CHARITABLE COMPANIES: HOW FAR DO FIDUCIARY DUTIES OF MEMBERS EXTEND?

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

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RESOURCE INFORMATION

RESOURCE ID

w-011-3430

RESOURCE TYPE

Article

LAW STATED DATE

8 November 2017

JURISDICTION

England, Wawles

In 2014 the High Court decided the biggest divorce case in English history: Sir Chris Hohn, hedge fund manager, was ordered to pay his wife, Jamie, $530 million.

But the real money didn't lie in their household fortune. It lay in the charity they had created together: the Children's Investment Fund Foundation (UK) which had assets of about $4.5 billion. It had an annual income of approximately $250 million, which was applied in support of children's programmes – mainly in the developing world.

The charity had been established as a *charitable company*, using the usual company limited by guarantee structure. The bitter breakdown in relationships which accompanied the divorce had an inevitable impact on the charity's governance. Husband and wife were two of the charitable company's eight directors (and therefore, its *charity trustees*). They were also two of the three members of the charitable company. The third was their university friend, Dr Marko Lehtimaki.

Eventually a deal was hatched:

- Each of the husband and wife would contribute $40 million to a new charity (to be run by the wife).
- The existing charity would make a grant of $360 million to the new charity and the wife would resign from the old charity.

Husband, wife and the remainder of the charity trustees agreed in principle, although the non-conflicted charity trustees of the existing charity made their approval of the grant conditional on *Charity Commission* (Commission) or court approval.

It was agreed that the court should be asked to bless the proposed grant.

An unexpected issue then arose. The deal would arguably come within the statutory definition of a payment for loss of office to a director (by reason of the wife's connection with the new charity). Under *section 217* of the Companies Act 2006 (CA 2006), such a payment requires the consent of the members. Under *section 201* of the Charities Act 2011 (ChA 2011), such consent requires the Commission's prior approval. For further details of these rules, see *Practice note, Transactions with directors requiring approval of members: Payments for loss of office*.

On the second day of the hearing of the charity trustees' application for the court to approve the grant, the court decided to join Dr Lehtimaki (the only member other than the husband and wife) as a party to the proceedings. The court was concerned that, if it was to go through the process of deciding whether it was in the best interests

of the charity to make the grant (in order to provide the charity trustees with the comfort they sought), it would be unfortunate if the sole member entitled to vote on the issue then came to a contrary conclusion.

In the event, the court decided that section 217 of CA 2006 did apply but that the deal was (in the unusual circumstances of the case) in the best interests of the Children's Investment Fund Foundation (UK) because:

- It would bring an end to its governance problems.
- The sum granted would be used (albeit by a new charity) in the pursuit of the Foundation's objects.
- Additional funds would be leveraged (by way of the wife's donation) for those charitable objects.

Charitable company members owe fiduciary duties

The High Court held that the members of a charitable company limited by guarantee owe fiduciary duties in connection with the exercise of their membership rights and that, since the court had decided that it was in the best interests of the Foundation to approve the grant, it would direct Dr Lehtimaki how to vote (in his capacity as a member).

The question whether the members of a charitable company owe fiduciary duties in connection with the exercise of their membership rights is an old chestnut which has divided charity lawyers for years. The Commission's view (that they do) was set out in a 2004 publication (see *Charity Commission: RS7 – Membership Charities*, at pages 33 to 34). But one of the leading charity law textbooks maintains a contrary view (see *Tudor on Charities, Sweet & Maxwell 10th edition, 2015*, at *section 6-051*).

So, now we know the answer. It is clear that members of a charitable company cannot vote in a *general meeting* or on members' resolutions otherwise than in a way which they genuinely believe to be in the best interests of the charity. They cannot use their votes to benefit themselves.

Implications of High Court's decision

But what might be the wider implications?

First, the decision suggests that, because the exercise of voting rights by members carries fiduciary obligations, the decision as to how to vote cannot (along with other fiduciary responsibilities) be delegated – at least not without a specific authority. Although *section 324* of CA 2006 extended the right to appoint a *proxy* to members of companies limited by guarantee (rather than simply companies limited by shares – which, subject to any express provision in the company's *articles of association*, was the position under the *Companies Act 1985*), it seems that a proxy can only be a delegate of the member. The member has to exercise his or her own independent judgment as to what is or is not in the best interests of the charity. The days of simply appointing the chair, or some other person, to cast a member's vote are over.

What is less clear is whether the duty extends to a duty to act. It is one thing to vote only in the best interests of the charity. It is another thing to be required to attend the general meeting (in the same way that charity trustees are expected to attend charity trustees' meetings) or at least to make the effort to vote. But if one's membership rights are subject to fiduciary obligations, it presumably follows that one must consider whether to exercise them from time to time.

Even less clear is how far the duties ordinarily attendant upon a fiduciary are to be extended to members. If members have valuable rights as such are they entitled to sell them and to profit personally? If so, does that have an impact on the charitable status of the institution in question? And to what extent can a company's articles of association relieve the extent of the duties?

Although the good sense of the outcome in the present case cannot be doubted, its consequences will take some time to explore.

Permission to appeal has been granted by the Court of Appeal.

For further details of the decision in *Children's Investment Fund Foundation (UK) v Attorney General and others [2017] EWHC 1379*, see *Legal update, Charitable companies: members must act in best interests of company (High Court*).