The Charity Law & Practice Review

TRUSTEE BENEFIT

Michael King[1]

Section numbers by themselves refer to the Charities Act 1993. The Charity Commissioners for England and Wales are referred to as "the Commission".

1. The No-Benefit Rule

1.1 Lord Herschell explained the no-benefit rule in admirably clear language in his *Bray v Ford*[2] judgment:

> "It is an inflexible rule of a Court of Equity that a person in a fiduciary position is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict"

Lord Herschell's words are admirably clear, yet a century later the rule is too often honoured in the breach.

1.2 The Commission are equally clear in their Guidance Leaflet CC11:

> "Charities exist for the public benefit. Those who administer charities must act altruistically and not for their own benefit."

And again in the Commission's 1999 Consultation Paper on Trustee Remuneration:

> "The purpose behind the principle of unremunerated trusteeship is a practical one; to control the human weakness that might lead the remunerated trustee to put private interests before duty to the

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2 *Bray v Ford* [1896] AC 44.

> charity and to deal with the fact that those who are absorbed in the work of a charity may not be sufficiently aware of a conflict of interest that is perfectly obvious to an objective observer"

The principle of voluntary altruistic governance is part of the culture of this country. In the view of the Commission it has helped to shape the ethos of the charity sector.

1.3 The no-benefit rule does not of course prevent trustees from recovering out of pocket expenses properly incurred in the execution of the trust [s.30(2) Trustee Act 1925]. However, the trustee cannot reclaim anything for his time and trouble – *Re Baber.*[3] It is sometimes difficult to know where out of pocket expenses stop and unauthorised benefits begin:

> A client of ours is a national umbrella group in the field of education, one of whose trustees is a teacher whose employer would not permit her to be absent from school for trustees meetings about four times a year unless a supply teacher was provided. The school asked the trustees of the charity to cover the cost of this supply teacher.
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> Although the Charity has wide powers to remunerate trustees for services which it needs, the Commission indicated that they would consider this payment benefit to the trustee if the charity were to make the payment. We begged to differ, mainly because the charity advanced education and any payment to a school would necessarily be charitable. However, it has occurred to us that if the teacher paid the cost and claimed it from the charity, that might be out of pocket expenses properly payable in the same way as a train fare or childcare.

1.4 If the no-benefit rule is so much part of our charitable heritage, how is it that breaches falling well short of theft are still occurring in substantial numbers? In 1998 the Charity Commission opened 194 s.8 Inquiries, of which possibly 30 dealt with trustee benefit issues. Why in particular are breaches of the rule occurring commonly where the governing instrument forbids payments to trustees, direct and indirect and largely in circumstances where the errant trustees appear to be acting entirely without malicious intent and in ignorance of their breach of trust?

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3 *Re Baber* (1886) 34 Ch D77.

Perhaps:

- because they haven't read the governing document
- because they have but do not understand it
- because they think that, if their motives are pure and if they are adding value to the charity, they cannot be at fault
- because they know that they can recover out of pocket expenses and consider that a payment to reimburse loss of earnings is a merely logical extension
- because they do not understand the concept of *indirect* benefit, - for example a payment to a professional firm of which the errant trustee is an equity partner or of fees a director of the charity's trading subsidiary who is also a trustee.

1.5 A scenario which I have often encountered is where a trustee resigns his trusteeship in order to be appointed to a paid position with the charity. In *Wright v Morgan*[4] the House of Lords held that it was not open to a trustee to resign in order to obtain a benefit which, as a trustee, he would not have been entitled to retain. Such a practice is a breach of trust and sadly is not uncommon, yet it is so easily avoided, for example by ensuring that the trustee in question resigns and is interviewed against criteria which he has had no part in preparing and preferably in comparison compared with other candidates for the job.

2. Exceptions to the No-Benefit Rule

2.1 The requirement to act gratuitously can obviously be waived if the governing document so allows. In practice one does regularly see remuneration clauses which allow one or more of the following benefits, and not only in the more recent governing documents:

- payment of an honorarium to an officer (e.g. a Treasurer) who is a trustee

4 *Wright v Morgan* [1926] AC 788.

- payment of a fixed attendance fee to all trustees, for example an 1893 Will Trust of which I am a trustee allows £5 per trustee twice yearly!

- payment of salary as Chief Executive to a named founder-trustee

- a standard professional charging clause, e.g. *"any trustee being a solicitor or other person* engaged in a profession shall be entitled to be paid fees for work done by him or his firm on the same basis as if he were not a trustee but was employed to act for the trustees".

- The CLA model governing documents allow up to half the trustees (or their firms/companies) to be remunerated provided that they follow basic rules to avoid conflicts of interest. These rules follow Commission advice in *Decisions, Vol. 2*[5] to ensure that the sum is related to services provided to and needed by, the charity, that the sum is reasonable having regard to those services and the ability of the charity to pay and that the trustee is absent when his terms are discussed and declares any interest he may have in the subject under discussion.

2.2 There are other situations where the no-benefit rule can be breached:

- where there is statutory authority, e.g. for teacher-governors in voluntary aided and foundation schools [Sch.9, School Standards and Framework Act 1998]

- where the Commission has given prior authority by virtue of a s.26 Order or in the case of a charitable company by consent under s.64 to amend the Memo and Arts, on the basis that such authority is "expedient in the interests of the charity".

- where a solicitor-trustee (or presumably any professional person) instructs his partners to act for himself and his co-trustees. However, there must have been ***prior*** agreement that the trustee would not share in the profits arising from the instruction – *Re Doody*[6]

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5 Decisions of the Charity Commissioners Volume 2 – August 1994.

6 *Re Doody* [1893] 1 Ch 129.

This was confirmed in *Re Gates*[7] in which Clauson J said, *"if the [solicitor-trustee] had employed other members of the firm to act as his solicitors, I should have felt justified ... in allowing his partners to take the profit costs. The difficulty is that the [solicitor-trustee] here did not take that course. Instead of doing so, he employed and acted by his firm and in so acting ... was acting as solicitor on his own behalf in transacting the legal business connected with the trust ..."*

In *Re Coxen*[8] a bequest provided for the giving of a dinner to trustees was considered charitable as tending to promote the efficient administration of the charity. In his article on Remuneration of Charity Trustees (CL & PR Vol 1 1992/3) Christopher McCall QC comments on *Re Coxen*, *"If that is correct, then how much the more reasonable to pay for the effort involved in discharging the trusteeship"*.

2.3 Finally there are those cases where common sense combines with custom and practice to waive the rule, whether or not with the formal approval of the Commission:

- where villagers who use a village hall and its facilities or where members of a theatre or museum receive certain benefits as part of their subscription, (e.g. a free newsletter, certain access rights or priority for ticket sales), those villagers or members who are trustees may take those benefits provided that, *qua trustees,* they receive no greater benefit than other members in a particular subscription class.

- where nuns, monks and other members of religious orders are provided with facilities or are maintained by the charity carrying out the order's charitable works, a trustee-member may take such notional benefits so long as they are not enhanced for someone who is a trustee. For example, the abbot of a monastery (who is invariably a trustee) might well need a car to fulfil his role; logic dictates that he may take that "benefit" because he does not receive it as trustee but as abbot.

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7 *Re Gates, Arnold v Gates* [1925] Ch 913.

8 *Re Coxen* [1998] Ch 747.

- I have been told by the Commission that the provision of care in a hospice to a person who happens to be a trustee (or to members of his family) would be a breach of trust; I would beg to differ, provided of course that the trustee (or his family) received no greater care or admissions priority than fellow sufferers. In any event it might be of great advantage to the Board for one of their number to experience at first hand the care provided.

Trustees who are worried about breaching the no-benefit rule in these and similar situations can always ask the Commission for formal advice under s.29 or for an order/consent under s.26/S.64

3. Consequences of Breaching the No-benefit Rule

3.1 The judge in *Re Keeler*[9] opined that:-

"The onus is on the fiduciary who takes unauthorised remuneration and desires to retain it to obtain proper authority for such retention within a reasonable period of becoming aware of circumstances which make the payments to him recoverable by the party to whom the fiduciary duty is owed

.....

The cost of obtaining such authority is usually the responsibility of the fiduciary (whether or not he is successful)"

This precedent is quite a hill to climb for a trustee who is in breach, all the more so if there is a specific prohibition in the governing document against trustees taking benefits, direct or indirect. As Lord Templeman observed in *Guinness v Saunders*[10]:

> "A director who does not read the articles or a director who misconstrues the articles is nevertheless bound by the articles".

3.2 The Court has discretionary power under s.61 Trustee Act 1925 to grant relief from liability for breach of trust but that power is interpreted under equitable principles, so it is crucial that the errant trustee is seen to have

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9 *Re Keeler's Settlement Trusts* [1981] Ch 156.

10 *Guinness plc v Saunders* [1990] 1 All ER 652.

acted properly and honourably throughout - "he who comes to Equity must come with clean hands". Bearing in mind the judgment in *Re Keeler* it is surely for the errant trustee, not the charity, to take steps to ask the Court to exercise the power to grant equitable relief, because the errant trustee is under a duty to account to the charity as constructive trustee for any benefit which he has received.

3.3 Any right minded person would surely support trustees and indeed the Commission in ensuring that a trustee who has had his hands in the till or who even was grossly negligent with the charity's money or property should restore to the charity what it had lost. However, the greater number of breaches of the no-benefit rule involve, in my experience, technical breaches of trust where the charity has lost no money but by contrast has received good value from the services provided by the errant trustee. Of course the possibility of conflict of interest remains, but that is also theoretically true whenever there is a power for a trustee to charge or be remunerated.

3.4 What then must the trustees do in these circumstances when, by all objective criteria, the "errant trustee" has added value and has charged, or been remunerated at, no more than the market rate and has not been primarily motivated by the benefit which he has wrongly obtained from the charity?

The answer is that the trustees must ask for return of the whole payment made by the charity for the service provided because charity trustees are obliged under general principles to enforce the charity's claim against people who owe it money. While there will be circumstances where it will not be in the charity's interests to pursue such a claim, the Commission consider these to be comparatively rare; certainly they are not very happy, given the *Guinness v Saunders*[11] judgment, to let professional trustees off the hook.

3.5 Trustees may well regard the law, thus interpreted, as harsh and lacking objectivity for these reasons:

- unlike the situation where money has been stolen from the charity or is owed to the charity by a debtor, there is rarely a willingness on the part of trustees to pursue someone with whom they have worked who has provided a satisfactory service, albeit in technical breach of the no-benefit rule.

11 *Guinness plc v Saunders* [1990] 1 All ER 652.

- trustees are often unhappy to pursue the errant trustee for what is in effect a bonus to the charity, given that the service for which he was paid in breach of trust would have had to be paid for in any event.

- trustees do not necessarily want to lose the "errant trustee" from the Board or face the bad odour, even bad publicity, which would be engendered.

3.6 The Court has inherent jurisdiction to authorise remuneration - see *The Duke of Norfolk's Settlement*[12] in which the Court awarded trustees enhanced remuneration for past services and allowed prospective trustees to make greater charges than those provided for in the trust instrument.

It is clear from the *Norfolk* case that the Court has to balance two principles:-

(1) that a trustee's office is gratuitous, but

(2) it is of major importance that a trust is properly run; it may be in the best interests of a trust and its beneficiaries that trustees be properly paid for their work.

3.7 The Commission do not however consider that their concurrent jurisdiction with the High Court extends to authorising charity trustees retrospectively to retain unauthorised remuneration.

3.7.1 The Commission's view is that, although they can exercise their power to allow *future* unauthorised trustee-benefits on the basis that it would be *"expedient in the interests of the charity"* [s.26(1)], they cannot sanction *past* unauthorised trustee-benefits because the charity already has the right to restitution of the benefit and it cannot therefore be in the charity's interests to give that up.

3.7.2 My own view is that the Commission should be able to consider, not just the money owed to the charity, but other factors such as:

- the trustees' wish to maintain good relations with the "errant trustee";

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12 *Re Duke of Norfolk's Settlement Trusts* [1982] Ch 61.

- the fact that the trustee benefit has been given in return for services received by the charity;
- the effect of adverse publicity on the charity;
- the manifest unfairness of pursuing a trustee who has incurred no loss;
- or, the sheer waste of time in trying to pursue money that was never lost.

I have wondered whether the Commission might in some instances be persuaded to use their power under s.27(b) *"to waive to any extent, on behalf of a charity, its entitlement to receive any property where the trustees consider that they have a moral obligation to do so"*, but I think that the moral obligation would have to be a strong one.

3.7.3 In the unreported case *Re Smallpiece Trust*[13] the Court indicated the circumstances in which it would be prepared to authorise remuneration in the future. The judge (denying members of a charitable company the right to alter its Memorandum to provide the best remuneration for its trustees) said :

> *"I would accept the formulation of the Charity Commission that in order to justify a right to charge the trustees have to show that it is both necessary and reasonable in the interests of the charity".*

It is perhaps a pity that the judge used the word "necessary" rather than the words "expedient in the interests of the charity" which is the Commission's test in deciding to make a s.26 Order. I suggest that the Commission should follow the wording of s.26 rather than the judgment in this unreported case, which does not appear to have arisen out of a failure to interpret "expedient in the interests of the charity".

3.8 Apart from "equitable relief" are there any other deductions which the trustees can reasonably allow when calculating the amount of restitution?

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13 The Smallpiece Trust - Charity Annual Report 1990 - p. 36.

Certainly:

- unclaimed out of pocket expenses of the current trustee.

Speculatively (and as this is in the realms of speculation, applying to the Court for equitable relief or asking the Commission to approve a compromise may well be sensible):

- VAT and other taxes which have been paid by the errant trustee to HM Customs & Excise or the Inland Revenue, unless of course these can be recovered by the errant trustee.

- the cost to the errant trustee (or his firm) of producing the service for which he has charged. If it costs £750 to produce a service costing £1000, is it reasonable for the errant trustee to have to repay the full £1000? Should the restitution therefore be limited to £250, the profit or benefit to that firm?

- but what about the benefit which the errant trustee actually shares with his partners? In the scenario above, suppose the errant trustee has four partners, he and they sharing equally. Should he be asked to return £250 for every £1000 charged to the charity or merely his personal benefit, £250 ÷ 5 = £50? The *Re Gates* case was, after all, decided 75 years ago when professional partnerships were very much smaller than is now the case. Mr Arnold, the errant trustee, had just two partners:-

3.9 In *Boardman v Phipps*[14] the Court awarded remuneration "on a generous scale" equated to the profits which the trustee had gained for himself through the technically improper use of information which formed part of the property of the trust.

3.10 Given that a restitution case, if started by the charity, would be "charity proceedings" requiring consent from the Commission under s.33, and given that litigation may not necessarily be in the best interests of the charity, a compromise to intended litigation may perhaps be approved by the Commission by means of a s.26 Order. Alternatively, rather than the charity having to commence proceedings, all that may be necessary for the charity is to ask for restitution and leave it to the errant trustee to put forward to the Court a request for equitable relief.

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14 *Boardman v Phipps* [1967] 2 AC 46.

3.11 The Commission do however appear to exercise a certain discretion in some cases by pointing out the trustees' duty to pursue an errant trustee and at the same time closing the s.8 Inquiry (if there is one) or bringing the correspondence to an end. Whether such judicious discretion is within the Commission's formal policy or Operational Guidance is open to doubt - more likely it is a commonsensual acceptance that the trustees, having been advised of the law, are the best judges as to what is in the best interests of the charity.

4. Miscellany

4.1 In their Information Sheet INF3 the Commission repeat at length their views that power to pay premiums for *Trustee Indemnity Insurance* ("TII") needs their consent if the power does not already exist, on the premise that TII provides a benefit to the trustee personally rather than the charity.

4.1.1 I have never wholly understood that argument because trustees who give their time, expertise and energy voluntarily to a charity should surely not as a matter of public policy be placed in the position where they are personally liable for acts not knowingly or recklessly committed. It is decidedly not in the charity's interest to have trustees resigning or refusing to join the Board because there is no TII cover.

4.1.2 In any event, far greater personal protection becomes available to trustees upon incorporation as a company limited by guarantee, giving the trustees protection against contractual and tortious claims.

4..1.3 However, one generally accepts the Commission's ruling on this point given that a s.26 order (or s.64 consent or amending a Memorandum of Association of a charitable company) is very easy to obtain.

4.2 **User trusteeship** is very much in vogue and so it should be. Charities which provide services will often want to involve the users of those services in improving those services. Subject to the governing document there is no reason why such involvement should not be at trustee level. The Commission is about to produce guidance on User Trusteeship in leaflet CC24 which they say will tackle issues such as the appointment or

election of users as trustees, the need for authority from the governing document or from the Commission itself and the management of conflicts of interest.

4.3 Questions surrounding the appointment of *employees as trustees* have been touched on above but they are discussed in the Commission's recent Consultation Paper on the Remuneration of Trustees. Management of potential conflicts of interest, in particular, needs careful consideration.

There has long been a precedent for employee-trustees in terms of teacher-governors in voluntary aided and foundation schools (which are charities, albeit exempt). The presence of teachers on governing bodies in the independent sector of education is much less common probably because decisions of governors have such a direct bearing on terms of employment. In my experience head teachers and bursars of independent schools are usually "in attendance".

4.4 Charity Commission Consultation Paper on Remuneration of Trustees 1999

4.4.1 In September 1999 the Commission produced an interesting Consultation Paper on Trustee Remuneration and the consultation period has now ended. The paper had two main discussion points:

- how the Commission should deal with questions on trustee remuneration under the current legal framework
- whether the Law Commission's proposals, for the Home Secretary to be given powers to make regulations for the remuneration of trustees of charities, should be supported.

4.4.2 The Charity Law Association has made extensive comments on the Consultation Paper which in summary are:

- public confidence in the charity sector appears to depend on the principle of voluntary trusteeship being upheld and generally trustees should be volunteers in the true sense of the word
- existing and new charities should be given the power to pay trustees for professional or specialist services (interpreted as

widely as possible) and the test as to whether such powers should be used and what the level of remuneration should be, should be whether it would be expedient in the interests of the charity

- on balance, the number of trustees providing such remunerated services should not exceed one third at any time

- the CLA is opposed to trustees being paid simply for being trustees, in similar fashion to non-executive directors

- it might however be appropriate for existing employees to be appointed as trustees provided they remain in a minority and provided the *"expedient in the interests of the charity"* test is applied

- some way needs to be found to broaden the social and experiential base of trustee boards and employers who allow their staff to attend such meetings.

5 Postscript

I am indebted to Francesca Quint of Counsel for pointing out the possible relevance of the decision of Blackburne J in *Nationwide Building Society v Various Solicitors* (No.3) *Times* 1st March 2000.

As may already be known to the reader, this case concerned firms of solicitors who acted on both sides of conveyancing transactions and had allegedly caused loss to the Nationwide but the report is significant in that it sets out the principle on which restitution should be made following breaches of fiduciary duty, an expression which Mrs Quint considers wide enough to cover a breach of duty by a charity trustee. In his judgment Blackburne J made it clear that compensation in such cases should reflect the actual loss suffered and that, in assessing the loss, the Court was entitled to draw a reasonable inference about what would have happened had there been no breach of duty.

As mentioned earlier in this article, there are many cases of breach of trust which one encounters in practice where the charity has suffered no loss as a result of a trustee's breach of duty but rather the trustee has taken an unjustified benefit and the question then arises as to what extent there should be restitution of the benefit. An errant trustee, for example a professional man who has, unauthorised, charged his charity fees for his professional work, may very well

argue in the light of the Nationwide case that, in the absence of dishonesty or bad faith, the amount of restitution should be the actual loss resulting from the breach of trust and not the benefit actually received by the trustee.