PROTECTION OF CHARITIES UNDER THE CHARITIES (PROTECTION AND SOCIAL INVESTMENT) ACT 2016: TOO LITTLE OR TOO MUCH?

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This article is based on the 2016 Annual Public Lecture of the Charity Law and Policy Unit at the University of Liverpool University by the author on 25 October 2016. It focuses on those provisions of the Charities (Protection and Social Investment) Act 2016 (the '2016 Act') which deal with the protection of charities.

Background to the 2016 Act

Following the review in 2011[1] by Lord Hodgson of Astley Abbots of the Charities Act 2006, which reformed charity law in particular by the strengthening of the public benefit and the restatement of what constitute charitable purposes, the Law Commission has been considering further reforms,[2] which can be expected in the next few years. One of the matters considered by the Law Commission in advance of the other topics was the formal recognition of social investment as a proper use of charitable funds.[3] The addition of a section on social investment to what was originally the Charities Protection Bill was an afterthought, and there is no substantive connection between the two portions of the Act. The Bill appeared at a time when public awareness of and concern about certain behaviours by charities was aroused for a number of reasons and discussed by, *inter alia*, the Public Accounts Committee and the Public Administration and Constitutional Affairs Committee of the House of Commons. These reasons included the sad death of an

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1 Cabinet Office, *Trusted and Independent: Giving charity back to charities – Review of the Charities Act 2006* (July 2012).

2 See http://www.lawcom.gov.uk/project/charity-law-selected-issues/

3 See http://www.lawcom.gov.uk/project/charity-law-social-investment-by-charities/

elderly lady, Olive Cooke, who had been depressed and had also been the recipient of numerous fundraising approaches on behalf of charities;[4] the tax avoidance scandal caused by the way in which the Cup Trust was administered, which led to severe criticism of the Charity Commission for England and Wales (the 'Commission') as well as of Mountstar, the BVI corporate trustee, and to lengthy legal proceedings;[5] the sudden collapse of the charismatic Kids Company after substantial and seemingly unsupervised Government support was withdrawn;[6] worries about Age UK's handling of its association with a commercial partner;[7] and more generalised concerns over potential terrorist infiltration into charities and increasing religious intolerance brought to light by an ITV 'Exposure' programme[8] as well as various inquiries by the Commission. In addition, the swingeing economies forced on the Commission itself had led it to reduce the scope of its activities, causing public dissatisfaction with its performance, and many charities were suffering from strained financial circumstances which had resulted from the effect of official austerity measures on the national economy. Against that background, the Commission actively sought additional powers which it felt would enable it to act as a more effective regulator.

Main purposes of the Act

The principal purposes of the 'charities protection' provisions in the 2016 Act are to confer on the Commission certain additional powers in cases where misconduct or mismanagement is shown or suspected, and to introduce reforms into the regulation of fundraising both for strictly charitable and for benevolent or philanthropic purposes. The new powers can be divided into two completely new powers and a number of powers which modify or complement pre-existing powers. There is an evident emphasis on preventive rather than merely corrective action, the opportunity is taken to clarify what behaviours are covered by 'misconduct' and 'mismanagement', and certain powers applicable to charity trustees and trustees for charities (to whom I shall refer simply as 'trustees') are extended both

4 See House of Commons Public Administration and Constitutional Affairs Committee, *The 2015 charity fundraising controversy: lessons for trustees, the Charity Commission, and regulators* (Third Report of Session 2015–16, HC 431, 25 January 2016).

5 See House of Commons Committee of Public Accounts. *Charity Commission: the Cup Trust and tax avoidance* (Seventh Report of Session 2013–14, HC 138, 4 June 2013).

6 See House of Commons Public Administration and Constitutional Affairs Committee, *The collapse of Kids Company: lessons for charity trustees, professional firms, the Charity Commission, and Whitehall* (Fourth Report of Session 2015–16, HC 433, 1 February 2016).

7 See Miles Brignall, 'Age UK criticised over E.ON partnership', *The Guardian*, 19 April 2016.

8 ITV, *Charities Behaving Badly*, 18 February 2015.

to the holders of senior management posts within charities and to the directors or equivalent officers of corporate bodies which are themselves trustees. Generally, the overall aim of the Act can be viewed as the provision of a more effective legislative regime for preventing and curtailing avoidable harm to charities and thereby encouraging public trust and confidence both in charities and in the Commission.

Technical matters

The 2016 Act is divided into 17 sections. Section 15 adds three sections to the Charities Act 2011 (the '2011 Act') which deal exclusively with social investment by charities. Sections 1 to 12 amend the 2011 Act by adding new powers exercisable by the Commission. Sections 13 and 14, which deal with fundraising, amend the Charities Act 1992 (the '1992 Act') as well as the 2011 Act. Section 16 provides for ministerial reviews of the 2016 Act – the first to be conducted within four years of Royal Assent and subsequent ones to be conducted at five-yearly intervals – to gauge the effect of the new legislation on public confidence in charities, the level of charitable donations and the public's willingness to volunteer. Section 17 relates to formalities, i.e. the short title, commencement, extent (the Act is confined to England and Wales) and the making of regulations. Commencement Regulations[9] were made on 27 July 2016 under which the bulk of the Act came into force on 31 July 2016, sections 10 and 11 (disqualification orders) on 1 October 2016, and section 1 (official warnings), section 13 (fundraising agreements) and part of section 2(2) (which depends on section 1) on 1 November 2016. At the time of writing, it is expected that the remaining provisions, i.e. section 12 (the civil and criminal consequences of acting while disqualified on the officers of corporate trustees of charities) and most of section 9 (extending the occasions for automatic disqualification) will take effect on 1 April 2017.

Two completely new powers for the Commission

(1) *Official warnings*

Section 1 of the 2016 Act inserts a new section 75A into the 2011 Act. This confers on the Commission power to issue an 'official warning' either to a trustee who is thought to be involved in a breach of trust or in behaviour amounting to misconduct or mismanagement or to a charity which has been affected by such a breach or behaviour. The power can be exercised at any time, whether or not (but usually not) a formal inquiry under section 46 of the 2011 Act has been opened.

9 The Charities (Protection and Social Investment) Act 2016 (Commencement No 1 and Transitional Provision) Regulations 2016 (SI 2016 No 815).

The form of the warning, and whether (and if so how) to publicise it, is entirely within the Commission's discretion, and, although the decision to issue a warning can be regarded as a 'final decision', there is no appeal to the First-tier Tribunal (Charity) (which for convenience I shall refer to as the 'Charity Tribunal'). The only statutory safeguards for trustees who may be affected by such a warning are (i) the requirement to give notice of the proposed warning, setting out that the warning is proposed to be issued under section 75A of the 2011 Act, the grounds for the proposed warning, the corrective action which the Commission considers appropriate and the proposed publicity for the warning, and (ii) the invitation to make representations (within a given time limit) which the Commission is then obliged to consider before proceeding. The Commission has power to modify a proposed warning or, upon notice giving the reasons, to vary a warning which has already been issued. It may also decide not to proceed to issue a proposed warning or to withdraw a warning which has been issued. The indications are that notice will normally be of 14 days and that a warning, once issued, will remain live on the Commission's website for two years before being archived. The new power has been the subject of considerable criticism from the charity sector, especially the fact that the only remedy for those aggrieved is to seek permission to bring proceedings for judicial review – an unattractive possibility given the expense and publicity involved. An appeal to or an application for review by the Charity Tribunal would seem more proportionate.

The Commission's response has been to emphasise that an official warning is intended to have a greater cautionary effect than (for example) an unofficial warning given in ordinary correspondence or the publication of a 'Regulatory Case' with or without the issue of 'Regulatory Advice', but is genuinely intended only for less serious cases: it is a milder form of action than the exercise of the stronger powers available when the Commission is satisfied that misconduct or mismanagement has taken place or steps are required to protect the charity's assets or their proper application.[10] It is not apparent, however, that the Commission fully appreciates the potential effect on a charity's general reputation and fundraising potential if the charity or any of its trustees is the subject of a published official warning, quite apart from the effect on the professional or business reputation of an individual trustee who is so subject, especially given the fact that the great majority of trustees are volunteers. It is unlikely that readers of the charity press, let alone of less specialised publications, will be able to draw a clear distinction between an official warning by the Commission and (say) the kind of criticism of individual trustees that often appears in the report of a formal inquiry. The new section can be seen as flawed in that, although the Charity Commission is on record as stating that it will take account of representations

10 See Charities Act 2011, s 76.

made about the proposed publicity arrangements, the statutory provisions[11] limit the scope of the representations to be invited in the relevant notice to the 'content' of the proposed warning. Errors or misjudgements in the content should, of course, be able to be corrected, but since it is the publicity that is most likely to be the direct cause of damage, it is a pity that section 75A does not accurately reflect the Commission's stated intention. Furthermore, it would strengthen the Commission's stance in treating warnings as applicable in less serious situations if the warnings were to be complemented by genuine efforts on the Commission's part to guide and help the trustees of a charity in continuing to administer it once an official warning has been issued.

(2) *Discretionary power of disqualification*

Sections 10 and 11(5) of the 2016 Act insert four new sections into the 2011 Act (sections 181A, 181B, 181C and 181D), amend section 182 and insert a new section 184A. They confer on the Commission a new power, exercisable by order, to disqualify any person from being a trustee or member of a charity's senior management (as defined).[12] The disqualification relates either to all charities or to a specified charity (or specified charities) or a specified class (or specified classes) of charities. From a date to be appointed, the disqualification will also apply to being an officer of the corporate trustee of a charity, a post defined in relation to the corporate body in the same way as a charity trustee relates to a charity.[13]

This power is available to the Commission when at least one of the following conditions applies:

A: The subject has been cautioned for an offence regarding a charity which would bring about automatic disqualification in the event of a conviction (which I paraphrase as a 'disqualifying offence'), e.g. for theft from a charity;

11 See Charities Act 2011, s 75A(5)(d).

12 The subject is disqualified from holding an office or employment (in the charity) with 'senior management functions'. Under Charities Act 2011, s 181A(4) (inserted by Charities (Protection and Social Investment) Act 2016, s 10), a function is a 'senior management function' of an office or employment with a charity if it relates to the management of the charity and the subject reports directly to the trustees (e.g. the subject is the charity's Chief Executive) or if it involves control over money and the subject reports to someone with a senior management function not involving control over money (e.g. the subject is the charity's Finance Director).

13 The essence of the definition being general control of the management and administration of the institution concerned, i.e. being a decision-maker: see Charities Act 2011, s 184A, which is to be inserted by Charities (Protection and Social Investment) Act 2016, s 12.

B: The subject has been convicted outside the UK for the foreign equivalent of a disqualifying offence (unless the conviction is spent under the relevant foreign law);

C: The subject has been held not to be a 'fit and proper person' to act as a trustee by HMRC;

D: The subject, being a trustee, officer, agent or employee of the charity, is responsible for, knew of and failed to oppose, or contributed to or facilitated, misconduct or mismanagement (which I paraphrase as being 'involved in misconduct or mismanagement');

E: The subject, being an officer or employee of a corporate body which is the trustee of a charity, is involved in misconduct or mismanagement;

F: The subject's past or continuing conduct (whether or not in relation to a charity) is 'damaging or likely to be damaging' to public trust and confidence in charities generally or in specified charities or classes of charities (which I paraphrase as conduct which 'damages trust and confidence').

The subject may appeal to the Charity Tribunal. Disqualification takes effect when the time limit for appealing expires or any appeal proceedings terminate, and the Commission may suspend the subject from office (for a maximum of two years) pending his or her disqualification.

Apart from the important possibility of an appeal, the procedural safeguards are similar but not identical to those applying to the issue of an official warning. Prior notice must be given to the subject (unless he or she consents to the making of the order) and to the trustees of the charity, inviting representations within a specified period. The period of such notice is longer than for official warnings, being in all cases at least one month. Any representations must be considered by the Commission before it proceeds to make the order. In addition, prior notice inviting representations must also be given to the public, and it is for the Commission to decide at what stage to give that notice. The duration of the disqualification, which may be up to a maximum of 15 years, must be stated in the notice. Once the order has been made, the subject is able to apply to the Commission for it to be varied or revoked, e.g. on a relevant change in the subject's circumstances. It is necessary that the duration of the disqualification should be proportionate, and in this connection an analogy is to be drawn with the concept of a spent conviction, as with waivers for automatic disqualification. Finally, records must be kept of all trustees removed under section 79A and all those disqualified under section 181A.

Disqualification is an exceptionally serious sanction which will obviously have the potential to damage the reputation of the subject and cause him or her emotional distress. It may also have a deleterious effect on the charity's reputation. It is to be

hoped that the Commission will adopt the practice of identifying the evidence and explaining the grounds on which a decision to disqualify is based, and that public notice will not normally be given before the individual concerned has received notice and had an opportunity to make representations, including representations about the duration of the disqualification and about the publicity arrangements. A policy document has been published but further guidance would be useful – perhaps after some experience has been gained of the use of this new power – to indicate what features are likely to lead to lengthy periods of disqualification compared with those of shorter duration, and what types of conduct will be taken as bring the subject within condition F (it damages trust and confidence) both in relation to the administration of charities and in other contexts. At present, the powers as set out in the legislation are expressed in the broadest terms and are capable in practice of a wide variety of different interpretations. The absence of detail appears to risk arbitrary decision-making or at least significant policy changes on the part of the Commission as regulator.

Filling in gaps in the 2006 regime

The 2016 Act also contains a number of provisions which expand or complement existing regulatory powers.

(1) Expanding the power of suspension

Section 2 of the 2016 Act amends section 76 of the 2011 Act by specifying a failure to comply with an order or direction of the Commission, or to remedy a breach in the manner identified in an official warning, as a type of misconduct or mismanagement. It goes on to enable the sanction of suspension, whether in relation to trustees or to others, to be renewed for up to 12 months, with an overall limit of two years.

(2) Conduct considered by Commission when exercising relevant powers

Section 3 of the 2016 Act inserts a new section 76A into the 2011 Act. When the Commission is satisfied that the subject has been involved in misconduct or mismanagement of a charity, it may take account of the subject's conduct in relation to any other charity or any conduct by the subject that appears to be damaging trust and confidence. In order to assess whether the Commission has acted in accordance with this provision, it will be necessary for it to specify the matters which it has taken into account when reaching its conclusion.

(3) Power to remove trustees etc after an inquiry

Section 4 of the 2016 Act replaces section 79 of the 2011 Act so that it provides a new power for the Commission to impose a scheme on a charity when satisfied

either that there has been misconduct or mismanagement or that there is a need to protect the charity or its property (or the proper application of its property). It re-enacts the existing power to remove a trustee, officer, agent or employee (referred to below as 'trustee etc') who has been involved in misconduct or mismanagement when satisfied of both sets of circumstances, and confers a further power to remove, and thereby automatically disqualify under section 178(1), a trustee etc who has already ceased to hold office. The last power has arisen from a few cases in which a trustee who was involved in a formal inquiry resigned before the Commission had exercised its power of removal and thereby escaped automatic disqualification and its consequences. There is an appeal in all three cases to the Charity Tribunal.

(4) Removing a disqualified trustee etc

Section 5 of the 2016 Act inserts a new section 79A into the 2011 Act and amends sections 82(1) and 89(1). Section 79A enables the Commission to remove a trustee etc who has already been disqualified either automatically under section 178 or by order under section 181A. This power is complementary to the third power under the substituted section 79 (removal of former trustee etc). In such cases notice must normally be given to the charity trustees of the charity (see the amended section 82(1)), but, owing to the amendment to section 89(1), there is no requirement for additional publicity.

(5) Power to direct trustee not to take or continue specified action

Section 6 of the 2016 Act inserts a new section 84A into the 2011 Act, enabling the Commission to make a direction requiring trustees not to take or continue specified action, i.e. prohibiting it. This complements the existing power of direction positively to take specified action, which is set out in section 84. Like the section 84 power (but unlike the Commission's power to direct a specified application of charity property in section 85), it applies only after a formal inquiry has been opened. It is appealable to the Charity Tribunal.

(6) Power to direct winding-up

Section 7 of the 2016 Act inserts a new section 84B into the 2011 Act empowering the Commission, after a formal inquiry has been opened, to direct that a charity be wound up if satisfied that it does not operate or that its purposes can be more effectively carried out if it ceases to exist. The direction is capable of overriding the charity's constitution, e.g. by requiring the trustees to take steps which would otherwise have to be taken by the members of the charity, but not an Act of Parliament. Thus, in the case of a charity having a permanent endowment, the Commission could direct the trustees to resolve to release the permanent endowment under section 281 or 282 of the 2011 Act and to transfer the funds to some other charity (presumably a charity with similar purposes). Before issuing

such a direction, the Commission must give notice of 60 days, or of a shorter period if it considers that there is a risk of misconduct or mismanagement or a risk to the charity's property or its proper application. This power may be generally more useful than the power to impose a scheme (see the substituted section 79 discussed above) since it avoids any need for the Commission to consider the way in which the charity is to be administered in future. There is an appeal to the Charity Tribunal.

(7) Direction to apply property

Section 8 of the 2016 Act amends section 85 of the 2011 Act by extending the circumstances in which a direction under this section can be given to include the case where the trustees are unable (as opposed to being unwilling) to apply the relevant property as directed, and the use of property which the Commission intends to direct is necessary in order to ensure a proper application of charity's property. An example of the circumstances in which this power might be used is where there are too few trustees to form a quorum and the direction will facilitate a swift resolution of the problem without the need to find and appoint additional trustees.

(8) Automatic disqualification

Section 9 of the 2016 Act, which will not take effect until 2017, will effect a major expansion of the circumstances in which a trustee etc can be automatically disqualified from holding a relevant office. It will amend section 178 of the 2011 Act by inserting four additional 'disqualifying events'.[14] A new section 178A will specify a number of new offences, including what I shall call 'inchoate and ancillary offences', conviction for which will effect automatic disqualification.[15] Section 179 will be amended to prevent contempt of court from effecting disqualification where, had the sentence been imposed on conviction for an offence, it would have been a spent conviction. Various amendments to the existing waiver provisions will be effected in order to make them consistent. Section 181 will be amended to enable the Commission, instead of granting a waiver in respect of the total offence, to waive only that part of the disqualification

14 Where the subject is guilty of contempt of court (Case H), is found guilty by the High Court of disobedience to an order of the Commission (Case I), is a designated person for certain asset-freezing provisions relating to terrorism (Case J) or is subject to notification under the Sexual Offences Act (Case K).

15 Offences involving dishonesty or deception (as at present); specified offences relating to terrorism, money-laundering, bribery etc; contravention of orders of the Commission under Charities Act 2011, s 76 (asset-freezing etc); misconduct in a public office, perjury and perverting the course of justice; and inchoate and ancillary offences, i.e. attempting, conspiring or inciting to commit, or aiding, abetting, counselling or procuring or encouraging or assisting the commission of any of the specified offences); plus any further offences that may be specified in regulations.

which relates to an inchoate or ancillary offence, and, if so, to allow the subject effectively to resume acting in a particular role or type of role. For example, if an employee of a charity had been convicted of aiding and abetting the Commission by a trustee of an offence involving dishonesty, the Commission might wish to grant a waiver of the disqualification in relation to the aiding and abetting offence but not in relation to the principal crime, and to allow the former employee to resume his or her post or take up a similar post in another charity.

(9) Officers of corporate trustees

Section 12 of the 2016 Act inserts a new section 184A into the 2011 Act which will apply sections 183 and 184 (criminal and civil consequences respectively of acting while disqualified) to the officers of a corporate trustee involved in the administration of the relevant charity as they apply to trustees. An 'officer' means a person such as the director of a company who relates to the corporate body in the same way as a charity trustee relates to a charity under section 117 of the 2011 Act: i.e. has the 'general control and management of the administration' of the body.

Fundraising reforms

The 2016 Act also contains significant provisions relating to fundraising by charities and by benevolent or philanthropic organisations.

(1) Amendments to fundraising safeguards

Section 13 of the 2016 Act amends section 59 of the 1992 Act. This section deals with agreements made by charities with professional fundraisers or commercial participators. Such agreements are now required to specify any voluntary fundraising regulation scheme or set of standards that the professional fundraiser or commercial participator is to be bound by, set out how the professional fundraiser or commercial participator will protect 'vulnerable' people from any unreasonable intrusion on their privacy, from unreasonably persistent approaches for money or undue pressure to donate, and set out the monitoring arrangements. This means that all fundraising charities which currently have such agreements in place will be obliged to modify them. The Fundraising Regulator[16] (see below) has indicated that it will allow charities time to change, probably until the end of March 2017. Presumably it will provide some guidance as to what is regarded as 'unreasonable' in terms of intrusiveness and persistence, and, in this connection, general awareness is high and work has already been carried out in relation to the Fundraising Preference Service.

16 See www.fundraisingregulator.org.uk/

Section 13 of the 2016 Act also inserts a new section 162A into the 2011 Act regarding annual reports. Where a charity's accounts must be audited, the trustees' annual report must include statements similar to those included in fundraising and commercial participator agreements. In addition to describing the charity's approach to fundraising (e.g. whether the charity relies on a trading subsidiary or whether an external fundraising organisation is employed), the report must identify any voluntary fundraising regulation scheme or set of standards by which the charity is bound, the protection afforded for vulnerable people and the monitoring arrangements. In addition, any failure to comply with the relevant scheme or standards must be disclosed as must the number of complaints about fundraising (against either the charity or its agents) which have been received.

(2) Reserve powers

Section 14 of the 2016 Act inserts two new sections, section 64B and section 64C, into the 1992 Act. These empower the Minister, after consulting the Charity Commission, to make regulations imposing requirements on charitable institutions (i.e. charitable, benevolent or philanthropic bodies) to comply with a specified regulator's rules, have regard to its guidance, pay fees to and register with such a regulator, and also to confer delegable or non-delegable powers and duties on the Charity Commission. The regulator has to be a body whose principal function appears to be the regulation of charity fundraising and cannot be a body funded by monies awarded by Parliament. Such regulations have not yet been made and may prove unnecessary if the Fundraising Regulator, which was established in early 2016, is found to perform satisfactorily and to gain sufficient support from charities.

Conclusion

The 2016 Act is capable of facilitating better regulation by the Charity Commission by providing a more coherent range of powers enabling different threats to charities to be reduced or removed. As such it is to be welcomed. However, the way in which the legislation is expressed places excessive importance on informal guidance and demands of the charitable sector a greater trust in the inherent fairness and proportionality of the Commission's approach to its powers than, perhaps, past experience would tend to justify. The Act can be regarded as imperfect in two particular respects: the absence of any effective remedy if the power to issue an official warning is exercised too harshly and the absence of any clear principles by which the Commission will be expected to judge whether lawful conduct by trustees and others which is not connected to the relevant charity is likely to damage public trust and confidence in charities. Unless these defects can be overcome in practice by clearer guidance than has so far emerged, there is a risk that trustees and prospective trustees will be discouraged

from giving their time and commitment to charities and that public trust and confidence in the Commission itself will be adversely affected. It is up to the Commission to dispel this risk.