CAN A CHARITY'S ASSETS BE PROTECTED FROM CREDITORS?

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A view from the charities bar: the fourth instalment of a regular series by Matthew Smith, Maitland Chambers, counsel specialising in charity law and practice.

by *Matthew Smith, Maitland Chambers*

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Is it possible to create a **charity** which protects assets in perpetuity, even from the claims of creditors?

This question is often asked in anticipation of donations of valuable artefacts to museums or significant paintings to galleries. Unexpected litigation, pension deficits or the loss of core income streams can imperil even major charities.

Of course, any action taken by **charity trustees** to put an asset presently available to creditors beyond their reach is highly likely to be undone by a subsequent **liquidator** or other office holder. But can intending donors do anything to protect their gift at the outset and ensure that it will be available for posterity?

WEDGWOOD MUSEUM INSOLVENCY CASE

The issue arose in the insolvency of the Waterford Wedgwood group a few years ago:

- In the 1960s, the board of the trading company then known as Josiah Wedgwood & Co was nervous about a speculative takeover and the subsequent fire sale of its historic collection of pottery dating back to the time of Josiah Wedgwood himself.
- The board resolved to gift the assets to a new **charitable company** incorporated to take over its museum.
- Unfortunately, the museum company enrolled its curator in the trading group's pension scheme. When the group went into **administration** in 2009, the effect of the "last man standing" rule for **multi-employer pension schemes** visited the group's entire £134 million pension deficit on the charity (see *Practice note, Statutory debt on the employer: overview: Problems for "last man standing" schemes*).

On ordinary principles, a charitable company owns its assets beneficially to be applied in accordance with its objects. Those assets therefore fall to be distributed to its creditors on insolvency.

The issue for the court was whether, when the collection had originally been given to the museum, a **trust** of it had been created (such that it was not part of the museum company's own property). However, that was not in and of itself a sufficient argument to protect the assets from the claims of the pension fund. If the relevant liabilities had been incurred by the company in its capacity as a trustee, its creditors would be entitled to be subrogated to the company's right to be indemnified out of the trust assets in respect of liabilities incurred by it as trustee.

On the facts, the judge held that no trust had been created and, as a result, the ordinary principles of corporate insolvency applied (see *Legal update, Wedgwood Museum collection not held on separate charitable trusts and available to meet insolvency costs and liabilities*).

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However, it is interesting to consider some of the arguments that the **Attorney General** (AG) deployed in an attempt to avoid the creditors' claims on the footing that a trust did exist. They offer an insight into how one might try to protect assets on insolvency.

Asset held on special trusts

First, the AG suggested that the liabilities incurred by the museum company relating to its curator were liabilities incurred in the pursuit of its own (educational) charitable objects whereas it held the collection as part of its permanent endowment (and therefore on a special trust, the purpose of which was the preservation in specie in perpetuity of items of outstanding artistic merit).

In other words, a creditor could not have access to the assets of one charity to meet liabilities incurred in connection with another.

In the case of the museum company, the argument was plainly difficult because it had no substantial assets other than the collection and it is hard to see how it could have performed its educational object without them. But the argument has better prospects where a charitable company does many things and the asset held on a special trust is just one of many artefacts or works of art held by it.

Right of indemnity excluded

The AG also suggested that there was no reason in principle why a trust could not exclude the trustees' right of indemnity, such that the creditor had nothing to which it might be subrogated.

At common law, such a right was implied. However, it has had a statutory basis since the late nineteenth century and is now found in the Trustee Act 2000 (TA 2000). *Section 31* of TA 2000 provides that a trustee is entitled to be reimbursed from, or may pay out of, trust funds any expenses properly incurred when acting on behalf of the trust (see *Practice note, Protecting trustees who part with trust assets: overview: Protection under trust law: right of indemnity and equitable lien*).

Some commentators take the view that one cannot oust the effect of section 31 of TA 2000 by a provision in a trust deed to the contrary (and, of course, in the Wedgwood case the difficulty was that such an exclusion would have had to be implied).

However, the AG argued that there was no reason in principle why a trustee might not contract not to exercise any right of indemnity as a condition of accepting a gift. In such a case, no creditor could claim to be subrogated to that right. So, one might consider an express agreement to this effect as a term of any gift.

Of course, excluding the right of indemnity to leave a creditor without a remedy is unlikely to be acceptable to individuals of a traditional trust, as this will leave them personally exposed (see *Practice note, Charity legal structures and how to choose the right one for your client: Potential unlimited liability for trustees*).

Make the gift defeasible

A third possible strategy is to make the gift defeasible.

For example, a donor might gift a painting to a gallery on terms that there should be a gift over to another in the event of the insolvency of the initial recipient. (Of course, a private donor will rarely wish to reserve such a benefit to his or herself because that is likely to create taxation problems). Whether the **anti-deprivation principle** (a principle of insolvency law) would be engaged by such a gift over is an open question.

Lessons to be learnt

What is clear is that, to protect culturally valuable artefacts or significant paintings from creditors, a gift to a specific charity should be made on express terms that, at the very least, require the asset to be held on trust in perpetuity.

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Whether charity trustees of museums and galleries can successfully impose similar protection on existing collections by unilaterally declaring items to be held on such terms is open to debate.

A happy ending

And what about the Wedgwood collection?

Fortunately, sufficient funds were raised from the Heritage Lottery Fund, the Art Fund, several smaller trusts and public donations to purchase the collection for the nation. The collection was then gifted to the Victoria and Albert Museum in perpetuity and is on long-term loan to the Wedgwood Museum (refurbished and reopened in 2015 as part of the World of Wedgwood attraction).

For further detail, see *Victoria and Albert Museum: The Wedgwood Collection*.

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