Where duty lies

Matthew Mills considers when members of charitable companies will be subject to fiduciary duties in light of the recent Supreme Court decision in Lehtimäki v Cooper

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There are now over 33,000 registered charitable companies limited by guarantee. Since March 2004, the Charity Commission for England and Wales (the Commission) has maintained that:

> ... the rights that exist in relation to the administration of a charitable institution are fiduciary, regardless of the identity of the person or persons on whom the rights are conferred. Therefore this applies to both individual and corporate members...

see RS7, Membership Charities, pp33-34. Nevertheless, some of the leading charity law works have persistently doubted this conclusion: eg *Tudor on Charities* (10th ed, 2015), paras 6-051 and 17-005. In *Lehtimäki v Cooper* [2020], the Supreme Court essentially confirmed the Commission's view. However, the 236 paragraphs taken to reach that conclusion raise many interesting and difficult issues. This article cannot cover them all but will instead aim to summarise the decision and pick out key issues for practitioners relating to fiduciary duties in charity law.

The facts

The Children's Investment Fund Foundation (UK) (CIFF) is a charitable company limited by guarantee which was founded on 8 February 2002 by Sir Christopher Hohn and Ms Jamie Cooper. Its current investments exceed £4bn. Since 2009, CIFF has had three members: Sir Christopher, Ms Cooper, and Dr Marko Lehtimäki (a university friend of Sir Christopher and Ms Cooper).

In late 2011, Sir Christopher and Ms Cooper's relationship broke down and in April 2013 they divorced. Unfortunately, the breakdown of their marriage caused governance issues for CIFF: two of the three members no longer agreed on how CIFF should be operated.

However, both Sir Christopher and Ms Cooper were committed to continuing to work in the charitable sector. To try to reach a compromise, they agreed as part of their divorce that

Ms Cooper would resign as a member and trustee (ie director) of CIFF and, in return, CIFF would make a grant of $360m to Big Win Philanthropy, a new charity which had been founded by Ms Cooper (the grant).

Legal issues

CIFF applied to the Commission for approval of the grant. The Commission declined to do so but authorised CIFF to bring proceedings seeking the court's approval. Therefore, originally the key issue was whether it was in CIFF's best interests to make the grant.

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At first instance in 2018, Sir Geoffrey Vos held that the grant *was* in CIFF's best interest, although he accepted that this was a point on which reasonable fiduciaries could disagree.

He also held that the grant would involve a payment in connection with Ms Cooper's resignation as director (which findings were not challenged in the Supreme Court). This meant that s217 Companies Act 2006 was engaged and the members of CIFF were required to approve a resolution to make the grant (the resolution). That gave rise to a difficulty. Dr Lehtimäki was the only unconflicted member who could vote on the resolution and he had expressed concerns over whether he could vote in favour of it (although he had not reached a final view).

The ultimate issue for the Supreme Court was thus whether the court could order Dr Lehtimäki to vote in favour of the grant. This required the court to answer three questions:

1) Was Dr Lehtimäki a fiduciary?

2) In principle, can a fiduciary be compelled to vote in favour of a resolution?

3) Would the conclusion to question 2 be affected by s217 Companies Act 2006?

The Supreme Court's decision

Was Dr Lehtimäki a fiduciary?

Lady Arden gave the sole judgment on the first issue. She held that a member of a charitable company owes fiduciary duties to the charity's purposes when deciding how to vote on a resolution under s217 Companies Act 2006: at para 200. Beyond this, the circumstances in which a member of a charitable company will be subject to a fiduciary duty 'must be worked out as and when they arise': see para 200. The 65 paragraphs' reasoning to this end point can be summarised as follows:

- Nothing in company law precluded charity law principles from being applied:
    - Parliament has clearly recognised the concept of a charitable company.
    - Following *Liverpool and District Hospital for Diseases of the Heart v AG* [1981], the rights and liabilities of a member in relation to a company stem from the company's constitution *and* the general law.

It did not matter that a member of a charitable company may not be subject to the full range of fiduciary duties, as long as they owed the 'irreducible core' of a fiduciary duty.

    - The law already recognises exceptions to the general principle that shareholders can exercise their membership rights as they please.
- The public and potential beneficiaries would reasonably expect the members of charitable companies to owe fiduciary duties.
- 'It will be easier for the court to exercise its inherent jurisdiction over charities, and the law of charities will be more internally coherent' if members of charitable companies owe fiduciary duties: para 93.
- There is no evidence that subjecting members of charitable companies to fiduciary duties would dissuade people from becoming members.
- It did not matter that a member of a charitable company may not be subject to the full range of fiduciary duties, as long as they owed the 'irreducible core' of a fiduciary duty to perform their role honestly and in good faith for the benefit of the charity's purposes: see paras 79-82.

Can Dr Lehtimäki be compelled to vote in favour of the resolution?

The majority judgment on the second issue was given by Lord Briggs, with whom Lord Wilson and Lord Kitchen agreed. Lady Arden dissented on the reasoning but not the result.

The majority held that where trustees had surrendered their discretion to the court on a particular transaction, and the court has decided that the transaction *would* be in the charity's best interests, then by definition the charity's purposes 'will not best be furthered by the transaction not going ahead': see paras 206-207 and 214. In those circumstances, the charity's fiduciaries (apparently regardless of whether they were joined to the litigation)

are obliged to ensure that the court's decision is implemented. In other words, unless there is an appeal, 'a significant change in circumstances before [the court's decision] is implemented', or 'something [went] badly wrong with the court proceedings', then the surrendered issue 'ceases to be a question for debate': see paras 208, 210 and 218. It did not matter that Dr Lehtimäki was technically 'only' a member and not a trustee: both groups of people, as the 'fiduciary organs of the company', were bound by the same fiduciary duty to further the charity's purposes and implement the court's decision: see paras 220-223.

There is no policy objection to the court directing a member as to how to vote on a section 217 resolution because the right to vote can already be restricted by the company's constitution or legislation.

Does s217 Companies Act 2006 prevent the court from directing Dr Lehtimäki to vote in favour of the resolution?

Lady Arden gave the sole judgment on the third issue. She held that s217 did *not* prevent the court from directing Dr Lehtimäki how to vote, and (at para 157):

> ... the court could intervene where this is necessary or expedient to see that the charitable trusts are performed and can do so by way of a direction as opposed to a scheme.

Lady Arden gave five core reasons:

- The purpose of s217 is not to veto transactions but to ensure that there is adequate disclosure to and approval by the company. In this case, there was no reason to assume that the court was lacking any relevant evidence.

- There is no policy objection to the court directing a member as to how to vote on a section 217 resolution because the right to vote can already be restricted by the company's constitution or legislation.

- The court has broad powers to give directions under the Companies Act 2006.

- The section 217 vote is 'a matter of the internal management of the company', so no public law principles apply and there is no need for the court to defer to the decision-maker (ie the member(s)): see para 165.

- A court order does not dispense with the need for a section 217 vote; it simply compels the member(s) to vote in a particular way.

Guidance for practitioners

The content of the fiduciary duty

The essence of the duty is 'one of single-minded loyalty' to act in the best interests of the charity's purposes: see paras 90 and 180. This is a higher standard than merely exercising a member's powers for proper purposes. Instead, the member must 'reach a conclusion… in good faith': see para 100. This draws heavily on well-established principles of fiduciary law: compare *Mothew v Bristol and West Building Society* [1996] at 18 per Millet LJ (as he then was).

Members of charitable companies may be concerned that Lehtimäki *encourages the 'losing side' in a members' vote to challenge the actions of the 'winning side'. However, one recent authority suggests that the courts will not encourage this.*

The duty is principally subjective as it requires the member to do what *they* think is in the charity's best interests. However:

> … the test for breach of fiduciary duty has never been purely subjective. The fiduciary's belief has to be both bona fide and reasonable, if he or she is to act upon it without risking breach of duty.

See paras 100 and 232.

In short, a member of a charitable company is under duty to single-mindedly do what *they* believe in good faith is in the best interests of the charity's purposes. Although this duty can be 'fashioned' by the company's constitution, in practice the court may declare as ineffective a clause which purports to reduce the core of this duty too far: see paras 79 and 83.

Members of charitable companies may be concerned that *Lehtimäki* encourages the 'losing side' in a members' vote to challenge the actions of the 'winning side'. However, one recent authority suggests that the courts will not encourage this. In *Re The Ethiopian Orthodox Tewahedo Church, St Mary of Debre Tsion* [2020], Mark Cawson QC, sitting as a deputy High Court judge, dismissed a challenge to a members' vote in a charitable incorporated organisation (CIO). The judge emphasised that the members' duty was primarily subjective and that in reality there were two groups within the church who honestly held strong views about what would be in the charity's best interests. It is submitted that this will be true in many cases of division. However, to decrease the chance of a successful challenge even further, those organising the vote should emphasise to all members *before* the vote opens that, however polarised they may be, they should vote for what they truly believe is in the charity's best interests. This was done in *Debre Tsion* and the judge relied on this fact as a reason to dismiss the challenge.

When will a member of a charitable company be subject to the fiduciary duty described above?
The starting point is that the duty (see para 78):

> … will apply to all other members of charitable guarantee companies which… contain restrictions which in general prevent members receiving profits from the company.

In short, *any* member could in theory be subject to fiduciary duties.
However, the situations in which a member may be subject to the fiduciary duty must

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be worked out on a case-by-case basis. The Supreme Court endorsed the remarks of Sales J (as he then was) in *F&C Alternative Investments (Holdings) Ltd v Barthelemy (No 2)* [2011] at para 223:

> … [t]he touchstone is to ask what obligations of a fiduciary character may reasonably be expected to apply in the particular context, where the contract between the parties will usually provide the major part of the contextual framework in which that question arises.

Unfortunately, it will not be easy to advise a client on when a member will be subject to the fiduciary duty described above. First, the ultimate question is fact sensitive. Second, the Supreme Court acknowledged that there will be some decisions in respect of which a member will *not* be subject to fiduciary duties. For example, a vote on 'a matter on which only the members qua private individuals have an interest': see para 101. This points away from an expansive approach. Third, the Supreme Court nevertheless suggested that a member should not be allowed to vote on their own appointments. This may surprise many clients and points towards an expansive approach. It will likely require further litigation and/or guidance from the Commission to clarify the boundaries of fiduciary law.

To which types of charity will the reasoning in *Lehtimäki* apply?
While the Supreme Court's decision will inevitably reignite debate, the law had already reached the position that most people involved in the governance of a charity may be subject to certain fiduciary duties. This case thus represents no sea-change in approach. For example:

- It is well known that trustees in the strict sense are subject to fiduciary duties.
- Since 2004 the Commission has maintained that members of charitable companies also owe fiduciary duties.

- Courts have previously suggested that the management committee of a charitable unincorporated association may be subject to fiduciary duties: *RSPCA v Attorney General* [2001], at para 36 per Lightman J, and *Marwaha v Singh* [2013] at para 32 per Sir Terence Etherton C.

- In *Re the French Protestant Hospital* [1951], Danckwerts J considered a charitable company created by Royal Charter and held that (para 570):

Fiduciary duties 'apply to charitable companies large or small' because 'the number of members which a guarantee company happens to have is not the deciding factor'.

> ... the persons who in fact control the corporation and decide what shall be done... are as much in a fiduciary position as trustees in regard to any acts which are done respecting the corporation and its property.

- A member of a CIO is by statute required to exercise their powers 'in the way that the member decides, in good faith, would be most likely to further the purposes of the CIO': s220 Charities Act 2011. Although no case has yet definitively decided whether this duty is fiduciary, it is submitted that it is. First, this would be consistent with the decisions above in other areas of charity law. Second, s220 is essentially the charity law equivalent of the company law rule which applies to directors: eg s172 Companies Act 2006. The company law duty is fiduciary: s178(2) Companies Act 2006 and *Re Smith and Fawcett Ltd* [1942] at 303 per Lord Greene MR. Third, the Court of Appeal in *Lehtimäki* treated s220 as analogous to the *fiduciary* duties of members in charitable companies: at para 48.

The more difficult question is whether members of 'mass membership charities' are subject to fiduciary duties. The Court of Appeal in *Lehtimäki* expressly reserved its position on this issue. The Supreme Court went further, albeit in obiter dicta. Lady Arden confirmed that fiduciary duties 'apply to charitable companies large or small' because 'the number of members which a guarantee company happens to have is not the deciding factor': at para 105. Lord Briggs suggested there might be 'slight differences in emphasis and detail' in such cases but he gave no further guidance: at para 215. The general message thus appears to be that there is no special treatment for mass membership charities.

Nevertheless, this issue remains ripe for full and proper consideration in a future case. Principally, the Supreme Court notably did not consider *Scott v National Trust* [1998]. In that case, Robert Walker J (as he then was) decided that certain members of the National Trust who had previously hunted deer on National Trust land had standing to bring charity proceedings to challenge the Trust's decision to end such deer hunting. At 715, in obiter dicta,

Robert Walker J doubted whether 'individuals [who] pay ordinary annual subscriptions as members of the National Trust… would by that alone… [have] a sufficient interest'. He relied on the remarks of Nicholls LJ (as he then was) in *Re Hampton Fuel Allotment Charity* [1989] at 493, that the definition of 'any person interested in the charity' should not be interpreted too widely otherwise all of the beneficiaries of a nationwide charity could qualify and the trust could become vexed with frivolous claims. While these remarks were made in a different context, the reasoning is relevant and persuasive. It is difficult to understand why a member paying just £6 per month to enjoy National Trust properties should be subject to onerous fiduciary duties.

Furthermore, the suggestion that *all* members of mass membership charities are fiduciaries could cause practical difficulties. For one example, mass membership charities may be discouraged from holding full membership-wide votes for fear of inducing a breach of duty. This could limit engagement with such charities and decrease their understanding of members' views on matters of policy or governance. In short, unless the Supreme Court's approach is tempered in subsequent cases or guidance, *Lehtimäki* could be a real blow to membership involvement in larger charities.

Conclusion

In summary, in certain respects, the Supreme Court's decision in *Lehtimäki* is consistent with longstanding principles of charity and fiduciary law. However, there is room for doubt over the precise impact of the decision. The overriding message from the Supreme Court is that members of charitable companies will be subject to fiduciary duties where it is appropriate. What this might mean in practice remains to be seen, although this article has offered some initial thoughts on this difficult question. It is hoped that the Commission will produce some authoritative guidance on this issue soon. ■

F&C Alternative Investments (Holdings) Ltd v Barthelemy & anor
[2011] EWHC 1731 (Ch)

Re the French Protestant Hospital
[1951] Ch 567

Re Hampton Fuel Allotment Charity
[1989] Ch 484

Lehtimäki & ors v Cooper
[2020] UKSC 33 (to be reported in the Autumn 2020 issue of *Wills and Trusts Law Reports*)

Liverpool and District Hospital for Diseases of the Heart v AG
[1981] Ch 193

Marwaha v Singh & ors
[2013] EWCA Civ 1878

Mothew (t/a Stapley & Co) v Bristol & West Building Society
[1996] EWCA Civ 533

RSPCA v Attorney General & ors
[2001] EWHC 474 (Ch)

Scott v National Trust
[1998] 2 All ER 705

Re Smith and Fawcett Ltd
[1942] Ch 304

The Children's Investment Fund Foundation (UK) v Attorney General & ors
[2017] EWHC 1379 (Ch)

Re The Ethiopian Orthodox Tewahedo Church, St Mary of Debre Tsion
[2020] EWHC 1493 (Ch)