LIABILITIES OF CHARITY TRUSTEES

Jean Dollimore[1]

One of the early observations of the leader of the Trustee Services Development Unit set up by the NCVO and funded by the Home Office clearly sets out the problems which charity lawyers face in advising their trustee clients in the expanding and increasingly challenging charity world;

> "If the role of the trustee is to remain viable in a world of increasing legal and financial complexity, trustees must be clear about their role and responsibilities - they must be able to access appropriate training, know where they can obtain affordable advice, and know how to spot situations where the alarm bells should be ringing."

Increasing Awareness of Trustees' Position

A number of factors have highlighted the trustee's position and brought into sharp relief the full extent of an onerous task. There was a time when the voluntary sector was a sort of "add on" to the public sector, and charities were viewed as worthy work which people undertook in their spare time or retirement. The whole ethos of that has changed now, and the voluntary sector is becoming increasingly a part of modern life. The new Community Care provisions, and the contracts being entered into between Local Authorities and charities to provide essential services clearly illustrate this.

The Charities Act 1992, now consolidated in the 1993 Act, has been something of a chicken and egg factor in highlighting awareness of the charity trustee's position. There can be no denying that increasing public disquiet over the last few years with what was seen as "malpractice" by some charities led to the Woodfield Report, the White Paper, and subsequently the Bill and Act. The publication of the Act itself and its new stringent provisions has highlighted like nothing else could what it means to be a charity trustee.
Even the recession can be seen to have taken its part in making the responsibilities and liabilities of the charity trustee more apparent, since a time of recession will inevitably give rise to a situation where claims against trustees which might previously have gone unnoticed, or indeed never have arisen, will become apparent as creditors take up their legal rights.

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[1] Jean Dollimore MA (Oxon), Solicitor, Partner, Trowers & Hamlins, 6 New Square, Lincoln's Inn, London.
Tel: (071) 831 6292 Fax: (071) 831 8700

The publication of the joint NCVO/Charity Commission Report *On Trust* in September 1992 created a momentum of interest in trusteeship, and some of its results will be referred to later on.

What is a Charity Trustee?

The important thing to note from the definition contained within Section 97 Charities Act 1993 is that it is not the word "trustee" which confers the status of a trustee. Charity trustees are defined by Section 97 as "the persons having the general control and management of the administration of a charity". Section 96 of the 1993 Act defines "charity" as "any institution, corporate or not, which is established for charitable purposes and is subject to the control of the High Court in the exercise of the Court's jurisdiction with respect to charities".

Such a definition means, of course, that people who are called Members of a Board of Management, Directors, Committee Members, are still trustees, and subject to all the rigour of the law. The NCVO's research which lead to their Report *On Trust* revealed that two-thirds of trustees in England and Wales do not even know they are trustees, i.e., because the title they have does not contain the word. The Report went on to say that half to two-thirds of the country's one million trustees do not receive any information about the nature of their responsibilities and only one in eight gets any training at all.

Trustee Training

Following its horrifying discoveries, *On Trust* went on to make a number of recommendations as to how trustees might be assisted; the following were the main points. Charities should produce guidelines about what is expected of their trustees in terms of time, with proper job descriptions for honorary officers, and a general handbook should be produced in a form which can be adapted and added to by individual charities. Newly and recently appointed trustees should be given a basic briefing pack covering such matters as a list of the trustees, their responsibilities, a copy of the organisation's constitution, and the last Report and Accounts. This induction course should be augmented by targeted and tailored training, supported by funding organisations, including training days, training reviews and joint training of trustees and staff.

One of the recommendations of the *On Trust* Report was that the Charity Commission should produce a basic booklet explaining in clear and simple terms the trustee's role and responsibilities. This it has, of course, done, and the new booklet entitled *Responsibilities of Charity Trustees* is now sent out to all trustees on appointment.

Trustees' Responsibilities and Liabilities

It has been said that the law knows no higher duty than that of the trustee, and of course to be a trustee is to take on some of the most onerous obligations known to English law. First and foremost there are the general fiduciary duties, but beyond that there are the statutory provisions, not least of all those contained within the

Charities Act 1993. For those charities which are incorporated there may also be potential liabilities under company and insolvency law, and trustees must also consider their liability in contractual relationships.

General Fiduciary Duties

The Duty of Skill and Care

The most important fiduciary duty imposed on a charitable trustee is an obligation to carry out his duties with the skill and care which can be expected of a prudent man of business in the exercise of his personal business affairs; an objective standard. Being honest and sincere is not enough; what is required is to be diligent, businesslike and prudent. Some charities will have an outline set of specifications for new charities, just as they would for any job specification for a paid employee, but this is probably the exception rather than the rule.

In practical terms, the duty of skill and care requires a trustee to attend meetings, to become actively involved in the management of the charity and decision making process and, in particular, to consider the appropriateness of any proposed new activity. Most charities in practice have meetings three or four times a year; it is hard to know if this is enough. Few trustees realise that the law treats them as primarily responsible for all the charity's activities. If a trustee is in the somewhat unusual position of being paid for his work, then the standard of skill and care expected is higher and will take into account any specialist knowledge which he may have. If a trustee is a financial expert he will be expected to show a high level of financial acumen in dealing with the charity's property.

A trustee must take particular care that every proposed activity falls within the permitted objects of the charity. If he agrees to an activity which falls outside those objects, this is a misapplication of charitable funds for which he will be liable.

Some charities' activities have veered from a charitable cause to a political one, by advocating and campaigning for political change in the UK or abroad. Perhaps the most notable example recently is Oxfam's mock referendum on Cambodia and its booklet "Free Frontline Africa" outlining a potential sanctions policy. The Charity Commission's inquiry in both cases held that those were non-charitable political activities and, consequently, a misapplication of charity funds.

The duty to protect the charity property requires trustees always to act in a manner which maximises charitable assets. This can result in trustees being placed in a position where their perceived ethical or moral duty conflicts with their duty as trustee. An example of this is the trustee's duty to gazump if a higher offer for the purchase of any property is received, a principle clearly set out in *Buttle v Saunders* [1950] 2 AER 193.

The trustee's enthusiasm to maximise charitable assets should not, however, extend too far. For example, a loss of tax relief can result from efforts to boost income such as selling alcohol at a charitable event. Loss of tax relief is a breach of trust, and the trustee will be liable.

The Duty Not to Profit

Today many trustees have high profile jobs in industry or in the City. Each trustee needs to consider if he will obtain an advantage, perhaps through commission or profit share, if the charity with which he is involved makes particular investments or enters into particular kinds of contracts. If the trustee does make a profit, albeit indirectly, he must account to the charity for that profit. Trustees cannot, of course, be paid for their services, unless there is a specific provision in the constitution, which is unusual, but perhaps this is an area which the Charity Commission should consider further.

One area of profit which is often overlooked is where a charity has an associated or subsidiary company within its group structure or has the right to appoint directors to other organisations. Here, any director's fees will not belong to the trustee but to the charity itself.

Personal Interest not to Conflict

Not only can the trustee not receive any direct financial gain from his position as trustee, he must also avoid ever putting himself in a position where his personal interests and those of the charity conflict, or might possibly conflict.

The general fiduciary duties of charitable trustees are long established and sweeping, and failure to discharge these duties, and any misapplication of charity funds can result in very strict personal liability being imposed on the charity trustee to make good any deficiency or loss, or indeed to account for any improper profit.

Particular Areas Considered

Delegation

Unlike trustees of non-charitable trusts, trustees of charitable trusts need not act unanimously; they can act by majority. They can, therefore, delegate their duties among themselves and in this way, if there is the slightest possibility that there may be a potential conflict between personal interest and duty as a trustee, the trustee in question need not involve himself with the particular matter in hand.

However, delegation is not abdication of responsibility. If trustees do appoint some of their number to represent their interests, then they must ensure that full terms of reference are given and that there is an adequate system of reporting so that the whole body of trustees is aware of the situation at all times. Further, if committees are formed to deal with particular aspects, there must not be so many committees that there is a fragmented approach to management control. In their recent Report on the Royal British Legion, the Charity Commission criticised that charity in both these respects.

Delegation of trustees' trusts, powers or discretions cannot be made to non-trustees, but they can, to make their burden lighter, delegate the carrying out of decisions previously taken by them, i.e., they can, of course, employ staff to manage the administration of the charity. The trustees, however, remain liable for their staff's actions.

In carrying out their work as trustees, the trustees can appoint agents, such as solicitors, banks, and stockbrokers, but they remain responsible for their actions. They will, however, not be liable for any loss arising from the default of an agent so long as the agent was employed only to do acts in the scope of his normal business, that he was employed in good faith, and that the trustees acted with common prudence in appointing him. The case of *Norman v Theodore Goddard* [1991] VCLC 1028 illustrates this point; it held that a company director was not irresponsible in trusting and instructing an offshore tax expert who advised investing in a particular offshore company even though the said expert had subsequently run off with the funds.

It is obviously not practical for trustees to be directly involved in a hands-on way with all aspects of the charity; delegation is essential. The granting of discretionary management to investment managers and stockbrokers is one area in particular which the Charity Commission are going to have to address.

Investment

The degree of responsibility and standard of care demanded of a charity trustee in investment matters is even higher than that with regard to the general running of a charity. In such matters, he must observe that standard which a prudent businessman would observe in making investment decisions on behalf of people for whom he felt morally obliged to provide.

If there is no specific provision relating to investment powers in the governing instrument, trustees of charitable trusts may invest only in securities which are authorised by the Trustee Investments Act 1961. Although Sections 70 and 71 of the Charities Act 1993 contain provisions allowing for the provisions of the 1961 Act to be relaxed, no amendments have so far been made, or indications given that they are likely to be made for the time being, and so the law remains, at the moment, that of the 1961 Act.

Whether the trustees have specific powers set out in their constitution or are relying on the statutory powers, their prime concern must be to safeguard the trust fund, and to balance the interests of both present and potential future beneficiaries of the charity. There should, therefore, be a reasonable balance between capital growth and income yield. There should also be a reasonable spread of investments. Above all, they must not risk the charitable funds in any form of speculative investment.

The fact that the objects of a trust are charitable does not alter the fact that the trustees should exercise their powers in the best financial interests of the beneficiaries. Trustees must not, when considering investments, let consideration of the objects and purposes of the trust override considerations of financial return, recently confirmed in the *Bishop of Oxford v The Church Commissioners* [1991] Pensions Law Reports 185. They cannot allow their own ethical and moral standards to influence investment policy.

Official Custodian for Charities

Many charities, either because their funds are invested primarily in, say, land, or because they simply are "small" charities, have relatively small investment portfolios. Obtaining investment advice and generally administering their investments may, therefore, seem to be uneconomic. The services of the Official Custodian have in the past proved beneficial to such small charities. By registering the charity's investments in the nominee name of the Official Custodian, trustees have been spared all the burden of registration with the Company Registrars, safekeeping of share certificates, investment management, dealing with such matters as rights issues, redemptions, conversions, etc., and arranging for the reclaiming of income tax. However, with effect from 1st September 1992 (in accordance with the provisions of Sections 29 and 30 of the Charities Act 1992), the services of the Official Custodian have started to be withdrawn. This will not affect any land held by the Official Custodian or other property vested in her by virtue of an order under Section 18 of the Charities Act 1993 for the protection of the charity. What it will mean is that gradually the investment services of the Official Custodian will be abolished and investments and cash will be transferred to charity trustees.

This will mean, of course, that a responsibility that had previously been removed from the shoulders of charity trustees will be thrown back on them with a vengeance. As investments are transferred to the charity trustees' names, they will have to start making arrangements for investment management and the investment administration. Failure to do so will be a failure to carry out their duties and responsibilities as charity trustees.

Increased Burdens under the Charities Act 1992

The whole philosophy of charities is changing, and this is emphasised by the provisions of the 1992 Act; trusteeship can no longer be undertaken lightly as some out of date, wishy washy, philosophic approach to the world; trustees are undertaking a responsible, demanding job and must justify and prove themselves. To a large extent, this change from the "traditional" view of the position of charity trustees reflects the public perception that has built up in recent years that many charities were out of control, building up large accumulations of funds, and not spending them on the stated objects of the charity. Add to this disquiet the fact that there are no longer sufficient public funds to finance the Charity Commission holding the hands of charities in all their actions, and you have a new regime which looks to charities to regulate themselves, and which imposes sanctions if they do not.

Increased Supervisory Powers

The 1992 Act puts trustees under increasing scrutiny by the Charity Commission, since it gives the Commission extended powers with regard to inquiries, and speeds up the Section 6 1960 Act process. Under the new regime, once an inquiry has been set up, documents can be requested, and evidence obtained, without the need to make an order. The results of inquiries can be made public under the new provisions even if it is not proposed to take any action. See now s.8 of 1993 Act.

The new regime also gives the Commission additional powers to act for the protection of charities by, say, suspending a trustee, appointing an additional trustee, restricting the trustees' powers, appointing a receiver or manager for a charity, making freezing orders, or vesting property in the Official Custodian.

Such extended powers show that charity trustees are likely to be under increasing scrutiny, and the pressure on them to act exclusively within the limits of their powers is thereby increased.

Criminal Offences

It is a well known fact that the Charities Act 1992 has introduced a total of 13 criminal offences, where previously there were almost no criminal sanctions. This topic has been dealt with in detail in a previous issue (CL&PR, Volume 1, 1992/93, Issue 2, pp 101-111).

Land Transactions

Although no criminal offences are introduced in the requirements relating to land transactions, the new provisions set out in Sections 36-40 of the Charities Act 1993 which came into force on 1st January 1993, are yet another way in which increased burdens are placed on charity trustees.

Until December 1992, charities wishing to dispose of land forming part of their permanent endowment, or used for the purpose of the charity, or wishing to mortgage any property forming part of their permanent endowment, were obliged under Section 29 of the Charities Act 1960 to obtain an order from the Charity Commission. Under the new provisions, a Section 29 order will not be required, even if the provisions of the charity's constitution itself require it. Instead, new rules are introduced regulating all dispositions of charity land, not just permanent endowment. In broad terms, these will require the charity to obtain a written report from a qualified surveyor, advertise the proposed sale, lease, etc., and be satisfied that the proposed terms are the best that could be reasonably obtained for the charity. Similar requirements apply on the mortgaging of land.

This all, therefore, puts an increased burden on trustees, or perhaps one should say on their legal advisors, to make sure that standard documentation contains the necessary wording. While the Act does not introduce any direct sanctions for failure to adhere to Sections 36 to 40, the withdrawal of the central control system laid down in Section 29 of the 1960 Act, and the reliance put on trustees to follow new regulations relating to a wider area of land transactions, puts a greater burden on trustees, and could be said, therefore, to expose charity trustees to greater risk of personal liability for breaches of trust.

Accounts

The new accounting requirements have yet to be introduced. The originally proposed date of 1st September 1993 has been postponed; the revised implementation date is now 30th June 1994.

At some stage before then, the regulations referred to in the Act will be issued. Until then, therefore, we know only the outline of the requirements, as set out in ss.41-49 of the 1993 Act.

All charities will be required to keep accounting records which will enable accounts to be prepared which will comply with the regulations, for six years from the end of the financial year in question. The form of the annual accounts themselves will be less stringent for charities with a gross income not exceeding £25,000. An audit will be required where gross income or expenditure exceeds £100,000, whereas an independent examination will be sufficient for charities with income or expenditure below that. Together with the Accounts, registered charities will need to submit an Annual Report and also an Annual Return.

All this can only add to the trustees' burdens, especially as Section 49 of the 1993 Act makes persistent failure to comply with the requirements as to submission of the Annual Report and Account or Annual Return to the Charity Commission, or the production of copy accounts to the public, a criminal offence punishable with a fine.

Liability to Third Parties

At the time the Bill which was eventually to become the Charities Act 1992 was going through the House of Lords, there was an amendment proposed which would have given trustees of unincorporated charities the benefit of limited liability in their dealings with third parties. It was eventually withdrawn by the Government on the grounds that the existing law was sufficient to cover the situation if a trustee acted prudently, as he should, on the premise, presumably, that a prudent man would not get himself into a situation where, through no fault of his own, he became personally liable for a large sum of money. That does not sound so much like a prudent man as a perfect man with 20-20 hindsight.

Personal Risk

The position remains, therefore, that when trustees enter into contracts with third parties, they are exposing themselves to personal risk. The majority of trustees may think that this is a prospect which will not affect them greatly. A charity whose principal activity is the investment of funds and the distribution of income or capital is not likely to enter into, say, property development or building contracts. But there are a number of occasions on which charity trustees will find that they are involved in dealings with third parties.

Even if the trustee has acted as a "prudent man of business", and has sought all the right kinds of advice, he can still find himself personally liable - there does not need to have been a breach of trust. In leases, in contracts for development, in loan agreements, in contracts of employment, the contracting parties enter into a contract with the trustees themselves, not with the trust as such.

In the normal run of things, this need not cause a problem; if the trustee has acted properly and has not exceeded his powers, he is able to look to the trust fund to reimburse him. This is perhaps the only scenario that those considering the question in the House of Lords were envisaging. What happens if the obligation of the trustee imposed on him by the contract is bigger than the trust fund - an enormous development project with associated borrowing where the debt is called in at a time when the investment portfolio hits an all time low and there are other outstanding debts? The answer is that, unless the contract, loan agreement, what have you, provides otherwise, the trustee remains liable even beyond the amount which the trust fund is able to reimburse him.

Limitation of Risk

It is, therefore, essential that trustees should be advised of this liability when entering into any contract, and that careful drafting should limit the liability of trustees to the extent of the assets of the trust. Whether it will be possible to limit the liability of the trustee in this way depends, of course, to a great extent on the strength of their negotiating position.

A commitment was given by Lord Ferrers during the course of the Lords' debate which rejected the idea of limiting trustees' liability to third parties that the Government would examine fully the nature of the existing problem and explore the options. It still remains to be seen exactly what proposals the Government will come up with. At a time when the Government is increasingly looking to the voluntary sector to provide services in many areas, which necessarily involves charitable trustees entering into ongoing major commitments, it must be aware that, without further protection from exposure to personal liability, people with the necessary skills, experience and other personal qualities will be increasingly reluctant to accept office as trustees.

Incorporation and its Problems

Increasingly aware of their potential liability, charity trustees sometimes seek to have their charity's constitution changed to that of a company limited by guarantee, to give them protection from personal liability. This may not give them all the protection they imagine. The Charity Commission usually insists upon the inclusion in the Memorandum of Association of a charitable company of a rather ambiguous proviso which purports to say that, despite incorporation, the doctrines of limited liability cannot apply fully to a charity. Although this has not been fully tested in the Courts, a fair interpretation of this might be that, although the fiduciary duty of the trustees or directors towards the charity itself cannot be reduced in any way, incorporation of a charity does give them some protection against liability to third parties.

Incorporation is not, however, a panacea for charity trustees. The Insolvency Act 1986 places an enhanced liability on company directors, or their equivalent. If the company is wound up at a time when its assets are insufficient for the payment of all its debts and liabilities and the expenses of winding up, then the liquidator can take proceedings for the Court to order that any director should contribute to the company's assets. If the company has engaged in wrongful trading, the director will be liable. The Court will not make an order for a director to contribute to the company's assets if it is satisfied that the director took every step with a view to minimising the potential loss to creditors.

The director is put in a difficult position, since he can be considered to be acting unreasonably if he allows the company to carry on trading and incurring fresh liabilities, knowing it was insolvent, although honestly believing that there was light at the end of the tunnel. Incorporation does, therefore, bring its own problems for the trustee/director.

Protection

Perhaps the best advice one can give to one's charity trustee clients is that they should make themselves fully aware of the objects and powers of their particular charity and understand all the obligations and responsibilities that they are taking on as trustees. With the best will in the world, however, trustees are only human and must be given some sort of comfort if they are to take on the onerous burden.

Statutory Protection

Some protection is afforded to trustees by statutory provisions. Trustees who are in doubt whether they have the power to carry out certain activities can seek the advice of the Charity Commissioners under Section 29 Charities Act 1993. If the trustees then act in accordance with that advice they are protected. Section 26 of the 1993 Act may also be helpful in that it enables the Charity Commission to authorise actions which might otherwise have exceeded the trustees' powers. The answer is to seek the Charity Commission's help before rather than after actions about which there might be some doubt.

If, however, the action has already been taken, and it is too late to go to the Charity Commission, help is available under Section 61 Trustees Act 1925. If it appears to the Court that a trustee is, or may be, personally liable for any breach of trust, but has acted honestly and reasonably and ought to be excused for the breach and for omitting to obtain the Court's directions in the matter in which he has committed the breach, the Court may relieve him wholly or partly from personal liability.

Insurance

For a long time the concept of the charity paying a premium on any form of indemnity insurance was dismissed by the Charity Commission. The objection always appeared to be that if the charity paid the premium, it would be construed as giving a benefit to the trustees, in blatant contravention of the overriding fiduciary duty that a trustee should not benefit from his trust. There has, however, been increasing pressure from various quarters over the last few years for charities to be able to insure against the liabilities of trustees at the expense of the charity, and disappointment that this was not covered specifically in the Charities Act 1992.

The Charity Commissioners did at last indicate their support for this in their Annual Report for 1991. They now confirm, first, that they have no objection to charities insuring against loss to funds from the acts and defaults of trustees. Secondly, and perhaps more immediately importantly for the trustees themselves, the Charity Commission have confirmed that they will not object to charities paying for insurance for trustees in respect of acts properly undertaken in the administration of a charity, although there remains some doubt whether such insurance could extend to acts undertaken in breach of trust, even if under an honest mistake.

Normally, an amendment to the charity's constitution will be needed to permit insurance, and the Charity Commission will need to be convinced that it is in the interests of the charity to insure its trustees. Perhaps one of the best arguments is the practical difficulty of obtaining new trustees without insurance protection.