CHARITY COMMISSION
FOR ENGLAND AND WALES

Legal underpinning

Conflicts of interest: a guide for charity trustees

Preliminary statement

a) This document is a summary of the Commission's view of the law underpinning its publication Conflicts of interest: a guide for charity trustees (CC29) and necessarily uses more technical language.

b) This analysis is not intended to be a comprehensive legal digest, but a useful reference point for trustees, their advisers and the public. It is intended to reflect law and practice at 27 March 2014. It is not binding in law. It offers a general analysis of the law but whether the analysis is appropriate in a particular case will depend on all the facts of that case.

c) The Commission takes the same approach as the courts and the Tribunal in applying the law.

1. Introduction

Identifying possible conflicts of interest at an early stage and taking appropriate action to avoid, or eliminate, or manage them is a key element for charity trustees in properly administering charities. This legal underpinning looks at the case law and statutes regarding this issue. Many of the relevant cases relate to private trusts. With charities, it is important that trustees act solely in the interests of the charity and take their decisions solely in the interests of furthering the charitable purposes. That this is the case has been most recently reaffirmed by Gerald J in **Mountstar (PTC) Limited v The Charity Commission for England and Wales** 2013 WL 6865275.

References to CA 2011 are to the Charities Act 2011.

2. Duty to avoid a conflict of interest

Definition of the term 'duty to avoid a conflict of interest'

The term 'conflict of interest' is often used to describe one of the following situations:

1) Where a person is in a position where their duty as a trustee may conflict with any personal interest they may have
2) Where a person may not be able to act properly in a particular capacity because of a person or matter with which they are connected
3) Where a person may profit personally from decisions made in their capacity as trustee or from knowledge gained through holding such position.

The duty to avoid a conflict of interest derives from the fiduciary obligation of undivided loyalty. In **Bristol and West Building Society v Mothew** [1998] Ch 1, 18 Millett LJ stated:

> *"A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence".*

The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. The core responsibility has several facets. A fiduciary *"must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations."* **(Bristol and West Building Society v Mothew [1998] Ch 1, 18)**.

Trustees certainly have fiduciary duties. Company directors at common law had a fiduciary duty to the company to act as best to promote the interests of the company (see **Aberdeen Railway v Blaikie**). Both they and the trustees of a Charitable Incorporation Organisation now have statutory duties to avoid a conflict of interests (see Part 7 of this guidance).

The charity trustees of a Charitable Incorporated Organisation (CIO) have a statutory duty (section 221 of the CA 2011) to exercise their powers and functions in the way that they each decide, in good faith, would be most likely to further the purposes of the CIO. Accordingly, they are undoubtedly fiduciaries. In fact, anyone acting as a charity trustee of a charity whatever the structure of the charity will be acting in a fiduciary capacity.

In **Aberdeen Railway v Blaikie** [1843-60] All ER Rep 249 Lord Cranworth said:

> *"it is a rule of universal application that no one having such duties [ie fiduciary duties] to discharge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict..."*

The meaning of the words '*possibly may conflict*' were considered by Lord Upjohn in **Boardman v Phipps** [1967] 2 AC 46 HL:

> *"In my view it means that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict."*

Thus, a reasonable perception that a conflict of interest exists is sufficient where the circumstances support this. This is further supported by **R v Solicitors Complaints Bureau** [1996] 6 CL 411 where it was considered that the words *'provided no conflict of interest appears'* in r.6.2 of the Solicitors' Practice Rules 1988 had to mean that which was apparent to a reasonable solicitor in the same position as the solicitor under scrutiny.

In **Bray v Ford** [1896] AC 44, 51 Lord Herschell said:

> *"It is an inflexible rule of a Court of Equity that a person in a fiduciary position……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 duty, and thus prejudicing those whom he was bound to protect."*

This statement makes abundantly clear the reason why such conflicts are to be avoided or eliminated wherever possible. It is also clear that it is the existence of the conflict that must be avoided, even if the conflicting interest cannot be said to have influenced a particular decision.

Lord Herschell went on to say:

> *"I am satisfied that it* [ie the rule] *might be departed from in many cases, without any breach of morality, without any wrong being inflicted, and without any consciousness of wrong-doing. Indeed, it is obvious that it might sometimes be to the advantage of the beneficiaries that their trustee should act for them professionally rather than a stranger, even though the trustee were paid for his services."*

However, this did not alter the fact that the fiduciary was still in breach of the fiduciary duty to avoid a conflict of interests even where the trustee was well-intentioned and considered he was acting in the interests of the charity.

Lord Langdale MR in **AG v Kerr** (1840) 2 Beav 420, 428 set out the matters charity trustees should consider in making any decision:

> *"A man acting for himself may indulge his own caprices, and consider what is convenient or agreeable to himself, as well as what is strictly prudent, and his prudential motives cannot afterwards be separated from the others which may have governed him. Trustees of a charity within the limits of their authority, whatever they may be, should be guided only by a desire to promote the lasting interest of the charity."*

More recently, Hart J in **The Public Trustee & anor v Paul Cooper & ors** [1999] WL 1425717 said in relation to the charitable trust with which he was concerned in that case:

> *"The* [Charitable Fund] *trustees owe duties to no one but their charitable objects and have no powers to benefit any but their charitable objects"*

Gerald J in **Mountstar (PTC) Limited v The Charity Commission for England and Wales** 2013 WL 6865275 at paragraph 246, commenting in relation to the role of the Charity Commission, said:

> *"It is the role of the Commission to promote compliance by charity trustees with their legal obligations in exercising control and management over the administration of charities and their accountability to donors, beneficiaries and the general public. One aspect of those overarching objectives is to ensure that charity trustees act in accordance with the standards of ordinary prudent men* (sic) *of business and independently of any conflicted party."*

3. Self-dealing

In **Tito v Waddell (No 2)** [1977] 3 All ER 129, 241 Megarry V-C said:

> *"The self dealing rule is (to put it very shortly) that if a trustee sells the trust property to himself the sale is voidable by any beneficiary ex debito justitiae, however fair the transaction."*

This derives from the 'no conflict' rule. As Vinelott J pointed out in **Re Thompson's Settlement** 1986 Ch 99:

> *"It is clear that the self-dealing rule is an application of the wider principle that a man must not put himself in a position where duty and interest conflict or where his duty to one conflicts with his duty to another: see in particular the opinion of Lord Dunedin in Wright v. Morgan [1926] A.C. 788 which I have cited. The principle is applied stringently in cases where a trustee concurs in a transaction which cannot be carried into effect without his concurrence and who also has an interest in or owes a fiduciary duty to another in relation to the same transaction. The transaction cannot stand if challenged by a beneficiary because in the absence of an express provision in the trust instrument the beneficiaries are entitled to require that the trustees act unanimously and that each brings to bear a mind unclouded by any contrary interest or duty in deciding whether it is in the interest of the beneficiaries that the trustees concur in it."*

Thus, it is the actual existence of the conflict which gives rise to the breach of duty, not any particular action taken as a result of it. In **Ex parte Lacey** (1802) 6 Ves Jr 625 the Lord Chancellor, Lord Eldon, indicated that where a conflict existed which might affect a transaction there was a breach of duty even where there was no advantage to the trustee.

In the absence of express authorisation, this principle holds true however fair the terms of a proposed transaction may be. This is made clear by Lord Cranworth in **Aberdeen Railway v Blaikie**:

> *"So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into..........It may sometimes happen that the terms on which a trustee has dealt or attempted to deal with the estate or interests of those for whom he is a trustee have been as good as could have been obtained from any other person; they may even at the time have been better. But still so inflexible is the rule that no inquiry on that subject is permitted. The English authorities on this subject are numerous and uniform ....The inability to contract depends not on the subject-matter of the agreement, but on the fiduciary character of the contracting party."*

Parker LJ in **Bhullar v Bhullar** [2003] EWCA Civ 424@27-28 emphasised that with self dealing there is no need for any improper dealing separate to the conflict:

> *"I agree ..... that the concept of a conflict between fiduciary duty and personal interest presupposes an existing fiduciary duty. But it does not follow that it is a prerequisite of the accountability of a fiduciary that there should have been some improper dealing with property 'belonging' to the party to whom the fiduciary duty is owed, that is to say with trust property......In a case such as the present, where a fiduciary has exploited a commercial opportunity for his own benefit, the relevant question, in my judgment, is not whether the party to whom the duty is owed (the company, in the instant case) had some kind of beneficial interest in the opportunity: in my judgment that would be too formalistic and restrictive an approach. Rather, the question is simply whether the fiduciary's exploitation of the opportunity is such as to attract the application of the rule."*

This latter statement also makes abundantly clear that the 'no conflict' rule applies not only to remuneration or transactions but also to situations where, for example, a trustee is also a potential beneficiary of a charity or has a personal potential advantage to be gained eg appointment as a director of a charitable company or share option only acquired through his or her position as a trustee, etc. Bodies such as local authorities who act in more than one capacity or trustees who are user trustees therefore need to be particularly mindful of this potential source of conflict of interest.

In **Keech v Sandford** (1726) Select Cases Temp. King 61 the Lord Chancellor considered the case of a lease devised to a trustee for the benefit of an infant. The lessor refused to renew the lease to the infant so the trustee took it himself. The Lord Chancellor said:

> *"I do not say there was a fraud in this case, yet he should rather have let it run out, than to have had the lease to himself. This may seem hard, that the trustee is the only person of all mankind who might not have the lease: but it is very proper that rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequence of letting trustees have the lease, on refusal to renew to cestui que use."*

The 'no profit' rule derives from this case; namely, if trustees without authority make a profit directly or indirectly from the use of property subject to a trust or other fiduciary relationship or in the course of the fiduciary relationship and by reason of the fiduciary position, they are not permitted to retain the profit.

The 'no conflict' and 'no profit' rules apply even where:

(i) a trustee acts honestly and in good faith;

(ii) the charity has not been disadvantaged, or has benefited;

(iii) the charity could not, or would not, have obtained for itself the advantage obtained by the trustee.

However, any proceedings in respect of self -dealing are likely to be taken either by the Attorney-General or by the Charity Commission (acting under section 114 of CA 2011). Where a proposed self-dealing transaction is in the interests of the charity, it is possible for the Charity Commission to authorise it under section 105 of CA 2011. Any proceedings in respect of self-dealing are likely to be taken where the transaction is not in the interests of the charity.

The self-dealing rule only applies to dealings between a trustee and the charity not to dealings between the charity and persons connected to the trustee such as a spouse[1] or a company in which the trustee owns shares. In such cases, although not automatically voidable, the transaction will be looked at very carefully to see if there has been any prejudice to the charity. In **Ferraby v Hobson** (1847) 2 Philllips 255 Lord Justice Cottenham said:

> *"Trustees expose themselves to great peril in allowing their own relatives to intervene in any matter connected with the execution of the trust; for the suspicion which that circumstance is calculated to excite, where there is any other fact to confirm it, is one which it would require a very strong case to remove."*

1 **Burrell v Burrell's Trustees** 1915 SC 333.

In **Burrell v Burrell's Trustee** (see footnote 1) Lord Mackenzie quoted this with approval and went on to say:

> *"Therefore I venture to remark that in all cases of this class the Court will seek to be certain, by vigilant scrutiny, of the true nature of such a transaction; because one can readily see that the close relationship between husband and wife may, unless the nature of the transaction is explained give rise to the not unnatural inference that the husband was truly the party intervening in the case, and that not without benefit to himself."*

It is also necessary to consider whether loans to or from trustees can be regarded as self-dealing.

In **Anon v Walker** (1828) 5 Russell 7 the Master of the Rolls stated:

> *"When a testator empowers three executors to lend money on personal security, he must be taken to rely upon the united vigilance of the three with respect to the solvency of the borrower. If two of the three lend it to the third, this object is defeated, and it is a breach of trust."*

In **Marley v Mutual Security Merchant Bank & Trust Co Ltd** [1995] CLC 261 Lord Griffiths delivering judgment for the Privy Council said

> *"In the opinion of their Lordships the judge was right to refuse to approve the conduct of the bank in placing estate funds on yearly deposit with itself, and to refuse to permit them to do so in the future.*
>
> *It is a rule so well established that no authority need be cited that a trustee in the absence of specific permission in the trust instrument or given by the beneficiaries is not entitled to make a profit for itself out of trust funds. A bank makes profits by taking money on deposit and then lending that money at a higher rate of interest than it pays on the deposit. This raises an immediate conflict of interest between the duty the bank owes to the beneficiaries which is to obtain the highest rate of interest on the deposit, and the duty to its shareholders to pay the lowest rate of interest on the deposit and thus maximise its profit when it lends the deposit to other customers."*

The logic of these cases would suggest that there would also be a vitiating conflict of interest in a trustee lending money to a charity - the trustee as lender having different interests to a trustee in his/her capacity as trustee acting in the best interests of the charity.

However, in **The Attorney-General v Hardy** (1851) 1 Simons, New Series 338 the Vice-Chancellor upheld the validity of a mortgage of the estate where one of the trustees was the mortgagee:

> *"It was necessary to raise money by mortgage for the purposes of the trust and that the money should be advanced by one of the trustees was natural and quite proper."*

This was in the context of a specific power to mortgage the property although there was no specific or implied power to mortgage the property to a trustee. However, the Vice-Chancellor did say:

> *"It may be that, in taking the account of what is due to him on his security, the parties interested in the trust of the deed may not be bound by the statement of the sum said to be advanced. In taking the account there may be various equities arising out of the character of Hardy as trustee, or as representing William Hardy deceased, the original mortgagee, which would not attach on a mere stranger. But this goes only to the question of the amount due, and not to the right of insisting on the character of mortgagee."*

It would therefore appear that the courts take a less stringent approach with regard to loans from trustees than loans to trustees. Undoubtedly, a trustee would have to account to the charity for any excessive amount of interest charged by a trustee lender, but not presumably for all the interest.

The courts have also considered that trustees loaning their own money as mortgagee to a third party to purchase trust property is not necessarily self-dealing.

It may however be necessary for the trustees to justify how their decision in respect of the sale was made solely in the interests of the charity.

4. The consequences of not avoiding a conflict of interest

Liability to the charity for loss arising from a breach of trust

Charity trustees who cause loss to a charity by their breach of trust are likely to be liable to the charity for making good that loss.

In **Target Holdings Ltd. Respondent v Redferns (A Firm) and Another Appellants** [1996] AC 421, 434 HL Lord Browne-Wilkinson said:

> *".......in the case of a breach of such a trust involving the wrongful paying away of trust assets, the liability of the trustee is to restore to the trust fund, often called 'the trust estate,' what ought to have been there.......the basic rule is that a trustee in breach of trust must restore or pay to the trust estate either the assets which have been lost to the estate by reason of the breach or compensation for such loss....Even if the immediate cause of the loss is the dishonesty or failure of a third party, the trustee is liable to make good that loss to the trust estate if, but for the breach, such loss would not have occurred."*

The trustee's duty to account to the charity for any unauthorised benefit

The 'no profit' rule which derives from the case of **Keech v Sandford** (1726) referred to has been regarded as part of the wider rule that a trustee must not place himself in a position where his duty and his interest may conflict, as per Lord Upjohn in **Boardman v Phipps** [1967] 2 AC 46 HL who said at paragraph 123:

> *"The relevant rule for the decision of this case is the fundamental rule of equity that a person in a fiduciary capacity must not make a profit out of his trust which is part of the wider rule that a trustee must not place himself in a position where his duty and his interest may conflict."*

It should be noted that this bar applies whether the profit or benefit derived would be direct or indirect and so also catches connected persons and may also catch, for example, user beneficiaries or trustees, or trustees who are also employees of an interested body. This is made clear by Millett LJ in **Bristol and West Building Society v Mothew** [1998] Ch. 1, 18: see under paragraph 2 'Duty to avoid a conflict of interest'.

This 'no profit' rule has been reaffirmed over and over again as Lord Cranworth pointed out in **Aberdeen Railway v Blaikie**:

> *"The English authorities on this subject are numerous and uniform. The principle was acted on by LORD KING in Keech v Sandford and by LORD HARDWICKE, in Whelpdale v Cookson and the whole subject was considered by LORD ELDON on a great variety of occasions."*

Cohen J said in **Re Macadam** [1946] Ch 73:

> *"The principle is one which has always been regarded as of the greatest importance in these courts, and I do not think I ought to do anything to weaken it. As I have said, although the remuneration was remuneration for services as director of the company, the opportunity to receive that remuneration was gained as a result of the exercise of a discretion vested in the trustees, and they had put themselves in a position where their interest and duty conflicted. In those circumstances, I do not think this court can allow them to make a profit out of doing so."*

And likewise Viscount Dunedin in **Wright v Morgan** [1926] AC 797-798, an appeal from New Zealand to the Privy Council:

> *"It would be profitless to quote the many cases which have arisen to illustrate the doctrine. They may all be referred to the same root idea, that equity will not allow a person, who is in a position of trust, to carry out a transaction where there is a conflict between his duty and his interest."*

As is clear from Viscount Dunedin's words, this fundamental rule is to be applied flexibly wherever 'the root idea' is the same and therefore it catches not just, for example, trustee remuneration but all scenarios where such a conflict could arise, whatever the circumstances. Such transactions may include the acquisition from, or disposal of charity property to, a charity trustee or the award of a service contract to a trustee, or even where a charity is, say, a grant making body or service provider and a trustee or close relative is a potential beneficiary or user of such service. This is expressed by Lord Upjohn in **Boardman v Phipps** as follows:

> *"Rules of equity have to be applied to such a great diversity of circumstances that they can be stated only in the most general terms and applied with particular attention to the exact circumstances of each case."*

Harman J in **Re Gee** [1948] Ch 284@ 295 said:

> *"A trustee who either uses a power vested in him as such to obtain a benefit (as in In re Macadam) or who (as in Williams v. Barton) procures his co-trustees to give him, or those associated with him, remunerative employment must account for the benefit obtained. Further, it appears to me that a trustee who has the power, by the use of trust votes, to control his own appointment to a remunerative position, and refrains from using them with the result that he is elected to the position of profit, would also be accountable."*

A disposition of the charity's property made in breach of these rules may be set aside

Even where there is no benefit to the trustee so no duty to account arises, a transaction conducted by a conflicted charity trustee may be subject to challenge.

In private trusts, a self -dealing transaction is voidable by a beneficiary of the private trust. In the case of a charity, there is a beneficiary class rather than individual beneficiaries. Accordingly, proceedings to declare a transaction void could be brought by the Attorney-General in his role as representing the charitable interests. This arises from his function of representing the Crown as *parens patriae*.

Under section 114 of the CA 2011, the Charity Commission may exercise the same powers as the Attorney-General regarding the taking of legal proceedings with reference to charities or the property or affairs of charities. The agreement of the Attorney-General is required for the Commission to exercise these powers.

5. Authorised conflict of interests

Lord Reid in **IRC v Brown** [1965] AC 244 @ 257 indicates:

> *"The general principle is well settled. A solicitor has a fiduciary duty to his clients and any person who has such a duty "shall not take any secret remuneration or any financial benefit not authorised by the law, or by his contract, or by the trust deed under which he acts, as the case may be" (per Lord Normand in Dale v. Inland Revenue Commissioners). If the person in a fiduciary position does gain or receive any financial benefit arising out of the use of the property of the beneficiary he cannot keep it unless he can show such authority."*

Authority may be conferred by:

1 by law

(a) by legal process

As pointed out by Cross J in **Re Brooke Bond & Co Ltd's Trust Deed** [1963] Ch 357@ 365 this may be by sanction of the court:

> *"I appreciate that it may well be that the chances of there being a conflict between interest and duty are less in the case of transactions between a custodian trustee and managing trustees than they are in the case of transactions between an ordinary trustee and his co-trustees. But the possibility of conflict is still there and the rule, as Lord Herschell pointed out in Bray v. Ford, is an inflexible one unless the trust instrument provides for a profit being made by the trustees or the court makes a special order in a particular case"*

The Commission also has jurisdiction under section 105 of the Charities Act 2011 to authorise trustees to enter into particular arrangements if the Commission is satisfied they are expedient in the interests of the charity.

(b) by an applicable statutory provision

An example of this is section 185 of the CA 2011, which authorises remuneration for services provided to a charity by a charity trustee.

2) by contract or by trust deed

The constitution of an unincorporated association is in the nature of a contract between the members as are (i) the articles of association with regard to the members of a charitable company and (ii) the constitution of a CIO with regard to the members of the CIO. An express power conferred by the governing document (used properly and with no fraud on such power) can authorise a conflict.

It is however worth specifically noting that even where there is an express power in the governing document, authorising eg trustee remuneration or a transaction, this does not override the fiduciary obligation to act in the interests of the charity and the decision of a board of trustees can still be vitiated if the trustees act other than in the interests of the charity.

Hart J in **Public Trustee & anor v Paul Cooper & ors** [1999] WL 1425717 dealt with the position where a trustee decision is called into question. In this case there was no authority for the conflict in question:

> *"The relative absence of authority certainly suggests that there is no iron rule that, where such action has taken place, a beneficiary is entitled* ex debito justitiae *to have it set aside. Equally, one would expect to find, in the absence of such an iron rule, that, where such action is challenged on such grounds, the onus would be thrown upon the trustee to demonstrate that the conflicting interest or duty has not in fact operated in a vitiating way…….If they do not do so, they run the risk of having to justify the exercise of their discretion in subsequent hostile litigation and then satisfy the court that their decision was not only one which any reasonable body of trustees might have taken but was also one that had not in fact been influenced by the conflict."*

Even in circumstances where payments or other transactions are authorised by a charity's governing document and there is a procedure for managing potential conflicts and the relevant decision has been taken by trustees who are independent and have no personal vested interest in the decision, trustees will need to be satisfied that their decision and consequent transaction or arrangement is 'robust', and can be justified.

6. Managing a conflict of interest

Sometimes in spite of trustees' best efforts, conflicts of interest will arise. The courts have referred to managing conflicts of interest. This does not mean proceeding as if they did not exist. It means ensuring that the conflict does not prevent the decision being made solely in the interests of the charity and that the trustees can demonstrate this.

Hart J in **The Public Trustee & anor v Paul Cooper & ors**, said:

> *"In some areas of our law the existence of conflicts of this kind is recognised and managed by a variety of devices, ranging from requiring the affected person to declare his interest to requiring him to abstain from participation in the relevant decision-making process…..Where a trustee has such a private interest or competing duty, there are, as it seems to me, three possible ways in which the conflict can, in theory, successfully be managed."*

Hart J went on to deal with each in turn:

Resignation

> *"One is for the trustee concerned to resign."*

This will clearly be appropriate where the conflict is so pervasive that it cannot be managed in any other way.

In some cases, resignation of the trustee may not save a transaction because the resignation comes too late and the vitiating conflict has already fatally compromised the transaction. In these situations the trustee may still be accountable for any loss to the charity or the compromised transaction may be voidable.

However, Hart J did recognise that there were circumstances in which a trustee may be justified in not resigning:

> *"This will not always provide a practical or sensible solution. The trustee concerned may represent an important source of information or advice to his co-trustees or have a significant relationship to some or all of the beneficiaries such that his or her departure as a trustee will be potentially harmful to the interests of the trust estate or its beneficiaries."*

In these circumstances, it was clearly envisaged that there was an appropriate means of managing the conflict in some other way.

Surrender of discretion to the court

> *"Secondly, the nature of the conflict may be so pervasive throughout the trustee body that they, as a body, have no alternative but to surrender their discretion to the court."*

This would involve making an application to the court, which would constitute charity proceedings requiring the authorisation of the Charity Commission under section 115 of CA 2011. Before giving such permission, the Commission has to consider whether the matter can be dealt with under its other powers. It is possible for the Charity Commission under section 105 of the CA 2011 to authorise the trustees to do something which they would not otherwise be authorised to do. In view of this, the circumstances in which a surrender of discretion to the court is likely to be invoked are extremely limited.

Trustees cannot surrender their discretion to the Commission as they can with the court but the Commission can authorise conflicted trustees to make a particular decision if the trustees can satisfy the Commission that they are acting in the best interests of the charity; the Commission can then authorise the decision as being expedient in the interests of the charity. In coming to such a determination, the Commission will, however, adopt an approach which is consistent with that of the court.

Taking decisions in spite of a conflict

> *"Thirdly, the trustees may honestly and reasonably believe that, notwithstanding a conflict affecting one or more of their number, they are nevertheless able fairly and reasonably to take the decision."*

Hart J did spell out the dangers of this.

> *"In this third case, it will usually be prudent, if time allows, for the trustees to allow their proposed exercise of discretion to be scrutinised in advance by the court, in proceedings in which any opposing beneficial interests are properly represented, and for them not to proceed unless and until the court has authorised them to do so. If they do not do so, they run the risk of having to justify the exercise of their discretion in subsequent hostile litigation and then satisfy the court that their decision was not only one which any reasonable body of trustees might have taken but was also one that had not in fact been influenced by the conflict."*

What this makes clear is that the trustees do not just have to make a decision which a reasonable body of trustees might take. They also have to be able to demonstrate that they have not in fact been influenced by the conflict. In some circumstances this may be very difficult to do and, as indicated in the immediately preceding section and in the light of the comments of Gerald J in **Mountstar (PTC) Limited v The Charity Commission for England and Wales**, the Commission or the court (as applicable) may apply wider criteria and adopt a less fettered approach in scrutinising any such trustee decisions and the exercise of their decision making discretion.

Often governing documents make provision that a conflicted trustee should absent him or herself from the relevant discussion and decision, it being open to the other trustees to make a decision by majority (rather than an unanimous decision being required as in the case of a private trust). In some cases, this will be sufficient for the charity trustees to demonstrate they have made a decision properly and without it being affected by the conflict.

Although this sets out the procedural means of managing some actual or potential conflict of interests, in some cases involving connected parties or, because of a relationship, present or historical, the standing aside of a trustee or trustees or their resignation may not be sufficient to avoid the taint of lack of integrity or appearance of a potential or actual conflict. As Gerald J pointed out in decision given on 17 October 2013 in the First Tier Tribunal in **Mountstar (PTC) Limited v The Charity Commission for England and Wales** 2013 WL 6865275, simply going through the procedural motions of compliance will not discharge the duty on trustees. As he states at paragraph 248:

> *".....even if the charity trustees have asked the "right" questions and taken into account the "right" factors, the Commission remains entitled to conclude in a suitable case that the charity trustee has reached the "wrong" answer ie it is a decision which no ordinary prudent man of business would reach acting independently of any conflicts of interest or loyalty."*

In those cases, the most appropriate course of action would be not to enter into the proposed transaction or arrangement.

However, this will be a judgment call for the relevant trustees, as illustrated by the case of **The Public Trustee & anor v Paul Cooper & ors** referred to, in which one of the trustees decided of his own accord to resign as a trustee from the charitable fund in question before the issue of potential conflict arising out of his personal shareholding even arose.

The relevance of **The Public Trustee v Cooper** case to charities

There was a charity involved in this decision but there were also two private trust funds. It may be that the test and criteria which the court would apply in scrutinising a proposed decision or the exercise by charity trustees of their discretion (in the case of an already made decision, subject to hostile litigation) would be wider and less fettered than those spelt out by Hart J in **The Public Trustee & anor v Paul Cooper & ors**. This is because, in the case of charities, there are public interest considerations which may arise which would not arise in the case of private trusts (eg the question of the acceptability from a public interest perspective of the terms of a proposed settlement offer which would essentially be a purely commercial consideration in a private trust scenario) and, in most charity cases, the whole beneficial interest will be represented by the Attorney General rather than a group of private beneficiaries as in the case of a private trust.

Public bodies as trustees

Sometimes local authorities or other public bodies such as NHS trusts have the power to act as trustees of certain charities. When they do, they have to make sure that when acting as trustee they act solely in the interests of the charity and are not acting in their own interests as the local authority or public body.

In **Manchester City Council v Greater Manchester County Council and others** (1980) 78 LGR 561 the Court reviewing various decisions affecting charities stated:

> *"The Council had no legal power to exercise direct personal control over the Trustees who were obliged under the general law to administer the trust fund in accordance with the purposes for which they held it."*

In **Maidment & Lennox Ryan v Charity Commission** CA/2009/0001 and 0002 the First-tier Tribunal (Charity) considered likely situations in which the interests of the local authority would conflict with its duty as charity trustee and stated:

> *"the Tribunal is concerned to see governance arrangements put in place which will provide for the Committee of the Council which administers the charity to be able to make quorate decisions in the absence of those affected by a conflict of interest.........It therefore seems to the Tribunal that the important issue for the Respondent to provide for in amending the Scheme is the number of independent (ie non-conflicted) persons who are able to form a quorum of the Committee under its standing orders, rather than merely the number of independent persons who are appointed to that Committee, but unable to form a quorum."*

The Tribunal clearly considered that it was necessary to have an unconflicted body capable of taking decisions in a particular matter. The mere presence of independent trustees was not sufficient if there were conflicted trustees (as is clear from the comments of Gerald J in **Mountstar (PTC) Limited v The Charity Commission for England and Wales** cited)). The Tribunal indicated that the only alternative to having an independent non-conflicted Committee in certain cases was for the District Borough Council to approach the Charity Commission to authorise all future transactions affected by the conflict of interest.

Similarly, in **Sparrow & others v The Charity Commission for England and Wales & Another** (CA/2013/0006, CA/2013/0007 and CA/2013/0008) (decision dated 27 March 2014) the First-tier Tribunal (Charity) criticised a local authority trustee for failing to manage their conflicts of interest and considered that a scheme was required to put in place *"appropriate governance arrangements for the Charity to ensure the proper management of conflicts of interests and the proper stewardship of the property and assets of the Charity."*(paragraph 39)

Corporate Trustees generally

In **Mountstar (PTC) Limited v The Charity Commission for England and Wales** cited Gerald J made clear that the directors of a corporate trustee were not themselves charity trustees. It is the corporate trustee which is the charity trustee and the directors of the corporate trustee owe fiduciary duties to the corporate trustee. If one or more of them is conflicted and this is not properly dealt with by the corporate trustee, it is the corporate trustee which is in breach of its duty to the charity.

7. Statutory provisions regarding conflicts of interest in respect of charitable companies and charitable incorporated organisations (CIOs)

While the charity trustees of charitable companies and of CIOs are fiduciaries, the duties they owe are set out in statute law in addition to those established at common law. In the case of charitable companies, section 178(2) of the Companies Act 2006 (CA 2006) makes clear the statutory duties imposed are fiduciary duties, which are enforceable in the same way as any other fiduciary duty owed to a company by its directors.

Section 178(1) of the CA 2006 sets out that the consequences of breaching the statutory duties imposed are the same as if the corresponding common law or equitable duty applied.

7.1 Charitable companies

The key relevant provisions of the CA 2006 regarding conflicts of interest are essentially those contained in Chapter 2 Part 10 which introduced for the first time a statutory statement of company directors' duties. As subsections 170(3) and 170(4) CA 2006 make clear, the statutory statement of these duties in sections 171-177 is essentially a codification of the common law and the duties are therefore to be interpreted consistently with this:

> *"(3) The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.*
>
> *(4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties."*

It has already been seen that at common law directors are fiduciaries and so subject to the duty not to put themselves in a situation where they have interests which conflict with their duty to the company.

In brief the statutory duties are:-

s. 171 Duty to act within powers

s. 172 Duty to promote the success of the company

s. 173 Duty to exercise independent judgment

s. 174 Duty to exercise reasonable care, skill and diligence

s. 175 Duty to avoid conflicts of interest

s. 176 Duty not to accept benefits from third parties

s. 177 Duty to declare interest in proposed transaction or arrangement

As already indicated, some of these obligations are modified to make them applicable to charitable companies and charity trustees. Section 175(1) of the CA 2006 sets out the basic duty to avoid a conflict of interest:

> *"(1)"A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company."*

Section 175(2) goes on to detail that a director benefiting from the exploitation of any property information or opportunity would be in breach of this duty even if the company itself could not benefit from such exploitation.

> *(2)This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity)"*

Section 175(3) as modified by section 181 in respect of charities states:

> *"This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company if or to the extent that the company's articles allow that duty to be so disapplied, which they may do only in relation to descriptions of transaction or arrangement specified in the company's articles."*

Article 7 of the Charity Commission's model articles (which can be found at http://www.charitycommission.gov.uk/media/94703/gd1textc.pdf) sets out the extent to which we consider the articles should authorise such an arrangement.

Section 175(4) states:

> *(4) This duty is not infringed-*
>
> *(a) if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or*
>
> *(b) if the matter has been authorised by the directors.*

Section 175(5) as modified by section 181 in respect of charities sets out the requirement for authorisation by the directors –

> *"Authorisation may be given by the directors where the company's constitution includes provision enabling them to authorise the matter, by the matter being proposed to and authorised by them in accordance with the constitution."*

The Charity Commission model articles set out a procedure which is considered appropriate for this purpose:

- Article 9 limits the directors to authorising a conflict of loyalty which does not involve a direct or indirect benefit of any nature to a director or to a connected person.
- Article 8 requires a director who has a direct or indirect interest in a proposed transaction or arrangement with the charity to declare that interest and to absent themselves from any discussions of the directors in which it is possible that a conflict will arise. In some cases this will be sufficient to avoid a conflict of interest and so comply with the duty in section 175(1).

Section 190

Section 190 CA 2006 sets out the basic rule in relation to companies, namely that:

> *(1)* ***A company may not enter into an arrangement under which-***
>
> *(a) a director of the company or of its holding company, or a person connected with such* ***a director, acquires*** *or is to acquire* ***from the company*** *(directly or indirectly) a substantial non-cash asset,* ***or***
>
> *(b)* ***the company acquires*** *or is to acquire a substantial non-cash asset (directly or indirectly)* ***from such a director or a person*** *so* ***connected****,*
>
> ***unless the arrangement has been approved*** *by a resolution of the members of the company* ***or is conditional on such approval being obtained****.*

A 'substantial' non-cash asset is more particularly defined in section 191 CA 2006 but essentially is any property or interest in property other than cash (see s1163 CA 2006) whose value (in accordance with the current thresholds):

> *(2) ....*
>
> *(a) exceeds 10% of the company's asset value and is more than £5,000, or*
>
> *(b) exceeds £100,000.*

Section 191 then goes on to provide how a company's 'asset value' is determined

What is clear is that s190 (and the related ancillary provisions) is yet another example of statutory expression being given to the principle that any potential conflicts of interest, in this context, between a director or a person connected with such a director and a company of which or of whose holding company he is a director, must be either avoided or properly authorised.

That this is the case is further corroborated by the fact that s195 goes on to set out the potential consequences of failure to comply with the requirements of s190. Effectively, this latter section likewise codifies the consequences of non compliance set out in Part 4: namely that any unauthorised transaction is potentially voidable at the instance of the company on the one hand and the person(s) responsible for any such unauthorised transactions or arrangements will be liable to account for any unauthorised profits or to make good any resultant losses. Section 195 provides:

195 Property transactions: civil consequences of contravention

(1) This section applies where a company enters into an arrangement in contravention of section 190 (requirement of members' approval for substantial property transactions).

(2) ***The arrangement, and any transaction*** *entered into in pursuance of the arrangement (whether by the company or any other person),* ***is voidable at the instance of the company, unless....***

And, as indicated, section 195(3) goes on to state:

(3) Whether or not the arrangement or any such transaction has been avoided, ***each of the persons specified in subsection (4) is liable-***

(a) ***to account to the company for any gain*** *that he has made directly or indirectly by the arrangement or transaction,* ***and***

(b) (jointly and severally with any other person so liable under this section) ***to indemnify the company for any loss or damage resulting from the arrangement or transaction***

Section 195(4) then goes on to set out the potential categories of persons who may, subject to specified exceptions, be held liable for any such contravention. However, it is worth noting that the statutory provision widens this category beyond the scope of those who might be caught in equity, to include, for example, not only the director who was party to the transaction or arrangement and/or any person(s) connected with him/her but potentially also:

(d) any other director of the company who authorised the arrangement or any transaction *entered into in pursuance of such an arrangement.*

Obviously, as charities can be established as companies or may subsequently become incorporated, for example, by a transfer of assets from an unincorporated charity to a newly formed company of which some ,if not all of the directors are also trustees of the formerly unincorporated charity and/or indemnities against potential ongoing liabilities are given for the transfer of the assets, it is easy to envisage situations where the application of the provisions of s190 may be triggered. Other scenarios may include, for example, where a corporate trustee is newly appointed and the assets of the charity need to be vested in it by the charity trustees (as opposed where this is a statutory vesting effected by the Commission itself eg by use of its scheme making powers).

It should however be noted that, in relation to charitable companies, the obligations under section 190 are further overlaid by the additional requirements imposed by s.201 CA 2011. These state:-

201 Consent of Commission required for approval etc by members of charitable companies

(1) ***In the case of a charitable company, each of the following is ineffective without the prior written consent of the Commission-***

(a) ***any approval given*** *by the members of the company under any provision* ***of*** *Chapter 4 of Part 10 of the Companies Act 2006 (****transactions*** *with directors requiring approval by members)* ***listed in subsection (2), and***

(b) ***any affirmation*** *given by members of the company under section 196 or 214 of the 2006 Act (affirmation of unapproved property transactions and loans).*

(2) The provisions of the 2006 Act are-

(a) section 188 (directors' long-term service contracts);

(b) section 190 (substantial property transactions with directors etc);

(c) section 197, 198 or 200 (loans and quasi-loans to directors etc);

(d) section 201 (credit transactions for benefit of directors etc);

(e) section 203 (related arrangements);

(f) section 217 (payments to directors for loss of office);

(g) section 218 (payments to directors for loss of office: transfer of undertaking etc).

Section 201(2) CA 2011 makes it clear that this same principle also applies to the other specified scenarios eg loans by a company to or from a directors where the same potential issue of a conflict of interests could arise.

Having said this, even where s190 CA 2006 and s201 CA 2011 (or any provisions specified ins s201(2) CA 2011) are not invoked because , for example, the relevant transaction does not exceed the specified financial threshold required to constitute the transfer of a 'substantial' non cash asset or because the party to the transaction or arrangement is not, for example, a company but, say, a CIO, the same issue of a potential conflict of interest may nonetheless still arise and should likewise be avoided or properly authorised. In such cases, where such authorisation is not provided for by the charity's governing document, we would normally expect authorisation to be sought or documented by way of a s105 order.

There will inevitably be occasions where it is subsequently realised or comes to light, without any intentional impropriety on the part of the parties, that a s190 CA 2006 and s201 CA 2011 consent, or, for example, a s197 approval for a loan and related s201 consent ought to have been obtained to a proposed transaction or arrangement. In these circumstances, the respective statutory provisions provide a window of opportunity for such technical procedural defect to be remedied by affirmation. In the case of a failure to comply with s190 CA 2006, s196 CA 2006 provides:-

196 Property transactions: effect of subsequent affirmation

Where a transaction or arrangement is *entered into by a company in contravention of section 190 (requirement of members' approval) but,* ***within a reasonable period****, it is* ***affirmed-***

(a) in the case of a contravention of subsection (1) of that section, by resolution of the members of the company, and

(b) in the case of a contravention of subsection (2) of that section, by resolution of the members of the holding company,

the transaction or arrangement may no longer be avoided under section 195

and, in relation to any such subsequent affirmation, section 201(1)(b) CA2011 mirrors what would have been the requirements under s190 CA 2006, had it been correctly complied with, namely, the need to obtain the Commission's prior written consent to such affirmation. Section 214 CA2014 provides in relation to loans an equivalent provision to affirmation under s196 CA2006 and, needless to say, this likewise requires the Commission's prior approval under s201 CA 2011 as is expressly apparent from that section.

Whilst s196 CA201 only states expressly that, where a transaction or arrangement is subsequently affirmed, the transaction may no longer be avoided under s195 CA2006, we take the view that, where s201 CA2011 has also been complied with, such affirmation takes effect as if the transaction had been properly authorised in the first place and therefore, logically, the other remedies under s195(3) CA2006 are no longer available in such instances either. The same approach is applied to affirmation of loans under s214 CA2006 and s201 CA2011 respectively.

7.2 CIOs

The duties of charity trustees of CIOs are similar to the duties of company directors in that under:

A) Section 221(1) CA 2011 says:

> *"(1) Each charity trustee of a CIO must exercise the powers and perform the functions that the charity trustee has in that capacity in the way that the charity trustee decides, in good faith, would be most likely to further the purposes of the CIO."*

This duty is analogous to the duty of a director of a charitable company set out in section 171 CA 2006, as modified by subsection 170(2), and that contained in sections 172 and 174 CA 2006.

B) Section 222 says

> *"(1) A charity trustee of a CIO may not benefit personally from an arrangement or transaction entered into by the CIO if, before the arrangement or transaction was entered into, the charity trustee did not disclose to all the charity trustees of the CIO any material interest (whether direct or indirect) which the charity trustee had in it or in any other person or body party to it.*
>
> *(2) Nothing in subsection (1) confers authority for a charity trustee of a CIO to benefit personally from any arrangement or transaction entered into by the CIO."*

C) Regulation 34 of The Charitable Incorporated Organisations (General) Regulations 2012 (SI 2012/3012) states that a charity trustee of a CIO must not accept a benefit from a third party which is conferred by reason of the charity trustee being a charity trustee of the CIO or doing or not doing something as a charity trustee. This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest (regulation 34(3)).

D) Regulation 36 of The Charitable Incorporated Organisations (General) Regulations 2012 (SI 2012/3012) states that a charity trustee who would benefit personally, whether directly or indirectly, from a transaction or arrangement into which the CIO proposes to enter must not take part in the making of the decision whether or not to enter into that transaction or arrangement. It also states that such a charity trustee must not be counted in the quorum necessary for the discharge of that business.

This also applies to a decision of the CIO's members. Under section 220 of the Charities Act 2011 a member of a CIO must exercise the powers that the member has in that capacity in the way that the member decides in good faith would be most likely to further the purposes of the CIO. Accordingly, a member of a CIO also has fiduciary duties to the charity and must be careful to make a decision solely in the interests of the charity. She or he must also not take part in a decision to enter into a transaction or arrangement from which the member will benefit, directly or indirectly, and must not be counted in the quorum necessary for such a decision.