above, where we discuss the powers of charitable companies and CIOs to amend their governing documents.

[29] In particular, the transferor charity must have an annual income of £10,000 or less, unless the merged charity is a CIO.

[30] The procedure is set out in Charities Act 2011, ss 240 to 243.

[31] The procedure is set out in Charities Act 2011, ss 235 to 238.

[32] See para 12.9 above.

consequences. First, it allows "vesting declarations" to be made, which are intended to effect the transfer of property on merger more efficiently. Second, it makes provision for a gift left by will to a charity that has merged to take effect as a gift to the merged charity. We consider both issues below.

12.21 The reforms only apply to "relevant charity mergers", which are:

(1) mergers where one charity transfers all of its property to another charity (or charities) and the original charity ceases to exist (or is to cease to exist after the transfer of its property); and

(2) mergers where two or more charities transfer all of their property to a new charity and the original charities cease to exist (or are to cease to exist after the transfer of their property).[33]

12.22 The meaning of "relevant charity merger" is modified in the case of a merger which involves the transfer of permanent endowment and the trusts on which the permanent endowment is held do not make provision for the termination of the charity. In such a case, references to the property of a charity are to its unrestricted funds only and there is no requirement for the charity to cease to exist.[34] This ensures that a merger can still fall within the definition of "relevant charity merger" even if the original charity's permanent endowment remains in existence as the original (or a separate[35]) charity.

12.23 The definition of "relevant charity merger" does not cover all types of merger (see paragraph 12.12 above). The original charity (or charities) must cease to exist before a merger can be a "relevant charity merger", so the definition does not include mergers where a shell charity is retained (unless the original charity holds permanent endowment; see paragraph 12.22 above).

12.24 An incorporation falls within the definition of a "relevant charity merger" provided the unincorporated charity does not continue to exist as a shell charity, so the benefits of the merger provisions are available to charities that are incorporating.

Vesting of property in a new charity on incorporation or merger

(1) Transferring assets

12.25 In some cases, it will be easy to transfer a charity's property on incorporation or merger. Ownership of many assets can be transferred by a simple deed. Registered freehold and leasehold estates in land can be transferred by the execution of a Land Registry TR1 form. Where leasehold land is subject to

[33] Charities Act 2011, s 306(1).

[34] Charities Act 2011, s 306(2) and (3).

[35] See paras 13.20 and 13.28 below.

covenants against assignment, the charity will often be able to obtain the landlord's consent to transfer the lease to the new charity without difficulty.[36]

12.26 Where the charity has permanent endowment, the trustees are likely to be able to transfer legal title to the new charity so that the new charity becomes the trustee of the permanent endowment.

12.27 In many cases, however, transferring property on incorporation or merger will be difficult or administratively burdensome, and the Charities Act 2011 provides some mechanisms that are intended to assist. These mechanisms are described below. There are problems with these mechanisms. The principal difficulty arises when a charity holds a lease containing a covenant against assignment (or sub-letting, parting with possession and sharing occupation). Such covenants are generally "absolute" (such that assignment is prohibited) or "qualified" (such that assignment is prohibited without the landlord's consent, usually subject to a proviso that consent is not to be unreasonably withheld).

(2) Charity Commission vesting orders under section 272 of the Charities Act 2011

12.28 When an unincorporated charity resolves to transfer all of its assets to another charity under section 268 (on incorporation or merger), the legislation anticipates that the trustees will execute the necessary documentation to effect the transfer.[37] However, the Charity Commission has a power, at the request of the trustees, to make an order vesting property in the transferee charity.[38] The power is unlimited in scope. It would be possible for the power to be used to transfer a lease to the new charity without obtaining the landlord's consent, despite the existence of an absolute or qualified covenant against assignment. Such a transfer either would not amount to an assignment,[39] or would be protected by section 286:

> No vesting or transfer of any property in pursuance of any provision of this Part [which includes section 272] operates as a breach of a covenant against alienation or gives rise to a forfeiture.

[36] A transfer of assets to a charitable company on incorporation or merger might amount to a substantial property transaction under s 190 of the Companies Act 2006 and therefore require the Charity Commission's consent under s 201 of the Charities Act 2011. Following discussions between the Charity Commission and the Charity Law Association, the Commission has set out the procedure that it will follow, and the information that it will require, before consenting to a substantial property transaction under s 201 of the Charities Act 2011: see letter of Kenneth Dibble dated 9 September 2013, available at http://charitylawassociation.org.uk/wp-content/uploads/2014/03/20130909LetterfromChiefLegalAdvisertoCharityLawAssociationres190CompaniesAct2006.pdf.

[37] Charities Act 2011, s 272(2): "The charity trustees must arrange for all the property … to be transferred in accordance with the resolution".

[38] Charities Act 2011, s 272(4). The Charity Commission states that it will rarely use this power: Charity Commission, *OG519 Unincorporated Charities: Changes to Governing Documents and Transfer of Property (Charities Act sections 268, 275 and 280)* (February 2014) section B2.5.

[39] By analogy with vesting orders made by the court, which do not infringe covenants against assignment: *Marsh v Gilbert* [1980] 2 EGLR 44; *Woodfall: Landlord and Tenant* para 11.166.

(3) Pre-merger vesting declarations under section 310 of the Charities Act 2011

12.29 Pre-merger vesting declarations were introduced, together with the register of mergers, by the Charities Act 2006. They were intended to provide a simpler means of transferring property to the transferee charity on merger or incorporation.[40] The trustees of the original charity make a declaration by deed that, from a specified date, all the charity's property is to vest in the transferee.[41] The declaration can only be made in respect of a "relevant charity merger", so the original charity must cease to exist once all of its property has been transferred to the merged charity.

12.30 A section 310 vesting declaration operates to vest the legal title to all of the transferor's property in the transferee, without the need for any further document transferring it.[42] A section 310 vesting declaration does not, however, apply to:

(1) any land held by the transferor as security for money subject to the trusts of the transferor (other than land held on trust for securing debentures or debenture stock) ("the first exception");

(2) any land held by the transferor under a lease or agreement which contains any covenant (however described) against assignment of the transferor's interest without the consent of some other person, unless that consent has been obtained before the specified date ("the second exception"); or

(3) any shares, stock, annuity or other property which is only transferable in books kept by a company or other body or in a manner directed by or under any enactment ("the third exception").[43]

12.31 These exceptions are modelled on those in section 40 of the Trustee Act 1925, which provides for the automatic transfer of trust property when the trustees change.

12.32 A section 310 vesting declaration:

(1) does not override the requirement that a transfer of land be registered;[44] and

(2) does not apply to a charity's permanent endowment, unless the transferee charity is a CIO.[45]

[40] Prime Minister's Strategy Unit, *Private Action, Public Benefit: A Review of Charities and the Wider Not-for-Profit Sector* (September 2002) para 4.59 and following.

[41] Charities Act 2011, s 310(1).

[42] Charities Act 2011, s 310(2).

[43] Charities Act 2011, s 310(3).

[44] Charities Act 2011, s 310(4).

[45] Charities Act 2011, s 312(1)(b), and the modifications made by the Charitable Incorporated Organisations (General) Regulations 2012 (SI 2012 No 3012), reg 61.

12.33 By section 313, no vesting or transfer of any property under section 310 operates as a breach of covenant or condition against alienation or gives rise to a forfeiture.

(4) Automatic vesting where the charity is a CIO under sections 239 and 244 of the Charities Act 2011

12.34 The power to make a vesting declaration under section 310 does not apply when the charity transferring its property is a CIO. When a transfer by a CIO to another CIO is approved by the Charity Commission:

> all the property, rights and liabilities of the transferor CIO become by virtue of this subsection the property, rights and liabilities of the transferee CIO in accordance with the resolution.[46]

12.35 And when the amalgamation of two or more CIOs is approved by the Charity Commission registering the new CIO:

> all the property, rights and liabilities of each of the old CIOs become by virtue of this subsection the property, rights and liabilities of the new CIO.[47]

12.36 Unlike section 310 vesting declarations, no property is expressed to be excluded from this automatic deeming provision: see paragraphs 12.30 and 12.32 above.

12.37 By section 250 of the Charities Act 2011, no vesting or transfer of property under these provisions operates as a breach of a covenant or condition against alienation or gives rise to a forfeiture.

(5) Vesting by a Charity Commission scheme or order

12.38 Where trustees cannot transfer property on an incorporation or merger, they can ask the Charity Commission to make a scheme to effect the transfer. We have heard that the Charity Commission has also effected transfers of property on merger using its power under section 105 of the Charities Act 2011 to sanction by order any action that would be expedient in the interests of the charity.[48]

12.39 Unlike section 310 vesting declarations, no property is expressed to be excluded from these powers.

Bequests to a charity that has incorporated or merged

12.40 When charities merge (including by incorporating), difficulties arise when gifts have been made by will to the original charity. A bequest takes effect at the date

[46] Charities Act 2011, s 244(1)(b).

[47] Charities Act 2011, s 239(2).

[48] Bates Wells Braithwaite, *BWB submission to Lord Hodgson on the property aspects of the Charities Act 2006* (September 2012). A transfer by scheme under s 69, or by order under s 105, would enjoy the protection of s 116, which provides that "no vesting or transfer of any property in pursuance of any provision of this Part operates as a breach of a covenant or condition against alienation or gives rise to a forfeiture". Further, such vesting of property might not amount to a breach of covenant against assignment at all: see n 39 above.

of death of the testator, not at the date of the will. Where an institution named in a will has ceased to exist at the date of death, it is necessary to ascertain whether the testator intended to benefit (a) the particular institution, or (b) the purposes of the institution. If it is the particular institution, the gift lapses and the gift will form part of the residuary estate. If it is the purposes of that institution, the gift can be applied cy-près.[49]

12.41 Where a named institution has ceased to exist following merger, there are ways to prevent a gift from lapsing.

(1) It might be possible to interpret the gift in such a way that it takes effect for the benefit of the new charity.

(2) The gift, on its true construction, might be a gift for particular purposes, so it can be applied cy-près. This will often be the case when gifts are to named unincorporated charities, which necessarily take effect as gifts on trust for those purposes;[50] conversely, it will rarely be the case when gifts are to named corporate charities, which are generally taken by the corporate body beneficially.[51]

(3) The gift might be saved by the existence of a general charitable intention, allowing the court or Charity Commission to make a cy-près scheme.[52]

12.42 To avoid arguments about gifts lapsing and the associated legal costs, many merging charities adopted the practice of retaining shells of their former selves on the register to capture gifts that might otherwise have lapsed post-merger. Gifts to the shell charity, once received, are then transferred to the merged charity.

12.43 The register of mergers was intended to eliminate the need for this inconvenient and costly practice. By section 311 of the Charities Act 2011, when a merger is registered, a gift to the original charity takes effect as a gift to the transferee, unless it is an excluded gift.[53] A gift is an "excluded gift" if the original charity held permanent endowment and the gift was intended to be held subject to the trusts on which the permanent endowment is held.[54] In such a case, the trust on which the original charity's permanent endowment was held will continue to exist separately and the gift will be added to that permanent endowment.[55]

PROBLEMS WITH THE CURRENT LAW

12.44 We now turn to consider some of the problems that arise under the current law.

[49] See, generally, H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) ch 31. See also para 3.20 and following above.

[50] *Re Vernon's Will Trusts* [1972] Ch 300, 303, by Buckley J.

[51] *Re Finger's Will Trusts* [1972] Ch 286; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 490 to 491.

[52] See para 3.30 and following above on the meaning of a "general charitable intention".

[53] Equivalent provisions apply where a CIO transfers its operations to another CIO, or where two or more CIOs amalgamate: Charities Act 2011, ss 239(3) and 244(2).

[54] Charities Act 2011, s 311(3).

[55] Charities Act 2011, s 306(2) and (3).

The power to incorporate or merge

12.45 Charities will usually have an express power to incorporate or merge. In the absence of such a power:

(1) charities will usually be able to introduce such powers; unincorporated charities can use the section 280 power and companies and CIOs can use their statutory powers of amendment;[56]

(2) unincorporated charities with an income of less than £10,000, and without "designated land", can transfer all of their property to another charity under section 268;

(3) unincorporated charities can transfer all of their property to a CIO under section 268, regardless of their income; and

(4) a CIO can amalgamate with another CIO, or transfer its property to another CIO, under sections 235 and 240, regardless of its income.

Conditions on the exercise of the section 268 power

12.46 Lord Hodgson recommended that the annual income threshold under section 268 should be increased to £25,000.[57] He did not adopt the Charity Commission's suggestion that the need for Charity Commission approval of a section 268 resolution be removed.[58]

12.47 In the light of the existence of express powers to incorporate and merge, and amendment powers that allow trustees to create such express powers, it is questionable whether there is a continuing need for the section 268 power. Nevertheless, it is a tailored statutory procedure which can provide trustees with comfort.[59] It could be made available to a wider range of charities. For example:

(1) it could be available to incorporated charities, rather than being limited to unincorporated charities;

(2) the financial threshold could be increased, or it could be available to all charities, regardless of their income;

(3) it could be available regardless of whether or not charities hold "designated land"; or

(4) the requirement for Charity Commission consent could be removed, either entirely or in respect of charities with an income below a certain level.

[56] See ch 3 above.

[57] Hodgson Report, Appendix A, para 26.

[58] Charity Commission's response to Lord Hodgson's call for evidence.

[59] See, by analogy, the s 275 power, which small charities might prefer to use rather than applying to the Charity Commission for a formal cy-près scheme: see ch 5 above.

12.48 Section 268 was introduced as a deregulatory measure, and it was designed for certain small charities.[60] Any extension of the power should therefore be approached with caution. In addition, it should be noted that the section 268 power is available not only to charities seeking to merge (including by incorporating) but also to facilitate the winding up of charities. Any expansion of the section 268 power would therefore also expand the circumstances in which a charity could transfer its assets to another charity before winding up. But as section 268 largely replicates existing powers, there is little danger in expanding its scope. It must still be exercised by trustees in the best interests of the charity. We can therefore see force in the argument that the power should be extended in each of the ways set out in paragraph 12.47 above.

12.49 The section 235 and 240 powers for CIOs to transfer and amalgamate are wider than section 268, but their exercise is still subject to Charity Commission consent. If the requirement for Charity Commission consent were removed from section 268, the same should apply to sections 235 and 240.

12.50 **We invite the views of consultees as to whether, and if so how, the power for unincorporated charities to transfer their assets to another charity under section 268 of the Charities Act 2011 should be expanded.**

The treatment of permanent endowment under section 268

12.51 The section 268 power can be used by some charities to transfer property to a merged charity whereupon the merged charity can use the property for its purposes. The section 268 power can only be used if one of the merged charity's purposes is substantially similar to one of the original charity's purposes, and the merged charity must seek to use the property for the original charity's purposes.

12.52 The section 268 power is subject to special rules when the property to be transferred is permanent endowment: see paragraph 12.10 above. Rather than the original charity and the merged charity having to share one similar purpose, *all* of the original charity's purposes must be similar to *all* of the merged charity's purposes. Accordingly, the power to transfer permanent endowment to a merged charity, and to apply that permanent endowment for the merged charity's purposes, is more restrictive than the power to transfer and apply unrestricted property on merger. If a charity wishes to transfer its permanent endowment to a merged charity to be used for the merged charity's wider purposes, it must first seek a cy-près scheme from the Charity Commission.

12.53 There is no clear rationale for this more onerous condition. Permanent endowment restrictions concern the expenditure of the funds, not the purposes for which the funds can be used (although a permanent endowment fund might be applicable only for particular purposes of the charity, in which case it will also be a "special trust": see Chapter 13 below). If permanent endowment is transferred on merger, it will remain subject to the same restriction on expenditure of capital. But our provisional view is that there is no reason for section 268 to adopt special requirements concerning the purposes for which permanent endowment, as opposed to unrestricted funds, can be applied on merger. The requirement for "similarity" under section 268 should, we think, be

[60] Charities Act 1985, s 3; Charities Act 1993, s 74.

the same whether the transfer concerns unrestricted funds or permanent endowment.

12.54 **We provisionally propose that the condition for the exercise of the power under section 268 of the Charities Act 2011 requiring similarity of purpose between the transferor and transferee charity should be the same in respect of both unrestricted funds and permanent endowment.**

Do consultees agree?

The impact of reform

12.55 When considering the impact of reform, we would be assisted by hearing of charities' experiences of using the section 268 power, including in respect of permanent endowment.

12.56 **We invite consultees to share with us their experiences of using the section 268 power, including in respect of permanent endowment, in particular the work, time and costs that have been involved.**

Transferring property on incorporation or merger

Property other than permanent endowment

12.57 Once a charity has resolved to merge or incorporate, whether by using the powers in its governing document, the statutory powers or a Charity Commission scheme, it must put that resolution into effect by transferring its assets to another charity. Different mechanisms are available to charities for this purpose:

(1) the transfer can be carried out in the usual way (usually by deed);

(2) the charity might rely on a pre-merger vesting declaration under section 310;

(3) if the charity is a CIO, it can rely on the automatic vesting provisions in sections 239 and 244;

(4) if the transfer is carried out under section 268, the trustees can request that the Charity Commission make a vesting order under section 272; or

(5) the charity can ask the Charity Commission to make a scheme to effect the transfer.

12.58 Options 1, 2 and 3 are available without the charity needing the Charity Commission's involvement. Options 2 and 3 were introduced to facilitate mergers between charities. The two options are very different. The automatic vesting provisions for CIOs are expansive. A section 310 vesting declaration, by contrast, is subject to limitations, and we have heard that this undermines its utility in practice.

(1) Certain property is excluded from section 310 vesting declarations (see paragraph 12.30 above), most notably leases containing qualified covenants against assignment.

(2) It is unclear whether a vesting declaration takes effect in respect of leases containing absolute covenants against assignment.[61]

12.59 The existence of express exceptions in section 310 (set out in paragraph 12.30 above) as compared with the absence of any express exceptions in sections 239 and 244 is unsatisfactory. It would appear from the statutory wording that automatic vesting under section 239 and 244 applies to the property excepted from section 310 vesting declarations.

THE FIRST EXCEPTION

12.60 The first section 310 exception[62] seems to be of a very limited scope, and we are doubtful that it causes any difficulties in practice.

THE SECOND EXCEPTION

12.61 The second section 310 exception[63] is, in our view, the most problematic. It stands in stark contrast to automatic vesting under sections 239 and 244 which seem to vest leases in the merged charity regardless of the existence of absolute or qualified covenants against assignment. This exception could be removed from section 310.

12.62 There is an argument against removing that exception. When a charity has a relationship with a third party in respect of its property, automatic vesting rides roughshod over the contractual provisions agreed between the parties. Those provisions are likely to have included protections for the third party and to have influenced the commercial bargain that was struck between the parties. For example, a lease containing an absolute covenant against assignment might have been granted at a below-market rent, or to a particular local charity favoured by the landlord. Covenants against assignment also protect the landlord against acquiring a tenant of poor covenant strength. By automatically vesting the lease in the merged charity, the landlord's rights are overridden.

12.63 Despite the strength of that counter-argument, our provisional view is that section 310 vesting declarations should apply to all leases, including those containing absolute and qualified covenants against assignment. This would override third-party rights, but:

(1) such rights can already be overridden under the current law by other means (by automatic vesting under sections 239 or 244 in the case of CIOs, by a Charity Commission order under section 272(4), or by a Charity Commission scheme); and

[61] One would expect that, if leases with qualified covenants are excluded, leases with more onerous absolute covenants should also be excluded. But if that were the case then s 313 (see para 12.33 above) was a curious provision to be included; the deeming provision would seem to be redundant if vesting declarations did not apply to leases containing absolute covenants. The exception was modelled on s 40 of the Trustee Act 1925. There is no indication from case law as to whether that similar statutory provision was intended to exclude leases with absolute covenants against assignment.

[62] See para 12.30(1) above.

[63] See para 12.30(2) above.

(2) automatic transfers will only take effect in respect of a merger with another charity, so charities will not be permitted to transfer leases to commercial organisations contrary to covenants against assignment.

12.64 Removal of this exception would remove with it any exclusion of leases containing absolute covenants against assignment (if, indeed, such leases are already excluded, about which there is uncertainty).

12.65 If this exception is not removed, uncertainty will remain as to whether the exception extends to leases containing absolute covenants. If the exclusion of leases with qualified covenants is retained, in our view, leases with absolute covenants should also be excluded and the legislation should be amended to make this clear.

THE THIRD EXCEPTION

12.66 It is perhaps surprising that automatic vesting under sections 239 and 244 is not subject to the third section 310 exception.[64] Conversely, however, it might be that the administrative costs of effecting a transfer of these assets separately from a section 310 vesting declaration are minimal. Even following automatic vesting under sections 239 or 244, notification would still have to be given in order to update the relevant register; having to execute a transfer as well might cause minimal additional inconvenience.

12.67 **We invite consultees to share with us their experiences of using vesting declarations under section 310 of the Charities Act 2011, including any difficulties that they have encountered and whether they consider the power to be satisfactory.**

12.68 **We provisionally propose that the exception in section 310(3)(b), in respect of leases containing qualified covenants against assignment, be removed.**

Do consultees agree?

12.69 **We invite the views of consultees as to whether the section 310 power and its exceptions are otherwise satisfactory.**

12.70 **If, contrary to our provisional proposal in paragraph 12.68 above, consultees do not agree that section 310 vesting declarations should apply to leases containing qualified covenants against assignment, we invite the views of consultees as to whether section 310 vesting declarations should apply to leases containing absolute covenants against assignment.**

Permanent endowment

12.71 Lord Hodgson said that, following a merger involving permanent endowment, a Charity Commission scheme generally has to be made to appoint the recipient charity (or its trustees) as the trustee of the endowment. He recommended that such transfer be possible without the need for a Charity Commission scheme.[65]

[64] See para 12.30(3) above.

[65] Hodgson Report, Appendix A, para 16.

12.72 There may be some confusion here between transferring permanent endowment on merger, and changing the purposes for which permanent endowment is held.

12.73 Permanent endowment can often be transferred to a merged charity without difficulty; the original trustees simply appoint the merged charity (or its trustees) as trustee(s) of the permanent endowment. The permanent endowment continues, however, to be held subject to (a) the restriction on spending capital, and (b) the original purposes of the trust. Difficulties might arise if the merged charity has wider purposes and wishes to use the permanent endowment for those purposes, but that difficulty arises whether the transfer is of unrestricted funds or permanent endowment. If the charity wants the permanent endowment to be used for the merged charity's wider purposes, then the purposes of the trust will have to be changed, whether in accordance with an express provision in the governing document, by exercising the section 275 power, or by seeking a cy-près scheme.[66]

12.74 We do not consider this to be a problem. If it is a problem, it concerns the law governing the change of a charity's purposes and cy-près schemes, not the merger provisions in the Charities Act 2011.[67] We addressed the former in Chapter 5 above.

12.75 Nevertheless, we think that there is scope for improving the position concerning the transfer of permanent endowment on merger. Currently, a section 310 vesting declaration cannot apply to a charity's permanent endowment, unless the transferee charity is a CIO.[68] We see no reason for excluding permanent endowment from section 310 vesting declarations where the transferee charity is not a CIO. A section 310 vesting declaration is simply machinery to vest assets in the merged charity. That machinery could usefully be available to transfer permanent endowment. It would not – without more – change the trusts (in particular, the purposes) on which the permanent endowment is held, but it would make the merged charity the trustee of the permanent endowment.

12.76 **We provisionally propose that vesting declarations under section 310 should apply to a charity's permanent endowment in the same way that they apply to a charity's unrestricted funds.**

Do consultees agree?

The requirement that the original charity cease to exist

12.77 Section 310 vesting declarations have also been criticised on the basis that they can only be made in respect of a "relevant charity merger".[69] If a shell charity is to be retained (for example, to hold leases which cannot be transferred because the

[66] See ch 3 above.

[67] Section 310 vesting declarations only facilitate the transfer of property on merger. They do not permit charities to transfer their property to a merged charity in order to be used for the merged charity's different purposes. So a s 310 vesting declaration does not itself allow a charity's unrestricted funds to be applied for the merged charity's (different) purposes; the same applies to permanent endowment. A change of purposes must be achieved by other means.

[68] See paras 12.22 and 12.32(2) above.

[69] See para 12.21 above.

landlord will not consent, or to capture gifts by will), a vesting declaration cannot be made. The same requirement effectively applies to automatic vesting under sections 239 and 244, since those statutory provisions only apply when the original CIOs cease to exist.[70]

12.78 The requirement that a charity cease to exist before it can use a section 310 vesting declaration should cause problems for charities less often as a result of our other provisional proposals for reform.

(1) One of the main reasons for charities retaining a shell charity is to hold leases that cannot be transferred on merger. If section 310 provides for the transfer of all leases (as we propose in paragraph 12.68 above), this motive for the retention of shell charities disappears.

(2) Another reason for the retention of shell charities is to capture bequests to charities that have merged. We make a provisional proposal in paragraph 12.92 below that would remove this need to retain shell charities.

12.79 Accordingly, there would be less need for charities to retain shells following merger, and the definition of "relevant charity merger" requiring the original charity to cease to exist would not present difficulties. We accept, however, that there might still be cases where it is necessary to retain a shell charity following merger. We do not, however, consider that section 310 vesting declarations should be extended so as to be available in those rare cases. We are conscious that the intention behind the register of mergers was to eliminate the need for shell charities on the register. To obtain the benefit of section 310 vesting declarations, charities must wind up shell charities. If section 310 vesting declarations were available regardless of whether the original charity ceased to exist, that incentive (which serves the purposes set out in paragraph 12.4 above) would be removed. In our view, the benefit of this incentive to remove shell charities outweighs the disadvantage caused to those few charities that cannot use a section 310 vesting declaration because they wish to retain a shell. We therefore make no provisional proposals for the definition of "relevant charity merger" to be reformed.

Transferring liabilities on incorporation and merger

12.80 Section 310 vesting declarations do not make provision for the transfer of liabilities to the merged charity, or for the merged charity to give indemnities to the original trustees (or the original charity) following merger.

12.81 We note that automatic vesting for CIOs under sections 239 and 244 transfers not only "property" and "rights" but also "liabilities" of the transferor CIO. That provision could be extended to mergers that do not involve CIOs, although careful attention would have to be given to specifying which liabilities are transferred. For example, on an incorporation, it would not be appropriate simply to transfer all of the trustees' liabilities to the new charity. Only liabilities incurred

[70] Charities Act 2011, ss 239(2)(b) and 244(1)(b).

on behalf of the trust should be transferred; the trustees' personal liabilities should be unaffected.[71]

12.82 The provision of indemnities to the original trustees (or original charity or charities) on merger is a matter that all the parties to a proposed merger should discuss, agree, and make express provision for in the documentation effecting the merger. We are not persuaded that statute should provide for the automatic transfer of liabilities, or for the automatic provision of indemnities, following a merger (whether a "relevant charity merger" or not).

Bequests to a charity that has incorporated or merged

12.83 Shell charities were often retained following merger (including incorporation) to prevent gifts to the original charity from failing. Section 311 of the Charities Act 2011 was intended to solve this problem and therefore remove one of the reasons charities might wish to retain a shell charity.[72] It has not, however, been entirely successful.

12.84 Gifts to a named charity by will are often expressed to be conditional on the charity continuing to exist. If a charity has merged and the merger is registered, the original charity will necessarily have ceased to exist.[73] Gifts expressed in this way will not, therefore, be caught by section 311. This issue was brought into sharp focus by *Berry v IBS-STL (UK) Ltd*.[74] The testatrix left the residue of her estate to "such of the following charities as shall to the satisfaction of my trustees be in existence at the date of my death, namely …". One of the listed charities had merged and the merger had been registered. But it was held that the testatrix had not "expressed … a gift to the transferor"[75] so as to be caught by section 311; rather, the beneficiaries were only such of the named charities as existed at the date of the testatrix's death.[76]

12.85 Section 311 is, therefore, perhaps not as effective as it was first hoped in ensuring that a gift by will to a charity takes effect as a gift to the merged charity. Indeed, rather than assisting charities, section 311 might have been detrimental; charities that merged and provided for the original charity to cease to exist (or subsequently wound up an existing shell charity) in reliance on section 311 are potentially in a worse position than if they had retained the shell charity. We have

[71] See para 13.35 and following below.

[72] See para 12.43 above.

[73] Since only "relevant charity mergers" can be registered, and the definition requires the original charity to have ceased to exist.

[74] [2012] EWHC 666 (Ch), [2012] PTSR 1619.

[75] Within the meaning of Charities Act 1993, s 75F(2), now Charities Act 2011, s 311(2)(a).

[76] "Accordingly, there was no gift to be transmuted by the statutory fiat into a gift to the new merged entity": [2012] EWHC 666 (Ch), [2012] PTSR 1619, [9], by David Donaldson QC (sitting as a Deputy Judge of the High Court). The will, in fact, made provision for what was to occur in the event of one of the named charities ceasing to exist, and it gave the trustees a discretion to give the same figure to the merged charity. On the peculiar facts, however, the merged charity had entered liquidation so the trustees did not want to give the gift to the merged charity. The question, therefore, was whether they were required to do so by s 311, or whether they had a discretion under the terms of the will to give the money to a different charity. In light of the merged charity's insolvency, the result is unobjectionable. It does, however, run counter to the policy behind s 311.

heard that merging charities are therefore still often advised to retain a shell charity. This is unfortunate, for the reasons set out in paragraph 12.4 above. It defeats one of the main purposes of the register of mergers and prevents charities from being able to take advantage of section 310 vesting declarations.

12.86 In devising a solution to this problem, it is necessary to give careful consideration to testamentary freedom; if a testator has stated that a gift is only to take effect in certain circumstances, that should be respected. Against that, however, are two competing considerations.

12.87 First, if the testator truly intends a gift to fail when a charity merges, his or her testamentary freedom is already curtailed in practice by charities' practice of retaining shell charities to capture such gifts.

12.88 Secondly, the *Berry* problem is likely to be an accident of drafting, rather than a deliberate decision on the part of a testator. A charitable gift may be expressed as "a gift to such of the following charities as exist when I die: Charity A, Charity B and Charity C" or as "a gift to charities A, B and C". If Charity C transfers its operations to Charity D following a merger:

(1) under the common law (ignoring section 311), the gift to Charity C would fail under both formulations; and

(2) under the current law, the effect of section 311 is that the gift to Charity C would fail under the first formulation, but that the gift would take effect as a gift to Charity D under the second formulation; but

(3) the testator in both cases would be likely to have intended Charity D to benefit from the gift, and the different results arising from the two formulations under the current law would be likely to surprise a testator.

12.89 We consider that both formulations in a will should be caught by section 311.

12.90 A solution to the problem highlighted by *Berry* would be to amend section 311 to provide that, for the purpose of ascertaining whether a gift has been made to a transferor charity under section 311(2)(a), the transferor charity is deemed to continue to exist despite the merger.

12.91 This, we think, would strike a fair balance between respecting testamentary freedom and ensuring that gifts do not lapse simply because a charity has merged. Testators would be able to exclude the effect of that deeming provision, for example, by stating that the gifts are conditional on the named charities not having merged. But testators would have to do so deliberately, rather than potentially by accident as is currently the case. Other conditions imposed by testators (for example, concerning the purposes that a named charity must pursue before a gift takes effect) would continue to operate.

12.92 **We provisionally propose that, when a charity has merged and the merger is registered, for the purposes of ascertaining whether a gift has been made to that charity under section 311(2) of the Charities Act 2011, the charity should be deemed to have continued to exist despite the merger.**

Do consultees agree?

The impact of reform

12.93 When considering the impact of reform, we would be assisted by hearing whether shell charities are still retained as a result of the potential limitations on the scope of section 311, as well as the administrative and legal costs of retaining such shell charities.

12.94 **We invite consultees to share with us their experiences of retaining shell charities as a result of the potential limitations on the scope of section 311, as well as the work, time and costs involved in retaining such shell charities.**

CHAPTER 13
CHARITABLE TRUSTS IN INSOLVENCY

INTRODUCTION

13.1 This Chapter is about what happens to property held on trust for charitable purposes, including permanent endowment, when the trustee becomes insolvent, and in particular whether it can be available to creditors of the trustee.

Trust insolvency

13.2 Insolvency is the situation where a debtor is unable to pay his or her debts as they fall due, or where the value of the debtor's liabilities exceeds the value of his or her assets. Strictly speaking, a trust cannot become insolvent because it has no legal personality of its own; it cannot own property or incur liabilities. The trustees are the legal owners of the trust property, and it is they who incur liabilities on behalf of the trust. We refer to such liabilities as "trust liabilities" (and the persons to whom the liabilities are owed as "trust creditors") to distinguish them from other liabilities, which we refer to as the "personal liabilities" of the trustees. Nevertheless, where trust property is insufficient to meet trust liabilities, it is common to refer to the situation as the "insolvency" of the trust.[1]

Trustee insolvency

13.3 Where a trust is insolvent, the consequence may be the insolvency of one or more of its trustees. Trustees might escape insolvency if they have other personal assets to discharge their liabilities. Trustees might also become insolvent as a result of being unable to meet their personal liabilities, regardless of whether the trust is solvent.

13.4 For a trustee, insolvency can have a variety of consequences, the most important being bankruptcy or, for a trustee which is a company, liquidation. Bankruptcy and liquidation involve the orderly collection of the property of the trustee and the use of that property to discharge (so far as is possible) the liabilities of the trustee, including trust liabilities.

The distribution of trust property on trustee bankruptcy or liquidation

13.5 In bankruptcy or liquidation:

(1) a trustee's personal assets will be distributed between the trustee's creditors; but

(2) as a general rule, trust property is not distributable to the creditors of the trustee.

[1] Charity Commission, *Managing Financial Difficulties and Insolvency in Charities* (CC12) (June 2010) section 3.1, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/390565/CC12_LowInk.pdf. We refer to the guidance as "CC12".

13.6 An unsecured creditor of a trustee has no direct claim over trust property.[2] However, some creditors are entitled to benefit indirectly from the trustee's rights over trust property.

13.7 Respondents to Lord Hodgson's review reported that there was uncertainty surrounding the availability of trust property on insolvency. Lord Hodgson identified, in particular, problems that are said to arise where the trust comprises permanent endowment or constitutes a special trust within the meaning of the Charities Act 2011, and a difference of approach by the Charity Commission to the availability of such property to meet the liabilities of the trustee depending on whether the trustee is an individual or a company.[3]

13.8 We have examined the law in this area and we take the provisional view that the law, in particular the law concerning the availability of permanent endowment and of special trust property to the creditors of an insolvent trustee, is both consistent and satisfactory. Furthermore, we take the view that the rules as to the availability of trust property to the creditors of an insolvent trustee are the same whether the trustee is an individual or a company. We do not propose any measures for reform of the law. We do, however, take the view that elements of the Charity Commission's guidance, *Managing Financial Difficulties and Insolvency in Charities* ("CC12"), require clarification for the benefit in particular of those who are in need of general guidance and cannot afford the services of a legal or insolvency professional.

13.9 In this Chapter we first provide a brief description of some relevant elements of insolvency law, and then of the circumstances in which charity property may be held on trust, and the principles governing the indemnity of trustees out of trust property. We explain the circumstances in which creditors of a trustee may have access to trust property, and then we consider the two issues raised by Lord Hodgson as to the specific availability of permanent endowment and special trust property. Finally we look at the content of CC12.

AN OVERVIEW OF INSOLVENCY LAW

Bankruptcy and liquidation as responses to insolvency

13.10 Insolvency is the situation where a debtor is unable to pay his or her debts as they fall due, or where the value of the debtor's liabilities exceeds the value of his or her assets.[4] On insolvency, the debtor or the creditors may invoke a formal process for the orderly collection of the property of the debtor and the use of that property to pay – so far as possible, and on an equal basis[5] – the debtor's debts. For debtors that are individuals this process is known as bankruptcy, and for debtors that are companies it is known as winding up or liquidation.

[2] A secured creditor with a proprietary interest in the trust property has a direct claim.

[3] The Hodgson Report, Appendix A, para 7. "Permanent endowment" is defined in s 353(3) of the Charities Act 2011 and "special trust" in s 287(1).

[4] The Insolvency Act 1986 (as amended by the Enterprise Act 2002) lists the situations in which a debtor will be insolvent: ss 122 (circumstances in which a company may be wound up by the court) and 267 (grounds on which a creditor may present a bankruptcy petition to the court).

[5] The traditional term is *pari passu*.

13.11 When an individual is made bankrupt the property belonging to the individual, known as his or her "estate", vests in a trustee in bankruptcy. For this purpose the estate does not include property held by the bankrupt on trust for another (which includes a charitable trust).[6] The responsibilities of the trustee in bankruptcy are to collect the bankrupt's property, realise it (if necessary) and pay the bankrupt's creditors in order of their priority.[7]

13.12 When a company is liquidated, control of the property of the company goes from the directors of the company to the liquidator. On the liquidation of a charitable company, the purposes of the company change: from the charitable purposes set out in the company's governing document to securing an orderly distribution of the company's assets to its creditors.[8] The liquidator is under a duty to collect the company's assets and apply them in discharge of its liabilities, just as is the trustee in bankruptcy of an individual. Property held on trust by the company is not available for distribution amongst its creditors.[9]

Other responses to insolvency

13.13 Bankruptcy or, for companies, liquidation is not an inevitable consequence of insolvency. Some of the other common responses to insolvency are set out in Figure 12.

Figure 12: responses to insolvency other than bankruptcy or liquidation

Sometimes a debtor will be able to continue to operate through a period of insolvency with the support of a formal or informal arrangement with creditors.

(1) Companies can enter, or can be made by their creditors to enter, into administration, a process governed by Part II of the Insolvency Act 1986. In an administration an insolvency practitioner, the administrator, becomes responsible for managing the affairs, business and property of the company, with the aim of rescuing the company as a going concern or, if this proves impossible, achieving a better result for the company's creditors as a whole than would be likely if the company were liquidated. Administration prevents the creditors of the company from taking action to recover their debts or to enforce their security.

(2) Companies can also restructure their debts by means of a company voluntary arrangement ("CVA"), governed by Part I of the Insolvency Act 1986.[10] A CVA must be approved by at least 75% of the company's creditors (by value of debt), but once approved it binds all unsecured creditors and, for companies of a certain size,[11] prevents

6 Insolvency Act 1986, s 283(3).

7 There is an order of priority because some will be secured creditors who have the first claim on the asset taken as security, some may be preferential creditors – for example unpaid employees – and the rest will rank equally. There may be nothing for the unsecured creditors; or they may all be paid the same proportion of their debt.

8 *Re Arms (Multiple Sclerosis Research) Ltd* [1997] 1 WLR 877, 881.

9 *Re Kayford* [1975] 1 WLR 279.

10 For CIOs, the process is called a voluntary arrangement.

11 The company must satisfy at least two of the following conditions: it must have (a) a turnover no greater than £6.5m; (b) balance sheet assets no greater than £3.26m; and (c) no more than 50 employees: Insolvency Act 1986, s 1A and Sch A1, para 3; Companies Act 2006, s 382(3).

individual creditors pursuing their claims. Informal equivalents to CVAs bind only those creditors who are party to them.

(3) For individuals there are individual voluntary arrangements ("IVA"), which offer protections similar to those of CVAs and are subject to similar requirements for their approval. Individuals can also enter into informal arrangements with creditors but, again, they will only bind those creditors who are party to them.

(4) A charity facing insolvency may consider that, rather than continuing to operate on its own, it would be in the best interests of the charity's present and future beneficiaries for it to transfer its assets and liabilities to another charity by way of merger.[12] The Charity Commission suggests that as an alternative to a full merger, whereby the insolvent charity transfers its entire property and thereafter ceases to exist, it might be possible for a charity to transfer some of its operations or activities to another charity.[13]

Consequences of insolvency for certain transactions

13.14 Creditors are protected against undue depletion of the debtor's assets, both before and during a period of insolvency. The Insolvency Act 1986 makes provision for the unwinding of transactions at an undervalue and transactions that have the effect of putting a creditor in a preferential position in the event of the debtor being made bankrupt or entering into liquidation (as the case may be).[14] It also provides that any dispositions of property entered into by a debtor during bankruptcy or liquidation are void unless the court directs otherwise.[15]

13.15 A final word should be said about the directors of insolvent companies. A director may be made liable to contribute to the assets of the company on liquidation where:

(1) he or she misapplied or retained, or became accountable for, any money or other property of the company;[16]

(2) he or she is guilty of any misfeasance or breach of duty in relation to the company;[17]

(3) he or she was knowingly party to the carrying on of the business of the company with intent to defraud creditors;[18] or

(4) at some time before the commencement of the liquidation, he or she knew or ought to have concluded that there was no reasonable prospect

[12] We address certain technical issues relating to the merger of charities in Chapter 12 above.

[13] CC12, section 2.2.

[14] For companies see the Insolvency Act 1986, ss 238 (transactions at an undervalue made prior to the onset of insolvency), 239 (preferences) and 423 (transactions at an undervalue entered into for the purpose of putting assets beyond the reach of creditors or otherwise prejudicing their interests). For individuals see ss 339, 340 and 423.

[15] Insolvency Act 1986, s 127 (for companies that are in liquidation) and s 284 (for individuals who have been made bankrupt).

[16] Insolvency Act 2986, s 212.

[17] Insolvency Act 1986, s 212.

[18] Insolvency Act 1986, s 213.

that the company would avoid going into insolvent liquidation, and yet did not take all possible steps to minimise the potential loss to the company's creditors.[19]

CHARITABLE TRUSTS

13.16 In Chapter 1 we explained the different legal forms that a charity can take. It will be obvious from what we said there that the property of an unincorporated charity must be held on trust. The property of a charitable company is not generally held upon trust unless the circumstances in which it was acquired point to the existence of a trust.[20] We expand upon these points briefly below.

Unincorporated charities

13.17 Unincorporated charities have no legal personality of their own; consequently, they cannot hold property in their own right. Legal title to the property of the charity (so to speak) is vested in the trustees, who hold it on trust. The trustees cannot hold the property for their own benefit; rather, they must hold it for the benefit of the charitable purposes for which their charity has been established. As Buckley J explained in *Re Vernon's Will Trusts*:

> Every bequest to an unincorporated charity by name without more must take effect as a gift for a charitable purpose. No individual or aggregate of individuals could claim to take such a bequest beneficially. If the gift is to be permitted to take effect at all, it must be as a bequest for a purpose, viz., that charitable purpose which the named charity exists to serve.[21]

13.18 It is common to speak of two types of unincorporated charity: the charitable trust and the charitable unincorporated association.

(1) "Charitable trust" is used to describe the situation where the charity comprises one or more trustees, whether individuals or companies, who hold property on trust for charitable purposes. The charity has no membership; the trustees take their direction from the terms of the trusts on which they hold the property of the charity, and any resolutions that they pass under the terms of the trust.

(2) "Charitable unincorporated association" describes the situation where the charity consists of members and a management committee bound by a network of contractual rights and obligations enforceable against one another. The structure is similar to that of a company, but the management committee acts as agent for the members as a whole rather than a corporate entity. The property of the charity is typically vested in a

[19] Insolvency Act 1986, s 214.

[20] *Re Finger's Will Trusts* [1972] 1 Ch 286; *Re Vernon's Will Trusts* [1972] 1 Ch 300; *Liverpool and District Hospital for Diseases of the Heart v Attorney General* [1980] 1 Ch 193; *Re ARMS (Multiple Sclerosis Research) Ltd* [1997] 1 WLR 877; *Re Wedgwood Museum Trust Ltd* [2011] EWHC 3782 (Ch), [2013] BCC 281. See para 13.20 and following below.

[21] [1972] 1 Ch 300, 303.

nominee or custodian who holds it on trust and takes its direction from the management committee as to how that property is to be applied.

Permanent endowment and special trusts

13.19 The trustees of an unincorporated charity may hold the charity's property in a single trust fund or in several funds, each subject to different trusts. If the fund (or one of the funds) is subject to a restriction on its being expended for the purposes of the charity, it will fall within the statutory definition of permanent endowment.[22] If the fund (or one of the funds) is held subject to trusts that require it to be used for particular purposes within the wider objects of the charity then the property will fall within the statutory definition of a "special trust".[23] And a fund that is held for special purposes of the charity and the capital of which cannot be spent for those purposes is both permanent endowment and a special trust.

Charitable companies and trusts

13.20 Unlike unincorporated charities, charitable companies are legal persons distinct from their charity trustees and members.[24] They can hold property on trust,[25] but they are also capable of absolute ownership of property. Whether a gift to a charitable company takes effect as an addition to its corporate property or is to be held on trust was considered in *Re Vernon's Will Trusts*.[26] It was held that a simple legacy to a charitable company was one that the charity was "entitled to receive as part of its general funds unfettered by any trust imposed by the testatrix as to the purposes for which it should be used".[27] The Judge reasoned that:

> A bequest to a corporate body … takes effect simply as a gift to that body beneficially, unless there are circumstances which show that the recipient is to take the gift as a trustee. There is no need in such a case to infer a trust for any particular purpose. The objects to which the corporate body can properly apply its funds may be restricted by its constitution, but this does not necessitate inferring as a matter of construction of the testator's will a direction that the bequest is to be held in trust to be applied for those purposes: the natural construction is that the bequest is made to the corporate body as part of its general funds, that is to say, beneficially and without the imposition of any trust. That the testator's motive in making the bequest may have

[22] Charities Act 2011, s 353(3). See para 9.10 above.

[23] Charities Act 2011, s 287(1).

[24] The same principle applies to CIOs.

[25] In which case, the Charity Commission regards the trust as a distinct, unincorporated charity. If the trust has been established for any special purpose or purposes of the company (a purpose or purposes within but narrower than the general charitable purposes of the company) then it can be treated as forming part of the charitable company for registration and accounting purposes by way of a linking direction under s 12 of the Charities Act 2011.

[26] [1972] 1 Ch 300.

[27] [1972] 1 Ch 300, 303 to 304, by Buckley J.

undoubtedly been to assist the work of the incorporated body would be insufficient to create a trust.[28]

13.21 Subsequent decisions of the High Court have affirmed this approach.[29] In *Re Wedgwood Museum Trust Ltd*, HHJ Purle QC regarded it as "settled at first instance" that, as a general rule, charitable companies do not hold their assets on trust.[30]

Permanent endowment

13.22 It appears, however, that this general rule does not apply to permanent endowment. In CC12 the Charity Commission expresses the view that a charitable company cannot hold permanent endowment "as part of its corporate property".[31] We understand this to mean that a charitable company cannot own permanent endowment absolutely, subject to its articles of association; it can only hold permanent endowment on trust for the charitable purpose or purposes for which it was acquired. If that is so, then the position of a charitable company in relation to its permanent endowment is no different from that of the charity trustees of an unincorporated charity.

13.23 There is little legal authority directly on point. It might be argued that the restriction on spending permanent endowment is, in the words of Buckley J in *Re Vernon*, a "circumstance which shows that the recipient is to take the gift as a trustee". But that simply begs the question why the spending restriction can only be given effect by the imposition of a trust and not by the articles of association of the company.

13.24 The answer, we suspect, is that articles of association cannot give proper effect to the restriction because they cannot be fully entrenched. The default rule is that a company can amend its articles of association by way of special resolution of its members.[32] The amendment of articles may be made subject to conditions that are more restrictive than those applicable in the case of a special resolution.[33] But this cannot prevent amendment by agreement of all the members of the company, or by order of a court or other authority having power to alter the company's articles.[34] If the restriction were always susceptible to removal by the members then it could not truly be said to be permanent. The only

[28] [1972] 1 Ch 300, 303.

[29] *Re Finger's Will Trusts* [1972] 1 Ch 286; *Liverpool and District Hospital for Diseases of the Heart v Attorney General* [1980] 1 Ch 193; *Re ARMS (Multiple Sclerosis Research) Ltd* [1997] 1 WLR 877; *Re Wedgwood Museum Trust Ltd* [2011] EWHC 3782 (Ch), [2013] BCC 281. See also *Phillips v Royal Society for the Protection of Birds* [2012] EWHC 618 (Ch), [2012] WTLR 891, [19] to [22].

[30] [2011] EWHC 3782 (Ch), [2013] BCC 281, [16].

[31] CC12, section 2.3.

[32] Companies Act 2006, s 21(1). A special resolution of the members of a company means a resolution passed by a majority of not less than 75%: s 283(1); see para 3.4 above.

[33] Companies Act 2006, s 22(1).

[34] Companies Act 2006, s 22(3).

juridical mechanism capable of giving effect to the permanence of the restriction is the trust.[35]

13.25 This reasoning appears to have featured in the judgment of HHJ Purle QC in *Re Wedgwood*. Although the court was primarily concerned with the issue of whether the collection was held on special trust, the charity also argued that the collection was permanent endowment and was therefore trust property. Clause 3.22 of the charity's articles of association gave it power:

> from time to time to dispose of [property] … provided always that such disposal shall be made only for the purpose of improving, enhancing or extending the quality and interest of the collection and in furtherance of the objects and providing that any such item is offered first to any museum which is administered by any public authority or charitable trust, by gift or private treaty, before such item is offered for sale to the public at auction or in any other manner.

13.26 According to the charity, clause 3.22 recognised that anything given to the charity for its charitable purposes, including the collection, was subject to restrictions on disposal and was therefore permanent endowment. In rejecting this argument, the Judge said:

> That in my judgment is reading far too much into that clause … . Clause 3.22 is a restriction on the power of the company contained in its memorandum of association. It is not the language of trust, nor is it necessary to construe it as a trust in order to give it proper effect. *The object might in theory be changed, albeit that would need the consent of the Charity Commission* (emphasis added).[36]

13.27 Thus the theoretical possibility of amendment to clause 3.22 (and the fact that it was not in the language of trust) were material to the conclusion that it did not create permanent endowment. This tends to reinforce the conclusion that the permanent endowment restriction can only be given effect by way of trust and not in a charity's articles of association.

13.28 In the light of the above analysis, and in the absence of clear legal authority on the point, the better view appears to be that expressed by the Charity Commission in CC12; we therefore proceed on the basis that a charitable company necessarily holds its permanent endowment on trust as corporate trustee.[37]

Special trusts

13.29 As with the trust property of an unincorporated charity, it is possible for the trust property of a charitable company to constitute a "special trust" within the meaning

[35] See also J Hill, "The trust versus the company under the Charities Act 1992 & 1993" [1994] 2(2) *Charity Law and Practice Review* 133, 144, and P Framjee, "Complexities of Predestination" (October 2008) *Caritas* 13, 15, who argue that a company is free to spend its corporate property without distinction between capital and income.

[36] *Re Wedgwood Museum Trust Ltd* [2011] EWHC 3782 (Ch), [2013] BCC 281, [36].

[37] Again, in these circumstances, the Charity Commission treats the permanent endowment fund as a separate charity: see n 25 above.

of section 287(1) of the Charities Act 2011.[38] This will be the case where the terms of the trust restrict the application of the property to particular purposes within the overall objects of the charity. In this context, the "charity" is the unincorporated charity of which the company is trustee, rather than the company itself.[39]

Multiple trusts

13.30 A trustee (including a corporate trustee) of an unincorporated charity may hold the property of the charity on a single trust or on different trusts.

13.31 *Charity Commission for England and Wales v Framjee*[40] concerned the property holding arrangements of the Dove Trust, an unincorporated charity that was under investigation by the Charity Commission for alleged financial mismanagement and breaches of trust by its trustees. The Charity Commission sought declarations and directions in relation to the distribution of a fund comprising online donations paid by the public to the Dove Trust as an intermediary.[41] Having concluded that the donations were subject to a trust, and were not merely the subject of contractual obligations between the donor and the charity, the court had to determine whether:

(1) the fund was an accretion to the general funds of the charity, held on trust in accordance with the charity's governing document;

(2) the fund was a "global sub-trust", or a single trust for special purposes of the charity; or

(3) each individual donation gave rise to a separate trust.

13.32 The Judge opted for (2). He concluded that the purposes for which the donations were held were "clearly separate from the general charitable objects of the Dove Trust".[42] The donations were not at the free disposal of the charity trustees as an accretion to the general funds of the charity, but nor did each donation give rise to a separate trust. Instead, the donations existed in "a global sub-trust established by the trustees under the aegis of the Dove Trust".[43]

[38] Although the statutory definition of "special trust" refers to the property being held and administered on separate "trusts", s 353(1) of the Charities Act 2011 in turn defines "trusts", in relation to a charity, as "the provisions establishing it as a charity and regulating its purposes and administration, *whether those provisions take effect by way of trust or not*" (emphasis added). The Act does not exclude the possibility of a special trust being created other than by way of a trust, for example by a clause in the articles of association of a charitable company. The existence of a trust does not, therefore, necessarily follow from the existence of a special trust for the purposes of the Act.

[39] The acquisition by a charitable company of property subject to a requirement that it be applied for particular purposes of the *company* might be a circumstance from which to infer the existence of a trust for those purposes.

[40] [2014] EWHC 2507 (Ch), [2015] 1 WLR 16.

[41] The Dove Trust would claim Gift Aid on the donations and then pay the grossed up amount to a charity of the donor's choice.

[42] [2014] EWHC 2507 (Ch), [2015] 1 WLR 16, [38].

[43] [2014] EWHC 2507 (Ch), [2015] 1 WLR 16, [40].

> Each donor was a separate settlor in relation to the funds which originated from him, and those funds had to be dealt with by the trustees in a way that ensured they reached their specified destination, subject only to a possible residual discretion where for one reason or another that could not be achieved. In the last resort, therefore, the difference between [the "global sub-trust" analysis] and [the "separate trust" analysis] may involve little more than a difference of emphasis, and a recognition that the donations could properly be kept by the trustees in a single fund, provided its component parts remained clearly identifiable within it. In this regard, I find the analogy of a solicitor's client account to be helpful.[44]

13.33 In that case, therefore, the property of the charity was held in two trusts: one containing the general funds of the charity, and administered in accordance with the charity's governing document, and another containing the donations. The latter trust would have been a "special trust" within the statutory definition.

13.34 More complex arrangements are possible. The trustees of a charity can hold the property of the charity in any number of trusts. Some of the trusts may comprise permanent endowment; some may constitute special trusts; some may be both. As we explain below, the separation of a charity's property into different trusts may have consequences on the insolvency of the trustee.

THE INDEMNITY OF TRUSTEES

13.35 A trustee is personally liable for debts incurred on behalf of the trust. Where the trust has more than one trustee, the trustees are jointly and severally liable for all trust liabilities. In addition to trust liabilities, a trustee will usually also have personal liabilities, or "corporate" liabilities in the case of a trustee that is a company. An individual's personal creditors might include a bank that holds a mortgage on his or her house, or businesses that have offered him or her goods and services on credit; a company might have corporate creditors with whom it has transacted in the conduct of its corporate affairs as distinct from its trust affairs.

13.36 Trustees have long been afforded rights to be indemnified out of trust property for liabilities properly incurred on behalf of the trust.

> Persons who take the onerous and sometimes dangerous duty of being trustees are not expected to do any of the work on their own expense; they are entitled to be indemnified against the costs and expenses which they incur in the course of their office; of course, that necessarily means that such costs and expenses are properly incurred … . The general rule is quite plain; they are entitled to be paid back all that they have paid out.[45]

[44] [2014] EWHC 2507 (Ch), [2015] 1 WLR 16, [40].

[45] *Re Grimthorpe* [1958] Ch 615, 623, by Danckwerts J.

13.37 This general rule has been given statutory force since 1859.[46] The current rule is contained in section 31(1) of the Trustee Act 2000, which provides that:

> A trustee –
>
> (a) is entitled to be reimbursed from the trust funds, or
>
> (b) may pay out of the trust funds,
>
> expenses properly incurred by him when acting on behalf of the trust.[47]

13.38 Section 31(1) confers two separate rights of indemnity. The first right, in section 31(1)(a), is the right to reimbursement. The right to reimbursement arises where the trustee has discharged a trust liability out of his or her own money and entitles the trustee to repayment out of the trust funds. The second right, in section 31(1)(b), is the right to exoneration, which entitles the trustee to discharge a trust liability directly from the trust funds.[48]

13.39 Prior to the Trustee Act 2000, the terms of a trust could exclude or restrict the statutory rights of indemnity.[49] Part V of the Trustee Act 2000, which includes section 31(1), contains no provision permitting any exclusion or restriction of the rights of indemnity by the terms of the trust. That might imply that such exclusion or restriction is no longer possible.[50] The rights of indemnity confer an equitable interest in the trust fund which is secured by way of a first charge or lien and which takes priority over the claims of the beneficiaries[51] or, in the case of a charitable trust, over any claim to apply the trust fund for the charitable purposes for which it is held.

13.40 As noted above, the statutory rights of indemnity arise only in respect of liabilities properly incurred on behalf of the trust. Unless the terms of the trust provide otherwise,[52] a trustee will not be entitled to be indemnified against liabilities incurred in a transaction which is unauthorised.

[46] Law of Property and Trustees' Relief Act 1859, s 31; Trustee Act 1925, s 30(2).

[47] The rule applies equally to a custodian trustee of the property of a charitable unincorporated association: Trustee Act 2000, s 31(2).

[48] In addition, a trustee has ancillary rights to retain trust assets or income until he or she has been indemnified and to realise trust assets for the purposes of meeting his or her costs and expenses (or, if necessary, to apply to the court for an order for sale).

[49] Trustee Act 1925, s 69(2).

[50] This is the view taken by the authors of *Lewin on Trusts* (19th ed 2014) para 21-008 ("*Lewin*"). The contrary view – that a trustee might agree with the donor at the time of the settlement that the trustee will not enforce his rights of indemnity – has been suggested to us by Matthew Smith. The authors of *Lewin* suggest that it is possible for the terms of a trust to *enhance* a trustee's statutory rights of indemnity by authorising a trustee to recover costs and expenses incurred in respect of unauthorised transactions entered into in good faith: *Lewin*, paras 21-008 and 39-147.

[51] *Re Exhall Coal Co Ltd* (1866) 35 Beav 449, 55 ER 970; *Re Pumfrey* (1882) 22 ChD 255, 262, by Kay J; *St Thomas's Hospital (Governors) v Richardson* [1910] 1 KB 271, 276, by Cozens-Hardy MR.

[52] See n 50 above.

13.41 In addition, a trustee who is in default owing to a past breach of trust is not entitled to an indemnity out of the trust property until he or she has made good the default.[53]

13.42 Where the trustee holds property on multiple trusts then he or she will benefit from multiple indemnities, each indemnity relating to a particular trust. The right to exoneration that the trustee has against one trust cannot be used to discharge liabilities incurred when acting on behalf of another trust of which he or she is also trustee.[54] In *Fraser v Murdoch*,[55] a trust estate was divided by the trustees into two distinct trust funds, one of which comprised £200 of bank stock. When the bank became insolvent and calls were made upon the trustees in respect of the stock, they sought to indemnify themselves for payment of the calls out of the whole estate. The beneficiary of the second trust fund objected to any portion of that fund being taken for that purpose. The House of Lords upheld her objection on the basis that once the estate was divided into distinct trusts, the trustees could not have recourse to one trust in respect of liabilities incurred on behalf of the other.[56]

TRUSTEE INSOLVENCY

13.43 In this section we look at the consequences, for the property of a trust, of the bankruptcy or liquidation of the trustee. Trust property is not available to satisfy the liabilities of the insolvent trustee unless it is security for a debt or the creditors are entitled to benefit indirectly from the trustee's rights of indemnity against the trust.

Bankruptcy of individual trustees

13.44 When an individual is made bankrupt, any property held on trust by the bankrupt for the benefit of another does not vest in the trustee in bankruptcy and does not therefore form part of the estate distributable to the trustee's creditors.[57] However, creditors may have indirect recourse to the trust assets.

13.45 We explained above the rights that a trustee has to be indemnified from the trust fund, namely the right to reimbursement and the right to exoneration. The right to reimbursement is the trustee's own right, and in the bankruptcy of the trustee it vests in the trustee in bankruptcy. This provides an additional source of funds for creditors in circumstances where the trustee has paid debts incurred on behalf of the trust and has not yet been reimbursed at the point when he or she becomes bankrupt. The trustee in bankruptcy can exercise the right as against the trust property and distribute the proceeds to both personal and trust creditors of the trustee in accordance with the priority of their claims against the trustee's estate.

[53] *Re Johnson* (1880) 15 Ch D 548.

[54] By contrast, the proceeds of the right to reimbursement from one trust can be used to discharge liabilities incurred on behalf of another trust: see para 13.45 below.

[55] (1881) 6 App Cas 855. See also *Hardoon v Belilios* [1901] AC 118, 123 to 124.

[56] In Australia, an analogous principle has been held to apply to the meeting of the costs and expenses of winding up a corporate trustee of multiple trusts: *Re Suco Gold Pty Ltd* (1983) 33 SASR 99 (Supreme Court of South Australia); *Trio Capital Ltd v ACT Superannuation Management Pty Ltd* [2010] NSWSC 941 (Supreme Court of New South Wales); and *Re Dalewon Pty Ltd* [2010] QSC 311 (Supreme Court of Queensland).

13.46 The right to exoneration, by contrast, is relevant when a debt incurred on behalf of the trust has not yet been paid. The right to exoneration enables the trustee to use trust property to discharge liabilities to trust creditors. Again, it is the trustee's own right; it vests in the trustee in bankruptcy and can be exercised by him, but only to discharge the liabilities to which it relates, that is to say, to pay trust creditors. This principle was established in *Re Richardson (ex parte Governors of St Thomas's Hospital*).[58] A lessee held a leasehold estate on trust for his wife. The wife was liable to indemnify her husband against any claim by the landlord under the covenants of the lease. On the expiration of the lease, the landlord obtained judgment against the lessee for rent and damages for breach of covenant, but before the amount of the lessee's liability was ascertained he was adjudged bankrupt. An issue arose as to whether the right of indemnity was exercisable by the trustee in bankruptcy for the benefit of the lessee's creditors generally, or only for the benefit of the landlord.

13.47 The Court of Appeal unanimously held that the right of indemnity was exercisable only for the benefit of the landlord. The Master of the Rolls said that:

> The respondent says, "This right to an indemnity which the bankrupt as trustee had against his cestui que trust is property which vests in me as his trustee in bankruptcy and I am bound to apply that like all other assets of the bankrupt for the benefit of all the creditors." But is that quite so? I cannot think it is. If and when he pays the amount of the debt he will have a right to treat the money, which he can then sue for from the person who is bound to indemnify, as part of the estate, but unless and until he pays I fail to see how it can be in accordance with justice and common fairness that he should be allowed to augment the estate of the bankrupt in a way which results in this, that the greater the liability the greater will be the advantage to the estate. The trustee cannot be allowed to say "I will take the money recovered under my right of indemnity against the claim of [the landlord] and will apply it, not towards satisfying the claim of [the landlord] in the way which the indemnity implies, but as part of the general assets, and I will give no effect whatever to the indemnity except so far as [the landlord] come in and prove for their claim in the bankruptcy." To allow that would be to allow a trustee to make a profit out of his position as trustee.[59]

13.48 Accordingly, a trustee in bankruptcy cannot exercise a right to exoneration for the benefit of the personal creditors of the bankrupt trustee but can exercise it to discharge debts incurred by the trustee on behalf of the trust.[60]

13.49 Where the bankrupt trustee holds property on multiple trusts, the collective rights of reimbursement from the different trusts can be exercised by the trustee in

[57] See para 13.11 above.

[58] [1911] 2 KB 705.

[59] [1911] 2 KB 705, 711.

bankruptcy for the benefit of all personal and trust creditors. But it follows from what has been said above[61] that the bankrupt's rights of exoneration must be treated separately. The trustee in bankruptcy can only exercise the right to exoneration from trust A for the benefit of trust creditors whose liabilities were incurred on behalf of trust A; the right to exoneration from trust B can only be exercised for the benefit of trust B creditors; and so on.

13.50 This is, of course, all subject to the above rules regarding the exclusion or restriction of the indemnity, or the loss or impairment of the indemnity owing to the prior breaches of trust by the trustee. The trustee in bankruptcy can have no greater recourse to the trust property than the trustee would have been able to enjoy, so any restriction on the indemnity will ultimately limit the amount of the trust assets that can be collected by the trustee in bankruptcy and distributed to the trustee's creditors.

Liquidation of corporate trustees

13.51 If the trustee is a company and is in liquidation, the position as regards creditors' indirect recourse to the trust property is the same. Unlike bankruptcy, the company's assets do not automatically vest in another person. Instead, the company's property remains with the company until it is disposed of by the liquidator in satisfaction of the company's liabilities.[62] But – as with bankruptcy – property held on trust is not available for distribution amongst the company's creditors generally.[63]

13.52 Where the company has a right to reimbursement from the trust for trust liabilities discharged out of its corporate property, that right is exercisable by the liquidator for the benefit of all the company's creditors (both trust creditors and corporate creditors).[64]

13.53 Any right of exoneration that the company has from the trust fund will remain vested in the company on liquidation, and again it will be the responsibility of the liquidator to exercise that right for the benefit of the company's creditors. But the liquidator would only be able to exercise the right for the benefit of trust creditors and not corporate creditors,[65] so the result is the same as in the case of a bankrupt individual trustee.

13.54 Where a company trustee in liquidation holds property on multiple trusts, the rights of reimbursement can be exercised by the liquidator for the benefit of the company's creditors generally, but the rights of exoneration must be exercised

[60] As well as the trustee in bankruptcy exercising the bankrupt's right to exoneration against the trust assets, the trust creditors can also take over the bankrupt's right to exoneration by a process called subrogation.

[61] See paras 13.42 and 13.46 above.

[62] *Lewin*, para 22-027.

[63] *Re Kayford* [1975] 1 WLR 279.

[64] *Re Suco Gold Pty Ltd* (1983) 33 SASR 99. See *Lewin*, para 22-041.

[65] *Re Richardson* [1911] 2 KB 705; *Re Suco Gold Pty Ltd* (1983) 33 SASR 99. See *Lewin*, para 22-041.

separately for the benefit of the trust creditors to whose liabilities the rights relate.[66]

TRUSTEE INSOLVENCY AND CHARITABLE TRUSTS

13.55 We can now discuss the application of the law set out above so as to explain how the current law treats charitable trusts in the insolvency of the trustee.

13.56 Property held by an insolvent trustee on trust for charitable purposes is not available for distribution amongst his or her creditors generally. This is so whether the trustee is an individual or a charitable company.

13.57 The creditors of the trustee may, however, have indirect recourse to the trust property through the trustee's rights of indemnity. Where at the time of insolvency the trustee has paid debts incurred on behalf of the trust, and is entitled to be reimbursed out of the trust property, that right of reimbursement is the trustee's own asset and may be realised by the trustee in bankruptcy or liquidator. The sum recovered is then available to all the trustee's creditors on the usual basis. Where the trustee is bankrupt or liquidated with unpaid trust liabilities, the right of exoneration that would have been available to the trustee in respect of those liabilities is available for the benefit of trust creditors only.

13.58 Where the trustee holds property on more than one trust for charitable purposes, the rights of reimbursement from the trusts are available for the benefit of the trustee's creditors generally, but the rights of exoneration must be exercised separately for the benefit of the trust creditors to whose liabilities they relate. This is even the case where the trusts exist under the aegis of a single unincorporated charity, as in *Charity Commission for England and Wales v Framjee*.[67]

13.59 Property that falls within the statutory definition of "permanent endowment" or "special trust", or both, is not as such accorded any special treatment in insolvency. The relevant question is whether or not the insolvent party holds the property on trust. The statutory classification of the property will not reveal the answer.[68] But the existence of a restriction on spending the property for the purposes of the charity, or a requirement that the property be applied only for special purposes of the charity, is almost always a circumstance from which to infer the existence of a trust.[69]

13.60 Permanent endowment and special trust property held on trust will therefore be dealt with in insolvency in the same way as any other property held on trust.

13.61 With these observations in mind, we turn now to the two concerns raised in the Hodgson Report that prompted our investigation.

[66] *Fraser v Murdoch* (1881) 6 App Cas 855; *Re Suco Gold Pty Ltd* (1983) 33 SASR 99.

[67] [2014] EWHC 2507 (Ch), [2015] 1 WLR 16; see para 13.31 and following above.

[68] Section 353(3) of the Charities Act 2011, which defines permanent endowment, does not refer explicitly to trusts. Nor is a special trust necessarily created by way of trust: see n 38 above.

[69] The test is whether the settlor has shown an intention to create a trust, as opposed to some other arrangement, by using words "that upon the whole … ought to be construed as imperative": *Knight v Knight* (1840) 3 Beav 148, 172, by Lord Langdale MR.

The availability of permanent endowment in insolvency

13.62 The Hodgson Report concluded that while it is "broadly accepted" that permanent endowment is available to meet the liabilities of the insolvent trustees of an unincorporated charity, the same is not true where the trustee is an insolvent charitable company. Lord Hodgson recommended that the position should be rationalised between the different legal forms of charity.[70]

13.63 We do not agree with the conclusion drawn in the Hodgson Report. The rules that govern the distribution of trust assets held by an insolvent trustee do not differentiate between different legal forms of trustee, so the availability of permanent endowment in insolvency does not depend – nor in our view should it depend – on whether the insolvent party is an individual trustee of an unincorporated charity or a charitable company acting as a trustee.

13.64 Misunderstanding appears to have arisen from certain passages in CC12, guidance which (in the absence of a significant body of case law) informs much of the thinking of trustees.

13.65 Section 2.3 of CC12 addresses the issue of how particular funds can be used by a charity to meet its liabilities. In relation to unincorporated charities, the guidance states that:

> Section 31 of the Trustee Act 2000 provides that a trustee is entitled to pay out of (or be reimbursed from) the charity's funds any expenses that have been properly incurred on behalf of the charity. In the case of an unincorporated charity, this may mean that permanent endowment or restricted funds of that charity could be used to cover the liabilities of the charity.

13.66 The wording of section 31 refers to liabilities incurred on behalf of the *trust*. The trustees of an unincorporated charity may hold its property on multiple trust funds.[71] The guidance might imply that one trust fund can be used to discharge liabilities incurred on behalf of another trust fund, which will not usually be the case. Otherwise, the guidance is consistent with what we have set out above so far as the right to reimbursement is concerned, although it does not discuss the right to exoneration which, as explained above, functions differently in insolvency and can be exercised by the trustee in bankruptcy or liquidator only to satisfy the specific debt to which it applies.

13.67 In relation to charitable companies, CC12 states that:

> A charitable company cannot hold permanent endowment as part of its corporate property. However, a charitable company can act as a corporate trustee of a permanently endowed charity. If the company is facing insolvency, these permanently endowed funds … would **not** normally be available as part of the company's corporate property to

[70] Hodgson Report, Appendix A, para 7.

[71] See para 13.30 and following above.

> settle debts not relating to the permanent endowment (emphasis in original).[72]

13.68 We agree with this analysis, but it is notable that the Commission has not added that debts that *do* relate to permanent endowment may be settled from it. This omission appears to be the source of confusion; it may give the impression that it is generally more difficult for creditors to have recourse to permanent endowment where it is held on trust by a charitable company as opposed to an individual trustee. In fact, as we have seen, the law makes no such distinction.

13.69 We would also add that any right that a charitable company has to be reimbursed from permanent endowment as trustee is part of its corporate property and can be realised by a liquidator for the benefit of both corporate and trust creditors.

13.70 There is therefore scope for clarification of the guidance in CC12.

The availability of special trusts in insolvency

13.71 The second concern identified by Lord Hodgson was the availability in insolvency of property held on special trust, that is to say, property held for a specific purpose or specific purposes of the charity. His recommendation[73] for a general review of this area of law followed the decision of the High Court in *Re Wedgwood Museum Trust Ltd*.[74] In *Re Wedgwood* it was held that a collection of pottery and other artefacts belonging to the Wedgwood Museum Trust, a charitable company, were available in its administration to meet its liabilities. The charity unsuccessfully argued that the collection was held on special trust. It is unclear whether this argument was referring to "special trust" within the meaning of section 287(1) of the Charities Act 2011; as noted above, that definition is not limited to property held on trust, and in itself accords no special treatment on insolvency. Rather, it appears that the argument was that the collection was held for specific purposes, and that it was held on trust. If successful, that would have protected the collection on the basis that the trust property would fall outside the assets distributable to the company's creditors generally.

13.72 In *Re Wedgwood* the company was faced with overwhelming liabilities because it was the "last man standing" in a group of companies and therefore became liable to make good the pension deficit of the whole group.[75] The result of the decision was that the collection of artefacts was simply an asset of the company, held beneficially and not on trust, and was therefore available to meet the liabilities of the company. This caused considerable interest and concern.[76] But those concerns do not arise from the rules relating to special trusts. Charities may today be increasingly vulnerable to insolvency because of the impact of rules

[72] CC12, section 2.3; see also section 5.2.

[73] Hodgson Report, Appendix A, para 7.

[74] *Re Wedgwood Museum Trust Ltd* [2011] EWHC 3782 (Ch), [2013] BCC 281.

[75] Under the Pensions Act 1995, s 75.

[76] Following the collapse of the Waterford Wedgwood group, an appeal was launched to save the collection (http://www.savewedgwood.org). In December 2014, following a successful appeal, the collection was purchased by the Art Fund, gifted to the Victoria and Albert Museum and finally loaned back to the Wedgwood Museum: see http://www.savewedgwood.org/news/loan-of-wedgwood-collection-to-barlaston-secured.

relating for example to pensions; and the "last man standing" rule for certain pension funds is a good example. But the rules relating to special trusts are the same as those that determine the availability of permanent endowment in insolvency, which in turn follow the general law. Since we make no provisional proposals to reform the law relating to permanent endowment, and we see no basis for reforming the law in relation to one type of arrangement but not another, we make no proposal to change the law in relation to special trusts. We do, however, ask consultees whether they consider the law in this area to be satisfactory, and we provisionally propose revisions to CC12 that mirror those proposed in relation to permanent endowment.

CONCLUSIONS

13.73 At the outset of CC12 the Charity Commission emphasises that insolvency "is a complex matter and we strongly recommend that professional advice is taken as soon as the trustees are aware that the charity is facing an insolvency situation".[77] We acknowledge that CC12 is only intended to serve as general guidance to charity trustees, and that it will often be advisable to rely instead on specialist advice in relation to points of detail. Nevertheless, it may be that parts of the guidance, identified above, are causing misunderstanding about the insolvency treatment of permanent endowment and special trusts which would benefit from clarification.

13.74 **We provisionally propose that the guidance of the Charity Commission in CC12 should be revised so as to make it clear that the availability of trust property, including trust property that falls within the statutory definition of permanent endowment or a special trust (or both), to meet the liabilities of an insolvent trustee is no different whether the trustee is an individual or a charitable company.**

Do consultees agree?

13.75 **We provisionally propose that the guidance of the Charity Commission in CC12 should be revised to reflect more fully and accurately the law governing the exercise of trustees' rights of indemnity from trust property for the benefit of the creditors of the trustee, in particular in respect of permanent endowment and special trusts.**

Do consultees agree?

13.76 **We invite the views of consultees as to whether the law relating to the availability of permanent endowment and special trusts to the creditors of an insolvent trustee is satisfactory and, if not, how it could be improved.**

[77] CC12, section 1.1.

PART 6

CHARITY COMMISSION POWERS

CHAPTER 14
CHARITY NAMES

INTRODUCTION

14.1 In this Chapter we review the statutory powers of the Charity Commission to require a charity to change its name, and to refuse to register a CIO unless it changes it name.

14.2 The Charity Commission has a power to direct a charity to change its name on any of the five grounds listed in section 42 of the Charities Act 2011. The first ground – that the name is the same as, or is too like, the name of any other charity (whether registered or not) – applies only to registered charities.[1] The remaining four grounds, which we discuss below,[2] apply to both registered and unregistered charities. Section 208 of the Charities Act 2011 gives the Charity Commission a discretion to refuse to register a CIO on any of the grounds listed in section 42.

14.3 Lord Hodgson made two recommendations to reform the current law.

(1) The first ground on which the Charity Commission can make a section 42 direction should be applicable to unregistered charities.

(2) The Charity Commission should be able to require an institution applying for registration as a charity to change its name as a condition of registration; in other words, the section 208 discretion should be extended to cover all applications for registration, not just applications to be registered as a CIO.[3]

14.4 The primary purpose behind the first ground in section 42 is to avoid donors and the general public mistaking one charity for another. The risk of confusion will be particularly high where a charity seeks to adopt a name the same as, or similar to, the name of a highly prominent charity. We do not see this as an issue peculiar to registered charities. Accordingly, we agree with Lord Hodgson that the first ground in section 42 should be applicable to unregistered charities as well as registered charities, and we make a provisional proposal to that effect below.

14.5 At present, the Charity Commission does not regard itself as capable in law of refusing or staying an application for an institution to be registered as a charity[4] on the basis that the name infringes section 42.[5] Nor in its view can the Commission postpone entering the new name of a registered charity on the register pending the resolution of a section 42 issue. The current practice is to ask the institution voluntarily to change its name; and in most cases it is willing to

1 Charities Act 2011, s 42(2)(a).

2 See para 14.12 and following below.

3 Hodgson Report, Appendix A, para 10.

4 Unless the institution is applying for registration as a CIO: Charities Act 2011, s 208; see para 14.33 below.

5 Charity Commission, *OG330 Names of Charities* (March 2012) para B5.11. We refer to the guidance as "OG330".

do so. If the institution refuses, the Commission can issue a formal direction requiring a change of name, but it cannot cite an infringement of section 42 as a reason for refusing or delaying an application for registration, or delaying the entry of a new name in the register. We agree with Lord Hodgson that this is unsatisfactory. Depending on the circumstances of the case, the Commission should be able to refuse or stay an application for registration, and delay the entry of a new name on the register,[6] pending the resolution of a section 42 issue.

14.6 The above reforms would enable the Charity Commission to conduct any inquiries into whether a proposed name infringes section 42 without having to be concerned about entering an infringing name on the register, only to remove it at a later date following the issue of a formal direction.

14.7 This Chapter does not consider the recent suggestion that the Charity Commission should be permitted to refuse registration where it believes that the work of the applicant is very similar to an existing charity.[7] Nor does it consider the position in relation to changing a name for the infringement of another's intellectual property rights.[8] These issues are outside our terms of reference.

REQUIRING A CHARITY TO CHANGE ITS NAME

Charity names

14.8 All charities have at least one name. Some charities have two: a main name and a working name. A main name is the full official name of the charity which appears in its governing document, or which the charity has otherwise formally adopted. A charity must have one main name. A working name is a name that a charity may use for its convenience when it carries out its business, for example in fundraising, publicity, advertising and trading. A charity can have any number of working names.

14.9 The statutory provisions discussed below which deal with changes to a charity's name make no explicit distinction between main names and working names. The Charity Commission has interpreted them as applying only to main names. Thus the Commission regards itself as having a statutory power to require a charity to change its main name, but not its working name.[9] The Commission considers, however, that when it is registering a charity it has an obligation[10] only to register its main name and not also its working name (though it will commonly choose to do so to promote transparency); thus it retains a discretion to refuse to enter a

6 As it is able to do under s 208 of the Charities Act 2011 in respect of an application to be registered as a CIO, and under s 227(3)(b) in respect of the entry of a CIO's new name in the register.

7 V Mair, "Charity Commission needs powers to refuse registration, says ICAEW" (7 May 2014) *Civil Society*, available at http://www.civilsociety.co.uk/governance/news/content/17425/charity_commission_needs_powers_to_refuse_registration_says_icaew.

8 For a discussion of how the Charity Commission approaches this issue see OG330, para B22.

9 OG330, para B3.

10 Section 29(2) of the Charities Act 2011 requires that the register of charities contain the name of every charity required to be registered.

working name into the register.[11] The Commission also regards itself as being able to remove from the register a working name that it has previously entered.[12]

14.10 Unless otherwise specified, references in this Chapter to the name of a charity should be treated as references to its main name.

Section 42 of the Charities Act 2011

14.11 Part 4 of the Charities Act 2011 deals with the registration and names of charities. Section 29(2)(a) provides that the register must contain the name of every charity registered in accordance with section 30.[13]

14.12 The Charity Commission has a power, under section 42(1) of the 2011 Act, to give a direction requiring the name of a charity to be changed, within such period as is specified in the direction, to such other name as the charity trustees may determine with the approval of the Commission. Subsection (2) provides that the power may be exercised in relation to a charity if:

> (a) it is a registered charity and its name ("the registered name") –
>
> (i) is the same as, or
>
> (ii) is in the opinion of the Commission too like,
>
> the name, at the time when the registered name was entered in the register in respect of the charity, of any other charity (whether registered or not) ("ground (a)"),[14]
>
> (b) the name of the charity is in the opinion of the Commission likely to mislead the public as to the true nature of –
>
> (i) the purposes of the charity as set out in its trusts, or
>
> (ii) the activities which the charity carries on under its trusts in pursuit of those purposes ("ground (b)"),[15]

[11] OG330, paras B3, B18 and E12.

[12] OG330, paras B3, B18 and E12.

[13] Under s 30, every charity must be registered in the register unless it is an exempt charity (s 30(2)(a); for the definition of exempt charity see s 22 and Sch 3), an excepted charity whose gross income does not exceed £100,000 (s 30(2)(b) and (c)), or a charity (which is not a CIO) whose gross income does not exceed £5,000 (s 30(2)(d)); see paras 1.24 to 1.28 above. The Charities Act 2011 makes provision for excepted and small charities, but not exempt charities, to register voluntarily (s 30(3)) but that provision has not yet been brought into force: Sch 9, para 8 (the equivalent provision in the Charities Act 1993, s 3A(6), was never brought into force). Lord Hodgson recommended it be brought into force; Government accepted that recommendation subject to a feasibility study by the Charity Commission: Government Responses to: 1) The Public Administration Select Committee's Third Report of 2013-14 and 2) Lord Hodgson's statutory review of the Charities Act 2006 (2013) Cm 8700, p 9, para 11.

[14] See further OG330, paras B6 to 7 and D1 to 3.

[15] See further OG330, paras B8 to 9.

(c) the name of the charity includes any word or expression for the time being specified in regulations made by the Minister and the inclusion in its name of that word or expression is in the opinion of the Commission likely to mislead the public in any respect as to the status of the charity ("ground (c)"),[16]

(d) the name of the charity is in the opinion of the Commission likely to give the impression that the charity is connected in some way with Her Majesty's Government or any local authority, or with any other body of persons or any individual, when it is not so connected ("ground (d)"),[17] or

(e) the name of the charity is in the opinion of the Commission offensive ("ground (e)").[18]

14.13 Ground (a) only applies to registered charities, and a direction on this ground must be given within 12 months of the registered name being entered in the register.[19] Grounds (b) to (e) apply to both registered and unregistered charities, and there is no time limit for exercising the power.

14.14 Section 42 applies to some, but not all, exempt charities.[20]

Powers in relation to working names

14.15 The Charity Commission takes the view that it can use section 42 to direct the change of main names only; while the Commission can remove a working name from the register, it cannot compel the charity to change it. However, the Commission regards itself as being capable of protecting an existing charity's working name under ground (d). If a charity is primarily or widely known by its working name (for example the RSPCA, which is the working name of the Royal Society for the Prevention of Cruelty to Animals) and the main name of another charity creates the unwarranted impression of a connection between the two charities, then the Commission can direct that the main name be changed under section 42.[21]

14.16 A refusal by the Charity Commission to enter a working name on the register, or a decision to remove a working name from the register does not in principle prevent the charity from using (or continuing to use) that name.[22] However, in circumstances where a charity has adopted or used a working name in bad faith, for instance to attract funds at the expense of another charity, it is open to the Commission to commence an inquiry into the charity under section 46 of the Charities Act 2011. Once an inquiry has been opened the Commission can take

[16] See further OG330, para B10. See the Charities (Misleading Names) Regulations 1992 (SI 1992 No 1901), which were enacted under s 4 of the Charities Act 1992.

[17] See further OG330, paras B11 and D2 to 3.

[18] See further OG330, para B12.

[19] Charities Act 2011, s 42(3).

[20] See Appendix A.

[21] OG330, para B5.12.

[22] OG330, paras E12.2 and 12.3.

measures including the suspension of charity trustees and the appointment of an interim manager, if it is found that there has been any "misconduct or mismanagement in the administration of the charity".[23]

When will the Charity Commission issue a section 42 direction?

14.17 The four situations in which a section 42 direction is most likely to be issued are:

(1) where a charity applies for registration[24] by the Charity Commission in the register of charities with a name that infringes one of the section 42 grounds;

(2) where a registered charity seeks to change its name in the register to a name that infringes one of the section 42 grounds;

(3) where a change in the circumstances of a charity (of which the Charity Commission is notified) results in its existing name infringing section 42; and

(4) where a dispute between two charities over the use of a name is referred to the Charity Commission and the Commission has a regulatory interest in the dispute.

(1) At the point of registration

14.18 When an institution applies for registration as a charity, the Charity Commission will consider whether its name complies with section 42. The Commission can look at the name in isolation when determining compliance with grounds (b), (c) and (e), but grounds (a) and (d) require the Commission to search the register of charities and its records of unregistered charities and charities that have been removed from the register.[25] Where a section 42 issue arises, the Commission will seek to resolve it informally by writing to the trustees of the applicant institution. If informal discussions do not resolve the matter, the Commission may issue a section 42 direction. If it is relying on ground (a), the Charity Commission must register the offending charity before issuing a direction, since that ground applies in respect of registered charities only.[26] Grounds (b) to (e) apply to registered and unregistered charities, so there is no requirement that a charity be registered before the Commission can issue it with a direction on one of those

[23] Charities Act 2011, s 76.

[24] Either when it is established or when it becomes obliged to register (for example, when a charity's income increases to more than £5,000 and it is therefore required to register: Charities Act 2011, s 30(2)(d)).

[25] OG330, paras B5.1 and 5.3.

[26] OG330, para B5.5 and 5.6.

grounds. However, the Commission considers itself unable to use section 42 as a reason for delaying an application for registration.[27]

(2) When a registered charity changes its name

14.19 The charity trustees of a registered charity must notify the Charity Commission when they change the name of the charity.[28] The Commission will investigate the new name in the same way that it investigates the name of an institution applying for registration on the register of charities. Again, if it identifies a possible infringement of section 42 then the Commission will try to resolve the matter informally. But – as with registration – the Commission regards itself as having no power to refuse to enter a new name on the register (unless it is a working name) on the basis that it fails to comply with section 42. If the matter cannot be resolved informally then the current practice is to enter the new name on the register before issuing a direction.

(3) Change in the circumstances of a charity

14.20 The name of a charity may comply with section 42 when it is first adopted, but a subsequent change in the circumstances of the charity may result in the name failing to comply. If a charity's name has a close connection with its objects, a change to those objects might result in the name of the charity no longer being apposite to its work, for example where the Trust for the Prevention of Youth Homelessness (a fictitious charity) changes it objects from the prevention of youth homelessness to the education and training of unemployed adults. At the point at which the objects are changed the name of the charity becomes likely to mislead the public as to the true nature of its purposes, thereby contravening ground (b). The Charity Commission will be likely to have become aware of the charity's change of objects;[29] this will have prompted an investigation into whether the name of the charity remained faithful to its purposes and activities or whether it was misleading. Again, the Charity Commission will seek to resolve such issues informally, but a direction may be required.

(4) Regulatory interest in a dispute between two charities

14.21 A charity might complain to the Charity Commission that another charity's use of a particular name is prejudicial to its reputation or its work. In these circumstances, the Commission will only intervene if it has a regulatory interest in the complaint, that is to say, if it can take action under section 42. Where the

[27] This is based on the combined effect of s 29 of the Charities Act 2011, which requires the Charity Commission to keep the register, and s 30, which requires certain charities (whether or not they comply with s 42) to be registered. In addition, there is an express power to refuse to register a CIO applicant if s 42 grounds exist; absent an express power to do the same with other charities, it is arguable that the Commission cannot do so. It is arguable, however, that the Commission could already stay an application for registration consistently with its duties under s 16 of the Charities Act 2011, particularly as there is no statutory obligation to register within a certain period.

[28] Section 35(3)(a) of the Charities Act 2011 provides that the charity trustees of an institution that is for the time being registered must "notify the Commission if the institution ceases to exist, or if there is any change in its trusts or in the particulars of it entered in the register".

[29] Whether because the charity will have been required to notify the Charity Commission of the change, or seek its prior consent to the change (see chs 3 and 5 above). Registered charities are under a statutory obligation to notify the Commission of any alteration to the particulars of the charity in the register: Charities Act 2011, s 35(3).

Commission has jurisdiction it will only consider taking action once satisfied that the parties involved have taken all reasonable steps to try to resolve the matter themselves.[30]

Charity Commission practice where it has section 42 jurisdiction

14.22 If the Commission concludes that it has jurisdiction under section 42 to direct a charity to change its name then it will first ask the charity trustees to make the change voluntarily, warning that it may issue a section 42 direction if they fail to do so. In most cases the charity trustees will comply and there will be no need to issue a formal direction.[31] In the event that they refuse to comply, the Commission will only issue a direction where:

(1) either–

(a) it has evidence that the name is causing loss, detriment or harm to one or more other charities and/or their beneficiaries;

(b) the name is causing significant public confusion; or

(c) it is satisfied that, if the charity continues to use the name, there is significant potential for it to cause these negative effects;

(2) in the case of a complaint or a dispute about the name between the charity and another charity, the parties' reasonable efforts to resolve the matter themselves have not succeeded; and

(3) having considered all of the factors relevant to the matter (including its obligations under the Human Rights Act 1998[32] and the Equality Act 2010) it is satisfied that formal intervention is a proportionate way of pursuing a legitimate policy objective, such as encouraging public trust and confidence in charity.[33]

Compliance with an informal request or a section 42 direction

14.23 A charity that is willing voluntarily to comply with an informal direction by the Charity Commission to change its name can do so by exercising an express power to make the change. Most charities will already have such a power,[34] but where necessary a charity can avail itself of one of the following:

[30] OG330, para B19.2.

[31] OG330, para B5.11.

[32] By s 6 of the Human Rights Act 1998, the Charity Commission must not use its power under s 42 of the Charities Act 2011 in a way that is incompatible with the rights guaranteed under the European Convention on Human Rights. Article 1 of the First Protocol provides that a charity must not be deprived of its property except in the public interest and subject to the conditions provided for by law. Article 6 guarantees the right of charities to a fair and impartial determination of their civil rights and obligations. The Commission takes the view that in making a s 42 direction it potentially engages both of these rights: OG330, para E5.2.

[33] OG330, para B13.1.

[34] The Charity Commission's model governing documents contain such a power. For charitable trusts, see Charity Commission, *Model trust deed for a charitable trust*

(1) for unincorporated charities, the power under section 280 of the Charities Act 2011 for the charity trustees to pass a resolution conferring an express power to change the charity's name;[35]

(2) for charitable companies, the power under section 77 of the Companies Act 2006 for the members of the company to pass a special resolution[36] authorising a change of name; or

(3) for CIOs, the power under section 224 of the Charities Act 2011 for the charity trustees to pass a resolution changing the charity's name.

14.24 A charity that has been formally directed to change its name under section 42 must give effect to the direction "regardless of anything in the trusts of the charity".[37]

Failure to comply with a section 42 direction

14.25 By section 336(1) of the Charities Act 2011,[38] charity trustees who fail to comply with a direction under section 42 may, on the application of the Charity Commission to the High Court, be dealt with in the same way as disobedience to an order of the High Court.

14.26 In the extreme case of a persistent failure to comply with a section 42 direction the Charity Commission may open an inquiry under section 46 of the 2011 Act. If the charity trustees are found to have been involved in misconduct or mismanagement then they can be suspended.[39]

The separate rules relating to charitable companies

14.27 Charitable companies are required to be registered on the register of companies at Companies House. As a result, the naming of charitable companies is regulated by Part 5 of the Companies Act 2006 in addition to section 42 of the Charities Act 2011.

14.28 Chapter 1 of Part 5 of the Companies Act 2006 sets out general requirements regarding company names. Section 53 provides that a company must not be

(November 2013) cls 2 and 31. For charitable unincorporated associations see Charity Commission, *Model constitution for an unincorporated charity* (November 2013) cl 7. For charitable limited companies see Charity Commission, *Model articles of association for a charitable company* (March 2012) cl 7. For charitable incorporated organisations see Charity Commission, *Model constitution for CIO with voting members other than its charity trustees* (August 2014) cl 28, and *Model constitution for CIO whose only voting members are its charity trustees* (August 2014) cl 28.

[35] In *Changing your Charity's Governing Document* (CC36) (August 2011) section C3, the Charity Commission states that s 280 can be used to make changes to the power to change a charity's name. Query whether "modify" (the statutory wording) or "make changes to" (the wording in the Commission guidance) permits charity trustees to create a power where none existed before; see para 6.5 above.

[36] A special resolution of the members (or of a class of members) of a company means a resolution passed by a majority of not less than 75%: Companies Act 2006, s 283(1).

[37] Charities Act 2011, s 43(1).

[38] Read in conjunction with s 338(2).

[39] Charities Act 2011, s 76.

registered by a name if, in the opinion of the Secretary of State, its use by the company would constitute an offence, or if it is offensive. The approval of the Secretary of State is required for a company to be registered by a name that:

(1) would be likely to give the impression that the company is connected with the Government, a local authority or a specified[40] public authority (section 54); or

(2) includes a word or expression for the time being specified in regulations[41] made by the Secretary of State (section 55).

14.29 Chapter 2 sets out the rules on limited companies having to indicate their status as such. Charitable companies are exempt from the requirement to end their name with "limited" or "ltd".[42] Chapter 3 deals with similarity to other names in the registrar's index. Chapter 4 deals with misleading names and the provision of misleading information for the purposes of registration. Chapter 5 deals with changes of name by the company. Notice of a change of name must be given to the registrar.[43] Chapter 6 empowers the Secretary of State by regulations to make provision requiring companies to disclose their name in certain circumstances.[44]

14.30 The Companies Act 2006 regime governing company names is broadly similar to section 42 of the Charities Act 2011, but there are two important differences.

(1) Sections 53 and 66 of the Companies Act 2006 stipulate that a company *cannot be registered* by a name which is offensive or is the same as a name already appearing in the register. By contrast, section 42 of the Charities Act 2011 does not prohibit such a name from being entered on the register and – in the Charity Commission's view – it does not even permit the Commission to refuse to register such a name; it only permits the Charity Commission to direct the change of such a name.

(2) Sections 54 (names indicating a connection with Government or a local or public authority) and 55 (names containing sensitive words or expressions) of the Companies Act 2006 require the consent of the Secretary of State to registration of a company by a name falling within those sections, whereas section 42 of the Charities Act 2011 does not require a charity to obtain the Charity Commission's prior consent to registration in those circumstances.

14.31 Where a charitable company has been issued with a section 42 direction, the direction is to be treated as requiring the name of the company to be changed by

[40] For the list of specified public authorities see the Company, Limited Liability Partnership and Business Names (Public Authorities) Regulations 2009 (SI 2009 No 2982).

[41] See the Company, Limited Liability Partnership and Business Names (Sensitive Words and Expressions) Regulations 2009 (SI 2009 No 2615).

[42] Companies Act 2006, ss 59(1) and (3) and 60(1)(a).

[43] Companies Act 2006, ss 78(1) and 79(1).

[44] The relevant rules are contained in the Companies (Trading Disclosures) Regulations 2008 (SI 2008 No 495).

resolution of the directors of the company.[45] Notice of the change of name in compliance with the direction must be given to the registrar of companies.[46] If satisfied that the new name complies with the requirements of Part 5 of the Companies Act 2006, the registrar must enter the new name on the register of companies in place of the former name.[47]

REFUSING AN APPLICATION FOR REGISTRATION

14.32 The section 42 power only permits the Charity Commission to direct a charity to change its name (and, where ground (a) is engaged, only a registered charity). The Charity Commission has no general power to refuse to register an institution as a charity on the grounds listed in section 42. Nor does it regard itself as capable of staying an application for registration pending resolution of a section 42 issue.

14.33 However, the Charity Commission does have a specific power in relation to CIOs. Section 208 of the Charities Act 2011 provides that the Commission may refuse an application for a CIO to be constituted and for its registration as a charity if any of the section 42 criteria apply in respect of the name of the applicant.[48]

REFORM OF THE LAW

14.34 In his report, Lord Hodgson said that:

> At present, an institution may apply to register even if it has the same name as a (completely unconnected) charity that is already registered. This is not always picked up at the application stage; even where it is, the Commission's power to require a change of name does not apply technically until the institution is already registered; at this point the risk of confusion has already arisen.[49]

14.35 Lord Hodgson recommended that ground (a) in section 42(2) – that the name of the charity is the same as or is too like the name of another charity – should be applicable to both registered and unregistered charities. He also recommended that the Charity Commission should be able to require an institution applying for registration as a charity to change its name as a condition of registration.

Extending ground (a) in section 42 to unregistered charities

14.36 We agree that ground (a) should be extended to unregistered charities. The purpose of this criterion is to ensure that the public does not mistake one charity for another and to prevent disputes between two charities over the use of a particular name. The importance of these aims is not limited to cases where the infringing name is being taken up by a registered charity. Accordingly, we agree

[45] Charities Act 2011, s 45(3).

[46] Charities Act 2011, s 45(4).

[47] Charities Act 2011, s 45(5).

[48] A decision under section 208 to refuse to register a CIO can be appealed to the Charity Tribunal: Charities Act 2011, s 319 and Sch 6; we discuss appeals to the Charity Tribunal in ch 16 below.

[49] Hodgson Report, Appendix A, para 10.

with Lord Hodgson's first recommendation and make a provisional proposal that section 42 be amended to give effect to it. [50]

14.37 **We provisionally propose that section 42(2)(a) of the Charities Act 2011 be amended to remove the reference to the charity being registered.**

Do consultees agree?

Extending section 42 to all exempt charities

14.38 We explained above that section 42 applies to many, but not all, exempt charities.[51] The power is a useful means to ensure that charities do not mislead the public and it might be beneficial for the power to be available in respect of all exempt charities, as it is applicable in respect of unregistered and excepted charities.

14.39 **We invite the views of consultees as to whether the Charity Commission's power under section 42 of the Charities Act 2011 to issue a direction requiring a charity to change its name should be extended to all exempt charities.**

New powers for the Charity Commission to refuse and stay applications for registration and applications to register a change of name

14.40 We now turn to Lord Hodgson's second recommendation. We noted above that the Charity Commission regards itself as having no power to refuse or to stay an application for registration by an institution on the basis that its name infringes section 42, unless the institution is applying for registration as a CIO. Moreover, the Commission takes the view that where a registered charity notifies the Commission of a change of its name, the Commission cannot postpone entry of the new name in the register pending the resolution of a section 42 issue.

14.41 This, in our view, undermines the effectiveness of the section 42 power. If the Charity Commission is not capable of refusing or delaying the entry of an offending name in the register of charities so that it can resolve a section 42 issue, where necessary by issuing a formal direction to the charity concerned, then the Commission may be faced with a situation where it has to register a name in the knowledge that it does not comply with section 42, only to have to remove that name from the register at a later date. Not only is this administratively inconvenient for the Commission, but it also means that anyone who consults the register in the period between registration and removal of the name will see that the charity concerned has been registered with that name. That could result in damage to the goodwill and reputation of another charity, mislead donors and generally undermine public trust and confidence in charities. We think it would be better for the Charity Commission to have enhanced powers to deal with any section 42 issue at the pre-registration stage, and we make provisional proposals to that effect below.

[50] This would, at the same time, remove the requirement that any direction under ground (a) in s 42 must be given within 12 months of the time when the offending name was entered in the register: s 42(3) of the Charities Act 2011.

[51] See Appendix A.

14.42 We emphasise that the occasions on which the Charity Commission will have to rely on a formal discretion to refuse (as opposed to stay) an application for registration[52] will be few. We expect that the Commission will continue to seek voluntary compliance with section 42 in the first instance, and will only have recourse to its enhanced powers as a measure of last resort. But it is important that these powers are in place to avoid a situation where the Charity Commission must register an infringing name, only to replace that name on the register once a section 42 direction has been issued and complied with. The proposed powers will enable the Commission to deal with issues regarding a charity's name in the pre-registration stage, eliminating the possibility of an infringing name entering the register at all.

14.43 **We provisionally propose that the Charity Commission be given a power to refuse an application by an institution for registration as a charity, and to refuse the registration of a change of name, if any of the criteria in section 42(2) of the Charities Act 2011 apply in respect of the name of the institution.**

Do consultees agree?

14.44 **We provisionally propose that the Charity Commission be given a power to stay an application by an institution for registration as a charity, and to stay the registration of a change of name, pending an inquiry into the compliance of the name of the institution with the criteria in section 42(2) of the Charities Act 2011.**

Do consultees agree?

[52] Or the registration of a change of name.

CHAPTER 15
DETERMINING THE IDENTITY OF A CHARITY'S TRUSTEES

DETERMINING THE IDENTITY OF A CHARITY'S MEMBERS

15.1 Section 111 of the Charities Act 2011 empowers the Charity Commission, or a person appointed by the Charity Commission, to determine who the members of a charity are.[1] This power may be exercised either where a charity applies for its membership to be determined, or where the Charity Commission has commenced an inquiry into a charity under section 46 of the Charities Act 2011. The power was introduced by the Charities Act 2006.[2]

15.2 The purpose of the Charity Commission's power to determine membership is to facilitate and ensure the proper administration of a charity. Members of a charity often have rights under the charity's governing document, for example the right to elect the trustees of the charity. In its guidance, the Charity Commission states:

> Experience has shown that incomplete membership records can impede the administration of charities leading to disputes about membership and claims of invalid elections of trustees. This power allows us or a third party appointed by us to determine who members are and therefore who is entitled to vote.[3]

15.3 Incomplete or inaccurate records of membership could mean that some or all of the charity's trustees have not been properly elected and as such lack the power to carry out the functions of trustees. The power to determine membership helps to ensure that this situation, and its associated administrative problems, does not arise, or that when it has already arisen it can be properly remedied.

DETERMINING THE IDENTITY OF A CHARITY'S TRUSTEES

15.4 Lord Hodgson recommended that this power be extended to allow the Charity Commission to determine the identity of a charity's trustees as well as its members.

> It is common to come across charities where the trustee body has been constituted incorrectly for a long period. Nominating bodies may have ceased to exist or may not have exercised their power to nominate for many years. The persons acting as trustees may not know they are trustees. It would be helpful for the Commission to be

[1] This will usually be the members of an unincorporated association, the members of a CIO or the members (usually guarantors) of a charitable company.

[2] Charities Act 2006, s 25, inserting s 29A of the Charities Act 1993.

[3] Charity Commission, *OG117 D5 Investigations Work – Using Permanent Protective Powers* (October 2014) section 7.1. See also the Explanatory Notes to s 25 of the Charities Act 2006.

able to ratify the appointment of such trustees and confirm who the trustees are.[4]

15.5 We agree that it would be helpful to empower the Charity Commission to determine the identity of a charity's trustees.[5] This extension of the section 111 power would further the purpose of the provision; allowing the Charity Commission to determine the identity of trustees, rather than just members, would expedite the process of ensuring proper administration of the charity envisaged by section 111. Determining the identity of a charity's trustees would allow the Charity Commission to remedy directly and quickly one of the difficulties that an incomplete or inaccurate record of members creates, rather than having to determine the membership under section 111 before an election of trustees can take place. It would also allow the Charity Commission to resolve uncertainties as to whether trustees had been properly appointed.

15.6 The Charity Commission can determine who the members of the charity are either: (1) on an application by the charity itself; or (2) of its own initiative where it has opened an inquiry into the affairs of the charity under section 46 of the Charities Act 2011. The new power should similarly be available under those circumstances, but since the power anticipates some uncertainty as to the identity of the charity trustees, an application should also be capable of being made by any person claiming to be a trustee of the charity, even if they are subsequently determined not to have been properly elected.[6]

15.7 **We provisionally propose that the Charity Commission be given the power to determine the trustees of a charity, either (1) on the application of the charity or any person claiming to be a trustee of the charity, or (2) following the institution of an inquiry into the charity under section 46 of the Charities Act 2011.**

Do consultees agree?

[4] Hodgson Report, Appendix A, para 12.

[5] The Charity Commission can direct a CIO to amend its register of members following a determination under s 111 of the Charities Act 2011: Charitable Incorporated Organisations (General) Regulations (SI 2012 No 3012), reg 27. That power would be amended to allow the Charity Commission to direct a CIO's register of trustees to be amended in accordance with a determination under the new power.

[6] This mirrors the Charity Commission's Operational Guidance in respect of its power to determine membership under s 111.

PART 7

THE CHARITY TRIBUNAL AND THE COURTS

CHAPTER 16
THE CHARITY TRIBUNAL AND THE COURTS

INTRODUCTION

16.1 The Charity Tribunal was created by the Charities Act 2006. It was established to provide a low-cost and user-friendly means to challenge certain decisions of the Charity Commission; it would be an alternative to High Court proceedings, which charities rarely embarked upon.[1] In addition, given that most cases concerning charity law do not come before the courts and are instead resolved by the Charity Commission, it was intended that publication of the Tribunal's decisions would encourage the evolution of charity law.[2] We are not considering whether those objectives have been achieved or whether they remain appropriate; the Hodgson review included a broad assessment of the success of the Charity Tribunal.[3] In this Chapter, we are considering four particular issues highlighted by Lord Hodgson that create difficulties for those who use the Charity Tribunal, and in the course of doing so we have identified an associated difficulty for those who issue court proceedings against the Charity Commission.

16.2 The Tribunals, Courts and Enforcement Act 2007 ("the TCEA 2007") created a single structure for most tribunals,[4] divided into the First-tier Tribunal and the Upper Tribunal. The First-tier Tribunal and the Upper Tribunal each have separate chambers covering different subject matters. The Charity Tribunal's work was transferred to the General Regulatory Chamber of the First-tier Tribunal ("the First-Tier Tribunal (GRC)") and the Tax and Chancery Chamber of the Upper Tribunal ("the Upper Tribunal (TCC)"). We use the term "Charity Tribunal" to refer to both the First-tier Tribunal (GRC) and the Upper Tribunal (TCC) when they are exercising the jurisdiction originally conferred by the Charities Act 2006, and the term "charity cases" to refer to cases falling within that jurisdiction.

THE WORK OF THE CHARITY TRIBUNAL

16.3 There are three types of charity cases that fall within the Charity Tribunal's remit: see Figure 13.

1 Prime Minister's Strategy Unit, *Private Action, Public Benefit: A Review of Charities and the Wider Not-For-Profit Sector* (September 2002) paras 7.69 to 7.80.

2 Joint Committee on the Draft Charities Bill, The Draft Charities Bill (2004) HL Paper 167-1, HC 660-1, para 241 and pp 200 to 201, available at http://www.publications.parliament.uk/pa/jt200304/jtselect/jtchar/167/167.pdf; A McKenna, "Transforming Tribunals: the reform of the Charity Tribunal by the Tribunals Courts and Enforcement Act 2007" (2009) 11 *The Charity Law and Practice Review* 1 to 2.

3 Hodgson Report, ch 7, and para (e) of the terms of reference at p 149.

4 The main exceptions are the Employment Tribunal and the Employment Appeal Tribunal.

Figure 13: cases heard by the Charity Tribunal

(1) *Appeals and reviews.* The Charity Tribunal considers challenges to decisions of the Charity Commission. The Act specifies the decisions that can be challenged. It provides that certain decisions are challengeable by way of appeal, when the Tribunal considers the matter afresh at a re-hearing and makes its own decision, and that other decisions are challengeable by way of review, when the Tribunal considers the way in which the Charity Commission made a decision applying judicial review principles.[5]

(2) *References.* The Attorney General, or the Charity Commission (with the consent of the Attorney General), can refer to the Charity Tribunal questions concerning charity law or its application to a particular case.[6] Two references have been determined by the Charity Tribunal thus far, one concerning the charitable status of independent schools[7] and the other concerning the charitable status of benevolent funds whose beneficiaries are limited to a particular class.[8]

(3) *Transferred applications for judicial review.* Applications to the High Court for judicial review of decisions of the Charity Commission can be transferred to the Upper Tribunal (TCC).[9] This power was exercised to transfer an application by the Independent Schools Council for judicial review against the Charity Commission to the Upper Tribunal (TCC) in order to be heard at the same time as the Attorney General's reference concerning the charitable status of independent schools.[10]

16.4 The majority of the Charity Tribunal's work falls within the first category above. The decisions that can be appealed or reviewed are set out in tabular form in Schedule 6 to the Charities Act 2011, together with the persons who can bring each specified challenge and the remedies that can be awarded by the Tribunal in respect of each challenge. This approach has been criticised on the following bases:

(1) the list does not include all decisions that the Charity Commission might make;[11]

(2) it sometimes omits "non-decisions", namely decisions by the Charity Commission not to exercise a particular power;

5 Charities Act 2011, ss 315(2)(a) and 319 to 324, and Sch 6. Appeals against orders under s 52 (giving the Charity Commission power to make orders requiring documents to be disclosed) are treated differently: s 320.

6 Charities Act 2011, s 315(2)(b) and 325 to 331. References by the Charity Commission must also have "arisen in connection with the exercise by the Commission of its functions": s 325(1)(a).

7 *Independent Schools Council v Charity Commission for England and Wales* [2011] UKUT 421 (TCC).

8 *Attorney General v Charity Commission for England and Wales* [2012] UKUT 420 (TCC).

9 Senior Courts Act 1981, s 31A. Such applications cannot be heard by the First-tier Tribunal (GRC).

10 *R (Independent Schools Council) v Charity Commission for England and Wales* [2010] EWHC 2604 (Admin). We consider this further below in the context of the Tribunal's powers when determining a reference.

11 Various cases brought before the Tribunal have been struck out owing to a lack of jurisdiction.

(3) the Charity Commission's modern approach to regulation has moved away from making formal decisions, thereby depriving the Tribunal of jurisdiction to entertain a challenge to the Charity Commission's activities;[12] and

(4) there is uncertainty as to the appropriateness of the range of persons who are entitled to bring a challenge before the Tribunal.[13]

16.5 Lord Hodgson recommended that Schedule 6 to the Charities Act 2011 be redrafted, and that it should expand the category of Charity Commission decisions that can be challenged.[14] His recommendations on this point are being considered by Government.[15] This issue falls outside our review.

16.6 The Tribunal Procedure Committee makes procedural rules for all tribunals within the TCEA 2007 framework.[16] Separate rules have been made for both the First-tier Tribunal (GRC) and the Upper Tribunal (TCC),[17] to which charity cases are subject.

16.7 There is no "costs-shifting" within the Charity Tribunal: each party must bear the legal costs it incurs (if any) in pursuing a case. There are limited exceptions to this rule, principally that the Tribunal can make a costs order if it considers that a party has acted unreasonably in bringing, defending or conducting the proceedings.[18] This power has never been exercised by the Tribunal.

EXPENDITURE ON PROCEEDINGS BEFORE THE CHARITY TRIBUNAL AND THE COURTS

16.8 Like all organisations, charities will often wish to instruct lawyers when they are involved in litigation. Trustees will want to ensure that the legal costs can be paid

[12] A McKenna, "Should the Charity Tribunal be Reformed?" (2012) 14(1) *Charity Law and Practice Review* 1; Hodgson Report, para 7.17.

[13] A McKenna, "Applications to the First-tier Tribunal (Charity) by 'persons affected' by the Charity Commission's Decision" (2013) 16(9) *Charity Law and Practice Review* 1. The definition effectively allows third parties to challenge a charity's decision, by allowing them to challenge the Charity Commission decision that the charity has requested in order to implement the charity's decision.

[14] Hodgson Report, para 7.16 and following and p 85, recommendation 3.

[15] Government Responses to: 1) The Public Administration Select Committee's Third Report of 2013-14 and 2) Lord Hodgson's statutory review of the Charities Act 2006 (2013) Cm 8700, p 34; Joint Committee on the Draft Protection of Charities Bill, Draft Protection of Charities Bill (2015) HL Paper 108, HC 813, para 282 and following, available at http://www.publications.parliament.uk/pa/jt201415/jtselect/jtcharity/108/108.pdf.

[16] TCEA 2007, s 22 and Sch 5.

[17] The current procedure rules are set out in the Tribunal Procedure (First-tier Tribunal) (General Regulatory Chamber) Rules 2009 (SI 2009 No 1976) and the Tribunal Procedure (Upper Tribunal) Rules 2008 (SI 2008 No 2698).

[18] Tribunal Procedure (First-tier Tribunal) (General Regulatory Chamber) Rules 2009, r 10(1)(b). The Tribunal may also make a wasted costs order where a party's representative has behaved improperly, unreasonably or negligently (r 10(1)(a)) and it may make a costs order against the Charity Commission when it considers that the decision subject to challenge was unreasonable (r 10(1)(c)). Similar, but not identical, provision is made in respect of the Upper Tribunal (TCC) hearing charity cases: Tribunal Procedure (Upper Tribunal) Rules 2008, r 10. Notably, costs orders can be made in judicial review proceedings heard by the Upper Tribunal (TCC): r 10(3)(a).

from the charity's funds and that, in the event that the litigation is unsuccessful, any costs order against them can be paid from the charity's funds.[19]

16.9 Lord Hodgson said that charities must apply to the Charity Commission to ascertain whether proposed litigation is an appropriate use of charity funds and that charities may feel reluctant to seek permission. He raised concerns that requiring the Charity Commission to authorise expenditure created a conflict of interest when the Commission is the respondent to the proposed litigation. He recommended that decisions concerning the use of charity funds in Charity Tribunal proceedings should be transferred to the Tribunal.[20]

16.10 Two separate issues arise when considering expenditure on litigation:

(1) whether the Charity Commission's or court's consent is required before proceedings can be pursued; and

(2) whether the trustees will be entitled to indemnify themselves from the charity's funds in respect of any costs incurred by them (and any costs order made against them in the event that they are unsuccessful).

16.11 We consider these issues separately below.

Court proceedings

Issue (1): whether the Charity Commission's or court's consent is required before proceedings can be pursued

16.12 Section 115 of the Charities Act 2011 prevents "charity proceedings" from being pursued, whether by or against a charity, unless authorisation has been obtained from the Charity Commission or the High Court.[21] The purpose of this restriction is "to prevent charities from frittering away money subject to charitable trusts in pursuing litigation relating to internal disputes".[22]

16.13 "Charity proceedings" are defined as:

> Proceedings in any court in England or Wales brought under –
>
> (a) the court's jurisdiction with respect to charities, or
>
> (b) the court's jurisdiction with respect to trusts in relation to the administration of a trust for charitable purposes.[23]

[19] The issues under this heading principally concern trustees in the strict sense. An incorporated charity can use its funds to pay for legal costs. On the other hand, litigation involving unincorporated charities will be conducted by the trustees and they must seek an indemnity from the trust fund in respect of the costs that they incur. We discuss trustees' right to an indemnity in para 13.35 and following above.

[20] Hodgson Report, para 7.24 and p 85, recommendation 7.

[21] Charities Act 2011, s 115(8). This does not apply to certain exempt charities: Sch 9, para 21.

[22] *Muman v Nagasena* [1999] 4 All ER 178, 183, by Mummery LJ; *Rai v Charity Commission for England and Wales* [2012] EWHC 1111 (Ch), [2012] WTLR 1053, [26].

[23] Charities Act 2011, s 115(8).

16.14 Although it is not entirely clear from the words themselves, it has been said that the definition is intended to distinguish internal disputes within the charity (which are charity proceedings[24]) from disputes with outsiders (which are not).[25] So a claim by a charity for breach of contract would not be charity proceedings, but a dispute concerning the administration of the charity would.[26]

16.15 The Charity Commission may not authorise the taking of charity proceedings where it considers that the case can be dealt with by the Commission under its other powers unless there are special reasons for doing so.[27]

16.16 When considering an application for authorisation under section 115, the Charity Commission will ask for the information set out in Figure 14.

Figure 14: information required by the Charity Commission to consider an application for authorisation to bring charity proceedings under section 115 of the Charities Act 2011

(1) What the charity hopes to achieve by taking or defending the legal proceedings.

(2) What advice the trustees have received about the merits of their case and how the trustees assess this.

(3) The basis on which the trustees have concluded that it is in the best interests of the charity to take or defend the proceedings. The trustees are expected to show that they have considered other options, that they have considered relevant factors and ignored irrelevant factors, that they have addressed any conflicts of interest that the trustees might have concerning the decision, and that they have taken and considered expert advice.

(4) Copies of the draft court papers and witness statements.[28]

16.17 If the Charity Commission refuses to authorise proceedings, authorisation can instead by sought from the High Court.[29] In *Rai v Charity Commission for England and Wales*,[30] the applicants purported to bring proceedings against the trustees of a charity. The applicants sought retrospective authorisation to pursue

[24] When we use the term "charity proceedings" in this chapter, we are referring to the meaning of that term in s 115 of the Charities Act 2011.

[25] *Muman v Nagasena* [1999] 4 All ER 178, 183, which concerned the identical wording in the Charities Act 1993.

[26] *Rendall v Blair* (1890) 45 Ch D 139, decided under the more complicated definition in the Charitable Trusts Act 1853, s 17. Disputes with outsiders would include family provision claims under the Inheritance (Provision for Family and Dependants) Act 1975 or disputes as to whether a trust is charitable, an example of the latter being *Re Belling* [1967] Ch 425. See also *Scott v National Trust for Places of Historic Interest or Natural Beauty* [1998] 2 All ER 705.

[27] Charities Act 2011, s 115(3).

[28] Charity Commission draft guidance for charity trustees on taking or defending legal proceedings, annexed to Board Paper No (10) OBM 27 for a meeting on 22 September 2010 ("Draft Guidance"). See also H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) pp 919 to 920. The Charity Commission is expected to publish formal guidance on this issue shortly.

[29] Charities Act 2011, s 115(5).

[30] [2012] EWHC 1111 (Ch), [2012] WTLR 1053.

those proceedings from the Charity Commission, which was refused, and then from the High Court. Having concluded that the applicants had a "legally sustainable claim", the Judge decided the application by asking the following question:

> if the Applicants have a legally sustainable dispute, is the commencement of litigation the best (or the least worst) course in the interests of the charity as a whole to deal with that dispute? Litigation may be the best course for the Applicants to pursue to achieve their objective. But it is the charity's interest (not that of the Applicants or proposed Respondents) that is the focus of the inquiry.[31]

16.18 The requirement that the Charity Commission or High Court authorise charity proceedings is long-standing and we have not heard that there is dissatisfaction with it.

16.19 The requirement would present a difficulty if (a) a charity wanted to pursue court proceedings against the Charity Commission, and (b) those proceedings fell within the definition of charity proceedings. A conflict of interest would arise since authorisation to pursue proceedings would be required from the very body against which those proceedings would be brought.[32] We do not, however, think that this is a problem since court proceedings against the Charity Commission will not fall within the definition of charity proceedings and will not therefore require authorisation from the Commission.

Issue (2): whether the trustees will be entitled to indemnify themselves from the charity's funds in respect of any costs incurred by them

16.20 Issue 1 is the first hurdle to litigation; if charity proceedings are not authorised by the Charity Commission or court, the litigation cannot proceed and litigation costs will not be incurred.[33] If that first hurdle is surmounted, then Issue 2 arises.

16.21 A charitable company or other incorporated charity can incur legal fees in pursuing court proceedings, and can be subject to a costs order if it is unsuccessful in the litigation. An unincorporated charity,[34] on the other hand, cannot itself incur legal fees or be ordered to pay legal costs. Rather, litigation will be conducted by the trustees who will be personally liable for the costs, unless the costs can be paid from the trust fund. Under the Trustee Act 2000, a trustee is entitled to be indemnified from the trust funds, or pay out of them, "expenses

[31] [2012] EWHC 1111 (Ch), [2012] EWHC 1111 (Ch), [27].

[32] It would be inappropriate for the Charity Commission to be required to consider authorisation of such proceedings, particularly in light of the questions that the Commission will ask before giving authorisation (for example, about the merits of the charity's case; see Fig 14(2) above).

[33] Costs might be incurred initially if the parties do not realise that authorisation is required (as in *Rai v Charity Commission for England and Wales* [2012] EWHC 1111 (Ch), [2012] WTLR 1053, where proceedings were instituted in ignorance of the s 115 restriction) but once that is realised no further costs should be incurred.

[34] Controlled by trustees in the strict legal sense.

properly incurred by him when acting on behalf of the trust".[35] Similarly, under the Civil Procedure Rules 1998, where a party to proceedings is a trustee, then "the general rule is that that person is entitled to be paid the costs of those proceedings, insofar as they are not recovered from or paid by any other person, out of the relevant trust fund or estate".[36]

16.22 But trustees can only be indemnified out of the funds of a trust if the costs are properly incurred. Litigation by unincorporated charities is therefore accompanied by a risk that the trustees will be personally liable for the costs.[37] To guard against that risk, trustees can obtain from the court a "*Beddoe* order".[38] A *Beddoe* order provides trustees with assurance that the costs incurred (or ordered to be paid if the litigation is unsuccessful)[39] can properly be paid from the trust fund. A *Beddoe* order is sometimes referred to as a pre-emptive, a protective, or a prospective costs order, but the terms overlap and they are not used consistently: see Figure 15.

Figure 15: terminology[40]

A *Beddoe order* provides trustees with an advance assurance that their costs will be paid from the trust fund.

A *protective costs order* provides a party with advance assurance that he or she will not have to pay the other party's costs, regardless of the outcome of the litigation.

The term *pre-emptive costs order* is used to describe both *Beddoe* orders and protective costs orders.

A *prospective costs order* is similar to a *Beddoe* order, but rather than providing trustees with assurance that their costs will be paid from the trust fund, it provides other individuals with that assurance. Such an order might be made, for example, in favour of a representative claimant challenging a change to the rules of a pension fund.

We refer to *Beddoe* orders as a separate category of order since they concern the relationship between trustees and their trust fund, rather than costs orders that can be made between different parties to litigation.

35 Trustee Act 2000, s 31(1). The right also exists at common law: *Re Beddoe* [1893] 1 Ch 547, 558; *Attorney General v Mayor of Norwich* (1837) 2 Myl & Cr 406, 424. We consider the right to indemnity in para 13.35 and following above.

36 Rule 46.3(1) and (2). Where that entitlement exists, costs will be assessed on the indemnity basis: r 46.3(3).

37 The risk of personal liability on the part of the trustees most often occurs in the case of unincorporated charities: see n 19 above. But litigation by incorporated charities also presents a risk for the charity trustees if it is subsequently found that they acted in breach of their duties to the charity in causing the charity to use its funds in the litigation. The trustees might seek protection against that risk, for example by seeking advice from the Charity Commission under s 110: see para 16.24 below.

38 *Re Beddoe* [1893] 1 Ch 547. See *Blackstone's Civil Practice*, paras 44.7 to 44.14; *Civil Procedure* (2014) Vol 1, para 64.2.3.

39 *McDonald v Horn* [1995] ICR 685, 695, by Hoffmann LJ; *Three Professional Trustees v An Infant Prospective Beneficiary* [2007] EWHC 1922 (Ch), [2007] WTLR 1631, [29].

40 See, generally, *Blackstone's Civil Practice*, para 44.7 to 44.14; *Butterworths Costs Service* (2014) para 87.4.

16.23 The court can make a *Beddoe* order if it decides that the proposed litigation costs would be a proper use of the charity's funds. In considering an application for a *Beddoe* order, the court has a wide discretion. It is likely to consider the trustees' prospects of success and whether the litigation is in the charity's interests.[41]

16.24 Applications for *Beddoe* orders are charity proceedings within section 115 of the Charities Act 2011. This is the case whether or not the substantive proceedings (in which the *Beddoe* application is made) are themselves charity proceedings.[42] Accordingly, an application for a *Beddoe* order must be authorised by the Charity Commission or the High Court. The Charity Commission generally refuses authorisation to make an application for a *Beddoe* order because it can deal with the matter using its other powers; the Charity Commission can make an order under section 105 of the Charities Act 2011 authorising the trustees to incur legal costs (and risk an adverse costs order) on behalf of the trust fund, or it can provide an opinion under section 110 to the same effect.[43] In considering whether to exercise its powers to provide trustees with protection equivalent to a *Beddoe* order, the Charity Commission will seek the information set out in Figure 16.

Figure 16: information required by the Charity Commission to decide whether to authorise expenditure on legal proceedings

(1) The strength of the trustees' case and any legal advice or other expert advice the charity has received in assessing this.

(2) What purpose the charity hopes to achieve by taking or defending legal proceedings.

(3) Whether the trustees have considered or tried other ways of achieving that purpose.

(4) An estimate of the costs involved, including the other side's costs should the charity lose.

(5) The charity's ability to meet the costs.

(6) The risks to the charity of litigation, not only in financial terms but also in terms of reputation, impact on its funding base, and in preventing the charity from carrying out its charitable purposes.[44]

16.25 If the Charity Commission refuses to exercise those powers, and refuses to authorise the making of the *Beddoe* application under section 115, the trustees can make a further application to the High Court.[45]

[41] There is a dearth of case law concerning *Beddoe* applications made by charity trustees, though some guidance is provided by *Singh v Bhasin* [2000] WTLR 275 and some general principles can be discerned from *Beddoe* applications made in respect of other trusts; see for example *Re Evans* [1986] 1 WLR 101.

[42] J Warburton, *Tudor on Charities* (9th ed 2003) para 10-027, n 2; H Picarda QC *The Law and Practice Relating to Charities* (4th ed 2010) p 921; Draft Guidance, section 10.

[43] Draft Guidance, section 11.

[44] Draft Guidance, section 11; see also H Picarda QC *The Law and Practice Relating to Charities* (4th ed 2010) pp 922 to 923.

[45] Charities Act 2011, s 115(5); see para 16.17 above. In addition, a refusal by the Charity Commission to exercise its power to make a s 105 order can be appealed to the Tribunal: Charities Act 2011, Sch 6.

16.26 In many cases, this will be unproblematic; the Charity Commission can consider whether the costs of litigation should be incurred by the trust fund and can provide trustees with the same protection as a *Beddoe* order under section 105 or 110 without the charity having to incur the costs of making a *Beddoe* application to the court. And if the Commission refuses to do so, an application for authorisation to make a *Beddoe* application can be made to the court. A problem arises, however, when the Charity Commission is the other party to the litigation. The trustees must seek authorisation to make a *Beddoe* application under section 115 – to protect themselves in the substantive proceedings – from the body against which those proceedings will be brought. And trustees might have a particular desire to obtain the protection of a *Beddoe* order when the court proceedings are against the Commission, since trustees might be concerned that, following the litigation, the Commission will challenge their use of charity funds to pursue the litigation.

16.27 We do not consider that it is appropriate for trustees to be required to first seek authorisation from the Charity Commission to apply for a *Beddoe* order when the substantive proceedings are against the Commission.[46] The same applies to any other ancillary application (within the definition of charity proceedings) that the trustees might wish to make in substantive proceedings against the Charity Commission.

Conclusion and provisional proposals for reform

16.28 When trustees apply for a *Beddoe* order (or any other order) during the course of proceedings against the Charity Commission, the application falls within the definition of charity proceedings, and section 115 requires the trustees to obtain the Commission's permission to make the application. The Charity Commission faces a conflict of interest in considering whether to allow the application to proceed.

16.29 It may be that this problem could be overcome by the Charity Commission establishing a "Chinese wall" and ensuring that different personnel considered a section 115 application and the substantive claim. The appearance of a conflict would, however, remain. Nor do we think that the ability to seek section 115 authorisation from the High Court following a refusal by the Charity Commission is an adequate solution. It is daunting enough for trustees to litigate against their regulator; they should not additionally be required to go through a process of obtaining the regulator's consent to an application for a *Beddoe* order in that litigation before they can apply for the court's permission.

16.30 It would be possible to remove all applications within, or in contemplation of, court proceedings against the Charity Commission (whether applications for *Beddoe* orders or otherwise) from the definition of "charity proceedings". Charities would then be free to make any applications within litigation against the Charity Commission without any need for authorisation. That, however, would remove some of the protection of charitable funds created by section 115. Whilst trustees might still be challenged on whether costs were properly incurred and therefore

[46] This is particularly the case given the information that the Charity Commission requires to consider such an application and to decide whether to exercise its s 105 or s 110 powers instead: see Fig 16 above.

whether they were entitled to an indemnity for those costs, the advantage of section 115 is that it can prevent costs from being incurred inappropriately in the first place. It is the requirement to obtain authorisation from the Charity Commission (when the Charity Commission is a party to the litigation) that we consider to be inappropriate, not the requirement to obtain authorisation. A requirement to obtain the court's authorisation to pursue charity proceedings, in our view, remains appropriate. Moreover, a charity might still wish to ask the Charity Commission for authorisation under section 115, despite the conflict of interest, to avoid the costs of an application to court.

16.31 Our provisional view, therefore, is that the definition of charity proceedings should remain, but that, when the Charity Commission is a party to the litigation, charities should have a choice as to whether they seek authorisation from the Charity Commission or the court. This would replace the current requirement that they must seek the Charity Commission's authorisation in the first instance before they can apply to the court.[47]

16.32 **We provisionally propose that, when applications within (or in contemplation of) proceedings against the Charity Commission fall within the definition of "charity proceedings" under section 115 of the Charities Act 2011, the charity should be permitted to obtain authorisation to pursue that application either from the court or the Charity Commission.**

Do consultees agree?

The impact of reform

16.33 When considering the impact of reform, we would be assisted by hearing consultees' views as to the likely differing costs of seeking authorisation under section 115 from the Charity Commission (as is currently the case) and from the court (which we provisionally propose as an option for charities).

16.34 **We invite the views of consultees as to the differing costs of seeking authorisation to pursue charity proceedings under section 115 of the Charities Act 2011 from (a) the Charity Commission and (b) the court.**

Charity Tribunal proceedings

16.35 The Charity Tribunal is intended to be a user-friendly forum where charities can represent themselves without having to engage lawyers. Given that there is generally no costs-shifting (see paragraph 16.7 above), it may be that charities would prefer to represent themselves because there is almost no prospect of being able to recover their costs, even if they are successful. The reality, however, is that charities do sometimes instruct lawyers to represent them at the Tribunal. The same issues discussed above in relation to court proceedings therefore apply.

[47] We do not think that the Charity Tribunal should be given concurrent jurisdiction to authorise charity proceedings under s 115. There seems little point in adding a third alternative body to the authorisation process. If the substantive proceedings are to be before the court, authorisations should be given by the court or the Charity Commission.

Issue (1): whether the Charity Commission's or court's consent is required before proceedings can be pursued

16.36 Proceedings before the Tribunal are not, in our view, "charity proceedings" within the meaning of section 115 of the Charities Act 2011.[48] They are not proceedings "in any court"; the definition of "court" in section 353(1) of the Charities Act 2011 does not include tribunals. Nor do proceedings before the Tribunal concern "the court's jurisdiction with respect to charities";[49] rather, the Tribunal exercises a statutory jurisdiction that is conferred on the Tribunal alone.

16.37 Accordingly, charities are not required by section 115 of the Charities Act 2011 to obtain the Charity Commission's or court's authorisation before bringing proceedings in the Charity Tribunal.[50] It is entirely sensible that charities should not have to obtain the Charity Commission's consent since all claims by charities in the Tribunal are against the Charity Commission, and a conflict of interests would inevitably arise.

16.38 But should there be a requirement that charities obtain authorisation from the Tribunal (or, at their option, from the Charity Commission), before they commence proceedings[51] in the Tribunal? Arguably the rationale behind section 115 – the protection of charitable funds – is equally relevant where proceedings are being commenced in the Tribunal. Our provisional view, however, is that authorisation to commence Tribunal proceedings should not be required, for the following reasons.

(1) Authorisation under section 115 is required in respect of internal disputes within the charity; the majority of Tribunal proceedings do not concern internal disputes but disputes between the charity and the Charity Commission. If those disputes were before the court, they would not be charity proceedings and would not therefore require section 115 authorisation. Nor should such disputes require authorisation when they are before the Tribunal.[52]

(2) Tribunal proceedings are different from court proceedings; legal representation is less common and there is minimal risk of adverse costs orders. Accordingly, there is a less pressing need to protect charitable funds.

[48] We share the view expressed by the Principal Judge of the First-tier Tribunal (Charity): see A McKenna, "Applications to the First-tier Tribunal (Charity) by "persons affected" by the Charity Commission's Decision" (2013) 16(9) *Charity Law and Practice Review* 1. We respectfully disagree with the suggestion that Tribunal proceedings "appear to be charity proceedings" in H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) p 915.

[49] Or "the court's jurisdiction with respect to trusts in relation to the administration of a trust for charitable purposes": Charities Act 2011, s 115(8). Judicial review claims transferred to the Tribunal, as opposed to appeals, reviews and references (see Fig 13 above) might, however, concern the court's jurisdiction with respect to charities.

[50] Nor are they required to obtain permission if they apply to be joined as a party to proceedings that have been brought by a third party.

[51] Or apply to be joined as a party to other proceedings.

[52] If authorisation were to be required, it would be necessary to define "charity proceedings" in the context of the Tribunal in order to exclude other disputes from the authorisation requirement.

(3) Part of the purpose of section 115 authorisation is to assess whether court proceedings are necessary at all; the Charity Commission must refuse consent if it can resolve the issue using its powers. That option is not available in respect of Tribunal proceedings, which involve charities disputing the Commission's use of its powers.

(4) Requiring authorisation would create an obstacle to access to the Tribunal. That might discourage charities from using it and result in increased costs for those charities that engage lawyers in the process.

16.39 **We invite the views of consultees as to whether charities should be required to obtain authorisation from the Charity Tribunal or the Charity Commission before commencing proceedings in the Tribunal.**

THE IMPACT OF REFORM

16.40 When considering the impact of reform, we would be assisted by hearing consultees' views as to the likely costs to charities of having to obtain authorisation from the Charity Tribunal before pursuing proceedings in the Tribunal.

16.41 **We invite the views of consultees as to the likely costs of having to obtain authorisation from the Charity Tribunal before pursuing proceedings in the Tribunal.**

Issue (2): whether the trustees will be entitled to indemnify themselves in respect of any legal costs from the charity's funds

16.42 An incorporated charity can incur legal fees in pursuing Charity Tribunal proceedings and a costs order can be made against an incorporated charity.

16.43 For unincorporated charities, any legal fees (or costs order) will be incurred by the trustees and they will seek an indemnity from the trust fund. Trustees face the same uncertainty noted in paragraph 16.22 above as to whether the costs of Tribunal proceedings will have been properly incurred, and therefore whether they can be paid from the trust fund. And as noted above in respect of court proceedings, charities might be concerned that the Charity Commission will subsequently challenge the trustees' use of charity funds in pursuing the Tribunal proceedings.

16.44 Currently there is no power for trustees to obtain advance protection, akin to a *Beddoe* order, from the Charity Tribunal in respect of the costs of Tribunal proceedings. In theory, trustees could seek a *Beddoe* order from the High Court in respect of the costs of proposed proceedings in the Charity Tribunal, and our provisional proposals above would ensure that authorisation to make such an application (which would be charity proceedings under section 115 of the Charities Act 2011) could be considered by the court rather than by the Charity Commission. However, one of the reasons for the creation of the Charity Tribunal was to avoid the need for charities to commence court proceedings; that policy is undermined if *Beddoe* protection in respect of Tribunal proceedings can only be obtained by going to court.

16.45 As an alternative to obtaining a *Beddoe* order from the court, an order or an opinion with the same effect could be sought from the Charity Commission under sections 105 or 110 of the Charities Act 2011, but for the reasons given in paragraph 16.26 above, such an application to the Charity Commission would inevitably create a conflict of interests since the Charity Commission will always be a party to proceedings before the Tribunal.

16.46 Alison McKenna, Principal Judge of the First-tier Tribunal (Charity), has suggested that the absence of a power to make a *Beddoe* order "may have [discouraged] some charities from using the Tribunal for fear that the Commission would deem the expenditure of charity funds on the case to have been inappropriate and that they might be directed to reimburse the charity". She considers that a power to make *Beddoe* orders "would provide a safeguard against such concerns on the part of the sector".[53] We agree that the Tribunal should have the power to make *Beddoe* orders in respect of proceedings before it.

16.47 It is necessary to consider the two types of *Beddoe* protection separately.

16.48 First, trustees will seek protection in respect of the legal costs that they propose incurring in Tribunal proceedings. The Tribunal should have the same power as the court to determine that those costs will be recoverable from the trust fund.

16.49 Second, trustees might additionally seek protection in respect of any costs order that might be made against them if they are unsuccessful in the litigation (see paragraph 16.22 above). Different considerations apply here. As noted above,[54] there is generally no costs-shifting in the Tribunal in appeals and reviews, and in references (see Figure 13 above); an adverse costs order is likely to be made only if the trustees have acted unreasonably and in such a case it would be inappropriate for a costs order to be paid from the trust fund rather than by the trustees personally. That being the case, we see no need for the Tribunal to have a power to provide the second type of *Beddoe* protection in appeals and reviews, or in references. That said, the current rules on costs-shifting are set out in secondary legislation which can be amended by the Tribunal Procedure Committee.[55] If those rules were to be amended so as to permit costs-shifting then there might be a legitimate call for the Tribunal to be able to provide the second type of *Beddoe* protection.

16.50 Moreover, costs-shifting is available in judicial review claims that are transferred to the Upper Tribunal (TCC).[56] We think that a new power for the Charity Tribunal to make *Beddoe* orders should extend to such claims.[57] In addition, costs-shifting

[53] A McKenna, "Should the Charity Tribunal be reformed?" (2011) 14(1) *Charity Law and Practice Review* 1.

[54] See para 16.7 above.

[55] The costs of and incidental to Tribunal proceedings shall be in the discretion of the Tribunal, but the exercise of this discretion is subject to the Tribunal Procedure Rules: TCEA 2007, s 29(1) and (3).

[56] See n 18 above.

[57] In theory, an application for a *Beddoe* order could be made to the Administrative Court that transferred the proceedings to the Upper Tribunal, but it would be preferable for a *Beddoe* application to be heard by the Upper Tribunal if the proceedings are currently before it.

is a feature of appeals from the Upper Tribunal to the Court of Appeal. We would expect *Beddoe* orders in respect of the costs of such an appeal to be made by the Court of Appeal,[58] but we see no reason to prevent the Tribunal from making such an order, for example at the same time as considering an application for permission to appeal.

16.51 Accordingly, we take the provisional view that the second type of *Beddoe* protection should be available, albeit that we only anticipate it being granted by the Charity Tribunal in judicial review claims that have been transferred from the High Court and possibly in respect of appeals to the Court of Appeal.

CONSIDERING AN APPLICATION FOR A *BEDDOE* ORDER

16.52 In considering an application for a *Beddoe* order, the Tribunal should apply the same criteria as the court would apply in respect of an application for a *Beddoe* order in court proceedings: see paragraph 16.23 above.

16.53 The Tribunal will have to strike a balance between considering *Beddoe* applications quickly and with a light touch, but also giving careful scrutiny to applications since they will be authorising the expenditure of charitable funds. The Attorney General is a party to "charity proceedings" in court as the constitutional protector of charity.[59] It would be possible to require *Beddoe* applications to name the Attorney General as a party, to ensure that the Tribunal hears competing arguments as to the appropriateness of a *Beddoe* order. We do not, however, think that this is necessary, since the Tribunal can be trusted to exercise the power carefully. If the Tribunal has doubts about whether a *Beddoe* order would be appropriate, it can refuse the application or invite the Attorney General to become a party for the purposes of considering the *Beddoe* application.[60]

16.54 **We provisionally propose that the Charity Tribunal should be given the power to make *Beddoe* orders in respect of proceedings before it.**

Do consultees agree?

16.55 **We invite the views of consultees as to whether the Attorney General should always be a party to applications for a *Beddoe* order.**

CREATING THE NEW POWER

16.56 The Costs Review Group has argued that a power to make *Beddoe* orders could be conferred on the Charity Tribunal by secondary legislation promulgated by the Tribunal Procedure Committee under section 29 of the TCEA 2007.[61] Indeed, it

[58] In addition, the new r 52.9A of the Civil Procedure Rules, which came into force on 1 April 2013, allows the Court of Appeal to limit the recoverable costs on an appeal from the Upper Tribunal: see *Blackstone's Civil Practice*, para 75.22.

[59] Civil Procedure Rules 1998, Practice Direction 64A, para 7; H Picarda QC, *The Law and Practice Relating to Charities* (4th ed 2010) p 924 and following.

[60] Under s 318 of the Charities Act 2011.

[61] Costs Review Group, *Costs in Tribunals: Report by the Costs Review Group to the Senior President of Tribunals* (December 2011), available at https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/costs-review-group-report-tribunals-dec-2011.pdf. The Costs Review Group was established to review the costs regimes in

has been held that the court has power to make protective costs orders in favour of trust beneficiaries (extending the protection available to trustees from a *Beddoe* order) under section 51 of the Senior Courts Act 1981,[62] which is in almost identical terms to section 29 of the TCEA 2007; if the *Beddoe* jurisdiction can be extended in such a way under section 51 of the 1981 Act, it ought be to possible to create a *Beddoe* jurisdiction under the equivalent power in section 29 of the TCEA 2007.

16.57 The Costs Review Group considered that *Beddoe* orders in the Charity Tribunal should be viewed as an exercise of the costs jurisdiction of the Tribunal, and therefore fell within section 29 of the TCEA 2007. The Group acknowledged, however, that if *Beddoe* orders were not seen as the exercise of the costs jurisdiction but as "an exercise of a jurisdiction over the conduct of trustees in the management of their trust, *Beddoe* orders could not be made by the Tribunals in the exercise of their costs powers".[63]

16.58 Our provisional view is that the Tribunal Procedure Committee does not have the power under section 29 of the TCEA 2007 to introduce *Beddoe* orders by amending the procedure rules. Section 29 is intended to cover orders against one party for the payment of another party's costs (which we refer to as "costs-shifting": see paragraph 16.7 above). By contrast, *Beddoe* orders in the Tribunal would not be about costs orders between the parties to the proceedings, but instead about the internal management of the charity and whether trustees are entitled to an indemnity from the charity's funds in respect of proposed legal costs.[64]

16.59 We therefore take the view that a power for the Charity Tribunal to make *Beddoe* orders should be introduced by way of primary legislation, rather than by way of amendment to the procedure rules by the Tribunal Procedure Committee.

THE PROCEDURE FOR APPLYING FOR A *BEDDOE* ORDER

16.60 Applications to the Charity Tribunal for a *Beddoe* order under a new statutory power would not be "charity proceedings" under section 115 of the Charities Act

tribunals in the light of Lord Justice Jackson's review of litigation costs in the courts: see *Review of Civil Litigation Costs: Final Report* (December 2009), available at http://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf.

62 *McDonald v Horn* [1995] ICR 685, 698; *IBM United Kingdom Pensions Trust Ltd v Metcalfe* [2012] EWHC 125 (Ch), [2012] 3 Costs LO 420, [20].

63 Costs Review Group, *Costs in Tribunals: Report by the Costs Review Group to the Senior President of Tribunals* (December 2011) para 164.

64 The use of s 51 to extend *Beddoe* protection to parties other than trustees, as explained in *McDonald v Horn* [1995] ICR 685, concerns costs orders in the proceedings, not the trustees' right to an indemnity from the trust fund. Moreover, different considerations apply to Charity Tribunal disputes than to the type of dispute in *McDonald v Horn*. In *Alsop Wilkinson v Neary* [1996] 1 WLR 1220, Lightman J provided a threefold classification of disputes involving trustees, saying that costs usually follow the event in "trust disputes" and "beneficiary disputes", rendering a *Beddoe* order inappropriate, but that different considerations applied to *Beddoe* orders in "third party disputes", where costs are usually paid from the trust fund, making *Beddoe* orders appropriate. *McDonald v Horn* concerned the former whereas proceedings before the Charity Tribunal concern the latter, so those different considerations apply.

2011[65] and would not therefore require the consent of the Charity Commission or court. No conflict of interest in considering an application to authorise the making of such an application therefore arises.

16.61 The Tribunal Procedure Committee could make procedure rules about applying for a *Beddoe* order, including directions as to the documentation that trustees should file in support of such an application. *Beddoe* applications to the court are generally considered without a hearing,[66] and we would expect the position to be the same in respect of *Beddoe* applications to the Tribunal.

16.62 Since there would be disclosure and consideration of the strengths and weaknesses of the claim as part of a *Beddoe* application, it would seem appropriate that the substantive claim is heard by different members of the Tribunal.

THE IMPACT OF REFORM

16.63 When considering the impact of reform, we would be assisted by hearing consultees' views as to the likely differing costs of seeking *Beddoe* protection from the Charity Commission or from the court (as is currently the case) and from the Charity Tribunal (which we provisionally propose as an option for charities).

16.64 **We invite the views of consultees as to the differing costs of seeking *Beddoe* protection from (a) the Charity Commission, (b) the court, and (c) the Charity Tribunal.**

SUSPENDING THE EFFECTS OF A CHARITY COMMISSION SCHEME OR DECISION PENDING THE DETERMINATION OF A CASE

16.65 Schedule 6 to the Charities Act 2011 often permits appeals and reviews (see Figure 13 above) to be brought by "persons affected" by the Charity Commission's decision. Such challenges can, effectively, be challenges by third parties against the decision of a charity, where the charity's decision has been given effect by a Charity Commission scheme or order.[67]

16.66 Lord Hodgson said that challenges by third parties to the Charity Tribunal could be rendered redundant because the Charity Tribunal has no power to suspend a Charity Commission scheme or decision pending the resolution of a challenge.

> There was a view that the ability of the Tribunal to protect third party rights (e.g. of beneficiaries) is too limited. There will be occasions where a third party (other than the charity involved in the situation complained of and the Commission) has standing to bring a claim, as set out in column two of the table in Sch 6. Concerns have been expressed that on some of these occasions, the claims relate to a decision or action of the charity which has been approved by the

[65] See para 16.36 above.

[66] Civil Procedure Rules 1998, Practice Direction 64A, para 6.5 and Practice Direction 64B, para 6.1.

[67] See, generally, A McKenna, "Applications to the First-tier Tribunal (Charity) by "persons affected" by the Charity Commission's decision" (2014) 16 *Charity Law and Practice Review* 147 to 162.

> Commission, which the Tribunal has no power to prevent the progress of despite the fact a complaint is before it. A classic example is the disposal of land – the Tribunal has no power to prevent trustees acting on a legal authority from the Commission to dispose of land, no matter what objection to the disposal is brought by the third party.[68] Further thought should be given to the Tribunal's powers to suspend the effect of a Commission scheme or authorisation pending determination of a case.[69]

16.67 We can see force in the argument that, if the right of third parties to challenge Charity Commission decisions is to be meaningful, the Charity Tribunal should have the power to suspend the effect of the Charity Commission's decision pending a challenge.

16.68 The problem is not limited to third party challenges. There may be circumstances in which charities or individual trustees wish to suspend the effect of a Charity Commission decision pending a challenge to that decision in the Tribunal. For example, if the Charity Commission decides to remove a charity from the register,[70] or to institute an inquiry,[71] or to amend a certificate of incorporation,[72] the charity concerned might wish to ask the Tribunal to suspend the effect of the Charity Commission's decision pending the hearing of its substantive challenge in the Tribunal. And if the Charity Commission makes a scheme at the request of the majority of a charity's trustees,[73] a dissenting trustee might wish to ask the Tribunal to suspend the effect of the Charity Commission's decision pending a challenge to that scheme in the Tribunal.

16.69 Before considering whether there is any need for the Tribunal to have a power to suspend the effect of a Charity Commission decision, it is necessary to ascertain the effect of a successful challenge in the Tribunal on the original decision. If the result of a successful challenge is that the decision is void and has no consequences then in theory there would be nothing to be gained by permitting the interim suspension of the decision pending the outcome of the challenge. It is to that question that we now turn.

What is the effect of a Charity Commission decision that the Charity Tribunal subsequently quashes or varies?

16.70 This question has not been tested in the Charity Tribunal or the courts, although it was raised in *Aliss and Hesketh v The Charity Commission for England and*

[68] As there is no power to challenge in the Charity Tribunal a decision of the Charity Commission to make an order under Charities Act 2011, s 117, authorising the disposal of land (see ch 8 above), we assume that the authorisation referred to here is that provided by way of a scheme when a scheme is necessary for the disposal of particular land. The decision to make schemes can be challenged in the Charity Tribunal.

[69] Hodgson Report, Appendix A, para 15.

[70] Charities Act 2011, s 34.

[71] Charities Act 2011, s 46.

[72] Charities Act 2011, s 262.

[73] Charities Act 2011, s 69.

Wales.[74] To facilitate a merger of two schools, the Charity Commission made a scheme that empowered the charity's trustees to enter into a lease. A 999-year lease of the charity's school site was executed before the scheme was made and was expressed to take effect when the scheme was sealed. A claim was commenced in the Charity Tribunal by third parties challenging the scheme. The challenge was brought after the lease took effect. If the Charity Tribunal had quashed the scheme, or removed from it the power to enter into the lease, a question would have arisen concerning the validity of the lease; it would have been executed pursuant to a scheme which had subsequently been quashed (or amended).

16.71 The Charity Tribunal decided that the Charity Commission had the power to make the scheme but that it contained deficiencies. The Tribunal therefore did not quash the scheme, but amended it. However, the parties to the lease voluntarily agreed to surrender and re-grant it on amended terms which responded to some of the third parties' challenges and which was consistent with the Tribunal's amended scheme. Accordingly, the effect of the Tribunal's decision on the validity of the original lease was not tested.[75]

16.72 At the hearing, the lessee expressed concerns that, if the scheme was quashed or amended, that might have a direct effect on the validity of the terms of the lease.[76] In its decision, the Tribunal made certain comments that seemed to assume that the original lease, if inconsistent with the Tribunal's amended scheme, would have been of no effect.[77] The Tribunal asserted its statutory powers to quash and to amend the scheme, and continued:

> The Tribunal takes the view that its authority in this respect cannot be restricted or constrained by the terms of any contact into which [the charity] has entered into in reliance upon the Scheme ordered by the Commission, which is the subject of an appeal to the Tribunal.[78]

16.73 In response to the lessee's concerns, the Tribunal stated that it had taken account of its human rights but that "the proper application of charity law in determining this Appeal [is] a legitimate basis for interfering with the peaceful enjoyment of the property that is the subject of the cy-près scheme, to the extent that this is required".[79]

[74] (31 August 2012) First-tier Tribunal (GRC) (Charity).

[75] The original lease would have been inconsistent with the amended scheme because its terms "[created] an unnecessary risk of conflict with the objects of the Charity" since the lease would have permitted the school site to be used "for purposes other than the provision of a school that will benefit local residents": para 4.1 of the decision. The scheme was amended so that the terms of any lease would have to "permit and require such land to be occupied for use as a school that will further the object of the charity": para 6.5 of the decision; see also para 4.1.

[76] Para 2.5 of the decision.

[77] These comments were not, however, necessary to the decision and, in any event, a decision of the First-tier Tribunal does not set any binding precedent. There was no appeal to the Upper Tribunal.

[78] Para 2.3 of the decision.

[79] Para 2.5 of the decision.

16.74 In our view, however, the original lease would not necessarily have been invalid by reason of the Charity Tribunal's decision. This issue has arisen in the context of judicial review. There is a debate as to the effect of actions taken (whether by a public authority or an individual) in reliance on another act that is subsequently successfully challenged.[80] In *R (Boddington) v British Transport Police*,[81] Lord Browne-Wilkinson said:

> The Lord Chancellor attaches importance to the consideration that an invalid byelaw is and always has been a nullity. The byelaw will necessarily have been found to be *ultra vires*; therefore it is said it is a nullity having no legal effect. I adhere to my view that the juristic basis of judicial review is the doctrine of *ultra vires*. But I am far from satisfied that an *ultra vires* act is incapable of having any legal consequence during the period between the doing of that act and the recognition of its invalidity by the court. During that period people will have regulated their lives on the basis that the act is valid. The subsequent recognition of its invalidity cannot rewrite history as to all the other matters done in the meantime in reliance on its validity. The status of an unlawful act during the period before it is quashed is a matter of great contention and of great difficulty. … I prefer to express no view at this stage on those difficult points.

16.75 There is an added complication in the case of transactions involving charity land. Third parties who purchase land from, or enter into certain leases with, charities are protected by provisions in the Charities Act 2011 which deem the trustees to have adequate power to enter into the transaction.[82] If a Charity Tribunal decision quashes a scheme which a charity has already relied upon to dispose of land, the disposal may be saved by these statutory provisions, even if it would otherwise be void by reason of the quashing of the scheme.

16.76 There is therefore uncertainty as to whether the original lease in *Aliss* would have had any effect following the Charity Tribunal's decision.

16.77 In the light of that uncertainty, in principle it would be helpful for the Charity Tribunal to have a power to suspend the effect of a Charity Commission decision pending the resolution of a challenge. If such a power is available to the Tribunal then arguments about the validity of actions taken in reliance on the decision could be avoided; the issue would not arise if the decision has been suspended and therefore no action has been taken in reliance on it. We turn to consider whether such a power would be workable in practice.

Suspending a Charity Commission decision pending the outcome of a challenge

16.78 Whether a Charity Commission decision is challenged in the Tribunal or in the courts, there are two separate problems.

[80] See H Woolf, J Jowell, A Le Sueur, C Donnelly, I Hare, *De Smith's Judicial Review* (7th ed 2013) paras 4-054 to 4-068.

[81] [1999] 2 AC 143, 164. See also *R (Shoesmith) v Ofsted* [2011] EWCA Civ 642, [2011] PTSR 1459.

[82] We discuss this in detail in ch 8 above.

(1) The complainant will want to prevent the charity or the Charity Commission from taking any action in reliance on the decision, pending a challenge to that decision ("the first problem").

(2) Even if such action can be prevented, the horse might already have bolted; swift-footed charities could still take action in reliance on a decision before a complainant can prevent it ("the second problem").

16.79 Both difficulties are clear from *Aliss.* Not only did the Tribunal have no power to prevent the charity from taking action in reliance on the Charity Commission's decision, but by the time the decision had been made the lease had already taken effect.

16.80 When a challenge is made to the court, the first problem does not arise. A complainant can apply to the court for an interim injunction restraining the proposed action. When a challenge is made in the Tribunal, the Tribunal cannot restrain the proposed action, but a complainant can instead apply to the court for an interim injunction. Accordingly, there is a partial solution to the first problem. We accept, however, that where the challenge is to be heard by the Tribunal, it would be helpful for the Tribunal to be able to grant relief that has the same effect as an interim injunction obtained from the court. That could be achieved in one of two ways.

(1) The Tribunal could be given a similar power as the court to award interim injunctions. This would align challenges in court with challenges in the Tribunal. But such a step would be out of kilter with the Tribunal's general powers, which do not include a power to award injunctions in other circumstances. It would seem illogical to confer on the Charity Tribunal a power to grant injunctions in this situation, when no such power would exist in respect of other claims before the First-tier Tribunal generally. Moreover, it would be necessary to create a mechanism within the Charity Tribunal (or by transferring proceedings to the court) for such injunctions to be enforced.

(2) The Tribunal could be given a power to suspend the effect of a decision, pending the challenge.[83] This would also have wide-ranging consequences. An injunction under (1) would prohibit a charity from taking any action in reliance on the decision. If that named charity took the prohibited action, it could be punished for contempt of court, but the action itself would be valid. An innocent third party dealing with the charity is therefore protected. Suspension of a decision under (2) would render any action taken in reliance on it void. That could have serious consequences for third parties transacting with charities. The problem could be lessened by the creation of a public register of decisions that are currently in suspense, but that would involve a call on the public purse and might make third parties reluctant to transact with charities at

[83] We note that decisions of some other public bodies are automatically suspended during the period in which a challenge can be made to the First-tier Tribunal (GRC) (or the Tribunal has the power to suspend a decision pending such a challenge): see s 145 of the Gambling Act 2005 and s 87 of the Immigration and Asylum Act 1999.

all. And expecting third parties to check such a register before transacting with charities seems excessive.

16.81 The second problem is even harder to solve. And, unlike the first problem, it is not unique to the Tribunal; the problem arises whether the challenge is made in the court or the Tribunal. Any solution, therefore, should not be limited to decisions that are challenged in the Tribunal; it should extend to any challenge to a decision, whether it is made to the Tribunal under Schedule 6 or to the court.

16.82 The only solution we see to the second problem would be for statute to provide that no challengeable decision of the Charity Commission (whether or not it falls within Schedule 6) is to be of any effect for a certain period of time after it is made.[84] That would allow an application to be made in that period to prevent action from being taken in reliance on the decision.

16.83 As well as being complicated and controversial, this would have wide-ranging consequences. Transactions that depend on Charity Commission decisions to proceed would inevitably be delayed. As well as being inconvenient, this could be damaging to charities when transactions are time-critical. Suspending all Charity Commission decisions would seem to be a disproportionate response to a relatively infrequent problem. Moreover, providing potential complainants with a window within which to make a challenge before a decision takes effect would be of limited assistance if they do not become aware of the decision within that period. Unless the Charity Commission is required to publish every decision it makes – which would be a substantial undertaking – automatic suspension of decisions might be of no assistance to complainants.

16.84 We have therefore concluded that the disadvantages that would arise from any attempt to solve the second problem far outweigh the advantages. And if the second problem is not going to be solved, there seems little point in attempting to solve the first problem because swift-footed charities will be able to take action before a challenge is made. Conferring a power on the Tribunal to award interim injunctions, or to suspend the effect of a Charity Commission decision, might only result in Pyrrhic victories for complainants. Added to that are the difficulties with solving the first problem set out in paragraph 16.80 above, and the fact that the option of applying to court for an interim injunction – whilst not ideal – is available to complainants.

16.85 Our provisional view is that the problem that arises in rare cases such as *Aliss* cannot be solved without creating significant difficulties in the majority of cases where Charity Commission decisions are not challenged, but we welcome consultees' views as to whether a solution is possible.

16.86 **We invite the views of consultees as to whether, in light of the associated difficulties:**

(1) **the Charity Tribunal should have the power to suspend the effect of a Charity Commission decision pending challenge (or to award an**

[84] This could be subject to a power for the Charity Tribunal or court to abridge time and allow the decision to take effect immediately.

interim injunction to prevent named persons from taking action in reliance on it); and

(2) **all decisions of the Charity Commission should take effect only after a certain period of time.**

REFERENCES TO THE CHARITY TRIBUNAL

Procedure for references by the Charity Commission to the Charity Tribunal

16.87 As explained in Figure 13 above, the Charity Tribunal has jurisdiction to hear references on questions of charity law from the Attorney General and from the Charity Commission. The Attorney General can make references of his own volition, but references by the Charity Commission can only be made with the consent of the Attorney General.

16.88 Lord Hodgson queried this requirement during the passage of the Charities Act 2006 through Parliament.[85] Lord Bassam responded that the requirement for the Attorney General's consent:

> is simply because it has the effect of reducing the costs. The purpose is to ensure that the Attorney [General] and the [Charity] Commission do not simply duplicate work and that the Commission does not inadvertently act without the Attorney's knowledge. It is simply to ensure that there is a common understanding behind the approach that is being adopted.[86]

16.89 In his review of the Charities Act 2006, Lord Hodgson noted respondents' views that this "[presented] a barrier to the Commission's ability to contribute constructively to the development of the law against which it is required to regulate. It is also true to say that the Commission has a great deal more daily interaction with charity law than the Attorney General's Office, and so is likely to become more quickly seized of issues". He concluded that the Charity Commission should have the power to make references without the Attorney General's consent, provided notification is given to the Attorney and that the Attorney retains the power to be joined as a party to the proceedings.[87]

16.90 We can see force in the argument that it is unnecessary for the Attorney General to have a power to prevent the Commission from seeking clarification from the Tribunal on issues that arise during the course of the Commission's work. In so far as the requirement prevents duplication of work, we agree with Lord Hodgson that that can equally be prevented by requiring the Charity Commission to notify the Attorney General of its intention to make a reference, and similarly by requiring the Attorney General to notify the Charity Commission of his intention to make a reference to the Tribunal.

16.91 The requirement to obtain consent, however, perhaps goes further than simply avoiding the duplication of work. For example, it ensures that the Tribunal is not

[85] *Hansard* (HL), 12 October 2005, vol 674, col 345, available at http://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo051012/text/51012-18.htm.

[86] *Hansard* (HL), 12 October 2005, vol 674, col 346.

presented with two related, but different, references. In the Independent Schools reference, the Attorney General and Charity Commission did not agree on the form of questions to be put to the Tribunal, and the Attorney General's power effectively allowed him to decide on the questions to be put to the Tribunal.[88] If the Attorney General's power were removed, the Tribunal may be faced with two different references raising similar points. But that is not an insurmountable problem; the Tribunal would be able to make directions that the two references be heard together, and could answer the questions in both references in the same judgment.

16.92 We have discussed this issue with officials from the Attorney General's Office. They are not yet persuaded that there is a problem, or that changing the position would be in the public interest; the Attorney General's Office and the Charity Commission discuss, and seek to agree, references that are to be made to the Tribunal, and this practice would continue even if the consent requirement were removed.

16.93 **We invite the views of consultees as to whether the Attorney General's consent should continue to be required before the Charity Commission can make a reference to the Charity Tribunal.**

The powers exercisable by the Charity Tribunal when considering references

16.94 The Charities Act 2011 provides that "questions" may be referred to the Charity Tribunal which involve either the operation of charity law in any respect or its application to a particular state of affairs.[89] The Act does not confer powers on the Tribunal to award particular remedies on determining a reference, such as an order quashing a decision of the Charity Commission or an award of damages. Rather, the Act refers to "determining" or "deciding" references.[90]

16.95 Lord Hodgson criticised the absence of express powers for the Charity Tribunal to award remedies on references.

> There are no specific statutory provisions as to the "remedy" available in Reference proceedings, or any description of the powers exercisable by the Tribunal on determining a Reference. … In the first Reference, the Tribunal relied on the parallel judicial review proceedings which had been transferred to it to make an order confirming the outcome; clarity over the remedies available would resolve the uncertainty.[91]

87 Hodgson Report, para 7.30 and p 86, recommendation 8.

88 *R (Independent Schools Council) v The Charity Commission for England and Wales* [2010] EWHC 2604 (Admin), [5], by Sales J.

89 Charities Act 2011, s 325(1) and 326(1). References by the Charity Commission must also have "arisen in connection with the exercise by the Commission of any of its functions": s 325(1)(a).

90 Charities Act 2011, ss 315(2), 325(4)(b)(i), 326(3)(b)(i) and 327(3)(b).

91 Hodgson Report, Appendix A, para 9.

16.96 The reference to which Lord Hodgson refers was the independent schools litigation.[92] The Independent Schools Council sought permission to bring judicial review proceedings against the Charity Commission seeking an order quashing the Charity Commission's guidance on public benefit ("the JR Claim"). The papers filed in those proceedings were considered by the Attorney General, who decided to make a reference to the Charity Tribunal concerning the "public benefit test" for charitable status[93] in relation to independent schools ("the Reference").

16.97 The Charity Commission argued that, given the "very substantial overlap" between the two claims, permission to pursue the JR Claim should be refused. The Judge rejected that argument; he gave permission in the JR Claim and transferred the claim to the Upper Tribunal, with a view to the Reference being transferred by the First-tier Tribunal to the Upper Tribunal in order that both claims could be heard together. In arriving at that decision, the Judge made the following comments:

(1) It is not certain that the Tribunal's decision on the Reference would resolve all the issues between the Charity Commission and the Independent Schools Council in the JR Claim.[94]

(2) The two claims had been made by different parties – the Reference by the Attorney General, the JR Claim by the Independent Schools Council – and the parties to the JR Claim had concerns about the questions posed in the Reference.[95]

(3) The Tribunal's decision on the Reference would not have the effect of quashing the guidance.[96] The JR Claim "offers to the Tribunal the potential for focusing upon a concrete form of relief which may crystallise the debate on the law in a manner different from the focus offered by the [Reference]…".[97] Further, "if the Commission's guidance is unlawful it should be quashed", and that "is relief which can only be granted … if the [JR Claim] proceeds".[98]

16.98 The Judge's comments have been used as the basis for criticism of the lack of remedies available to the Charity Tribunal in references.[99] We respectfully disagree with that criticism. The reference procedure allows "questions" to be put to the Charity Tribunal. The answer to those questions will assist the Charity Commission in the exercise of its functions; indeed, the Commission is required

[92] *R (Independent Schools Council) v The Charity Commission for England and Wales* [2010] EWHC 2604 (Admin); *Independent Schools Council v Charity Commission for England and Wales* [2011] UKUT 421 (TCC).

[93] Then in s 3 of the Charities Act 2006, now in s 4 of the Charities Act 2011.

[94] [2010] EWHC 2604 (Admin), [20] to [22].

[95] [2010] EWHC 2604 (Admin), [23].

[96] [2010] EWHC 2604 (Admin), [20] to [21].

[97] [2010] EWHC 2604 (Admin), [24].

[98] [2010] EWHC 2604 (Admin), [25].

[99] See also A McKenna, "Should the Charity Tribunal be reformed?" (2011) 14(1) *Charity Law and Practice Review* 1.

to act in accordance with the Tribunal's decision on the reference in respect of the particular state of affairs to which it relates.[100] But we see no need for the Tribunal to award remedies. Remedies should become available if the Charity Commission acts in such a way that is inconsistent with the Tribunal's decision in a reference; before that point, it would be premature for the Charity Tribunal to award remedies.

16.99 In the independent schools litigation, the Judge allowed the JR Claim to proceed because, without it, the Tribunal would have had no power to quash the Charity Commission's guidance in the Reference. That does not, in our view, reflect a deficiency in the Tribunal's powers in reference proceedings; rather, it reflects the fact that the JR Claim and the Reference were different claims. They raised overlapping issues but, fundamentally, the relief claimed in each was very different. In the JR Claim, the Independent Schools Council wanted the Charity Commission's guidance to be quashed; in the Reference, the Attorney General sought guidance on the charitable status of independent schools. It is entirely unsurprising that the powers of the Tribunal in determining the Reference would have been inadequate to deal with the different JR Claim. The sensible solution was for both claims to proceed together.

16.100 We accept that conferring powers on the Tribunal to award certain remedies in reference proceedings might be welcomed by charities in order to deal with the consequences of a reference quickly and with certainty. But we do not think that the reference jurisdiction should extend this far. We are also mindful of the fact that the power to make references is intended to stimulate the evolution of charity law and that, to achieve that purpose, references should be encouraged. But if the Tribunal is to be given powers to award remedies against the Charity Commission in references, it is unlikely to encourage the Charity Commission to make references in the first instance.

16.101 We consider that the Charity Tribunal had adequate powers to deal with the two references that have been made since the jurisdiction was established. Our provisional view is that the ability of the Charity Tribunal to determine references is satisfactory, but we welcome consultees' views.

16.102 **We invite the views of consultees as to whether the Charity Tribunal should have the power to award remedies in reference proceedings and, if so, which.**

[100] Charities Act 2011, s 327(3).

PART 8

CONCLUSIONS

CHAPTER 17
PROVISIONAL PROPOSALS AND CONSULTATION QUESTIONS

CHANGING PURPOSES, AMENDING GOVERNING DOCUMENTS AND APPLYING PROPERTY CY-PRÈS

Charities incorporated by statute or by Royal Charter: changing purposes and amending governing documents

17.1 We provisionally propose that, subject to paragraphs 17.2 and 17.3 below, the Royal Charter and bye-laws of Royal Charter charities should be deemed by statute to include a power for any provision of the Royal Charter or bye-laws to be amended, subject to any amendment being approved by the Privy Council.

Do consultees agree?

[Paragraph 4.30]

17.2 We provisionally propose that the power of amendment should be exercisable:

(1) by a resolution of at least two-thirds of the trustees who vote on the resolution; and

(2) if the charity has a separate body of members, by a further resolution of at least two-thirds of the members who vote on the resolution at a general meeting.

Do consultees agree?

[Paragraph 4.31]

17.3 We provisionally propose that the power of amendment should not apply to a charity's Royal Charter or bye-laws if those documents already make express provision for their amendment.

Do consultees agree?

[Paragraph 4.32]

17.4 We invite the views of consultees as to whether Royal Charter charities would find it helpful for the Privy Council and Charity Commission to issue guidance concerning the types of provision that they consider to be appropriate for the Royal Charter, bye-laws and regulations, to form a basis for Royal Charter charities to seek amendments to their governing documents.

[Paragraph 4.37]

17.5 We provisionally propose that charities established or governed by statute or Royal Charter should have a statutory power to make minor amendments to their governing documents.

Do consultees agree?

[Paragraph 4.54]

17.6 We invite the views of consultees as to the types of amendment that should fall within, and outside, the amendment power.

[Paragraph 4.55]

17.7 We invite the views of consultees as to whether the Secretary of State should have power to alter any list of permitted amendments by secondary legislation.

[Paragraph 4.56]

17.8 We provisionally propose that the power to make minor amendments to statutory and Royal Charter charities' governing documents should be exercisable by the trustees of the charity rather than by the Charity Commission.

Do consultees agree?

[Paragraph 4.59]

17.9 We provisionally propose that the power should be exercisable by a resolution of the trustees and, if the charity has a separate body of members, by a further resolution of at least two-thirds of the members who vote on the resolution at a general meeting.

Do consultees agree?

[Paragraph 4.66]

17.10 We provisionally propose that the power should apply to provisions in a charity's governing document, whether those provisions are contained in a statute, regulations made pursuant to a statute, a Royal Charter, or bye-laws or regulations made pursuant to a Royal Charter.

Do consultees agree?

[Paragraph 4.67]

17.11 We provisionally propose that amendments should take effect once the necessary resolutions have been passed.

Do consultees agree?

[Paragraph 4.68]

17.12 We invite the views of consultees as to whether charities that exercise the power should be required to notify the Privy Council or lay the amendments in Parliament (as the case may be).

[Paragraph 4.69]

17.13 We invite the views of consultees as to whether the power of amendment (see paragraph 17.5 above) should operate (a) alongside, or (b) instead of, guidance from the Privy Council concerning the reallocation of provisions in governing documents (see paragraph 17.4 above).

[Paragraph 4.72]

17.14 We invite the views of consultees as to whether, and if so how, the involvement of the Charity Commission in making amendments to statutory and Royal Charter charities' governing documents should be increased or reduced.

[Paragraph 4.88]

17.15 We provisionally propose that all section 73 schemes should be subject to the negative procedure, regardless of whether the governing document is contained in a private Act or a public general Act.

Do consultees agree?

[Paragraph 4.89]

17.16 We provisionally propose that the Privy Council Office amend its guidance to make clear that amendments to bye-laws only require approval when that is expressly required by the Royal Charter itself.

Do consultees agree?

[Paragraph 4.90]

17.17 We invite the views of consultees as to whether it would be helpful for the Office for Civil Society and Charity Commission to issue joint guidance in respect of the amendment of statutory charities' governing documents, and for the Privy Council and Charity Commission to issue joint guidance in respect of the amendment of Royal Charter charities' governing documents.

[Paragraph 4.91]

17.18 We invite the views of consultees as to whether any further amendments could be made to the existing procedures for amending the governing documents of statutory and Royal Charter charities.

[Paragraph 4.92]

17.19 We provisionally propose that the new power of amendment should not apply to the governing documents of Parochial Church Councils.

Do consultees agree?

[Paragraph 4.97]

17.20 We invite the views of consultees as to:

(1) whether the new amendment power should apply to higher education institutions without modification;

(2) whether the new amendment power should apply to higher education institutions in accordance with regulations made by the Secretary of State and Welsh Ministers setting out the provisions that can be amended without Privy Council oversight;

(3) whether, and if so how, the 2006 list for universities should be revised;

(4) whether, and if so how, that approach should be extended to higher education corporations;

(5) whether, and if so how, the amendment procedure for higher education corporations under the Education Reform Act 1988 could be improved; and

(6) whether, and if so how, the amendment procedures for the universities and colleges set out in Figure 7 could be improved.

[Paragraph 4.110]

17.21 We invite the views of consultees as to whether there are any other categories of charities established by statute or Royal Charter for which special provision should be made when creating any new amendment power.

[Paragraph 4.112]

17.22 We invite consultees to share with us their experiences of amending statutory or Royal Charter charities' governing documents, in particular the work, time and expense that have been involved.

[Paragraph 4.114]

Other charities: changing purposes and cy-près schemes

17.23 We invite the views of consultees as to whether, and if so how, the powers to amend charities' purposes (and other provisions in their governing documents) should be aligned between incorporated and unincorporated charities established in the future.

[Paragraph 5.19]

17.24 We provisionally propose that the power of unincorporated charities to amend their purposes under section 275 of the Charities Act 2011 should be extended to charities with a larger income.

Do consultees agree?

[Paragraph 5.32]

17.25 We invite the views of consultees as to the appropriate income threshold.

[Paragraph 5.33]

17.26 We provisionally propose that the power of unincorporated charities to amend their purposes under section 275 should be extended to charities that hold designated land.

Do consultees agree?

[Paragraph 5.34]

17.27 We invite the views of consultees as to whether trustees should continue to be required to notify the Charity Commission of a section 275 resolution and whether the Charity Commission should retain its power to object to the resolution.

[Paragraph 5.35]

17.28 We invite the views of consultees as to whether the power of unincorporated charities to amend their purposes under section 275 should be subject to a requirement that the members of the charity (if any) agree to the trustees' resolution.

[Paragraph 5.36]

17.29 We invite the views of consultees as to whether trustees should be given the power to make cy-près schemes in light of the availability of the section 275 power and the loss of Charity Commission oversight that would be involved.

[Paragraph 5.37]

17.30 We invite consultees to share with us their experiences of changing charities' purposes under section 275 of the Charities Act 2011 and under cy-près schemes, in particular the work, time and expense that have been involved.

[Paragraph 5.39]

Other charities: amending governing documents

17.31 We invite the views of consultees as to whether the power to make administrative amendments to unincorporated charities' governing documents under section 280 of the Charities Act 2011 is helpful and whether its scope is sufficiently clear.

[Paragraph 6.15]

17.32 We invite the views of consultees as to the types of provision that should be included within, or excluded from, the section 280 amendment power.

[Paragraph 6.16]

17.33 We invite consultees to share with us their experiences of amending administrative provisions under section 280 of the Charities Act 2011, in particular the work, time and expense that have been involved.

[Paragraph 6.18]

Cy-près schemes and the proceeds of fundraising appeals

17.34 We invite the views of consultees as to whether the requirement for a general charitable intention, as a precondition for a cy-près scheme in respect of the proceeds of a failed appeal, should be removed:

(1) generally; or

(2) in respect of small funds or small donations and, if so, what size of fund or donation.

[Paragraph 7.38]

17.35 We invite the views of consultees as to whether the procedures governing the distribution of the proceeds of failed appeals under sections 63 to 66 of the Charities Act 2011 could be improved, and in particular whether:

(1) the advertisement and inquiry procedure could be simplified; and

(2) the disclaimer and declaration procedures remain of use.

[Paragraph 7.44]

17.36 We invite the view of consultees as to whether trustees should be given the power – in place of the Charity Commission – to apply small funds or small donations (from a failed appeal or a surplus case) cy-près, and the size of fund or donation for which the power should be available.

[Paragraph 7.49]

17.37 We invite the views of consultees as to whether trustees should be given any broader power – in place of the Charity Commission – to apply funds (from a failed appeal or a surplus case) cy-près.

[Paragraph 7.50]

17.38 We invite consultees to share with us their experiences of administering the proceeds of failed fundraising appeals, including the procedures under sections 63 to 66 of the Charities Act 2011, in particular the work, time and expense that have been involved.

[Paragraph 7.52]

REGULATING CHARITY LAND TRANSACTIONS AND THE USE OF PERMANENT ENDOWMENT

Acquisitions, disposals and mortgages of charity land

17.39 We provisionally propose that the provisions of Part 7 of the Charities Act 2011 relating to dispositions to connected persons be repealed.

Do consultees agree?

[Paragraph 8.68]

17.40 If, contrary to our proposal in paragraph 17.39 above, the provisions concerning connected persons are retained, we provisionally propose that the definition of "connected person" should exclude:

(1) a charity's wholly-owned subsidiary company; and

(2) a trustee for a charity who is not also a "charity trustee", as defined by the Charities Act 2011.

Do consultees agree?

[Paragraph 8.70]

17.41 We provisionally propose that:

(1) the general prohibition on trustees disposing of charity land should be removed; and

(2) in its place should be a duty on trustees, before disposing of charity land, to obtain and consider advice in respect of the disposition from a person who they reasonably believe has the ability and experience to provide them with advice in respect of the disposal; but

(3) the duty to obtain advice should not apply if the trustees reasonably believe that it is unnecessary to do so.

Do consultees agree?

[Paragraph 8.85]

17.42 We provisionally propose that the requirements in section 121 of the Charities Act 2011 concerning advertising proposed disposals of designated land and considering any responses received should be abolished.

Do consultees agree?

[Paragraph 8.89]

17.43 We invite the views of consultees as to whether the advice requirements that we propose governing dispositions by non-exempt charities should be extended to dispositions by exempt charities.

[Paragraph 8.91]

17.44 We invite the views of consultees as to whether the new advice requirements that apply to disposals of charity land should also apply to the acquisition of land by charities.

[Paragraph 8.95]

17.45 We provisionally propose that if the Part 7 requirements are not amended, or are replaced with other requirements non-compliance with which will render the transaction void, then a purchaser should be protected by a certificate, deemed conclusively to be correct, in the contract that the statutory requirements have been complied with.

Do consultees agree?

[Paragraph 8.109]

17.46 We provisionally propose that the advice requirements under the new regime should apply even if the transaction must be authorised by the Secretary of State under the Universities and College Estates Act 1925.

Do consultees agree?

[Paragraph 8.123]

17.47 We invite the views of consultees as to whether the Universities and College Estates Act 1925 should be repealed and the institutions to which it applies given the general powers of an owner similarly to trustees under the Trusts of Land and Appointment of Trustees Act 1996 and the Trustee Act 2000.

[Paragraph 8.125]

17.48 We invite consultees to share with us their experiences, including any delays and costs incurred, in seeking to comply with Part 7 of the Charities Act 2011 when disposing of or granting mortgages over charity land.

[Paragraph 8.127]

Permanent endowment

17.49 We provisionally propose that the parallel regime for "special trusts" in sections 288 and 289 of the Charities Act 2011 be repealed.

Do consultees agree?

[Paragraph 9.51]

17.50 We provisionally propose that sections 281 and 282 of the Charities Act 2011 be amended to make it clear that they apply to permanent endowment held by an incorporated charity.

Do consultees agree?

[Paragraph 9.57]

17.51 We invite the views of consultees as to whether the financial thresholds in sections 281 and 282 should be increased, to what level, and why.

[Paragraph 9.60]

17.52 We invite the views of consultees as to whether the time limit in section 284 of the Charities Act 2011 for the Charity Commission to consider a resolution passed under section 282 should be reduced to 60 days.

[Paragraph 9.63]

17.53 We invite the views of consultees as to whether the current regime in sections 281 and 282 of the Charities Act 2011 is otherwise satisfactory.

[Paragraph 9.66]

17.54 We invite consultees to share with us their experience of releasing the restrictions on the expenditure of permanent endowment, including the procedures under sections 281 and 282 and sections 288 and 289 of the Charities Act 2011, in particular the time and costs involved.

[Paragraph 9.68]

17.55 We invite the views of consultees as to whether a new regime should be devised that permits charities to use permanent endowment more flexibly whilst seeking to maintain its real value in the long term. We also invite consultees to comment on how such a scheme might operate.

[Paragraph 9.80]

17.56 We invite the views of consultees as to whether, and if so how, such a new regime would be likely to increase or decrease the costs incurred by charities in administering permanent endowment.

[Paragraph 9.82]

PAYMENTS TO CHARITY TRUSTEES AND OTHER NON-BENEFICIARIES

Remuneration for the supply of goods and the power to award equitable allowances

17.57 We provisionally propose the introduction of a new statutory mechanism for the authorisation of remuneration of trustees for the supply of goods that mirrors section 185 of the Charities Act 2011.

Do consultees agree?

[Paragraph 10.47]

17.58 We invite consultees to share with us their experiences of considering whether to authorise, and subsequently authorising, the remuneration of trustees for the supply of services and for the supply of goods to a charity, in particular the work, time and expense that have been involved.

[Paragraph 10.49]

17.59 We provisionally propose that the Charity Commission should have a statutory power to relieve a trustee, in whole or in part, from liability to account for a profit (of any size) made in breach of fiduciary duty.

Do consultees agree?

[Paragraph 10.59]

17.60 We invite the views of consultees as to whether the criteria that apply to the exercise of the power:

(1) should be the same as the criteria applied by the court when considering whether to award an equitable allowance; or

(2) should be the same as the criteria that apply to the exercise of the power in section 191 of the Charities Act 2011, namely whether the trustee has acted honestly and reasonably and ought fairly to be relieved from liability.

[Paragraph 10.60]

17.61 We invite consultees to share with us their experiences of seeking to authorise an equitable allowance for a trustee, in particular the work, time and expense that have been involved.

[Paragraph 10.62]

Ex gratia payments out of charity funds

17.62 We provisionally propose that a new statutory power be introduced allowing trustees to make small ex gratia payments without having to obtain the prior authorisation of the Charity Commission, the Attorney General or the court.

Do consultees agree?

[Paragraph 11.40]

17.63 We invite the views of consultees as to the appropriate financial threshold for the exercise of such a new statutory power.

[Paragraph 11.41]

17.64 We provisionally propose that the Minister be given a power to vary the financial threshold by secondary legislation.

Do consultees agree?

[Paragraph 11.42]

17.65 We provisionally propose that such a statutory power should be capable of being excluded or limited by a charity's governing document.

Do consultees agree?

[Paragraph 11.43]

17.66 We invite the views of consultees:

(1) as to whether the trustees of a charity should be capable of delegating the taking of a decision to make an ex gratia payment (whether under any new statutory regime for the making of payments without Charity Commission authorisation, or under section 106 of the Charities Act 2011) to another officer of the charity;

(2) as to whom the taking of the decision should be delegated; and

(3) as to whether such a power should be limited to payments of a certain value and, if so, what that value should be.

[Paragraph 11.48]

17.67 We provisionally propose that the Attorney General, the court and the Charity Commission should have the power to authorise ex gratia payments by statutory charities.

Do consultees agree?

[Paragraph 11.50]

17.68 We provisionally propose that the new statutory power for charity trustees to make small ex gratia payments (under paragraph 17.62 above) should be available to the trustees of statutory charities.

Do consultees agree?

[Paragraph 11.51]

17.69 We invite consultees to share with us their experiences of considering whether to make, and seeking authorisation to make, ex gratia payments, in particular the work, time and expense that have been involved.

[Paragraph 11.53]

INCORPORATION, MERGER AND INSOLVENCY

Charity incorporations and mergers

17.70 We invite the views of consultees as to whether, and if so how, the power for unincorporated charities to transfer their assets to another charity under section 268 of the Charities Act 2011 should be expanded.

[Paragraph 12.50]

17.71 We provisionally propose that the condition for the exercise of the power under section 268 of the Charities Act 2011 requiring similarity of purpose between the transferor and transferee charity should be the same in respect of both unrestricted funds and permanent endowment.

Do consultees agree?

[Paragraph 12.54]

17.72 We invite consultees to share with us their experiences of using the section 268 power, including in respect of permanent endowment, in particular the work, time and costs that have been involved.

[Paragraph 12.56]

17.73 We invite consultees to share with us their experiences of using vesting declarations under section 310 of the Charities Act 2011, including any difficulties that they have encountered and whether they consider the power to be satisfactory.

[Paragraph 12.67]

17.74 We provisionally propose that the exception in section 310(3)(b), in respect of leases containing qualified covenants against assignment, be removed.

Do consultees agree?

[Paragraph 12.68]

17.75 We invite the views of consultees as to whether the section 310 power and its exceptions are otherwise satisfactory.

[Paragraph 12.69]

17.76 If, contrary to our provisional proposal in paragraph 17.74 above, consultees do not agree that section 310 vesting declarations should apply to leases containing qualified covenants against assignment, we invite the views of consultees as to whether section 310 vesting declarations should apply to leases containing absolute covenants against assignment.

[Paragraph 12.70]

17.77 We provisionally propose that vesting declarations under section 310 should apply to a charity's permanent endowment in the same way that they apply to a charity's unrestricted funds.

Do consultees agree?

[Paragraph 12.76]

17.78 We provisionally propose that, when a charity has merged and the merger is registered, for the purposes of ascertaining whether a gift has been made to that charity under section 311(2) of the Charities Act 2011, the charity should be deemed to have continued to exist despite the merger.

Do consultees agree?

[Paragraph 12.92]

17.79 We invite consultees to share with us their experiences of retaining shell charities as a result of the potential limitations on the scope of section 311, as well as the work, time and costs involved in retaining such shell charities.

[Paragraph 12.94]

Charitable trusts in insolvency

17.80 We provisionally propose that the guidance of the Charity Commission in CC12 should be revised so as to make it clear that the availability of trust property, including trust property that falls within the statutory definition of permanent endowment or a special trust (or both), to meet the liabilities of an insolvent trustee is no different whether the trustee is an individual or a charitable company.

Do consultees agree?

[Paragraph 13.74]

17.81 We provisionally propose that the guidance of the Charity Commission in CC12 should be revised to reflect more fully and accurately the law governing the exercise of trustees' rights of indemnity from trust property for the benefit of the creditors of the trustee, in particular in respect of permanent endowment and special trusts.

Do consultees agree?

[Paragraph 13.75]

17.82 We invite the views of consultees as to whether the law relating to the availability of permanent endowment and special trusts to the creditors of an insolvent trustee is satisfactory and, if not, how it could be improved.

[Paragraph 13.76]

CHARITY COMMISSION POWERS

Charity names

17.83 We provisionally propose that section 42(2)(a) of the Charities Act 2011 be amended to remove the reference to the charity being registered.

Do consultees agree?

[Paragraph 14.37]

17.84 We invite the views of consultees as to whether the Charity Commission's power under section 42 of the Charities Act 2011 to issue a direction requiring a charity to change its name should be extended to all exempt charities.

[Paragraph 14.39]

17.85 We provisionally propose that the Charity Commission be given a power to refuse an application by an institution for registration as a charity, and to refuse the registration of a change of name, if any of the criteria in section 42(2) of the Charities Act 2011 apply in respect of the name of the institution.

Do consultees agree?

[Paragraph 14.43]

17.86 We provisionally propose that the Charity Commission be given a power to stay an application by an institution for registration as a charity, and to stay the registration of a change of name, pending an inquiry into the compliance of the name of the institution with the criteria in section 42(2) of the Charities Act 2011.

Do consultees agree?

[Paragraph 14.44]

Determining the identity of a charity's trustees

17.87 We provisionally propose that the Charity Commission be given the power to determine the trustees of a charity, either (1) on the application of the charity or any person claiming to be a trustee of the charity, or (2) following the institution of an inquiry into the charity under section 46 of the Charities Act 2011.

Do consultees agree?

[Paragraph 15.7]

THE CHARITY TRIBUNAL AND THE COURTS

The Charity Tribunal and the courts

17.88 We provisionally propose that, when applications within (or in contemplation of) proceedings against the Charity Commission fall within the definition of "charity proceedings" under section 115 of the Charities Act 2011, the charity should be permitted to obtain authorisation to pursue that application either from the court or the Charity Commission.

Do consultees agree?

[Paragraph 16.32]

17.89 We invite the views of consultees as to the differing costs of seeking authorisation to pursue charity proceedings under section 115 of the Charities Act 2011 from (a) the Charity Commission and (b) the court.

[Paragraph 16.34]

17.90 We invite the views of consultees as to whether charities should be required to obtain authorisation from the Charity Tribunal or the Charity Commission before commencing proceedings in the Tribunal.

[Paragraph 16.39]

17.91 We invite the views of consultees as to the likely costs of having to obtain authorisation from the Charity Tribunal before pursuing proceedings in the Tribunal.

[Paragraph 16.41]

17.92 We provisionally propose that the Charity Tribunal should be given the power to make *Beddoe* orders in respect of proceedings before it.

Do consultees agree?

[Paragraph 16.54]

17.93 We invite the views of consultees as to whether the Attorney General should always be a party to applications for a *Beddoe* order.

[Paragraph 16.55]

17.94 We invite the views of consultees as to the differing costs of seeking *Beddoe* protection from (a) the Charity Commission, (b) the court, and (c) the Charity Tribunal.

[Paragraph 16.64]

17.95 We invite the views of consultees as to whether, in light of the associated difficulties:

(1) the Charity Tribunal should have the power to suspend the effect of a Charity Commission decision pending challenge (or to award an interim injunction to prevent named persons from taking action in reliance on it); and

(2) all decisions of the Charity Commission should take effect only after a certain period of time.

[Paragraph 16.86]

17.96 We invite the views of consultees as to whether the Attorney General's consent should continue to be required before the Charity Commission can make a reference to the Charity Tribunal.

[Paragraph 16.93]

17.97 We invite the views of consultees as to whether the Charity Tribunal should have the power to award remedies in reference proceedings and, if so, which.

[Paragraph 16.102]

APPENDIX A

APPENDIX A
CHARITY NAMES AND EXEMPT CHARITIES

CHARITY NAMES

A.1 In Chapter 14, we discussed the Charity Commission's power to direct a charity to change its name under section 42 of the Charities Act 2011. In paragraph 14.14 we said that section 42 applies to some, but not all, exempt charities. In this Appendix, we explain the basis for that statement.

The Charities Act 1993

A.2 The predecessor to section 42 of the Charities Act 2011 was section 6 of the Charities Act 1993.

A.3 Section 6(9) of the 1993 Act provided that "nothing in this section applies to exempt charities". Originally, therefore, the Charity Commission's power to direct a charity to change its name did not apply to exempt charities.

The Charities Act 2006

A.4 Section 6(9) of the 1993 Act was removed by paragraph 1 of Schedule 5 to the Charities Act 2006, but paragraph 1 of Schedule 5 was not commenced immediately in relation to all exempt charities. Instead, it was commenced in relation to certain exempt charities, called "specified exempt charities", by two Ministerial Orders.[1]

The Charities Act 2011

A.5 The Charities Act 2011 repealed section 6 of, and Schedule 5 to, the Charities Act 1993. Section 42 of the 2011 Act was drafted with no exception for exempt charities. But paragraph 10 of Schedule 9 to the 2011 Act provided that, in the case of an exempt charity to which paragraph 1 of Schedule 5 to the 2006 Act did not apply (namely, a charity that still enjoyed the exception in section 6(9) of the Charities Act 1993), section 42 would be read as excluding that charity from its scope until a commencement order was made.

A.6 Two further commencement orders have been made, extending the range of "specified exempt charities" to which section 42 applies.[2]

A.7 The current position, therefore, is that section 42 does not apply to any exempt charities that have not been the subject of any of the four commencement orders.

[1] Charities Act 2006 (Commencement No 7, Transitional and Transitory Provisions and Savings) Order 2010 (SI 2010 No 503) and Charities Act 2006 (Commencement No 8, Transitional Provisions and Savings) Order 2011 (SI 2011 No 1728).

[2] Charities Act 2011 (Commencement Order No 1) Order 2012 (SI 2012 No 3011) and Charities Act 2011 (Commencement Order No 2) Order 2013 (SI 2013 No 1775).