Charity law and the boundaries of non-political law reform

A public lecture for the Charity Law and Policy Unit at the University of Liverpool, 18 February 2016

Elizabeth Cooke

I am very grateful to the Charity Law and Policy Unit of the University of Liverpool for inviting me to give this lecture. It is a privilege to be able to make a very small contribution to the Unit's important work of research and education.

If I may add to Professor Morris's very kind introduction, perhaps I could summarise who I am, who I was, what I would like to be, what I am not, and what I am doing here. So:

- What I was: for many years an academic at the University of Reading; from 2008 to 2015 a Law Commissioner with responsibility for projects relating to property, family law and trusts. More about the Law Commission shortly.
- What I am: the Principal Judge of the Land Registration Division of the tribunal service. This is not relevant to this lecture.
- What I would like to be: able to get out and do a bit more rock-climbing, if the rain ever stops. This too is not relevant to this lecture.
- What I am not: government in any form, nor a charity trustee. Nor do I have any connection with any charity save as a donor, nor do I have any connection with the Charity Commission.
- What I am doing here: I would like to open a window for you on to the process of law reform, from the perspective of the Law Commission for England and Wales – an unusual and unique body with an important role in non-political law reform.

Much law reform is political. Promises for reform win votes and appear in manifestos. The Law Commission is designed to produce a different sort of reform: we are the maintenance men of the law. We install updates, mend leaks, re-connect pipes and put in new fittings in place of old. The Law Commission was created by the enthusiasm of an incoming government in 1965 with a mission – set out in the Law Commissions Act 1965 – to keep the law under review and to recommend reform to government. The Commission's specific brief initially was to clear out the dead wood of the law, the really antiquated material that a government department would struggle to find the time or the expertise to deal with. Over the years we have carried out that mission, and added new work that our founders could not have imagined. We are not concerned with government policy; we are not involved in major ideological issues (abortion and the death penalty are the usual examples, but also same-sex marriage and immigration are equally examples of topics outside our purview). Within my own area, property and trusts law, the Commission's work has led to the Trustee Act 2000, the Land Registration Act 2002, the Perpetuities and Accumulations Act 2009, and the Inheritance and Trustees' Powers Act 2014. Those titles alone give you a flavour of what we do. Much of it is undramatic. All of it has a real effect on millions of lives.

I pause to note that I have been using the personal pronoun "we". I am no longer a Commissioner; but old habits die hard, and in any event I still feel passionate about the Commission's work. I hope that something of what I say this evening will give you a sense of the importance and relevance of its often un-sung work.

I'd like to do this by using as a case-study the recent reform of trustees' powers to carry out social investment. The Commission is in the course of a project rather off-puttingly titled "Technical Issues in Charity Law", on which it has yet to report. The project picks up on a number of issues that arose

from Lord Hodgson's report on charity administration, "Trusted and Independent". Issues covered include the powers of the Charity Tribunal, the ability of certain charities to change their governing documents, the requirements charities must meet before they sell land – lots of very technical stuff. But at the request of the Government the Commission extracted one issue from the bundle and consulted early and separately on it. Last summer it produced recommendations and draft legislation, which are now awaiting royal assent as just one clause in the Charities (Protection and Social Investment) Bill 2016.

So what is social investment?

Let me make some introductions. Meet Tim the trustee. He is one of three trustees of a small local wildlife charity, with a few thousand pounds in the bank, a small income from donations each year, and a special interest in providing care for injured birds. He and his fellow trustees want to give a low-interest loan to an owl sanctuary. The interest on the capital lent will be at about half the market rate; the owl sanctuary is, Tim thinks, not at risk of defaulting on the loan.

Now meet Tina the trustee. She is one of twelve trustees of a large charity devoted to the rehabilitation of offenders. The charity has a large portfolio of investments. She and her fellow trustees want to buy a 25% shareholding in a small start-up company that aims to assist women to find employment after prison. There will be no dividends for the first seven years. The charity wants a shareholding partly to help finance the company, partly to encourage others to do the same, and partly to have voting power. It expects a small financial return eventually, and it expects to be able to sell its shareholding, again eventually.

Tim's plans and Tina's are both examples of social investment, where charity trustees make a financial commitment for some return, which may be small, while at the same time helping to advance the charity's objects. It can almost be seen as a short-cut. Tina and her fellow trustees could invest the money on the stock market and donate the income from its capital to the company; social investment short-circuits the process.

The diagrams below give two different pictures of social investment and ways of thinking about it.

Figure 1: social investment as a spectrum

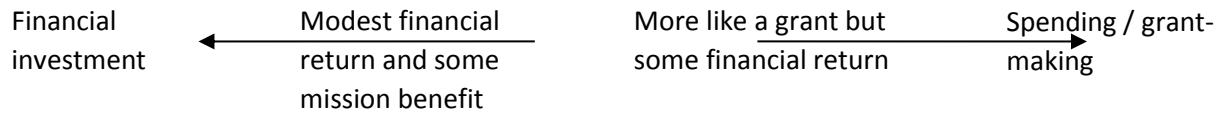
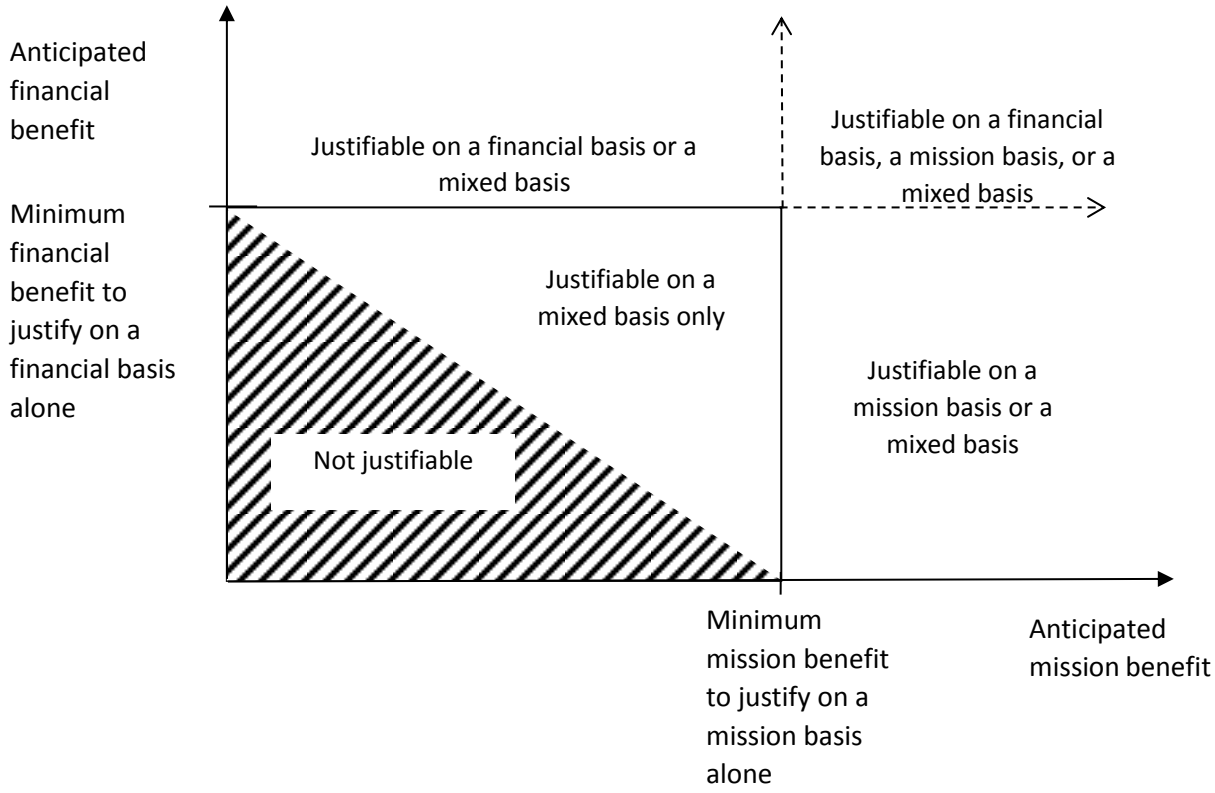


Figure 2: Mission and financial benefit from social investments



Trustees are under a duty to act in the best interests of the charity. There will be potential social investments that they have to reject because the combination of financial return and mission benefit is not sufficient to justify their expenditure. Hence the bottom left corner of the second diagram.

Now – moving back to Tim's and Tina's aspirations – these are such obviously good plans, so what is the problem and why might law reform be needed?

Let's take another look inside the head of a trustee and consider some of the things he or she ought to be thinking about. Relevant thoughts about social investment include the following:

- A charity trustee must act exclusively in pursuit of the charity's objects. So the charitable objective of the social investment must be within the trustee's charity's objectives. Tim and his fellow trustees cannot invest in a homelessness project, for example. Any private benefit – that is, benefit to people who are not the beneficiaries of the charity – must be limited to what is necessary and incidental; so Tina and her fellow trustees need to think hard about their investment if part of the object of the exercise is to encourage others to invest in the company. That is not to say that that objective is not legitimate, but that it must be thought about.
- A charity trustee can only do what the governing document of the charity says he or she can do. In other words, a trustee must act within his or her powers. A large charity created in recent years may well have a "catch-all" power to do anything in pursuit of the charity's objects. Tim, running a small and perhaps older charity, may well have a power to spend and a power to invest; the views of charity lawyers differ as to whether that is sufficient to

confer power to carry out social investment, which appears to be neither wholly expenditure nor wholly investment.

- A charity trustee is under a duty to act in the best interests of the charity. But there is more. Some trustees are subject to the duties imposed by the Trustee Act 2000, and must therefore have regard to the standard investment criteria – which include a duty to consider the suitability of investments and the need to diversify the charity's portfolio. A social investment may not fit comfortably within this picture.
- A charity trustee must not spend permanent endowment – that is, funds that have been given on condition that the capital is not spent. Tim or Tina may hold permanent endowment; they need to know what part of their charity's funds is and is not permanent endowment, and they need to be aware that they cannot use the latter for any endeavour where they do not expect the money to be preserved, pound for pound.

It is fair to say that there is plenty to make a charity trustee anxious here. Moreover, he or she is being watched, and there are many anxious observers:

- The public
- The beneficiaries of the charity
- Donors
- The Charity Commission
- Her Majesty's Revenue and Customs

The consequences of getting it wrong are considerable: the social investment itself may be void; a trustee may be removed; the charity may lose its charitable status.

Accordingly, whilst the Law Commission was asked by stakeholders in the course of its project for a "simple power" for charity trustees to carry out social investment, the statutory provision eventually enacted – it is currently awaiting royal assent – was neither brief nor particularly simple, at least at first sight. Section 15 of the Charities (Protection and Social Investment) Bill 2011 inserts three new sections in to the Charities Act 2011. A careful reading reveals that the words of these provisions respond carefully to many of the anxieties considered above.

Defining social investment New section 292A defines social investment. It captures everything on the scale within diagram 1 above. Careful provisos (eg 292A(7) ensure that there are no unwanted exclusions).

The trustee's powers The power to engage in social investment is set out in section 292B. The power is put beyond doubt; but so is the obligation to preserve permanent endowment. In an addition not suggested by the Law Commission, charities established by statute or by Royal Charter are excluded.

The trustee's duties when engaging in social investment are set out in 292C, and take the form of a structure for decision-making. In particular, trustees must consider whether they need to take advice on the financial or the charitable aspects of their proposed investment and, having considered that question, if they think they should take advice they must take it. There is no universal obligation to take advice. There is therefore an obligation to use common sense. Disproportionately expensive advice never has to be taken. Nor is there any need to take advice where the trustees are confident that their own expertise will carry them through. There is an obligation to review social investments "from time to time" … but no definition of "from time to time". Again, common sense takes centre stage.

Nowhere in these provisions is there any encouragement, let alone compulsion, for charities to carry out social investment. This is “can” and “may” but not “should”.

I hope that this lightning tour of a law reform project and its outcome may have given you an insight into how technical and law reform works. It has a place alongside, but not part of, the political process, keeping the law up to date and workable. To learn more, visit the website of the Charity Law and Policy Unit, or of the Law Commission for England and Wales.
Thank you for listening.