WINDING UP AND INSOLVENCY OF CHARITIES

Including Rescue Mechanisms

Thesis submitted in accordance with the requirements of the University of Liverpool for the degree of Doctor of Philosophy by

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ABSTRACT:

Elizabeth Yates: Winding up and Insolvency of Charities (Incuding Rescue Mechanisms)

This study aims broadly to explore the legal and practical problems of winding up and insolvency for charities that are, or ought to be, registered with the Charity Commissioners for England and Wales and to explore possible 'rescue mechanisms.' It seeks to identify common underlying factors or trends associated with charities becoming insolvent or being wound up.

The methodology consisted of book work and practical research in which a detailed study was made of 130 charitable companies and the experiences of legal and accountancy practitioners were sought. Twenty case studies were put together from information provided by the practitioners and from the author's own experience.

The areas of legal complexity explored include problems associated with land and endowments, and the augmentation principle in respect of bequests to a corporate charity that has been dissolved. Some issues such as property holding and personal liability are more complex in an unincorporated association. Practical difficulties such as disputes between trustees, between staff and trustees, or between members are significant as are the legal and practical complexities associated with the contract culture.

Charities represent an important sector of the economy, collectively being worth £19.7bn in 1998, and their success or failure is of public concern. The research indicates that charities are affected by societal changes, legislative change and changes in the attitudes of beneficiaries. Their dissolution or winding up is often a result of a combination of factors, both internal and external and service providing charities appear to be particularly vulnerable.

The quality, cost, and availability of professional advice is considered. It is suggested that the role of local intermediary bodies could be enhanced and that a means be found for accrediting the competence of charity advisors, whether professional or lay.

PART ONE:

Chapter 1 : Introduction and Context

Chapter 2 : Insolvency, Winding Up, Dissolution and Liquidation

Chapter 3 : Winding Up and Dissolution in Unincorporated Associations and Charitable Corporations – An Overview

CHAPTER 1: INTRODUCTION AND CONTEXT

I. INTRODUCTION

The inspiration for this study originates with a charitable company of which the author was a director. The company, established in 1981, the International Year of Disabled People, provided training and employment for people with special needs. Having struggled through the 1980s, the charity's manufacturing subsidiary was wound up insolvent in 1990 and the parent charity, which focussed on training, ceased to trade in 1993 having been given five days notice that its contract with the local Training and Enterprise Council would not be renewed. It was eventually wound up in 1995. Whilst the legal process of winding up a company is laid down in legislation and therefore reasonably straightforward, the process of winding up this charitable company seemed bedevilled by a catalogue of practical difficulties.

A. THE REMIT

The purpose of this study is broadly to consider the winding up and dissolution of charities. In particular it is intended first, to explore the legal and practical problems of winding up and insolvency for charities which are, or ought to be, registered with the Charity Commission for England and Wales and to consider possible 'rescue mechanisms'. Secondly, it is intended to consider whether there are any common or underlying factors associated with charities being removed from the register, or which result in charities being wound up because of insolvency or some other reason.

As the remit for this study is charities that are registered or ought to be registered with the Charity Commission, charities which are exempt or excepted from registration, which includes industrial and provident societies and registered friendly societies, are excluded from consideration.[1] The law considered is that applying to England and Wales and it is intended that it be up to date to June 1999.

As a matter of nomenclature it may be helpful to clarify the use of "Charity

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[1] Charities Act 1993 ss.3 and 96 and Sched. 2 para.y

Commissioners" and "Charity Commission" in this study. In recent years the body has referred to itself as the Charity Commission[2] although the legislation refers to the Charity Commissioners.[3] In what follows both forms are used although, technically, any decisions or orders are made by the Charity Commissioners.

B. THE RESEARCH METHOD

Several approaches were taken.

1. Legal and Practical Problems

Much of this research has been undertaken on the basis of case studies of charities being wound up or 'rescued'. In gathering this case material it was necessary to give the reassurance of confidentiality to those who provided the material and an undertaking to anonymise the cases as far as possible. The case studies are, therefore, referred to only by number. The networks associated with the Charity Law Unit at Liverpool University and the Charity Law Association were used to make contact with a variety of practitioners including lawyers, accountants and insolvency practitioners. Their help was sought in identifying areas of legal or practical difficulty which they or their clients had encountered in winding up charities and, where appropriate, they provided the material for the case studies. Included within these case studies was material provided by several receivers and managers appointed by the Charity Commission as well as administrative receivers. Some case material was also provided by the author's own work experience as director of a council for voluntary service (C.V.S.). C.V.S.s are the umbrella bodies for the local voluntary sector and exist, amongst other things, to support voluntary organisations.

Charity law is a technical area in which there are a limited number of practitioners with expertise. Some less expert practitioners raised questions of supposed legal or practical difficulty which demonstrated their lack of knowledge of charity law rather than identifying a legal grey-area. The co-operation of the Charity Law Association

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[2] See "Reports of the Charity Commission" for 1995, 1996, 1997, and 1998 as compared with the earlier form of "Reports of the Charity Commissioners".

[3] See Charities Act 1993 passim.

has been important – their members raised the better, if harder to answer, questions!

Note was also taken of reports of charities in financial or other difficulty appearing in journals for the charity sector as a means of identifying possible case material. Other reports such as those of the Charity Commission and other organisations also provide information about cases and provide examples.

A good deal of the case-related material is woven into the relevant sections of the study.

2. Trends Relating to Charity Insolvency or Associated Issues

Two approaches were adopted. First, a number of journals relating to the charity field were trawled during the period of the study. Note was made of reports of charities in financial or other difficulty and any information as to causative factors was noted. Secondly, for a fifteen - month period information was gathered on charities being removed from the Register of Charities on the grounds they had ceased to exist. The co-operation of the Charity Commission was vital in that they provided a print-out of each removed charity. It is worth noting here that this part of the study was undertaken at a time when the Charity Commission were 'tidying up' the register[4] which may have resulted in a higher than normal number of charities being removed. The picture may also have been distorted by the use of the new powers under sections 74 and 75 of the Charities Act 1993 Act to transfer the property or spend the capital of small charities, – around 12% of the charities were removed as a result of exercising these powers.

The detailed study of charities removed from the register, including the general issues identified in the case studies together with an exploration of the possible factors involved is considered at chapter eleven. For a variety of reasons explained in that chapter little of any substance was gleaned from this general study. However, a further study was then undertaken of the charities removed during that period whose

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[4] [1993] Ch. Comm. Rep., p9 para. 28 a "data cleaning exercise aimed at correcting errors that had occurred during the many years during which the Register was maintained manually"

governing instrument was a memorandum and articles of association, that is, those that were companies. The Charity Commission kindly gave access to the public files of all these charities which had a positive income in the previous year. In many cases, through their annual reports, combined with some correspondence, it was possible to discern some history to their being wound up and removed.

In all, fairly basic information was gathered on over 4,000 charities removed from the register during the fifteen month period but more detailed case information has been gathered on 150 charities, 130 of which were corporate charities removed from the register (CCRs) and 20 were case studies. An alphabetical list of the corporate charities removed is contained in Appendix 1.

3. Generally

Conferences and seminars related specifically to the topic of this study, or to charity law generally have been attended or reports of them acquired.

C. REVIEW OF THE LITERATURE

There is a good deal written about the relatively straight-forward aspects of winding up charities. For example, most standard company law texts contain chapters relating to dissolution[5] and there are a number of texts dealing with winding up companies or corporate insolvency.[6] There are also journals covering insolvency issues.[7]

There is much less available in respect of unincorporated associations. Although Warburton,[8] examines some of the issues relating to dissolution, the work is not focussed specifically on unincorporated charities. The most recent edition of *Tudor*

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[5] See, e.g. Pennington R.R., *Pennington's Company Law*, 7th Ed., Butterworths, 1995; Gower L.C.B., *Gower's Principles of Modern Company Law*, 4th Ed., Stevens 1979 and Supplement 1988.

[6] See, e.g. Rajak H., *Company Liquidations*, CCH Editions, 1988; Pennington R.R., *Corporate Insolvency Law*, 2nd Ed, Butterworths, 1997; Fletcher I. F., *The Law of Insolvency*, 2nd Ed., Sweet & Maxwell, 1996; Sealy L.S., and Milman D., *Annotated Guide to the Insolvency Legislation*, 4th Ed , CCH Editions 1994; French D., *Applications to Wind Up Companies*, 1993 Blackstone Press; Snaith I., *Law of Corporate Insolvency*, Waterlow, 1989; Rajak H., *Insolvency Theory and Practice*, Sweet & Maxwell, 1993; Walton R., *Kerr on Receivers*, 17th Ed, Sweet & Maxwell, 1989

[7] See e.g. Insolvency Law and Practice, pub. Tolleys

[8] Warburton J., *Unincorporated Associations*, 2nd Ed, Sweet & Maxwell, 1992

on Charities[9] contains a chapter on dissolution. On the more legally awkward issues such as property holding, members' rights, liability to contribute as well as the specific problem of charity insolvency relatively little is written. *Managing Your Solvency*[10] was published following the Directory of Social Change Conference in autumn 1993 and is a compilation of the papers presented there. Other relevant material, whether books or articles, is referred to and considered at the appropriate point in the study.

D. THE FORMAT OF THE STUDY

The study is divided into three parts.

The first part, chapters one to three, explores the context (the environment) within which the research was undertaken and outlines the broad legal issues concerned with winding up and insolvency of charities, whether they are unincorporated associations, trusts, incorporated charity trustees, limited companies, or chartered corporations. It also includes a brief overview of the opportunities for corporate rescue under the insolvency legislation.

The second part of the study, chapters four to ten, considers areas of legal or practical difficulty either associated with winding up, or which create difficulties for charities and can thus lead to insolvency or winding up. The predominantly legal issues are considered before more practically orientated matters, although these usually have a legal context. Charity land and endowments appear to complicate the dissolution of charities considerably, although the new provisions now contained in the 1993 Charities Act[11] have improved the situation in respect of dispositions of land. The destination of surplus assets and the problems of legacies which 'mature' after a charity has been wound up are also explored. Some matters such as property holding are more complex where the charity is an unincorporated association. Problems with members or trustees can present difficulties irrespective of the charity's legal vehicle although they may be more easily solved in an

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[9] Warburton J., *Tudor on Charities*, 8th Ed., Sweet & Maxwell, 1995

[10] Norton M., (Ed), *Managing Your Solvency*, Directory of Social Change, 1994

incorporated charity. The questions of who will be required to contribute to the assets if the charity is insolvent and the amount required are more complex in an unincorporated association but are also considered in relation to companies. The 'rescue mechanisms' available generally to charities, such as the use of receiver and manager appointments under the Charities Act and alternative dispute resolution is explored in part two as are difficulties associated with taxation, particularly Value Added Tax (VAT), accounting and trading.

The third and final part, chapters eleven and twelve, examines the findings from the empirical research and considers the factors which may lead to the insolvency or winding up of charities. By way of conclusion, chapter twelve also attempts to identify lessons to be learned and ways in which support and advice for charities could be improved in this context . References are made to case studies and materials at appropriate parts of the text but trends raised by case studies or other elements of the research are also explored in this part.

There are significant distinctions in this area of law as applicable to corporate bodies and unincorporated associations. There are many occasions in what follows where the two have to be treated separately.

II. GENERAL CONTEXT

Charities, collectively, control funds amounting to billions of pounds and successive governments' policies are placing increasing reliance on them for the delivery of services to the community generally, and to vulnerable people in particular. At the time of the Charity Commission's publication of the new classification system in 1997[12] there were 182,000 registered charities in England and Wales. Twenty two per cent of these were associated with social welfare, twenty three per cent with education, eleven per cent health, and two per cent were concerned with housing or providing accommodation. To put this into perspective at a local level, one local housing charity registered in 1999 has assets of over £200M, employs over 500 staff

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[11] Charities Act 1993 ss.36-40, introduced in the Charities Act 1992 ss.32-37

[12] *Charity Commission Classification System*, Charity Commission, March 1997

and owns around 14,500 'units of accommodation'. At the other end of the scale in the same locality there are very many more charities which have no staff, very few assets and an income of a couple of thousand pounds per year. The *Voluntary Sector Almanac, 1998-1999*[13] indicates that general charities employ 485,000 people, have a gross expenditure of £12.5bn with assets worth £39.8bn and, according to the Office for National Statistics, equate to .72% of G.D.P., (taking into account volunteer effort – 1.89% GDP). The 1998 Annual Report of the Charity Commission indicates that the income of the sector was £19.7bn.[14] Thus charities form a significant sector of the economy whose success or failure is of public concern.

Charities operate in a changing environment. They are responsive to, and affected by, changes in society. The mid 1980's to the mid 1990's was a period of considerable change. At national level there were economic difficulties and high unemployment; Government was reducing personal taxation with the expectation that people would provide for themselves and their families and that those who could afford to do so would give to charity. This period saw the development of tax-effective methods of charitable giving (individual and corporate covenants,[15] gift aid,[16] and payroll giving[17]) and the birth of the National Lottery[18] as a means of increasing the funding available for 'good causes'. There were also philosophical questions raised as to the role of central and local government in relation to the delivery of public services that led to change in Government policy.

At another level, the Charities Acts of 1992 and 1993, with their accounting requirements,[19] and the introduction of the 'Charity S.O.R.P.',[20] whilst not changing the essential responsibilities of charity trustees, had served to remind them of their responsibilities. This, together with the difficult economic climate, may have encouraged unincorporated charities to seek corporate status in order to limit the

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[13] Hems L., and Passey A., *Voluntary Sector Almanac 1998-1999*, N.C.V.O., 1998
[14] [1998] Ch. Comm. Rep. p.29
[15] Income and Corporation Taxes Act 1988 ss.660, 671, 339
[16] Finance Act 1990 s.25 and Income & Corporation Taxes Act 1988 s.339
[17] Income and Corporation Taxes Act 1988 s.202
[18] National Lottery etc Act 1993
[19] now Charities Act 1993 Part VI ss.41-46
[20] *Accounting by Charities, Statement of Recommended Practice*, Charity Commission, October 1995.

trustees' risk. In a recent survey on legal structures for charities[21] 57.9% of respondents said they would prefer a structure with limited liability, the remainder already had it. The Trowers and Hamlins survey also found that smaller charities were concerned about liability.[22] Charities not entirely reliant on endowment funds were seeking additional ways of raising resources including trading operations, whether by running charity shops or more traditional commercial ventures. Successful trading may lead to the requirement to pay Value Added Tax (VAT). Unsuccessful trading may bring the charity's solvency into question. The application of Accounting Standards[23] required provision to be made for future commitments. This too may have caused trustees to focus on their charity's solvency.

A. THE ECONOMIC CLIMATE

This is not a study of economics and therefore will not explore complex economic definitions. However, the economic climate of the country clearly impacts on charities in terms of donations from companies and individuals; grants or contracts from local or central government; and income from fund raising or trading operations. In identifying the periods of economic difficulty it seems relevant, therefore, to consider factors such as unemployment, company and individual insolvency.

Graph 1 overleaf, which combines Central Statistical Office data for unemployed claimants with company and individual insolvency, identifies fairly clearly two periods around the mid 1980s and 1992-1994 when some or all of these factors were high. In 1985 over three million were unemployed and in 1993 almost three million people were in that position. Individual bankruptcies (including individual voluntary arrangements available since 1986[24]) appear to have risen from 1985 with a sharper rise from 1991 to peak at 36,794 in 1993. Corporate insolvencies (including

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[21] *Legal Structures for Charities Survey*, Charity Law Association, N.C.V.O., Liverpool University Charity Law Unit 1995

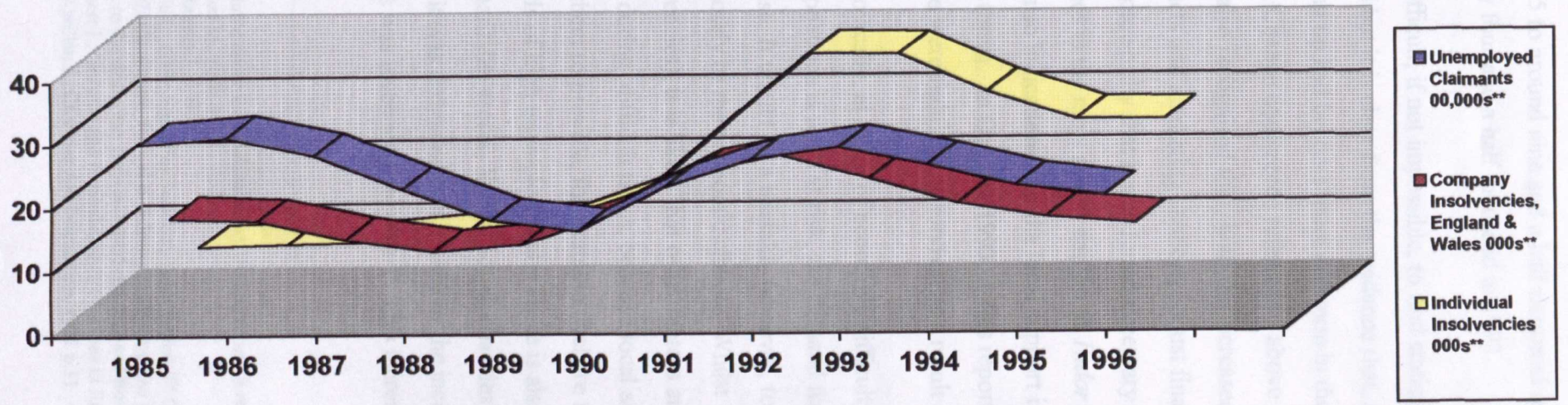
[22] *Charities Structure and Governance Survey Report* produced 1997 by Trowers and Hamlins, solicitors, reported that smaller charities were worried inter alia about liability.

[23] produced by the Accounting Standards Board prescribed under Companies Act 1985, s.256(1|) as a standard issuing body with which the Charity SORP complies.

[24] introduced in Insolvency Act 1986 Part VII

GRAPH No 1.

Unemployment, Company and Individual Insolvencies 1985-1996*



Data*:	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
Unemployed Claimants 000s (extracted from Table 6.1 of Abstract*)	3,019	3,120	2,836	2,294	1,786	1,615	2,301	2,734	2,919	2,644	2,313	2,150
Individual Insolvencies England & Wales (extracted from Table 17.26 of Abstract*) Includes I.V.A.s	6,778	7,155	7,427	8,507	9,365	13,987	25,640	36,794	36,703	30,739	26,319	26,271
Company Insolvencies England & Wales (extracted from Table 17.27 of Abstract*) includes Administration Orders and Administrative Receiverships.	14,898	14,405	11,439	9,427	10,456	15,051	21,827	24,425	20,708	17,728	14,536	13,461

***Data Extracted from Central Statistical Office "Annual Review of Statistics" 1998 (1985 figures derived from 1996 edition)**

** N.B. units of measurement different in plot compared to table

administrative receiverships and administration orders[25]) dropped from almost 15,000 in 1985 to around nine and a half thousand in 1988 only to rise again to around twenty four and a half thousand in 1992.

It is difficult, if not impossible, to find statistics specifically for charities during that period but it is clear from the evidence that, for whatever reason, insolvency and winding up had become more common in the sector. For example, the Directory of Social Change conference referred to above was, in part, a response to the problem, but it also recognised that, with the increased emphasis on earning money from contracts and marketing services, robust financial structures were important.[26] It is also noteworthy that it was found necessary to include a chapter on termination of charities in the most recent edition of *Tudor on Charities*[27] published in 1995. There were also indications that the local support infrastructure for local charities was under threat. In October 1993, it was reported that some councils for voluntary service were fighting for survival as a result of reductions in local authority funding.[28]

Paradoxically, at times of economic difficulty, when funding to the sector from grants and donations is most at risk, the demand for the sector's services is likely to increase. It would be a mistake, however, to ally charity winding up and insolvencies too closely to the economic climate. Whilst that may well be relevant (more so to insolvencies), it is likely that other factors are also at work. Sometimes charities grow during difficult times, because local and national governments seem willing to fund them to provide, for example, welfare services, support or training during periods of high unemployment. There is also significant investment income within the charitable sector. Whilst not all charities have endowment or capital funds,[29] in 1990 it was estimated that 15.4% of the income of registered charities in England and Wales was investment income.[30] This increased to 20.3% of income in 1994-1995.[31]

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[25] available under the Insolvency Act 1986 ss.42 and 8 respectively

[26] Norton M., (Ed), 1993

[27] Warburton J., 1995.

[28] Noble L., *CVSs Fight For Survival*, Third Sector, 7th October, 1993

[29] [1992] Ch. Comm. Rep. at p. 4 draws attention to the dramatic change in the charity world since the 1960 Act in the shift away from endowed charities and their greater reliance on collected funds.

[30] Posnett J., "Income and Expenditure of Charities in England and Wales", *Charity Trends 1992*, Ed. McQuillan J., Charities Aid Foundation, 1992 p.11

B. THE 'CONTRACT CULTURE'

During the 1980's services hitherto delivered directly by central or local government departments were 'externalised.' Since 1980 local authority services have been increasingly subject to 'compulsory competitive tendering'[32] which has resulted in the contracting-out of services to external agencies.[33] The National Health Service and Community Care Act 1990 demonstrates the way in which authorities have been encouraged to become 'enablers' or commissioners of services rather than service providers. That Act envisages a split between 'purchasers' and 'providers'.[34] The legislation encouraged the purchase of social care from the independent sector by providing that transitional grant to local authorities (intended to cover the costs of nursing home placements previously paid to the client by the Department of Health and Social Security) would only be paid if at least 85% of the care services provided by the authority were purchased from independent (private or voluntary sector) agencies.[35] The term 'externalisation' has been coined to describe the process by which local authorities have transferred their services to the private or voluntary sectors by establishing trusts or companies in order to retain this government funding. Some of these trusts and companies are charities. More recently the Housing Act 1998 makes provision for large scale voluntary transfers of local authority housing and the financial arrangements tend to encourage this since financial benefits are available to the 'new' landlords which would not be accessible to cash limited local authorities.

Local authority support for other community or charitable organisations reflects these trends. Traditionally such organisations providing welfare services have been supported by grant-aid either under the functional budgets of local authorities, or

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[31] Pharoah C., "Income from Government, National Lottery and Individuals", *Dimensions of the Voluntary Sector 1997 Edition*, Ed. Pharoah C., and Smerdon M., Charities Aid Foundation, 1997 p16

[32] See Local Government, Planning and Land Act 1980 Part III; Local Government Act 1988 s.2(2) and Sched. 1

[33] C.C.T. will be replaced by "Best Value" when legislation in the Local Government Bill 1998 comes into force.

[34] See e.g., Cross C., and Bailey S., *Cross on Local Government Law*, Sweet & Maxwell, 1991 (loose-leaf) para. 18-04.

[35] National Health Service and Care in the Community Act 1990 ss.46-50 and powers thereunder.

under the discretion of section 137.[36] Whilst grant aid continues to be a significant source of funding for community organisations, financial contributions from local authorities are increasingly allied to a contract or service level agreement between the authority and the organisation.

The same trends have affected central government departments. Of particular relevance to this study are the Training and Enterprise Councils (TECs), which were established in 1989[37] to undertake some of the functions hitherto within the remit of the Training Services Agency (now Employment Services Agency). They are Government funded (under service agreement) and they themselves contract with a variety of providers. Many of the organisations with which TECs contract are charitable organisations engaged in offering training and educational services.

This tendency for government, whether central or local, to be enablers for the delivery of community services through agreements with outside organisations has come to be known as the 'contract culture'.

The contract culture has many implications for charities,[38] particularly those that rely on volunteers, and especially if funding is closely linked to the achievement of targets. Output related funding[39] can create considerable difficulties for organisations working, for example, with disaffected trainees likely to drop out of a programme of training or study. There may be penalties under the contract if predetermined targets are not met, resulting in non-payment for the charity. A further hazard not foreseen, and hitherto unheard of, is that a central government-funded agency might become insolvent and unable to meet its commitments. This was the case with the South Thames TEC which went into receivership in 1994. In 1995 the receivers estimated that over £7 million was owed to the TEC's creditors. The Government refused to underwrite the debts. A survey of the voluntary sector groups which had training contracts with the TEC revealed 41 organisations were owed an average of £48,700

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[36] Local Government Act 1972 (c.70) s.137

[37] Employment Act 1988 and powers thereunder, and Employment Act 1989 s.22 and Sched. 5

[38] See e.g., Hawley K., *From Grants to Contracts,* NCVO / Directory of Social Change, 1992. See also Warburton J. and Morris D., *Charities and The Contract Culture* [1991] Conv. 419.

[39] funding which only recognises certain defined results as triggering any payment

each.[40] Most of them were specialists dealing with training for people with special needs or for other disadvantaged groups. Several of the TEC's contractors received funding from more than one programme.[41] This is considered further in chapter ten.

In 1992, Brophy, Executive Director of Charities Aid Foundation (CAF) noted, in respect of Government support for 1990/91, that contract-culture-government had, indeed, increased the amount it is willing to pay for prescribed services whilst reducing genuine grants, particularly grants for core funding.[42] In 1994/95 the breakdown of Government support showed that 11% was funding through service contracts which were defined as contracts that may be bid for by both private and voluntary providers.[43] In respect of local authority and health authority funding the proportion may be higher. A number of local authorities are now insisting that 'project funding' be in the form of service level agreements rather than grants and this is particularly, but not solely, the case in relation to social services departments. The service level agreement is a strange hybrid. It appears to have arisen in part from the arrangements under the National Health Service and Care in the Community Act 1990 for the establishment of 'internal market' arrangements between Health Authorities and N.H.S. Trusts. These were expressed to be not legally binding between Health Authority and Trusts although ordinary contract law applies in respect of contractual arrangements with external providers.[44] Whether service level agreements are legally binding when established between authorities and voluntary organisations is no doubt a matter to be determined from the facts in each case.

The Charity Commission referred to the problems of the contract culture for charities in their 1996 Report, and in particular the difficulties which charities have encountered in the contracting process.[45] As a result they published Leaflet CC37, *Charities and Contracts*, in 1998. Research has been undertaken into issues

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[40] Routledge J., *From Flagship to Shipwreck. South Thames TEC in Receivership – Impact on the Voluntary Sector*, Voluntary Action Lewisham, 1995 p6

[41] The TEC was contracting under the following programmes – Training for Work; Training Credits; Ethnic Minority Grant; European Social Fund; TEC Surpluses(!)

[42] Brophy M., "Foreword", *Charity Trends 1992*, Ed Pharoah C., and Smerdon M., 15th Ed Charities Aid Foundation, p. 4

[43] *Dimensions of the Voluntary Sector 1997 Edition*, Charities Aid Foundation p.54

[44] Cross C., and Bailey S., (Looseleaf) para 18-05

[45] [1996] Ch. Comm. Rep. Paras.40 and 41

associated with the contract culture by the Charity Law Unit at Liverpool University.[46]

This study considers the extent to which the contract culture impacts on the winding up of charities in chapter ten in particular.

C. CHARITY LEGISLATION AND TRUSTEE ISSUES

Undoubtedly the 1992 and 1993 Charities Acts have some impact on this study both in terms of accounting practice and in respect of accounting standards to be applied to registered charities. The joint N.C.V.O. – Charity Commission Working Party[47] chaired by Winifred Tumin identified the fact that few trustees seemed to recognise themselves as such and were uncertain as to their responsibilities. In this climate of misunderstanding, the charities legislation was understood to change trustee's duties and personal liabilities, although this was not in fact the case in respect of fiduciary obligations. The Act did add to the responsibilities of charity trustees in other ways, particularly in connection with accounting and reporting.[48] The Charity Commission and other organisations established to support voluntary organisations such as the National Council for Voluntary Organisations (N.C.V.O.) (who established a trustee unit), councils for voluntary service and rural community councils took this opportunity to reinforce the obligations of trustees. There may have been several results of this. First, unincorporated charities may have considered seeking limited liability probably by converting to a company limited by guarantee. Secondly, the additional obligations in respect of accounting and a better understanding that national-and-branch charities needed a clearer delineation of responsibilities, may have resulted in clarification of branch structures for some of these charities.[49]

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[46] Morris D., *Charities and The Contract Culture: Partners or Contractors? Law and Practice in Conflict*, Charity Law Unit, Liverpool University, July 1999

[47] *On Trust*, The Report Of The Working Party Chaired By Winifred Tumin, National Council for Voluntary Organisations (N.C.V.O.), 1992

[48] Charities Act 1993 Part VI

[49] *Charities Structure and Governance Survey Report, Trowers and Hamlins*, 1997. See also the Minutes of the charity Law Association 11th December 1997 generally.

D. ACCOUNTING STANDARDS, TRADING, VAT

1. Accounting Standards.

The foreword to "*Managing Your Solvency*"[50] suggests that concern with insolvency is also a consequence of the 1992[51] Charities Act which introduces new accounting and reporting standards for charities focussing attention on liabilities and contingent liabilities – and whether the charity has sufficient assets to cover these.

The Charity S.O.R.P.[52] was intended to apply to all charities in the U.K. regardless of size, complexity or constitution and, where necessary, the recommendations should be adapted to meet any applicable statutory requirement, or any requirements imposed by the charity's own governing document.[53] Whilst the accounting policies adopted must be appropriate to the charity, they must be consistent with the broad basic assumptions for accounts intended to show a true and fair view[54] and should follow standards laid down in Statements of Standard Accounting Practice (SSAPs) and Financial Reporting Standards (FRSs) issued by the Accounting Standards Board (A.S.B.). There is no definition in the Companies Act (which prescribes the A.S.B. as a standards issuing body)[55] of 'true and fair', although the A.S.B.'s standards are applicable to all accounts which are intended to give such a view. Accounts which depart from these standards without justification may be held not to be true and fair. Wainman[56] quotes counsel's opinion which suggests that the value of an SSAP to a court deciding whether accounts are true and fair is two-fold: it represents an important statement of professional opinion and it creates an expectation of conformity with prescribed standards.[57]

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[50] Norton M., (Ed), 1993

[51] now Part VI of the Charities Act 1993

[52] Accounting by Charities A Statement of Recommended Practice, Charity Commission, October 1995

[53] *op.cit.* para. 6 – Scope. N.B. charities with neither income nor expenditure over £10,000 produce accounts on an income and expenditure or accruals basis – the 'light touch' regime. See CC51, *Charity Accounts*, Charity Commission, 1999 and CC52, *Charity Accounts : Charities Under the £10,000 Threshold*, Charity Commission, 1999

[54] *S.O.R.P.* para. 32 and App. 2

[55] S.I. 1990 No. 1667 under Companies Act 1985 s256(1)

[56] Wainman D., *Company Structures*, Sweet & Maxwell, 1995

[57] An opinion by Leonard Hoffmann Q.C. and Mary Arden in 1983 quoted by Wainman (op. cit.) at p21

Framjee,[58] focussing on accountancy issues relating to insolvency, considers accounting standards and best practice in respect of financial reporting. The most significant of the standards is SSAP 2 – *The Disclosure of Accounting Policies*. The four fundamental concepts are that accounts are prepared on a going concern basis (and any doubts about this must be disclosed); on an accruals basis (so that income or expenditure is matched to the period to which they relate); so that the accounting treatment of items is consistent from one year to the next; and are based on prudence. The impact of the various standards which might lead to a technical insolvency for a charity, is considered briefly in chapter ten.

2. VAT, [59] Taxation and Trading

The situation for charities and Value Added Tax (VAT) is 'intellectually and academically challenging'[60] and VAT is misunderstood by many charity trustees who are of the erroneous opinion that charitable status confers an automatic exemption from VAT. It is said[61] that the sudden discovery of a liability for VAT (and the ability of Customs and Excise to examine previous years' liabilities) was a significant cause of charity insolvency. Both the contract culture, where there may be a liability for VAT on the contract, and the growth in trading or fund raising activities by charities can be factors leading to increased liability for VAT.

Charities have sought to increase their income through trading, witness the growth of charity shops and fund raising generally. Trading and fund raising are not, of themselves, charitable activities and the activity is potentially risky financially. The increase in trading or fund raising activities may lead to problems in addition to VAT. The charity may be trading *ultra vires* (if it is not primary purpose trading) or it may wrongly have invested charitable funds in the venture. This can lead to the loss or partial loss of corporation tax exemption[62] and the liability to refund taxes.[63] In

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[58] Framjee P., "Going Concern Status : An Accountancy Perspective," in Norton M., (Ed) 1994

[59] see Value Added Tax Act 1994 and European Directives e.g., Dir. 77/388/EEC

[60] quoted from a Charity / VAT practitioner.

[61] e.g., Michael Norton at the conference on charity insolvency in 1993 organised by Directory of Social Change

[62] Income and Corporation Taxes Act 1988 s.505 gives exemption from corporation tax on most sources of charity income.

[63] also possible actions against trustees for breach of trust

order to protect themselves from risk and to separate fund raising from charitable objects, charities frequently establish subsidiaries which may be wholly owned by the charity through which the trading or fund raising activities are undertaken. It is then customary for the trading subsidiary to covenant its profit back to the charity. Where a charity has established such a subsidiary in this way, over-estimates of profit can lead to difficulties for both parent and subsidiary. Furthermore, if care is not exercised to separate activities clearly, parties dealing with an insolvent subsidiary may believe that they are trading with the main charity and seek redress from it.[64]

It is not the purpose of this study to examine VAT, taxation or trading in depth, those are probably subjects in their own right, but the impact of VAT and trading on insolvency is one of the recurring themes of this study and is considered in chapter ten below.

III. General Introduction of The Law in This Area

A. Insolvency

Although winding up of associations and corporations is not necessarily related to the fact of their solvency, insolvency is probably the most significant factor influencing whether or not a particular body is wound up. Insolvency law has developed in a haphazard fashion over a long period of time and is based on statutes, supplemented by common law and equitable principles, all of which are much affected by case law.[65]

The courts had, and continue to have, an inherent jurisdiction to wind up trusts, associations and corporations but successive Companies Acts have contained provisions enabling companies to be wound up. The latter provisions derive originally from Victorian statutes enabling joint stock companies to be wound up.[66] That legislation provides for a variety of parties (such as members or creditors) or

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[64] See [1988] Ch. Comm. Rep. paras 45-48

[65] See Ratford W.F., Smith R., Gregory R.M., Griffiths M.J., and Williams J.S., *Insolvency : Understanding the New Law*, Financial Training Publications, 1987, Introduction p.xv

[66] Joint Stock Companies (Winding Up) Act 1848 and Joint Stock Companies (Winding Up) Act 1849

individuals to petition for a company to be wound up and, where the company is a charity, the Attorney General is included in those who may petition.[67]

In 1984 the White Paper *A Revised Framework for the Insolvency Law*[68] identified the principal role of the insolvency legislation as being to establish procedures for settling the affairs of corporate insolvents in the interests of their creditors; to provide a statutory framework to encourage companies to pay attention to their financial circumstances so as to recognise difficulties at an early stage and before the interests of the creditors are seriously prejudiced; to deter irresponsible behaviour by company managers; to ensure that those who act in cases of insolvency are competent and to facilitate the reorganisation of companies in difficulty to minimise unnecessary loss to creditors and to the economy generally.

The ensuing Insolvency Act of 1986 also established a new procedure – the administration order - designed to enable companies which might otherwise go into liquidation to be reorganised and restructured, in effect, rescued.[69]

One of the circumstances in which a company may be wound up is that it is unable to pay its debts.[70] Interestingly, however, there is no statutory definition of an "insolvent" company although insolvency includes the approval of voluntary arrangements, the making of an administration order or the appointment of an administrative receiver.[71] "Onset of insolvency" is defined in relation to transactions at undervalue and preferences where an administration order is made, or a company goes into liquidation immediately on the discharge of an administration order.[72] Where a company goes into liquidation and its assets are insufficient to meet its debts and other liabilities it is in "insolvent liquidation."[73] Sealy and Milman[74] comment that the Act tends to use 'insolvency' to describe proceedings. They consider the meaning of 'insolvent company' and 'insolvency' and conclude that, in the context of

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[67] Charities Act 1960 s.30, now Charities Act 1993 s.63
[68] 1984 Cmnd. 9175
[69] Insolvency Act 1986 Part II ss.8-27
[70] Insolvency Act 1986 s.122(1)(f) and s.123. This is explored further in chapter 2.
[71] Insolvency Act 1986 s247
[72] Insolvency Act 1986 s240(3)
[73] Insolvency Act s214(6)
[74] Sealy L.S. and Milman D., 1994 pp.273/4 and 307

the Insolvency Act this refers to a company subject to the proceedings described in the Act, and not necessarily to describe a company's adverse financial position. However, 'insolvent liquidation' is defined as going into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of winding up.[75]

B. CHARITY

Whilst unincorporated associations can be wound up by the courts, Insolvency Act procedures are not applicable to unincorporated charities[76] but the Charities Act 1992[77] introduced a mechanism whereby, in respect of charities other than those which are exempt,[78] the Charity Commission may, after instituting an inquiry, and being satisfied that there has been misconduct or mismanagement, or that it is desirable to act for the protection of the charity, appoint a receiver and manager. The Commission may determine the functions to be discharged by the receiver and manager under the supervision of the Commission.[79]

The corporate'rescue' mechanisms, namely administration, receiver and manager and receiverships generally are discussed further in chapter three. Other rescue mechanisms available to charities irrespective of their legal vehicle are considered in chapter nine. Winding up generally is discussed in chapter three.

C. THE LEGAL VEHICLE

The 'legal vehicles' of charities may be unincorporated associations, trusts, or corporate bodies. Incorporation may take several forms, not all of which result in limited liability for the individual members. Charities frequently operate through trust deeds whose trustees may be incorporated or unincorporated.

The 'incidents' associated with these legal vehicles vary considerably particularly in

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[75] Insolvency Act 1986 s.214(6)
[76] See Chap. 3.
[77] Charities Act 1992 s. 8, amending Charities Act 1960 s20, now Charities Act 1993 ss.18(1)(vii) and 19
[78] Charities Act 1993 s.18(16)
[79] Charities Act 1993 s.19(1)

relation to property holding and liability of members.

1. Unincorporated Associations

Unincorporated associations do not exist in their own right separately from the members.[80] Property of the association must be held by trustees on the members' behalf; legal actions must be brought and defended in the name(s) of individual member(s); the individual(s) will only be indemnified from funds of the association if it is permitted in the constitution and the liability of members is unlimited. Because an unincorporated association only lives though its individual members, there can be practical difficulties for a group in, for example, holding a lease or a freehold, which will probably result in several changes of trustee during the term of the lease or ownership of land. One of the case studies[81] indicated that associations which have property are not always aware of the implications of a holding trustee's resignation. The committee of the association received a letter from a holding trustee who resigned as he was leaving the area. They duly wrote and thanked him for his services but no one was aware that any other legal processes were required, so he remained a trustee on the Land Registration Certificate. Consequently, when the property came to be sold ten years later, the winding up was delayed by the need to track him down in order to convey the property. Whilst changes of trustee may be tedious it is the matter of personal liability which creates most difficulty as individuals are reluctant to assume this degree of personal financial responsibility. There is, therefore, a tendency for members of unincorporated associations to seek limited liability by incorporation.

Several statutes provide for incorporation although not necessarily unlimited liability for members.

2. Charitable Trusts and Incorporated Charity Trustees[82]

Where the trustees are not incorporated, the same difficulties arise in respect of

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[80] See discussions of the separate legal identity in a corporation in company law texts e.g. Pennington, 1995, Chapter 2: Gower, 1979, Chapter 1. See also Warbuton J., 1992,Chapter 1. See also Chapter 8

[81] Case Study 7

property holding, suing and being sued as in an unincorporated association.

The trustees of a charity may apply to the Charity Commission for a certificate of incorporation, and the Commission may agree where this is considered to be in the best interests of the charity.[83] The trustees may then sue and be sued in their corporate name but they have the same liabilities and powers as under the unincorporated trust.[84]

3. Industrial and Provident Societies

Associations formed to carry on industry, trade or business, which are either bona fide co-operative societies or intended to be conducted for the benefit of the community, may be incorporated under the Industrial and Provident Societies Act 1965 by registration with the Chief Registrar of Friendly Societies.[85] This gives limited liability,[86] the ability to hold property, sue and be sued, in the association's name.[87] If the Registrar is satisfied that the objects are wholly charitable or benevolent permission may be given to dispense with 'limited' in the name.[88]

Industrial and provident societies which are charitable are exempt from registration under the Charities Act 1993.[89]

4. Friendly Societies

Friendly Societies are now able to incorporate under the 1992 Friendly Societies Act.[90] Such bodies, if charitable, are exempt from registration with the Charity Commission.[91]

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[82] Now Charities Act 1993 ss.50-62
[83] Charities Act 1993 s.50
[84] Charities Act 1993 s.51
[85] Industrial and Provident Societies Act 1965 s.1(1) and (2)
[86] Industrial and Provident Societies Act 1965 s.5
[87] Industrial and Provident Societies Act 1965 ss.3, 30
[88] Industrial and Provident Societies Act 1965 s.5(2)
[89] Charities Act 1993 ss.3, 96 and Sched. 2(y)
[90] Friendly Societies Act 1992 s.5(1)
[91] Charities Act 1993 ss.3, 93, and Sched. 2 para. (y)

5. Companies Act 1985

Incorporated charities tend to be limited by guarantee[92] rather than by shares because, as Warburton suggests, the key thing is the participation of the members rather than raising capital[93] but trading subsidiaries are often limited by shares[94] and the profits covenanted back to the parent. Companies can sue, be sued and hold property in their own name. There is perpetual succession.

6. Other Methods

Corporations may also be established by Royal Charter and by statute.[95]

7. Incorporated Trustees and Company Compared

There are several differences between the corporate body formed when trustees are incorporated and that formed when a company is formed and registered under the Companies Act[96] which impact on property holding and the distribution of surplus assets on winding up.

First, the act of incorporation is different. When a company is formed under the Companies Act[97] the memorandum and articles, when registered, bind the company and its members[98] thus making the company itself a party to the contract of incorporation.[99] This, indeed, is the essential difference between the company and an unincorporated association whose members only are bound by the contract of association, usually called the constitution or rules. The Charities Act,[100] on the other hand, provides only for the incorporation of the trustees[101] and, although there

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[92] Companies Act 1985 s.1(2)(b)
[93] Warburton J., 1992 p.7
[94] Companies Act 1985 s.1(2)(a)
[95] see e.g., *Construction Industry Training Board v Att.-Gen.* [1973] 1 Ch. 173; Further and Higher Education Corporations; N.H.S. Trusts
[96] under Companies Act 1985 s.1
[97] Companies Act 1985. The same applies when a society is registered under the Industrial and Provident Societies Act 1965.
[98] Companies Act 1985 s.14(1)
[99] The same provisions apply in respect of registered industrial and provident societies under the Industrial and Provident Societies Act 1965 s.4(1).
[100] Charities Act 1993 ss.50-62
[101] Charities Act 1993 s.50(1)(a)

is a body corporate formed in which the property of the trust is vested,[102] that corporate body is not made party to the contract of association or incorporation.

Secondly, although the trustees can sue and be sued in the name of the corporate body,[103] there is no alteration to their powers, and the trustees personal liability remains unlimited.[104]

Thirdly, the trust concept remains central where trustees are incorporated. Although the Charity Commission have the power to dissolve incorporated trustees,[105] the trust is not destroyed by such dissolution. Any property remaining is vested in the trustees in their unincorporated form, or in other specified persons,[106] who then re-acquire the rights and liabilities as individuals. This is quite different from the dissolution of a company whose property is dealt with under the provisions of the companies and insolvency legislation[107] and which ceases to exist on dissolution. This applies where the company is also a charity. In a voluntary winding up the property of the company is, subject to preferential debts, applied *pari passu* and, subject to the articles,[108] distributed to members according to their interests in the company,[109] although surplus funds of a charitable company would be applied cy-près.[110]

Fourthly, it has been held that a charitable company holds its property beneficially and not on trust for its objects.[111] Property holding and trusteeship in charitable companies is considered in chapters seven, in the context of endowments, and eight, as compared with unincorporated associations.

IV. RECURRING THEMES

Several topics within this study are interconnected (and interdependent conceptually)

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[102] Charities Act 1993 s.50(3(a) and s51
[103] Charities Act 1993 s.50(4)
[104] Charities Act 1993 s.50(3)(b), 4(b) and s.54
[105] Charities Act 1993 s.61(1),(2)
[106] Charities Act 1993 s.61(3)
[107] Companies Act 1985 and 1989 and Insolvency Act 1986
[108] Clearly the articles of a charitable company would require a charitable disposition of surplus assets.
[109] Insolvency Act 1986 s.107
[110] *Re Liverpool and District Hospital for Diseases of the Heart v Att.-Gen.* [1981] 1 Ch 191
[111] *ibid.*

particularly in relation to charity law. The perpetual nature of the charity concept[112] as distinct from its mechanism; endowment; and cy-près are typical areas where concepts are interdependent. For this reason it is sometimes an arbitrary decision as to where material is located. Chapters are therefore cross referenced but it is inevitable that in what follows the chicken may occasionally precede the egg!

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[112] see *Re Vernon's Will Trusts* [1972] 1 Ch 300n at 304 per Buckley J

CHAPTER 2 : INSOLVENCY, WINDING UP, DISSOLUTION AND LIQUIDATION

I. INSOLVENCY, WINDING UP, LIQUIDATION TERMS, DEFINITIONS AND LEGISLATIVE BACKGROUND

A. INSOLVENCY

> "Annual income, twenty pounds; annual expenditure, nineteen pounds and sixpence; result happiness. Annual income, twenty pounds; annual expenditure twenty pounds ought and six; result, misery"[1]

Simplistically, insolvency means inability to pay debts.

A solvent charity is a 'going concern' which means that it "will continue in operational existence for the foreseeable future. In particular the Statement of Financial Activities and Balance Sheet assumes no intention or necessity to liquidate or to curtail significantly the scale of operation of the charity"[2]

Two tests are used to determine whether or not an organisations is solvent, namely, the 'going-concern' (or 'cash-flow' or liquidity) test and the 'balance-sheet' test. The going concern test relates to whether the organisation can pay its debts as they fall due and the balance sheet test compares the assets of the organisation with its liabilities.

If the company will be able to pay its debts in full, together with interest at the official rate within 12 months from the commencement of winding up, the directors are in a position to swear a declaration of solvency[3] and a members' voluntary winding up can take place. Although its directors could validly swear a declaration of solvency, a company may still have failed the cash-flow test. However, the directors must be certain that the assets can be liquidated quickly and once liquidated will be adequate to meet all the liabilities. Because of the additional liabilities of liquidation, however, a members' voluntary liquidation is most likely to apply to a company being wound

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[1] Mr Micawber's advice to David, *David Copperfield* by Charles Dickens.

[2] SSAP 2 "Fundamental Accounting Concepts" in *Accounting by Charities: Statement of Recommended Practice*, Charity Commission October, 1995

up where insolvency is not an issue.

If the directors cannot properly swear the statutory declaration[4] the company will be wound up by creditors' voluntary winding up or court order.

The circumstances in which a company may be wound up by the court are stated in section 122 of the 1986 Insolvency Act and include, *inter alia*, that "the company is unable to pay its debts".[5] Section 123[6] provides that a company (in England and Wales) is deemed unable to pay its debts if, *inter alia*, it is unable to pay them as they fall due;[7] the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities;[8] a creditor to whom the company is indebted for an amount greater than £750[9] has served a written demand on the company and the company has neglected for three weeks to pay, secure, or compound for it;[10] or if an execution or process is returned unsatisfied.[11]

The first definition above, section 123(1)(e), is the 'cash-flow' or 'going- concern' test and that in section 123(2), the 'balance-sheet' test. It is possible for a company which fails the cash flow test to be wound up and pay all its liabilities in full, but this is only achieved by winding up and cashing the assets, which would be impossible as a going concern.

The result of applying the balance sheet test will vary according to whether the assets and liabilities are valued on a 'going-concern' or 'break-up' basis and this means that solvency may be a relative issue. As a going concern the organisation need not take into account potential liabilities such as redundancy, cost of liquidation and the like, and its assets will appear in the accounts at 'written - down - book - value.' Thus, a company which, as a going concern, has been managing to trade at break-even and

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[3] Insolvency Act 1986 s.89
[4] Insolvency Act 1986 s.89
[5] Insolvency Act 1986 s.122(1)(f)
[6] Insolvency Act 1986 s.123
[7] Insolvency Act 1986 s.123(1)(e)
[8] Insolvency Act 1986 s.123(2)
[9] or a revised amount as specified in an order made under Insolvency Act 1986 s.416, by virtue of Insolvency Act 1986 s.123(3)
[10] Insolvency Act 1986 s.123(1)(a)
[11] Insolvency Act 1986 s.123(1)(b)

just about solvently can, on winding up, be pretty insolvent. This is because the cost of liquidation, redundancy payments and the like, which will become liabilities; and any bank borrowings will become immediately due rather than repayable over a period of time. In addition, speedy realisation of the assets means that it is difficult to market specialist plant so its full value may not be realised. Certain equipment, notably computers, has a useful life of several years, but there is no second hand market so sale value is negligible. The value of book debts becomes reduced. Debtors dispute what they owe, or query, for example, the quality of goods or services supplied. They may be looking for set off in full which is more to their benefit than the rated settlement they might receive as a creditor (always assuming there is anything left for ordinary creditors). The liquidator then has to decide on balance whether to pursue debts thereby incurring greater liquidation costs, or perhaps to accept a considerably lower offer of payment than full value. For these reasons, valuation on a 'break-up' basis often achieves quite different results from 'going concern' valuations.

B. LIQUIDATION, WINDING UP, DISSOLUTION, ADMINISTRATION ORDER, ADMINISTRATIVE RECEIVER

Liquidation is the process by which the assets of a company or an individual are turned into cash and distributed to the creditors. **Winding up** is the process of "putting an end to the carrying on of the business of a company or partnership, realising the assets and discharging the liabilities of the concern, settling any question of account or contribution between the members, and dividing any surplus assets (if any) among the members".[12] French[13] suggests that 'winding up'and 'liquidation' are interchangeable terms.

Dissolution of a company "extinguishes its legal personality, so that it goes out of existence for all purposes".[14] A company being wound up voluntarily is automatically dissolved three months after the filing of the liquidator's final accounts

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[12] Bird R., *Osborn's Concise Law Dictionary*, 7th Ed Sweet & Maxwell, 1983
[13] French D., 1993
[14] Sealey L.S. and Milman D., 1994 p.236

with the registrar of companies,[15] or when otherwise wound up, after three months of receipt of the notice following the final meeting of creditors, or from the official receiver that the winding up of the company by the court is complete.[16]

A partnership or unincorporated association may be said to be dissolved as from the time that its ending is decided upon by the members or is ordered by the court. The process of winding up the affairs of a partnership or association may follow its dissolution.[17]

The making of an **administration order**[18] automatically imposes a moratorium for the company during which it cannot be put into liquidation, nor an order be made winding it up; securities may not be enforced or goods repossessed nor other proceeding be commenced without the court's leave.[19] Before making an administration order the court must be satisfied that the company is, or is likely to become, unable to pay its debts.[20]

An **administrative receiver** is a receiver or manager of the whole or substantially the whole of a company's property who is appointed by or on behalf of the holders of debentures secured by a charge which, as created, was a floating charge (or by a floating charge and other security).[21]

C. WINDING UP, RESCUE AND INSOLVENCY- GENERAL BACKGROUND

Two areas of legislation are particularly relevant to this study.

For companies the main provision is the Insolvency Act 1986 which deals with the winding up of registered[22] and unregistered companies[23] and covers opportunities for

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[15] Insolvency Act 1986 s.201(1) and (2)
[16] Insolvency Act 1986 s.205(1) and (2)
[17] French D.,1993 p.7
[18] Under Insolvency Act 1986 s.8
[19] Insolvency Act 1986 s.10
[20] Insolvency Act 1986 s.8(1). Sealy & Milman suggest that insolvency for these purposes is likely to be determined primarily on a cash flow (liquidity) basis rather than balance sheet basis (*op.cit.* p.43)
[21] Insolvency Act 1986 s.29(2)
[22] Insolvency Act 1986 Part IV
[23] Insolvency Act Part V

rescue such as voluntary arrangements with creditors;[24] administration orders;[25] receivers and managers and administrative receivers.[26] The Companies Acts 1985 and 1989 are also relevant.

The second significant provision is contained in section 18 of the Charities Act 1993[27] which permits the Charity Commission to appoint a receiver and manager in respect of the property and affairs of the charity where there has been an inquiry and the Commission are satisfied that there has been misconduct or mismanagement or it is desirable to act to protect the charity or secure proper application of its property. Section 19[28] contains supplementary provision and enables the Secretary of State to make regulations.[29] This provision will be discussed later when opportunities for rescue are examined.

II. PRELIMINARY MATTERS

Before proceeding further, there are two matters which need to be explored.

First, there is strong authority for the proposition that a charity cannot die. Secondly, it is necessary to consider whether unincorporated associations are able to be wound up compulsorily by the court under Part V of the Insolvency Act 1986.

A. CAN A CHARITY DIE, BE TERMINATED, OR DISSOLVED?

First, an endowed charity, so long as its funds are devoted to some charitable purpose under some duly authorised scheme remains existent.[30] Thus where a charity has been altered by a scheme,[31] in accordance with the trust deed,[32] or by amalgamation,[33] the charity continues even though it has been through one of these processes. The courts have also distinguished between the moribundity of a charity

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[24] Insolvency Act 1986 Part I
[25] Insolvency Act 1986 Part II
[26] Insolvency Act 1986 Part III
[27] Charities Act 1993 s.18(1)(b)(vii)
[28] Charities Act 1993 s.19
[29] currently contained in the Charities (Receiver and Manager) Regulations 1992, S.I. 1992 No. 2355
[30] *Re Faraker* [1912] 2 Ch 488
[31] *Re Lucas* [1948] Ch 424
[32] *Re Bagshaw* [1954] 1 W.L.R. 238

and its death.[34] Secondly, it is not so much the means to the charitable end (the mechanism or the institution)[35] which has to be considered as the charitable object itself.

In *Re Roberts*[36] the constitution apparently permitted termination. Wilberforce J. referred to *Re Faraker*[37] but thought that case not necessarily applicable where trustees are given express powers to terminate the charity. Nevertheless, he held that the trustees were not empowered to decide whether the trust as a whole failed, only the machinery. Thus 'the charity' is distinct from its mechanism or the institution.[38]

In some charities, however, the charity and mechanism are bound up together, as in Case Study 5[39] when winding up the institution would also wind up the charity. Charities whose governing instrument permits dissolution, can be wound up and thus die.[40] Powers of dissolution are fundamental to registered companies. *Re Stemson's Will Trusts*[41] suggests that the 'charity' dies as well as its legal vehicle. Slade J's judgement in *Liverpool and District Hospital for Diseases of the Heart v Attorney-General*[42] suggests that the 'charity' continues to exist after dissolution if only to the extent that a surplus can be applied cy-près. This is discussed further in chapters four and five regarding endowments and surplus assets respectively.

The situation therefore appears to be that some charities can be wound up, in that they may cease operations and pay off liabilities out of the funds. Once any surplus has applied cy-près and it has no further assets, a charity can be dissolved.

The existence of permanent endowment is capable of causing difficulties where charities whose solvency is doubtful are being wound up. This will be discussed in

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[33] *Re Faraker* [1912] 2 Ch 488
[34] *Re Buck (Bruty v Mackey)* [1896] 2 Ch. 727
[35] *Re Faraker* [1912] Ch 488 and *Re Roberts* [1963] 1 W.L.R 406
[36] [1963] 1 W.L.R. 406
[37] [1912] 2 Ch. 488
[38] see also *Re Vernon's Will Trusts* [1972] 1 Ch 300n at 304 per Buckley J.
[39] see pp.80 (for details of constitution),139,269,292
[40] It is apparent from *Re Roberts* [1963] 1 W.L.R. 406 that this can be the case. See also *Re Stemsons Will Trusts* [1970] 1 Ch 16, and the Charity Commission model governing instrument for an unincorporated association -GD3 January 1998 contains provision for dissolution.
[41] [1970] 1 Ch 16
[42] [1981] Ch 193

B. Are The Procedures Under The Insolvency Act 1986 Available To Charities Which Are Not Registered Companies?

Section 220 of the Insolvency Act 1986 apparently deals with unincorporated associations: "the expression 'unregistered company' includes...any association and any company....",[42] but recent decisions appear to confirm that section 220 is inapplicable in winding up not-for-profit organisations. The wording of section 220 derives originally from the Joint Stock Companies Winding Up Acts[43] and comes in its present form via the Companies Act 1948 and section 665 of the 1985 Act.[44]

The winding up of unincorporated associations under the Joint Stock Companies Winding Up Acts 1848-1849 was considered in *Re St James's Club* in 1852.[45] The club was a non-profit-distributing members club which had become insolvent. Knight Bruce V.-C. had ordered the dissolution and winding up of the club under the Acts. On appeal, Lord St. Leonards L.C. examined the scope and tenor of the Acts and the nature and constitution of such clubs. Having noted that the purpose of the second Act was to enlarge the powers of the earlier Act, but that it embraced only the same purposes,[46] he concluded that such unincorporated associations as this club were not partnerships or associations within the meaning of the provisions of the Acts.

> "I cannot hold [the Act] to apply to every association or company. If I were to do so, I might be called upon to carry the application much lower than to such a club as that now in question. A cricket club, an archery society, or a *charitable society*, would come under the operation of the Act, and indeed every club would be included. Though 'associations' are mentioned, I cannot think that word is to be treated without regard to the particulars with which it is associated."[47]

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[42] Insolvency Act 1986 s.220(1) - with exclusions which are not relevant to this study in s.220(1)(a)(b)
[43] Joint Stock Companies (Winding Up) Act 1848 and the Joint Stock Companies (Winding Up) Act 1849
[44] Companies Act 1985
[45] (1852) 2 De G. M. & G. 383
[46] (1852) 2 De G. M. & G. 383 at 387
[47] (1852) 2 De G. M. & G. 383 at 389 per Lord St. Leonards L.C. (emphasis added)

Sealy and Milman[48] note that:

> "[t]he earliest companies legislation ... was accompanied by Winding-up Acts which provided machinery for the winding up of companies which had not registered. Part V of the [1986 Insolvency] Act, which consolidates [the Companies Act] 1985, Part XXI, is what survives today of that legislation. There are almost certainly, however, no 'unregistered companies' in the old sense still around; and for practical purposes it is probably true to say that Pt. V will be applied to two types of 'unregistered' company -(1) statutory companies incorporated by private Act of Parliament ... and (2) oversea companies.... Obsolete references to partnerships and limited partnerships contained in [the Companies Act] 1985 s665 were repealed by [Insolvency Act] 1985, Sch. 10, Pt. II; but paradoxically this part of the Act is now made to apply to the winding up of certain insolvent partnerships...."[49]

Having said that the term "association" has been held to mean only an association for gain or profit in *Re St James's Club*[50] and *Re The Bristol Athenaeum*,[51] Sealy and Milman comment[52] that the decisions may have turned, in part, on the special wording of the earlier legislation but the ruling in *Re St James's Club* was given renewed authority when endorsed by the Court of Appeal in *Re International Tin Council*[53] and applied in *Re Whitney Town Football and Social Club.*[54]

The applicability of the forerunner of section 220 of the Insolvency Act 1986, namely section 665 of the Companies Act 1985 to "associations" was discussed in 1988 in *Re International Tin Council.*[55] The International Tin Council was an international organisation established by treaty between sovereign states under which it had the legal capacities of a body corporate. At first instance Millett J. held that although the I.T.C. fell within the literal meaning of 'association', Parliament could not have intended it to be subject to the winding up jurisdiction of the English Court. This view was endorsed by Nourse L.J., delivering the judgement of the court.[56]

In 1994 the applicability of section 220 of the 1986 Act[57] was raised in *Re Witney*

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[48] Sealy L.S. and Milman D, 1994
[49] op.cit. p.267
[50] (1852) 2 De G. M.& G. 383
[51] (1889) 43 ChD 236
[52] Sealy L.S., and Milman D., 1994, p.268
[53] [1988] BCLC 404
[54] [1994] 2 BCLC 487
[55] [1988] BCLC 404
[56] [1988] BCLC 404 CA at 525 per Nourse L.J.
[57] Insolvency Act 1986 S.220

Town Football and Social Club.[58] The club rules provided, *inter alia*, that the club existed solely for professional football and on dissolution the assets should not be distributed among the members. A creditor had petitioned for the winding up of the club. The County Court judge had rejected the petition. In the Chancery Division the decisions under the predecessor provisions of section 220 were not disturbed. Morritt J. said:

> "Ever since 1948 the statutory provisions conferring jurisdiction on the court to wind up unregistered companies have defined an unregistered company as including 'an association and any company' subject to various exclusions which are not material.... Moreover the various re-enactments since 1852 have been made in the light of the decision of the Lord Chancellor in *Re St James's Club* so that the apparently unlimited word 'any' cannot be given its literal meaning. The decision of the Court of Appeal in *Re International Tin Council*, which is binding on me, establishes that the question is whether Parliament could reasonably have intended a club of this sort to be subject to the statutory winding-up procedure.... Thus ... a club such as that with which the Lord Chancellor dealt in *Re St James's Club* did not come within the words 'any association' as used in s 220 of the 1986 Act"[59]

Morritt J. commenting on the distinction in the respective rules of the St James Club and Witney Town F.C. said:

> "I do not think that the distinction warrants any implication that Parliament must have intended this type of club to be capable of being wound up under the provisions of the 1986 Act for, in appropriate cases it could be wound up by the High Court under its inherent jurisdiction without bringing in all the detailed provisions of the 1986 Act and rules.... The remedy of the creditors lies against the individuals with whom the contracts were made."[60]

This latter point is probably significant. Were section 220[61] to be applicable to unincorporated associations, the legislation would, in effect be conferring some aspect of corporate personality on unincorporated associations.

None of these cases concerns an unincorporated charity but it seems to have been assumed since *Re St James's Club*[62] that it would be unthinkable for this legislation,

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[58] [1994] 2 BCLC 487 Ch D
[59] [1984] 2 BCLC 487 at 489-90 per Morritt J.
[60] [1994] 2 BCLC 487 at 491 per Morritt J.
[61] Insolvency Act 1986s.220
[62] (1852) 2 De G. M.& G. 383

now section 220, to apply to unincorporated charitable societies. The International Tin Council was established by international treaty under the Royal Prerogative so it would have been inappropriate for English courts to have interfered by winding it up. Nevertheless, the Tin Council was a corporate body and it is uncertain whether, following the line of authority in the cases cited above, the courts would find it appropriate in the absence of express applicability, to allow section 220 to be used to wind up a corporate charity established by a statute such as the Construction Industry Training Board;[63] a Further Education Corporation; or an incorporated trust particularly since such directors, governors or trustees do not have the benefit of limited liability and the remedy of the creditors would lie against them in person. The assumed-intention-of-Parliament would presumably still be the significant factor. This view of section 220 is strengthened by *Re Devon and Somerset Farmers Ltd*[64] in which it was held that an industrial and provident society, which is a corporate trading body with limited liability[65] is not a company for the purposes of section 40 of the Act.[66]

It also seems unlikely that the procedures under section 220 would be applicable to a charity established by Royal Charter although there are instances of commercial companies established by Royal Charter being wound up under the forerunner of the present legislation.[67]

French[68] suggests that non-business societies cannot be wound up under the insolvency legislation because the court's jurisdiction is dependent on a 'business address' so a society which does not carry on business cannot be wound up as an unregistered company. He asserts that unincorporated friendly societies can be wound up by the insolvency legislation because they have a 'pseudo-corporate'

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[63] see *Construction Industry Training Board v Att.-Gen.* [1973] 1 Ch 173
[64] [1994] Ch 57
[65] Industrial and Provident Societies Act 1965 ss.1,5
[66] Insolvency Act 1986 s40 - which requires preferential creditors to be paid out of the assets subject to the floating charge in priority to claims under the debenture.
[67] See e.g., *Re Oriental Bank Corporation* (1885) 54 L.J. Ch 481; *Re English Scottish & Australian Chartered Bank* [1893] 3 Ch 385; *Re Commercial Buildings Co. of Dublin* [1938] IR 477.
[68] French D., 1993

existence by virtue of the statutes regulating their existence.[69]

Although the compulsory winding up procedure through the court under section 220 of the Insolvency Act 1986 seems unavailable in respect of unincorporated charitable associations, it is still possible to rely on the inherent jurisdiction of the High Court to wind up certain associations. This is discussed in chapter three below.

It is worth noting that, under the Insolvency Act, unregistered companies can, in any event, only be wound up compulsorily by the Court. Voluntary winding up is not available under the Act[70]and the grounds on which a petition may be brought are more restricted than those for registered companies.[71] The winding up of unincorporated associations and corporate bodies will, therefore be dealt with separately in what follows.

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[69] French D., 1993, p.34

[70] Insolvency Act 1986 s.221(4)

[71] Insolvency Act 1986 s.221(5) – a company is dissolved, has ceased to carry on business or is only carrying on business for the purpose of winding up; unable to pay debts; just and equitable grounds. This can be compared with Insolvency Act 1986 s 84 (voluntary winding up) – when the period (if any) fixed for the duration of the company expires; a special resolution of members is passed; extraordinary resolution of members that it cannot by reason of its liabilities carry on and that it is advisable to be wound up is passed.

CHAPTER 3 : WINDING UP AND DISSOLUTION IN UNINCORPORATED ASSOCIATIONS AND CHARITABLE CORPORATIONS - AN OVERVIEW

UNINCORPORATED ASSOCIATIONS

> "Unincorporated associations reside on the shifting interface of the law of contract and the law of trusts, and one's answers to the proprietary questions posed by their dissolution must necessarily reflect one's assumptions about the proper relationship between those two conceptual receptacles of English law."[1]

I. INTRODUCTION

This chapter will explore the mechanisms for cessation, winding up, and dissolution of unincorporated associations whether solvent or not and it will briefly consider the possible consequences for members of insolvent unincorporated associations.

As explained above, it would appear that the provisions of Part V of the Insolvency Act 1986 do not apply to unincorporated not-for-profit associations. It is, however, possible to 'close down' or dissolve the operations of unincorporated associations and corporate bodies outside the provisions of the Insolvency Act 1986. For example, the constitutions of many unincorporated associations will contain a dissolution clause;[2] Industrial and Provident Societies are advised to include a voluntary (solvent) dissolution clause in their rules;[3] small charities can be merged[4] or their endowment spent[5] and, for the purposes of the register of charities, cease to exist; schemes[6] can be established; associations can dissolve spontaneously by

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[1] Green B., *Dissolution of Unincorporated Non-Profit Associations* [1980] 43 M.L.R. 626 at 626

[2] see, for example, *Model Constitution for a Charitable Unincorporated Association - G.D.3* - Charity Commission, 1998

[3] Registrar of Friendly Societies, *Guide to the Law Relating to Industrial and Provident Societies*, H.M.S.O., 1978 para. 42(1) page 14

[4] Charities Act 1993 s.74 (2) - property may be transferred to another charity (Charities Act 1993 s.74(2)(a) or charities (Charities Act 1993 s.74(2)(b)).

[5] Charities Act 1993 s.75

[6] Charities Act 1993 s.17

ceasing to function, without a formal resolution to dissolve[7] and the high court has inherent jurisdiction to wind up certain associations. These options will be considered in due course.

Unincorporated associations present problems because they only exist through their members. Should the members disappear, there can be no association. The meaning of 'ceased to exist' is therefore explored below.

There is some relevant literature in respect of unincorporated associations and their winding up, notably Warburton's *Unincorporated Associations.*[8] In addition Green,[9] Rickett,[10] Gardner[11] and others have considered aspects of the dissolution of unincorporated associations and their work is considered where appropriate in what follows. Green's focus is not for profit associations. His analysis is not, therefore, always relevant to charities.

II. UNINCORPORATED ASSOCIATIONS

In *Conservative and Unionist Central Office v Burrell*[12] Lawton L.J. defined an unincorporated association, for the purposes of income and corporation tax, as

> "two or more persons bound together for one or more common purposes, not being business purposes, by mutual undertakings, each having mutual duties and obligations, in an organisation which has rules which identify in whom control of it and its funds rests and upon what terms and which can be joined or left at will. The bond of union between members... has to be contractual".[13]

Warburton suggests that "whenever several people join together to carry out a mutual purpose, otherwise than for profit, an unincorporated association comes into being.... founded by the agreement between members....[and with] intention to create

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[7] *Abbatt v Treasury Solicitor & Ors* [1969] 1 W.L.R. 561 at 569 per Pennycuick J. Although the first instance decision was overruled on the question as to whether the club had actually ceased to function -[1969] 1 W.L.R. 1575 – this particular point made by Pennycuick J. at first instance was not overruled.

[8] Warburton J., (1992)

[9] Green B., op.cit. [1980] 43 M.L.R. 626

[10] Rickett C.E.F., *Unincorporated Associations and Their Dissolution*, [1980] C.L.J. 88-123

[11] Gardner S., *New Angles on Unincorporated Associations*, [1992] Conv. 41

[12] [1982] 1 W.L.R. 522

[13] [1982] 1 W.L.R. 522 at 525 per Lawton L.J.

legal relations."[14]

The basis of both unincorporated associations and corporate bodies is contractual. Walton J. said:

> "there is no doubt that, as a result of modern cases...judicial opinion ... is now firmly set along the lines that the interests and rights of persons who are members of any type of unincorporated association are governed exclusively by contracts; that is to say rights between themselves and their rights to any surplus assets."[15]

The rules tend to be in a trust deed or constitution.

Other issues related to unincorporated associations are explored in several of the chapters which follow. The nature of property holding in unincorporated associations which are charities is explored further elsewhere.

III. CESSATION OF EXISTENCE - DISSOLUTION

In attempting to identify when a charity has ceased to exist, it is important to distinguish between the charity as a concept, and the charity with a numbered identity on the register of charities.

From the study of charities removed from the register during the first fifteen months of this study, it appears that a charity is removed from the register as having ceased to exist if its assets are transferred to another; when an unincorporated association is converted into a company; and when section 74[16] is used to transfer the assets of a small charity to another. This does not necessarily mean, however, that if a bequest were made to one of these removed charities it would lapse because, in many instances, the charity as a concept has continued and the transferee charity would in all probability, therefore, receive the bequest. (see chapter five on the destination of surplus assets)

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[14] Warburton J., (1992) p.1

[15] *Re Buckinghamshire Constabulary Widows and Orphans Fund Friendly Society No.2* [1979] 1 W.L.R. 936 at 952

[16] Charities Act 1993 s74

In *Re Roberts*[17] the charity which ran a working boys home, had been wound up, that is, 'dissolved' for the purposes of this part of the study, but its conceptual charity continued in existence for the purposes of enabling a scheme to be established for a subsequent bequest.

It is a question of fact whether or not a charity is in existence. Because unincorporated charities do not exist in their own right, other than as entities on the register of charities, it is important to identify the events or factors that identify a charity as ceased or dissolved. In *Re Buck*[18] where there was a surviving annuitant, the charity was 'moribund'[19] rather than 'dead' - a matter of fine judgement. In *Re Slatter's Will Trusts*[20] a charity established to provide a tuberculosis hospital had ceased, not solely because the machinery had ceased but, as TB had largely been eradicated there was no further need for its work and it had no endowments. It was redundant. In *Re Withall*[21] it was said that where a charity is being carried on by those administering its funds, without funds from day to day, when the administrators cease to carry on the work for lack of funds, so that there are no longer people or funds to carry on the work then "in a full and true sense that institution has ceased to exist."[22]

In the tidying up of the register of charities following the Charities Acts 1992 and 1993, it is clear that where the Commission had not had contact with an unendowed charity for several years, such a charity would probably be removed as having 'ceased to exist'.[23]

IV. MECHANISMS FOR WINDING UP OR DISSOLUTION

Many unincorporated associations are capable of being wound up under their own constitutions. Where this is not possible the high court has inherent jurisdiction to dissolve an association. Spontaneous dissolution of associations is recognised in the

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[17] [1963] 1 W.L.R. 406
[18] [1896] 2 Ch 727
[19] which the Pocket Oxford Dictionary defines as "at the point of death, likely soon to perish or pass"
[20] [1964] 1 Ch 512
[21] 1932] 2 Ch 236
[22] as described by Clauson J. in *Re Withall* [1932] 2 Ch 236 at 241

cases. In *Re William Denby Sick and Benevolent Fund*[24] Brightman J. outlined the modes of dissolution of an unincorporated association as being (1) voluntary dissolution by members; (2) the occurrence of an event specified as effecting automatic dissolution; (3) automatic dissolution on 'loss of substratum' by the association and (4) winding up under the court's inherent jurisdiction where it appears just and equitable to do so. These modes are explored below.

A. VOLUNTARY DISSOLUTION BY MEMBERS

As the basis of unincorporated associations is the contract between the members,[25] usually a written constitution, it follows that an association whose constitution contains provision for dissolution may be dissolved in accordance with that provision.

Where there is no provision for dissolution but the constitution of the association provides for amendments, arrangements for dissolution can normally be added, provided that there is compliance with the constitutional procedures for amendments.

In a non-charitable unincorporated association it may be open to the members to dissolve the association in the absence of an express constitutional provision or powers to amend the rules. Green suggests that in order to terminate a multipartite contract, all ties must be released and unless the rules specify otherwise, a unanimous resolution will be required. A single dissentient may obstruct.[26] The contrary conclusion, however, was reached in *M'Kenny v Barnsley Corporation*[27] where the Court of Appeal held that in any group enterprise there will be an implied power in the will of the majority to bind the minority. This was also Lord Denning's view in *Abbatt v Treasury Solicitor.*[28] He also opined that where a majority of members in general meeting purport to amend the rules and the others acquiesce by subsequent

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[23] Charities Act 1993 s3(4)

[24] [1971] 1 W.L.R. 973 at 978-989 per Brightman J.

[25] *Bucks Constabulary Widows & Orphans Fund Friendly Society (No.2)* [1979] 1 W.L.R. 936; Re Rechers Will Trust [1972] 1 Ch 526

[26] Green op. cit. p.631. He cites *Harrington v Sendall* [1903] 1 Ch 921 in which an injunction was granted to restrain expulsion of a club member who refused to pay increased subscription for which he had not voted, and Re Tean F.S. (1914) 58 S.J. 234 where Astbury J. refused to recognise a purported voluntary dissolution by a majority where the rules included no provision.

[27] *M'Kenny v Barnsley Corporation* (1894) 10 T.L.R.

[28] [1969] 1 W.L.R. 1575 (CA) at 1583

conduct, the change in rules becomes binding. In a charitable association, however, the guidance of the Charity Commission would need to be sought in such circumstances. It is perhaps worth noting that, in the *Legal Structures for Charity Survey,*[29] 24.2% of the respondent charities' constitutions did not contain a provision for winding up the organisation and 66.7% did not have a provision dealing with endowment at dissolution.

There may be problems even where there is a dissolution provision. In Case Study 7, the charity's constitution envisaged the possibility of dissolution but failed to provide the mechanism whereby the association could resolve to wind up. In addition, the constitution envisaged that surplus assets would go to another charity which had, itself, already ceased to exist. Fortunately, the constitution was capable of amendment and the Charity Commission advised appropriately.

B. An Automatic 'Dissolving Event'

In the case of a non-charitable unincorporated association, such an event will automatically dissolve the association without any resolution by its members recognising the event. Green asserts that the same rule applies in partnership law.[30]

In the context of unincorporated charities, time charities (for example, where investment property is so settled that a charity benefits from the income for a specific period of time) perhaps fall into this category, otherwise it is difficult to see that automatic dissolution is relevant in the context of this study.

C. Automatic Dissolution On 'Loss Of Substratum'

Green argues that in company law 'loss of substratum' simply provides one of the several bases for winding up under the 'just and equitable' grounds and, whilst it is said to be automatic for an unincorported association, in a company it merely provides a basis for the court to assume jurisdiction to wind up a body which will otherwise continue to exist. He also includes 'the prospect of inevitable insolvency,'

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[29] NCVO/Liverpool University/ Charity Law Association 1995

which is a principle basis for winding up an unincorporated association within the loss of substratum category as understood by companies legislation, but suggests that Brightman J.'s 'loss of substratum' is an unnecessary and restrictive relabelling of what would otherwise be called 'contractual frustration'.[31] Green argues that the contract is discharged by frustration if events occur which make its performance illegal, impossible, or otherwise sterile in so far as they destroy some basic purpose for which the parties contracted. He argues that the effect of frustration is to automatically terminate a contractual relationship and hence where a contract of association has been frustrated, no further act of dissolution will be required.[32] He suggests that this was recognised in unincorporated associations by Brightman J. in R*e William Denby Sick and Benevolent Fund,*[33] and gives examples where the courts have distributed surplus assets on an assumption that dissolution had already occurred.[34]

The term 'spontaneous dissolution' was not used in *Re William Denby Sick & Benevolent Fund* but, from Megarry V.-C.'s observations (below), loss of substratum clearly falls within this category.

It is possible for an association to 'dissolve spontaneously' by ceasing to exist. This possibility was recognised in *Abbatt v Treasury Solicitor.*[35] In *Re G.K.N. Bolts & Nuts Ltd Sports and Social Club*[36] membership cards had ceased to be issued in 1975. At the hearing in 1979 it was held that prolonged inactivity might be such as to cause the reasonable inference that the club had dissolved spontaneously. In 1953, in *Re Harrow Literary Institution,*[37] the court had refused to dissolve an association which

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[30] Green op. cit. p.34 at n.50 - Partnership Act 1890 s32(a)
[31] Green op. cit. p.630-631
[32] Green op. cit. p.634
[33] *Re William Denby Sick and Benevolent Fund* [1971] 1 W.L.R. 973 at 979
[34] *Braithwaite v Att.-Gen.* (1909) 1 Ch 510 - association on threshold of exhaustion of objects; *Tierney v Tough* [1914] 1 I.R. 142 post National Assistance Act 1911- no purpose for association; *Re Customs and Excise Mutual Guarantee Fund* [1917] 2 Ch 18 abolition of need for fidelity bonds - no further purpose for fund; *Feeney and Shannon v Macmannus* [1937] I.R. 23 club's premises destroyed so no membership.
[35] [1969] 1 W.L.R. 561; although the first instance decision was overruled [1969] 1 W.L.R. 1575, the possibility of spontaneous dissolution was not.
[36] *Re G.K.N. Bolts and Nuts (Automotive Division) Birmingham Works Sports and Social Club* [1982] 1 W.L.R. 774
[37] [1953] 1 W.L.R. 551

had been dormant since 1894 as it "dissolved itself and has vanished into thin air."[38] However, Vaisey J. made an order transferring its assets to the County Council for the purpose of equipping a museum.

In *G.K.N. Sports and Social Club*[39] Megarry V.-C. made some useful observations as to what constitutes 'spontaneous dissolution'. He did not accept that mere inactivity was sufficient, but "inactivity may be so prolonged or so circumstanced that the only reasonable inference is that the club has become dissolved".[40] He considered that the notion of spontaneous dissolution was supported in *Abbatt v the Treasury Solicitor*[41] although he suggested that the mere cessation of function which was mentioned in *Abbatt* would not suffice *per se*.[42] Having examined Brightman J.'s classification in the *Denby* case Megarry V.-C. suggested that the judgement "plainly supports the view that there may be a spontaneous dissolution of a society".[43] Inactivity of the officers is insufficient, but coupled with other circumstances may demonstrate that "all concerned regard the society as having ceased to have any purpose or function, and so as no longer existing".[44]

Megarry V.-C. was hesitant about using the phrase 'loss of substratum' in this context. "[I]t has strong overtones of the Companies Court. There, it may form the basis of a winding up order, but it does not by itself initiate or complete the termination of the existence of the company. It therefore seems not altogether appropriate for establishing that there has been a spontaneous dissolution."[45] Megarry was also reluctant to use the term 'frustration' with its contractual overtones.[46] Nevertheless, he regarded this as a mere matter of nomenclature not affecting the principle.[47]

It would appear that the Charity Commission recognise the possibility of

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[38] [1953] 1 W.L.R. 551 per Vaisey J. at 553
[39] [1982] 1 W.L.R. 774
[40] [1982] 1 W.L.R. 774 at.779
[41] [1969] 1 W.L.R. 561
[42] [1982] 1 W.L.R. 774 at 780 per Megarry V.-C.
[43] [1982] 1 W.L.R. 774 at 780 per Megarry V.-C.
[44] *Re G.K.N.*[1982] 1 W.L.R. 774 at 780 per Megarry V.-C.
[45] [1982] 1 W.L.R. 774 att 780/781 per Megarry V.-C.
[46] [1982] 1 W.L.R. 774 at 780/781 per Megarry V.-C.
[47] [1982] 1 W.L.R. 774 at 780/781 per Megarry V.-C.

'spontaneous dissolution' in so far as it reflects prolonged inactivity. In the period following the enactment of the Charities Act 1993 many unendowed charities were removed from the register where there had been no contact over several years, no contact could be established and the charity had plainly ceased to exist.[48] Green[49] makes no reference to the 'spontaneous dissolution' which occurred in *Re Harrow Literary Institution.*[50]

D. HIGH COURT'S INHERENT JURISDICTION

If there is no dissolution provision, or for some reason it cannot be complied with[51] or there are no powers to amend the constitution, the High Court has jurisdiction to order the winding up of the association.[52]

Warrington J. said

> "[W]here you have... funds which belong to a number of persons who have individually certain interests therein regulated either by a trust deed or... by a body of rules, and especially where... you find those funds are vested in trustees for the members of that society, then I think the court has jurisdiction to interpose."[53]

However, the courts will only order a winding up if the continuance of the society is a practical impossibility and there is a clear majority in favour of dissolution.[54]

Although 'practical impossibility' clearly includes insolvency, this is not the sole ground. In *Keys v Boulter (No.2)*[55] the court 'de-combined' SOGAT, whereas SOGAT"s dissolution clause would have required distribution of assets amongst members.

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[48] [1993] Ch. Comm. Rep. para. 28
[49] Green B., op. cit.
[50] [1953] 1 W.L.R. 551
[51] e.g. *Pearse v Piper* (1809) 17 Ves. 1; *Baring v Dix* (1786) 1 Cox 213 - partner refusing to agree to dissolution, or *Keys v Boulter (No.2)* [1972] 1 W.L.R. 642 where it was necessary to 'disaggregate' rather than wind up the body.
[52] *Baring v Dix* (1786) 1 Cox 213 partnership case; *Lead Company Workmen's Fund Society (Lowes v Governor & Co for Smelting Down Lead with Pit and Sea Coal)* [1904] Ch D 196 unregistered friendly society case; *Re The Blue Albion Cattle Society* [1966] C.L.Y. 1274
[53] *Lead Company's Workmen's Fund Society* [1904] 196 at 204 per Warrington J
[54] *Blake v Smithier* (1906) 22 T.L.R. 698 (an unregistered friendly society)
[55] [1972] 1 W.L.R. 642

V. DISPOSAL OF SURPLUS ASSETS

There are several possibilities in respect of the destination of surplus assets when an unincorporated association is wound up.

First, the constitution itself may be specific, and where the unincorporated association is a charity, it will specify that the surplus assets must not be distributed to members. Even if the association is not a charity, its members may have agreed that, on winding up, any surplus should go to some other organisation rather than be divided between members.

Otherwise, where the rules are silent the surplus assets may go on resulting trust;[56] be divided equally between the members at the time of dissolution;[57] or be *bona vacantia*[58] if the beneficiaries are exhausted. If the rules are silent and the association is a charity the surplus will go cy-près[59] or a scheme will be established for administering the funds.[60] The distribution of surplus assets on winding up is dependent on how the assets were held by the association. The mechanisms for property holding in unincorporated associations is discussed in Part Two of this study as is the distribution of surplus assets following dissolution.

This distribution may be disturbed where the association being dissolved is a branch of a larger organisation as in *Hall v Job*[61] where the larger organisation was held to be beneficially entitled to the property of the dissolved branch. The constitution in this case was specific in respect of dissolution and the decision may be dependent on a similar constitutional arrangement relating to a branch structure.

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[56] e.g. *Re Printers & Transferers Amalgamated Protection Society* [1899] 2 Ch. 184

[57] e.g. *Re. Customs & Excise Mutual Guarantee Fund* [1917] 2 Ch 18; *Re The Blue Albion Cattle Society* [1966]

[58] e.g. *Re West Sussex Constabulary's Widows, Children & Benevolent (1930) Fund Trusts* [1971] 1 Ch 1; *Braithwaite v Att.-Gen.* [1909] 1 Ch 510

[59] e.g. *Re Lepton's Charity* [1972] 1 Ch 276; *Re Finger's Will Trust* [1972] 1 Ch 286;

[60] e. g. *Mills v Farmer* (1815) 19 Ves. Jun. 483, *Moggridge v Thackwell* (1792) 1 Ves. Jun 464; *Re Roberts* [1963] 1 W.L.R. 406

[61] [1952] 86 C.L.R. 639

VI. CONSEQUENCES OF INSOLVENCY- LIABILITY OF MEMBERS

Providing that the members of the committee are carrying out functions on behalf of the association, it is possible for them to be indemnified out of the funds of the association.[62] However, that indemnity is limited to the extent of the funds of the association.[63]

Because an unincorporated association does not have a separate legal existence from its members, in the event of the association becoming insolvent, the members of the committee may become personally liable in respect of the deficit.

The extent of the liability of a committee member or trustee of an unincorporated association is considered in chapter eight.

VII. CHARITABLE PROPERTY HELD BY AN UNINCORPORATED ASSOCIATION OR COMPANY WHICH IS ITSELF BEING WOUND UP

It is possible that a members' club or company will have raised funds for charity or has an identified charitable fund. If the club or company is wound up, the charitable funds will be regarded as being held on trust for the charity, and will not form part of the assets of the club or company which can be used to satisfy creditors' claims. This topic is explored in chapter six.

CHARITABLE CORPORATIONS

I. INTRODUCTION

According to Professor Pennington[64] winding up or liquidation is the process by which the management of a company's affairs is taken out of the directors' hands, its assets are realised by a liquidator, and its debts and liabilities are discharged out of

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[62] *Egger v Viscount Chelmsford* [1964] 3 All ER 406 at 411

[63] A member's liability to contribute to the association is normally limited to the requirement to pay the subscription Finch v Oake [1896] 1 CH 409 at 417. See also *Wise v Perpetual Trustee Co Ltd* [1902] AC 139 (PC) at 149 per Lord Lindley.

the proceeds of realisation (so far as they are sufficient for the purpose). At the end of the winding up the company will have no assets or liabilities and it will therefore be simply a formal step for it to be dissolved, that is, for its legal personality as a corporation to be brought to an end.[65]

For registered companies,[66] including charitable companies, the position in respect of winding up or dissolution is relatively straightforward in that there is a statutory regime contained in the Insolvency Act 1986 but, in addition, a defunct company can be struck off the register of companies and thus dissolved.[67] These possibilities are discussed below. Corporations may, however, also be established by Royal Charter and under statute and charity trustees may be incorporated. The mechanisms for winding up these corporations are considered below.

II. REGISTERED COMPANIES

The liquidation of a company under the Insolvency Act may be voluntary or compulsory by the court.

A voluntary liquidation results from a resolution passed by the members[68] or the creditors[69] according to whether the company is able to pay its debts. Compulsory winding up is undertaken by order of the court. These arrangements are discussed in more detail below.

A. VOLUNTARY LIQUIDATION

The members of a company may pass a resolution to the effect that the company be put into liquidation.[70] An ordinary resolution of members is required if, by virtue of the company's articles, the company has a set duration, or if the articles specify some

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[64] Pennington R.R., *Corporate Insolvency Law*, 2nd Ed, Butterworths, 1997.
[65] Pennington R.R., 1997 at p. 10
[66] i.e., registered by the Registrar of Companies under the provisions of the Companies Acts, currently Companies Act 1985 ss.10 and 12.
[67] Companies Act 1985 s.652 and ss.652A-F
[68] Insolvency Act 1986 s.84
[69] Insolvency Act 1986 Ch IV, s.97 et seq
[70] Insolvency Act 1986 s.84(1)

event on the occurrence of which the company is to be dissolved.[71] The company may also, by special resolution, resolve that the company be wound up voluntarily.[72] If the company cannot continue in business because of its liabilities the company may, by extraordinary resolution, resolve that it is advisable to wind up the company.[73]

A copy of the company's resolution must be forwarded to the Registrar of Companies within 15 days;[74] and notice of it must be given within 14 days by advertising in *The Gazette*.[75]

The winding up is deemed to commence when the resolution is passed.[76] The company should then cease to carry on business except as necessary for its beneficial winding up[77] but the corporate state and its powers continue until the company is dissolved.[78] Once the liquidator has sent his final account of the liquidation to the Registrar of Companies together with his return, these are registered by the registrar and the company is normally dissolved three months after their registration, although the court may make an order deferring dissolution.[79]

1. Members' Voluntary Liquidation

For the liquidation to be under the control of the members, that is, a members' voluntary liquidation[80] the directors must swear a declaration of solvency.[81] That requires the directors to inquire into the company's affairs and swear that they are of the opinion that the company will be able to pay its debts in full, together with any interest, within a maximum period of twelve months[82] from the commencement of winding up.

The requirements relating to the declaration are that it must have been made within

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[71] Insolvency Act 1986 s.84(1)(a)
[72] Insolvency Act 1986 s.84(1)(b)
[73] Insolvency Act 1986 s.84(1)(c)
[74] Insolvency Act 1986 s.84(3) and Companies Act s.380
[75] Insolvency Act 1986 s.85(1)
[76] Insolvency Act 1986 s.86
[77] Insolvency Act 1986 s.87(1)
[78] Insolvency Act 1986 s.87(2)
[79] Insolvency Act 1986 s.201
[80] Insolvency Act 1986 s.90
[81] in accordance with Insolvency Act 1986 s.89

five weeks prior to the passing of the resolution by the company; it must contain a statement of the company's assets and liabilities at the latest practicable date before the making of the declaration;[83] and the declaration must be delivered to the Registrar of Companies within fifteen days of the resolution being passed.[84]

Making the declaration of solvency without reasonable grounds for the opinion is an imprisonable offence[85] and there is a presumption that reasonable grounds were absent where a company subsequently proves unable to pay its debts within the specified time.[86] As the burden of proof is then on the directors to prove that they had reasonable grounds for making the statutory declaration, it is clear that companies will only use this route to winding up where directors are confident that assets will cover liabilities.

In a members' voluntary winding up the liquidator is appointed by resolution of the members[87] at which point the powers of the directors cease unless the company or the liquidator sanction their continuance.[88] The property of the company is then used in accordance with the statutory regime, in the satisfaction of the company's liabilities and any surplus will be distributed according to the company's articles.[89] In the case of a charitable company this will usually be to another charity.

As soon as the affairs of the company are fully wound up, the liquidator must make an account showing how the liquidation has been conducted and how the company's property has been disposed of. The account must be laid before the company in general meeting.[90] The liquidator must send a copy of the account together with a return on the meeting to the registrar of companies within one week of the meeting.

If, despite the making of the statutory declaration, the liquidator is of the opinion that

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[82] Insolvency Act 1986 s.89. The period may be specified in the declaration and may be less than 12 months.
[83] Insolvency Act 1986 s.89(2)
[84] Insolvency Act 1986 s.89(3)
[85] Insolvency Act 1986 s.89(4)
[86] Insolvency Act 1986 s.89(5)
[87] Insolvency Act 1986 s.91
[88] Insolvency Ac t 1986 s.91
[89] Insolvency Act 1986 s.107. See *Liverpool & District Hospital for Diseases of the Heart v Att.-Gen* [1981] Ch 193, regarding the position where articles are silent but memorandum prohibits distribution of surplus to members.
[90] Insolvency Act 1986 s.94

the company will not be able to pay its debts in full he must, *inter alia*, summon a meeting of creditors within twenty-eight days and make a statement of the affairs of the company to be laid before the creditors' meeting.[91] From the date of the creditors' meeting, the winding up becomes a creditors' voluntary winding up.[92]

2. Creditors Voluntary Liquidation

In the absence of a statutory declaration of solvency by the directors, the winding up will be a creditors' voluntary liquidation - supervised by the creditors.

A meeting of creditors must be held within fourteen days of the company meeting at which it was agreed to wind up the company. A statement of affairs must be made out by the directors and laid before the creditors' meeting[93] of which seven days notice must be given.[94] It must show the company's assets, debts and liabilities and information about the creditors and their securities.[95] The creditors or the company may nominate the liquidator, but the nominee of the creditors will be the liquidator unless none is so nominated. If different persons are nominated by the company and creditors, a member, director or creditor may apply to the court for an order appointing the company's nominee instead of, or jointly with the creditors' nominee, or appointing someone else.[96] The creditors may establish a liquidation committee of not more than five persons.[97]

On the appointment of the liquidator, all the powers of the directors cease except so far as the liquidation committee (or if none was appointed, the creditors) sanction their continuance.[98]

As soon as the company's affairs are fully wound up the liquidator must draw up an account, showing how the winding up has been conducted and how the company's property has been disposed of, to be laid before and explained to meetings of the

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[91] Insolvency Act 1986 s.95(1), (2), (3)
[92] Insolvency Act 1986 s.96
[93] Insolvency Act 1986 s.99
[94] Insolvency Act 1986 s.98(1)
[95] Insolvency Act 1986 s.99
[96] Insolvency Act 1986 s.100
[97] Insolvency Act 1986 s.101

company and the creditors.[99]

3. Distribution Of Assets In Voluntary Winding Up

The regime in respect of the distribution of company assets in a voluntary winding up is the same irrespective of whether it is a members' or creditors' voluntary liquidation.[100]

The order of application of the company's assets in the hands of the liquidator is as follows:

1. expenses of the winding up including the liquidator's remuneration[101]

2. the preferential debts[102]

3. any preferential charge on goods distrained arising under section 176(3)[103]

4. the company's general creditors pari passu[104]

5. debts due from the company to members *qua* members[105]

6. the members generally according to their respective rights and interests.[106]

Secured creditors are normally entitled to be paid out of the proceeds of their security ahead of other claims. If the security is by way of a floating charge, the preferential debts have priority over it.[107]

Although the winding up is voluntary, the liquidator, a contributory, or creditor may apply to the court to determine any question arising in the company's winding up;[108]

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[98] Insolvency Act 1986 s.103
[99] Insolvency Act 1986 s.106
[100] Insolvency Act 1986 Chapter V (ss.107-116) Heading – "Provisions Applying to both kinds of Voluntary Winding Up"
[101] Insolvency Act 1986 s.115
[102] Insolvency Act 1986 ss.386, 387, 175 and Sched 6
[103] Insolvency Act 1986 s.176(3)
[104] Insolvency Act 1986 s.107
[105] Insolvency Act 1986 s.74(2)(f)
[106] Insolvency Act 1986 s.107
[107] Insolvency Act 1986 s.175(2)(b)
[108] Insolvency Act 1986 s.112. See e.g. *Re ARMS (Multiple Sclerosis Research) Ltd* [1997] 2 All ER 679 which concerned a charitable company.

or to exercise the powers, which it might exercise if the winding up were by order of the court, in respect of enforcement of calls or any other matter.[109]

B. Compulsory Liquidation By Order Of The Court

The High Court has jurisdiction to wind up any company registered in England and Wales.[110]

Voluntary liquidation is likely to be quicker and cheaper than compulsory liquidation but compulsory winding up will be necessary where, for example, the company refuses to recognise its insolvency and continues to trade to the disadvantage of its creditors. It also serves to protect minority shareholders against the oppression of the majority.[111]

1. The Circumstances In Which A Company May Be Wound Up By The Court

The circumstances in which a company may be wound up by the court are, *inter alia*,[112]

-if it has resolved by special resolution to be so wound up;[113]

-it has not commenced business within a year from its incorporation or suspends its business for a whole year;[114]

-the company is unable to pay its debts;[115] or

-it is just and equitable that the company should be wound up.[116]

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[109] Insolvency Act 1986 s.112(1)
[110] Insolvency Act 1986 s.117
[111] under Companies Act 1985 ss.459 to 461
[112] Only the factors relevant to this study have been identified.
[113] Insolvency Act 1986 s.122(1)(a)
[114] Insolvency Act 1986 s.122(1)(d)
[115] Insolvency Act 1986 s.122(f)
[116] Insolvency Act 1986 s.122(1)(g)

(a). In England and Wales a company is deemed to be unable to pay its debts if

-a creditor, to whom the company owes a minimum of £750 or more of which payment is then due, has served a written demand on the company which the company has neglected for three weeks to pay, secure or compound for;

-execution or process issued on a court judgment is returned partly or wholly unsatisfied; or

-if it is proved that the company is unable to pay its debts as they fall due.[117]

(b). Just and equitable grounds – Professor Pennington's[118] five broad categories[119]:-

-the company's substratum (its main purpose)has disappeared because it has abandoned its objects, or cannot achieve them;

-its objects are illegal or have become so, or the company was promoted for a fraudulent purpose;

-there is deadlock at board or general meetings such that it becomes impossible to manage the company's affairs;

-in substance the company is a partnership in corporate form which, were it a partnership, the court would order wound up; or

-there is oppression of the minority and wrongdoers are in control.

(c). The petitioner to the court may be:

-the company, the directors, a creditor(s), a contributory(ies).[120]

Certain individuals may also make application. Amongst these are

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[117] Insolvency Act 1986 s.123(1). Only the relevant factors to this study have been listed.
[118] Pennington R.R., 1997
[119] Pennington R.R., 1997, pp.38-42
[120] Insolvency Act 1986 s.124(1)

-the clerk of a magistrates court if the company has failed to pay a fine[121];

-the Attorney-General, if the charity may be wound up under the jurisdiction of the High Court under the Insolvency Act;[122] or

-the Charity Commission after conducting a section 8 inquiry.[123]

-The Secretary of State at the Department of Trade and Industry (D.T.I.) may also present a petition to wind up a company where it appears to him, from a company investigation, and certain other specified information, that it is expedient in the public interest that the company should be wound up if the court thinks it just and equitable to do so.[124]

The court has a very wide discretion in respect of petitions to wind up[125] but, where petitions are presented by members of the company as contributories on just and equitable grounds, the court must make a winding up order if it is of the opinion that the petitioners are entitled to relief (by winding up or other means) and in the absence of any other remedy, it is just and equitable for the company to be wound up.[126] This does not apply, however, if there is some other remedy available to the petitioner and the petitioner is being unreasonable in not pursuing it.[127] Thus, the availability of an alternative remedy is not sufficient cause to refuse the application.

At any time after the presentation of the petition, the court may appoint a provisional liquidator[128] to carry out such functions as the court confers.[129]

The voluntary winding up of a company does not bar a creditor or contributory from seeking to have the company wound up by the court. However, if the application is by a contributory the court must be satisfied that the rights of the contributories will

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[121] Insolvency Act 1986 s.124(1)
[122] Charities Act 1993 s.63(1)
[123] Charities Act 1993 s. 63(2)
[124] Insolvency Act 1986 s.124A(1)
[125] Insolvency Act 1986 s.125(1)
[126] Insolvency Act 1986 s.125(1)
[127] Insolvency Act 1986 s.125(2)
[128] Insolvency Act 1986 s.135
[129] Insolvency Act 1986 s.135(4)

be prejudiced by a voluntary winding up.[130]

At any time before the court has made a winding up order, the company, or a creditor may apply to the court to stay or restrain further proceedings.[131] The making of a winding up order automatically operates to stay actions and proceedings against the company as does the appointment of a provisional liquidator.[132] The court may also stay or sist winding up, after the order has been made, on the application of either the liquidator or the official receiver for such period and on such terms as the court thinks fit.[133]

An order for winding up a company operates in favour of all creditors and all contributories of the company as if it had been made on the joint petition of a creditor and a contributory.[134]

The official receiver becomes the liquidator of the company until another person is appointed to that office.[135] If the company is already subject to an administration order or voluntary arrangement, the court may appoint the insolvency practitioner who has been administrator or supervisor to be the liquidator in the winding up.[136] The official receiver must investigate the affairs of the company generally, and if the company has failed, the causes of that failure.[137] He may make a report to the court as he thinks fit on these matters.[138]

When a winding up order has been made, or a provisional liquidator appointed, the liquidator or provisional liquidator must take all the property and choses in action, to which the company appears entitled, into his custody or under his control.[139] The court may, on the liquidator's application, vest the property belonging to the company, or held for it by trustees, in the liquidator and he may bring or defend any

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[130] Insolvency Act 1986 s.116
[131] Insolvency Act 1986 s.126(1)
[132] Insolvency Act 1986 s.130(2)
[133] Insolvency Act 1986 s.147
[134] Insolvency Act 1986 s. 130(4)
[135] Insolvency Act 1986 s.136(2)
[136] Insolvency Act 1986 s.140
[137] Insolvency Act 1986 s.132.
[138] Insolvency Act 1986 s.132
[139] Insolvency Act 1986 s.144

action relating to that property which is necessary in order effectually to wind up the company or recover its property.[140]

Once the liquidation is complete the liquidator must summon a general meeting of the company's creditors to receive the liquidator's report and determine whether the liquidator should have his release under section 174.[141] The liquidator must send a copy of this notice to the registrar of companies[142] for registration, and the company is normally dissolved three months after the date of registration.[143] If the official receiver is responsible for the liquidation, the dissolution takes place three months after the registration of the notice that the winding up by the court is complete.[144] Where a company is hopelessly insolvent the official receiver may apply to the registrar of companies for early dissolution of the company.[145] Again the company is dissolved three months after the registration of that notice.[146]

The principles governing the application of assets in voluntary and compulsory winding up are substantially the same[147] except that the court must settle a list of contributories and has power to rectify the register of members in this regard.[148]

C. Destination Of Surplus Assets

Generally, when a company is dissolved all property and rights vested or held in trust for the company immediately prior to its dissolution, but not including property held on trust for some other person, are deemed to be *bona vacantia*[149] although the Crown's title may be disclaimed.[150] In a charitable company surplus assets will generally go cy-près,[151] having been transferred before the company has been dissolved. The applicability of the augmentation principle to corporate charities is

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[140] Insolvency Act 1986 s.145
[141] Insolvency Act 1986 s.141(1)
[142] Insolvency Act 1986 s.172(8)
[143] Insolvency Act 1986 s.205(1)(a) and (2)
[144] Insolvency Act 1986 s.205(1(b) and (2)
[145] Insolvency Act 1986 s.202
[146] Insolvency Act 1986 s.202(1)(2)(5)
[147] Sealy L.S., and Milman D., 1994, p.148
[148] Insolvency Act 1986 s.148
[149] Insolvency Act 1986 s.654
[150] Companies Act 1985 s.656(1)
[151] *Liverpool & District Hospital for Diseases of the Heart v Att.-Gen.* [1981] Ch 193

discussed in chapter five.

D. OTHER : STRIKING OFF

Under provisions in the Companies Act, a company may be struck off the register and dissolved in two circumstances, namely, because it is defunct or on the application of the company.

1. Defunct Company

The registrar of companies may strike a defunct company off the register if he has reasonable cause to believe that a company is neither carrying on business nor in operation. He may make inquiries and, having complied with the requirements of notice and advertisement in The Gazette specified in section 652,[152] the company will be struck off the register and dissolved.[153] Certain persons, including the Charity Commission may object to the striking off under section 652 and apply to the court within twenty days of the publication of the notice in the Gazette. The court may restore the company to the register if it is satisfied that the company was carrying on business or in operation, or it is just that the company be restored.[154]

2. On Application Of The Company

The Deregulation and Contracting Out Act 1994[155] amended the 1985 Companies Act[156] and introduced a new procedure allowing non-trading, but still operational, private companies to apply for striking off and thus be dissolved. To be eligible to apply for striking off the company must not be *inter alia*, in the process of a compromise action,[157] nor engaged in any of the proceedings under the Insolvency Act 1986, nor in receivership.[158] Secondly, a company can only take advantage of

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[152] Companies Act 1985 s.652
[153] Companies Act 1985 s.652(1),(2),(3)
[154] Companies Act 1985 s.653 a amended by Charities Act 1960 s.30 (as amended) and the Deregulation and Contracting Out Act 1994 Sched.5.2
[155] 1994 c.40
[156] Companies Act 1985 s.652A-F as inserted by Deregulation and Contracting Out Act 1994 s.13(1) and Sched. 5
[157] under Companies Act 1985 s.425
[158] Companies Act 1985 s.652B(3)

the procedure if it has not, within the previous three months, changed its name, traded, disposed for value of 'trading'assets[159] or engaged in any activity other than one expedient or necessary for making the striking off application, settling the company's affairs or meeting a statutory requirement. [160] However, it may be expedient for professional advice to be sought, and it would be permitted to pay its debts.[161] All or a majority of the directors may make an application for striking off on behalf of the company, in the prescribed form, to the Registrar of Companies. Copies of the application must be sent, *inter alia,* to members, employees, creditors, directors, or a manager of any pension fund.[162] The Registrar must publish a notice of his intention to strike the company off after three months, also inviting objections, in The Gazette.[163] If the company is struck off the Registrar must publish a further notice to that effect and the company is dissolved on its publication.[164]

On application by a notifiable person, the court may order the company's name to be restored if it is satisfied that the directors have not provided the specified parties with copies of the application as required; that it was, or has become, ineligible to apply for striking off because it has been trading, has been subject to insolvency proceedings within the previous three months of the application, or that it is just to restore it.[165] Interestingly, the Charity Commission is not included in the list of 'notifiable persons' who may object to a striking off by application of the company.[166] The Secretary of State, however, may bring an application to restore the company's name if it is in the public interest to do so.[167]

There are safeguards in the legislation to prevent this form of striking off being used as a cheap mechanism when the company is either trading or insolvent, chiefly

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[159] i.e., property it held for disposal for gain in the normal course of trading. (Companies Act 1985 s.652B(1)(c))
[160] Companies Act 1985 s.652B(1)
[161] Companies Act 1985 s.652B(2)
[162] Companies Act 1985 s.652B(6)
[163] Companies Act 1985 s.652A(1)(2)(3)
[164] Companies Act 1985 s.652A(4)(5)
[165] Companies Act 1985 s.653(2B)
[166] Companies Act 1985 s.653(2C)
[167] Companies Act 1985 s.653(2D)

resulting from the imposition of duties on the directors of the applicant company.[168] Failure to fulfil these duties constitutes a criminal offence.[169]

3. Both Methods

Because the liabilities of the directors of a company dissolved by striking off continue and may be enforced as if the company had not been dissolved,[170] those using this cheap mechanism[171] for dissolution need to be very certain of the extent of the company's liabilities as they may subsequently become personally liable. In addition, because all property and rights whatsoever vested in or held in trust for the company immediately before its dissolution are deemed to be *bona vacantia* it is important that it has identified all its assets and already transferred them to another charity.

Despite its being struck off and dissolved, the court still retains the power to wind up a company which has been struck off the register.[172]

Striking off is not usually recommended by practitioners as a mechanism for winding up companies although Adirondak and Sinclair Taylor[173] suggest that it is a useful and inexpensive way to close a company which has paid its debts and is no longer required.

E. Restoration to Register and Void Dissolution

A company can be restored to the register if, within two years of dissolution,[174] an

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[168] Companies Act 1985 s.652C imposes duties on the directors of the applicant company. First, directors must ensure that specified parties receive copies of the application within a specified time. Secondly, they must ensure that the application is withdrawn if the company engages in any of the activities which, had it undertaken within the three months prior to application for striking off, would have disqualified it from doing so.

[169] Under Companies Act 1985 s.652E failure to fulfil either of these duties constitutes an offence with a liability to a fine and if the failure results from an intention to conceal the making of the application, to imprisonment or fine. Under Cocmpanies Act 1985 s.652F it is also an offence knowingly, or recklessly to supply the registrar of companies with false or misleading information.

[170] Companies Act 1985 ss.652(6) and 652A(6)

[171] At June 1999 the fee to be included with the application to strike off was £10.

[172] Companies Act 1985 s.652(6) and s.652A(7)

[173] Adirondak S., and Sinclair Taylor J., *The Voluntary Sector Legal Handbook*, Directory of Social Change, 1996 p.276

[174] Companies Act s.651 subject to caveats in (5), and (7) regarding damages for personal injuries or fatal accidents and the court's powers under (6) to direct that the period between dissolution and the making of the order shall not count.

application is made by the company, or a person aggrieved (which includes a member, or creditor) who satisfies the court either that the company was in operation, or that it is just and equitable to restore it.[175] The Charity Commission may make an application as a person aggrieved to restore the company to the register.[176] This enables the Commission to protect the assets where the company was actually continuing. Generally, the provision would, for example, enable an aggrieved creditor to have access to assets of the company.

The court may, on the application of the liquidator, or some other person appearing to be interested, within two years of the date of dissolution, declare the dissolution of a company void.[177] A person is interested only if he would have some claim against its assets if they were re-vested in it.[178] Any proceedings may then be taken as if the company had not been dissolved.[179] The Charity Commission may bring an application for the dissolution of the company to be declared void[180] but a post-dissolution bequest will not of itself be adequate reason for such a declaration to be made.[181]

F. 'RESCUE' OF CHARITABLE COMPANIES

Following the *Report of the Review Committee on Insolvency Law and Practice*[182] mechanisms were introduced in the Insolvency Act 1986 by which an ailing company may be rescued, in part or as a whole, rather than being wound up. Lightman and Moss[183] refer to "the rescue culture now prevalent in insolvency". The rescue mechanisms include voluntary arrangements, administration orders and administrative receivership of companies. These rescue mechanisms are, of course, only available to companies, but they are available to charitable companies. There remains the

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175 Companies Act 1985 s.653(2)
176 Charities Act 1993 s.63(4) and Companies Act 1985 s.652(1) and (2)
177 Companies Act 1985 s.651(1),(4) as amended by Companies Act 1989 s.141, and Companies Act 1989 s.141(5)
178 *Re Belmont & Co Ltd* [1952] Ch 10; *Re Test Holdings (Clifton) Ltd* [1970] Ch 285
179 Companies Act 1985 s.651(2)
180 Charities Act 1993 s.63(3)
181 *Re Servers of the Blind League* [1966] 1 W.L.R. 564
182 Cmnd. 8558 1982
183 Lightman G., & Moss G., *The Law of Receivers of Companies*, (2nd Ed), Sweet & Maxwell, 1994 at para. 2-13

possibility of compromising with creditors under the Companies legislation.

Other mechanisms exist by which a charity which is not a company may be rescued. These are discussed in chapter nine.

1. Voluntary Arrangements - Insolvency Act 1986 Section 1

The Insolvency Act contains procedures[184] whereby a company may make a composition with its creditors or a scheme of arrangement of its affairs - a voluntary arrangement[185]- without the intervention of the courts. The arrangement is supervised by an insolvency practitioner- the nominee.[186]

The following may make an application for a voluntary arrangement with creditors. The directors of a company not subject to an administration order, nor being wound up;[187] the liquidator; or the administrator, may make the proposal for a voluntary arrangement with creditors. Although the company may be insolvent, it is not a prerequisite that this should be the case because, as Fletcher points out, the procedure may be used to avert a threatened or predictable insolvency before it occurs.[188] The proposal must explain why a voluntary arrangement is desirable and why the company's creditors are likely to agree to it.[189] A statement of the company's assets should be included together with details of how it is proposed to meet, modify, postpone, or otherwise deal with liabilities under the arrangement. [190]

The proposals must include provision for a nominee (an insolvency practitioner[191]) to act in the arrangement.[192] If the nominee is not the administrator or liquidator, he must prepare a report of his assessment of the soundness of the proposals. This report must be submitted to court within 28 days of his notice of the proposal,[193] stating whether, in his opinion, a meeting of the company and creditors should be

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184 Insolvency Act 1986 Part I
185 Insolvency Act 1986 s..1(1)
186 Insolvency Act 1986 s1(2)
187 Insolvency Act 1986 s.1(1)
188 Fletcher Ian F., *The Law of Insolvency*, 1990, Sweet & Maxwell at p.334
189 Insolvency Rules 1986 r.1.3(1)
190 Insolvency Rules 1986 r.1.3(1)(2)
191 Insolvency Act 1986 s.1(2)
192 Insolvency Act 1986 s.1(2)

summoned. In practice, the directors are likely to have involved an insolvency practitioner in drawing up the proposals. If the nominee's report is favourable, the proposals are put to a meeting of the company and of its creditors. At the meeting unless the contrary appears from the company's articles, a simple majority of the company will be sufficient to pass a resolution[194] although at least three quarters in value of the creditors must agree,[195]excluding secured creditors who must approve the proposals.[196] If the proposal is approved by the meetings of company and creditors, the court and those entitled to attend either of the meetings are notified.[197] The arrangement takes effect as if made by the company at the creditors meeting and binds every person who had notice of it and was entitled to vote as if he were a party to the arrangement whether or not he was present at the meeting.[198] The arrangement may be challenged within 28 days by a member or creditor (or the administrator or liquidator if applicable) on the ground that it unfairly prejudices the interests of a creditor, member or contributory of the company, or that there has been some material irregularity relating to either of the meetings.[199]

The nominee (or person substituted) acts under the supervision of the court and may apply for directions[200] or to have the company wound up.[201] He must produce an annual abstract of receipts and payments together with a progress report to the court, the Registrar of Companies, the company and its auditor and all creditors bound by the arrangement.[202] When the arrangement has been fully implemented notice must be sent to all creditors, company members, the Registrar of Companies and the court.[203]

Sealy and Milman[204] suggest that the voluntary arrangement has proved to be of limited use. First, because it cannot be made binding on a secured or preferential

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[193] Insolvency Act 1986 s.2(2)
[194] Insolvency Rules 1986 r.1.20(1)
[195] Insolvency Rules 1986 r.1.19(1)
[196] Insolvency Act 1986 s.(3) and s.4(4)(b) provides an effective veto.
[197] Insolvency Act 1986 s.4(6)
[198] Insolvency Act 1986 s.5(2)
[199] Insolvency Act 1986 s.6(1)(a)(b) see also Rajak, 1988 paras. 126-129
[200] Insolvency Act 1986 s.7(4)
[201] Insolvency Act 1986 s.7(4)(b)
[202] Insolvency Rules 1986 r.1.26(1) and(2)
[203] Insolvency Rules 1986 r.1.29(3)
[204] Sealy L.S. and Milman D., 1994,

creditor without his consent[205] and secondly, there is no provision for obtaining a moratorium whilst the arrangement is being drawn up and considered although the moratorium can be achieved if the proposal for a voluntary arrangement is combined with an application to court for the appointment of an administrator[206] (as envisaged by the Cork Committee[207]). Sealy and Milman suggest that voluntary arrangements have only been used in one per cent of recorded insolvencies and that in perhaps half of these cases, it has been combined with an administration order.[208] In Case Study 3, voluntary arrangements were combined with an Administration order.[209] This was the only case study in the research in which voluntary arrangements were encountered.

2. Compromise With Creditors - Companies Act 1985 Sections 425-427

It is possible for compromises or arrangements,[210] between the company and its creditors, or between the company and its members, to be sanctioned by the court. Providing that three-quarters (in value) of the creditors or members (or a class of them) as the case may be, present and voting at the relevant meeting agree to the proposal, the compromise is binding on all creditors or members with the sanction of the court.[211] It has been said that this method was too "slow, cumbersome and costly to be at all useful in practice."[212]

3. Administration Orders Under Section 8 Insolvency Act 1986

The Cork Committee[213] argued for a new procedure, similar to a receivership, when a company was in difficulties but where it was not possible to mount a rescue operation by having a receiver appointed because there was no floating charge over its

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[205] Insolvency Act 1986 s.4(4)
[206] see also Fletcher *op.cit* p.335
[207] Cmnd. 8558 paras. 419-422, 428-430
[208] Sealy L.S., and Milman D., 1994, p. 26
[209] The administrator was able to persuade creditors to waive their debt. See pp 69 and 252.
[210] "Arrangement" includes a reorganisation of the company's share capital by consolidating shares of different classes or by division of shares into different classes – Companies Act 1985 s.425(6)(b)
[211] Companies Act 1985 s.425
[212] Sealy and Milman, 1994, p.26
[213] Cmnd. 8558, 1982

undertaking.[214]

The making of an administration order establishes a moratorium during which the company can either be rescued, or a more beneficial realisation of the company's assets can be achieved.

(a). The Grounds

There are two elements. First, the company must be, or likely to become unable to pay its debts,[215] probably on the cash flow rather than balance sheet test.[216] Secondly, the court must be satisfied that the making of an order would achieve one of the purposes specified,[217] namely,

-to enable the company to survive as a going concern;[218]

-to approve voluntary arrangements;[219]

-to sanction a compromise or arrangement between the company and its members or creditors;[220] or

-to achieve a more advantageous realisation of the company's assets than on winding up.[221]

The petition may be made before the company goes into liquidation[222] (that is, either before the company has resolved,[223] or a court ordered,[224] that the company be wound up) by the company, directors, creditors (including contingent or prospective creditors), or by the clerk of a magistrates court (when a company has failed to pay a fine).[225] The members of the company do not have a right to seek an administration

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[214] *op.cit.* chapter 9
[215] Insolvency Act 1986 s.8(1)(a)
[216] Sealy and Milman,1994 p.43
[217] Insolvency Act 1986 s.8(3)
[218] Insolvency Act 1986 s.8(3)(a)
[219] Insolvency Act 1986 s.8(3)(b)
[220] under Companies Act 1985 s.425, Insolvency Act 1986 s.8(3)(c)
[221] Insolvency Act 1986 s.8(3)(d)
[222] Insolvency Act 1986 s.8(4)
[223] Insolvency Act 1986 s.86
[224] Insolvency Act 1986 s.129(2)
[225] Insolvency Act 1986 s.9(1)

order.

(b). The Moratorium to Protect The Assets of The Company

The petition to the court effectively creates a moratorium until the court decides on the application. No resolution may be passed for winding up the company,[226] no steps may be taken to enforce any security over the company's property or repossess goods on hire-purchase without the court's leave[227] and no other proceedings may be commenced or continued or distress levied, except with the leave of the court.[228] These provisions serve to prevent the assets of the company being removed piecemeal from the business.

However, the moratorium is not absolute in that, even though a winding up order cannot be made during the moratorium, a petition can be presented[229] and an administrative receiver can be appointed without the court's leave.[230]

(c). The Operation of Administration

Once the court is satisfied of the grounds and makes the Administration Order it appoints the administrator, an insolvency practitioner,[231] who assumes charge of the ailing business, with broad powers.[232] The administrator must take all the property to which the company appears entitled into his custody or control.[233] He is deemed to act as agent for the company,[234] may remove and appoint directors[235] and apply to court for directions.[236] Any power conferred on the company which could be exercised so as to interfere with the exercise of his powers, can only be exercised with the administrator's consent.[237] The fact that a company is subject to administration must be stated on all documents issued by or on behalf of the company

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[226] Insolvency Act 1986 s.10(1)(a)
[227] Insolvency Act 1986 s.10(1)(b)
[228] Insolvency Act 1986 s.10(1)(c)
[229] Insolvency Act 1986 s.10(2)(a)
[230] Insolvency Act 1986 s.10(2)(b)
[231] Insolvency Act s.230(1)
[232] Insolvency Act 1986 s.14(1) and Schedule 1
[233] Insolvency Act 1986 s.17(1)
[234] Insolvency Act 1986 s.14(5)
[235] Insolvency Act 1986 s.14(2)(a)
[236] Insolvency Act 1986 s.14(3)
[237] Insolvency Act 1986 s.14(4)

or administrator.[238] Once an administration order is made any petition for the winding up of the company is dismissed, any administrative receiver must vacate office[239] and any receiver of only part of the company's property must vacate office if the administrator requires it.[240]

The effect of the administration order is to extend the protection offered to the company from its creditors. No resolution may be passed for the liquidation of a company;[241] neither can an administrative receiver be appointed.[242] No other steps can be taken to enforce a security over the company's property, or to repossess goods under a hire purchase agreement except with the administrator's consent or leave of the court.[243] No other proceedings, execution or other legal process may be commenced or continued, and no distress may be levied against the company except with the administrator's consent or leave of the court.[244] Should leave of the court be given to the disposal, the court may impose terms.[245]

In rescuing the company, the administrator may dispose of property subject to a floating charge as if it were not subject to the security.[246] If he applies to, and satisfies, the court that a disposal of company property subject to other security or hire purchase (H.P.) agreement would be beneficial, the court may order the disposition as if the property were free of the security or the company held full title to it.[247] Where property subject to a security is disposed of, the holder of the security has the same priority in respect of company property as he would have had in relation to the charged property.[248]

Where the court orders the disposition of secured property (including that subject to an H.P. agreement) the net proceeds of the disposal (or if the proceeds are less than

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[238] Insolvency Act 1986 s.12(1)
[239] Insolvency Act 1986 s.11(1)(a) and (b)
[240] Insolvency Act 1986 s.11(2)
[241] Insolvency Act 1986 s.11(3)(a)
[242] Insolvency Act 1986 s.11(3)(b)
[243] Insolvency Act 1986 s.11(3)(c)
[244] Insolvency Act 1986 s.11(3)(d)
[245] Insolvency Act 1986 s.11(3)(c)(d)
[246] Insolvency Act 1986 s.15(1) and 15(3)
[247] Insolvency Act 1986 s.15(2) and (3)
[248] Insolvency Act 1986 s.15(4)

what would normally be obtained on the open market such other sums to make good the shortfall) must be applied towards the discharging the sums secured or payable under the H.P. agreement.[249]

Once appointed, the administrator will require a statement of affairs of the company to be produced by, *inter alia*, the company's officers, promoters, or employees.[250] The statement must show particulars of the company's assets, debts and liabilities, creditors, securities etc.[251] On the basis of that statement the administrator must formulate proposals (within 3 months, or longer if the court allows) to be considered by a meeting of creditors.[252] The report of the meeting must be given to the court.[253] If the proposals are rejected, the court may discharge the order, adjourn the hearing, or make an interim order.[254] If accepted at the meeting, the administrator then manages the company according to that plan until the purposes are successfully achieved, or, unless he forms the opinion that they cannot be achieved, when he applies to court for the order to be discharged or varied.[255]

(d). Use of Administration Generally

In 1994, Sealey and Milman commented that the procedure has been given an encouraging start in this country. One hundred and thirty one administration orders were made during the first year of operation of the Act and one hundred and ninety eight in the second. They point out, however, that in addition to financial rehabilitation, an administration order can be used to further a scheme of voluntary arrangement and to secure a more advantageous realisation of the company's assets than would be effected by a winding up. These additional purposes are to the advantage of creditors and the burden of satisfying a judge that such a purpose can be achieved is likely to be more easily discharged.[256] A holder of a floating charge has the right to veto the appointment of administrator and install a receiver himself

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[249] Insolvency Act 1986 s.15(5)
[250] Insolvency Act 1986 s.22(3)
[251] Insolvency Act 1986 s.22(2)
[252] Insolvency Act 1986 s.23(1)
[253] Insolvency Act 1986 s.24(4)
[254] Insolvency Act 1986 s.24(5)
[255] Insolvency Act 1986 s.18(1)(2)
[256] Sealy L.S., & Milman D., 1994 p.41

instead.[257] The charge-holder is at a disadvantage where an administrator is appointed, partly because his charge is subordinated to subsequently incurred debts. However, it would appear that, in a significant number of cases, the charge holder has been prepared to accept administration, especially where the company's objects are not purely commercial, and where a secured lender thus avoids the adverse publicity associated with appointing a receiver and the forced sale of assets.[258] This is borne out by Case Study 3.[259] Despite the early promise of administration, it has been suggested that there has been a relatively low use of administration although there has been a rising trend over recent years.[260]

Brown suggests[261] that most administration orders end in liquidation, and that they yield a better realisation of assets because of the moratorium combined with the fact that the administrator has wider powers than a liquidator. He suggests, however, that a fully-fledged liquidation could not take place under the guise of administration.[262] A later case, *Re Mark One (Oxford Street) plc,*[263] came to the contrary conclusion.

(e). Use of Administration in Charities

In Case Study 3, the charity had been insolvent on both the cash flow and balance sheet tests, resulting in part from changes in the nature of government funding, and partly from the fact that substantial expenditure was financed out of short-term borrowings. In this case the voluntary arrangements were backed by an administration order. Preferential creditors were paid by instalments, and other creditors were persuaded to forgo their entitlement by the fact that there was no prospect of a distribution to the creditors and the charity clearly had a worthwhile role. Following the administration donations were raised from the private sector and central government funding was resumed.

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[257] Insolvency Act 1986 s.9(3)
[258] Sealy L.S., & Milman D., 1994, p.41
[259] see p. 69 and 252
[260] *Review of Company Rescue Mechanisms - Consultative Document*, D.T.I. Insolvency Service, 1999
[261] Brown D., *Administration as Liquidation* [1998] JBL 75 (note)
[262] see *Re Powerstore (Trading) Ltd* [1998] 1 All ER 121
[263] *Re Mark One (Oxford Street) plc* [1999] 1 All ER 608

In *Re ARMS*[264] an administrator, Alleyne, had been appointed but had concluded that the purpose for which he had been appointed could not be achieved and accordingly the company was wound up and Alleyne was then appointed liquidator.

4. Administrative Receiverships

A receiver may be appointed on a debenture or mortgage when the mortgage money (principal or interest) has become due and there is a default in payment.[265] Where the debt is secured by a charge which, as created, was a floating charge (or by such a charge and one or more fixed charges) over the whole or substantially the whole of the company's property, the receiver is an administrative receiver.[266] Samwell has suggested[267] that in corporate receiverships the type of agreement most frequently encountered, probably in the majority of all companies, is the debenture secured by a floating (or fixed and floating) charge.[268]

The appointment of a receiver takes the management of the company's property out of the hands of the directors.[269] The powers may be exercised either with a view to reviving the company or with a view to the beneficial sale of the company as a going concern. The power to carry on the business is deemed to be granted by the debenture except in so far as it is inconsistent with any provision in it.[270]

Samwell suggests that, in practice, the deed or mortgage will contain additional powers to those contained in the Law of Property Act 1925. The main additional provisions are details of circumstances under which a receiver may be appointed, and secondly, power for the receiver to sell the mortgaged property, since the Act gives the receiver power only to receive the income arising from the property.

Sealy and Milman[271] suggest that to all intents and purposes appointments of receivers are effected out of court in pursuance of a contractual power contained in

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[264] *Re ARMS (Multiple Sclerosis Research Ltd, Alleyne v Att.Gen. & Or* [1977] 2 All ER 679
[265] Law of Property Act 1925 ss.101,109 see discussion below
[266] Insolvency Act 1986 s.29(2)(a)
[267] Samwell S., *Corporate Receiverships : A Practical Approach*, ICEAW, 1981
[268] Samwell S., 1981, p,5
[269] *Re Joshua Shaw & Sons* (1989) 5 BCC 199 at 190
[270] Insolvency Act 1986 s.42(1) and Sched.1 para. 14

the debenture although in special circumstances appointments may be made following applications to the courts.[272] If a debenture contains a hybrid security of fixed and floating charges, any appointment of an administrative receiver must be made under the floating charge element in order for an administrative receivership to result.[273]

5. The Provisional Liquidator

In a limited sense the appointment of a provisional liquidator provides a rescue mechanism in that he may be appointed by the court to protect the assets of a company after a winding up petition has been presented but before the company is placed in liquidation. It has been suggested that the primary reason for the appointment of a provisional liquidator is usually to ensure the preservation of the company's assets pending the hearing of the winding up petition.[274] As the appointment anticipates the winding up as a foregone conclusion it is usually made only with the consent of the company or in a case of clear insolvency.

III. STATUTORY CORPORATIONS

Where companies are established by public[275] statute the legislation may make provision for their winding up[276] or legislative change may be required. Corporations established by private statute were able to be wound up under the predecessor legislation of Part V of the Insolvency Act. As Sutcliffe[277] explains (1925), apart from special statutory provision there were two methods of winding up a statutory corporation without recourse to Parliament. Firstly, an appropriate company[278] could register under Part VII of the Companies (Consolidation) Act 1908 and that registration would not be invalidated solely because it was registered with a view to winding up the company or secondly, an unregistered company could be wound up

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[271] Sealy & Milman, 1994, p8

[272] see e.g. *Bank of Credit and Commerce International v BRS Kumar Bros. Ltd.* [1994] BCLC 211 where the borrower purported to transfer all its assets to a new company, but the charge was held to have crystallised before the transfer.

[273] *Meadrealm Ltd. v Transcontinental Golf Construction* (1991), Vinnelott J (unreported) noted by Marks in (1993) 6 Insolvency Intelligence 41 see also Marks and Emmett [1994] JBL 1

[274] Sealey L.S. & Milman D., 1994, p.180

[275] e.g. Further or Higher Education Corporations under the Education Reform Act 1988

[276] as e.g. The Light Railways Act 1912 c19

[277] Sutcliffe R.J., 1924

under sections 267 to 273 of the Companies (Consolidation) Act 1908. Sealy and Milman[279] suggest that Part V will be applied to statutory companies incorporated by private Act of Parliament.

Many charitable statutory corporations, such as colleges of further education, universities and schools, are likely to be exempt from registration as charities and are therefore not considered further in this study

IV. INCORPORATED TRUSTEES

The Charity Commission have power to dissolve the body of incorporated trustees if they are satisfied that any of the criteria specified in section 61 of the Act[280] are met. The necessary factors are that the incorporated body has no assets or does not operate; that the charity has ceased to exist; the body has ceased to be charitable; that the purposes of the charity have been achieved or are unable to be achieved.[281] In addition the trustees may apply to the Commission for the dissolution of the body on the grounds that it is in the interests of the charity for the body to be dissolved.[282] Any property remaining for the charity then vests either in the unincorporated trustees or some other person[283] in trust[284] and any rights or liabilities of the incorporated body become the rights and liabilities of the charity and any legal proceedings will then be commenced against the unincorporated trustees.[285]

V. CONTRIBUTORIES IN THE EVENT OF INSOLVENCY

The liability of directors, trustees and members to contribute to the assets of a corporate charity in the event of its insolvent winding up is discussed in chapter eight.

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[278] see Companies (Consolidation) Act 1908 s.249(1) and (2)
[279] Sealy L.S., and Milman D., 1994, p267
[280] Charities Act 1993 s.61
[281] Charities Act 1993 s.61(1)
[282] Charities Act 1993 s.61(2)
[283] Charities Act 1993 s.61(3)
[284] The Charity Commission may specify that all or part of the property of the charity vest with specified trustees (Charities Act 1993 s.61(4)).
[285] Charities Act 1993 s.61(5)

PART TWO:

Chapter 4 : Land and Endowment and Funds on Special Trust

Chapter 5 : Destination of Post Wind Up Surplus Assets : Cy Près, Scheme, or Resulting Trust

Chapter 6 : Property Holding in Unincorporated Associations

Chapter 7 : Recalcitrant Members and Trustees

Chapter 8 : Liability to Contribute in an Insolvency

Chapter 9 : Rescue Mechanisms

Chapter 10 : Contract Culture : Trading, Tax and Accounting Issues

CHAPTER 4 : LAND, ENDOWMENT, AND FUNDS ON SPECIAL TRUSTS IN THE WINDING UP OF CHARITIES

I. INTRODUCTION

The existence of an endowment and the ownership of land appear to cause both legal and practical difficulties when winding up a charity. For example, one of the practitioners who provided case material for several studies routinely sought the confirmation of the Charity Commissioners, prior to undertaking any other work on the winding up, as to which, if any, of the charity's property was part of an endowment so as to identify such difficulties at the earliest opportunity.

Land is frequently part of an endowment but, even if it does not form part of the charity's endowment, there may be difficulties in respect of its disposal.

The intention in this chapter is to focus on what happens to land and permanent endowment in the winding up of charities and the availability of the proceeds of their sale to pay debts. The legal and practical difficulties in respect of land are considered first. Permanent endowment is considered secondly.

II. LAND

A. THE NATURE OF THE PROBLEM

Interests in land may cause complications in a winding up, even if the land is not part of the charity's endowment.

On the face of it, the Charities Act[1] sets out a procedure which trustees, who have power to effect a disposition of land, may follow. The procedure (discussed in more detail below) is potentially time consuming and, where a charity is in financial difficulty, that time may risk the solvency of the charity. Two examples: A

[1] Charities Act 1993 ss.36-40

Women's' Institute[2] decided that its war-surplus hut was too much of a liability and decided to sell. It was almost three years to the day between the first contact with the Charity Commission following their decision to sell and the conveyance of the land even though the purchaser had already been found. In Case Study One, the charity leased premises. Although the delay did not jeopardise the solvency, the charity had to spend significant resources meeting its liabilities under the lease, for example insuring, maintaining the burglar alarm, and protecting against frost damage thereby incurring on-going costs until the lease could be disposed of.

Leases may constitute onerous property, defined in the Insolvency Act 1986 as an unprofitable contract or other property, which is unsaleable or difficult to sell, and which gives rise to the liability to pay money or perform some other onerous act.[3] Even if the onerous property is disclaimed, liabilities may remain in respect of that property, for example future rents may become due. Whilst a benevolent landlord may be prepared to waive these, the negotiations can take time, and therefore cost resources.

As will be seen from the discussion below, trustees with an apparent power to sell may be considered by the Charity Commissioners to have power to dispose of their interest in land only in order to replace it.

There may also be practical difficulties relating to land where there is some unusual factor. For example, there was a problem regarding valuation in Case Study Five in which the charity's property consisted of a listed building. This clearly affected the commercial value and saleability of the land. In 1988 the property was marketed at £20M but uncertainty and subsequent litigation prevented the sale at that point. When authority to sell was subsequently obtained in 1995/6 the premises were expected to raise less than half that amount because, although on a prime city site, redevelopment was not possible because the shell of the building, at least, had to remain. The problem of the valuation of charity land which may be hedged about

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[2] author's knowledge

[3] Insolvency Act 1986 s.178(3) For the purposes of this section "property" includes money, goods, things in action, land and every description of property wherever situated and also obligations and every description

with legal and practical difficulties will be considered below.

B. THE NATURE OF THE LAND HELD : COMPARISON OF PERMANENT ENDOWMENT AND FUNCTIONAL LAND

Richens and Fletcher[4] suggest that it is important to identify what category of land is held as this may influence the way in which it can be dealt with or what must be done with the proceeds of sale. In addition to distinguishing between freehold and leasehold land they identify three categories: permanent endowment, functional land and investment land, although the distinction is not necessarily that clear cut since the particular piece of land may fall into more than one category. For example, land may be functional land and part of the charity's permanent endowment (e.g. alms houses), or endowment and investment (such as an office block providing income for the charity). Richens and Fletcher[5] suggest that it will normally require careful examination of the governing instrument or the terms of the document under which the land or property was acquired to ascertain whether it is permanent endowment. It also appears[6] to be the case that the Charity Commissioners and charity's advisers may come to different conclusions in this respect.

Charity land which is subject to a restriction preventing the capital being expended will constitute permanent endowment. This is discussed in the second part of this chapter. Although a charity may be able to sell land which is permanent endowment, the proceeds remain subject to the original special trusts and must, therefore, be invested to produce income, or used to buy other land. Functional land is land which is held on trusts stipulating that the land must be used for the purposes, or any particular purposes of the charity.[7] For example, in Case Study One, the leased factory from which the charity operated its workshop was held 'for the purposes of the charity' and was, therefore, functional land. Similarly, the hospital premises in

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of interest, whether present or future or vested or contingent, arising out of, or incidental to, property.(Insolvency Act 1986 s.436)

4 Richens N.J., and Fletcher M.J.G., *Charity Land and Premises*, Jordans, 1996

5 Richens and Fletcher, 1996, at 1.4 *et seq.*

6 from conversations with practitioners

7 Charities Act 1993 s.36(6)(b)

case Study Five constituted functional land. Richens and Fletcher[8] say that land will be functional land if the trusts *require* it to be used for the charity's purposes. If they merely *allow* it to be used for those purposes but also permit other uses, the land is not functional land and, for example, property which is simply rented by the charity for offices will not be functional land. Special procedures apply in respect of the disposition of functional land (see below).

Richens and Fletcher[9] indicate that the corporate property of charitable companies will not be functional land. That is not to say, however, that all land held by a charitable company will, automatically, be corporate property and, indeed a charitable company may hold functional land or endowment.

C. DISPOSITIONS AND MORTGAGING OF CHARITY LAND : PART V CHARITIES ACT 1993

1. Introduction

Prior to the 1992 Act[10] the Charity Commissioners' consent was required in respect of the sale or mortgage of charity land[11] which would inevitably cause delay if a landed charity was being wound up. Stebbings[12] suggests that such control was one lasting aspect of law which had its roots in the law of mortmain which came to embody a prohibition on the alienation of land to any corporation or perpetual trust. The Charities Act 1993 has gone some way towards liberating charity trustees from this prohibition providing they can comply with the statutory requirements.[13] The following section applies equally to unincorporated and corporate charities unless an exception is specified or the context suggests otherwise. The legislation refers to charity trustees, that is, those who have general control of the management and administration of the charity,[14] irrespective of the charity's legal vehicle.

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[8] Richens N.J., and Fletcher M.J.G., 1996 para. 1.4.3.
[9] *op.cit.* para 1.4.3
[10] Charities Act 1992 ss.32-37, now Charities Act 1993 ss.36 -40
[11] Charities Act 1960 s.29(1) and (2)
[12] Stebbings C., *Charity Land : A Mortmain Confusion* 12 J. Legal Hist. pp.1-19
[13] Charities Act 1993 ss.36,37
[14] Charities Act 1993 s.97

Part V of the 1993 Act[15] provides for the disposition[16] and mortgaging[17] of land and the release of rent charges.[18]

(a). Dispositions

The Commissioners' consent to dispositions of land is now only required in certain circumstances, namely where the disposition is to a connected person or to the trustee or nominee of such a person, providing that the requirements of section 36(3), (5), or (6) have been complied with.[19] The trustees will be required to certify in the conveyance or lease, under section 37, that this is a disposition to which section 36(1) or (2) applies and, either that it has been sanctioned by the court or the Commissioners, or is one which the trustees have the power under the trusts to effect.[20] The question of trustees' powers is explored further below.

Sections 36 and 37 of the Act apply to all sales or disposition of land or of an interest in land.

Unless the disposition is by way of a lease for not more than seven years,[21] the trustees must first obtain and consider a written report on the proposed disposition from a qualified surveyor acting exclusively for the charity.[22] The trustees must advertise the proposed disposition as advised in the surveyor's report (unless he advises that this would not be in the charity's best interests)[23] and they must decide, having considered the surveyor's report, that the proposed terms of the disposition are the best that can reasonably be obtained for the charity.[24]

If the disposition is by way of a lease up to seven years the trustees must first obtain a report from a person who they reasonably believe to have the necessary ability and practical experience to provide them with competent advice on the disposition. They

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[15] Charities Act 1993 ss.36-40
[16] Charities Act 1993 ss.36 and 37
[17] Charities Act 1993 ss.38 and 39
[18] Charities Act 1993 s.40
[19] Charities Act 1993 s.36(1) and (2)
[20] Charities Act 1993 s.37(1) and (2)
[21] Charities Act 1993 s.36(3) and (5)
[22] Charities Act 1993 s.36(3)(a)
[23] Charities Act 1993 s.36(3)(b)
[24] Charities Act 1993 s.36(3)(c)

must consider the report and decide that they are satisfied that the proposed terms are the best which can reasonably be obtained for the charity.[25]

In addition, in respect of functional land (that is, land held by, or in trust for, the charity and the trusts stipulate that it is to be used for the purposes, or some particular purposes of the charity[26]), unless replacement property is to be acquired to be held on the same trusts,[27] or the disposition is by way of a lease for less than two years,[28] a number of restrictions apply notwithstanding anything in the trusts of the charity.[29] The restrictions are that the charity trustees must first give public notice of the proposed disposition inviting representations to be made. At least a month must be allowed for this and the trustees must take any representations into consideration.[30] In certain circumstances the Charity Commission may direct that the requirements to give public notice be dispensed with in respect of a particular charity, class of charities, or particular disposition of land.[31] This occurred in Case Study One. Because the local authority encouraged the charity to continue to maintain its premises for charitable use, the intended disposition had become very public knowledge and a large number of organisations had already had the opportunity of looking round the premises and making representations.

The restrictions do not, however, apply to a disposition for which general or special authority is expressly given by statute or a legally established scheme; nor where land held by, or in trust for a charity is disposed of at undervalue to another charity (and is authorised in the trusts of the disposing charity); nor to the granting of a lease to a beneficiary of the charity at the best rent obtainable and intended to enable the demised premises to be occupied for the charity's purposes.[32] Neither do the restrictions apply to dispositions by an exempt charity;[33] dispositions of an

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[25] Charities Act 1993 s.36(5)
[26] Charities Act 1993 s.36(6)(a),(b)
[27] Charities Act s.36(7)(a)
[28] Charities Act 1993 s.36(7)(b)
[29] Charities Act 1993 s.36(9)
[30] Charities Act 1993 s.36(6)
[31] Charities Act 1993 s.36(8)
[32] Charities Act 1993 s.36(9)(a),(b),(c)
[33] Charities Act 1993 s.36(10(a)

advowson;[34] dispositions by way of mortgage or other security;[35] or to the release of rentcharges.[36]

(b). Mortgages (Including Charges)[37]

Under section 38 of the Charities Act 1993, providing that a mortgage is for the purposes of securing a loan,[38] and the trustees have obtained and considered proper written advice by a qualified and independent person[39] on the matters listed in section 38(3), the trustees may mortgage charity land. The matters required to be covered by the report are: whether the loan is necessary to enable the trustees to follow a particular course of action; whether the terms of the proposed loan are reasonable having regard to the status of the charity as a prospective borrower; and the ability of the charity to repay on the terms proposed.[40] Again the trustees will be required to certify either that the Court or Commissioners consent, or that they have power under the trusts.[41]

2. Legal Problems Regarding Dispositions : Do The Trustees Have Powers To Dispose Of, Or Mortgage, Charity Land?

The wording of sections 37(2) and 39(2) suggests that an express power is required in the trusts, namely that the charity trustees, which term includes directors of a corporate charity,[42] have power *under the trusts* of the charity.

Even where the trustees ostensibly have power to dispose of land the question is not necessarily as clear cut as first appears. In Case Study 5, a receiver-managership[43] (prior to 1996 legislation considered below), the charity's objects were:

> "to establish and/or maintain and/or carry on... an establishment or

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[34] Charities Act 1993 s.39(10)(c)
[35] Charities Act 1993 s.36(10)(b)
[36] Charities Act 1993 s.36(1)
[37] under Charities Act 1993 ss.38(6) and 39(6) 'mortgage' includes 'charge'
[38] Charities Act 1993 s.38(2)
[39] Charities Act 1993 s.38(4)
[40] Charities Act 1993 s.38(3)
[41] Charities Act 1993 s.39(2)
[42] As the charity trustees are those responsible for the management and administration of the charity (Charities Act 1993 s.97), this provision is applicable irrespective of legal vehicle.
[43] established under Charities Act 1993 s.18(1)(vii)

establishments.... and as ancillary thereto *inter alia* to purchase take on lease hire exchange... and hold temporarily or permanently for the purposes of the Institution any real or personal property and in particular any lands... and to sell demise let mortgage or otherwise dispose of the same."

In addition to this apparent power to sell, the constitution also contained powers to wind up the institution, "all its property realised". The receiver-manager commented that the Commissioners were of the opinion that the power of sale expressed was ancillary to the objects and:

> "only extended to a sale if it was with a view to acquiring from the proceeds of sale another establishment that would fall within the definition.... The charity Commission were of the opinion that if I wished to sell... in order to apply the proceeds for some other purposes I would have to...sell ...as part of the process to wind up the Charity following a resolution... passed at a Special General Meeting. I believe the Attorney-General considers that [the ancillary power] does give me the power to sell...other than for the purpose of acquiring another.... However, that alternative view is rather academic because it did not emerge until after...."[44]

Presumably, it was thought that the wording of the constitution was such as to make the premises functional land.

Following the Trusts of Land and Appointment of Trustees Act (TLATA) 1996 there are now three possibilities in relation to the powers of trustees to dispose of, or mortgage, charity land.

(a). Express powers in the trust instrument

It is clear in this situation that the trustees have the requisite power to authorise these dealings in charity land.

(b). Trust deed silent

Until the position was clarified under the TLATA 1996 there was some uncertainty as to the extent of the implied powers of the trustees.[45]

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[44] correspondence with the receiver/manager 15.6.95

[45] Picarda identified a number of sources (Picarda H., 1995, chap 36. p 485, p486 n7, {cases cited: - *Att.-Gen. v Hungerford* (1834) 2 Cl & Fin 357 at 374-5; *Att.-Gen. v South Sea Co* (1841) 4 Beav 453; *Att.-Gen. v Warren* (1818) 2 Swan 291 at 303; *Att.-Gen. v Pilgrim* (1849) 12 Beav 57 at 60 (1850) 2 H & Tw 186; *Att.-Gen. v Davey* (1854) 19 Beav 521 at 525}) however, in the light of Halsbury's Laws (5(1) Halsbury's

The TLATA 1996, section 6, provides that the trustees of land have all the powers of an absolute owner[46] unless restricted by an order made in pursuance of or any other enactment or rule of law or equity.[47] Although, generally, dispositions of land may exclude the provisions of section 6[48] this is not the case with charitable, ecclesiastical or public trusts.[49] "Trusts of land" in this context does not include settled land[50] and the Act also provides that no land held on charitable, ecclesiastical or public trusts shall be deemed to be settled land after the commencement of the Act, even if that was previously the case.[51] It would now seem to be clear, therefore, that charity trustees have the requisite power of sale.

However, just as it appeared to Davey L.J. to be a strong assertion to hold that charity land would not constitute endowment,[52] it seems a strong conclusion to draw that trustees may sell and mortgage charity endowment. It is, therefore worth examining the provisos contained in section 6 TLATA 1996 and other sources considered below to explore whether this is the case.

In his annotations to the Act[53] Professor Kenny comments that under section 6 trustees will now have (subject to section 8 which is discussed below) considerably enlarged powers in relation to land, including the power to raise the purchase price by mortgage, which are given for the purposes of exercising their functions as trustees.

Sub-section 6, however, provides that the powers must not be exercised in contravention of any other enactment, or any order[54] made under such an enactment, or any other rule of law or equity. Professor Kenny [55] suggests that this subsection is caused by failure of nerve on the part of the draftsperson, and that doubts will arise in

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Laws (4th Ed) 222 para. 336) he felt that such reliance would be unsafe. The Charity Commissioners also recognised the uncertainty ([1995] Ch. Comm. Rep. paras. 25-27)

[46] Trusts of Land and Appointment of Trustees Act (TLATA) 1996 c.47 s.6(1)

[47] TLATA 1996 s.6(6) and (8)

[48] TLATA 1996 s.8(1)

[49] TLATA 1996

[50] TLATA 1996 s.1(3)

[51] TLATA 1996 s.2(5)

[52] for the original version see *Re Clergy Orphan Corporation* [1894] 3 Ch 145 at 153 per Davey L.J.

[53] Current Law Statutes Annotated

[54] including an order of any court or the Charity Commissioners (s6(7) TLATA 1996)

[55] Current Law Statutes Annotated

practice as to the relationship with the wide powers in subsection 1 and the need to conform to existing rules of law or equity. He suggests that this is resolved as follows:-

> "In form the trustees have unrestricted powers of management. These must be exercised in conformity with principles of equity such as sound business management, holding the balance between capital and income and between the interests of different beneficiaries. Any breach of such a principle will not affect an innocent purchaser relying on the width of the statutory powers, but a purchase with an improper purpose may, as it has always been, be challenged by beneficiaries."

The Charity Commission leaflet,[56] *Disposing of Charity Land,* states that Commissioners' consent will not usually be required if trustees follow the statutory requirements of the Charities Act. "This is true whether the land is permanent endowment or whether it has been occupied for the purposes of the charity".[57] Furthermore the Commissioners will only give consent to a disposal where the trustees are unable to follow the statutory requirements. [58]

In relation to mortgages of charity land the same leaflet states that "[t]rustees may, without our consent, grant a mortgage over charity land as security for money they have borrowed provided they can meet the two requirements laid down in section 38 of the 1993 Act."[59]

(c). The deed requires specific consents to be obtained

Under section 8(2) of TLATA 1996 if any disposition creating a trust of land makes provision requiring any consent to be obtained to the exercise of any power conferred by section 6, the power may not be exercised without that consent. Professor Kenny [60] comments on the word 'disposition.' He questions whether a trust constitutes a

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[56] CC28, *Disposing of Charity Land*, Charity Commission, June 1996

[57] CC28, para. 15 p 9

[58] CC28, para. 15 p 9

[59] CC28, para. 46 p.20. With regard to the purchase of land by charities, the Law Commission Consultation Paper No. 146, Trustees Powers and Duties, proposed that all trustees, other than trustees of land and trustees of a settlement should have powers to purchase land for investment, occupation by beneficiaries, or otherwise, and should be able to do so by way of mortgage (Paras. 8.11, 8.12) This was endorsed by the response from the Charity Law Association (30.9.97) For the current position regarding purchase of land see CC33, *Acquiring Land*, Charity Commission, March 1995.

[60] Current Law Statutes Annotated

disposition, and he suggests that it probably does not although the definition of conveyance in section 205 of the Law of Property Act 1925 does include a disposition and could easily be read as including a declaration of trust. Undoubtedly, the legal advisor of any charity in this situation will clarify the position with the Charity Commissioners, particularly since it is their consent which is most likely to be needed (but see discussion of section 36 of the 1992 Act[61] below).

The Charity Commissioners have power to sanction dealings with charity property and can authorise, *inter alia* dispositions of land[62] but obtaining consents from any source does take time, and this points to the need for good drafting of the charity's governing instrument in the first place if such problems are to be avoided at a later stage. The Charity Commission itself identified the possibility of difficulties being encountered in respect of sale or leasing under a scheme. It had been their custom to make sales subject to further orders of the Commission or subject to such consents as are required by law. They concluded that the provisions in schemes go no further than providing a power of sale or lease which is itself subject to the restrictions of section 36 of the 1993 Act. They comment that a different form of words is now being used in schemes.[63]

(d) Section 36 Charities Act 1992

According to section 36, any provision establishing or regulating a particular charity contained in, or having effect under an Act of Parliament, or contained in the trusts of a charity, which requires the consent of the Commissioners to dispositions or dealings in land held by, or in trust for a charity shall, to that extent, cease to have effect. This presumably means that section 8 of TLATA will only apply where consents, other than the Commissioners' consent, are required under the trust deed.

The juxtaposition of section 36 CA 1992 and section 36(9)(a) CA 1993 have been considered by the Commissioners,[64] particularly whether the combination of the two sections gave the trustees much wider powers of disposal than had been intended.

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[61] Charities Act 1992 s.36
[62] Charities Act 1993 s.26
[63] 5(1997) D.C.C. 21

The Commissioners' view is that section 36 of the 1992 Act merely confers a power to dispose subject to the provisions of sections 36-40 of the 1993 Act and was intended to prevent the unnecessary burdening of the Commission.[65]

(e). Summary and comment

In summary, therefore, the current position appears to be that, unless there is some expression in the trust of land to the contrary, the trustees have power to dispose of charity land and to mortgage it. Arguably, the caveats in section 6 TLATA may have the unfortunate effect of reducing the confidence of trustees, purchasers of charity estates and their advisers, and lenders, and encourage them to seek the authority of the Commission when the intention of the legislation was to enable trustees to dispose of property without consent providing they followed the statutory procedures.[66]

The Charities Act 1993 does not specify the use of proceeds of sale or other disposition. The legislation appears to permit the sale of land that could be endowment. However, the proceeds of such disposition will also be permanent endowment[67] which the trustees may not **expend**, whatever its form, without the prior authority of the Charity Commissioners.[68]

If trustees sell land and provide the certificate specified under section 37,[69] any purchaser for value is protected.[70] However, if the trustees did not have the power and therefore provided the certificate wrongly, they will be in breach of trust and personally liable to remedy the breach.

Richens and Fletcher[71] point to a difficulty specifically concerning mortgages effected by *charitable companies* relating to the trustees' certificate required under section 39 of the Charities Act. The certificate must certify that the trustees have power under

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[64] 5(1997) D.C.C. 21
[65] 5(1997) D.C.C. 21.
[66] Cm. 694 1989, *Charities: A Framework for the Future*, Ch 7
[67] CC 28, para. 8 p7
[68] CC 28, para. 2 p3
[69] Charities Act 1993 s.37(2)
[70] Charities Act 1993 s.37(3)
[71] Richens N.J., and Fletcher M.J.G., 1996

the trusts to grant a mortgage. Technically the mortgage is granted by the company, so on a strict interpretation the certificate is inappropriate and probably ineffective. They comment that this has caused some lenders to insist that the mortgage is sanctioned by an order from the Charity Commission. They suggest that is probably an over fastidious approach, and the court would interpret the certificate, in the context of a charitable company, as a statement that the charity trustees have the power to cause the charity to grant the mortgage.[72]

3. Reverter of Site and Rentcharges

Richens and Fletcher comment that another trap for the unwary trustees is that the site may be subject to **reverter**.[73] During the nineteenth century, a number of Acts encouraged the grant of land for use in conjunction with specific charitable purposes.[74] This is particularly relevant to schools, amongst which there have been several insolvencies. The authors point out that, because the incidence of reverter does not depend on an express provision in the conveyance but on the land having been conveyed under the authority of a particular Act which may be difficult to identify, it may not be apparent to the layman that the land is subject to reverter.[75] The effect of the reverter when the charity is being wound up is that, although the land may be sold,[76] the proceeds are held on trust for the benefit of the persons entitled to the reverter.[77] If, after making enquiries and advertising, the persons entitled to the reverter cannot be identified, the Charity Commissioners may make a scheme establishing new trusts for the net proceeds.[78]

Since 1977 the creation of new **rentcharges** has been prohibited[79] and all rentcharges will be extinguished at the latest by 2037[80] but the owner of land charged may redeem the rentcharge.[81] This produces a capital sum intended to provide an annual

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[72] *op. cit.* para. 5.6.1.
[73] *op.cit.* para. 3.5.1
[74] e.g. The School Sites Act 1841 and the Literary and Scientific Institutions Act 1854
[75] Richens N.J., and Fletcher M.J.G., 1966 para. 3.5.2.
[76] Reverter of Sites Act 1987
[77] Reverter of Sites Act 1987 s.1
[78] Reverter of Sites Act 1987 s.2. See also Morris D., *Education Matters*, 2 (1993/94) CL&PR 243
[79] Rentcharges Act 1977 s.2
[80] Rentcharges Act 1977 s.3
[81] Rentcharges Act 1997 ss.8 and 9. Section 10 sets out the formula for the redemption value.

income from its investment equivalent to the rentcharge. Whilst the redemption figure may be small, the rentcharge itself was a capital asset. The redemption monies will therefore also be capital funds of the charity.[82]

4. Availability Of Proceeds Of The Disposition Of Land In An Insolvency

It is important that trustees have a full understanding of the nature of their 'land-holding' be it endowment, functional land, investment land, freehold, leasehold or subject to a reverter, because in several of these categories the proceeds of the disposition of land will not automatically be available to meet liabilities if the charity is in financial difficulty.

The availability of permanent endowment to meet liabilities is discussed in the second part of this chapter.

There is an expectation that, if functional land is sold, the proceeds will be used to replace it because if the charity is to continue to function it will continue to have need of land. Similarly,the proceeds of the sale of endowment land remain endowment because the purpose of an endowment is to provide for the charity in perpetuity. It seems that, where a charity's governing instrument contains a power to wind up and dissolve the charity including the sale of assets and payment of debts, this power would authorise the sale of assets in order for the charity to be dissolved. This could include the sale of functional land.[83] The availabilty of endowment funds, which would include endowment land, to meet debts is considered in the next section.

D. Practical Problems

Two significant areas of practical difficulty were identified in relation to land, namely, delays in obtaining Commissioners' consent to sale and issues associated with valuation of land.

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[82] Richens N.J., and Fletcher M.J.G., 1996, para. 6.5 p. 116
[83] Case Study 5.

1. Delays in obtaining consents

It has been said that delays in obtaining the Charity Commissioners' consent to dispositions of land created difficulties for winding up charities. During 1992 the Charity Commission made 1,027 Orders in respect of dispositions of land generally and a further 1,226 Orders giving specific consents to land transactions.[84] This was reduced to 140 Orders in 1993 and the majority of those were in respect of sales to 'connected persons'.[85] Clearly, therefore the 1993 charity legislation had an impact. The effect of the 1993 Charities Act, combined with the Trusts of Land and Appointment of Trustees Act 1996 suggests that delays in obtaining such consents as are still needed would be reduced although TLATA 1996 does not assist the speedy disposal of land where the trusts require consents other than the Commissioners' consent to be obtained.

2. Problems of Valuation of Land

A major practical difficulty concerns the valuation of land for accounting and other purposes. One of the difficulties in relation to charities, perhaps generally, but which becomes more acute if the charity falls into financial problems, is the valuation which is placed on land in a charity's accounts.

There are a number of bases on which the valuation of land or premises can be based. For example, the reinstatement value could be used, or a sale value. So long as a charity's accounts are being prepared on a going concern basis and its solvency is not in question the basis of the valuation may not seem to be of vital importance. Some case examples[86] may demonstrate why this is not the case if the charity's solvency comes into question:-

A charity exists to provide accommodation for the voluntary sector. It had leasehold land on which the premises were built. The costs of building were met by the charity, trusts and two public bodies, with about £400,000 out of £680,000 being provided by

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[84] [1992] Ch. Comm. Rep. para. 53
[85] [1993] Ch. Comm. Rep. para. 49
[86] derived from the author's work experience

charitable donations. The charity bought the freehold for £1 on terms such that, if the land is disposed of within twenty-one years or it ceases to be used for the stated purposes within that time, the premises and land must revert back to one of the public sector donors for £1. With the, hopefully realistic, expectation of remaining for at least twenty-one years, the figure which appears on the company's balance sheet is the reinstatement value. But suppose that the company hit serious problems during that period and had to be wound up, or its land was compulsorily purchased, its major asset is technically valueless. The charity also aims to extend the property, but it is doubtful whether a lender would accept the premises as good security.

The effects of owning listed buildings[87] have already been commented on, and the impact which this can have on realisable asset values.

A recreational charity's sole asset of any significance is the cricket field. In the event of the land ceasing to be so used, it reverts to the original owner with little recompense for any works on it. What value should they place on it in the accounts?

A charity owns a number of lesser stately homes[88] and keeps them partially open to the public whilst letting other areas for residential uses. The reinstatement value would be considerably higher than the value that could realistically be obtained if they were sold.

For these reasons at least one accountant (who is also an insolvency practitioner) specialising in charity affairs recommends that trustees have their charity's land revalued regularly and using more than one valuation basis. This would not necessarily cost them more, since the same valuer would be used, but would provide them with a fuller picture of the worth of the asset.

The same insolvency practitioner described a number of problem situations in which there was difficulty with land valuation for the purpose of assessing the solvency of the charity:

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[87] Case Study 5
[88] Case Study 18

(a) A property, subject of a residual grant from the Greater London Council, with a restrictive covenant in favour of the grantor in the event of a change of use, was wound up halfway through the period of the restrictive covenant. It was assumed that half of the value would have to be repaid.

(b) The covenants in respect of the use of particular land effectively created an endowment – it cannot be used for any other purpose. There is no change in the land although there is a figure in the accounts for a depreciating asset. The historic cost was included in the accounts, but as the asset was depreciating the view was taken that there was no point including a value in the SOFA, and treated the 'endowment' solely as a 'balance sheet problem'.

(c) A charity apparently held a considerable city centre property. The site in question had no parking, and as a result the value of the premises was considerably less than what was owed on the mortgage. Whilst the building society were prepared to overlook this situation, once the trustees realised the position they felt they must act and make provision in the accounts for the reduced value. This could have affected the solvency of the charity in the balance sheet test.

This raises the question of the purpose of property valuations in accounts. How should an endowment or premises be valued in capital terms in a charity's accounts if its value is doubtful in terms of resale, as in the case of some of these examples above? It is not the purpose of this study to explore accounting theory and practice in great depth. It would seem, however, that the facts of the situation should at least be clearly explained in a note to the charity's accounts!

III. ENDOWMENT AND FUNDS ON SPECIAL TRUSTS

This section attempts to identify what constitutes endowment and to explore its availability to meet liabilities on winding up. These issues are explored in the context of unincorporated and incorporated charities.

A. MATTERS OF DEFINITION

Most of the cases relating to endowments predate the 1960 Charities Act and

concern the jurisdiction of the Charity Commissioners in relation to funds and property because the Commissioners' jurisdiction only extended to endowed charities under the Charitable Trusts Act 1853. [89]

"Endowment" in section 66 of the Charitable Trusts Act 1853[90] was defined as meaning and including all lands and real estate whatsoever, of any tenure, and any charge thereon, or interest therein, and all stocks, funds, moneys, securities, investments and personal estate whatsoever, which shall for the time being belong to or are held in trust for any charity, or for all or any of the objects or purposes thereof. The expression 'land' extends to and includes manors, messuages, buildings, tenements, and hereditaments, corporeal and incorporeal, of every tenure and description.[91] By virtue of section 62[92] of the same Act, the Commissioners' powers only extended to charitable 'endowment.'

The classification of charities into plain, endowed, or mixed charities resulting from section 62 of the same Act[93] ceased to have any significance following the Charities Act 1960.[94] Nevertheless, section 29(1)[95] continued to protect any property which formed part of the permanent endowment preventing its sale, lease or mortgage without the consent of the Court or Charity Commissioners. Section 29(2) similarly protected the functional land occupied for the purposes of the charity, which was permanent endowment.[96] The definition of permanent endowment in the 1960 Act was contained in section 45(3), now section 96(3) of the 1993 Act.[97]

Now, a charity is **deemed to have a permanent endowment** unless all property held for its purposes may be expended without distinction between capital and income, and "permanent endowment" means "property held subject to a restriction on its being expended for the purposes of the charity".[98] This is potentially a wider

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[89] Charitable Trusts Act 1853 (16 & 17 Vict.), ss.62 and 66
[90] Charitable Trusts Act 1853 (16 & 17 Vict.)
[91] Charitable Trusts Act 1853 (16 & 17 Vict.), s.66
[92] Charitable Trusts Act 1853 (17 & 17 Vict.), s.62
[93] Charitable Trusts Act 1853 (16 & 17 Vict.), s.62
[94] Charities Act 1960 s.48 and Sched. 7, Charitable Trusts Act 1853 repealed
[95] Charities Act 1960 s.29(1)
[96] Charities Act 1960 s.29(2)
[97] Charities Act 1993
[98] Charities Act 1993 s.96(3), previously Charities Act 1960 s.45(3)

definition, in terms of what property can be comprised in an endowment, than under the old (1853) law but does not seem to affect the basic concept. However the 1853 legislation leaves a legacy of 'terms of the art' all of which mean endowment, such as "funds held on special trusts" or "property subject to the Charity Commissioners" which serve to confuse laymen, some lawyers!, and the index compilers of learned works. The result is that the law concerning endowment is unhelpfully obscure. The formulation of these terms of the art are considered in what follows.

As has already been discussed, the 1993 legislation[99] and the Trustees of Land and Appointment of Trustees Act 1996 combine to change the provisions relating to the disposition and mortgaging of charity land, whether or not it forms part of the charity's permanent endowment. Although, traditionally, endowed charities receive capital at their foundation, it is clear from *Re Meyers*,[100] in which a testator bequeathed legacies to be added to the invested funds of several charities, that the endowment can come later in the charity's life.

1. Some Terms Explained

The terms "capital" and "endowment" are used almost interchangeably in texts and cases, but they are not identical concepts and the difference may be significant when the charity is to be, or is being wound up.

In what follows the Statement of Recommended Practice - **S.O.R.P.**[101] definitions of terms are used. However, as these definitions mainly come from Appendix 3 of the S.O.R.P. whose purpose is expressly stated as being "to explain the legal position as regards the various funds of a charity and the implications this has for the way in which the funds are accounted for" it is assumed that they are legal definitions.

The **S.O.R.P. defines capital** as resources which become available to the charity and which trustees are legally required to invest or retain and use for its purposes. **Capital** may be permanent endowment, where the trustees have no power to convert

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[99] Charities Act 1993 ss.36-39
[100] [1951] 1 Ch. 534

it into income and apply it as such, or expendable endowment, where they do have the power. **Expendable endowment** is distinguished from 'income' by the absence of a positive duty on the part of the trustees to apply it for the purposes of the charity, unless and until this power to convert into income is actually exercised.[102] Neither of these, however, includes **invested reserves** which a lay person (including a trustee) might include within the definition of capital but which are income available to the charity to be spent on the general purposes of the charity. The term invested reserves excludes any kind of endowment, restricted or designated finds or income funds which could only be used by realising fixed assets which are held for charity use.[103]

The S.O.R.P. further defines **permanent endowment** as a capital fund where there is no power to convert the capital into income, which must generally be held indefinitely[104] and either be used in connection with a charity's work, or invested to produce an income.[105] The fact that it is permanent does not mean that assets which comprise the permanent endowment cannot be exchanged, nor does it mean that they are incapable of depreciation or loss.[106] If a gain is made on the disposal of an asset in a capital fund, the gain will become part of the capital, which will increase the fund. Capital funds will also be increased by receiving further donations on the same trusts, and by recognising unrealised investment gains on assets held in the fund.[107]

In respect of **expendable endowment**, namely, property held as capital, which the trustees have power to convert to income and expend[108] it seems clear that the power to convert must be express otherwise it will be deemed to be permanent endowment.[109]

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[101] *Accounting by Charities- Statement of Recommended Practice*, (S.O.R.P.), Charity Commission, October 1985

[102] S.O.R.P. Appendix 1 – Glossary, para. 2

[103] CC19, *Charities' Reserves*, Charity Commission, May 1997, para. 11

[104] S.O.R.P. Appendix 3 para. 7

[105] S.O.R.P. Appendix 1 para. 2, and App 3 para. 2 and CC38, *Expenditure and Replacement of Permanent Endowment*, Charity Commission, April 1994 para. 2

[106] S.O.R.P. Appendix 3 para. 7

[107] S.O.R.P. Appendix 3 para. 8

[108] S.O.R.P. Appendix 1 para. 2

[109] Charities Act 1993 s.96(3)

The picture is further complicated because a charity may have **restricted funds**, that is, funds subject to specific trusts, which may be declared by the donor(s), or with their authority (for example, raised in a public appeal), but still within the objects of the charity. Restricted funds may be restricted income funds, which are expendable at the discretion of the trustees in furtherance of some particular aspect(s) of the objects of the charity; or they may be capital funds, where the assets are required to be invested, or retained for actual use, rather than expended.[110] Restricted funds are not available for general purposes. The trustees will be in breach of trust if they expend restricted income on items outside the area of restriction.[111] Nevertheless, the fact that a fund is restricted does not make it endowment. This distinction was drawn by Davey L.J. in *Re Clergy Orphan Corporation*[112] who said that the test is **not** whether the fund is applicable to the general purposes of the charity or only to some specific purposes in connection with it. *Liverpool and District Hospital for Diseases of the Heart v Attorney General*[113] provides an example where the charity had operated two distinct areas of work, a hospital and a research institute, each of which kept separate accounts and were managed by different groups of trustees. A restricted capital fund will, however, constitute endowment.

In some of the case studies,[114] whilst the main property of the charity did not form an endowment, there were several restricted funds which were, in effect, endowments in respect of some part, or ancillary aspect of the charity's work. Whilst these were relatively small funds each had to be examined to establish whether it was a restricted endowment or whether its funds could be used to cover debts, and those which constituted endowments had to be dealt with during the process of winding up the charity.

Restricted funds must be distinguished from **designated funds** which are unrestricted funds which have been earmarked for a specific purposes by the trustees themselves,

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[110] S.O.R.P., Appendix 3 para. 2
[111] S.O.R.P., Appendix 3 para. 4
[112] [1894] 3 Ch 145 at 152 per Davey L.J.
[113] [1981] 1 Ch 193
[114] For example, Case Studies 5 and 8

as an administrative decision.[115] As trustees would normally be able to re-designate the fund, designated funds should cause no problems in a winding up. However, some trustees have power to declare specific trusts over unrestricted funds, once assets have been identified in this way they comprise restricted rather than designated funds.[116] The two terms are confused in practice and some charities refer to restricted funds when, in fact, they mean designated funds. The use of the S.O.R.P. may be useful in clarifying the position.

Finally, the term **functional fixed assets** needs to be considered. These are assets used in connection with the charity's work and which are essential to enable the trustees to carry out the purposes of their charity. Where a charity which operates from premises which it owns is a going concern, and chooses to sell its premises, the funds from the sale will not be available for general running costs, but will be held on the same trusts as the land which was sold.[117] The position where a charity is not a going concern is explored later in this chapter.

Property may be part of an endowment, **and** a functional asset of the charity. For example endowed land may be alms houses or a school, part of an endowment and an investment (property let to provide an income for the charity); or property may have been acquired using income resources and not be part of the endowment.

2. What Words Are Needed To Create The 'Special Trusts' Of An Endowment?

A charity needs to be clear which of its capital funds constitute endowment, or which, in the absence of an express power to expend, will be deemed permanent endowment.[118] The question may be straightforward if a charity is endowed at its foundation or by, for example, a subsequent bequest[119] but, supposing there has been an appeal for which donations are sought, what words or terms are needed to create an endowment for a charity?

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[115] S.O.R.P., Appendix 3 para. 1
[116] S.O.R.P., Appendix 3 para. 1
[117] Richens N.J., and Fletcher M.J.G., 1996 para. 7.1
[118] Charities Act 1993 s.96(3)
[119] e.g. *Re Meyers (London Life Association v St George's Hospital)* [1951] 1 Ch 534

Re Clergy Orphan Corporation[120] concerned the Charity Commissioners' jurisdiction in respect of charity land sold compulsorily to a railway company. The charitable corporation had originally used voluntary contributions to make the investment in the land. Kekewich J. held that as the land was originally purchased and paid for by voluntary contributions it was not an endowment.

On appeal, Counsel for the Charity Commissioners had argued that although voluntary contributions would be invested for a temporary purpose, here they were invested as capital thus becoming endowment and it was the present state of the fund that should be looked at rather than its original form. Furthermore, counsel argued, the funds produced from the sale of land were impressed with a trust to be reinvested in land. On the other hand, counsel for the charity argued that both the income and capital were applicable to the general funds of the charity, although he recognised that it would be different if the income only were applicable, or the fund were impressed with a special trust.

Davey L.J. recognised that "the ultimate source of all charitable endowments is to be found in the spontaneous bounty of founders and supporters"[121] but distinguished between endowment,[122] which confines the charitable application to the income, and voluntary subscriptions denoting recurring gifts repeated annually or otherwise with more or less regularity.[123] "The test whether the property of a charity is an endowment... is not whether it is applicable to the general purposes of the charity or only to some specific purpose in connection with it...."[124] The corporation was empowered to purchase and hold land for the purposes of the charity. The land had been purchased from the sale of consols which arose from investment of subscriptions. He continued:

> "We are unable to say that the investment in land altered the character of the funds invested. The retention of the lands was not essential to the existence of the charity, for the corporation might have rented schools elsewhere, or a site... might have been given to them. In these circumstances, we cannot hold

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[120] [1894] 3 Ch 145
[121] [1894] 3 Ch. 145 at 150 per Davey L.J.
[122] as contained in the Charitable Trusts Act 1853 s.66
[123] [1894] 3 Ch 145 at 151 per Davey L.J.
[124] [1894] 3 Ch 145 at 152 per Davey L.J.

> that the funds ceased to be legally applicable as income at the discretion of the governors. The governors... could not... alter the destination of the funds or the trusts upon which they were held by investing them in land, or deprive their successors of the discretion invested in them. We are therefore of the opinion that the proceeds of the sale of the lands are still applicable as income to the general purposes of the charity...."[125]

The reasoning in the *Clergy Orphan Corporation* case[126] was followed in *Re Church Army*[127] in which the charity appealed for donations and subscriptions. In the appeal the incorporated charity which trained clergy, ran homes, and promoted the welfare of the poor, stated the amount which was needed and the proportion which was required for each of the objects. Since the charity decided to build a new headquarters, this had been added to the list of objects for which funds were required in the appeal and donors stated the objects to which their gifts should be applied. The subscriptions thus raised were less than that which was needed, and funds from other departments were also used. No deed or declaration of trust of the premises or of the sums raised had ever been executed by the society.

Kekewich J. held that the lease could be registered without the consent of the Commissioners as money given to the society, although subscribed for a particular purpose, was given subject to the control of the managers and to the objects of the charity as defined by its memorandum and articles of association.

-On appeal, Collins M.R. commented that the governing factor is whether the subscriber intends that his contribution shall be used as capital or only as income. He said that if the donation is given so that the capital may legally be applied for the maintenance of the charity, then *prima facie* that does not come within the jurisdiction of the Charity Commissioners,[128] that is, is not endowment. He thought that although the charity was divided into different purposes, this was part of the machinery for carrying on one large charitable purpose, and a subscription which happened to be allocated to the new headquarters, although specially allocated, so long as it not restricted from being applied as income,

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[125] *Re Clergy Orphan Corporation* [1894] 3 Ch 145 at 153-154 per Davey L.J.
[126] [1894] 3 Ch 145
[127] (1906) 94 L.T. 559
[128] (1906) 94 L.T. 559 at 563 per Collins M.R.

could be applied for the ordinary current expenses of the charity.[129] He commented that the charity did not invest subscriptions. "Even if they did...that would not determine the question. The real question at the bottom of the whole thing is, What is the intention of the donor?"[130] Romer L.J. was of the same opinion. He felt that as far as concerned the general property of the society, by its memorandum and articles of association, the society was to retain the fullest power over it. It was permitted to mortgage or sell it and monies from those dealings might be applied in discharge of any other liabilities of the society.[131] The new headquarters would become the ordinary property of the society and would not be an endowment. "There is nothing... to show that the new headquarters were given on the footing that the subscriptions or donations were to be treated as distinct from any other property of the society." He continued "it was the intention of all concerned that the society should have and hold the power to deal with the new headquarters in the same way as it had power to deal with the other property which it might temporarily own...."[132] He did, however, allow the possibility that the charity could hold property on special trusts which could create an endowment.[133] Cozens-Hardy L.J. agreed.

Neville Estates v Madden,[134] concerned the premises of the Catford Synagogue. The charity was an unincorporated association. One question was whether the donations made to the building, including proceeds of entertainments, were donations of which special application or appropriation had been attached by donors. It was argued that if a charity invites donations to a special fund declared to be for the purpose of buying land and erecting a building, subscribers could be said to be directing a special application. Cross J. felt himself precluded from accepting that argument. "It follows from [*Re Church Army*][135] that a donor does not direct a special application of his gift unless he subjects it to a trust which prevents the governing body of the charity from using it for its general purposes. The fact that he expects it to be used -

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[129] *Re Church Army* (1906) 94 L.T. 559 at 563 per Collins M.R.
[130] (1906) 94 L.T. 559 at 564 per Romer L.J.
[131] (1906) 94 L.T. 559 at 564 per Romer L.J.
[132] (1906) 94 L.T. 559 at 564 per Romer L.J.
[133] (1906) 94 L.T. 559 at 564
[134] [1962] 1 Ch. 832

and that it is in fact used - for a special purpose is not enough".[136]

In summary therefore :-

-It would appear that where property is acquired from general funds, subscriptions or voluntary contributions, this property will not be permanent endowment.[137]

-The fact that the property is of a class normally associated with endowments does not convert it into an endowment.[138]

-The intentions of the donor are the key issue.[139] Where there has been an appeal to the public, even where donors have been given the choice of directing their donation to a particular aspect of a charity's work,[140] or to a particular 'capital' project[141] any property acquired (e.g. premises) will not, without more, be permanent endowment.

-Although a donor may direct a special application of his contribution, he must subject it to a trust which prevents its use for the general purposes of the charity in order to create a special trust. The fact that he expects it to be used, and that it is used for a special purpose is not enough to create that special trust.[142]

- In order to create endowment the donor must subject his contribution to a trust preventing its use for general purposes. *Neville Estates v Madden*[143] was decided in 1962 but on the basis of the pre-1960 law. Whilst the 1960 Act rendered definitions of endowed, mixed and plain charities obsolete, arguably, the essential concept of permanent endowment is not altered by the 1960 Act section 45(3)[144] although what it comprises may be wider. It can not be expended on the general purposes (maintenance and running costs) of the charity. Although the source of funds was an

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[135] (1904) 96 L.T. 559
[136] *Neville Estates v Madden* [1962] 1 Ch 832 at 860 per Cross J
[137] *Re Clergy Orphan Corporation* [1894] 3 Ch 145; *Re Church Army* (1906) 94 L.T. 559
[138] *Re Clergy Orphan Corporation* [1894] 3 Ch 145 at 153-4 per Davey L.J.
[139] *Re Church Army* (1906) 94 L.T. 559 at 563 per Collins M.R. See also *Att.-Gen v Mathieson* [1907] 2 Ch 832 in which a subsequent declaration of trust was deemed to have been created on the authority of the donor and reflect the donor's intention.
[140] *Re Church Army* (1906) 94 L.T. 559
[141] *Neville Estates v Madden* [1962] 1 Ch 832
[142] *Neville Estates v Madden* [1962] 1 Ch. 832
[143] [1962] 1 Ch 832
[144] Charities Act 1960 s45(3) restated in Charities Act 1993 s.96(3)

issue in *re Church Army*,[145] *Re Clergy Orphan Corporation*[146] and *Neville Estates v Madden*[147] it would seem that the use to which funds are put, that is, the investment in land, does not create endowment and the governing factor seems to be whether the subscriber intends his contribution to be used without restriction, or is to be held on trust for a particular purpose.

B. THE LAW PROTECTS ENDOWMENT

It is clear that common law and statute protect permanent endowment.

It is settled that an endowed charity, so long as it has resources which are devoted to charitable objects can not die, even if it has been altered by scheme,[148] in accordance with the trust deed,[149] or amalgamated[150] with another charity.

The court's tendency to protect endowment is clear in Davey L.J.'s judgement in Re *Clergy Orphan Corporation*.[151] Although he held the proceeds of the sale to be applicable as income, he commented: "[i]t seems at first sight a strong thing to hold that lands purchased and held for the purpose of carrying on the charitable work of the corporation are not part of the permanent endowment of the corporation".[152] Generally, the costs of cases are ordered not to be paid out of endowment[153] although rare exceptions may be made.[154] In the rare instances where the courts permit the expenditure of permanent endowment, steps are usually required for the recoupment of the capital. For example, in *Andrews v M'Guffog*[155] (H.L. Sc.) although the respondents who intermixed capital funds were not held blameworthy by the Court, the case was referred back to the Court of Session to consider whether

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[145] (1906) 94 L.T. 559
[146] [1894] 3 Ch 146
[147] [1962] 1 Ch 832
[148] *Re Lucas* [1948] Ch 424
[149] *Re Bagshaw* [1954] 1 W.L.R. 238
[150] *Re Faraker* [1912] 2 Ch 488
[151] [1894] 3 Ch. 145
[152] [1894] 3 Ch 145 at 153 per Davey L.J.
[153] e.g., see *Re Manchester New College* (1853) 16 Beav. 610 51 E.R. 916
[154] e.g. *Att.-Gen. v Day* [1900] 1 Ch 31
[155] (1886) XI H.L. 313

and how the capital ought to be recouped. *Re Willenhall Chapel of Ease*[156] is unusual in that it was agreed that capital could be used for the repair and extension of the church, although it was noted that the court will usually take steps to ensure that the capital is recouped.[157]

The Charity Commissioners also protect permanent endowment, but have power to authorise its expenditure[158] although they normally require recoupment.

Statutory provisions also tend to protect endowment. Although the Charities Act 1993 enables a small charity, whose income does not exceed £1,000[159] and whose permanent endowment does not consist of any land, to spend its capital (the endowment),[160] the provision is so couched as to continue to safeguard it. The trustees must first consider whether the charity's property can be transferred to another charity, a resolution to spend the capital must be passed by a voting majority of two- thirds, the Charity Commissioners must be informed and their approval is required[161] before it can be expended. It follows that restrictions remain on the expenditure of endowment for larger charities. Although section 75[162] does not permit the expenditure of endowment which is land, presumably, where there is a power of sale in respect of the land, the land can be sold and proceeds be spent (providing the charity's total income from the invested proceeds and other sources would be within the statutory limit).

C. AVAILABILITY OF AN ENDOWED CHARITY'S ASSETS TO MEET LIABILITIES ON WINDING-UP

In this context 'liabilities' is being used to describe the liabilities which arise from the general running of the charity or in relation to property held.

The extent to which endowment assets, being subject to special trusts, are generally

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[156] (1865) 8 L.T. 354 See also *Att.-Gen v Day* [1900] 1 Ch 31 in which North J. held that costs could come from the endowment

[157] (1865) 8 L.T. 854 per Kindersley V.-C.

[158] Charities Act 1993 s.26

[159] or such different sum as the Secretary of State may substitute under Charities Act 1993 s.75(9)

[160] Charities Act 1993 s.75

[161] Charities Act 1993 s.75

available to creditors is unclear (although it is generally accepted that they are not available). However, it must be clear that, where permanent endowment has been mortgaged, and the charity defaults in repayments, the mortgagee has a right to be repaid what is owed out of the charged assets.

The factors which may affect the availability of endowment to pay creditors are discussed in terms of the nature of the fund, any limitations arising from the charity's capacity to be dissolved and how its property is held. The Court's and the Charity Commission's ability to sanction the expenditure of endowment is then considered.

1. Factors That May Affect the Situation

First, since different types of fund are subject to different rules, it is important to be clear whether particular funds constitute general funds, endowment, expendable endowment or are restricted funds. There may be general endowments, restricted fund endowments, or restricted revenue funds. For example, a charity may have an endowment intended generally to support its objects, a specific endowment to support some specified aspect of its work and it may receive revenue funding for a specific project which cannot be used for anything else. Each of these will be held by trustees who will probably be the charity trustees of the main charity, but there could also be different trustees of the restricted funds. To what extent is each of these funds limited in its availability to meet liabilities and is that reflected in the accounting treatment of the asset or income? Issues associated with the nature of the fund are explored in what follows. The question of the destination of surplus funds is considered in chapter five.

The second major factor which will determine whether a charity's assets can be used to meet liabilities relates to whether the charity can, in fact, be wound up or dissolved. As the position is different according to whether the charity is unincorporated, or a company, these two are considered separately. The position in respect of unincorporated associations may differ according to whether the governing instrument provides for dissolution. Where the charity is a company it will be capable

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[162] Charities Act 1993 s.75

of dissolution. However, the question of how property is held in a charitable company and the capacity of a company to hold endowment are both factors which need to be discussed in respect of the availability of funds to meet liabilities. Since many corporate charities began life as unincorporated associations the position in respect of pre-incorporation trusts is also explored below.

(a). The Nature of the Fund

This section explores the extent to which the nature of the fund determines whether and to what extent it can be available to meet liabilities to creditors.

(i). General funds

There would appear to be no particular problem regarding the availability of general funds to meet liabilities in the event of winding up.

(ii). Endowment[163]

Permanent endowment can not generally be converted to income funds, but that which is expendable endowment may be converted. The discretion may be general or more prescriptive of the circumstances in which it can be exercised. Presumably, where the discretion is general, the potential insolvency of a charity would be a circumstance for conversion. However, a charity in difficulty needs to be aware which of its capital funds constitute endowment which, in the absence of express power to expend, will be deemed permanent endowment.[164] The position may be straightforward if a charity is endowed at its foundation or there has been a subsequent bequest.[165] The problem may be more complicated, for example, if there has been an appeal for which donations are sought: (will this constitute an endowment?), or if the Charity Commission comes to a different view from the trustees as to the nature of a given fund.

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[163] See previous discussion at p.95.
[164] Charities Act 1993 s.96(3)
[165] as in e.g. *Re Meyers (London Life Association v St. George's Hospital)* [1951] 1 Ch 534

(iii). Endowment mortgaged

It is in the essence of a mortgage that if the mortgagor defaults on payment due, the mortgagee is entitled to be paid from the mortgaged property.[166]

(iv). Endowment and unsecured loans

Where a charity has some endowment and the trustees are obtaining unsecured loans the Charity Commissioners' advice is that trustees should ensure that the charity has sufficient assets to discharge the loan if it suffers a sudden loss of income and professional advice should always be sought before taking out such a loan. Although consent is not required to take out an unsecured loan, the Commissioners advise the trustees of a charity whose assets consist largely of land to discuss whether an order is desirable to authorise the loan. "If the trustees later found difficulty in repaying the loan, they would not be permitted to use the land, or the proceeds of sale of land, to repay the loan **unless** the borrowing had originally been authorised by us."[167] In one of the case studies[168] the trustees found it necessary to obtain such an order because their borrowing powers were inadequate.

The Charity Commissioners' Report 1968 comments with regard to borrowing:

> "Charity trustees cannot pledge charity property unless they can show power to do so....This should not be overlooked as regards any borrowing, even by way of a bank overdraft, since this creates an implied charge on the charity's property and if the borrowing is covered by a written memorandum that will be invalid so far as it charges permanent endowment without the Commissioners' order."[169]

(v). If a charity with wide objects held property on special trusts for only part of its objects, could that property be used in the insolvency?

It is often the case that one charity has associated funds (which may be a restricted fund or an endowment). For example, a school charity may have funds to provide prizes, or a residential home may have a charitable fund which can help 'poor'

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[166] Trustees mortgaging permanent endowment need to be very clear of their powers – see discussion at p.82 et seq. because of the possibility of personal liability if the mortgage was ultra vires

[167] CC28, *Disposing of Charity Land*, para. 50 p.21

[168] Case Study 8

residents with rent, and the main and associated charities may be managed by the same or a different body of trustees. Whether or not the charities are incorporated, it is very unlikely that the associated funds could be used in the insolvency of the main charity because, in fact, they are two different charities, with different objects, even though related.

> **(vi).** Restricted use rather than over the whole purposes of the charity. (Restricted use, project funding, service level agreement or contract funding compared.)

The S.O.R.P.[170] suggests that if restricted funds are used for another purpose, the trustees are in breach of trust. Technically, therefore, an unincorporated charity being wound up ought only to use the funds to meet the liabilities in relation to the restriction. The S.O.R.P. definition refers to funds subject to specific trusts. This may suggest a distinction between funds provided as part of a service level agreement (S.L.A.), or as a donation for a specific project. This raises the question as to whether S.L.A. and project funding can be used to meet general liabilities, as compared with funds provided on trust for a particular purpose which can not. Presumably,[171] the same situation appertains in respect of a corporate charity. In practice, the accounts of many charities would identify project-S.L.A. funding as restricted in their accounts and, since it is not clear whether service level agreements are legally funds held on trusts or subject to contracts, this may be the correct view. If, however they are contracts, would an advance payment on the contract be part of the general funds of the charity and not restricted? The *Quistclose*[172] case suggests that such an advanced payment can be seen as restricted funding in certain circumstances. However, the charity would not be required to account back to the funder for any surpluses which had been made by it on the S.L.A.

The issues around restriction in relation to project funding were raised by the author

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[169] [1968] Ch. Comm. Rep. para. 14

[170] S.O.R.P., Appendix 3 para. 4.

[171] Although a company owns its assets beneficially, property held on trust, including presumably a restricted fund, is not available to meet general liabilities – *Liverpool & District Hospital for Diseases of the Heart v Att.-Gen.* [1981] 1 Ch.D. 193

[172] *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567

with the Charity Commission in connection with the review of S.O.R.P.[173] and in relation to insolvency in particular. Their response recognises that some charities do incorrectly classify funds as restricted when they may not be, such as where a contract is so specific that any profits can not be used for anything else. "Whilst this may in an operational sense restrict the activities of a charity there may not be a specific trust created in a legal sense." The correspondent makes the point that a service level agreement may constitute grants, and the terms of the donation may be such as to create a restricted trust, whereas if it is in effect a contract for services it does not create a restricted trust. It continues "[*t*]*he exact nature of such agreements is difficult to determine*." The further comment is made that "it is potentially the weak bargaining position which charities find themselves in which leads to service level agreements with local authorities being onerous upon the charity rather than the fact that any special protection is provided to such agreements under trust law".[174]

In one of the case studies the main charity 'borrowed' from a restricted trust fund. Presumably, in the insolvency, although the 'borrowing' was a breach of trust, the restricted fund would rank with other creditors. If the debt was not satisfied in full, and other remedies such as tracing were unavailable, recourse would be had to the trustees personally for the shortfall.

(vii) A capital fund established from revenue

If what is held is a capital fund which has been established from revenue, intended by the trustees to be used as a source of income in years to come, this is not technically an endowment and can therefore be used in the satisfaction of liabilities (unless the trustees have power under the governing instrument to create trusts of the charity's funds, and have so created permanent endowment).

(b). The Nature of the Organisation : (1) The Unincorporated Charity

The availability of assets to meet liabilities will vary according to whether the

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[173] author's correspondence, December 1998

[174] correspondence from the charity Commission, 2nd March 1999. See also Morris D., *Charities and the Contract Culture: Partners or Contractors? Law and Pratice in Conflict*, Charity Law Unit, July 1999 Themes p.13 et seq.

unincorporated charity is endowed, and then according to whether the endowed charity has the power to wind up.

(i). Endowed charity without power to wind up

There is some authority for the proposition that charity cannot die which clearly impacts on the capacity of the charity to go through the process of being wound up, that is, liquidating its assets, if necessary, to pay debts. As is explored further in chapter five, in the context of the destination of surplus assets, the fact that a charity has been altered by a scheme,[175] in accordance with the trust deed,[176] or by amalgamation[177] does not put an end to the charity. Neither does moribundity.[178]

Re Faraker[179] concerned an endowed charity. Farwell L.J. said:

> "[s]uppose the charity commissioners or this court were to declare that a particular existing charitable trust was at an end and extinct... they would go beyond their jurisdiction in so doing. They cannot take an existing charity and destroy it; they are obliged to administer it.... In all these cases one has to consider not so much the means to the end as the charitable end which is in view, and so long as that charity end is well established the means are only machinery."[180]

Kennedy L.J. said:

> "no case has been shewn to me in which an endowed charity has been treated as having...lost its life by reason of the exercise of the perfectly competent authority... of the Charity Commissioners, or the equally competent authority of this Court, under which its funds have come to be applied somewhat differently to the way in which they were applied under the original foundation.... It seems to be the law, that *an endowed charity* (my emphasis), to whatever purpose its funds are devoted, if and so long as they are devoted to some charitable purpose under some duly authorised scheme, remains still existent so as to draw to it a sum of money given by a will for, presumably, the same purpose as the original charity".[181]

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[175] *Re Lucas* [1948] Ch 424
[176] *Re Bagshaw* [1954] 1 W.L.R. 238
[177] *Re Faraker* [1912] 2 Ch 488
[178] *Re Buck* [1896] 2 Ch. 727
[179] [1912] 2 Ch 488
[180] [1912] 2 Ch 488 at 495
[181] [1912] 2 Ch 488 at 496 per Kennedy L.J.

In *Re Lucas*[182] funds bequeathed to a charity running a home for crippled children, in which the home had been closed and the charity schemed by the date of the will, were held to be intended to contribute to the endowment of the charity. Lord Greene M.R. said "[i]t is settled... that so long as there are funds in trust for the purposes of a charity the charity continues in existence and is not destroyed by any alteration in its constitution or objects made in accordance with law, as for example by a scheme...."[183]

It should be noted, however, that in all of these cases[184] the issue was whether a charity which had in effect ceased to exist could still be a legatee which is not the question being considered here. They lend weight to the traditional view, certainly in respect of an unincorporated association, that the endowment is not available to meet liabilities. This accords with the author's comment in *Tudor on Charity*[185] that "[i]t is in relation to charitable trusts that the general proposition that a charity cannot die is most powerful".[186]

(ii). Where the governing instrument contains the power to wind up

Re Roberts[187] concerned a bequest to the Sheffield Boys' Working Home which, as a result of changing social conditions, had closed by the time of the testatrix' death. The charity's freehold and leasehold assets had been sold and the funds remaining transferred to the Sheffield Town Trust. Two particular features were first, that the trusts permitted the sale of land and for the proceeds to be added to the general funds of the charity, applicable at the discretion of the committee in payment of debts et cetera or towards the general expenses of the charity or in the purchase of other land. Secondly the trust contained a power to sell these hereditaments and distribute the surplus to other charities if the "governors consider that the [home] is not required or

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[182] [1948] 1 Ch 424
[183] [1948] 1 Ch 424 at 426 per Lord Greene M.R.
[184] *Re Faraker* [1912] 2 Ch 488 at 495 per Farwell L.J. and 496 per Kennedy L.J.; *Re Lucas* [1948] 1 Ch 424 at 426 per Lord Greene M.R.. These cases are also considered in the following chapter – destination of surplus.
[185] Warburton J., 1995 p.454
[186] *op.cit.* p.454
[187] [1963] 1 W.L.R. 406 also considered in Chapter 5 in the context of destination of surplus

cannot be efficiently kept up or that it ought to be discontinued".[188] The charity was wound up in 1945, well before the 1960 Act. Potentially, therefore, the land would have been classed as endowment by section 66 of the Charitable Trusts Act 1853. Whilst the main issue in the case was whether the bequest had lapsed, the questions relevant here concern the charity's winding up and its impact on any endowments.

Wilberforce J. considered the point that an endowed charity cannot be put an end to. He referred to Kennedy L.J.'s judgement in *Re Faraker*[189] that an endowed charity cannot die so long as it has funds devoted to some charitable purpose[190] but concluded that those words seem not necessarily to apply to a case where the trustees were given express power to terminate the charity.[191]

In fact, any endowment which the charity possessed in the form of land was sold, and the cash transferred to another for the use of its general funds. For the purposes of the destination of the bequest it was held that the charity had not been wound up, only its mechanism. The bequest, however, did not follow the funds, which had already been transferred to a charity with much wider objects (that is, the augmentation principle in *Re Faraker*,[192] *Re Lucas*,[193] and *Re Bagshaw*[194] was not extended to this case), rather, a scheme was directed to provide the machinery by which the charitable trusts would conntinue.

In *Re Roberts*[195] the trusts permitted the endowment to be expended on debts or losses irrespective of the power to wind up the charity. Wilberforce J. contemplated the possibility that an endowment can be 'wound up' and its proceeds transferred to another charity on the basis of such a dissolution clause.

(c). The nature of the Organisation : (2) Companies

There is a school of thought which suggests that because a company, constitutionally,

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[188] [1963] 1 W.L.R. 406 at 409
[189] [1912] 2 Ch 488
[190] [1912] 2 Ch 488 at 496
[191] *Re Roberts* [1963] 1 W.L.R. 406 at 414
[192] [1912] 2 Ch 488
[193] [1948] Ch 424
[194] [1954] 1 W.L.R. 238
[195] [1963] 1 W.L.R. 406

can make no distinction between capital and income, it is unable to hold a permanent endowment.[196] This seems to overstate the case, not least because several of the cases already considered concerned corporations,[197] and one was registered under the Companies Act[198] but it was the existence of otherwise of the endowment which was at issue, not the capacity of the corporation to be endowed. The problem seems to hinge on questions of trusteeship, the company's capacity and the mechanism for property holding by a charitable limited company.

(i). Trusteeship - the directors as trustees

Charitable companies are legal entities in their own right. In a commercial context company directors have fiduciary duties, as opposed to being, strictly, trustees.[199] But in the charity context are the directors trustees or is the company itself a trustee? As far as the directors of charitable companies are concerned, the courts are prepared to look behind the veil of incorporation to examine the realities of the situation,[200] and view the directors as trustees.

In *Re French Protestant Hospital*[201] the Governors and Directors of the hospital had been incorporated by Royal Charter. Dankwerts J. addressed the 'trustee' argument:

> "It is said...that it is the corporation which is trustee of the property of the charity... and that the governor and directors are not trustees. Technically that may be so. The property of the charity is, of course, vested in and held by the corporation. It is a perpetual person which exists...according to the rules of law.... It seems to me that in a case of this kind the court is bound to look at the real situation which exists.... It is plain that those persons are as much in a fiduciary position as trustees in regard to any acts which are done respecting the corporation and its property.... Therefore ...they are...bound by

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[196] See, e.g., Judith Hill, *The Trust v The Company Under the Charities Act 1992 & 1993* (1993/94) 2 CL&PR 133 at 144

[197] *Re Clergy Orphan Corporation* [1894] 3 Ch. 146; Re Church Army (1906) 94 L.T. 559

[198] *Re Church Army* (1906) 94 L.T. 559

[199] *Re Forest of Dean Coal Mining Co* (1878) 10 Ch D 450 at 451 per Sir George Jessell M.R.; *Re Lands Allotment Co* [1891-1894] All ER Rep. 1034; *Re City Equitable Fire Insurance Co* [1925] Ch. 407; *Selangor United Rubber Estates v Cradock No 3* [1968] 2 All E.R. 1073; *Belmont Finance Corporation v Williams Furniture Ltd No 2.* [1980] 1 All E.R. 392 C.A.

[200] See *The Abbey Malvern Wells Ltd v Ministry of Local Government & Planning* [1951] 1 Ch 728; *Construction Industry Training Board v Att.-Gen.* [1973] 1 Ch 173; *Re French Protestant Hospital* [1951] 1 Ch 567

[201] [1951] 1 Ch 567

the rules which affect trustees."[202]

In *Manchester Royal Infirmary v Attorney-General*[203] the funds of a charity were originally vested in trustees. When the corporate body was created[204] the trusts were unaltered, but the corporation was substituted for the individual trustees. Were they subject to the Trustee Investment Act? North J. declared that "the corporation are trustees...."[205] A chartered corporation is in the same position.[206]

Thus, those who direct charitable companies, together referred to as 'the corporation' in some cases, whilst not technically trustees, have been held bound by rules which specifically affect trustees (such as payments to trustees and investment powers) and as they have general control and management of the administration of a charity are 'charity trustees' for the purposes of the 1993 Act.[207]

(ii). Trusteeship - the company as trustee : *Liverpool and District Hospital for Diseases of the Heart v Attorney General*[208] explored

Liverpool and District Hospital for Diseases of the Heart v Attorney General which is discussed in chapter five in the context of the destination of surplus assets at winding up. concerned the legal consequences of winding up a charitable company incorporated under the Companies Acts which had not previously been determined. Was the surplus remaining after the satisfaction of liabilities to be distributed to members (and if so, on what basis) or were the assets to be given or transferred to some other charitable institution? One argument on behalf of the Attorney General had been that the statutory provisions in respect of winding up do not apply to assets held by a charitable company on the grounds that all such assets are *ex hypothesi* held by the company solely as trustee and not beneficially.

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[202] [1951] 1 Ch 567 at 570 per Dankwerts J.

[203] (1889) 63 Ch.D.420

[204] by special Acts - inter alia, "An Act for enabling Sir Oswald Moseley to grant certain lands... for the purpose of Manchester Public Infirmary..." 48 Geo 3, c.127; 5&6 Vict. c.i. 1842. Section 2 - a body corporate with perpetual succession, and a common seal, and with power to hold and retain, for the purposes of this Act, the lands comprised..."

[205] (1889) 63 Ch. D 420 at 430 per North J.

[206] *Soldiers Sailors and Airmens' Families Association v Att.-Gen.* [1968] 1 W.L.R. 313

[207] Charities Act 1993 C.10 s.97

[208] [1981] 1 Ch.D. 193. See also Warburton J., *Charitable Corporations and the Ultra Vires Rule,* [1988] Conv. 275-282 and *Charitable Corporations : The Framework for The Future,* [1990] Conv. 95-105

Counsel for the Attorney General submitted that a company established for charitable purposes held its general corporate assets as trustee for the general purposes in its memorandum. Whilst recognising that *Re Dominion Students' Hall Trust*[209] and *Re French Protestant Hospital*[210] proceeded on the basis that the corporation was a trust, Slade J. reviewed a number of authorities. In *Von Ernst & Cie S.A. v I.R.C.*[211] Bridge L.J. assumed that " a company formed under the Companies Acts, though its objects may be exclusively charitable, is nevertheless not a trustee of its assets."[212]

Slade J. said:

> "In a broad sense a corporate body may no doubt aptly be said to hold its assets as 'trustee' for charitable purposes...where the terms of the constitution place a legally binding restriction ... which obliges it to apply its assets for exclusively charitable purposes. In a broad sense it may even be said ... that the company is not the 'beneficial owner' of its assets. In my judgment none of the authorities... establish that a company formed... for charitable purposes is a trustee in the strict sense of its corporate assets, so that on winding up these assets do not fall to be dealt with in accordance with ...s.257 [CA 1948]. They do, in my opinion, clearly establish that such a company is in a position *analogous to that of a trustee* in relation to its corporate assets, such as ordinarily to give rise to the jurisdiction of the court to interfere in its affairs; but that is quite a different matter."[213]

Slade J. felt that there was support for his view in *Bowman v Secular Society*.[214] In that case it had been argued that as the society was a corporate body, its funds could only be applied for purposes in its memorandum, so a gift to it was a gift for those purposes, therefore the society was a trustee, for those purposes, of the gift. Lord Parker of Waddington had said that this argument was fallacious. If a gift is given to a limited company it takes it absolutely to be used for any lawful purpose.[215] (In the case of a charitable company, however, its use would be confined to the purposes of the charity.)

> "If a gift to a corporation expressed to be made for its corporate purposes is

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[209] [1947] Ch 183
[210] [1951] Ch 567
[211] [1980] 1 W.L.R. 468 at 479
[212] [1980] 1 W.L.R. 468 at 475
[213] *Liverpool & District Hospital for Diseases of the Heart v Att.-Gen.* [1981]1 Ch.D. 193 at 209 per Slade J
[214] [1917] A.C. 406
[215] *Bowman v Secular Society* [1917] A.C. 406

> nevertheless an absolute gift to the corporation, it would be quite illogical to hold that any implication as to the donor's objects in making a gift to the corporation could create a trust. The argument, in fact, involves the proposition that no limited company can take a gift otherwise than as a trustee."[216]

Slade J.'s second point was that the idea of a company incapable of holding its assets beneficially, yet capable of incurring liabilities in its own name was inconsistent with the general intention of the legislature as it appears from the Act because the creditors could never resort to its assets as provided by the legislation in winding up.

There seems, therefore, to be clear authority for the proposition that a company holds, at least its general assets, beneficially which coincides with Buckley J.'s views in *Re Vernon's Will Trusts.*[217] This is also the case in respect of companies established by charter.[218]

(iii). Companies' capacity to hold endowment

It would appear from *Re Roberts*[219] that the power to wind up makes a significant difference in an unincorporated association (perhaps especially when linked with a power to sell and use the proceeds of sale of endowment property, although that linkage was not made in the judgment). All registered companies are inherently able to be wound up.

The Liverpool Heart Hospital case[220] seems to be taken as authority for the proposition that when a registered company is involved, it is not possible to protect endowment which, it appears, translates into the proposition that a company is unable to hold an endowment.

Whilst the summons in *Liverpool Hospital for Diseases of the Heart v Attorney General*[221] specifically sought the settlement of a scheme "for the administration of the association and the endowments thereof" and, indeed such a cy-près scheme was

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[216] [1917] A.C. 406 at 441 per Lord Waddington
[217] [1972] 1 Ch. 300 at 303 per Buckley J.
[218] *Att.-Gen. v The Master & Wardens of the Haberdashers' Company* (1834) 1 My & K 420 at 429 per Brougham L.C.
[219] [1963] 1 W.L.R. 406
[220] *Liverpool and District Hospital for Diseases of the Heart v Att.-Gen.* [1980] 1 Ch 193

so directed,[222] (at least allowing the possibility of a company having endowments[223]) Slade J. expressly decided the case on the basis that at dissolution the funds remaining were held for its general purposes and not on any special trusts.[224]

The possibility of a statutory corporation holding an endowment was recognised in *Re Clergy Corporation*[225] which had existed since 1749 but been created a corporation in 1809,[226] although the land in question was held not to be endowment in that case even though part of the purchase price had come from the income from endowments.

In practice, charitable companies do have endowments. It is said that the Charity Commissioners' practice is not to permit the transfer of endowments from unincorporated associations to corporate bodies[227] but a charitable company with suitable provisions in its memorandum may act as a trustee of charitable assets which are not freely expendable. It is suggested that there will have to be a separate subsidiary trust, but the assets will appear in the charity's accounts as restricted funds.[228] Incorporated charities may be given an endowment after incorporation. For example, when the New Town Development Corporation was wound up TCC (Ltd) was given £100,000 as an endowment and an undertaking was sought from the committee (directors) that it would be invested and only the income used for the running costs of the charity.[229] Many of the community trusts, some of which are companies, are establishing "endowments", some of these funds are legally endowments whereas others are funds which when invested provide income from which annual grants can be made.

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[221] [1980] 1 Ch 193
[222] [1980] 1 Ch 193 at 216 per Slade J
[223] The possibility of an endowment was recognised in *Re Church Army* (1906) 94 L.T. 559 which concerned a company registered under the Companies Acts.
[224] [1980] 1 Ch 193 at 200
[225] [1894] 3 Ch 146
[226] 49 Geo. 3, c.xviii
[227] see Warburton J., 1995, p.455; Claricoat J., and Phillips H., *Charity Law A to Z*, 2nd Ed Jordans, 1998
[228] Correspondence from Charity Commissioners 29.10.96
[229] information known to the author

(iv). Whether the company has the power to hold funds on special trusts, and the breadth of the company's powers

In *Re Church Army*,[230] whilst the origin of the funds (subscriptions) was significant in the court's decision, Collins M.R. considered that the appeal for funds for premises, and other projects were part of one whole scheme[231] for carrying on the charity, and Romer L.J. was of the opinion that the company's powers were such as to retain the fullest powers over any land it acquired[232] thus land and other property held was not part of endowment.

Many charitable companies have the power to hold property on trust for other bodies, or on special trusts.

In *Liverpool and District Hospital for Diseases of the Heart v Attorney General* Slade J., referring to the general law, outlined the assets which would be available for the discharge of a company's liabilities[233] which would include only those items of property which under the general law are available for the discharge of a company's liabilities. Thus they will include assets of which the company is beneficial owner, even though the legal title may be vested in other trustees. They will not, however, comprise assets of which the company was merely a trustee (in the strict sense) for third parties or for charitable purposes, even though the legal title may have been vested in it.[234]

Thus property held in trust for another charity could not be used to satisfy a charitable company's liabilities, and arguably neither would endowment since that would be held 'for purposes'. Slade J.'s exclusion of funds "for charitable purposes" suggests that he contemplated the possibility that a restricted fund or endowment would fall outside the assets available to meet liabilities.

The availability of endowment assets may depend on the way in which it was given. A gift to a corporate body "takes effect simply as a gift to that body beneficially,

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[230] (1906) 94 L.T. 559
[231] (1906) 94 L.T. 559 per Collins M.R. at 563
[232] (1906) 94 L.T. 559 at 564 per Romer L.J.
[233] [1980] 1 Ch 193 at 205 G

unless there are circumstances which show that the recipient is to take the gift as trustee".[235] Clearly, either the corporation or the directors can be put into the situation of trustee. Were the directors, in fact put into the position of trustees of the endowment? In the TCC example given above, an assurance was sought from the committee, (whether as trustees or as agents of the company is not certain), that only the income would be used for running costs. Although on a practical, day to day basis, the endowment is invested in the corporate name of TCC, and shown in TCC's accounts as an endowment, the directors may be holding it on trust or the company may be trustee. Arguably, the same situation could apply in respect of restricted funds (see below). There is support for this view in Richens and Fletcher[236] who comment that:

> "one point to watch... is that charitable companies can also be trust deed charities.... [A] trust deed may appoint a charitable company as trustee of the trust deed, or property may be given to the charitable company to be held on specific trusts. In these cases, the company is merely the trustee of a separate charitable trust, and the trust property must be held and used only on the terms of its specific trusts".

The question is, therefore whether the way the gift was made is such as to make it the corporate property of the company or creates the company or its directors trustee of a separate trust.[237] In the absence of such a trust, where the supposed-endowment was part of the corporate property, it could be liquidated in the winding up of the charity.

(v). Pre-incorporation trusts

Many organisations become incorporated having existed for some time as an unincorporated trust or association.

In *Re Vernon's Will Trusts*[238] Buckley J., considering the funds of the incorporated guild said "[w]hether and how far it would be right to regard the funds of the

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[234] [1981] 1 Ch. 193 at 205 per Slade J.
[235] *Re Vernon's Will Trust* [1972] 1 Ch 300 at 303 per Buckley J (emphasis added)
[236] Richens N.J., and Fletcher M.J.G., 1966 para. 1.2.3.
[237] see Richens N.J., and Fletcher M.J.G., 1996 para. 1.4.2.
[238] [1972] 1 Ch 300 at 304 per Buckley J.

incorporated guild as subject to a charitable trust, I do not pause to consider beyond pointing out that any assets which it took over from the unincorporated guild would appear to have been subject to such a trust". This suggests that if the unincorporated association or trust held an endowment, the endowment assets would continue to be held by the incorporated body on the same trusts. In practice, however, Claricoat and Phillips,[239] former senior lawyers at the Charity Commission, suggest that the normal procedure, which involves the transfer of the unincorporated charity's assets to the new corporation, will not apply where the unincorporated body had permanent endowment. In such cases, the approach sometimes taken is that a company is created with the power to be a trustee of special trust property, then the property of the 'old' charity which is *not* permanent endowment is made over to the company charity and an application is made to the Commissioners for a scheme to appoint the company charity as the trustee of the permanent endowment.

It is suggested, therefore, that funds held by a company which were held by the precursor unincorporated association as endowment, will not be available to meet liabilities in a winding up.

2. Court's Ability to Sanction Expenditure of Endowment

It is clear that the court can sanction the use of endowment. In *Re Willenhall Chapel of Ease*,[240] considered earlier in this chapter, the charity was allowed to spend capital on purposes not strictly of a permanent character. The capital was used for the repair and enlargement of the building. £3,000 was estimated to be raised from subscriptions but the total cost was £4,000. The charity sought to use £1,000 from the endowment and the Charity Commissioners certified their approval of the application. The court was requested not to make an order for recoupment, as this would fall too heavily on the incumbent. Kindersley V.-C. said that the general rule adopted by the court in these cases is to require money which is laid out for a special purpose to be recouped, and the question is whether, having regard to the special circumstances of the case the court ought to depart from this rule. He noted that the

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[239] Claricoat J., and Phillips H., 1998
[240] (1865)8 L.T. 854

support of the incumbent was the charity's main object, which would be adequately provided for. He held therefore that the general rule was not applicable to this particular case. [241]

In *Attorney General v Day*[242] North J. held that the costs of the petition should be paid out of the capital fund. The case concerned the continued payment towards, *inter alia*, the maintenance of a causeway after it had come under the control of the local county and district councils. It was held that this circumstance did not put an end to the trust and the councils were now entitled to the payments.

Picarda says that there are rare exceptions to the rule that money spent out of the endowment should be recouped which have occurred in most unusual circumstances.[243]

3. Charity Commission Ability to Sanction Expenditure of Endowment

Under the Charities Act 1993 section 26(4) the Charity Commissioners may authorise the expenditure of part of the Charity's endowment where it is in the interests of the charity.[244] The Charity Commissioners can sanction the use of capital to be used for the repair, improvement or modernisation of buildings used by charities but can also consider the expenditure of permanent endowment for other purposes[245] provided that it will be replaced out of future income.[246] In special cases the Commissioners will also consider the spending of permanent endowment without replacement.[247] Anything done under the authority of an order under section 26 is deemed to be properly done in the exercise of those powers.[248] An order may *inter alia* sanction a particular transaction or a particular application of property;[249] it may give directions

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[241] (1865) 8 L.T. 854 at 854/855
[242] [1900] 1 Ch 31
[243] Picarda H., 1995, p504
[244] Charities Act 1993 s.26(1)
[245] See CC38, *Expenditure and Replacement of Permanent Endowment*, para. 1
[246] Ch. Comm. Rep. 1963 paras. 55-56, see also CC 38, para. 5
[247] CC 38, para. 5
[248] Charities Act 1993 s.26(1)
[249] Charities Act 1993 s.26(2)

as to the manner in which the expenditure is to be borne;[250] and it must, in particular, include directions for meeting any expenditure out of a specified fund, for charging any expenditure to capital or to income, for requiring expenditure charged to capital to be recouped out of income within a specified period.[251] This provision might be useful where, once the cash flow problem is resolved, the charity can continue in operation and will have some income from which the capital can be recouped. It would not be so useful where that is not the case.

It is possible that the Charity Commissioners might approve the use of endowment funds to avoid the insolvency of a charity, but in those circumstances they would generally wish to see a financial plan demonstrating the long term financial viability of the charity, sufficient to recoup the endowment as well as maintaining the charity's activities.

Warburton[252] suggests that there is a distinction between a charity with a permanent endowment and a charity which has power to spend both income and capital. In the case of a charity with a permanent endowment the only way in which the charity trustees would be able to expend all the funds of the charity is if the terms of the trust were varied by scheme by the Charity Commissioners. "This is highly unlikely as the Charity Commissioners probably do not have the power to order such a variation if it is sought with a view to bringing the charity to an end; their general function is to promote the effective use of charity resources and not to destroy charities."[253] Farwell J. in *Re Faraker*[254] indicated that the Commissioners would exceed their jurisdiction if they declared a charitable trust at an end. Nevertheless, in one of the case studies[255] the Commissioners permitted the partial expenditure of permanent endowment to enable the charity to be wound up and its surplus assets transferred to a similar charity operating in the vicinity. Had this permission not been forthcoming the trustees of the charity would have been trapped, the charity not able to function, insolvent (but for the endowment) for the purposes of winding up, although solvent

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[250] Charities Act 1993 s.26(3)
[251] Charities Act 1993 s.26(4)
[252] Warburton J., 1995, p.453
[253] *op.cit.* p.453
[254] [1912] 2 Ch 488 at 495 – see text at note 178 above

so long as, technically, a moribund but, for accounting purposes, 'going concern'! It was confirmed in correspondence with the Commission that it may be possible to use permanently endowed funds where a charity is facing severe financial difficulties which would otherwise result in trustees making payments out of their personal assets.[256]

It remains uncertain, however, whether an application to spend the whole of a permanent endowment would have to be a matter for the High Court. As a general rule, questions in the administration of charitable trusts being charity proceedings come to court only with the consent of the Charity Commissioners or if leave to proceed is granted by the High Court following a refusal by the Commissioners.[257] This is discussed in the concluding chapter. Court involvement is also possible if a scheme were being sought which the Charity Commissioners considered would be better or more appropriately dealt with by the courts.[258]

4. Some Tentative Conclusions

With such an apparent dearth of cases, particularly in relation to companies having endowments and given that there appear to have been no cases to date of endowed charities being wound up insolvent, it would be foolish to try to second guess how the courts would face a request to expend such a charity's endowment. But charity insolvency is a modern problem, admittedly, more likely to affect organisations which rely on grant aid or contracts from local or other public authorities than the more traditional endowed charities. Perhaps because of that, the robustness of the concept of endowment has not yet been tested in this context but the world in which charities exist is changing very fast and many established (perhaps endowed) charities are encountering financial problems because of this change. Charities providing, for example, training, education, housing, and hospitals are today operating in a very fluid environment, and their services may well become outmoded. It may be that the first indicator of this to trustees is financial difficulties and it may take time to

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[255] Case Study 16
[256] correspondence from the charity Commission 2nd March 1999
[257] Charities Act 1993 s. 33(1),(2) and (5)
[258] Charities Act 1993 s.16(10)

recognise the charity's true plight, time during which the charity has actually become insolvent. In such a case, it seems unlikely that a significant creditor would not attempt to gain access to a substantial endowment when otherwise the debt would remain unpaid. Indeed, the appropriateness of the rigid concept of permanent endowment might be questioned.

This is the approach suggested by the Trust Law Committee[259] which recognises that contractual liabilities are increasingly being incurred on behalf of trusts whether through borrowing, credit purchases or financial market transactions, and the value of family trusts, commercial trusts and financial trusts is increasing.[260] Whilst noting that a balance needs to be struck between the interests of the beneficiaries and creditors,[261] the committee recommends *inter alia* that it should be tilted more towards the creditors[262] who should have an original primary right of recourse against trust funds;[263] that trustees should have powers to create floating charges;[264] and that these new provisions should apply to all trusts whether family, commercial, financial, private or charitable.[265] It remains to be seen, however, whether and to what extend these suggestions become law.[266]

D. CERTAINTY AND S.O.R.P.[267]

Part VI of the Charities Act 1993[268] sets out the regime for charities in respect of accounting, providing returns and reporting to the Commission and authorises the Secretary of State to make regulations.[269] The latter deal, *inter alia*, with the form and content of accounts; audit or independent examination; the content of annual reports; the statement of financial activities and the format of the balance sheet. The

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[259] *Rights of Creditors Against Trustees and Trust Funds*, April 1997 – consultation paper -published by the Trust Law Committee in association with Society of Trust and Estate Practitioners and Tolley's Law International

[260] *op.cit.* para. 1.1

[261] *op.cit.* para. 1.2

[262] *op. cit.* para. 4.21

[263] *op. cit.* para. 4.4

[264] *op. cit.* para. 4.15

[265] op. cit. par. 4.20

[266] See also discussions in Warburton J., *Charitable Trusts - Unique?*, [1999] 63 Conv. 20

[267] *Accounting by Charities- Statement of Recommended Practice*, Charity Commission, October 1995

[268] Charities Act 1993 ss 41-48 as amended by the Deregulation and Contracting Out Act 1994 s.12

[269] S.I. 1995 No. 2724, *Charities, The Charities (Accounts and Reports) Regulations 1995*

S.O.R.P., the document most likely to be used by trustees and their advisers, outlines the recommended practice based on this primary and secondary legislation as well as providing explanations and glossaries.

As the requirements for separate fund accounting in the Statement of Financial Activities take effect, charities themselves, and their advisors, have to be clear about the source of, and any restrictions on their funds. For the reasons described above, it may be less clear where a charity contracts or has service level agreements as to whether they do, in fact, establish a restriction. This must be a matter of fact in each situation.

Since insolvency brings the possibility of personal liability for the trustees[270] they need to know with clarity whether endowment is expendable. Since the donor's wish is paramount in so far as imposing any special trusts on the donation, trustees offered an endowment might find it useful to suggest wording which permits the endowment to be expended. It is clearly important that the trustees or directors of a charity, as well as third parties, should be aware as to which assets are held on special trusts which would make them unavailable to creditors and of the value of those assets. Charity trustees should be aware of the nature of, and their powers to deal with the charity's property. Without this, it is conceivable that a charity could be seriously technically insolvent but appear to have capital assets which were, in reality, unavailable endowment.

The S.O.R.P. is intended to apply to all charities in the United Kingdom regardless of size, constitution or complexity. This includes charities financed from permanent endowments, public appeals, subscriptions, covenants, trading profits et cetera and which may operate by themselves undertaking charitable activity or by making grants. Where necessary the regulations in the S.O.R.P. should be adapted to meet any statutory requirements which apply to the charity (such as, for example, the Companies Acts) and any requirement imposed by the Charity's own governing

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[270] whether because the association or trust is unincorporated, or perhaps because the directors have been trading wrongfully, or, less likely, fraudulently

instrument.[271] The objective is to improve the quality of financial reporting by charities and to reduce diversity in accounting practice and presentation.[272] Charity trustees are also required to produce an annual report containing prescribed information.[273] First, trustees are, *inter alia*, required to indicate the nature of their governing instrument, identify any specific restrictions imposed by it concerning the way the charity can operate and any specific investment powers.[274] This should at least ensure that trustees seek out this information. Secondly, trustees are required to provide a narrative report which explains how the charity is organised and the activities which it has engaged in through the year.[275]

The accounts should show a true and fair view of the charity's financial affairs[276] which means that they should comply with Statements of Standard Accounting Practice (SSAPS) and Financial Resorting Standards (FRS's) issued by the Accounting Standards Board. These topics are considered in chapters two and ten.

Perhaps the greatest innovation, within the S.O.R.P. itself, is the requirement to account for separate funds. Paragraph 36 states that charities need to account for the proper administration of the individual funds in accordance with their respective terms of trust. To discharge this obligation, the accounts should provide a summary of the main funds, differentiating in particular between the restricted and unrestricted funds.[277] In addition, the charity is required to prepare a Statement of Financial Activities which will analyse all capital and income resources and expenditures and contain a reconciliation of all movements in the charity's funds.[278] Hopefully, third parties and trustees themselves should obtain a clearer picture of the charity's financial position. It is also possible that producing the accounts in this way may show some charities to have been relying on the existence of endowment for their solvency, or for the solvency of a particular set of activities.

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[271] S.O.R.P., – Scope - paras. 6 and 8
[272] S.O.R.P., para. 12
[273] S.O.R.P., para. 26
[274] S.O.R.P., para. 27
[275] S.O.R.P., para. 28
[276] S.O.R.P., para. 5
[277] S.O.R.P., para. 36
[278] S.O.R.P., para. 69

The S.O.R.P. may benefit two groups in particular. First, where a charity is producing accounts in S.O.R.P. format, the trustees should have given serious consideration to the types of funds and trusts for which they are responsible and should have a fairly clear idea which of the property is permanent endowment, restricted funds, general funds etcetera. Secondly, for creditors, the new S.O.R.P. format should at least have put them on notice that all the assets of the charity may not be available to meet liabilities in the event of an insolvency.

E. CONCLUDING COMMENTS:

There is an absence of modern cases (post 1960) probably due to the Charity Commission's concurrent jurisdiction with the High Court on charity endowment.

Practitioners sometimes indicate surprise at the interpretation put upon trust documents by the Commission, only to discover that different staff at the Commission have different views on it. This poses particular difficulties when the question is whether the property constitutes functional land or permanent endowment. The legal complexity of endowment means that there are practical implications flowing from it. For example, it takes time to negotiate with the Charity Commission. A corporate charity may find that mortgagees are overfastidious in their requirement for consents because the directors are not technically 'trustees'.[279] Because of the mystique associated with 'charity' and 'endowment' in particular, it is difficult to distinguish between legal and practical problems in respect of endowment (and some other technical charity areas). The Commissioners are asked for 'solutions' and these will contain both practical and legal guidance. As the legal is not always distinguished from the practical by the Commissioners the law, as expounded by the Commission, is not always clear.

IV. SURPLUS ASSETS

The destination of endowment or other assets surplus after the winding up of a charity is discussed in chapter five.

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[279] Richens N.J., & Fletcher M.J.G., 1996 p.108

CHAPTER 5 : THE DESTINATION OF POST-WIND-UP SURPLUS ASSETS : CY-PRÈS, SCHEME, OR RESULTING TRUST?

I. INTRODUCTION

Following the winding up of a charity there may be surplus remaining, whether endowment or general funds, after the liquidation of assets and the satisfaction of debts and liabilities. Alternatively, there may be a fund arising from an appeal for the establishment of the charity or a particular project which has failed to achieve its target and is being wound up. This chapter explores the destination of such surpluses.

Some of the charities being wound up may be unincorporated associations being wound up in order to pass their assets to a newly established corporate body. Whilst that procedure appears relatively uncomplicated in itself, one of the issues raised in the research is whether a testamentary gift to the unincorporated association would lapse if, by the time of the testator's death, the company to which the unincorporated association's assets had been transferred had already been dissolved. This issue is also explored in this chapter. The avoidance of lapse is also considered in respect of both unincorporated associations and corporate bodies and the application of the augmentation principle is explored in respect of bequests to dissolved corporate charities.

A corporate charity ceases to exist when it is dissolved and removed from the Register of Companies. Until then, even if it is in the process of liquidation, it continues to exist.[1] It may be more difficult to identify the point of ceasing to exist in an unincorporated charity. Clauson J. considered this question in *Re Withall*[2] and said that:

> "if the work of an institution... is being carried on by those who are administering its affairs, without funds, from day to day on such bounty as it

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[1] See e.g. *Re ARMS (Multiple Sclerosis Research) Ltd* [1997] 2 All ER 679

[2] [1932] 2 Ch 236 at 241

> can obtain, when those administrators cease for lack of funds to carry on the work, the work ceases, there are no longer any persons associated for the purposes of the work, and there are no funds dedicated to the work which was heretofore carried on: in such circumstances in a full and true sense that institution in my view has ceased to exist".

In *Re Slatter's Will Trusts* Plowman J. extended the idea to a case where the institution closes down because the need for it has gone, and where it closes down for lack of funds. "Once one finds that there are no funds dedicated to the work which was carried on before the institution closed down, then... the institution must cease to exist in such a way as to cause a lapse in the absence of any general charitable intention."[3]

A charity may have come to the end of its ability to function, may even be operationally insolvent but have an endowment, or be a charitable corporation in liquidation, in which case the charity (the purposes or objects), as an abstract concept,[4] and the machinery or institution by which the abstract concept is manifested, are separable. Whilst the cy-près doctrine and schemes for the administration of charities are generally considered together, cy-près schemes in particular operate to ensure that the assets remain effectually dedicated to the same, or as near as possible, genre of abstract concept (the purposes), whereas schemes for the administration of a charity operate to ensure that the mechanical, institutional, or operational aspect of the charity functions effectively.

Charities with surplus assets after their assets have been liquidated and liabilities met, will probably be those which have come to the end of their practical existence. They might also, for example, be endowed charities which were operationally (mechanically, or institutionally) insolvent because income from endowments, grants, and other sources was inadequate to meet expenditure; charities which, having appealed for funds for a particular project and failed to achieve the target, have decided to wind up; or unincorporated charities which are winding up and transferring their assets to a corporate body.

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[3] [1964] 1 Ch 512 at 527

[4] see e.g. *Re Vernon's Will Trusts* [1972] 1 Ch 300n at 304 per Buckley J; *Re Withall* [1932] 2 Ch 236 at 242; *Liverpool and District Hospital for Diseases of the Heart v Att.-Gen.* [1981] 1 Ch 193 at 215

In the context of this study, there should be no doubt that the organisation being wound up is a charity: its presence on the register provides a conclusive presumption of that,[5] and, once money is effectually dedicated to charity there can be no question of subsequent lapse, or of anything analogous to lapse, whether in pursuance of a general or particular charitable intent.[6] This means that the surplus, effectually dedicated, funds of a registered charity being wound up will be passed on to another charity, in some way whether by cy-près application or scheme. The question of 'effectual dedication' will be considered later in the section on resulting trusts.

It is, however, not always necessary to invoke the Court or Commission' powers in respect of cy-près application of surplus. Many charities' governing instruments which permit their dissolution also make provision in respect of the destination of any surplus. In the absence of such provision, however, or in the event of problems with the provision, it may be necessary to apply to the Commissioners, in the first instance, for a cy-près scheme.

II. FUNDS ARE EFFECTUALLY DEDICATED TO CHARITY

A. THE CHARITY'S GOVERNING INSTRUMENT IS SPECIFIC AS TO THE DESTINATION OF SURPLUS FUNDS

The governing instrument of many charities is specific in respect of surplus funds on winding up. A charity may be specified by name, or the constitution may require the surplus to be given to another charity or charities, usually with similar objects.[7] Those constitutional provisions should be followed unless there are factors that make it impracticable or impossible.

In one of the case studies[8] the constitution of an unincorporated parents' association provided that in the event of it winding up, the surplus assets should pass to the school. But the association was winding up precisely because the school (together

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[5] Charities Act 1993 s.4(1) (which re-enacts Charities Act 1960 s5)

[6] *Re Wright* [1954] 1 Ch 347 at 362 per Romer L.J.

[7] Both the Charity Commissioners *Model Constitution for a Charitable Unincorporated Association* Leaflet GD 3 January 1998, and *Model Memorandum and Articles of Association for a Charitable Company*, Leaflet GD1 January 1998 contain this requirement.

with another nearby) was to close. The association owned a house which was used as a respite care facility for the seriously physically impaired children who attended the school. Although a new school was to be established, the association's members did not want the house to pass to that school because it would probably be sold and the respite facility lost. A further factor was that Social Services Inspectors had advised the association that the building did not meet current requirements. Bringing the house up to scratch would involve more expense than the association could afford. Fortunately, the association had power to amend its constitution. The Charity Commission advised that the constitution be amended, first, so that another charity could receive the house, one which had already agreed to continue the service and upgrade the facilities; and secondly to clarify the mechanism for winding up which was clearly contemplated in the original constitution but for which no mechanism was provided.

B. Where the Governing Instrument does not deal with the destination of surplus

If the constitution does not provide a mechanism for identifying the destination of surplus assets nor for its amendment, it will be necessary to seek the advice of the Charity Commission for a cy-près scheme or a scheme for administering the remaining assets of the charity.

C. Cy-près Application of Assets and Schemes

1. Cy-Près Application

The original rationale for the cy-près doctrine, namely, that giving to charity was an expiation of sin to be rewarded in heaven,[9] incorporating perhaps a notion that if the validity of a charitable bequest was rejected, the court was committing the testator's soul to purgatory, seems a far cry from the application of surplus funds in the winding up of a charity in the twentieth century!

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[8] Case Study 7

[9] See *Att.-Gen. v Lady Downing* (1796) Amb. 571 per Wilmot C.J.

According to Picarda[10] the classic operation of the cy-près doctrine is where there is a failure of the charitable object in question; sometimes the failure is initial, sometimes it is supervening.[11] He quotes[12] the "Restatement of Trusts" as providing the most satisfactory modern formulation of the doctrine despite its being American:

> "If property is given in trust to be applied to a particular charitable purpose, and it is or becomes impossible or impracticable or illegal to carry out the particular purpose, and if the settlor manifested a more general intention to devote the property to charitable purposes, the trust will not fail but the court will direct the application of the property to some charitable purpose which falls within the general charitable intention of the settlor"[13]

That definition, and many of the cases concerning cy-près involve the question of the donor's (usually a testator's) general charitable intention[14] where there is *initial* failure. As this study is concerned with registered charities or organisations capable of being registered, and it is the *destination* of the charity's surplus funds which is being considered, following *Re Wright*[15] and *Re Wokingham Fire Brigade Trusts*,[16] the question whether there had been a general charitable intention is not an issue which needs to be explored here.

The cy-près doctrine is also applicable to the surplus assets of charitable registered companies.[17] In *Liverpool and District Hospital for Diseases of the Heart v Attorney General* Slade J. said that the charity created by the incorporation of the association has not ceased to exist merely by virtue of its being in liquidation. "In my judgement, the court, in the exercise of its jurisdiction over charities, can and should give effect to this provision by directing a cy-près scheme."[18] It should be noted that Slade J was referring to the continuance of the charity because, clearly, as a separate legal entity, the company (the mechanism) was in the process of dissolution.

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[10] Picarda H., 1995
[11] *op.cit.* p.298
[12] *op.cit.* p279
[13] Restatement of Trusts (2d), s.399.
[14] e.g. *Re Rymer* [1895] 1 Ch 19; *Re Slatter's Will Trusts* [1964] Ch 512; *Re Stemson's Will Trusts* [1970] Ch 16;
[15] [1954] Ch 347
[16] [1951] Ch 373
[17] *Re Liverpool and District Hospital for Diseases of the Heart v Att.-Gen.* [1981] Ch 193 at 213 *et seq* referring to *Re Dominion Students' Hall Trust* [1947] Ch 183 and *Construction Industry Training Board v Att.-Gen.* [1973] Ch 173
[18] [1981] 1 Ch 193 at 215 per Slade J.

2. Cy-près Occasions

For funds to be applied cy-près the disposition must be charitable and there must be a cy-près occasion.

Prior to the 1960 Charities Act, there were, in equity, two cy-près occasions, namely where the charitable purpose has become impossible or impraticable to perform. Examples include the obsolescence of a charity for "British slaves in Barbary",[19] or for "infidels in America,"[20] or the effect of the eradication of tuberculosis on a T.B. hospital.[21]

The Charities Acts[22] provides further cy-près occasions:

-where the original purposes have been fulfilled as far as possible, or cannot be fulfilled[23];

-where the original purposes provide a use for only part of the property of the gift;[24]

-where the property available by virtue of the gift can more effectively be used in conjunction with other property available for similar purposes;[25]

-where the purposes are defined in relation to an area of benefit or class of persons which has ceased to be suitable;[26]

-where the original purposes have been otherwise adequately provided for, have ceased to be useful or have become harmful to the community, or ceased to be charitable or ceased to provide a suitable and effective method of using the property available.[27]

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[19] *Ironmongers Co v Att.-Gen.* (1844) 10 Cl. & Fin 908, H.L.
[20] *Att.-Gen. v London Corporation* (1790) 3 Bro. CC 171
[21] See e.g. the facts of *Re Slatter's Will Trust (Turner v Turner)* [1964] 1 Ch 512, although in that case, the charity was held to have ceased and the gift to it lapsed rather than being applied cy-près.
[22] Charities Act 1960 s13, repeated in Charities Act 1993 ss.13
[23] Charities Act 1993 s13(1)(a)
[24] Charities Act 1993 s 13(1)(b)
[25] Charities Act 1993 s13(1)(c)
[26] Charities Act 1993 s15(1)(d)
[27] Charities Act 1993 s13(1)(a)

By virtue of section 13(4)[28] the court may also make schemes for the enlargement of local charities.[29]

The trustee of a trust for charitable purposes has a duty to secure the effective use of charity property, which includes taking steps for it to be applied cy-près where appropriate.[30]

Picarda suggests that, although questions of surplus income are conventionally discussed within cy-près, it is questionable whether all the surplus income cases are properly classified as examples of the application of cy-près except in the limited sense that the court reserves to itself such dispositions to ensure that it is applied as nearly as possible to purposes intended by the testator.[31] He also suggests that confusion has resulted from the use (or misuse) of the term cy-près in situations where there is no question of carrying out the intention of the donor 'as nearly as possible'. He asserts that nowhere is this confusion more apparent than in the cases relating to surplus income. Picarda suggests that the question of whether the testator intended the surplus to go to the very charitable objects which he designated is not a question of cy-près at all.[32] For example, the charity's objects were effectively changed in *Re Dominion Students' Hall Trust*[33] (a registered company) in which the court authorised a scheme removing the 'colour bar'. The court viewed the arrangement as notionally two charities, one for white and one for coloured students, both of which the trust could and should administer together.[34] Such a case would be unlikely to come to court nowadays since a company may now amend its memorandum of association to alter its objects[35] providing that, in the case of a

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[28] Charities Act 1993 s.13(4)

[29] where the purposes are laid down by reference to areas in Schedule 3 of the Charities Act 1993

[30] Charities Act 1993 s.13(5). This is not limited to strictly charitable **trusts** as opposed to charitable companies, {Charities Act 1993 s.97(1)} "trusts" - means the provisions establishing it as a charity whether those provisions take effect by way of a trust or not. See also *Liverpool & District Hospital for Diseases of the Heart v Att.-Gen.* [1981] 1 Ch 193 at 213 et seq. per Slade J and cases referred to in that judgement.

[31] Picarda H., 1995 p.256

[32] Picarda H., *op. cit.* p.280. The extent to which the courts accurately interpret the testator's intention is also considered by Martin J., *Construction of Charitable Gifts*, 38 Conv. 187; Cotterrell R.B.M., *Gifts to Charitable Institutions : A Note on Recent Developments*, 36 Conv. 198; and Hutton J.B.E., *The Lapse of Charitable Bequests*, (1969) 32 M.L.R. 283-301

[33] [1947] 1 Ch 183

[34] [1947] 1 Ch 183 at 187

[35] Companies Act 1985 s.4 as substituted by Companies Act 1989 s.110(2)

charitable company, the Charity Commissioners have given their prior written consent.[36]

D. SCHEMES FOR THE ADMINISTRATION OF A CHARITY

A scheme means "a scheme for the administration of the charity established by that legal authority which was accustomed to establish schemes"[37] namely the court or the Charity Commission, under their concurrent jurisdiction.[38] Cy-pres schemes and schemes for the adminiatrtion of charity are distinguishable.

Cy-près schemes are likely to be introduced where a new mode is desirable for the pursuit of the objects. For example in *Clephane v The Lord Provost of Edinburgh*[39] the fabric of a hospital had been compulsorily purchased by a railway company for which the trustees had received compensation. In a previous judgement the moneys were to be used for the enlargement and maintenance of the charity and a scheme settled, including the rebuilding of the hospital if necessary. The hospital had not been rebuilt and the sick aged and poor had received out-door relief. It was held that the courts could prescribe a new mode for carrying out the objects when the former means became outdated.

Schemes for the administration of charities are likely to be made where the property of the charity remains, but otherwise there are few traces of it and there is uncertainty about the proper operation and administration of the charity. For example, in *Attorney-General v St Cross Hospital*[40] a hospital had been founded in the 12th century. It, with another charity, Noble Poverty, had been managed under the *'Consuetudinarium'* of 1696 under which all the revenues went to the master. Sir John Romilly M.R. said "[a] more barefaced and shameless document than this *'Consuetudinarium'* could not well... be framed, nor could a more manifest and

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[36] Charities Act 1993 s64(2)

[37] *Re Mason's Orphanage & London & North Western Railway Co* [1896] 1 Ch 596 at 603 per Kay L.J. and see also *Att.-Gen. v National Hospital for the Relief and Cure of the Paralysed and Epileptic* [1904] 2 Ch 252 at 258

[38] Charities Act 1993 s.16(1)

[39] (1869) L.R. 1 H.L.Sc. 417

[40] (1853) 17 Beav. 435

probably wilful breach of trust have been committed by the master and brethren"[41] and a scheme was required to settle the charities.[42]

The court[43] and the Charity Commission, under its concurrent jurisdiction,[44] has powers to make schemes for, *inter alia*, the administration of charity[45] and where the court directs a scheme it may refer the matter to the Commission for them to settle a scheme.[46] The Commissioners' jurisdiction may be exercised on the application of the charity, on an order of the court, or on the application of the Attorney General.[47] Where the Commissioners are satisfied that the trustees of a charity ought to have applied for a scheme, but have failed to do so they may proceed to establish a scheme although they do not have the power to alter the purposes of a charity in this situation unless 40 years have elapsed since its foundation.[48] Where the charity trustees are unable to apply for a scheme because of a vacancy or incapacity in the trustees but sufficient of the active trustees make application the Commissioners may proceed to make a scheme.[49]

The Court and Commissioners[50] have power to make schemes in relation to corporations established by charter, (although the scheme does not come into effect until the charter is amended by Her Majesty[51]) and in relation to charities governed by certain statutes.[52] The jurisdiction of the court also extends to any matters not dealt with in the statutory provisions.[53]

The Attorney General may appeal against an order made by the Commissioners under

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[41] (1853) 17 Beav. 435 at 464 per Sir John Romilly M.R.
[42] (1853) 17 Beav. 435 at 468 per Sir John Romilly M.R.
[43] In *Att.-Gen. v Mayor of Bristol* (1820) 2 Jac. & W. 294 at 319/320 Lord Eldon L.C. was in no doubt that the court had the authority to alter the trust in the distribution of increased revenues if it was expedient to do so.
[44] Charities Act 1993 s.16
[45] Charities Act 1993 s.16(1)(a)
[46] Charities Act 1993 s16.(2)
[47] Charities Act 1993 s.16.(4). If the charity has an aggregate income of £5,000 or less, (or such other sum as the Secretary of State orders -s.16(15)) one or more trustees, any person interested in the charity, or any two or more inhabitants of the area may also apply-s.16(5).
[48] Charities Act 1993 s.16(6)
[49] Charities Act 1993 s.16(7)
[50] Commissioners by virtue of their concurrent jurisdiction under Charities Act 1993 s.16(1)
[51] Charities Act 1993 s.15(1)
[52] Charities Act 1993 s.15(3) and Sched. 4.4.
[53] *Re Shrewsbury Grammar School* (1849) 1 Mac & G 324

section 16[54] as may, *inter alia*, the charity trustees[55] providing that it is certified as a proper case for appeal, or with leave of a high court (chancery) judge.[56]

E. SOME CASES CONSIDERED

What follows is a consideration of some of the cases concerning surplus assets after the winding up of a charity.

In *Chamberlayne v Brockett*[57] Lord Selborne L.C. said that when personal estate is once effectually given to charity it is taken entirely out of the scope of the law of remoteness. If the fund should, either originally or in process of time, be or become greater in amount than is necessary for that purpose, or if the strict compliance with the wishes and directions of the author of the trust should turn out to be impracticable, the court has power to apply the surplus, or the whole " to such other purposes as it may deem proper, upon... the cy-près principle."[58]

In *Re Welsh Hospital (Netley) Fund (1921)*[59] a hospital had been provided at Netley to treat the sick and wounded Welsh soldiers of the 1914-1918 war. At the end of the war the hospital closed, its property was sold to the War Office and there remained a surplus of £9,000. It was held that there was no resulting trust for donors but a general charitable intention enabled the fund to be applied cy-près.

In *Re North Devon and West Somerset Relief Fund Trusts* [60] Wynn-Parry J. regarded the decision in the Netley case as binding on him[61] and held the surplus of the Lynmouth flood disaster appeal applicable cy-près.

The Court of Appeal had the opportunity to consider the question of surplus funds in *Re Wright*[62] which concerned a bequest of residue, subject to a prior life interest, to

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[54] Charities Act 1993 s.16(11)
[55] Charities Act 1993 s.16(12)
[56] Charities Act 1993 s.16(13) - requires a certificate of the Commissioners or leave of a High Court, Chancery judge
[57] (1872) L.R. 8 Ch. App. 206
[58] (1872) L.R. 8 Ch. App. 206 at 211 per Lord Selbourne L.C. at 211
[59] [1921] 1 Ch 655
[60] [1953] 1 W.L.R. 1260
[61] [1953] 1 W.L.R. 1260, 1268 per Wynn-Parry J.
[62] [1954]1 Ch 347

set up a trust for a convalescent home for gentlewomen. Following the death of the life interest the trustees questioned whether this constituted a good charitable gift. There was no question of lapse. It was held that once money has been effectually dedicated to charity there can be no question of a subsequent lapse, nor of anything analogous to lapse affecting the matter.[63]

In *Re The British Red Cross Balkan Fund* case[64] the surplus was held to be on resulting trust which does not accord with the later cases of *Re Wright* and *Wokingham Fire Brigade Trusts.*[65] The Red Cross case was not considered in *Re Wright,*[66] was distinguished in the Netley Hospital case[67] and it has been suggested[68] that the former was wrongly decided as the Attorney-General should have been made a party.

On the face of it *Re Stanford*[69] also conflicts with this line of cases. A testator gave consols to Cambridge University 'on trust' for the express purpose of completing an Etymological Dictionary; the surplus was held on resulting trust for the testator. However, on the facts, it was held that the university had only been made trustees for an express purpose, not beneficially.

In *Re British School of Egyptian Archaeology*[70] the situation was complicated by the fact that there were grades of membership (depending on the contributions which had been made) and members were variously entitled to copies of publications which were usually produced annually. The question was whether the funds were held on resulting trust for subscribers (members) or on charitable trusts; if the latter, whether a memorial scholarship in Egyptian archaeology could be established. Harman J. noted that under the regulations all money received was to be applicable to the purposes only.[71] He declared that the funds were held on a valid charitable trust and

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[63] [1954] 1 Ch 347 at 362/3 per Romer L.J. giving the decision of the C.A.
[64] [1914] 2 Ch 419
[65] [1951] Ch 373
[66] [1954] 1 Ch 347
[67] *Welsh Hospital (Netley) Fund (Thomas v Att.-G.)* [1921] 1 Ch 655
[68] Picarda H., 1995 at 337 n2
[69] [1924] 1 Ch 73
[70] [1954] 1 W.L.R. 546
[71] [1954] 1 W.L.R. 546 at 551

referred to chambers to settle a scheme establishing the scholarship.

III. FUNDS NOT EFFECTUALLY DEDICATED TO CHARITY. FAILED APPEALS - RESULTING TRUSTS OR CY-PRÈS?

Having said[72] that once funds are effectually dedicated to charity, there is no place for the resulting trust, it is necessary to consider the position of failed appeals.

A. IDENTIFIABLE DONORS

Re University of London Medical Sciences Institute[73] (Court of Appeal) concerned a legacy to a fund aiming to establish the Institute. The project later proved impracticable and was abandoned. The gift lapsed (see below) but Farwell L.J. explained that "the right of the donor to a return of the money arises when the trust is on the face of it contingent on the proposed institute being called into being."[74] Regarding the money paid over to the fund Kennedy L.J. said "those who received it are trustees for its repayment; so far as regards payments not yet made, they are not now to be made because before they were made the one specific object had been altogether abandoned."[75]

In *Re Ulverston Hospital Fund*[76], in which insufficient funds had been raised, Jenkins L.J. distinguished the *Netley Hospital* case.[77] In the latter the surplus was applied cy-près because, *inter alia*, in the case of initial failure, "the whole of the fund is *ex hypothesi* intact and there has been no effective application of it"[78] and "once the charity for which the fund was raised had been effectively brought into action, the fund was to be regarded as permanently devoted to charity to the exclusion of any resulting trust."[79] The Ulverston fund was held for donors on resulting trust.

Thus it would appear that where an appeal has failed to achieve its target, the funds

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[72] section II above
[73] [1909] 2 Ch 1
[74] [1909] 2 Ch 1 at p8/9 per Farwell L.J.
[75] [1909] 2 Ch 1 at 10 per Kennedy L.J.
[76] [1956] 3 All E.R. 164
[77] *Re Welsh Hospital (Netley) Fund* [1921] 1 Ch 655
[78] *Re Ulverston Hospital Fund* [1956] 3 All E.R. 164 at 172
[79] *Re Ulverston Hospital Fund* [1956] 3 All E.R. 164 at 172

are **contingently**, rather than **effectually** dedicated to charity as there is an implied understanding[80] that donations do not become effectually dedicated to charity until fund raising for the whole project is complete, and by implication, in the event of failure, subscriptions are held on resulting trust for donors.

Other factors may be relevant to the destination of surplus, however. In the *Ulverston Hospital* case counsel for the Attorney General argued in the court of appeal that, although the funds had been raised for the replacement hospital, on the facts, they had been for the general purposes of the existing hospital and secondly for the purpose of benefiting the inhabitants of the area. Jenkins L.J. noted that the *Netley Fund* subscribers, contributing to a mixed fund, would be taken to have known that they were contributing to a general fund, not earmarked, and not intending that the surplus would be returned to them when the immediate object of the charity came to an end. He also distinguished the case on the language of the appeals,[81] although it seems clear that the Netley fund's being effectually dedicated to charity was the major factor. Jenkins L.J. also distinguished *Re Hillier,*[82] another hospital fund appeal. In that case, on construction of the appeal documents, no definable class of donors was entitled to the return of contributions. Evershed L.J., referring to his own judgement in *Re Hillier,* was clear that the fact of anonymous donations would not necessarily mean that gifts would be treated as subject to general charitable intent, but such anonymous donations might perhaps be relevant in determining the general or particular intention of named subscribers.[83]

Clearly, therefore, the construction of the appeal documents and other factors will be taken into account. This is further borne out by *Re Henry Wood National Memorial Trust*[84] which, when initially discussed, was intended to be for Sir Henry to nominate the cause. Funds started to come in at this stage. However, the formal appeal was published later, February 1944, and was then stated to be for the provision of a concert hall. The trusts, declared in May 1946, also included the extension of

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[80] *Re University of London Medical Sciences Institute Fund* [1909] 2 Ch 1; *Re Henry Wood National Memorial Trust* [1967] 1 All ER 238; *Re Ulverston & District New Hospital Building Fund* [1956] 3 All E.R 164

[81] *Re Ulverston Hospital Fund* [1956] 3 All E.R. 164 at 172 per Jenkins L.J.

[82] [1944] 1 All E.R. 480

[83] *Re Ulverston Hospital Fund* [1956] 3 All E.R. 164 at 175 per Lord Evershed M.R.

musical appreciation as well as the concert hall. The fund was inadequate to build the concert hall and the trustees asked whether the assets were held on the trust deed; fell to be dealt with as given for a specific purpose which had failed; were held in trust to provide a music centre; or were held in trust for charitable purposes generally. Stamp J. held that the funds were given for a specific charitable purpose which had failed but that declaration did not extend to monies received before the appeal was formally published in 1944, nor to monies received after May 1946 since the objects in the declared trusts were not confined to the provision of a new concert hall. He declared the assets returnable to donors unless they were unidentifiable or had disclaimed in which case they would be applied cy-près under section 14 of the Charities Act.[85]

B. UNIDENTIFIABLE AND DISCLAIMING DONORS

Section 14 of the Charities Act 1993 provides that property given for specific charitable purposes which fail is applicable cy-près where the donor(s) cannot be identified or cannot be found, or where they have disclaimed.[86] The proceeds of cash collections through collection boxes, lotteries, competitions, entertainments, sales or other similar fund raising activities are conclusively presumed to belong to unidentifiable donors and thus applied cy-près.[87] In addition, the court may also direct that other property be treated as belonging to unidentified donors where it would be unreasonable, because of the amounts, to incur the expense of returning it,[88] or where in the light of the nature, circumstances, amounts and lapse of time since the gifts were made, it would be unreasonable for the donors to expect the return of the property.[89] The donor is treated as having parted with his interest in the property at the time the donation was made. Where, however, a donor not found as a result of the required advertisements and enquiries,[90] comes forward within six

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[84] [1967] 1 All E.R.238
[85] Charities Act 1960 s.14(1) and(2), now Charities Act 1993 s.14
[86] Charities Act 1993 s.14(1). See also *Charities (Cy-Pres Advertisements, Inquiries and Disclaimers) Regulations*, 1993
[87] Charities Act 1993 s.14(3)
[88] Charities Act 1993 s.14(4)(a)
[89] Charities Act 1993 s.14(4)(b)
[90] Charities Act 1993 s.14(1)(a)

months after the date of the cy-près scheme, he is entitled to recover the equivalent sum less any expenses incurred by the trustees.[91]

IV. LAPSED GIFTS AND AVOIDANCE OF LAPSE

A. LAPSE

It is a general rule that bequests to specific organisations which existed at the time the will was made, but had ceased by the time of the testator's death (or the bequest becomes available), lapse.[92] The same basic rule appears to operate in respect of a gift to an incorporated charity that has ceased to exist by the testator's death. This was accepted by Pennycuick J. in *Re Servers of the Blind League*[93] although the point had not been argued before him and in *Re Stemson's Will Trusts*[94] Plowright J. held that a gift to a charitable company which had ceased prior to the testator's death lapsed in the absence of general charitable intention.

In the context of this study the problem of lapse can be significant in a number of areas. Two particular areas were raised by the research.

In Case Study 5 because the unincorporated charity was indistinguishable from its 'mechanism,' it was thought that its winding up could lead to the lapse of bequests which became available subsequent to the dissolution. Similar issues were raised in respect of a merger involving the winding up of three charities, two of which were incorporated, and transfer of surplus assets to a new charity.[95] Clearly, this is a problem which can be anticipated when the dissolution of the charity is being considered and it can be resolved, as it was in Case Study 5, by the establishment of a scheme by the Commissioners.

In one of the cases referred by practitioners, it was suggested that an area of

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[91] Charities Act 1993 s.14(5)

[92] See e.g. *Re Rymer (Rymer v Stanfield)* [1895] 1 Ch 19 - bequest to seminary in Westminster lapsed as training was, by the time of the testator's death undertaken in Birmingham and the bequest was for a particular institution.

[93] [1960] 1 W.L.R. 564

[94] [1970] 1 Ch. 16

[95] Case Study 18

difficulty could arise when an unincorporated charity was wound up in order to become a company limited by guarantee. Would subsequent bequests to the unincorporated charity lapse? It is thought, however, that a greater area of uncertainty in respect of the loss of subsequent bequests might occur when a charitable company has been wound up and its assets are transferred to another charity. These questions are explored below.

The fact of cessation and the the timing of the death and subsequent availability of the bequest can be significant. These matters are discussed in what follows as is avoidance of lapse in respect of gifts to unincorporated associations, and gifts to corporate bodies.

1. What Constitutes Cessation?

It is a question of fact whether or not the charity continues in existence. In *Re Buck*[96] it was held that a friendly society charity with only one surviving annuitant was "moribund" rather than "dead". Consequently, the legacy did not lapse although, as it was not required for the annuity, it was applicable cy-près. Similarly, in *Re Withall*[97] the charity was not operating but the bequest to the Margate Hospital did not fail because the Charity Commissioners had settled a scheme in respect of the hospital although it was not yet binding.

In *Re Slatter's Will Trusts*,[98] which concerned a bequest to a redundant T.B. hospital, Plowman J. compared the situations where the institution has closed down because it was redundant, there were no endowments and there was no further need for its work;[99] with that where the machinery had ceased;[100] and with that where an organisation whose work which, having been carried on without funds, ceases and there is neither anyone doing the work nor funds dedicated to the work – "in a full and true sense that institution... has ceased to exist".[101] He concluded that the

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[96] [1896] 2 Ch 727
[97] [1932] 2 Ch 236
[98] [1964] 1 Ch 512 at 526/527
[99] *Re Slatter's Will Trusts (Turner v Turner)* [1964] 1 Ch 512
[100] as in *Re Roberts* [1963] 1 W.L.R. 406
[101] as described by Clauson J in *Re Withall* [1932] 2 Ch 236 at 241

Malahyde Hospital charity had ceased to exist.

With regard to a registered company, the actual time of dissolution is clear. It would appear that the Charity Commissioners would not remove a charitable company in liquidation (that is, in the process of dissolution but not yet dissolved) from their register.[102] In *Re ARMS Ltd*[103] the charity was in insolvent liquidation (debts totalling £1,466,000) but had not yet been struck off the register of companies. Since appointment, the liquidator had received bequests of £117,208. Did these take effect if the testator's death was after the company went into compulsory liquidation but before it had formally been dissolved? Neuberger J. held that the bequest was for the company and as it was in compulsory liquidation, was available for the creditors. (It would appear that the courts were chosing to benefit the creditors in this case, although the majority of the debt was owed to another charity, an N.H.S. Trust so the decision benefited charity indirectly.)

It is clear that charities are deemed still to be in existence if they have been altered by scheme,[104] even if they have amalgamated and a class of beneficiaries is omitted from the scheme[105] and even if the machinery of the (unincorporated) charity can be terminated.[106] The same applies if the charity has lawfully altered its objects[107] or following statutory re-organisation.[108] The position is different in respect of charitable companies, which have been dissolved. This is discussed separately.

2. The Time of Testator's Death

The time of the testator's death is relevant in relation to whether a gift lapses. In *Re Slevin*[109] the institution had ceased before the legacy was handed over. Nevertheless,

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[102] see *Re ARMS (Multiple Sclerosis Research) Ltd* [1997] 2 All ER 679

[103] [1997] 2 All ER 679 at 685

[104] *Re Faraker* [1912] 2 Ch 488; Re Lucas [1948] Ch 424

[105] *Re Faraker* [1912] 2 Ch 488

[106] *Re Roberts* [1963] 1 W.L.R. per Wilberforce J.

[107] *Re Bagshaw* [1954] 1 W.L.R. 238

[108] *Re Donald* [1909] 2 Ch 410 - legacies to volunteer units which had been re-organised by Territorial and Reserve Forces Act 1907; *Re Morgan's Will Trusts* [1950] Ch 637 hospitals re-organised under National Health services Act 1946; *Re Hutchinson's Will Trusts* [1953] Ch 386, bequest to ENT hospital *which had been re- organised was for the ENT department - funds augmented. See also* Att.-Gen. v Day [1900] 1 Ch 31 causeway maintenance.

[109] [1891] 2 Ch 236

Kay L.J. held that because the charity existed at the testator's death, this legacy became the property of that charity, and on its ceasing to exist, its property fell to be administered by the Crown who will apply it for some analogous purpose of the charity."[110] Kay L.J. was clear that this was not dependent on the existence of a general charitable intention.[111]

B. AVOIDANCE OF LAPSE : GIFTS TO DISSOLVED UNINCORPORATED CHARITIES

In terms of unincorporated associations there are a number of circumstances in which the lapse of bequests can be avoided.

1. General Charitable Intention

Bequests to charities that have ceased may be saved if the testator, on the construction of the will, had a general charitable intention[112] although both Warburton[113] and Picarda[114] suggest that 'paramount charitable intention' is a better description.

Kay J. in *Re Taylor* said:

> "if upon the whole scope and intent of the will you discern the paramount object of the testator was to benefit not a particular institution, but to effect a particular form of charity independently of any special institution or mode, then, although he may have indicated the mode in which he desires that to be carried out, you are to regard the primary paramount intention chiefly, and if the mode for any reason fails, the court, if it sees a sufficient expression of a general intention of charity, will... execute that cy-près...."[115]

Parker J in *Re Wilson*[116] identified two classes of case. First, where the gift is given for a particular charitable purpose but, taking the will as a whole, the paramount

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[110] [1891] 2 Ch 236 at 243 per Kay L.J. (C.A.) giving the judgement of the court. The same point in respect of timing is made in *Re Wright* [1954] 1 Ch 347.
[111] [1891] 2 Ch 236 at 243 per Kay L.J. (C.A.) giving the judgement of the court
[112] The terms 'general charitable intention' and 'paramount charitable intention' tend to be used interchangeably. See e.g. Warburton J., 1995 . p 410 p409 and Picarda, 1995, p 304
[113] Warburton J., 1995 p 410
[114] Picarda H., 1995 p. 305
[115] (1888) 58 L.T. 538, 543 per Kay J.
[116] [1913] 1 Ch 314

intention is to give property, for a general charitable purpose rather than a specific charitable purpose. In that case, though it is impossible to carry out the precise directions, the gift for general charitable purposes will remain and be perfectly good, and the court can direct a scheme as to how it can be carried out. Secondly, if on the true construction of the will, no such paramount general intention can be inferred, and the gift is for a particular purpose which is impossible to carry out, the whole gift fails.[117]

Paramount or general charitable intention "does not merely mean an intention to give to charity generally, without reference to a specified object, but it means an intention the substance of which is charitable whether generally or without any specified object."[118]

2. Gift for Purposes

In *Re Vernon's Will Trusts*[119] Buckley J. held that every bequest to an unincorporated charity without more must take effect as a gift for charitable purposes. This was applied in *Re Finger's Will Trusts*[120] so that a gift to an unincorporated association which had ceased to exist by the time of the testatrix' death was held to be a trust for the purposes of the association and, by analogy, effect could be given to the bequest. This would not be the case had there been something in the will to indicate that the continued existence of the named charity was essential.[121]

3. Augmentation to Funds

In *Re Faraker*[122] it was held that, where a bequest was made to an endowed charity which had been schemed, a subsequent bequest was to be treated as an augmentation to the endowment. This decision was followed in *Re Lucas*[123] in which the home, the

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[117] [1913] 1 Ch 314 at 320 per Parker J
[118] *Re Templemoyle Agricultural School* (1869) IR 4 Eq. 295 at 301 per Chatterton V.-C.
[119] (1962) [1972] 1 Ch 300n
[120] [1972] 1 Ch 286
[121] *Re Vernon's Will Trusts* [1972] 1 Ch 300n at 303 per Buckley J.
[122] [1912] 2 Ch 488
[123] [1948] 1 Ch 424 See also *Re Bagshaw* [1954] 1 W.L.R. 238

subject of the bequest, had been closed before the testatrix' death. It was held that, as her apparent intention had been to contribute to the endowment and not particularly to the upkeep of the home in question, the gift did not lapse but passed to the charity's trustees.[124] A similar outcome occurred in *Re Roberts.*[125] Even though the trust contained powers to terminate the charity, and it is unclear whether there was an endowment, it was held that only the machinery of the trust had wound up, but the purposes continued and the surplus could be administered by a scheme.

4. Conclusions : Unincorporated Associations

Bequests to charities which have ceased to exist by the time of the testator's death may be saved if there is a general charitable intention or the gift is construed as being for the charity's purposes and not dependent on the charity's continued existence. Hutton[126] suggests that in recent years the courts have tended to favour charity and hold that a bequest is for purposes rather than a particular institution. The gift may also be saved if it can be construed as an augmentation to funds which have been schemed or transferred to another charity.

3. Gifts to Unincorporated Charities Which Have Subsequently Incorporated and the Latter Remains in Existence - Are They Lost?

This problem was referred as an area of difficulty by a practitioner.

First, following *Re Vernon's Will Trusts*[127] a gift to an unincorporated charity, without more, is most likely to be treated as a gift for purposes, which would arguably continue through the incorporated body. This view is supported by Luxton[128] who suggests that, interpreted narrowly, Buckley J's judgement in *Re Vernon's Will Trusts*[129] indicates that a legacy to an incorporated charity, dissolved before the testator's death, may be saved from lapse if the dissolved charity had

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[124] see also *Re Bagshaw* [1954] 1 W.L.R. 238
[125] [1963] 1 W.L.R. 406
[126] Hutton J.B.E., *The Lapse of Charitable Gifts* 32 [1969] M.L.R. 283 T 287
[127] [1972] 1 Ch 300n
[128] Luxton P., *Legacies to Charitable Corporations* NLJ Annual Charites Review 1977. p.17
[129] [1972] 1 Ch 300n

originally been formed to take over the assets and liabilities of a previously existing non-endowed charitable trust or association. He asserts that the same principle ought to apply where the legacy is to a charity that has incorporated before the testator's death.[130] It may be helpful to this process if those drafting the articles of such companies ensure that the objects are expressed to take over the assets and liabilities of the particular unincorporated association.

Even if that argument fails and the testator is found to have a general charitable intent the incorporated charity is likely to benefit as a result of the cy-près doctrine, assuming of course that its objects are the same as its unincorporated predecessor.

Thirdly, since most such companies have dispensed with "Ltd" in their names, the issue may never arise if the charity has retained its pre-incorporation name because it is unlikely that anyone administering the testator's estate will realise that there has been a change in legal vehicle. Alternatively, the bequest may be seen as an augmentation of the funds of the former unincorporated association, now in the hands of a corporate charity, (although if the Commissioners are aware of an endowment they will require unincorporated trustees to hold it for the benefit of the purposes carried out by the corporate charity, and that will be the fund augmented if the bequest is to endowment). Again the charity will receive the benefit of the bequest.

Luxton suggests that, even if the incorporated charity has been wound up after the testator's death without a cy-près application of funds prior to that dissolution (if, say, it were struck off as being defunct) undistributed assets will vest in the Crown as *bona vacantia*, but the latter will permit their application for charitable purposes through the exercise of prerogative cy-près.[131]

It is only if the bequest appears to be contingent on the existence of the particular unincorporated charity that the bequest will be lost, and that seems a doubtful possibility.

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[130] Luxton P., *op.cit.* at p.20

[131] Luxton P., *op.cit.* at p.21. He suggests comparison with *Re Slevin* [1891] 2 Ch 236

C. AVOIDANCE OF LAPSE : GIFTS TO DISSOLVED INCORPORATED CHARITIES

The problem of bequests to incorporated charities which have been wound up is clearly of some significance, particularly since the fact of a subsequent bequest does not necessarily form a sufficient ground to have the company's dissolution declared void.[132] In respect of incorporated charities there are a number of circumstances in which the lapse of a testamentary gift can be avoided.

1. General Charitable Intention

It is clear from the cases that a bequest to a charitable company, which has ceased to exist, can be saved if the testator has shown a general charitable intention.[133]

2. Gift for Purposes

If a gift to a dissolved corporate charity is construed as a gift for purposes it may be saved. In *Re Meyers*[134] several bequests had been made to hospitals, some of which were unincorporated, others were corporate, many were misdescribed, all had been subject to the 1946 National Health Service reorganisation and some had subsequently been dissolved. Many of the hospital charities remained in existence, but not as hospitals. Some, including incorporated charities, were virtually moribund although technically still in existence. Harman J. considered that it would be contrary to common sense not to give a like construction to all the gifts and felt that all the gifts must be construed as a gift for the purposes of the hospital in question, which in all cases was being carried on by the governors or the hospital management committees.[135] He continued:

> "it would be a most extraordinary result if, in a few cases in which the testator

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[132] *Re Servers of the Blind League* [1960] 1 W.L.R. 564 - Companies Act 1948 s352, now Companies Act 1985 s.651 by which "Where a company has been dissolved, the court may...on an application made for the purpose by the liquidator [or the Charity Commissioners (Charities Act 1993 s63(3)] of the company, or by any person... interested, make an order, on such terms as the court thinks fit, declaring the dissolution...void"

[133] See *Re Finger's Will Trusts* [1972 1 Ch 286 at 299 and *Re Stemson's Will Trust* [1970] 1 Ch 16 at 22 para. A

[134] [1951] 1 Ch 534

[135] [1951] 1 Ch 534 at 541

> has rightly named the corporate body, these shadows of their former selves should be the only persons who could give good receipt or be entitled to these gifts. It would be, as it seems to me, equally extraordinary if some of the gifts should go, as it were, to the old corporations, some of which are so ancient as to include among their powers ordinary eleemosynary purposes, which are... not hospital purposes.... I do not think it right to produce an effect so confusing and so contrary to common sense.... I am doing no violence to the language which the testator has used, in the context which he has used it, in saying that in every case when he gave money to a hospital he did not regard the fact whether it was corporate or not, but he gave to the work that the hospital was carrying on"[136]

Clearly, this judgement is based on particular and unusual circumstances, but no distinction was made between unincorporated and corporate charities.

It would appear, however, from the reported cases, that it is more difficult to "fix" a purpose on a gift to a corporation than on one to an unincorporated association. In *Re Vernon's Will Trusts*[137] Buckley J. distinguished between gifts to unincorporated and corporate bodies on the basis that a bequest to the former, without more, takes effect as a gift for a charitable purpose whereas a gift to the latter takes effect as a gift to the company beneficially, "unless there are circumstances which show that the recipient is to take the gift as trustee".[138] Nevertheless, he clearly considered that a charitable company was a special case. He considered all of the company's assets were effectually dedicated to charity but a change in the charity's mechanical aspect, that is, the company's winding up, did not involve the charity's ceasing to exist. Buckley explained that his decision was related to the charity's continued existence as a concept and not as a result of construing the gift as for purposes.[139] In *Re Vernon's Will Trusts* the corporate charity had been dissolved and the company struck off the register.

In *Re Stemson's Will Trusts*[140] it was conceded that the gift to the Rationalist Endowment Fund Ltd was not a purpose gift.

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[136] [1951] 1 Ch 534 at 542 per Harman J
[137] [1972] 1 Ch 300n
[138] [1972] 1 Ch 300n per Buckley J
[139] [1972] 1 Ch 300n at 304 per Buckley J
[140] [1970] 1 Ch. 16

The point was again considered in *Re Finger's Will Trusts*.[141] Goff J. commented that had the matter been *res integra* he would have thought there was much to be said for the view that the status of the donee charity, whether corporate or not should make no difference to the construction of the will in these circumstances, but he was compelled to follow the authorities.[142] Whilst Goff J. considered the context of *Re Meyers*[143] absolutely compelling[144] in the finding of a purpose gift, he was unable to find a purpose gift in respect of the corporate body - the mere fact that the residue was given to a number of charities was not a sufficient context.[145]

3. Augmentations to a Fund

Re Faraker,[146] *Re Lucas*,[147] and *Re Bagshaw*,[148] mentioned earlier, concerned augmentation to the endowments of unincorporated charities by bequests. Those charities had been altered by scheme or as a result of statute. In *Re Meyers*[149] although Harman J. found all the bequests, whether to unincorporated or corporate charities, to be purpose gifts, the work of the various recipient charities was continuing and the gifts were in fact specifically in augmentation of endowment funds. Neither *Re Faraker*[150] nor *Re Lucas*[151] were considered in *Re Meyers*.

In *Re Vernon's Will Trusts*[152] Buckley J. specifically excluded the possibility of a purpose gift to a corporation. However, he held that the augmentation principle was applicable equally to a charitable company. Buckley J's reasoning is as follows:

> "The guild was, however, incorporated for exclusively charitable purposes, and its memorandum of association was so framed that its funds could never be distributed among its members and that in a winding up any surplus assets would continue to be applied for objects similar to those of the incorporated

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[141] [1972] 1 Ch 286
[142] *Re Finger's Will Trusts* [1972] 1 Ch 286 at 294 per Goff J
[143] [1951] 1 Ch 534
[144] *Re Finger's Will Trusts* [1972] 1 Ch 286 at 298
[145] *Re Finger's Will Trusts* [1972] 1 Ch 286 at 299 per Goff J
[146] [1912] 2 Ch 488 - gift to endowed charity which had merged by scheme
[147] [1948] Ch 424, gift to a home which had closed but surplus was schemed
[148] [1954] 1 W.L.R. 238 gift to Bakewell & District War Memorial. Hospital endowments transferred on establishment of N.H.S.
[149] [1951] Ch 534
[150] [1912] 2 Ch 488 - gift to endowed charity which had merged by scheme
[151] [1948] Ch 424, gift to a home which had closed but surplus was schemed
[152] [1972] 1 Ch 300n

> guild. Whether and how far it would be right to regard the funds of the incorporated guild as subject to a charitable trust, I do not pause to consider.... Trust or no, however, it is true to say that the assets of the incorporated guild were all effectually dedicated to charity. In no circumstances... could any of those funds have been used otherwise than for charitable purposes of the kind for which the guild existed so long as the purposes remained practicable. Even if those purposes ceased to be practicable, the charity would not cease to exist, although its funds would be applied cy-près. Such a charity, considered as a charity and apart from the mechanism provided for the time being and for time to time for holding its property and managing its affairs, could never cease to exist except by exhaustion of all its assets and cessation of its activities. *A change merely in its mechanical aspect could not involve the charity ceasing to exist. The principle of the decisions in Re Faraker and Re Lucas is...equally applicable to an incorporated charity of this kind as to a charity constituted by means of a trust.*" [153]

Since Buckley J. refused to consider whether the property was held on trust, apart from that held on trusts before the guild was incorporated, it is not clear whether he was using "endowments" in a strict legal sense, or whether he was actually referring to other assets. The fact that he specifically excluded discussion of whether property was held on trust suggests that he did not regard the endowment factor as significant.

In *Re Stemson's Will Trusts*[154] counsel for the Attorney General argued that the augmentation principle was as applicable to an incorporated charity as an unincorporated charity. Plowman J.[155] however, suggested that there would have been a different result had the incorporated guild (in *Re Vernon's Will Trusts*) wound up and transferred its property elsewhere rather than it being compulsorily transferred. "[T]he *Re Faraker* line of cases does not go as afar as that.... I think the true position was... that a charitable trust, which no one has power to terminate, retains its existence despite such vicissitudes as schemes, amalgamations and changes of name so long as it has any funds."[156] This last point sits strangely in the context of *Re Vernon's Will Trust*, since the incorporated guild's memorandum of association contained the provisions usually found in a company limited by guarantee, including the power to wind up. Plowman J. appears to be inferring that Buckley's decision in

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[153] *Re Vernon's Will Trusts* [1972] 1 Ch 300n at 304 per Buckley J. emphasis added
[154] [1970] 1 Ch 16 at 26
[155] [1970] 1 Ch 16 at 26
[156] *Re Stemson's Will Trusts* [1970] 1 Ch 16 at 26 per Plowman J

Re Vernon's Will Trusts was incorrect.

Arguably, it is the capacity of the charity to wind itself up which is potentially problematic. *In Re Roberts*[157] (concerning an unincorporated charity) Wilberforce J. questioned the applicability of the augmentation principle to charities capable of being wound up, but held that in that case only the mechanism was capable of dissolution. The difficulty with a charitable company is that the winding up may be seen as a termination of both the charity and the mechanism. This is considered below in the context of *Liverpool and District Hospital Hospital for Diseases of the Heart v Attorney General.*[158]

Re Stemson's Will Trusts[159] specifically concerned a gift to the, now dissolved, Rationalist Endowment Fund Ltd. Despite its title, it seems unlikely that the fund was, strictly speaking, endowed. Plowman J. described it as "a receptacle for charitable donations on behalf of the Rationalist movement."[160] He held that where funds come to the hands of a charitable organisation, such as R.E.F., which is founded as one liable to termination, and its constitution provides for the disposal of its funds in that event, then if the organisation ceases to exist and its funds are disposed of, the charity or charitable trust itself ceases to exist and there is nothing to prevent the operation of the doctrine of lapse.[161]

Goff J. in *Re Finger's Will Trusts*[162] held that the augmentation point was not open to him so followed the decision in *Re Stemson's Will Trusts*[163] although he noted that the Attorney General had reserved the point should the case go higher.

Liverpool and District Hospital for Diseases of the Heart v Attorney-General,[164] is particularly interesting in that the specific issues associated with winding up a corporate charity under the Companies Acts were explored for the first time. In that

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[157] [1963] 1 W.L.R. 406
[158] [1981] 1 Ch 193
[159] [1970] 1 Ch 16
[160] [1970] 1 Ch 16 at 20 per Plowman J
[161] [1970] 1 Ch 16 at 26 per Plowman J
[162] [1972] 1 Ch 286
[163] [1970] 1 Ch 16
[164] [1981] 1 Ch 193

case Slade J., having quoted Buckley J. in *Vernon's Will Trusts,*[165] said "[I]n my judgement, the same principles are applicable to the present case." He continued "[t]he charity created by the incorporation of the association has not ceased to exist merely by virtue of its winding up.... In my judgment, the court, in the exercise of its jurisdiction over charities can and should give effect to this provision by directing a scheme cy-près."[166]

Slade J. was, of course, referring solely to the continuance of the charity, not of the company as a continuing entity and he clearly separated the charity and its mechanism. If the charity continues sufficiently for its surplus assets to be applied cy-près when it is in liquidation, why then is such continuance insufficient to enable a subsequent bequest to be applied by augmentation?

It is arguable, of course, that in the *Liverpool Heart Hospital* case[167] this was not, strictly, an application of assets cy-près but merely the consequences of the wording of the memorandum of association of the company. This seems unlikely for the following reasons.

Throughout its life, a company owns its corporate property beneficially, and not as trustee[168] but at the moment when it goes into liquidation, the legal and beneficial ownership of the company separate. Whilst the legal ownership vests with the company, the assets become impressed with a trust by which all the assets of the company are to be applied in discharge of the liabilities of the company,[169] cease to be beneficially the property of the company[170] and can only be dealt with by the liquidator.[171] In *Ayerst v C & K Construction Ltd* Lord Diplock said that the authority for the proposition, that the property ceases upon winding up to belong beneficially to the company, had stood unchallenged for a hundred years.[172] Giving

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[165] see text at note 153 above
[166] *Liverpool & District Hospital for Diseases of the Heart v Att.-Gen.* [1981] 1 Ch 193 at 215 per Slade J
[167] [1981] 1 Ch 193
[168] *Re Vernon's Will Trust* [1972] 1 Ch 300n and *Liverpool and District Hospital for Diseases of the Heart v Att.-Gen.*[1981] 1 Ch 193
[169] *Re Albert Life Assurance Co., the Delhi Bank Case* (1871) 15 S.J. 923, 924 per Lord Cairns
[170] *Re Oriental Inland Steam Co* (1874) 9 Ch App 557 at 560 at 559 per James L.J.
[171] The point is also made by Mellish L.J. in *Re Oriental Inland Steam Co* (1874) 9 Ch App 557 at 560.
[172] [1976] A.C. 167 at 180

the judgement of the House of Lords, Lord Diplock distinguished between 'trustee' proper and the role of the liquidator of a company. He said that all that was intended to be conveyed by the use of the expression 'trust property' and 'trust' in these and subsequent cases was that the effect of the statute gave the property of a company in liquidation that essential characteristic which distinguished trust property from other property, namely, that it could not be used or disposed of by the legal owner for his own benefit, but must be used for the benefit of other persons[173] as set out in the statutory scheme.[174] The functions of the liquidator in a voluntary winding up are to apply the company's property "in satisfaction of the company's liabilities *pari passu* and, subject to that application, shall (unless the articles otherwise provide) be distributed among the members according to their rights and interests in the company" and in a compulsory winding up are to "secure that the assets of the company are got in, realised and distributed to the company's creditors and, if there is a surplus, to the persons entitled to it".[175]

Since the 'persons entitled to the surplus' in a charitable company, in which there can be no distribution to members, will be the objects of the charity it can be argued that, at this point, the assets are held for the purposes of the charity. Slade J. had considered *Ayerst v C & K Construction*[176] which suggests that his decision was based on the operation of the cy-près doctrine rather than simply the provisions of the memorandum of association.

It is worth bearing in mind that the assets of a company in liquidation have usually been distributed by the time that it is dissolved.[177] Thus, by the time of dissolution of a charitable company, not only have the charity and its 'vehicle' become separated but the legal and beneficial interests are also separate. When the company which provides the mechanism has been wound up, the charity and its former mechanism are separate. The surplus is, arguably therefore, a fund held on trust for the charity's objects which ought to be available to receive augmentations and the fact that a

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[173] [1976] A.C. 167 at 180 per Lord Diplock, giving the judgement of the House of Lords.
[174] Companies Act 1948, now Insolvency Act 1986 Part IV
[175] Insolvency Act 1986 s143(1) See also *I.R.C. v Olive Mill Spinners* [1963] 2 All E.R. 712
[176] [1976] A.C. 167

company is wound up should have no more effect on the charity's capacity to receive a bequest than it did in *Re Roberts*.[178]

Re Stemson's Will Trust[179] has particular facts. A significant argument for the bequest not following the surplus funds to the Rationalist Press Association Ltd was the fact that the bequest in question was dependent on the existence of Rationalist Press Association, for a specific purpose, namely, a hostel for reduced rationalists, when the Rationalist Press Association Ltd contained no equivalent object and presumably there were no other rationalist charities able to undertake a hostel project.

Unfortunately, the applicability of the augmentation principle to corporate charities did not go to appeal in *Re Finger's Will Trusts*.[180] As neither *Re Finger's Will Trusts*, nor *Re Stemson's Will Trusts*[181] was cited before Slade J. in *Liverpool and District Hospital* case, there remains some uncertainty. This would appear to be an area that could benefit from further research or an airing in the Court of Appeal.

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[177] see Insolvency Act 1986 s201(1) and (2) Note also the side heading to Insolvency Act Chapter IX entitled "Dissolution of Companies After Winding Up."
[178] [1963] 1 W.L.R. 406
[179] [1970] 1 Ch 16
[180] [1972] 1 Ch 286
[181] [1970] 1 Ch 16

CHAPTER 6 : PROPERTY HOLDING IN UNINCORPORATED ASSOCIATIONS

"There are many thousands of these associations in the United Kingdom, with widely differing functions.... Between them they control assets running into thousands of millions of pounds.... Despite these facts, the law relating to the dissolution of such associations is in a most unsatisfactory condition. The cases are contradictory and, even where they have managed to reach common conclusions, their reasoning has often been sparse and confusing" [1]

I. INTRODUCTION

There are a number of areas of difficulty associated with unincorporated associations that are particularly relevant to this study. As Warburton[2] points out, most unincorporated associations are eventually wound up either voluntarily by the members or by order of the court.[3] Given that many terminate their activities each year it is perhaps surprising that there remain so many unanswered legal and practical questions relating to property holding and their dissolution. As this study relates to registered (or registerable) charities at least some of the more general questions relating to unincorporated associations can be excluded. Nevertheless, there remain significant areas of complexity relating to property holding and the distribution of surplus assets, including the circumstances when assets may go *bona vacantia*; member involvement and rights; as well as who are the contributories and priorities for the payment of liabilities in the event of an insolvent dissolution.

Property holding is considered in this chapter. Questions of member involvement and rights are considered in chapter seven and the liability of members or trustees to contribute in the event of insolvency is examined in chapter eight.

One difficulty is that the cases, and the relevant literature (discussed below) seem bedevilled by slipshod use of terminology, particularly the use of "charity" and "charitable" which serves further to confuse the situation. To be a charity, an association must have charitable objects; there must be public benefit and the association must be established for exclusively charitable purposes. For example, in

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[1] Green B., *The Dissolution of Unincorporated Associations* [1980] 43 M.L.R. 626 - 649
[2] Warburton J., *Unincorporated Associations*, 2nd Ed. Sweet & Maxwell 1992
[3] Warburton J., 1992 p.101 see also Green op.cit. p.626

the *Hobourn Air Raid Distress Fund*[4] case, although the objects for which the fund were held were *prima facie* charitable, in the absence of public benefit the fund was not a charitable trust. In what follows therefore, "charity" is used when the objects are charitable and other requisite factors are present, unless reference is being made to the work of other authors.

It has been said that unincorporated associations operate at the interface between the law of contract and trust law and the proprietary questions raised by their dissolution reflect the relationships between those areas of law.[5] The distribution of surplus assets on winding up and dissolution is dependent on, *inter alia*, how the assets were held. A second difficulty is that many of the cases in which the mechanisms for holding property are considered concern the construction (including questions of the donor's intentions[6]) and the validity or otherwise of testamentary gifts.[7] Unless the recipient unincorporated association is charitable, or the association's life can be terminated so as not to breach the rule against perpetuities, such gifts will be invalid.[8] As a result, the decisions reached in the cases may ignore the *inter vivos* property holding realities. Indeed Brightman J., as he then was, commented that it would astonish a layman to be told that there was a difficulty in his giving a legacy to an unincorporated non-charitable society which he had, or could have supported during his lifetime.[9] It is worth noting that non-charitable unincorporated associations are not illegal, they are often established by lay people who know nothing of these rules, and they may apparently be constituted as quasi perpetual associations. There is, however, nothing to prevent *inter vivos* donations to such an association.[10] Law and practice have, therefore, to co-exist and this may have led to the development of

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[4] [1946] 1 Ch 86

[5] Green B., *The Dissolution of Unincorporated Associations* [1980] 43 M.L.R. 626 - 649 p.626. See also Chapters 2 and 3.

[6] Matthews P., *(A Problem in the Construction of Gifts to Unincorporated Associations* [1995] Conv. 302 - 308) notes the impact which the recipient organisation's rules can have on the court's construction of donor's intention and the point is further explored by Gardner (Gardner S., *A Detail in the Construction of Gifts to Unincorporated Associations* [1998] 62 Conv. 8). These discussions relate to non-charities so are not considered further.

[7] e.g. *Re Recher's Will Trusts* [1972] 1 Ch 526; *Re Grant's Will Trusts* [1979] 3 All E.R. 359; *Re Finger's Will Trusts* [1972] 1 Ch 286

[8] e.g., *Re Recher's Will Trusts* [1972] 1 Ch 526; *Re Grants Will Trusts* [1979] 3 All E.R. 359 (Ch.D); *Leahy v Att.-Gen. New South Wales* [1959] AC 457

[9] *Re Recher's Will Trusts* [1972] 1 Ch 526 at 536 per Brightman J.

[10] *Re Recher's Will Trusts* [1972] 1 Ch 526 at 536 per Brightman J.

some legal fictions!

Green[11] argues that, since an association is essentially no more than a simple contractual aggregation of individuals without a separate legal identity, any property beneficially "owned" by the association must actually belong to the members and, as a matter of convenience, it will normally be held by one or more trustees to be dealt with according to the association's rules. The beneficiaries of this trust will be the members.

Clearly, where the association is charitable, its property will be held, usually by trustees, for the association's purposes or objects. Whilst some of the members may receive services from the charity (for example, members of the Royal Society for the Protection of Birds receive a regular magazine) and some may indeed be beneficiaries (for example, some members of a MIND group may suffer mental ill health and attend MIND's facilities), the property of a charitable association is not held on trust for its members and, on dissolution, its property cannot be divided amongst its members *qua* members. It is conceivable, however, that the member charities of, say, a council for voluntary service might benefit from its surplus assets on winding up but *as charities having similar objects* to the C.V.S. (that is, cy-près) not *qua* member.

II. MECHANISMS FOR HOLDING COMMUNAL PROPERTY : CONSIDERATION OF CASES AND LITERATURE

Several mechanisms for holding property have been described.[12] As this study is concerned solely with charitable organisations, the general rules on property holding, and distribution of surplus in the winding up of unincorporated associations will not be discussed at length. The property holding mechanisms are briefly analysed below in respect of active associations generally, as well as those which are charitable, and in respect of surplus funds after dissolution.

Relevant literature and cases relating to the dissolution of unincorporated

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[11] Green, [1980] 43 M.L.R. 626

associations[13] not referred to elsewhere is also considered in the section which follows. Although the property holding mechanisms are considered first, for active associations, and then in respect of surplus funds after dissolution, the mechanisms are continuously numbered.

A. In Active Associations

1. Property Held By The Members As Joint Tenants Or Tenants In Common Or As A Quasi-Corporate Entity

Leahy v Attorney-General N.S. Wales[14] was decided by the Privy Council in 1959. There had been a sharp division of opinion in the High Court, several members of which had viewed the gift in question as being to the individual members for the benefit of the community, whereas the others concluded that it was intended to further the purposes of the organisation.[15] Viscount Simonds suggested that the differing comments in the High Court indicate the difficulty of solving the question which "arises out of the artificial and anomalous conception of an unincorporated society which, though it is not a separate entity in law, is yet for many purposes regarded as a continuing entity and, however inaccurately, as something other than an aggregate of its members."[16] The question of perpetuity was also considered in the context not only of a gift creating an endowment, but in terms of an absolute gift in the nature of an endowment and therefore tending to a perpetuity.[17] This latter point would only prevent the validity of a testamentary gift where the association were not a charity, as in this case.

In *Neville Estates v Madden,*[18] concerning the Catford Synagogue, Cross J. summarised the position on the construction of gifts following *Leahy* as taking effect

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[12] For a general discussion of the various mechanisms regarding the constructions of property holding in trusts see e.g., Warburton J., 1992 pp. 43-53; Hayton D., *Hayton & Marshall : Cases and Commentary on the Law of Trusts*, 10th Ed Sweet & Maxwell, 1998 pp. 199-202; Warburton J., [1985] Conv. 318-327

[13] Green, *Dissolution of Unincorporated Non-Profit Associations* [1980] 43 M.L.R. 626; Rickett C.E.F., *Unincorporated Associations and Their Dissolution* [1980] C.L.J. 88-123

[14] [1959] AC 457

[15] [1959] AC 457 at 476/477 per Viscount Simonds giving the judgement of the court

[16] [1959] AC 457 at 477 per Viscount Simonds, giving the judgement of the court.

[17] *Leahy v Att.-Gen. New South Wales* [1959] AC 457 at 478

[18] [1962] 1 Ch 832.

in one of three ways. It may be a gift to the members of the association as joint tenants in which case a member can, if the rules allow, sever his share and claim it; it may take effect as a gift to existing members subject to their respective contractual rights and liabilities to one another as members of the association; and thirdly the terms or circumstances of the gift may show that the property is held in trust to be applied for the purposes of the association 'as a quasi-corporate entity'.[19] A gift in the third category will fail unless the association is a charitable body. Cross J. held that there was enough to show that "this fund be held for the purposes of the synagogue as a quasi-corporate entity"[20] which he also held to be charitable.

2. Beneficial Co-Ownership With Mutual Contractual Restrictions

Green's[21] view is that members of a non-profit association are beneficial co-owners (either joint tenants or tenants in common of their society's common property) and that any superficial distinction between their apparent rights and those of other co-owners is best explained in the light of mutual contractual restrictions which have voluntarily been superimposed upon the basic proprietory framework.[22] However, he suggests that two principal contractual restrictions on the individual's ownership are fundamental:

> "First...in the absence of an express term to the contrary - a member will be presumed to mandate his share to the purposes of the association...for as long as it continues to function.... Secondly, members have no transmissible interest in their association's property, so that their rights will be extinguished when their membership ceases - except in so far as the association continues to owe a subsisting contractual obligation towards them. Hence as a matter of contract, the interests of past members will be fully satisfied when they have received what they have paid for, and in the absence of an express term to this effect, the courts have been ready to imply one."[23]

The notion of *implied* contractual restrictions, which effectively dispose of the member's share temporarily or permanently, is at odds with the requirements of

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[19] See Cross J.'s comments in *Leahy v Att-Gen New South Wales* [1959] AC 457 at p.849.
[20] *Neville Estates v Madden* [1962] 1 Ch 832 at 851 per Cross J
[21] Green B., [1980] 43 M.L.R. 626
[22] *op. cit.* p.628
[23] *op. cit.* p. 628. He cites *Re St James Club* (1852) 2 De G.M. & G 383 at 387 per Lord St Leonards L.C. as authority for this proposition

section 53(1)(c) of the Law of Property Act, 1925 which requires the disposition of an equitable interest or trust to be in writing and signed by the disposer or his agent. Another view, however, is that the events causing termination of the interest are simply limitations on the extent of the member's interest.

3. An Accretion To The Funds Which Are The Subject Matter Of The Contract Of Association

It has been held that a gift to a non-charitable "outward-looking-purpose-trust" (the Anti-vivisection Society) could be held beneficially as an accretion to the funds which constituted the subject matter of the contract by which the members had bound themselves *inter se*[24] (although in the particular case, the society had been dissolved by the time of the testatrix' death so the gift was void).

Some of the cases[25] refer to "inward looking" and "outward looking" unincorporated associations, the latter being, in effect, void non-charitable purpose trusts. *Re Grant's Will Trusts*[26] concerned a bequest for the benefit of the Chertsey H.Q. of the local constituency labour party. Although the possibility of accretions to the association property and gifts to members was considered, it was held that the gift must be construed as imposing a trust which, not being charitable, was void as it infringed the rule against perpetuities.

4. Funds Mandated To, Or Held On An Agency Basis By A Non-Corporate Organisation

In *Conservative and Unionist Central Office v Burrell (Inspector of Taxes)*[27] the Court of Appeal held that the Conservative Central Office was NOT an unincorporated association for Income and Corporation Tax purposes as there was no contractual bond of union between constituency parties and Members of Parliament. Accordingly, the contributors of funds to this non-corporate association mandated them to the treasurer of the organisation with authority to add the

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[24] *Re Recher's Will Trusts* [1972] 1 Ch 526
[25] e.g. *Re Recher's Will Trusts* [1972] 1 Ch 526
[26] [1979] 3 All E.R. Ch D 359
[27] [1982] 1 W.L.R. 522

contributions to the mixed fund which he holds on an agency basis.[28] Central Office was an administrative unit of the Conservative Party.[29] Some of the difficulty in this decision lay in the fact that the court was unwilling to find that the Party's officers held funds for party purposes as trustees "since the law does not recognise trusts for non-charitable purposes."[30] Arguably, it is non-charitable perpetual funds which the law does not recognise. Brightman L.J. accepted that no problem arose if the contributions were held as an accretion to the funds, the subject of the contract between members but he was unable to identify that contract. The solution decided by the court, with considerable benefit to the conservative party, may work where a contributor consciously mandates funds. The position is less clear where someone (not necessarily party faithful) purchases a ticket in a raffle or for some entertainment. Gardner[31] would argue that such money was given absolutely. Brightman L.J. himself acknowledged that the mandate theory cannot apply to an attempted bequest since "no agency could be set up at the moment of death".[32] It is difficult, therefore, to see how all the funds could be held on a mandate basis.

5. Where The Association Is A Charity

Where the association is a charity, the property of the association will be held, by trustees, for the purposes or objects of the charity.

B. In Respect Of Surplus Funds After Winding Up

The mechanisms discussed so far describe property holding in active associations. Other possibilities occur where an association has been wound up and there are surplus funds:-

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[28] [1982] 1 W.L.R. 522 at 529 per Brightman L.J.
[29] [1982] 1 W.L.R. 522 at 524
[30] [1982] 1 W.L.R. 522 at 528 per Brightman L.J.
[31] Gardner S., *New Angles on Unincorporated Associations* [1992] Conv. 42-52
[32] *Conservative and Unionist Central Office v Burrell (Inspector of Taxes)* [1982] 1 W.L.R. 522 at 530 per Brightman L.J.

6. Surplus Funds Held on Resulting Trust for Donors

In *Re Gillingham Bus Disaster Fund*[33] in 1959, the Court of Appeal held that, as the imperfect trusts could not be validated,[34] surplus funds remaining after the needs of the potential beneficiaries had been satisfied were held on resulting trust for the original donors. This decision has caused considerable difficulty for those winding up the fund, which had been contributed, largely anonymously, from street collections, football matches and other fund raising events.[35] The funds were released by the High Court in 1991. The final memorial to the dead was held 4th December 1993. One of the surviving cadets who had been nine at the time of the disaster was by then aged 51.

7. The Funds Are Ownerless And *Bona Vacantia*

In *Re West Sussex Constabulary's Trusts* case[36] in which members had contributed to a fund for the benefit of their dependants it was held that surplus could not belong to the members since only third parties could benefit and, as the basis of the contributions was contractual, it could not be held on resulting trust for them. As the contract was frustrated, these surplus funds were *bona vacantia*.

However, in Re *Buckinghamshire Constabulary Widows' and Orphans' Fund Friendly Society (No.2)*,[37] concerning a registered friendly society, it was held that where "on dissolution there were members of the society... in existence, its assets are held on trust for such members to the total exclusion of any claim on behalf of the Crown".[38] Walton J held that the distribution would be on the basis of equality if no other method were provided by the contract.[39] It was argued that the fund should be distributed between the members on equitable principles, but Walton J. denied that premise. "The members are not entitled in equity to the fund, they are entitled at law. It is a matter of pure contract, and... completely divorced from all questions of

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[33] [1959] 1 Ch 62 (not a charity)
[34] by virtue of the Charitable Trusts (Validation) Act 1954
[35] "Independent on Sunday" 5.12.1993
[36] *Re West Sussex Constabulary's Widows, Children and Benevolent (1930) Fund Trusts* [1971] 1 Ch 1
[37] [1979] 1 W.L.R. 936
[38] [1979] 1 W.L.R. 936 at 951 per Walton J.

equitable doctrines."[40] In any event, as a registered friendly society, surplus funds would belong to members as the possibility of funds being *bona vacantia* was excluded by statute.[41]

Following the general principle expounded in the *Buckinghamshire* case, it is suggested that surplus funds would be likely to be paid to existing members at the time of dissolution. However, if there are no members, surplus funds may be *bona vacantia*.[42]

C. PROBLEMS, CASES AND LITERATURE

1. Difficulties With The Analyses Of Mechanisms For Holding Property

For reasons rehearsed above, the day to day reality of property holding in non-charitable unincorporated associations appears to be beset by legal fictions and strained definitions.

-If the association's property is held by members as joint tenants, how do new members join subsequently?[43]

-In *Re Grant's Will Trusts*[44] the local Labour Party constituency H.Q. was held by trustees for the Party. Grant's subsequent bequest to the Labour Party property Committee for the benefit of the local H.Q. was held not to be a valid gift as it was construed neither as an accretion, nor a gift to members, but was held to impose a

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[39] [1979] 1 W.L.R. 936 at 952 per Walton J.

[40] [1979] 1 W.L.R. 936 at 953 per Walton J

[41] [1979] 1 W.L.R. 936 at 941 per Walton J referring to Friendly Societies Act 1896 s.49(1) which expressly provides that property must vest. This provision appears to remain unaltered by the Friendly Societies Act 1974 s.116 and Sched 9 cl.1. The rules of an incorporated friendly society must contain provision regarding the entitlement of members to participate in the distribution of surplus assets after payments to creditors, on the winding up, or dissolution by consent of the society.- Friendly Societies Act 1992 c.40 s.5 Sched. 3 para. 5(12).

[42] see *Braithwaite v Att.-Gen.*[1909] 1 Ch 510. See also *Re Brighton Cycling and Angling Club Trusts* [1956] The Times Mar. 7

[43] see Morris J.H.C., and Leach W.B., *The Rule Against Perpetuities (with supplement)*, 2nd Ed, Stevens, 1962 pp.314-315

[44] [1979] 3 All E.R. 359

purpose trust which, being non-charitable, infringed the rule against perpetuities.[45]

-The theory of beneficial co-ownership relies on implied contractual terms at odds with the Law of Property Act.[46]

-The proponent of the mandate theory, Brightman L.J. said:

> "[t]he discussion of mandates and complaining contributors, is all very remote and theoretical. No contributor to central office funds will view his contribution in this way.... He believes he is making an out and out contribution or gift to a political party. And so he is in practical terms. The only justification for embarking on a close analysis... is the challenge... to suggest any legal framework which fits the undoubted facts...."[47]

- The courts have been prepared to validate non-charitable purpose gifts by adopting various constructions. In *Recher's Will Trusts*,[48] a legacy to an anti-vivisection society was construed as an accretion to members' funds subject to the contract *inter se*. In *Re Denley's Trust Deed*,[49] and *Re Lipinski's Will Trusts*[50] bequests which would otherwise have been void for uncertainty were held valid because the beneficiaries could be ascertained. In *Re Denley's Will Trust*, (not concerning an unincorporated association) a limited period non-charitable use of land for a recreation ground for employees and others who the trustees might permit (for less than the perpetuity period) was construed as a trust for employees with a power in respect of other beneficiaries. *Parker and Mellows*[51] questions whether this approach is correct. The author argues that if a provision is framed as a purpose, which appeared to be the case in *Re Denley's Trust Deed*, the purpose is the dominant factor and it should fail if non-charitable.[52] *Re Lipinski's Will Trusts*[53] concerned a bequest of residuary estate to a non-charitable unincorporated association. Oliver J. held this to be a valid bequest because the beneficiaries were ascertainable. The

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[45] [1979] 3 All E.R. 359 at 371-372 per Vinelott J.
[46] Law of Property Act 1925 s.53(1)(c)
[47] *Conservative Association v Burrell (Inspector of Taxes)* [1982] 1 W.L.R. 523 at 530 per Brightman L.J. - the proponent of the mandate theory in that case.
[48] [1972] 1 Ch 526
[49] [1969] 1 Ch 373
[50] [1976] Ch 235
[51] Oakley A.J., *Parker and Mellows, Modern Law of Trusts*, 7th Ed Sweet & Maxwell 1998
[52] Oakley A.J., 1998 p. 115
[53] [1976] Ch 235

practical result of these decisions is the judicial recognition of non-charitable, perpetual purpose trusts.

2. Contradictory Decisions and Confused Reasoning

Green[54] comments that, despite the fact that these associations control millions of pounds between them, the law relating to their dissolution is in a most unsatisfactory condition. "The cases are contradictory and, even when they have managed to reach common conclusions, their reasoning has often been sparse and confusing...."[55]

3. *Davis v Wallington Industries Ltd* : Gardner, *New Angles on Unincorporated Associations.*[56]

In *Davis v Richards and Wallington Industries Ltd*[57] Scott J. explored the hypothetical situation as to how the pension fund surplus, contributed by both employees and employers, would have been dealt with in the absence of an express dissolution clause. Gardner[58] considers Scott J.'s decision. According to Gardner, the key factor is whether the money was given on trust in the first place. As both employees and employers had contributed under contract, they would have paid absolutely so an equal division of surplus would have been expected, with no question of resulting trust and no case for *bona vacantia.*

Scott J. however, would have found a resulting trust and *bona vacantia.* He would have separated the interests of employees and employers. Employees contributed a fixed amount and, when annuities had been purchased to meet this pre-determined provision, they had no further interest in the fund. The employers contractual obligation was "conceptually certain but the amount was inherently uncertain. The obligation was to pay whatever was necessary to fund the scheme."[59] Scott J. thought the employees' contribution unlikely to be adequate to produce sufficient assets for the scheme pension so considered the surplus funds as derived from employers'

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[54] Green B., [1980] 43 M.L.R. 626
[55] op. cit. p.626
[56] Gardner, *New Angles on Unincorporated Associations* [1992] Conv. 42-52, p. 42
[57] *Davis v Richards & Wallington Industries Ltd* [1991] 2 All ER 563
[58] Gardner, [1992] Conv. 42-52, p. 42
[59] *Davis v Richards & Wallington Industries Ltd* [1991] 2 All ER 563 at 593

contributions.[60] Thus they would be entitled to claim the surplus.

Gardner notes that it is possible for trusts to be made under contract, for example *Barclays Bank Ltd v Quistclose Investments Ltd*[61] and, by analogy, extends this to a club making a sponsorship deal with a company. If the payment were absolute the club could change rules and direct money elsewhere and the company would only have a contractual claim for damages. The company might prefer to place the money on trust for the club's purposes with a resulting trust returning its money in the event of failure.[62] Although a similar situation might arise with service level agreements and contracts which charities enter into in respect of care in the community Gardner is, of course, referring to the non-charitable context.[63] He also notes that, as far as the donor is concerned, the contract under which the money is paid to an unincorporated association frequently gives the donor no choice, for example, by the purchase of a raffle ticket, in which case it is paid absolutely, not through a trust.

Gardner suggests that Scott J.'s judgement in *Davis v Richards & Wallington Industries Ltd* decouples the connection between how the money is paid in and how it is treated on dissolution.[64] He suggests the existence of a result-oriented approach as, for example, "in the cases which place a 'preservative construction' on apparently failed charities, such as *Re Roberts*."[65]

4. Rickett : *Unincorporated Associations and Their Dissolution*[66] : A Critique

Rickett's article is germane to this study. He examines three questions of which one, namely, whether there is a special problem concerning charitable associations and their property on dissolution, is relevant here. Unfortunately, his description of a

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[60] [1991] 2 All ER 563 at 594
[61] [1970] A.C. 567
[62] Gardner S., *New Angles on Unincorporated Associations* [1992] Conv. 42-52 p.45-46
[63] See the discussion of *Neville Estates Ltd v Madden* [1962] 1 Ch 832 per Cross J., *Re Church Army* (1906) 94 L.T. 599) and *Re Roberts* [1963] 1 W.L.R. 406 at 413 regarding the use of funds once effectually donated to a charity.
[64] Gardner S., [1992] Conv. 42-52 p.49
[65] [1963] 1 W.L.R. 406 at 413
[66] Rickett C.E.F., *Unincorporated Associations and Their Dissolution* [1980] C.L.J. 88-123

charitable trust[67] in which he discusses a society existing for *exclusively* charitable purposes yet providing for distribution of surplus to members on dissolution is a little confusing at first glance, although he recognises that such a body could not be a charitable trust. Rickett identifies some confusion on the question of certain gifts from outside sources to unincorporated associations, that is, property donated otherwise than by "regular (contractual?) [sic] subscriptions and contributions from the members".[68] He describes such gifts as being of three kinds, namely, to an unincorporated charity (which exists exclusively to promote charitable purposes) without more; to an unincorporated charity directing use of the gift for a non-charitable purpose, or for the personal benefit of members; and to an unincorporated association not existing for charity; but with a direction that the gift be devoted to charitable purposes.[69] (These definitions refer to Rickett's use of 'charity' and 'charitable')

He asks whether these gifts raise presumptions as to how they are held which determine their destination on dissolution and makes a number of points:

(a). Exclusively charitable objects but not a charitable trust

Rickett asserts that a gift to an association existing exclusively for charitable purposes would not necessarily be a charitable gift and refers to the situation in which the members could agree to dissolve the association and divide the property amongst themselves. Arguably, the objects of such an association are not exclusively charitable so the assertion is not strictly correct.

(b). Gifts held by charities, not for the purposes, on dissolution

Rickett notes Buckley J.'s statement in *Re Vernon's Will Trusts*,[70] that every bequest to an unincorporated charity by name, without more, must take effect as a gift for the purpose, not for individuals or an aggregate of individuals. He suggests, however, that this does no more than indicate that the nature of the donee association must be

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[67] *op.cit.* at p. 90
[68] *loc.sit.*
[69] *op.cit.* p.91
[70] [1972] 1 Ch 300n

taken into account when interpreting the donor's intention. Gifts for charity would, in the event of dissolution, go cy-près but, if is it intended that the gift be held in some other way, for example, as joint tenants or tenants in common, he suggests that the outcome may be different at dissolution.

Arguably, the gift is either construed as one for the association, in which case it is a gift for the purposes, or it is a gift for the members in which case it was not a gift for charity and the dissolution of the charity need not necessarily affect the members' fund. For example a convent, as a charity, could cease to exist. Surplus property would go cy-près. The individuals who were previously the members of the charity would continue to be joint tenants or tenants in common of any funds to which they were entitled as the individuals who formed the membership.

Regarding gifts to a charity for non-charitable use, Rickett suggests that such a gift will only be valid if it is a gift for existing members beneficially as joint tenants or tenants in common or on the basis that it is an accretion to the subject matter of the contract of association. This may be the case if it is a testamentary gift but, as Brightman J. recognised[71] an *inter-vivos* donation to a non-charitable association is not invalid *per se*. Neither is Rickett's analysis the only possibility. The trustees of a charity might accept a donation for a non-charitable purpose, for example, to send the staff on a week's holiday to the Bahamas, but they would clearly need to keep such a fund separate from the charitable trust and not attempt to claim charitable tax relief on it.[72]

They might also accept a donation to provide capital for a non-charitable trading subsidiary. Again, the fund would need to be kept separate. In practice, however, the lucky staff would probably be paid for directly by the donor, and the capital would be paid directly to the trading subsidiary.

In neither of these examples would the trustees be holding the gift beneficially and if they were holding the fund as an accretion to the association's funds, they would not

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[71] in *Re Recher's Will Trusts (National Westminster Bank Ltd v National Anti-Vivisection Society Ltd & Ors)* [1972] 1 Ch. 526 at 536 per Brightman J.

[72] Income and Corporation Taxes Act 1988 s.505 applies to charitable income.

be giving effect to the donor's intention because they would then be holding the donation for charitable purposes! Arguably, this problem arises because of Rickett's confused terminology between 'charitable objects' and a 'charity'.

In any event, there is some authority for the proposition that, in respect of contributions to charity, unless it is express, the donor's intention is irrelevant once the property has become part of the charity's funds providing that the purpose to be benefited was within the charity's objects.[73]

(c). A gift to charity for a purpose other than currently being undertaken must create a new charitable trust, rather than an accretion to the existing fund

Rickett provides no authority for his analysis on this point. Whether or not a separate trust is of necessity established must depend on a number of factors amongst which will be the breadth of the objects and powers of the recipient association. If the recipient has wide objects and may accept gifts subject to various trusts a new trust will not be created. If a charity which exists to serve, say, pre-school children were offered a gift to work with teenagers, the trustees might refuse the gift unless they felt that the fund could somehow benefit the children by helping their teenage mothers. This would depend on the terms of the gift. Some charities such as community trusts or foundations have very wide objects and powers, and frequently establish 'field of interest funds' to which donors are encouraged to contribute. Arguably, such a fund, say for care in the community, or youth, would create a separate 'budget' (perhaps a restricted fund), indeed, applications for grants might be considered by separate groups of trustees. The Charities S.O.R.P.,[74] which deals with separate, restricted and endowment funds,[75] makes it clear that such funds should be separately accounted for. In that particular sense, an association holding a restricted fund may be said to be establishing a separate trust.

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[73] *Re Roberts* [1963] 1 W.L.R. 406 at 413; *Neville Estates Ltd v Madden* [1962] 1 Ch. 832 at 860 per Cross J. - following *Re Church Army* (1906) 94 L.T. 599.

[74] *Accounting by Charities : Statement of Recommended Practice*, (S.O.R.P.) Charity Commission, October 1995

[75] S.O.R.P. paras 36,37,38,39

(d). Gift to non-charity for charitable purpose – effect must be given to donor's intention

Rickett argues that effect must be given to the intention of the donor giving property to a non-charitable unincorporated association to use for charitable purposes. Again, he cites cases dealing with testamentary gifts, but fund raising for charity in general or for particular charities by societies such as Lions, or Rotary clubs is perhaps more common. His conclusion, that on dissolution of the unincorporated association such funds would remain for charitable purposes, must be correct because the charitable fund is held on charitable trusts as accepted or understood by the donor and is not therefore part of the members' property, whether or not it is held by trustees, under the contract of association.

This view is reinforced by, for example, *Re Hobourn Aero Components Limited's Air Raid Distress Fund.*[76] Although the question at issue was whether the distress fund was charitable, the members of the fund also made additional voluntary contributions from which donations were made to hospitals, St Dunstan's, Dr Barnardo's and the Red Cross. It is obvious from the judgements in *Re Gillingham Bus Disaster*[77] and *Hobourn Air Raid Distress Fund* that although the funds were not held to be charitable, where charitable funds are held those funds will be applied cy-près or be schemed and will not be available for distribution to members.

Where a non-charitable association holds charitable funds, those funds are not members' property, should be kept separately and should be applied for charitable purposes.

(e). Effect must be given to the donor's intention when a charity is dissolved

Arguably, attempting to assess the donor's intention may actually be unhelpful and impracticable for those attempting to dissolve an association. Donors to

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[76] [1946] 1 Ch 86
[77] [1959] 1 Ch 62

unincorporated charities come in various guises, funds are raised from events, street collections and the like and only a proportion of donations are testamentary gifts. The funds or property may have been contributed many years, indeed centuries ago. Looking to the intention of the donors potentially raises the problems of the 'resulting trust' cases such as the *Gillingham Bus Disaster Fund*[78] and it may be impossible to construe the intention. At least, where gifts are testamentary, testators themselves will probably have been clear as to their intention (even if the courts are unsure later) but what is the precise intention of a donor responding impetuously to a heart rending appeal on the radio or in the local newspaper, beyond a general intention to benefit the purposes for which the gift was sought?

Many modern charities (post the 1960 Act in particular) are established and registered without endowment, before their funding is fully established and many charities such as playgroups and Parent Teacher Associations are unlikely ever to become endowed.[79] Many rely for their funding on grants in aid and, more recently, on service level agreements and contractual arrangements with public bodies such as local authorities, health authorities and N.H.S. Trusts, and Training and Enterprise Councils.[80] These latter arrangements are legally very different from donations, and there may well be absolutely no charitable intention present - a service is being purchased. The service so purchased, however, must be one which it is competent for the particular charity to provide[81] so, arguably, the funds are caught for the charity.

In any event, the trustees of an association that is exclusively charitable are obliged to register with the Charity Commissioners.[82] Once the funds are effectually dedicated to charity and held by trustees, then at dissolution, the intention of the donors is irrelevant and the Charity Commissioners will provide supervision or guidance even

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[78] [1959] 1 Ch. 62

[79] In 1993 12,559 new charities were registered with the Charity Commission of which 3,326 were women's Institutes; 2,736 were pre-school playgroups; 1172 were Parent Teacher type associations ([1993] Ch. Comm. Rep.).

[80] see chapter 1 'contract culture' and chapter 10

[81] CC37, *Charities and Contracts*, Charity Commission, October 1998, para. 14

[82] Charities Act 1993 s.3 unless it is exempt, excepted, has no permanent endowment, nor use or occupation of land and whose income is less than £1,000 from all sources; or is a registered place of worship.

where the charity is not registered[83] to ensure that surplus funds on dissolution will go cy-près. Only if the fund is not effectually dedicated to charity, perhaps because a charitable appeal has failed to achieve its target, will any surplus funds go on resulting trust, but even then the contributions of disclaiming or unidentifiable donors will go cy-près.[84]

III. THE DISTINCTION BETWEEN UNINCORPORATED ASSOCIATIONS AND CORPORATE BODIES IN RESPECT OF HOLDING PROPERTY

A. UNINCORPORATED ASSOCIATIONS AND COMPANIES

In *Re Vernon's Will Trust*[85] the distinction was drawn between gifts to unincorporated associations and corporate bodies.

> "Every bequest to an unincorporated charity by name without more must take effect as a gift for a charitable purpose, viz., that charitable purpose which the named charity exists to serve.... A bequest to a corporate body, on the other hand, takes effect simply as a gift to that body beneficially, unless there are circumstances which show that the recipient is to take the gift as trustee."[86]

In *Re Finger's Will Trusts*[87] the same distinction was drawn.

In *Liverpool and District Hospital for Diseases of the Heart v Attorney-General*,[88] concerning the legal consequences of winding up a charitable company, Slade J. concluded that a charitable company holds its assets beneficially unless it is holding assets as trustee for another individual, organisation or purposes. Property holding and the question of trusteeship in companies were considered further in chapter four. This distinction in property holding between unincorporated associations and corporate bodies has implications in respect of post wind-up bequests and was explored further in that context in chapter five.

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[83] Charities Act 1993 ss.1, 8, 16, 18, 19, 26

[84] see chapter 5 - destination of surplus assets

[85] [1972] 1 Ch 300n

[86] [1972] 1 Ch 300 at 303 per Buckley J. The distinction also proved relevant in *Re Stemson's Will Trusts* [1970] 1 Ch 16. See also *Re Servers of the Blind League* [1960] 1 W.L.R. 564

B. TRUSTS, INCORPORATED TRUSTEES AND COMPANIES

The property of a trust is in the legal ownership of one or more trustees who hold it for the benefit of the objects of the trust.

The trust remains central where trustees are incorporated. Such a trust is not destroyed by dissolution. Surplus assets remaining at the dissolution of an incorporated trust[89] remain vested in unincorporated trustees,[90] who then re-assume the rights and liabilities as trustees. This is quite different from the dissolution of a company that ceases to exist when it has been dissolved.[91]

IV. PROPERTY HOLDING IN CHARITIES : THE OVER-SIMPLISTIC TRUST?

A. THE COMMON GROUND

In an unincorporated charity property will be held by trustees for the purposes of the association and in other types of legal vehicle there will be at least some element of a trust. This is confirmed by the Charities Act, which states that the persons who have general control and management of the administration of a charity are charity trustees,[92] at least for the purposes of the Act. By extrapolation trustees hold property for beneficiaries. In an unincorporated charity, particularly a service provider rather than a grant maker, there may be charitable objects rather than human beneficiaries, so the trustees hold the property for the charitable objects.

In a corporate charity, the company holds its property beneficially[93] but for the furtherance of its purposes.[94] An inanimate entity, suitably veiled, requires human agents, namely, its directors and employees and, in a charity, the directors are

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[87] [1972] 1 Ch 286
[88] [1981] 1 Ch. D. 193
[89] Charities Act 1993 s.61(3)and (5)
[90] Charities Act 1993 s.61(3)
[91] Insolvency Act 1986 ss.201, 202, 203, 204
[92] Charities Act 1993 s.97
[93] *Liverpool and District Hospital for Diseases of the Heart v Att.-Gen.* [1981] 1 Ch.D. 193

required to act in the best interests of the company, that is, for its objects.[95]

B. Some Complications

Property holding in unincorporated associations is complex even if the structure is a 'simple' trust. Further complications may arise, however, either from constitutional peculiarities of that particular organisation, or because the charity has endowment or restricted funds.

1. Constitutional Peculiarities or Complex Structures

Whilst it is clear that the trust relationship is central to property holding, particularly in relation to unincorporated associations, that relationship may also be overlaid by other relationships considered earlier in this chapter that may result from constitutional peculiarities. For example, an ecumenical religious charity,[96] which is an unincorporated association, is the umbrella body for the Churches in its locality. Each denomination in the area has a representative on the executive committee, which oversees the charity's work, holds the charity's funds. Apart from a team of 'ecumenical officers', the charity engages in social welfare provision, runs a Christian bookshop, and has two wholly owned subsidiary companies which are limited by guarantee. Each member of the team of ecumenical officers, most of whom are clergy, is employed by one of the denominations and seconded wholly or part-time to the charity. The heads of the denominations (Bishops, Moderators, and the like) form the Advisory Body to which the executive committee must refer certain matters, which sets the agenda at least for the ecumenical part of the work of the charity, and which expresses its views with considerable clarity from time to time in respect of the charity's other activities. This description perhaps demonstrates the possibility that there may be a question (which it is not proposed to discuss further) of an agency relationship between some of the actors in this scenario in respect of some of the

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[94] The company's memorandum and articles of association, taken with Companies Act 1985 s.35 as restricted in s.35(4) and see also Megarry V.-C.'s judgement in *Estmanco (Kilner House) v G.L.C.* [1982] 1 All E.R. 437

[95] see also Megarry V.-C.'s judgements in *Estmanco (Kilner House) v G.L.C.* [1982] 1 All E.R. and *Gaiman v National Association for Mental Health* [1971] Ch 317

[96] author's knowledge

work.

Similarly, the constitutional arrangements of charitable schools can be complex with trustees, governors, subsidiary (for example, prize) funds and the like.

2. Restricted or Special Trust Funds

In both unincorporated and corporate charities, the same trustees (or directors if a charitable company) may also hold property on special trusts or restricted funds. The type of legal vehicle is then immaterial in the sense that the special property is likely to be held by the individual trustees for the objects within the special or restricted trusts or, as is explored in chapter four, a charitable company may itself be trustee. The more specific problems associated with the holding of land and endowments are considered in chapter four.

Thus the original objects-trustee relationship has been overlain by a subsequent relationship. The second relationship may be a further trust (as where there is property on special trusts – usually endowment) or the additional relationship may be created by some kind of agreement. Loose wording is deliberately chosen here because the restriction on funds may be created by a contract, which the law can recognise[97] or it may be established by a service level agreement whose legal provenance would appear to be less certain.[98] This 'restriction' may not be the motivation of, say, local authorities which establish contracts with charities, but it could appear to be the result of such arrangements, whether or not that is appropriate. All of this may have a bearing on which assets can be available for distribution to creditors if the charity is wound up insolvent. The availability of different types of funds to meet liabilities is discussed in chapter four.

From the forgoing it is clear that the mechanism, or mechanisms, for property holding in an unincorporated association are more complex than in a company. The latter

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[97] e.g. *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] A.C. 567

can, however, be complicated by virtue of the charitable overlay, particularly where endowments are concerned, with questions such as whether that property is held by the directors as trustees, or whether the company is trustee.

CHAPTER 7 : RECALCITRANT MEMBERS AND TRUSTEES

One of the recurrent themes concerning charities in difficulties is the effect that refractory members or trustees can have on an organisation, particularly when they are intransigent in attitude and will not 'give way' to the majority. This chapter explores this problem and considers the circumstances in which a charity may take the serious step of expelling members or considering the removal of trustees.

I. ROLE OF MEMBERS IN A CHARITY

Although the members of a charity can play a very valuable role in its life and work, it is also clear that internal disputes and disaffected members can substantially hinder a charity's work, possibly leading to its winding up or insolvency.

The positive aspects of membership will be briefly explored, the problems created by disaffected members will be considered, and some possible solutions will be discussed.

A. POSITIVE ASPECTS OF MEMBERSHIP INVOLVEMENT

It can be argued that members of both corporate charities and charitable unincorporated associations fulfil a number of positive functions.

1. They Encourage User Involvement And Provide Support

Many charities identify the need for a membership. Some charities recognise that a substantial membership demonstrates public interest in their particular cause and gives them 'weight' when negotiating with large organisations or public authorities.[1] Other charities claim a representative role for themselves and need to evidence this by a membership.[2] In the present climate, in which user involvement and participation is considered important, a membership consisting of at least some service users can be significant with potential funders as well as bringing the services provided by the

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[1] e.g. the Royal Society for the Protection of Birds million members campaign

charity nearer to beneficiaries. Some charities are concerned to extend this member (beneficiary) involvement to their committees or trustee bodies. For example, both SCOPE (formerly Spastics Society) and Action for Blind People have restructured their committees in order to include disabled or blind people.[3] A very important function of a membership in most charities is, however, to provide support as voluntary workers or through donations.

2. Guardians Of The Objects And The Constitution

It is clear that the membership, as the body that must receive annual reports and accounts, is in a very good position to identify possible abuses or malpractice and, if necessary, contact the Charity Commission, or otherwise seek legal redress. To that extent, at least, they act as supervisors of the charity trustees.

It is usual for the members' consent to be required to any change in the charity's constitution. As a majority of them (and usually considerably more than a simple majority) must agree before the constitution can be amended, they also have a role as guardians of the association's objects and constitution.[4]

3. Financial Support

Membership and membership growth may be important for the financial viability of the organisation.[5] In 1995, the Community Sector Observatory survey results indicated that 41% of community organisations'[6] funding came from members' subscriptions.[7]

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[2] e.g. councils for voluntary service

[3] author's knowledge

[4] See e.g. Warburton J., *Charities, Members, Accountability and Control* [1997] 61 Conv. Mar/April

[5] See Harris M., *Games Members Play ; Re-writing the Rules of Association*, NGO Finance, April 1998 p. 26 for discussion of the unique characteristics of membership associations.

[6] i.e. working in an immediate locality... basically self reliant... self-sufficient, controlled... by volunteers, unpaid workers, users, members, or the wider community (Humm J., "The Size and Scope of the Community Sector", *Dimensions of the Voluntary Sector 1997 Edition*, Ed. Pharoah C., and Smerdon M., Charities Aid Foundation, 1997 p. 81)

[7] Humm J., "The Size and Scope of the Community Sector", *Dimensions of the Voluntary Sector 1997 Edition*, Ed. Pharoah C., and Smerdon M., 1997 p. 82

B. NEGATIVE ASPECTS OF MEMBERSHIP

Unfortunately, the interventions of members are not always helpful. It is obvious from comments in many of the Charity Commission Annual Reports[8] and from many of the cases identified during the course of this study that individual and groups of members can create problems for charities which may have serious results. An organisation which is putting a significant amount of its energy into the management (or mismanagement) of internal disputes is likely to get into other difficulties as well.

Adverse gossip and litigation lowers the parties, and indeed charity generally, in the eyes of the public on which charity depends for support.[9] Volunteers are less likely to be attracted to an organisation which has internal strife (after all they are forgoing their leisure time to undertake this activity) and committee members have to be extremely committed to the organisation to remain involved and sort the problem out – if it can be resolved. They too can find other, less stressful, hobbies!

The management of the organisation may be stultified by deadlock if opposing factions refuse to budge from entrenched positions.

Member disputes may result in litigation. The charity is likely to seek the Commissioners' authority to incur legal expenses but, in bringing or defending an action, expense will be incurred which may not be covered by legal expenses insurance even if the charity has such a policy. Thus the charity's resources will be further depleted. Litigation is also likely adversely to affect the morale of trustees, which again puts the organisation at a disadvantage. This situation is made even worse if the member's litigation is intended to oppose a rescue plan.[10] Whilst attention is distracted by the dispute, funding opportunities may be missed, service developments may not take place, or worse still, the service standards may fall. As a result of this the organisation may cease to be financially viable. Opportunities for

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[8] e.g. [1985] Ch. Comm. Rep. para. 72 p. 24 [1996] Ch. Comm. Rep. pares. 146-152 (general discussion) and para. 173 (Re C.L.I.C.)

[9] *British Diabetic Association v Diabetic Society Ltd* [1995] 4 All E.R. 812 at 818 per Robert Walker J.

[10] see e.g. Brooks v Richardson & Ors [1986] 1 WLR 26

rescue are considered in chapter three[11] and chapter nine.

In the Legal Structures for Charities Survey[12] 53 organisations (9.4% of respondents) reported disputes over members' rights but 256 charities (46%) had a procedure for settling disputes. Given that 5.7% of the respondents were industrial and provident societies[13] or friendly societies in which there is a statutory procedure for dealing with disputes, this means that around 40% of the respondents with other types of legal vehicle had such a procedure. A similar number (251) had a procedure for removing members' rights and 139 (39.4%) organisations would like a power to remove members.

II. Examples of Disputes and Their Effects on The Charity

A. A Local Mental Health Organisation[14]

This organisation had a high profile, good reputation, was delivering excellent day care service, and attracted high calibre trustees. A service-user, member, took exception to a minor policy change. The constant bickering and bad atmosphere at committee meetings and at the day centre (which was extremely bad for beneficiaries) had a number of effects. First, the various statutory bodies entitled to nominate, sent subordinates to committee meetings rather than the senior staff who had hitherto attended. The clients left and went elsewhere (or nowhere). The chair (who held a very prominent position in the community) resigned and whilst subsequent chairs have been very committed none has been so influential. The centre manager became ill (stress and exhaustion) and eventually resigned. All of this happened more than 10 years ago, but the organisation has never been able to regain its previous respect locally. This has been reflected in its funding and staffing and it has limped along rather than being the vibrant organisation it once was.

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[11] statutory rescue opportunities under the Insolvency Act 1986
[12] Charity Law Association/ N.C.V.O./ University of Liverpool Charity Law Unit 1995
[13] Industrial and Provident Societies Act 1965 s.60.
[14] personal knowledge of author

B. THE ROYAL MASONIC HOSPITAL

One of the features of the Royal Masonic Hospital saga was ongoing disputes between one or two members and the rest, evidenced, for example, by *Brooks v Richardson & Ors.*[15] Richardson was the chairman of the trustees of the Royal Masonic Hospital. At the time the action was brought, 1986, the trustees were aware that the institution was running into difficulties and an extraordinary meeting had been called at which a resolution to sell the hospital as a going concern was to be put. Brooks, a member of the association, brought this action in an attempt to prevent the sale. His motion also challenged the qualification of the chairman to act as a member of the board of management of the institution. He had previously sought to put a resolution of no confidence seeking the resignation of the trustees to the annual general meeting which had been refused and also sought a declaration that the defendants were not entitled so to refuse. Brooks claimed that the constitution of the association created a contract between the subscribers, which he sought to enforce. Warner J. held that there was, in fact, no contract between the members and that any rights which a member acquired a result of his membership were not contractual rights but rights to take part in the government of the charity for the benefit of the charity. Unfortunately, this was not the end of the matter and, in early 1994, the Charity Commissioners used their, then, new powers to appoint a receiver and manager of the charity.[16] In an unrelated charity case[17] Robert Walker J. commented adversely on the numerous reported and unreported cases concerned with the Royal Masonic Hospital.

The eligibility of members to litigate is considered later.

C. N.A.M.H.

The tale of the National Association for Mental Health's problems with members[18] is also salutary, and suggests that charities may need safeguards in respect of those who

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[15] *Brooks v Richardson* [1986] 1 WLR 26

[16] [1993] Ch. Comm. Rep. para 64

[17] *Scott & Ors v National Trust for Places of Historic Interest or Natural Beauty & Or* [1998] 2 All ER 705 at 715 per Robert Walker J.

they accept into membership. A sudden influx of applications for membership prior to an A.G.M., which was to be held in November 1969, eventually alerted the association to the possibility of a take-over by Scientologists, with whom the association had previously crossed swords, particularly when some of those new members put themselves forward for election to key office. Fortunately the association was a corporate body whose articles of association envisaged that members might be asked to resign. The plaintiffs (who had been asked to resign) claimed rights of membership and sought an injunction on the morning of the annual meeting to prevent it being held without allowing them to be present and vote. Megarry J., as he then was, granted an *ex parte* injunction restraining the association from holding the meeting except for the purpose of adjourning it and it was not until 25th March 1970 that the motion was heard at which the application for interlocutory relief was refused.[19]

D. R.S.P.C.A. AND NATIONAL TRUST

Similar dissent amongst the membership occurred when the R.S.P.C.A. introduced a policy against blood sports and more recently the National Trust[20] encountered problems over its decision to ban deer hunting with hounds on its land. The Trust took the decision at it's A.G.M. in April 1997. Subsequently, some of the members, together with other interested parties sought to challenge the decision through judicial review. That was refused, but was followed by proceedings by 'persons interested.' Subsequently the Trust council's decision was confirmed. However, at the A.G.M. held on 7th November 1998, described as "one of the most ill-tempered annual general meetings in the trust's 103 year history",[21] a rebel group of Trust members unsuccessfully sought election to the Council claiming that the new Trust policy was causing bequests of land and property to dry up. The dissident members reportedly filled up most of the 2,000 seats but the postal votes, many of which gave a blank proxy to the chairman, carried the vote. The Trust's council was reportedly

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[18] *Gaiman v National Association for Mental Health* [1971] 1 Ch 317
[19] *Gaiman v National Association for Mental Health* [1971] 1 Ch 317 at 339
[20] *Scott & Ors v National Trust for Places of Historic Interest or Natural Beauty & Or* [1998] 2 All ER 705
[21] Hornsby M., *National Trust Stag Ban 'Drives Away Donors,'* The Times, 9.11.98

accused of being over bureaucratic and sanitising and packaging the countryside to suit the prejudices of its urban membership!

E. THE DIABETIC ASSOCIATIONS

The dispute between diabetic associations[22] demonstrates similar problems. The acrimony, "the context and flavour of the case,"[23] which developed between members, led to the establishment of another organisation, leaving a trail of litigation in the form of a libel action, and an action for passing off. There had also been campaigns of letters to the press and suggestions that local volunteers were ineffective.[24] It is interesting that a receiver and manager was placed in the second charity set up as a result of this dispute in 1997 when trust assets were seemingly 'expatriated' to purchase property abroad.[25]

F. LOCAL SPORTS CLUB FOR DISABLED[26]

A club established to encourage sporting activities by young people with physical or mental impairments, which had no power to expel members, was forced to close and start again as a Gateway group[27] because one of its adult members persistently failed to comply with club rules and influenced less mentally able members against any proposed change to the rules regarding expulsion or disciplining of members.

G. RESEARCH EXAMPLES

Further examples of member disputes are contained in chapter eleven where internal factors are considered. Several of the corporate charities removed from the register referred to a problem of this type and present unfortunate tales. One referred to "almost a year of staffing problems" and members of the management group disappeared.

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[22] *British Diabetic Association v Diabetic Society Ltd* [1995] 4 All E.R. 812
[23] [1995] 4 All E.R. 812 at 816 per Robert Walker J.
[24] [1995] 4 All E.R. 812 described at 817-818 per Robert Walker J.
[25] Case Study 20
[26] author's knowledge
[27] national association of youth groups for people with learning difficulties

III. CHARITY COMMISSION AND COURT'S VIEWS ON DISPUTES

Over the years the Annual Reports of the Charity Commissioners have commented on this type of dispute.[28] In 1985 the Commission commented that these disputes are particularly time-consuming where the accuser becomes obsessive and is unwilling to let the smallest matter rest.[29]

In 1996 the Charity Commission again expressed concern about disputes and began research to identify 'early warning' signs. They commented "[d]isputes are amongst the most intractable problems that come our way. They are demanding of resources, both ours and the charity's, demoralise those involved and, if conducted in the public arena corrode confidence in charities".[30] They add, "[i]t is clearly regrettable that any charity should have to use its charitable funds to settle a dispute...."[31]

The judiciary is often critical of dispute litigation. In 1869, Lord Hatherley was very censorious of the conflict "which a little good humour, joined to the great intelligence which I have no doubt, is possessed by the parties, might easily have prevented" in *Clephane v Provost of Edinburgh*.[32] Megarry J. hinted at criticism of the National Association for Mental Health in 1971, when he commented that had the council of the association not admitted over ten times the usual number of members in one month the need for wholesale expulsions would probably never have arisen.[33] In the *National Trust* case in 1998, Robert Walker J. said " [i]t is most regrettable that this very expensive and time-consuming litigation should have occurred between two groups both of which... share many admirable aims."[34]

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[28] e.g., [1985] Ch. Comm. Rep. para. 72; [1996] Ch. Comm. Rep. paras. 146-152; [1998] Ch. Comm. Rep. p.15-16

[29] e.g., [1985] Ch Comm Rep. para. 72.

[30] [1996] Ch. Comm. Rep. 1996 para. 146

[31] [1996] Ch. Comm Rep. 1996 para. 150

[32] (1869) L.R. 1 H.L. Sc 417 at 418 per Ld. Hatherley L.C. Adverse criticism was also expressed of the dispute in *British Diabetic Association v Diabetic Society Limited* [1995] 4 All ER 812, 818 per Robert Walker J.

[33] *Gaiman v National Association for Mental Health* [1971] 1 Ch 317 at 339 per Megarry J.

[34] *Scott & Ors v National Trust for Places of Historic Interest or Natural Beauty & Or* [1998] 2 All ER at 705 at 719

IV. MEMBERS' CAPACITY TO LITIGATE

A. MEMBERS RIGHTS GENERALLY

As Warburton points out[35] charities are public bodies. The notion of member-power or member-rights is inimical to that public character and opposed to the hope of benefit for beneficiaries.[36] The position of members' rights and roles in a charitable company is much clearer than in an unincorporated association, despite the fact that many of the corporate rules have been developed with shareholders and the profit motive in mind.

B. CHARITABLE COMPANY AND MAJORITY RULE

The principle of majority rule is central to company law. As a general rule, the courts will not interfere in the management of a company at the instance of dissatisfied members, because the proper party to bring an action is the company.[37] There are, however, several exceptions. For example, a member may bring a representative action (on behalf of himself and others) to restrain the company from committing an *ultra vires* act;[38] from breaching a provision in the company's memorandum and articles of association; or to enforce the company's rights. There are a number of important exceptions to the principle of majority rule, some of which are more likely to be applicable in a commercial context.[39] However, these may have some application in a charitable setting. For example, in a not-for-profit company, it may be a fraud on the minority (although not *ultra vires*) if the majority attempts to stultify the purposes for which the company is formed.[40] Warburton suggests that there may also be an exception to the rule in *Foss v Harbottle* "where justice demands that an action be brought".[41] She suggests that the special nature of a charitable company with the over-riding obligation to apply funds for charitable

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[35] Warburton J., *Charities, Members, Accountability and Control* [1997] 61 Conv. 106

[36] Warburton J., [1997] 61 Conv. 106 at 107

[37] *Foss v Harbottle* (1843) 2 Hare 461

[38] Companies Act 1985 s.35(2) as substituted by Companies Act 1989 s.108(1)

[39] fraud on the minority - Companies Act 1985 s.35(2) as substituted by Companies Act 1989 s.108(1); affairs conducted in a manner unfairly prejudicial to the minority Companies Act 1985 s. 459; application to DTI for company to be investigated (Companies Act 1985 s. 431.)

[40] *Estmanco (Kilner House) v G.L.C.* [1982] 1 W.L.R. 2

purposes may provide a ground for a liberal exception to the majority rule.

It is likely that the attention of the Charity Commissioners would be drawn to such a legal action since it would probably constitute charity proceedings which require the authority of the Commissioners or leave of a Chancery judge in the High Court.[42] As Warburton points out[43] although the particular proceedings may not themselves be charity proceedings so as to require consent, charity trustees will often require the protection of the court or Commissioners before spending charitable funds in respect of a court action. The Commissioners are at least then able to advise the trustees or take any other appropriate action.

Warburton[44] also suggests that the 'unfair prejudice' grounds[45] may be invoked where an individual's legitimate expectation is ignored (perhaps where a significant donor has contributed on the basis that he would become or remain a director of the charity) or where there has been serious mismanagement causing harm to the company.[46]

In both companies limited by shares and charitable companies the exercise of directors' powers by the can be challenged if it was for an improper purpose even if the directors believed themselves to have been acting in the company's best interest. In *Gaiman v National Association for Mental Health*,[47] concerning a dispute between two groups of members in a charitable company, it was argued that the council of the association had acted in the interests of its non-scientology members (the majority) at the expense of the minority. Counsel for the scientologists relied on *Hogg v Cramphorn Ltd*[48] which concerned the issue of shares to company employees to manipulate the voting position to forestall a take-over. Megarry J. was of the opinion that this ignored an essential distinction in the powers to issue shares in a commercial company, which was primarily given to the directors in order to raise

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[41] Warburton J., *Charities, Members, Accountability and Control* [1997] 61 Conv. 106 p.115
[42] Charities Act 1993 s.33(2) and (5)
[43] Warburton J., *Charities Act 1993 Text & Commentary*, Sweet & Maxwell 1993 regarding s.33(1)
[44] Warburton J., *Charities, Members, Accountability and Control* [1997] 61 Conv. 106 at 116
[45] Companies Act 1985 s.459
[46] *Re Macro (Ipswich) Ltd* [1994] 2 BCLC 354
[47] [1971] 1 Ch 317 at 330
[48] *Hogg v Cramphorn Ltd* [1967] Ch 254.

capital, and the present case where the directors' powers related to depriving a member of membership. He thought that such a power was plainly intended to be exercised in the best interests of the association. As the association is an artificial entity, it is not easy to determine the best interests of the association without paying attention to the membership. However, the interest of some particular sections cannot be equated with the interests of the association and he was prepared to accept the interests of both present and future members of the association as a whole as being a helpful expression of a human equivalent. The question for the Council of the association was, therefore, was this decision in the best interests of the association?

C. Does A Member Of A Charitable Company Have A Duty Towards The Company?

It is said that the member of a company has no obligation to vote merely in the best interests of the company as a whole and, in a commercial context, the shareholder has a right "to give his vote from motives or promptings of what he considers his own individual interest".[49] The position is slightly different in respect of majority shareholders and is arguably (see below) different where the company is charitable.

The *Scottish Co-operative Wholesale Society*[50] case concerned oppression by the majority shareholders. Lord Simonds's commented that "whenever a subsidiary is formed... with an independent body of shareholders, the parent company must...accept...an obligation so to conduct its own affairs as to deal fairly with its subsidiary".[51]

In *Gaiman v National Association for Mental Health*[52] the directors' responsibility to the membership was considered. Counsel for the plaintiffs had argued that the directors of N.A.M.H. (the Council of the association) had failed to consider the scientology section of the membership. Megarry J. felt that the power conferred was plainly to be exercised in the best interests of the association. He commented that, as the association was an artificial legal entity, it was not very easy to determine its

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[49] *Pender v Lushington* (1877) 6 Ch.D. 70 at 75,76 per Jessell M.R.
[50] *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324
[51] [1959] AC 324 at 342

interests without paying due regard to the members as a whole. Here there was a perceived threat to the association and all that it stood for.[53] This forms an interesting comparison with his later views in *Estmanco*.

In *Estmanco (Kilner House) Ltd v Greater London Council*[54] which concerned a company limited by guarantee, Megarry V.-C. explained that, as the company was not for profit, the test of its best interests could not be the financial benefit of the company. Rather, his comments suggest that the test might be aligned to the enhancement of the purposes of the company.[55]

In the light of these comments, it would be tempting to suggest the imposition of some kind of fiduciary obligation on the majority shareholder, or the members in a charitable company, but this would be overstating the case.

However, in joining in the activities of a charitable company, it is suggested that a member must be entering into a contract with fellow members and the company, to advance the cause (the objects) of the charity since the memorandum and articles bind the company and its members[56] and there can be no commercial motive for the member. Arguably, therefore, the members are the guardians of the objects and the constitution, whether or not that necessarily connotes a fiduciary relationship. This would appear to accord with Warner J.'s view of the non-contractual nature of the rights (or privileges) of membership in an unincorporated association as expressed by him in *Brooks v Richardson*[57] as being rights to take part in the government of the charity for the benefit of the charity.

D. MEMBERS IN AN UNINCORPORATED ASSOCIATION

The legal basis of an unincorporated association generally is said to be contractual.[58]

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[52] [1971] 1 Ch 317
[53] [1971] 1 Ch 317 at 330-331
[54] [1982] 1 All E.R. 437 at 448 per Megarry V-C
[55] [1982] 1 All E.R. 437 at 445h per Megarry V-C
[56] Companies Act 1985 s.14
[57] [1986] 1 W.L.R 383 at 390
[58] *Re Bucks. Constabulary Widows & Orphans Fund Friendly Society (No2)* [1979] 1 WLR 936

In *Koeppler's Will Trusts*[59] it was said that it was "an association of persons bound together by identifiable rules and having an identifiable membership"[60] but what is the nature of the supposed contractual rights of the members where the unincorporated association is a charity? Clearly, in order to be a charity, the resources of the association must all be dedicated to the beneficiaries therefore one expects that the members cannot benefit *qua* member, only *qua* beneficiary.

The question of members' rights in charitable unincorporated associations has been discussed by the courts. In *Re British School of Egyptian Archaeology*[61] all contributors of one guinea annually were members of the school and entitled to receive publications of the school's works free. Those who contributed more received more copies, or were allocated antiquities for their museums, and those who contributed seven or ten shillings received the half-yearly bulletin. It was argued that this showed the basis of the relationship to be contractual. The court was required to decide on the destination of surplus assets on winding up. Harman J., having commented on the drafting inadequacies of the constitution,[62] held that the subscriptions were given on a contractual basis to the extent that the subscriber had a right to expect to receive the appropriate copies of published works, but that further than that there was no contract.[63] He also considered whether the members had any other right and concluded that the members must be taken to have parted with their money once and for all.

Rights of members were also considered in *Brooks v Richardson.*[64] Again membership (in this case referred to as governors) was open to those who had made particular levels of contribution. The plaintiff litigant-in-person argued that the constitution of the association had a dual effect; it created a charitable trust but also constituted the basis of a contract between the subscribers (governors) which regulated their rights and obligations *inter se*, which each was entitled to enforce. Although initially attracted to that argument, Warner J. concluded that there was no

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[59] [1985] 3 W.L.R. 765
[60] [1985] 3 W.L.R. 765 at 771 per Slade L.J.
[61] [1954] 1 W.L.R. 546
[62] [1954] 1 W.L.R. 546 at 549
[63] [1954] 1 W.L.R. 546 at 552/3

contract between the governors.

> "A person making a donation...is not thereby giving consideration (in the contractual sense) for the acquisition of rights under the constitution. Such a person is correctly described ... as a "donor". The legal nature of the rights conferred on him by the constitution does not... differ from that of the rights conferred [on other members who were not donors]. Whether a person becomes a governor by virtue of having made a donation or (without making a donation) ... the rights he acquires as such are not contractual rights but rights to take part in the government of the charity. It is indeed noteworthy that paragraph 16 calls them not 'rights' but 'privileges'. The analogy to a members' club is... imperfect, because the rights of a member of such a club are rights he acquires for his own benefit."[65]

This, of course, meant that the plaintiff could not sue on the basis of a contractual right, rather that the Attorney-General was entitled to be represented, as the action constituted charity proceedings. This decision has been judicially criticised by Robert Walker J. in *Scott v National Trust.*[66] He noted that the National Trust has about two million members, which would cast the net very wide if every member had a sufficient interest to commence charity proceedings, and he believed that Nicholls L.Js comments in the Court of Appeal in *Re Hampton Fuel Allotment Charity*[67] seem fairly definitely against it. He suggested therefore, that the apparent concession in *Brooks v Richardson*[68] cannot be regarded as sound.[69]

The availability of judicial review to challenge a charity's decision was considered in *Scott v National Trust*[70] Robert Walker J. considered the essential public element. He identified a public element in all charities but particularly in relation to the National Trust, which has a high public profile, and he noted that the courts have jurisdiction to prevent misuse of public powers either by judicial review or, in the case of a charity, as a result of charity proceedings under section 33 of the Charities Act 1993, by a 'person interested'. He identified the fact that, in both judicial review and charity proceedings there is a protective filter "intended to protect... charities

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[64] [1986] 1 W.L.R 383
[65] [1986] 1 W.L.R 383 at 390
[66] [1998] 2 All ER 705 at 715, - a corporate charity.
[67] [1989] Ch 484 at 493
[68] [1986] 1 All ER 952
[69] *Scott & Os v National Trust for Places of Historic Interest or Natural Beauty & Or* [1998] 2 All ER 705,715
[70] [1998] 2 All ER 705 at 712 et seq

from being harassed by a multiplicity of hopeless challenges (as has nevertheless occurred in one series of cases... in connection with the trusts of the Royal Masonic Hospital)."[71] He continued by analysing Nicholls L.J.'s judgement in *Re Hampton Fuel Allotment Charity*[72] in which there was a contractual relationship with the charity. Similarly *Haslemere Estates Ltd v Baker*[73] concerned a commercial dispute. Robert Walker J. did not consider the question as to whether any charity is subject to judicial review. He noted, however, that judicial review will not normally be granted where an alternative remedy is available, namely charity proceedings.[74]

The *National Trust* case concerns a corporate charity. Although not concerning a charity, persons seeking membership of the unincorporated ratepayers association in *Woodford v Smith,*[75] who sought a declaration that they, together with others, were members, were granted an interlocutory injunction even though this effectively granted all the relief claimed in the action and effectively re-inforced their claim to be members.

The law regarding members' rights remains unclear. Warburton comments that "[m]embers are at the core of an unincorporated association" although "their actual rights have long been a matter of dispute and are still far from settled".[76]

It is worth noting that as far as trusts are concerned, a 'membership' is rare. Warburton comments that members do not fit naturally into the structure of a charitable trust.[77]

V. Expulsion Of Misbehaving Members?

Where a disaffected member is also an active beneficiary (such as in the local mental health example) there are additional factors to be considered, such as the member's welfare, which are likely to complicate the organisation's attitude to the member.

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[71] [1998] 2 All ER 705 at 713 per Robert Walker J
[72] [1989] Ch 484
[73] [1982] I.W.L.R. 1109
[74] *Scott & Os v National Trust for Places of Historic Interest or Natural Beauty & Or* [1998] 2 All ER 705,716
[75] *Woodford & Or v Smith & Or* [1970] 1 W.L.R. 806
[76] Warburton J., *Charities, Members, Accountability, and Control* [1997] 61 Conv. 106 at 109
[77] *op.cit.* p.109

Nevertheless, it may be necessary to consider the possibilities of expulsion from the organisation or committee.

A. COMPANIES LIMITED BY GUARANTEE

A company is a separate legal entity from the members. Even where the articles of association do not provide for the expulsion of members it is likely to be possible to amend them. However, specified procedures laid down in the memorandum or articles of association must be followed[78] as they constitute the contract between the members *inter se* and the company in respect of their rights as members.

The application of the principles of natural justice in respect of the removal of members in a charitable company was considered by Megarry J., in *Gaiman v National Association for Mental Health.*[79] He considered that there were sufficient indications to exclude any implication of the requirements of natural justice. He said that, even if the principles of natural justice can apply to a company limited by guarantee, they are confined to cases where the article in question does not confer an unlimited discretion, but rather provides the power to exclude for some stated reason.[80] He also identified the serious consequences for the association, in terms of loss of valuable support, staff and revenue, if the relief sought (injunction) were granted.

It would appear from *Gaiman v National Association for Mental Health*[81] that any powers of expulsion must be exercised in the best interests of the charity as a whole. Although the rules of natural justice may be incorporated into the terms of the company's articles, where this is not the case, the courts will be slower to infer them[82] in a charitable company where the particular member does not have property rights.

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[78] *Hickman v Kent or Romney Marsh Sheep Breeders Association* [1915] 1 Ch 881
[79] [1971] 1 Ch 317
[80] [1971] 1 Ch 317 at 337
[81] [1971] 1 Ch 317
[82] [1971] 1 Ch 317 at 337

B. UNINCORPORATED ASSOCIATIONS

First, there is no inherent power in a club, and presumably in an unincorporated association to pass a rule to expel a member.[83] The rules must either contain the power to expel members, or be capable of alteration to include such a power. It is not clear what majority is required to pass a resolution to amend the rules in order to expel a member. In *Dawkins v Antrobus*[84] the rules were capable of amendment. Jessell M.R. was at pains to consider the validity and application of the new rule. As it was passed unanimously, and in the plaintiff's presence, it was held to apply to the plaintiff. Will a lesser majority serve? On appeal, Cotton L.J.'s main point was that the rules contained the power to make amendment and he held that, on construction of the original rules, rules affecting the general interests of the club could be validly passed.[85]

If the rules of the association contain the power[86] to remove a member then, provided the power is exercised in good faith,[87] in accordance with the rules,[88] and following the principles of natural justice, expulsion or discipline[89]of a member may be an option.[90] In the absence of such provision the association may have to wind up if no other way can be found for dealing with the member.

It is worth noting that should an association decide to expel or suspend a member who brings proceedings against the chairman or trustees, the latter should seek the authority of the court before defending such an action using the association's funds, by seeking a *Beddoe Order*,[91] or they may find themselves personally liable for costs.[92]

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[83] *Dawkins v Antrobus* (1881) 17 Ch D 615 at 620
[84] *Dawkins v Antrobus* (1881) 17 Ch D 615
[85] (1881) 17 Ch D 615 at 634 per Cotton L.J.
[86] (1881) 17 Ch D 615 at 620
[87] (1881) 17 Ch D 615 at 630,634; *Tantussi v Molli* (1886) 2 T.L.R. 731
[88] *Labouchere v Earl of Wharncliffe* (1879) 13 Ch D 346; *Young v Ladies Imperial Club* [1920] 2 K.B. 523
[89] *John v Rees* [1970] Ch 345, 397; *Brentnall v Free Presbyterian Church of Scotland* [1986] S.L.T. 471
[90] see also *Baker v Jones* [1954] 1 W.L.R. 1005
[91] *Re Beddoe* [1893] 1 Ch 547
[92] *Singh v Bhasin* "The Times" 21st August 1998

C. In Practice

It is worth noting that in the *Legal Structures for Charities Survey*[93] 53 of the respondent charities, 9.4%, had had disputes over members' rights. 53.6% did not have a procedure to settle disputes between members. 53.3% had no procedure for removing members. This suggests that the matter of members' rights might usefully be considered as a drafting issue.

The Charity Commission Model Constitution for an Unincorporated Association[94] provides two alternative membership clauses, 'E' and 'F' both of which provide for the expulsion of members. Both require a unanimous vote within the executive committee. Interestingly, both clauses leave membership open to individuals interested in furthering the objects of the association who pay the subscription laid down from time to time by the executive committee. By comparison, the Model Memorandum and Articles of Association for a charitable company[95] article 2, requires applications for membership to be approved by the trustees and the question of termination of membership is left to be dealt with by the trustees under power to make rules.[96]

VI. Removal of Trustees

It is not only members who can be recalcitrant. The position of the difficult trustee, committee member, or board member can also present considerable problems. Tensions among trustees[97] can threaten a charity's work, or a dominant group of trustees may create a situation in which there is a conflict of interest.[98] Receiver and Manager appointments have been seen to be effective in cases where trustees cannot or will not act in the management of the charity.[99]

The position is considered below according to the legal structure of the organisation,

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[93] *Legal Structures for Charity Survey* Liverpool University/ NCVO/ Charity Law Association
[94] GD3, Charity Commission January 1998
[95] GD1, Charity Commission, January 1998
[96] GD1, Charity Commission, January 1998 article 61.
[97] [1996] Ch. Comm. Rep. para. 26
[98] [1996] Ch Comm. Rep. para. 205
[99] [1996] Ch Comm. Rep. para. 168

but it must be borne in mind that directors of a charitable company are the charity's trustees and are therefore capable of being removed by the court or the Charity Commission.

A. UNINCORPORATED CHARITY

This section also relates to the committee members, the trustees, of an unincorporated association in addition to trusts established by trust deed.

There are three circumstances in which a trustee can be removed:

1. Under Powers Contained In The Trust Instrument

Such powers will be strictly construed,[100] and it must be clear that the circumstances envisaged in the deed actually appertain.[101] If the trustees are capable of removing a trustee, it would appear that the trustee to be removed must be consulted as the act of removal is a trust act and all trustees must be involved in it.[102]

The Charity Commission Model Declaration of Trust, clause H,[103] includes four circumstances in which trusteeship is determined, namely, disqualification under the Charities Act, incapacity by reason of mental disorder, absence from all trustee meetings for six months without permission and resignation. Similar provisions are contained in clause I of the model for unincorporated associations.[104]

2. Under The Statutory Powers Contained In Section 36 Of The Trustee Act 1925

The statutory powers apply if the trustee is abroad for more than twelve consecutive months; refuses, is unfit, or is incapable of acting. Where a trustee has been so removed new trustees may be appointed in accordance with section 36 including, *inter alia* by the person(s) nominated in the trust deed for the purpose of appointing

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[100] *Gibbs v Stanners* 1975 SLT (Notes) 30
[101] *London and County Banking Co v Goddard* [1897] 1 Ch 642
[102] *Gibbs v Stanners* 1975 SLT (Notes) 30 at p.31
[103] GD2, Charity Commission, January 1998
[104] GD3, Charity Commission, January 1998

new trustees[105] and the surviving trustees.[106]

3. By The Courts Or Charity Commissioners (Under Their Concurrent Jurisdiction)

It would appear that the main guide for the courts, after careful examination of the case, is the welfare of the beneficiaries.[107] Trustees will not automatically be removed if there has been a breach of trust,[108] "[y]ou must find something which induces the court to think either that the trust property will not be safe, or that the trust will not properly be executed in the interests of the beneficiaries,"[109] although a trustee may be removed in the absence of a breach of trust if his own business could be in conflict with the trust.[110]

The Charity Commissioners have concurrent jurisdiction with the High Court under Charities Act 1993 section 16 with regard to discharging or removing a charity trustee.[111] In exercising their protective powers, the removal will be under section 18(2). The exercise of the protective powers of the Charity Commission between 1992 and 1998, to remove or suspend trustees is analysed in the following table.

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[105] Trustee Act 1925 s.36(1)(a)
[106] Trustee Act 1925 s.36(1)(b)
[107] *Letterstedt v Broers* (1884) 9 App. Cas. 371 at p. 387 per Lord Blackburn giving the judgement of the court
[108] *Re Wrightson* [1908] 1 Ch 789
[109] *ibid* at 803 per Warrington J
[110] *Moore v M'Glynn* [1894] 1 IR 74
[111] Charities Act 1993 s.16(1)(b)

TABLE: No.1 : Use of Protective Powers by Charity Commissioners : 1992-1998

Year of Report	Number Trustees Removed	Number of Trustees Suspended
1992	3	0
1993	3	0
1994	0	0
1995	9 (2 charities)	0
1996	9	0
1997[112]	28	13
1998	9	11
Total 1992-98	**62**	**24**

Trustees who have been removed do not always 'go quietly'. The Charities Act provides a mechanism for appeal.[113] For example, Arthur Scargill and a fellow trustee who had been removed for misconduct or mismanagement appealed, unsuccessfully, to the High Court[114] against their removal as trustees of Miners' Welfare charities. Hedley Roberts, founding trustee of the Hedley Roberts Trust, in which a receiver manager was appointed, has subsequently figured in legal proceedings.[115] Former trustees of Christ the Sower Trust appealed against their suspension, and the appointment of a receiver and manager and appealed against their

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[112] [1997] Ch. Comm. Rep. differentiated between protective powers exercised by support staff as compared with the same powers exercised by investigation staff. Support staff removed 2 trustees, suspended none, and used protective powers on 51 occasions. (para 86). Investigation staff removed 26 trustees, including 8 discharged at their own request, suspended 13 trustees and exercised their protective powers on 414 occasions.(page 18) The table summates interventions by both support and investigations staff. No particular reason is given or apparent for the high numbers of trustees removed during 1997.

[113] Charities Act 1993 s.16(11), (12),(13)

[114] *Scargill & Or v Attorney General* (Unreported) 4th September 1998

[115] "Charity", December 1997, published by Charities Aid Foundation, p.5. He reportedly threatened new trustees with legal action after 'exhausting other routes'.

removal as trustees.[116] . Neuberger J, refused to re-instate Weth as he felt that if re-instated, he would continue to use up a considerable amount of the charity's time and money pursuing 'old' issues.[117]

B. REMOVAL OF A DIRECTOR

There is no inherent power in the company or in the board to remove a director before the expiry of the period of office. In *Imperial Hydropathic Hotel Co, Blackpool v Hampson*[118] the articles provided that directors were to hold office for three years and retire by rotation. Cotton L.J. said that there was nothing in the Act or the Articles that enabled a general meeting to remove directors. The articles were capable of amendment, and should have been amended separately from this resolution.[119] If a director's term of office is indeterminate he may be dismissed by an ordinary resolution of members at any time.[120] Directors owe a fiduciary obligation to act in the best interests of the company, so any power in the board to remove a fellow director (or call on him to resign) must be so exercised in good faith.

There is a statutory power whereby the company (that is the members) may remove a director before the expiration of his period of office notwithstanding anything in the articles or in any agreement between the company and the director.[121] On receipt of an intended resolution to remove a director under this section, the company must send the director a notice of the resolution and he is entitled to be heard on the resolution at the meeting[122] or to make written representations,[123] which must usually be circulated or read out at the meeting.[124] Special notice must be given.[125]

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[116] *Weth & Or v Att.-Gen.*(Unreported) 21 November 1997; *Weth & Or v Att.-Gen.* (Unreported) 23rd March 1998 (C.A.); *Weth & Or v Att.-Gen. & Ors* (Oct.98) [1999] 1 W.L.R. 686 (C.A.); *Weth & Or v Att.-Gen. & Ors* (Unreported) 29 April 1999

[117] Quint F., *Testing Time in Court for Trustee Rights*, NGO Finance June 1999 p.59 commenting on judgement delivered 29.4.99

[118] (1883) 23 Ch.D. 1 (CA)

[119] (1883) 23 Ch.D. 1 (CA) p11

[120] *James v Thomas H. Kent* [1951] 1 KB 551

[121] Companies Act 1985 s.303(1)

[122] Companies Act 1985 s.304(1)

[123] Companies Act 1985 s.304(2)

[124] Companies Act 1985 s.304(2)(a)(b), (3), (4)

[125] Companies Act 1985 s.303(2)

The Charity Commission's model documents for a charitable company[126] contain similar provisions to trusts and unincorporated associations, namely, disqualification under the Charities Act; mental incapacity, resignation and six months absence from meetings.[127]

C. Automatic Removal As A Charity Trustee Or Disqualification As A Director

Under section 72 of the Charities Act 1993 trustees are automatically disqualified in a number of circumstances. A trustee is automatically disqualified from acting where he has been convicted of an offence involving dishonesty or deception, which is not yet spent; he has been adjudged bankrupt or his estate has been sequestered or he has made a composition agreement with his creditors, and has not yet been discharged.[128] Disqualification also applies to trustees who have been removed by the Commissioners or High Court following mismanagement or misconduct in the management of a charity, because it was necessary to protect the charity;[129] or where a trustee has been disqualified from acting as a director;[130] or is subject to an order under section 429(2)(b) of the Insolvency Act 1986.[131] Such disqualification is automatic and it is an offence to continue, or purport, to act punishable by imprisonment.[132]

In addition, charitable companies are affected by regulations in the Tables prescribed in section 8 of the Companies Act 1985. Table A article 81[133] provides that a person ceases to be a director in a number of circumstances which include bankruptcy, making a composition agreement with creditors, or if suffering from a mental disorder.[134] A person also ceases to be a director if he resigns or is absent from

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[126] GD1, Charity Commission, 1998
[127] GD1, Charity Commission, 1998 article 38
[128] Charities Act 1993 s.72.(1)(a),(b),(c).
[129] Charities Act s.72(1) (d)
[130] under the Company Directors Disqualification Act 1986 or Insolvency Act 1986 s. 429(2)(b)
[131] Charities Act 1993 s.72(1)(f)
[132] Charities Act 1993 s.73
[133] which, according to Table C also applies to a company limited by guarantee
[134] and an application is made for his admission to hospital under the Mental Health Act 1983. For such an application to be made an approved social worker must be satisfied that detention in hospital is the most appropriate way of meeting the patient's needs and the application must be supported by two doctors. As

meetings for more than six months and his fellows resolve that his office is vacated.

VII. POSSIBLE SOLUTIONS

Rescue mechanisms, which the Charity Commissioners clearly consider to be of considerable importance in the resolution of disputes,[135] are considered in chapter nine.

A. DRAFTING ISSUES

In a preventative sense, it is important to note that careful and considered drafting of rules and documentation can ensure that a charity at least has the option to remove a recalcitrant member. In view of the fact that many new charities adopt the model documents, some consideration might be given by the Charity Commission as to the provisions contained in their model documents for governing instruments. The Charity Law Association Model Documents[136] are perhaps more useful in the circumstances discussed in this chapter. The membership clauses of the model documents for both the charitable associations and limited company contain provisions permitting termination of membership of an individual whose continued membership would, in the reasonable view of the committee or trustees, (including directors in the company situation) be harmful to the association (subject to the rules of natural justice).[137] All three documents (that is, including the model trust deed) provide for the removal of a trustee or committee member.[138] The provisions for the removal of a trustee are described in the accompanying notes to both the model

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most mental illness is treated in the community, the illness would need to be serious before compulsory admission were considered, ergo before the individual were disqualified as a director.

[135] see e.g. [1996] Ch Comm Rep. paras. 146 – 152

[136] Model Documents: *Constitution for a Charitable Unincorporated Association*; *Trust Deed for A Charitable Trust*; *Memorandum and Articles of Association for a Charitable Company Limited by Guarantee*, Drafted by Francesca Quint on Behalf of the Charity Law Association, 1977.

[137] Model Documents: *Constitution for a Charitable Unincorporated Association* clause 4.6; *Memorandum and Articles of Association for a Charitable Company Limited by Guarantee* article 1.5.4, Drafted by Francesca Quint on Behalf of the Charity Law Association, 1977.

[138] Model Documents: *Constitution for a Charitable Unincorporated Association* clause 6.5.6; *Trust Deed for A Charitable Trust* clause 4.7.6; *Memorandum and Articles of Association for a Charitable Company Limited by Guarantee* article 3.6.6, Drafted by Francesca Quint on Behalf of the Charity Law Association, 1977.

unincorporated association, and trust deed as being a "wise precaution."[139]

B. Proper Admission and Selection Policies

Clearly, the salutary lesson from *Gaiman's*[140] case is the importance of proper admissions policies and the danger of welcoming all-comers in membership drives. One area of difficulty may relate to organisations, for example, councils for voluntary service, where the membership itself consists of organisations. The potential member-organisation itself may be very suitable to become a member, but the volunteer they put forward, as their representative, may be a different matter. It may be important therefore in drafting documents for such bodies, that a mechanism is provided for removing or rejecting unsuitable nominative members.

It is important that careful selection processes also apply to trustees and that those appointed are capable of acting reasonably and working together with other trustees in a democratic fashion.

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[139] Model Documents (C.L.A.): *Constitution for a Charitable Unincorporated Association* page 14
[140] [1971] 1 Ch 317

CHAPTER 8 : LIABILITY TO CONTRIBUTE IN AN INSOLVENCY

I. INTRODUCTION

What follows is an exploration of the persons who may be required to contribute in the event of an insolvency where there are insufficient assets to cover the organisation's liabilities. The discussion will be confined, as far as possible, to the charity context.

Essentially, there are three groups of persons who may be required to contribute, namely, members, trustees (the directors if the organisation is a company) and third parties. Some organisations, particularly trusts, or companies established to mirror a trust structure, will either have no members or the members will be the same individuals as the directors. In what follows the position of these three categories is therefore examined *qua* member, *qua* trustee or director, and *qua* adviser or other third party. Of course, the liability will be different according to whether acts prior to the winding up (which have contributed to the insolvency) were *ultra vires* the objects of the charity, or *extra vires* the powers of the directors.

The law is quite different between unincorporated associations and corporate bodies and because the situation is potentially more complex than that it needs further comment.

First, with regard to incorporated trustees, the trustees remain answerable in the same manner and to the same extent as if no incorporation had been effected[1] so their situation will be the same as trustees of unincorporated associations below.

Secondly, some corporations are established with unlimited liability, for example, Further and Higher Education[2] institutions. Most are exempt charities and therefore do not fall within the ambit of this study.

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[1] Charities Act 1993 s.54

[2] Education Reform Act 1988 ss.121(1) and 124 and Further and Higher Education Act 1992 ss.15(4), 16(1) (FE) ss.18-20 (powers), s.71(1) amending s.124 Education Reform Act 1988

It would seem unlikely that corporate charities, except those established by Royal Charter or statute, would be established with unlimited liability since the prime purpose nowadays for the use of a corporate structure is to limit the liability of trustees (directors[3]) and members[4]. The liability of members of corporations with unlimited liability is considered separately.

Incorporation by Royal Charter tends to be 'earned' by a predecessor body and charter corporations are likely to have unlimited liability. Sutcliffe[5] asserts that

> "while the law for centuries discouraged all attempts so to frame a 'company' as to limit the liability of the individual members, it was at common law not in the power of the Crown so to incorporate persons as to make them liable to any extent to the debts of the corporation - in other words, the persons so incorporated would only lose the money which they had subscribed to the capital... in the event of the undertaking proving unsuccessful."[6]

II. UNINCORPORATED ASSOCIATIONS

Although there are various mechanisms for holding property in unincorporated associations, in the charitable association, the mechanism will usually be that property is held by trustees for the objects (beneficiaries). The trustees may be beneficiaries of the charity but that will not usually be the case. The discussion which follows will, therefore, largely be confined to the liabilities of trustees and members in those capacities, and will also consider the extent to which third parties may become liable to contribute.

A. TRUSTEES

1. The Trustee's Indemnity And Lien - Where The Activities Have Been *Intra Vires*

Where a trustee enters into a contract as trustee of an unincorporated association it

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[3] Companies Act 1985 s.741 –"includes any person occupying the position of director, by whatever name called"

[4] see Companies Act 1985 s.22 - the subscribers, and others who agree to become members and whose name is entered on the register of members

[5] Sutcliffe R.J., *Statutory Companies and The Companies Clauses Consolidation Act*, Stevens & Sons Ltd, 1924

[6] Sutcliffe R.J., 1924 at p. 2. He cites *Elve v Boyton* (1891) 1 Ch. 507

may, with the agreement of the other party, be possible for him to limit his contractual liability to the extent of the trust's assets.[7] If he has not done so he becomes personally liable under the contract.[8]

Under section 30(2) of the Trustee Act 1925 a trustee "may reimburse himself or pay or discharge out of the trust property all expenses incurred in or about the execution of the trusts or powers" and he may discharge the liability directly out of the trust estate,[9] providing that the expense was properly incurred. The trustees' indemnity, "as old as trusts themselves,"[10] against all costs and expenses properly incurred, is a first charge on the trust property, both income and corpus (capital)[11] and a trustee has a right to retain the costs out of trust income that would otherwise be paid to a beneficiary, until provision can be made for raising them out of the corpus. The right to indemnity is in the nature of a lien[12] and the trustee has a right to assert his indemnity, or lien, over that of the *cestui que trust* until the charge has been satisfied.[13]

A trustee's right to indemnity is different from a contractual right of indemnity. Cozens-Hardy MR explained in *Re Richardson* that the trustee's indemnity is "an equitable right, which every trustee has, to be indemnified by his *cestui que trust*".[14] With a contractual indemnity no action can be maintained until an actual loss has occurred. However, it is not necessary for the trustee to be ruined before his indemnity can assist; he may take proceedings to avert ruin.[15]

In *Jennings v Mather*[16] Kennedy J explained that, trust assets having been (legitimately) devoted to trade, the *cestui que trust* cannot profit without paying the liabilities, otherwise it would be possible to set up a man of straw as trustee to avoid

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[7] see e.g., *Muir v City of Glasgow Bank* (1879) IV App. Cas. 337 (HL) at 361-362 per Lord Cairns
[8] *ex parte Garland* (1804) 10 Ves Jun 111 at 119 per Eldon LC
[9] *Re Blundell, Blundell v Blundell* (1888) XL Ch D 370 at 377 per Stirling J.
[10] *Hardoon v Belilios* [1901] AC 119 at 124 per Lord Lindley
[11] *Stott v Milne* (1882) XXV Ch. D710 at 715 per Earl Selbourne L.C.
[12] *Jennings v Mather* [1901] 1 Q.B. 108 at 113
[13] *Jennings v Mather* [1901] 1 Q.B. 108 at 113-114; see also *Octavo Investments Pty Ltd v Knight* [1979] 144 C.L.R. 360 at 367
[14] *Re Richardson, ex parte The Governors of St Thomas' Hospital* [1911] 2 KB 705 (CA) at 709 per Cozens - Hardy M.R.
[15] *ibid.* at 709 per Cozens -Hardy M.R.
[16] [1901] 1 QB 108 per Kennedy J at 115

the liabilities of trading. The same arguments were rehearsed in *Octavo Investments Pty Ltd v Knight & Ors*[17] where the trustee was a straw company. In the *Octavo* case two classes of persons were identified as having a beneficial interest in the trust assets, namely, the *cestui que trust* and the trustee, in respect of his right to be indemnified against personal liabilities incurred in the performance of the trust. The trustees indemnity will be preferred to that of the *cestui que trust* so that the beneficiaries are not entitled to call for a distribution of trust assets that are subject to the trustees' lien.[18]

If trustees are managing funds for several beneficiaries, they are not entitled to be indemnified out of the whole fund, only the one from which the investment has been made.[19]

(a). Supposing That The Trustee Is A Man Of Straw Or Bankrupt

The trustee's lien extends to the assignee of the trustee, so that, for example, where a trustee becomes bankrupt and his assets have been assigned to his trustee in bankruptcy, the trustee's lien also passes to the trustee in bankruptcy. The latter is entitled to succeed as against the bankrupt's judgement creditor. The trust *property*, of course, does not pass to the trustee in bankruptcy.[20]

However, the proceeds of the bankrupt trustee's lien do not necessarily become part of his general bankruptcy estate. In *Re Richardson*[21] a husband, trustee of a marriage settlement, became bankrupt owing the landlord (hospital governors) rent. He (and therefore his trustee in bankruptcy) was entitled to be indemnified by the wife's trust fund, but specifically for the purpose of passing the funds on to the principal creditor, the hospital. Otherwise, the trust estate would augment the bankrupt trustee's estate and the trustee would be profiting from his trust. Thus, money recovered from the trust estate is applicable exclusively to repaying that debt against which the trustee is

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[17] [1979] 144 CLR 360 per Murphy J at 372
[18] [1979] 144 CLR 360 per Stephen, Mason, Aicken, Wilson JJ.
[19] *Fraser v Murdoch* (1881) VI App. Cas. 855 (HL)
[20] *Jennings v Mather* [1901] 1 Q.B. 108
[21] [1911] 2 KB 705 (CA)

entitled to be indemnified.[22]

Thus, if a trustee has paid a trust creditor[23] but not been reimbursed from the trust fund before becoming insolvent, the income from his indemnity will become part of his general estate. On the other hand, if the trustee owes a trust creditor at the time of his insolvency, his lien will entitle his trustee in bankruptcy to claim what is owed from the trust estate, but it must be passed on to the trust creditor.

As against the trustee's judgement creditor, the trustee has a right to prevent any person from carrying away the trust property and, having an indemnity in the goods, to declare a pecuniary interest in them.[24] That right passes to the bankrupt trustee's assignee. If, when the accounts are made up, there is nothing owing to the trustee, there is no indemnity and consequently no lien,[25] in which circumstances the trustee in bankruptcy would have no further right in the goods.

(b). "Trust Creditor's" Right To Trust Assets?

A 'trust creditor' has no right to seek satisfaction of the debt from the trust fund. It is said[26] that the basis of this decision lies in *Dowse v Gorton.*[27] The creditor's only right is to sue the trustee personally. In *Re Evans*[28] Cotton L.J. said that the creditor cannot have anything higher than a right to be substituted to the right of the trustee to his indemnity. Where the trustee purchases goods for which he is personally liable, the *cestui que trust* cannot claim the goods without regard to that indemnity. The creditors of the trustee have limited rights with respect to trust assets, which may not be taken in execution but, in the event of the trustee's bankruptcy, the creditors will be subrogated to the beneficial interest enjoyed by the trustee.[29]

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[22] [1911] 2 KB 705 (CA) at 717 per Buckley L.J.

[23] In this context it is inaccurate to speak of a trust creditor, as the liability will be the trustee's. This term is used here to describe a creditor to whom a trustee is liable in respect of a commitment entered into as part of his trusteeship, but for which the trustee is entitled to be indemnified from trust funds.

[24] *Jennings v Mather* [1901] 1 Q.B. 108 at 113 per Kennedy J

[25] *Jennings v Mather* [1901] 1 Q.B. 108 at 114 per Kennedy J

[26] *ibid.* at 111 per Kennedy J

[27] [1891] A.C. 190

[28] (1887) 34 Ch D 597 at 601 per Cotton L.J.

[29] *Octavo Investments Pty Ltd v Knight & Ors* [1979] 144 CLR 360 at 367 per Stephen, Mason, Aicken, WilsonJJ.

In *Re Pumphrey*[30] the trustees of a marriage settlement provided additional finance (through mortgage) to enable the purchase of property, the husband having undertaken, but failed, to provide the shortfall. When the trustee died, the husband was unable to pay the mortgage. The bank sought to realise their security. It was agreed that the first person liable to pay was the husband. Kay J. referred to *Re German Mining Company*[31] where it was said that where a trustee *bona fide* advances money for the acquisition of trust estate, he has a right to be indemnified, which he may claim at any time.[32] He concluded that the creditor was entitled to be subrogated to the trustee's lien.

(c). Are There Limits To The Operation Of The Trustee's Lien?

The courts will resist an intervention to sell or foreclose on trust property if the result will be the destruction of the trust.[33] In *Darke v Williamson*[34] trustees had raised funds by mortgage to enable the purchase of a chapel and for some time the interest was paid out of chapel funds. When this became impossible the representatives of the trustees were compelled to pay the interest. It was held that the (personal representatives) of the original trustees had a lien on the deeds but the court would not grant foreclosure. However, it was said that if the (subsequent) trustees of the trust property attempted to sell or dispose of it, the personal representatives of the original trustees were entitled to apply to the court, and if the (subsequent) trustees of the trust property sought to put an end to the trust, the original trustee's lien would be enforceable.[35]

(d). If The Trust Fund Is Inadequate To Meet The Indemnity, What Is The Trustee's Position?

> "[W]hether, in any particular case, the contract of a ...trustee is one which binds himself personally, or is to be satisfied only out of the estate of which he

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[30] (1882) 22 Ch D 255 Per Kay J
[31] (1854) 4 D.M.& G 19
[32] *Re Pumphrey, Worcester City & County Banking Co. v Blick* (1882) 22 Ch D 255 at 260-262
[33] *Darke v Williamson* (1858) 25 Beav 622
[34] *ibid.*
[35] (1858) 25 Beav 622 at 626 per Romilly MR

> is the [trustee], is... a matter of construction, to be decided with reference to all the circumstances of the case; the nature of the contract; the subject - matter in which it is to operate, and the capacity and duty of the parties to make the contract in the one form or in the other."[36]

If the trustee has not limited his liabilities to the extent of the trust assets then, as Eldon L.C. in *ex parte Garland*[37] said, the trustee:

> "becomes liable, as personally responsible, to the extent of all his own property; also in his person; and as he may be proceeded against as a bankrupt; though he is but a trustee. But he places himself in that situation by his own choice; judging for himself whether it is fit and safe to enter into that situation, and contract that sort of responsibility".[38]

This apparently harsh situation arises because the trustee acted personally. As far as a creditor is concerned the debt is owed to him personally by the trustee. If there is more than one trustee their liability is joint and several. If action is brought against one, he may bring proceedings against his fellows.[39] Similarly, even if one trustee enters into a compromise in discharge of his liability this does not operate to release the others. An action may be brought against other trustees until the plaintiffs have received the full amount owed to them.[40]

The demise of the City of Glasgow Bank, an unlimited company, provides further examples of the operation of unlimited liability in respect of trustees. In *Muir & Ors v City of Glasgow Bank and Liquidators* [41] trustees who were members of the company (as investors) were personally liable to contribute towards the loss. The situation was similar in *Fraser v Murdoch.*[42]

It will be clear from some of the cases above that the personal liability of the trustee on contractual matters such as mortgages and leases may extend beyond the lifetime of the individual trustee and may be 'bequeathed' to the personal representatives on

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[36] *Muir v City of Glasgow Bank* (1879) IV App. Cas 337 (HL) at 355 per Lord Cairns
[37] (1804) 10 Ves Jun 111 at 119 per Eldon L.C.
[38] see also e.g., *Fraser v Mordoch* (1881) VI App. Cas. 855 (HL); *Muir & Ors v City of Glasgow bank & Liquidators* (1879) IV App. Cas. (HL)
[39] see *Edwards v Hood-Barrs* [1905] 1 Ch 20; *Re Ingham* (1885) 52 LTR 714; *Devaynes v Robinson* (1857) 24 Beav 86.
[40] *Edwards v Hood-Barrs* [1905] 1 Ch 20 at 23 per Kekewich J
[41] (1879) IV App. Cas. 337 (HL)
[42] (1881) VI App. Cas. 855 (HL)

the death of the trustee.[43]

(e). Indemnity Extends To Tortious Liability

The trustees' indemnity also extends to tortious matters. In *Re Raybould*[44] a trustee had been properly carrying on a colliery business and in doing so damaged the land of an adjacent owner. Byrne J. recognised the trustee's entitlement to indemnity providing he acted with due diligence and reasonably. He found that the damage was not caused recklessly or by improper working therefore the trustee was entitled to indemnity and the adjacent landowner was entitled to be subrogated to the lien.[45]

(f). Cost Of Proceedings

The Rules of the Supreme Court[46] provide that a trustee is entitled to the cost of proceedings (in the capacity of trustee) out of the fund unless he has acted unreasonably. However, trustees contemplating litigation would be advised to seek authority from the court[47] or Charity Commissioners. Where authority is given they will be entitled to have the costs reimbursed irrespective of the outcome of the case. In *Singh v Bhasin & Another*[48] the committee of the Sikh Gurdwara had sought to expel a member. The expulsion was contrary both to the association's rules and the rules of natural justice and the executive committee had received clear advice from the Charity Commissioners and the Treasury solicitor that court authorisation was needed before Bhasin's (the then President of the association) costs could be taken out of the association's funds. In parallel proceedings Singh's suspension had been declared "on all evidence manifestly invalid". Boyle J. said that once Singh obtained the Charity Commission's consent to charity proceedings "continued defence of the proceedings was unjustifiable." In the absence of such a *Beddoe* order, even where counsel has indicated that the trustee had a good case, the trustee proceeds at his own risk unless the court were satisfied that it would have authorised the proceedings

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[43] e.g. *Darke v Williamson* (1858) 25 Beav 633 and see the facts of *Wise v Perpetual Trustee Co* [1903] AC 139

[44] [1900] 1 Ch 199

[45] [1900] 1 Ch 199 at 202

[46] R.S.C. Ord 62 rule 2(2) – Civil Procedure Rules 1998 sched. 1 under Civil Procedure Act 1997

[47] *Re Beddoe* [1893] 1 Ch 541

[48] *Singh v Bhasin & Or* The Times, 21st August 1998

at the expense of the fund.[49]

2. Where The Activity Was *Ultra Vires* (Beyond The Trust's Objects)

The insolvency may lead to the identification of, or be attributable to, a breach of trust in which case there is no question of trustee's indemnity or lien operating.

The trustee(s) can be required to replenish the trust funds and an action may be brought jointly against all of the trustees, or against one. Where action is brought against one trustee he will have a right to bring proceedings against any co-trustees unless he was fraudulent[50]. If he has acted wrongfully on the advice of a fellow trustee with special knowledge, such as a solicitor[51] he may be able to throw all the loss onto that other trustee although the fact that one of the trustees is a solicitor will not, however, automatically protect other trustees.[52]

(a). Factors Affecting The Trustee's Quantum Of Liability

The liability of the individual trustee for breaches is likely to be a matter of fact in every case. For example in *Baker v Jones*[53] in which members of the committee had misapplied the society's funds, it was held on those particular facts, that those who resigned from the council prior to the misapplication were not liable.[54] A trustee is responsible for his own acts and defaults, and not for those of a fellow trustee unless the loss happens through his own wilful default[55] but if there is more than one trustee liable, their liabilities are joint and several.[56]

Under the Civil Liability (Contribution) Act 1978, the courts have discretion to fix the contribution that a trustee is required to make. Under section 1(2) of the Act the court has power to exempt a person from liability, or to direct that the contribution to

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[49] *Singh v Bhasin & Or* The Times, 21st August 1998 – the case concerned a registered charity
[50] *Att.-Gen. v Wilson* (1840) Cr & Ph 1 at 28
[51] *Re Partington* (1887) 57 LT 654
[52] *Head v Gould* [1898] 2 Ch 250
[53] [1954] 1 WLR 1005
[54] [1954] 1 WLR 1005 at 1013 per Lynskey
[55] Trustee Act 1925 s.30(1)
[56] see *Edwards v Hood-Barrs* [1905] 1 Ch 20; *Re Ingham* (1885) 52 LT 714; *Devaynes v Robinson* (1857) 24 Beav 86

be recovered shall amount to a complete indemnity.

(i). What Constitutes 'Wilful Default'?

The question of wilful default can be an important issue in considering whether a trustee should become liable for a fellow trustee's defaults.

In *Bartlett v Barclays Bank Trust Co Ltd*[57] Brightman J referred to the 'prudent man of business' who will act to safeguard his investment. If facts come to the trustee's knowledge which suggest that affairs are not as they should be, or which put him on enquiry he will take appropriate steps to deal with the situation.[58] Wilful default was discussed in *Re Vickery*[59] in which it was interpreted as being consciousness of committing a breach of duty or reckless as to whether or not a breach was being committed. There has been criticism of this case[60] on the basis that it was out of line with pre 1925 trust cases which establish that wilful default includes want of ordinary prudence and it was discussed in the Law Commission Consultation Paper No 146.[61] However, in *Armitage v Nurse*[62] Millett L.J., giving the judgement of the Court of Appeal, confirmed that in the context of section 30 of the Trustee Act 'wilful default' means a deliberate breach of trust. He confirmed that the decision in *Re Vickery*[63] was in line with earlier authority, which requires nothing less than conscious and wilful misconduct[64] to constitute wilful misconduct.

(ii). Extent of Trustee's Liabilities in Breach

If a breach of trust occurs the "obligation of a defaulting trustee is essentially one of effecting a restitution to the estate. The obligation is of a personal character and its

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[57] [1980] Ch 515
[58] [1980] Ch 515 at 532
[59] [1931] 1 Ch 572
[60] e.g. Oakley A.J., *Parker and Mellows , Modern Law of Trusts*, 7th Ed, Sweet & Maxwell, 1994; Hayton D. J., *Cases and Commentary on the Law of Trust*, 10th Ed., Sweet & Maxwell, 1996 at p.772; Jones Gareth (1959) 22 MLR 390
[61] Law Commission Consultation Paper No. 146 *Trustees' Powers and Duties*, 1992 para. 4.39 *et seq.*; Law Reform Committee Report 1997 Cmnd. 8733 paras. 4.10 - 4.15
[62] [1997] 2 All ER 705 (CA)
[63] [1931] 1 Ch 572
[64] *Armitage v Nurse & Ors* [1997] 2 All ER 705 (CA) at 712.

extent is not limited by common law principles governing remoteness of damage".[65] A trustee's liabilities have a long reach and do not necessarily end with his death. His estate remains liable.[66] However, *Target Holdings Ltd v Redferns*[67]

Where it appears to the court that a trustee liable for breach of trust has acted honestly and reasonably and ought fairly to be excused for the breach and for omitting to obtain the directions of the court, the court may relieve him wholly or partially from personal liability for the breach.[68] In respect of trust property, the Statute of Limitations 1980 makes various provisions but there is no limitation period in respect of fraudulent breach to which a trustee was party, [69] or where the trustee has converted trust property to his own use.[70]

(b). Particular Problems Associated with Insolvency, Dissolution or Winding Up

From the dissolution or insolvency perspective the particular problems with trustee liability are associated with the difficulties of deciding who, out of the trustees, is liable for particular breaches or expenditure.

A trustee is only liable for his own acts or breaches. But trustees are required to act jointly.

Clearly, a trustee who is present and concurring at a meeting that agrees action in breach of trust will be liable. If a trustee subsequently comes to learn about a breach of trust he should take appropriate steps to remedy the situation. On his appointment, the trustee should, amongst other things, have checked that there had

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[65] *Re Dawson* [1966] 2 NSWR 211 at 214-216 per street J, endorsed by Brightman L.J. in *Bartlett v Barclays Bank Trust Co Ltd (No2)* [1980] Ch 515 at 543

[66] see e.g. *Devaynes v Robinson* (1857) 24 Beav 86 in which the trustee's personal representative was made a party to the action; in *Darke v Williamson* 1858) 25 Beav 622, the personal representatives of the trustee had been paying interest on a loan although the chapel was now vested in new trustees.

[67] *Target Holdings Ltd v Redferns (a firm) & Or*[1995] 3 All ER 785 (HL) See also Capper D., *Compensation for Breach of Trust* [1997 Conv. 14--25

[68] Trustee Act 1925 s.61.

[69] Limitation Act 1980 s.21(1)(a)

[70] Limitation Act 1980 s.21(1)(b). See provisions under s.21(2) -trustee beneficiary (unlikely in charitable situation); s.21(3)action for recovery within six years unless the beneficiary was under a disability (s.28(1)); s.21(3) in respect of actions for account.

been no previous breaches of trust.[71] In the absence of suspicious circumstances he may assume that previous trustees have discharged their obligations[72] but if there were circumstances which suggested a possible breach he may be liable because he would have committed a breach by not enquiring.[73] If the breach occurred before he became a trustee, he should obtain satisfaction from the previous trustee or risk his own liability, unless it appears that the former trustee cannot be found, or is a man of straw.[74]

A trustee realising that his trust is in financial difficulties will wish to limit his own personal liability. This may be easier said than done in practice. Will his retirement facilitate a breach? If he retired so as not to be involved in wrongdoing, but knowing that the remaining trustees would breach their trust he will remain liable because he will have failed to prevent a breach.[75] On the other hand, if he merely realised that his retirement could facilitate a breach, he may not *ipso facto* be liable, only if he foresaw the breach.[76] That the issue is a matter of fact depending on the individual case no doubt makes for nervousness in trustees who sometimes feel that they are "between a rock and a hard place".[77] In one case[78] four trustees were establishing a charity. One of their members who tended to see greater potential in situations than there actually was, established several contracts which were out of the reach of the charity to fund. Initially, his fellow trustees were caught by his enthusiasm. Whilst they quickly realised the problem the enthusiast continued to set up arrangements against their advice. The enthusiast was eventually made bankrupt owing a debt of £95,000. The other trustees had resigned before this although they were concerned as to how to draw a line under their commitment. Each of them is still being chased to repay the debts incurred by the association and for them the notion of 'joint and several liability' carries considerable trauma.

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[71] see e.g., Oakley A.J., 1994 p.383 for the steps which a trustee should take on appointment.
[72] *Re Stratham ex p. Greaves* (1856) 8 De G M & G 291
[73] *Harvey v Olliver* (1887) 57 L.T. 239
[74] *Re Forest of Dean Coal Co* (1887) 10 Ch D 450
[75] *Head v Gould* [1898] 2 Ch 250.
[76] *ibid*
[77] Author's conversation with a trustee who publicly resigned from a trust believing that he had a choice between two evils, but the (marginally) greater one was to remain a trustee.
[78] Author's knowledge

A further difficulty is that trustees are, legitimately, not always in absolute control. For example, trustees may properly have employed staff but the staff failed to follow the trustees' instructions. In two of the case studies the most senior employees failed to carry out the express instructions of the trustees which would have limited financial liability. In one[79] the workshop manager delayed declaring redundancies that the board had directed; in the other the headmaster of an insolvent, unincorporated school[80] failed to follow instructions which resulted in further losses. In the first case the company had limited liability. In the second case trustees made personal contributions (voluntarily, not as a result of legal action) to maintain contracts sufficient to enable the charity to be wound up.

Furthermore it is not always possible to walk away from onerous contracts. Service providing charities may find themselves with longer-term problems. In the same school example, when the trustees first decided to close the school they were sued by some of the parents who argued that there was an implied term in the contract that the school would be available to provide education until the child achieved school leaving age. The trustees' problems became deeper before they could withdraw from them.

Similarly, parents attempted to prevent the closure of the school in *Gunning & Ors v Buckfast Abbey Trustees Registered & Or.*[81] The Benedictines had resolved to close a school whose numbers had reduced to 58 boarders and 49 day children. Arden J. held that parents, who were neither subscribers nor beneficiaries of the charity, had sufficient standing to bring charity proceedings.

3. In Practice

There is a tendency to think that charity trustees will not be pursued by creditors and creditors may occasionally be sympathetic to waiving minor debts arising, for example, from a rained-out fete. However in the instance given above at footnote 77, a trustee was made bankrupt.

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[79] Case Study 1
[80] CaseStudy 8
[81] The Times, 9th June 1994

In the *Legal Structures for Charity* survey[82] 34 (5.8%) of the organisations responding said that their trustees had been made personally liable and incurred financial loss. It was not certain from the survey whether the trustees had been made personally liable on contracts or in breach of trust but in the context of the question it would seem likely to be in respect of contracts.

B. MEMBERS

Members may be the focus of interest either from unsatisfied 'trust creditors' or from other creditors who claim to be personally owed by members because of contracts, the operation of agency, or because of tortious liabilities.

1. Are Members Liable, As Beneficiaries, To Indemnify Trustees?

Clearly, 'trust creditors' are likely to pursue one or more of the trustees in the first place but if they fail to achieve satisfaction creditors may wish to seek redress from members individually or collectively. If a trustee has a right to be indemnified by the *cestui que trust*[83] are the members of an unincorporated association obliged to indemnify trustees?

It appears that there is a distinction to be made between associations for profit, and not-for-profit in relation to the extent that beneficiaries of the trust may become liable. In *Hardoon v Belilios*[84] the Privy Council was required to decide whether beneficiaries, in this case the beneficial owners of shares, were liable to indemnify the trustee against calls on the shares and it was held that they were so liable. By contrast, the following year the privy council decided *Wise v Perpetual Trustee*[85] in which it was held that the principle in *Hardoon v Belilios*[86] does not apply to cases where the nature of the transaction excludes it.[87] Lord Lindley said:

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[82] Charity Law Association, N.C.V.O./ Liverpool University Charity Law Unit
[83] *Re Richardson, ex parte The Governors of St Thomas' Hospital* [1911] 2 KB 705 (CA) at 709 per Cozens-Hardy MR
[84] [1901] AC 118 (P.C.)
[85] [1903] A.C. 139
[86] [1901] A.C. 118
[87] *Wise v Perpetual Trustee Co* [1902] A.C. 139 at 149

> "Clubs are associations of a peculiar nature... and the feature which distinguishes them from other societies is that no member as such becomes liable to pay to the funds of the society or to any one else any money beyond the subscriptions required by the rules of the club to be paid so long as he remains a member. It is upon this fundamental condition, not usually expressed but understood by everyone, that clubs are formed; and this distinguishing feature has been judicially recognised"[88]

What then is the difference? In Hardoon, the beneficial owners of the shares held them absolutely, were deriving a financial benefit from that shareholding, and were presumably capable of removing their property, the shares, from the fund. In an association the members are perpetually changing, associations are not formed for gain, and the member has no right to claim a separate share of the property except on dissolution.[89] There is, of course, no capacity for the members to benefit in a charitable association.

Flannigan[90] is critical of Lord Lindley's rationale of the decision in *Wise*. He asserts that prior to *Wise*, the law had become reasonably settled that the liability of members turned on the question of agency. This analysis often resulted in liability for committee members due to their actual participation in controlling the affairs of the association. He argues that ordinary members were not usually held liable but that was because they were passive, or the organisation was run on a ready-money basis. He asserts, however, that there was no presumption of liability one way or another for either class of member. Principal status was to be demonstrated and only from that did liability follow. Flannigan doubts whether the fundamental condition referred to by Lord Lindley coincided with legal understanding although he does not suggest that the decision in *Wise* was wrong.[91]

2. Are Members Personally Liable On Contracts?[92]

Much of the case law regarding the liabilities of members in unincorporated associations comes from the 'gentlemen's club' cases which were said to be

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[88] *Wise v Perpetual Trustee Co Ltd.* [1902] AC 139 (P.C.) at 149 per Lord Lindley

[89] Ford H.A.J., *Unincorporated Non-Profit Associations*, Clarendon Press, 1959 – p. 5; Lloyd D., *The Law Relating to Unincorporated Associations*, Sweet & Maxwell, 1938 pp.20-21

[90] Flannigan R., *Contractual Responsibilities in Non-Profit Associations*, 18 [1998] O.J.L.S. 631

[91] Flannigan R., 18 [1998] O.J.L.S. 631 pp. 642-644

organised on a 'ready money' basis.[93]

In *Re St James Club*[94] Lord St Leonards L.C. said:

> "The law...is now settled that no member of a club is liable to a creditor, except so far as he assented to the contract in respect of which such liability has arisen. The member pays on the spot, and were he also liable to those supplying the articles, he would pay twice over".[95]

There is no implied power to pledge the credit of the members of an association.[96]

(a). Did The Member(s) Assent To The Contract?

A person seeking to make the members liable in contract must prove that they assented to the contract. As Ford[97] points out this must be by proving that they, either by themselves, or by their agent, entered into the contract. Lloyd[98] says that a "fundamental condition of a voluntary society's funds being made available... is... that the agreement shall have been entered into with the whole body of members".[99] In *Wise v Perpetual Trustee Corporation,*[100] considered above, the trustee of the lease of the former club premises sought to make the members liable. At first instance the question of assent was considered. It was held that as the member, Wise, knew of the liabilities of the club, including the trustees' liabilities under the lease, and encouraged members to carry on the club in the hope that it would tide over its difficulties[101] this was sufficient to render him liable to indemnify the trustees. The Privy Council, however, rejected this argument.[102]

(b). Agency

It is not proposed to recite the law of agency here, so questions such as authority and limitations thereon, which will be questions of fact in the particular case are not

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[92] See generally Warburton J., 1992, Chapter 8 in particular.
[93] *Flemyng v Hector* 2 M & W 172
[94] (1852) 2 De G.M. & G 383
[95] (1852) 2 De G.M. & G 383 at 387
[96] *Cockerell v Aucompte* (1857) 2 C.B.N.S. 440
[97] Ford H.A.J., 1959
[98] Lloyd D., *Law of Unincorporated Associations*, Sweet & Maxwell 1938
[99] Lloyd, *op.cit.* p.135
[100] [1903] A.C. 139
[101] [1903] A.C. 139 at 140

explored.

A trust creditor will only succeed against the members if he can show that the agent (committee member or trustee) did, in fact, have power to pledge the members' credit or that the members ratified a transaction which had been entered into purportedly on their behalf but without authority.[103] For example, where goods are ordered for the association without authority, and they are subsequently used by the members, the members will be taken to have ratified the contract and be liable.[104]

The question of members' liability may depend on the construction of the constitution[105] but a rule providing that a committee should manage the affairs of the club is insufficient.[106] Ford[107] suggests, following *Wise*, that the bias of English decisions is towards fixing personal liability on a member only where there is particular transactional authority, where it can be proved that the member authorised the transaction or subsequently ratified it. The trend of English authority has been almost to exclude any possibility of the imposition of personal liability on the basis of management authority; where the member left the general management of the association in the hands of the person(s) who acted in that particular transaction.[108]

Flannigan,[109] writing jurisprudentially, compares liability in partnerships with non-profit associations. He concludes that from the beginning contractual liability has been assigned on the basis of a standard agency analysis of the internal controls relations of the association. Members who participate in managing the affairs of the association are acting as principals or co-principals and will attract the liability

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[102] [1903] A.C. 139 at 150 per Lord Lindley giving the judgement of the court

[103] *Delauney v Strickland* (1818) 2 Stark 416

[104] *Delauney v Strickland* (1818) 2 Stark 416

[105] *Flemyng v Hector* (1836) 32 M.& W. 172 at 179-180 per Lord Abinger C.B.

[106] *Flemyng v Hector* (1836) 32 M.& W. 172 but in Cockerell v Aucompte 2 C.B. (n.s.) 440 the members were liable to pay for coal since the secretary who was empowered to order it had no control over club funds so the contract must have been made on the credit of the members. In *Todd v Emly* 7 M & W 489 it was recognised that there might be occasions where the committee would have to deal on credit, for example, hiring staff, where the association could not operate on a ready money basis, and which might result in a member having to pay twice.

[107] Ford H.A.J., 1959

[108] Ford H.A.J., 1959 at p.57

[109] Flannigan R., 18 O.J.L.S. p.631

approach.[110]

In respect of tortious acts of officials or committee members there may be liability if the official or member is acting under a separate duty of care, for example, in respect of premises[111] or where the activity of the individual member gives rise to tortious liability.[112] In *Baker v Jones*[113] Lynskey J. said that the members of the association individually would not be liable for such tortious acts except so far as they had individually authorised them. *Baker v Jones* is also instructive in relation to the capacity of an unincorporated association to fund the defence to a legal action on behalf of its members. Lynskey J. said it would be wrong for an unincorporated association to finance an action in tort in which its officials or servants are involved, if it does not have a common legal interest. That is, the judgement must affect the rights of the persons encouraging or financing the litigation. He was of the view that even if the rules had permitted the application of the association's funds such a use would have been unlawful as being the tort or crime of maintenance.[114]

(c). The Relevance To This Study

It was suggested by a practitioner that one area of difficulty relating to this study concerned the extent of the liability of members of an association. Leading authors[115] have explored the circumstances in which individual members may become liable and some examples are discussed in the paragraphs above.

It would appear that difficulties in this area are not necessarily difficulties relating to the law as such, but rather practical problems relating to the application of the law to a particular member or members.

In order to determine a member(s) liability a number of questions have to be asked such as whether the member assented; was the member acting as agent within or outside authority, or was he acting as a principal? The difficulties are evidentiary.

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[110] Flannigan R., 18 O.J.L.S. p.631 at 659
[111] e.g. *Brown v Lewis* (1896) 12 T.L.R 455
[112] e.g. *Miller v Jackson* [1977] Q.B. 966
[113] [1954] 1 W.L.R. 1005 at 1011
[114] *Baker v Jones* [1954] 1 W.L.R. 1005 at 1012
[115] see e.g., Warburton J., 1992; Lloyd, D., 1938; Ford H. A., 1959.

Where was the decision regarding the particular commitment made? Was it at a members' meeting? What was actually said? Are there minutes of the decision and now, with the benefit of hindsight and an eye to potential liabilities, what do the words mean? The evidence might be contained in a well kept set of minutes but, even where a decision is recorded, those who were present may have different understandings of what was agreed. Did all the members agree : were they all present? Did the member agree to the particular decision? Was a vote taken, were the names of those voting against or abstainers recorded? Was the decision by consensus? It is clearly important that a member not in agreement asks for his opposition to be recorded in the minutes. No doubt he will understand the significance of that if he is later sued even if he was not aware of it at the time when he may have decided 'not to make waves'!

If the member was not present when the decision was made, has his subsequent behaviour been such as to adopt the decision that was made? If he voted against, and remains opposed, to a particular decision or was absent when it was made, does he need to keep registering his opposition? What actions must he avoid in order not to adopt a decision? If action was agreed upon, were subsequent activities in accordance with the agreed action, or were they in excess of it?

The law in this area is not particularly complex (although all possible questions may not yet have been answered by the common law) but its awkward retrospectiveness of application for members, when an association is being dissolved, makes questions as to contributories and their respective liabilities difficult.

(d). Extent of Liability

Unless the liability has been limited to the extent of the funds of the association, where it exists, the liability of a member(s) is unlimited. Where several members are liable, liability is joint and several and they should all be joined as parties to the action[116] but where one has contracted on behalf of the others the contracting

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[116] *Everett v Tindall* (1804) 5 Esp 169

member, or all of them may be sued as principals.[117]

Providing that all the members have the same liability a representative action can be used to enforce a contract made with an unincorporated association[118] but not if the liability is different, or if the members have different defences.[119]

3. Priorities In Insolvency Of An Unincorporated Association.

The question of priorities in winding up unincorporated associations was raised as having presented a problem in one of the receiver and managerships. In this case, the Charity Commissioners proposed that it be dealt with pragmatically on the basis of the 1986 Insolvency Act.

Technically, the question of priorities in the insolvency of an unincorporated association is not particularly relevant since it will be the trustees who are personally liable to the extent of their individual estates. It may, however, become an issue if, for example, in the winding up of a charity, it becomes clear that the association's funds will be inadequate to meet all liabilities and the creditors do not wish to pursue individual trustees. The question of priorities could also become relevant if trustees had undertaken several contracts limiting liability to the extent of the association's funds which were inadequate to meet all liabilities in full.

As priorities in respect of bankruptcy were established by pre-Insolvency Act (1986) common law and are now contained in the insolvency legislation, the Charity Commission's pragmatism may be warranted.

III. CONTRIBUTORIES IN COMPANY WINDING-UP

A. INTRODUCTION

"Contributory" means every person liable to contribute to the assets of a company in the event of its being wound up, excluding a person deemed liable to contribute by

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[117] *Duke of Queensbury v Cullen* (1787) 1 Bro Parl Cas 396
[118] *Barker v Allanson* [1937] 1 KB 463
[119] *Barker v Allanson* [1937] 1 K.B. 463

the court by virtue of sections 213 or 214 of the Insolvency Act (that is, fraudulent or wrongful trading).[120] The liability of a contributory creates a debt, in the nature of a specialty, equivalent to a contract under seal, accruing from the time when the contributory's liability commenced, but payable at times when calls are made for enforcing the liability.[121]

B. MEMBERS

The general position when a company is wound up, is that every present and past member is liable to contribute to its assets to any amount sufficient for the payment of its debts and liabilities, and the expenses of winding up, and for the adjustment of the rights of contributories among themselves.[122] There are, however, exceptions to this in respect of past members[123] and members of limited companies. A past member is not liable on any debt or liability contracted after he ceased to be a member;[124] and is only required to contribute if it appears that he is likely to satisfy the contributions required of him.[125]

In a company with unlimited liability all contributories are liable. In the winding up of the Glasgow City Bank,[126] an unlimited company, the bank suspended payment with immense liability which resulted in members (who happened to be trustees of other funds) being called upon as liable in their own right. It is very unlikely that charitable corporations, except some established by Royal Charter or statute[127] would have unlimited liability.

Members of companies limited by shares or guarantee are only required to contribute

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[120] Insolvency Act 1986 s.79(1) and(2)
[121] Insolvency Act 1986 s.80
[122] Insolvency Act 1986 s. 74(1)
[123] i.e. Insolvency Act 1986 s.74(2)(a) - whose membership ceased at least a year before the commencement of winding up [date of company's resolution or time of presentation of petition – Insolvency Act 1986 s.129(1) and (2)]
[124] Insolvency Act 1986 s.74(2)(b)
[125] Insolvency Act 1986 s.74(2)(c)
[126] see *Muir v City of Glasgow Bank & Liquidators* (1979) IV AC 337 H.L.(Sc) and *Fraser v Murdoch* (1881) VI AC 855 (HL Sc)
[127] e.g. Further and Higher Education Corporations established under the Further and Higher Education Act 1992 and Education Reform Act 1988

either to the extent of the amount outstanding (if any) unpaid on shares[128] or, if the company is limited by guarantee, to the extent that they have undertaken to contribute to the company's assets in the event of the company being wound up.[129] If the company is limited by shares and guarantee, the member is liable to contribute to the extent of unpaid shares and to the limit of his guarantee[130] although Professor Pennington doubts if any such companies continue to exist.[131]

C. THE LIABILITY OF DIRECTORS

Providing that there has been no wrongful or fraudulent trading, breach of duty, or other corporate wrong-doing by the directors, in their capacity as directors, there is no liability to contribute to the assets in the event of a company being wound up.

1. Wrongful Trading

The potential financial difficulties facing service providing charities and those which are undertaking activities under contracts are considered in chapter eleven. If funding runs out and the activities are not or can not be terminated immediately, the directors may find themselves liable for wrongful trading. By virtue of section 214 of the Insolvency Act 1986, the court may declare that a director, or shadow director[132] is liable to contribute to the company's assets (as the court thinks fit and proper) if the company has gone into insolvent liquidation and some time before the commencement of winding up, that director knew, or ought to have concluded that there was no reasonable prospect of the company avoiding insolvent liquidation.[133] However, it is a defence if the director can satisfy the court that as soon as he became aware of the situation, he took every step to minimise the potential loss to the company's creditors.[134]

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[128] Insolvency Act 1986 s.74(2)(d)
[129] Insolvency Act 1986 s.74(3)
[130] Insolvency Act 1986 s.74(30
[131] Pennington Robert R.,Corporate Insolvency Law, 2nd Ed, Butterworths 1997
[132] Insolvency Act 1986 s.214(7) - Shadow director : a person in accordance with whose directions or instructions the directors of a company are accustomed to act (but not merely professional advisors) (Insolvency Act 1986 s.251)
[133] Insolvency Act 1986 s.214(1) and (2)
[134] Insolvency Act 1986 s.214(3)

The test to be applied in respect of the facts which a director ought to know, the conclusions he should reach and the steps he ought to take are those of a reasonably diligent person having both the general knowledge, skill and experience reasonably expected of a person carrying out these functions and the general knowledge, skill and experience that the director has.[135] As Sealy and Milman point out the test is both subjective and objective. "The director is thus to be judged by the standards of the 'reasonable' director, even though he is himself lacking or below average in knowledge, skill or experience, but by his own higher standards if these are above average."[136] The notion of objective standards may not be absolute. In *Re Produce Marketing Consortium Ltd*[137] Knox J. accepted that the objective standard needed to relate to the particular company. Sealy and Milman comment that this approach permits the court to make allowances in the case of non-executive and part-time directors.[138] Passive inactivity is unacceptable and the same test applies to functions that the director does not carry out but which are entrusted to him.[139]

Applications to the court in respect of wrongful trading are made by the liquidator if it becomes apparent to him during the course of the liquidation that this has occurred.[140] It is also worth noting that the court may make such order as it thinks fit. It has been suggested that it is primarily compensatory rather than penal so *prima facie* the contribution would relate to the depletion in the company's assets but the section confers wide discretion and it would be undesirable to spell out limits on the discretion.[141]

It has also been decided that section 727 of the Companies Act 1985, under which the court may relieve a director of liability for breach of duty where he has acted honestly and reasonably and ought fairly to be excused, does not apply in relation to wrongful trading.[142]

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[135] Insolvency Act 1986 s.214(4)(a) and (b)
[136] Sealy L.S., and Milman D., 1994 at p.256
[137] (1989) 5 BCC 569
[138] Sealy L.S., and Milman D., 1994 at 257
[139] Insolvency Act 1986 s.214(5)
[140] *Insolvency Act 1986 s.214(1)*
[141] *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569 at 597 per Knox J.
[142] *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569

It is important therefore that the directors of a charitable company which is in difficulty keep a close eye on the financial and other commitments of the company and take any necessary, if painful steps, to limit losses to creditors. It is not the fact that the company was wound up insolvent that will provoke the liquidator to make an application in respect of wrongful trading. An element of irresponsibility (in the lay sense) is necessary.

2. Fraudulent Trading

Where, in the course of winding up, it is apparent that the company's business has been carried on with intent to defraud the creditors of the company or of another person, or for any other fraudulent purpose, the liquidator may apply to the court for a declaration that those knowingly party to this activity are liable to make contributions to the company's assets as the court thinks proper.[143] Sealy and Milman suggest that there will be little reason for liquidators to invoke this provision since the new concept of wrongful trading is wide enough to include fraudulent trading, its standard of proof is less onerous and the practical consequences will be the same.[144] The difference is that only directors can be made liable for wrongful trading, whereas the scope of those liable for fraudulent trading is wider, namely, "persons knowingly parties".[145]

3. Breach of Trust

Directors of charitable companies are charity trustees.[146] Although, in a commercial context the validity of an act of a company may not be called into question on the ground of lack of capacity[147] and the power of the directors in respect of transactions with third parties dealing in good faith is deemed to be free of limitation under the company's constitution[148] there are limitations in terms of charitable companies

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[143] Insolvency Act s.213(1)and (2)

[144] Sealy L.S., and Milman D., 1994 at p.252. The provisions may be invoked, however, if a punitive order is being sought for reprehensible conduct -*Re a Company (No 001418 of 1988* [1990] BCC 526)

[145] Insolvency Act 1986 s.213(2)

[146] Charities Act 1993 s.97 – charity trustees are those having general control and management of the charity.

[147] Companies Act 1985 s.35(1)

[148] Companies Act 1985 s.35A(1) as amended by Companies Act 1989 s.108(1)

imposed by the Charities Act.[149] Although transactions beyond the powers of the company are binding in favour of third parties who do not know they are dealing with a charity, other *ultra vires* acts of a charity remain void. In a commercial or charitable context, where transactions are beyond the capacity of the company, a member may bring proceedings to restrain acts outside the company's capacity;[150] and it remains the duty of company directors to observe limitations on their powers. Directors remain (personally) liable for acts outside their powers.[151] The difference is that in a non-charitable context extra-capacity transactions may be ratified by the members,[152] in which case the directors will not be personally liable.[153] In a charitable company the ratification of extra-capacity acts is only valid with the prior approval of the Charity Commissioners.[154] Clearly, if the Charity Commissioners do not give such approval, they may decide to recover any loss of charity funds resulting from the breach from the directors personally.

Actions for breach of trust against company directors may also arise where a company has been made a party to illegality by the wrongdoing of its directors or other constructive trustees. This was explained by Ungoed-Thomas J. in *Selangor United Rubber Estates v Cradock (N.o3).*[155] Ordinarily where a beneficiary is claiming against a trustee for breach of trust, the beneficiary is not a party to the illegality. However, when the directors acting for a company become involved with an illegal transaction with a stranger, the company itself becomes a party to the transaction and therefore the illegality. For that reason, the company could not sue the stranger. The company's claim for breach of trust is against the directors and any other constructive trustees for perpetrating the transaction and making the company party to the wrong-doing in breach of the duty owed by the directors to the company.

Where a corporate body is a charity, and any offence has been committed by it with the connivance of, or attributable to the neglect of any director, manager, secretary or

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[149] Charities Act 1993 s.65(1) and Companies Act 1985 ss.35 and 35A as amended
[150] Companies Act 1989 s.35(2)
[151] Companies Act 1989 s.35(3)
[152] Companies Act 1989 s.35(3)
[153] Companies Act 1985 s.35(3)
[154] Companies Act 1985 s.35(4) and Charities Act s.65(4)
[155] [1968] 3 All ER 1073 at 1151 et seq

similar officer, that person, as well as the corporate body is guilty of the offence and is liable to be proceeded against and punished accordingly. If a corporate body is managed by its members, this would also apply to members.[156]

4. 'Delinquent' Directors

If, during the course of winding up a company, it becomes apparent that a present or past officer (which will include a director) of the company has committed certain wrongs including misapplication of company funds or property, or breach of fiduciary duty in relation to the company, the official receiver, liquidator, creditor or contributory can apply to the court to have the director's conduct examined.[157] The court may compel the company officer to repay or otherwise restore the property, with such interest as the court thinks fit[158] or to contribute to the company's assets by way of compensation.[159] It is also possible that the same facts may result in the disqualification of a director.[160]

A contributory may only make an application to have a director's conduct examined with the leave of the court but, as it is not a requirement of such an application that he will benefit from any order made,[161] a member of a charitable company could theoretically apply to the court.

5. Power of the Courts to Excuse the Breach

Under section 727 of the Companies Act 1985 where there has been negligence, breach of duty or breach of trust by an officer of a company and it appears to the court that he has acted honestly and reasonably and having regard to all the circumstances of the case he ought fairly to be excused, the court has power to

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[156] Charities Act 1993 s. 95. See also Companies Act 1985 s733(2)(3) for similar provision in non-charity context.

[157] Insolvency Act 1986 s.212

[158] Insolvency Act 1986 s.212(3)(a)

[159] Inbsolvency Act 1986 s.212(3)(b)

[160] Company Directors Disqualification Act 1986 (CDDA)s.2 - offences regarding promotion, formation, liquidation of a company; CDDA ss.3,5 - persistent breach of company legislation, CDDA s.4 - fraudulent trading or fraud in relation to company; CDDA s.6 - company insolvency, unfit conduct; CDDA s.8 - disqualified after DTI inquiry; CDDA s.10 - wrongful trading.

[161] Insolvency Act 1986 s.212(5)

relieve him wholly or partly from the liability on such terms as it thinks fit.[162] An officer of a company anticipating such a claim against him may apply to the court for such relief before the claim is made against him.[163] There are parallels between these provisions and those relating to trustees under section 61 Trustee Act 1925.

IV. RECOVERY OF TRUST PROPERTY AND THIRD PARTY'S POSITION

It is not the function of this study to explore issues relating to restitution in depth.[164] Nevertheless, it is worth noting that, for a charity whose assets have been misapplied, actions for restitution of property and tracing may be more productive than chasing an insolvent trustee.[165]

A. THIRD PARTY'S FRAUD

It may also be possible for a charity to recover funds where a fraud has been perpetrated on the charity by a third party. For example, in 1992, the National Hospital for Neurology and Neurosurgery Department Foundation was able to recover property stolen by its employee Rosemary Aberdour. The loss had not been identified by the charity's auditors. The trustees managed to recover almost the full amount stolen from the bank and building societies where the charity's accounts were held and from a number of other organisations which had provided services for Miss Aberdour. In addition, the charity's auditors made a substantial payment to the charity.[166] Similarly, in 1995 it was reported that the Salvation Army had recovered all of the £8.8M funds that had been lost through the fraud perpetrated on the organisation.[167]

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[162] Companies Act 1985 s.727(1)
[163] Companies Act 1985 s.727(2)
[164] see Millett P.J.'s recent articles for a discussion of the associated issues : *Equity's Place in the Law of Commerce* (1998) 114 LQR 214 and *Restitution and Constructive Trusts* (1998) 114 LQR 399
[165] Tracing – see e.g. Oakley A.J., 1994 pp.608-611; Hayton D., 1996, Chapter 11
[166] [1992] Ch. Comm. Rep. Paras. 94-97
[167] [1995] Ch. Comm. Rep. Paras. 59-61

B. FACTORS AFFECTING THIRD PARTY LIABILITY

A stranger receiving money from the trust (including a company) which he knows to be property of a trust is liable, as a constructive trustee, if facts are brought home to him which show that to his knowledge the money is being applied inconsistently with the trust, if he is made out to be a party to a fraud, or to a breach of trust on the part of a trustee.[168]

1. *Royal Brunei Airways v Tan*: Liability of Third Parties

The liability of third parties in respect of trustees and beneficiaries was discussed in *Royal Brunei Airlines v Tan*[169] by the Privy Council in 1995:-

(a). Trust Advisers – Honest Third Parties

Lord Nicholls said :

> "All these people will be accountable to the trustees for their conduct. For the most part they will owe to the trustees a duty to exercise reasonable skill and care. When that is so, the rights flowing from that duty form part of the trust property. As such they can be enforced by the beneficiaries in a suitable case if the trustees are unable or unwilling to do so. That being so, it is difficult to identify a compelling reason why, in addition to the duty of skill and care vis a vis the trustees... third parties should also owe a duty of care directly to the beneficiaries."[170]

(b). Others Who Deal With Trustees

Lord Nicholls commented that it was difficult to see why obligations should be owed to the beneficiaries.[171]

(c). Third Parties Acting For Dishonest Trustees

In such cases the trustees would have no claims against the third party, but does the third party owe a duty to the beneficiaries? The third party must act honestly – is

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[168] see *Re Blundell (Blundell v Blundell)* (1888) XL Ch D 370 at p.381 per Stirling J. See also *Belmont Finance Corporation v Williams Furniture Ltd No. 2* [1980] 1 All E.R. 392 C.A.
[169] *Royal Brunei Airlines v Tan* [1995] 2 AC 379 (P.C.)
[170] [1995] 2 AC 379 (P.C.) at 391 per Lord Nicholls of Birkenhead, giving the judgement of the court
[171] [1995] 2 AC 379 (P.C.) at p.392 per Lord Nicholls of Birkenhead

that enough? It was considered that dishonesty was an essential ingredient.

> "There may be cases where, in the light of the particular facts, a third party will owe a duty of care to the beneficiaries. As a general proposition, however, beneficiaries cannot reasonably expect that all the world dealing with their trustees should owe them a duty to take care lest the trustees act dishonestly."[172]

In conclusion Lord Nicholls said

> "dishonesty is a necessary ingredient of accessory liability. It is also a sufficient ingredient. A liability in equity to make good resulting loss attaches to a person who dishonestly procures or assists in a breach of trust or fiduciary obligation. It is not necessary that, in addition, the trustee or fiduciary was acting dishonestly, although this will usually be so where the third party who is assisting him is acting dishonestly"[173]

V. CONCLUDING COMMENT

In a number of areas there are difficulties associated with the unincorporated association as a vehicle for charity. By comparison, the law appears to be clearer in respect of members' rights and obligations in respect of companies. It is, however, the question of personal liability which is of most concern to trustees.

The appropriateness of the unincorporated association as a vehicle for a service providing, as opposed to a strictly grant making charity, has to be questioned.

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[172] [1995] 2 AC 379 (P.C.) at p.392 per Lord Nicholls of Birkenhead .
[173] [1995] 2 AC 379 (P.C.) at p.392 per Lord Nicholls of Birkenhead

CHAPTER 9 : RESCUE MECHANISMS

I. INTRODUCTION

It is clear from the case material referred to in this study, if evidence were needed, that charities can find themselves in a variety of difficulties. Financial problems are common, but trustees, or trustees and staff, can be at loggerheads, there may be misapplication of resources, or the management of the charity may be in a muddle and need help to sort itself out. This chapter examines the legal or practical opportunities for help and assistance that may be available to a charity in difficulty although opportunities for corporate rescue under the Insolvency Act are covered in chapter three.

Perhaps the oldest rescue mechanism applicable to charities in the context of this study would be the appointment of a receiver or receiver and manager.[1] A receiver and manager of a charity can now be appointed by the Charity Commission under the Charities Act 1993[2] as part of their protective powers in respect of charities. Such receiverships are explored below. The Commission also has power to remove or suspend trustees, employees, and others associated with a charity in order to protect charities.[3] Those powers are considered below but their application is also mentioned in chapter eight with regard to the removal of trustees. The Commission is also able to authorise dealings with charity property, authorise *ex-gratia* payments and, probably most importantly from the perspective of this study, advise charity trustees.[4] In addition to these statutory provisions a number of consultancy services have been developed for charities, and the National Council for Voluntary Organisations (N.C.V.O.), in conjunction with the Commission supported the introduction of a dispute resolution service now managed by the Centre for Dispute Resolution (CEDR). These services are also considered below.

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[1] See *Att.-Gen v Schonfield* [1980] 1 WLR 1182 at 1187 per Megarry V.-C. See also, e.g., the Newport Schools cases, *Att.-Gen. v Haberdashers Company ex.rel. Whitworth* (1852) 15 Beav. 397; *Att.-Gen. v Haberdashers Co* (1791) 1 Ves. Jun. 294; (1791) 4 Bro C.C. 103 which show the established use of the remedy in the 18th century.

[2] Charities Act 1993 s.18(1)(vii) and s.19

[3] Charities Act 1993 s.18

[4] Charities Act 1993 ss.26,27,29 respectively

II. RECEIVERS

A. INTRODUCTION

A receiver is a person appointed for the collection or protection of property. Unless the receivership concerns a floating charge and is an administrative receivership[5] there is no requirement that the receiver be qualified as an insolvency practitioner.[6]

Receivers may be appointed in several circumstances. First, a receiver may be appointed out of court either under the Law of Property Act on a mortgage when the mortgage money has become due[7] or under powers contained in a debenture. This is particularly relevant in the non-charitable company situation in respect of secured loans whether over fixed or floating assets.[8] Secondly, a receiver may be appointed by the court by way of equitable execution when a debtor is in possession of property, or has an interest in property, which cannot be reached by ordinary process of execution.[9] Thirdly, the court may appoint a receiver on an interlocutory application to receive rents, or get in personal property affected by the proceedings, in lieu of the person having control of the property, in order to protect the property until the respective rights of the parties has been ascertained.[10] Fourthly, following a section 8 inquiry[11] the Charity Commission may appoint a receiver and manager of the charity.[12]

Neither a receiver appointed under the Law of Property Act, nor a receiver appointed by way of equitable execution constitutes a rescue mechanism for the purpose of this study, although such an appointment might be made in order to rescue some particular property belonging to a charity. Those two options are not, therefore

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[5] see chapter three

[6] It would appear that minors, peers, M.P.s and persons living outside the jurisdiction are excluded, and it is not fatal to such a receiver's appointment that he has no experience of estate management, or that he is illiterate. (39 Halsbury's Laws (4th Ed) para. 847)

[7] Law of Property Act 1925 ss.101,109

[8] Insolvency Act 1986 Part III. A receiver appointed under a debenture secured by a floating charge over the whole of the company's assets is an administrative receiver (s29(2)) and must be an insolvency practitioner (s230(2))

[9] Civil Procedure Rules Sched 1 - Rules Supreme Court Ord. 51

[10] C.P.R. Sched 1 - R.S.C. Ord 30 r.1/2

[11] Charities Act 1993 s.8

[12] Charities Act 1993 s.18(1)(vii) and s.19

explored further. Administrative receivers were considered in chapter three.

B. COURT APPOINTED RECEIVERS AND MANAGERS

1. Receivers

By section 37(1) of the Supreme Court Act 1981[13] the High Court has jurisdiction to appoint a receiver by interlocutory or final order in all cases where it appears to the court to be just and equitable to do so, and the appointment may be unconditional or on such terms as the court thinks just.[14]

Apart from appointments by way of equitable execution,[15] the general ground on which the court appoints a receiver is ultimately, in every case, the protection and preservation of property for the benefit of persons who have an interest in it.[16] The receiver may be appointed on the application of any beneficiary if required for the safety of trust property or due administration of trust property, and, if necessary, the receiver may be appointed against charity trustees.[17] The safety of trust property and due administration of it are deemed to be imperilled where the trustee(s) are guilty of losing, wasting, improperly disposing of, or neglecting trust property.[18]

2. Managers[19]

The court can appoint a receiver to act as manager of an undertaking but this is for a limited period specified in the order, although it can be extended if appropriate.[20] Such an appointment takes the conduct of the business out of the hands of those who had previously carried it on and vests control in the hands of the manager. A court appointed manager is not an agent or employee of the business although a manager appointed out of court may be.[21] The court appointed manager is to be regarded as

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[13] Supreme Court Act 1981 s.37(1)
[14] Supreme Court Act 1981 s.37(2)
[15] under R.S.C. Ord. 51
[16] 39 Halsbury's Laws (4th Ed) para. 827
[17] See the discussion of *Att.-Gen. v Schonfield* below.
[18] 39 Halsbury's Laws (4th Ed) para. 831
[19] A receiver appointed by the court under Supreme Court Act 1981 s37 may also be appointed manager.
[20] 39 Halsbury's Laws (4th Ed) para. 974
[21] 39 Halsbury's Laws (4th Ed) para. 980

custodian or caretaker of the business for the owners.[22]

The powers of the manager are to buy and sell, pay outgoings, appoint and dismiss staff and, unless expressly prohibited, enter into fresh contracts in the usual course of business, but he must not enter speculative dealings or allow his personal interest and duty to conflict. His terms of appointment must be strictly observed.[23]

3. Circumstances In Which The Courts Will Appoint A Receiver Or Receiver And Manager

The court powers of appointment are applicable in all cases in which it appears just and convenient to make an appointment under section 37 of the Supreme Court Act 1981. Lightman and Moss suggest that the rules of practice expressed in the cases are, for practical purposes, the same as those governing the grant of an injunction. Thus a receiver will only be appointed where this secures some legitimate advantage for the applicant, where the property over which he is sought to be appointed is of some value or is capable of beneficial realisation, and where it will not operate unfairly between creditors.[24]

Lightman and Moss identify several situations in which the courts will appoint a receiver[25] *inter alia* where the undertaking is incapable of managing its own affairs because of the absence of directors, or of dissension within the board. They suggest that such an appointment will only be temporary, pending the resolution of the obstacles to effective control by the board and their resumption of control.[26] Interestingly, in a commercial context, Fennell[27] comments that a court appointed receiver can be valuable in a deadlocked business or where assets are misapplied.

The court may also appoint a receiver and manager of specified assets of a company at the instance of a shareholder or creditor if assets are in jeopardy because of the risk of misappropriation or dissipation by those controlling its affairs. According to

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[22] 39 Halsbury's Laws (4th Ed) para. 980
[23] 39 Halsbury's Laws (4th Ed) para. 982
[24] Lightman G., & Moss G., *The Law of Receivers of Companies*, (2nd Ed), Sweet & Maxwell, 1994 p.337
[25] op.cit., p.338 et seq.
[26] *Stanfield v Gibbons* [1925] W.N.11
[27] Fennell S., *Court Appointed Receivers A missed Opportunity*, 14 [1998] Insolvency Law & Practice p.208

Lightman and Moss the only criterion is whether the appointment is right and just in the particular circumstances.[28]

Although Lightman and Moss are referring specifically to companies, it would appear that the court's powers in this context to protect assets extends to unincorporated bodies including trusts and charities. In the charity context the courts have appointed receivers, for example, where the identity and appointment of trustees was uncertain and there were disputes as to the charity's affairs (*Attorney-General v Schonfield*[29]); where charity funds might be misappropriated (*Attorney-General v Wright*[30]); and to receive rents and make certain payments on behalf of the charity (*Attorney-General v Haberdashers Co. ex rel Whitworth).* [31]

In *Attorney-General v Schonfield* the charity's instrument of government was made under section 17(2) of the Education Act 1944. As a result of uncertainty as to the appointment and identity of trustees, and disputes as to the affairs of the charity, a receiver and manager had previously been appointed.[32] The case concerned the powers of such a receiver and manager.

Receivers may be appointed against trustees. For example, a receiver may be appointed on the application of a beneficiary if the appointment is required to safeguard trust property or proper administration of the trust.[33] Receivers may be appointed against charity trustees[34] and in respect of a public trust[35] although in respect of charities and public trusts such appointment will not be made unless the Attorney General is a party.[36]

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[28] *op.cit.* p339

[29] [1980] 1 W.L.R. 1182

[30] [1987] 3 All ER 579

[31] *Att.-Gen. v Haberdashers Company ex.rel. Whitworth* (1852) 15 Beav. 397 in particular. Other cases *Att.-Gen. v Haberdashers Co* (1791) 1 Ves. Jun. 294; (1791) 4 Bro C.C. 103

[32] *Jewish Schools Secondary Movement's Trusts* (unreported) October 1979 per Megarry V.-C.

[33] *Beaumont v Beaumont* (1811) cited 3 Mer. at 696; *Brodie v Barry* (1811) 3 Mer. 695; *Browell v Reed* (1842) 1 Hare 434

[34] see *Att.- Gen. v Schonfield* [1980] 1 W.L.R. 1182 and *Att.-Gen. v Haberdashers. Corporation ex.rel. Whitworth* (1852) 15 Beav. 397

[35] *Skinners. Co. v Irish Society* (1836) 1 My & Cr 162 and *Gray v Chaplin* (1826) 2 Russ 126

[36] *loc.cit.*

4. Court Appointed Receivers in Respect of Charities

Prior to the recent charity legislation, the mechanism of appointing a receiver to manage the affairs of a charity was available in respect of charities only through the courts.

In *Attorney-General v Schonfield*[37] the court was required to determine the ambit of the receiver and manager's powers. Sir Robert Megarry V.-C. commented that although he had not previously encountered the appointment of a receiver he did not doubt the court's power to make such an appointment.[38] It is clear from the Adams Grammar School, Newport, cases[39] that the appointment of a receiver was not uncommon, and in the eighteenth century the receiverships lasted many years albeit improperly.[40] These cases are considered below.

(a). The Adams Grammar School Cases, Newport, Shropshire

In the Adams Grammar School cases, there had been gross misconduct on the part of the trustees on several occasions[41] and reference was made to the Master for the settlement of a scheme to use surplus income. Under the new settlement, a receiver was also appointed in 1797 to receive the rents and profits of the charity estate, with liberty to set and let and to make certain payments on account of the charity according to the scheme.[42] The original receiver was a Mr Cotes, a solicitor. By 1852, his business successors had 'inherited' the receivership. In 1852 the court also considered a petition in respect of a similar long-term receivership in respect of the Free Grammar School in Monmouth[43] in which the receiver had been appointed almost 150 years previously- in 1708. It is clear from the 1852 cases that the proper persons to have the execution of a trust are the trustees[44] and that the appearance of

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[37] 1990] 1 W.L.R. 1182

[38] [1980] 1 W.L.R. 1128 at 1184 per Sir Robert Megarry V.-C.

[39] *Att.-Gen. v Haberdashers Company ex.rel. Whitworth* (1852) 15 Beav. 397 in particular. Other cases *Att.-Gen. v Haberdashers Co* (1791) 1 Ves. Jun. 294; (1791) 4 Bro C.C. 103

[40] *Att.-Gen. v Haberdashers Co* (1852) 15 Beav 397

[41] *Att.-Gen. v Haberdashers Co* (1792) 4 Bro C.C. 103 itself deals with misapplication of trust property and refers to previous gross misconduct up to 1700.

[42] see *Att.-Gen. v Haberdashers Co* (1852) 15 Beav 397 at 398

[43] see *Att.-Gen. v Haberdashers Co* (1852) 15 Beav 397 at 403

[44] *Att.-Gen. v Haberdashers Co* (1852) 15 Beav 397, Sir John Romilly referred to Lord Thurlow's judgment concerning the same case at (1791) 1 Ves Jun 295

solicitors on behalf of the Attorney-General and the charity since the decease of the relator was improper.[45]

(b). *Attorney-General v Schonfield*[46]

Attorney-General v Schonfield explores the role of receiver and manager in respect of a charity in greater depth. The originating summons was taken out by three purported trustees of the Jewish Secondary Schools Movement's Trusts, seeking to have two main questions determined, namely, who were the trustees, and by what trusts was the charity governed. The charity was also in serious financial difficulties and there was disquiet about the way the schools were being run.[47] Unusually, a receiver was appointed in respect of the Jewish Secondary Schools Movement's Trusts to "collect get in and receive all the assets property and effects" belonging to the charity and to "manage the affairs of the said charity" until the substantive hearing of the summons. During the course of the receivership it became clear that the appointment of a headmaster was urgent, but who were the correct persons to make the appointment?

One argument advanced was that the receiver could do anything that the trustees could do, so he could appoint the head. However, the trustees had power to appoint the governors who were responsible for the head's appointment and it was impossible to sustain the contention that the trustees could do directly what they could do indirectly. Sir Robert Megarry V.-C. was clear that, had the trustees had the power to appoint, as was the situation in the case of the girls' school,[48] the receiver would have had the power to appoint.

The second argument was that the receiver could and should exercise the powers of the trustees to remove the existing governors of the school and appoint new ones in their stead. These could then, together with the representative governors, exercise all the functions of the governors, including the appointment of a head. This would also

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[45] *Att.-Gen. v Haberdasher Co* (1852) 15 Beav 397 at 407
[46] [1980] 1 W.L.R. 1182
[47] [1979] Ch. Comm. Rep. para.s 46 et seq
[48] *Jewish Secondary Schools Movement's Trusts* (unreported) 1979

serve to clarify the identity of the school governors.

Megarry V.-C. explored what the receiver and manager had been appointed to do. He explained that a person appointed to be a receiver and manager of a company's property is not thereby appointed to be a manager of the company.[49] Here the receiver was appointed to manage the affairs of the charity. In the event of deadlock in the foundation governors, Megarry V.-C. would have been reluctant to say that the power to manage the charity's affairs did not include power to secure the due management of one of the schools by doing what was needed to ensure effective foundation governors.[50]

> "The power 'to manage the affairs' of the charity must mean the power to manage those affairs effectively, and that must mean the power of conducting and controlling those affairs according to their nature. It means conducting and controlling directly what can be done directly, and making proper provision for others to conduct and control what has to be done by others."[51]

Megarry V.-C. hesitated over the powers of receiver and manager in respect of the appointment of governors as not being an activity usually associated with receivers. He had no hesitation over the need to bring about the proper operation of the charity in accordance with its governing provisions. In the end he reached the conclusion that the receiver had the power to remove the existing foundation governors whoever they might be, and appoint new governors in their place. He saw that someone who was or claimed to be a foundation governor could be removed and then appointed to the foundation thus removing doubt as to his position as a foundation governor.[52]

He noted that the power to appoint a receiver is of purely equitable origin, and is one of the oldest remedies in the Court of Chancery. The remedy is one to be "moulded to the needs of the situation: within proper limits a receiver may be given such powers as the court considers to be appropriate to the particular case".[53] Megarry V.-C. made it clear, however, that he was not holding that a receiver of an educational charity's affairs would routinely have such a power; and secondly, the

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[49] *Re B Johnstone & Co (Builders) Ltd* [1955] Ch 634,646, 661, 662
[50] *Att.-Gen. v Schonfield* [1980] 1 W.L.R. 1182 at 1187 per Megarry VC
[51] [1980] 1 W.L.R. 1182 at 1187 per Megarry V.C.
[52] [1980] 1 W.L.R. 1182 at 1187

receiver should only exercise the power after obtaining and considering proper advice about the persons to be appointed governors. Thirdly, in removing existing governors, the receiver was required to make it plain that their removal was solely in order to enable the school to be properly carried on and such removal was not in any way to be a criticism of those being removed but that a clean sweep was being made so as to remove uncertainties and put into office the requisite number of foundation governors whose title is derived from an order of the court.[54]

It is clear therefore, that in moulding the remedy to the particular circumstances, the courts may give the receiver quite wide and unusual powers if needed.

A court appointed receiver is an officer of the court, appointed for the benefit of all the parties to the action.[55] The period of receivership may be specified by the court, or it may be "until judgement or further order" in which case it is terminated by the judgement.[56] As an officer of the court the receiver may seek the guidance of the court on his actions or future actions.[57]

The future of court appointed receivers in the charity context since the 1992 Charities Act is considered below.

III. 'RESCUE' BY THE CHARITY COMMISSION

A. GENERAL PROTECTIVE POWERS

The Charity Commission has power to institute inquiries into a particular charity or into a class of charities under section 8 of the Charities Act.[58] Following the institution of such an inquiry there are a number of steps which they can take if they believe that the charity is being badly administered and/or its property needs to be protected, including the appointment of a receiver and manager.[59]

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[53] [1980] 1 W.L.R. 1182 at 1187
[54] [1980] 1 W.L.R. 1182at 1188 per Megarry V. -C.
[55] 39 Halsbury's Laws (4th Ed) para. 808
[56] 39 Halsbury's Laws (4th Ed) para. 810
[57] C.P.R. Sched 1 -R.S.C. Ord 30 r.8
[58] Charities Act 1993 s.8(1) providing that the charity(ies) are not exempt.
[59] Charities Act 1993 ss.18 and 19

The 'rescue mechanisms', or protective powers, available to the Commissioners are contained in section 18 and supplemented by section 19 of the Charities Act 1993. They are available to all charities irrespective of the mechanism under which they exist. The commissioners, of their own motion,[60] may order the removal of inappropriate or unsuitable trustees,[61] replace trustees,[62] or appoint trustees.[63]

The protective powers of the Commissioners come into play if *either* there has been misconduct or mismanagement in the administration of the charity, *or* it is necessary or desirable to act to protect the property of the charity or to secure its proper application.[64]

If *either* of these factors is established during the inquiry the Commissioners may order the suspension of, *inter alia*, a trustee, officer, or employee of the charity pending consideration of their removal.[65] They may also order the appointment of additional trustees as necessary for the proper administration of the charity[66] or order the vesting of charity property in the Official Custodian.[67]

The Commissioners also have powers more directly geared towards protecting charity property. Where property is held on behalf of the charity, the Commissioners may order that person not to part with it without their approval,[68] or where money is owed to the charity, the debtor may be ordered not to repay without the Commissioners' approval.[69] Failure to obey the Commissioners Orders constitutes

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[60] compare powers under Charities Act 1993 s.16 – concurrent powers which must be exercised on the application of other parties namely, the charity (or sufficient trustees : s.16(7)(b)) , on the order of the court, or on the application of the Attorney General (s.16(4)) or if the charity is small – any trustee, interested person, or two local inhabitants(s.16(5)), unless the trustees should have applied for a scheme and have not done so (s.16(6)

[61] Charities Act 1993 s.18(4) – trustee who was recently discharged from insolvency procedures (s.18(4(a)); is an insolvent corporation (s.18(4)(b)); is incapable by virtue of a mental disorder (s.18(4)(c); is inactive or unwilling to act(s.18(4)(d); or is abroad.(s.18(4)(e)

[62] Charities Act 1993 s.18(5)(a)- who have been removed under s.18(4) or otherwise

[63] Charities Act s.18(5) where there are no trustees, or too few of them (s.18(5)(b)); where there is a single trustee and the Commissioners believe the numbers should be increased for the proper administration of the charity(s.18(5)(c); an additional trustee is necessary for the proper administration of the charity because one of the trustees does not act, is abroad etc(s.18(5)(d)

[64] Charities Act 1993 s.18(1)(a) and (b)

[65] Charities Act 1993 s.18(1)(i)

[66] Charities Act 1993 s.18(1)(ii)

[67] Charities Act 1993 s.18(1)(iii)

[68] Charities Act 1993 s.18(1)(iv)

[69] Charities Act 1993 s.18(1)(v)

contempt of court.[70] The Commissioners may also restrict the transactions that the charity can enter into or the payments that can be made.[71] Since 1992, they may also appoint a receiver and manager in respect of the property and affairs of the charity.[72]

Both of the factors must be established (that is, there is misconduct or mismanagement and it is necessary to protect the charity's property) before the Commissioners may order the removal of, *inter alia*, a trustee, officer or employee who has been responsible for, or facilitated, the misconduct or mismanagement and/or they may establish a scheme for the administration of the charity.[73]

The Charity Commission Annual Reports prior to 1992 suggest that, to some extent, the inquiries themselves produced desirable results in that the inadequacies identified were remedied after correspondence or discussions with the trustees.[74] Examples in the reports include trustees, who had been accused of exercising undue influence or receiving benefit from a trust, who resigned and new trustees were appointed,[75] or trustees who were advised to apply for a scheme to widen objects.[76] In other cases the trustees accepted the shortcomings identified in the inquiry report and applied funds appropriately, or inappropriate payments were refunded[77] and the charity was kept under review.[78] Where necessary, however, the Commissioners used their powers by, for example, freezing accounts,[79] removing and replacing trustees[80] or prohibiting transactions or further appeals for funds.[81] In 1992[82] it was reported that 24 bank accounts were frozen; 3 trustees were removed and 9 appointed and 51 cases were referred to the police. Fundraising was prohibited in a further 20 cases and improved practices secured in a further 24 cases.

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[70] Charities Act 1993 s.88(b)
[71] Charities Act 1993s.18(1)(vi)
[72] Charities Act 1993 s.18(1)(vii)
[73] Charities Act 1993 s.18(2)
[74] see e.g. [1981] Ch. Comm. Rep. para. 106
[75] [1981] Ch. Comm. Rep para. 117
[76] [1980] Ch. Comm. Rep. para. 165
[77] [1990] Ch. Comm. Rep. para. 67, 68
[78] [1990] Ch. Comm. Rep. para.75 and [1991] Ch. Comm. Rep. para. 130
[79] [1990] Ch. Comm. Rep. para.73 and 74
[80] [1991] Ch. Comm. Rep. paras. 109,129; [1978] Ch. Comm. Rep. para. 161; [1977] Ch. Comm. Rep. para. 165

B. Background to Introduction of Receiver-Manager Powers

The Commissioners acquired the power to appoint a receiver and manager in the 1992[83] legislation. Their reports prior to 1992 indicate areas in which they were powerless to intervene. For example, in 1981, the Commissioners noted that their inability to act in the administration of a charity meant that their powers were limited where the trustee body was divided on questions of policy, or on other internal matters,[84] or where there were internal disputes which only the courts could resolve,[85] although the Commission was still able to exercise its advisory powers in a positive way in many cases.[86] In 1986 the Commissioners commented on their inability to appoint a receiver and manager of a charity and identified the need for legislative change to widen their powers to enable them to wind up a charity and transfer its assets to another where they were not satisfied that the trustees were administering the charity in good faith; and to act for the protection of charity property without giving notice to defaulting trustees and thereby giving them the opportunity to cover their traces.[87]

As is clear from the previous discussions, it was possible for the courts in a suitable case to appoint a receiver and manager.[88] In 1982, serious mismanagement was identified in VOLSTAIC[89] which appeared to be insolvent. Attempts were made to establish whether there was a responsible body willing to take over the administration of the charity, probably for the purpose of winding it up, but in the meantime the Commissioners ordered the charity's bank account to be frozen and forbade it to enter into further transactions or appeal for funds. The Commissioners sought to

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[81] [1979] Ch. Comm. Rep. para. 138
[82] [1992] Ch. Comm. Rep. para. 90
[83] Charities Act 1992 s.8(2)
[84] [1981] Ch. Comm. Rep. para. 110
[85] [1981] Ch. Comm. Rep. para. 111
[86] see [1979] Ch. Comm. Rep. para.s 128-131 – Gurdawara Sikh Temple, Coventry : dispute between members – parties were warned that, if the matter was fought to the bitter end, they might be left to bear some of the costs personally, and fresh elections were held on the basis of the new constitution. See also [1998] Ch. Comm. Rep. pp. 15,16
[87] [1986] Ch. Comm. Rep. para.47
[88] e.g. *Att .-Gen. v Schonfield* [1980] 1 W.L.R. 1182
[89] [1982] Ch. Comm. Rep. paras. 105-109

appoint the Official Solicitor as trustee. Subsequently[90] the Official Solicitor was appointed trustee of the charity in order to wind it up. "Where, however, no other body is willing to act; there are substantial assets outstanding but which may be insufficient... to meet the liabilities; and where the only reasonable course is to wind up the charity, it seems to us that the Official Solicitor's experience of acting in receivership could be invaluable."[91] Whilst this appears to have provided a similar mechanism to the appointment of a receiver and manager made possible by the 1992 Charities Act, later consolidated into the 1993 legislation,[92] it would not necessarily mean that a receiver and manager would now be appointed in a case such as this. If the charity were insolvent on both tests (rather than the cash flow test only) it would be unlikely that there would be adequate resources with which to fund a receiver and manager's appointment which in such a case would require technical (probably paid), rather than lay, expertise. Since 1992, however, the Attorney General, or the Commission after an enquiry, may petition the court for a charitable company to be wound up.[93] As there is no mechanism for the compulsory winding up of an unincorporated charity[94] the option to use a similar arrangement to that in VOLSTAIC remains important.

C. Receiver and Manager Appointments Under the Charities Act

The appointment of a receiver and manager is probably the closest 'rescue mechanism' to those available in respect of companies, under the Insolvency Act 1986.

Where an inquiry has been instituted[95] and misconduct or mismanagement in the

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[90] [1984] Ch. Comm. Rep. paras.51-53
[91] [1984] Ch. Comm. Rep. para. 53
[92] Charities Act 1993 s18(1)(vii) and s.19
[93] now Charities Act 1993 s.63(1) and (2)
[94] See the discussion of the applicability of Insolvency Act 1986 s.220 in chapter 2.
[95] under Charities Act 1993 s.8

administration has been identified,[96] or it is necessary or desirable to act to protect the charity's property or to ensure that it is applied properly,[97] the Commissioners may, *inter alia*, order the appointment of a receiver and manager[98] and in doing so they are not required to give notice to the trustees of their intention to make such an appointment.[99]

The Commissioners may appoint an appropriate person to be receiver, providing that the appointee is not employed by the Commission[100] and they may determine his functions, together with such incidental powers as they think expedient, to be carried out under their supervision.[101]

The order may provide for the appointee to have such of the trustees' powers as are specified in the order, and for such powers to be exercised to the exclusion of the trustees.[102] The appointee may take advantage of the Commissioners' advisory powers as if he were a trustee.[103] The Commissioners may themselves seek directions from the High Court in connection with the functions of the appointee[104] and the application must be paid for by the charity.[105] The High Court may give directions, and may make declarations as to rights, whether or not the parties are before the court.[106] It is worth noting that in an 'ordinary' court appointed receivership, the receiver may seek the court's directions directly, himself, and several of the receiver-managers interviewed regretted that they do not have this power.

The Secretary of State may make regulations in respect of the appointment, remuneration of, and reporting by appointees[107] as well as the requirement to provide

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[96] Charities Act 1993 s.18(1)(a)
[97] Charities Act 1993 s.18(1)(b)
[98] Charities Act 1993 s.18(1)(vii)
[99] Charities Act 1993 s.18(12)
[100] Charities Act 1993 s.19(1)
[101] Charities Act 1993 s.19(2) and s.89(1)
[102] Charities Act 1993 s.19(3)
[103] Charities Act 1993 s.19(4)(a) and s.29
[104] Charities Act 1993 s.19(4)(b)
[105] Charities Act 1993 s.19(5)
[106] Charities Act 1993 s.19(5(a)(b)
[107] Charities Act 1993 s.19(6)

security, and determining or disallowing the appointee's remuneration.[108] The Regulations authorise the Commissioners to require the appointee to provide security[109] and to determine the appointee's remuneration[110] to be payable out of the income of the charity[111] (capital or endowment are not expressly included). The appointee must report to the Commissioners not later than three months after appointment.[112] The report must include an estimate of the total value of the charity's property at his appointment[113] and such information about the property and affairs of the charity immediately prior to his appointment as he believes should be included even if it may eventually be included in an inquiry report.[114] The report should also outline the appointee's strategy for discharging his functions[115] and include any other matters that should be brought to the Commissioners' attention.[116]

The appointee must continue to make reports to the Commissioners annually (not later than one month after each anniversary of his appointment), estimating the current value of the charity's property; outlining his activities during the previous twelve months and any changes to his strategy.[117] The appointee must also make a report not later than three months after he ceased to hold office estimating the value of the charity's property at that date and summarising his activities either since the date of his appointment, (if that was less than twelve months ago), or since his last 'anniversary' report[118] (unless he ceased to hold office less than a month after the anniversary of his appointment and the 'anniversary' report has been duly made[119]).

Since 1992 (up to and including the 1998 Report) Annual reports of the Commission indicate that twenty six[120] receiver-manager appointments have been made, although

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[108] Charities Act 1993 s. 19(7)
[109] The Charities (Receiver and Manager) Regulations 1992, SI 1992 No 2355 r.2
[110] SI 1992 No 2355 r.3(1)
[111] SI 1992 No 2355 r.3(2)
[112] SI 1992 No 2355 r.5(2)
[113] SI 1992 No 2355 r.5(2)(a)
[114] SI 1993 No 2355 r.5(2)(b)
[115] SI 1993 No 2355 r.5(2)(c)
[116] SI 1993 No 2355 r.5(1)
[117] SI 1993 No 2355 r..5(3)
[118] SI 1993 No 2355 r..5(4)
[119] SI 1993 No 2355 r..5(5)
[120] [120] [1992] Ch.Comm.Rep. page 12; [1993] Ch.Comm.Rep. para. 54; [1994] Ch.Comm.Rep. para. 90; [1995] Ch.Comm.Rep. para. 49; [1996] Ch.Comm.Rep. para. 169; [1997] Ch.Comm.Rep. paras. 86 and 110 [1998] Ch. Comm. Rep. p.21

a press release issued February 1999 suggests that it was 25.[121] During the research information was gathered on ten receiver–managerships and in three the charity has been insolvent on the cash flow test but had other assets.[122] In three, the appointment was made in order to repatriate assets which had been moved abroad.[123] In these cases the appointee has been an accountant; and in one case a solicitor with particular expertise in charity and insolvency law was briefed by the Commission to support the receiver-manager.[124] There have been other occasions, however, when the appointee's technical accounting expertise was not so essential. For example, where a dispute had arisen between a national body and one of its local branches (independently registered as a charity) over the ownership of local charity assets, the Operations Director of the national charity was appointed to take possession of 'branch' premises.[125]

1. Receiver and Manager Appointments in Practice

In 1997 Runacres[126] outlined some of the reasons for receiver-manager appointments as being mismanagement, failure to achieve objectives, trustees' unwillingness to respond to problems, undue influence or breach of duties, concerns of other regulatory bodies, deadlock on the trustee body or the need to secure assets. Other reasons include, for example, where there are protracted disputes within the charity which become so disruptive as to prevent the proper administration of the charity[127] or where the current trustees were unable to administer the charity.[128]

In discussion, with receiver-managers some points have recurred. First, the lack of direct access to the courts has been identified as a possible disadvantage, because the receiver-manager feels, perhaps wrongly, that the advice of the Charity Commission[129] does not give the same legal protection that a court order would. It

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[121] Charity Commission Press Release, February 1999 advising of the appointment of R-M in the Tracheotomy Patients Aid Fund.
[122] Case Study 4, Case Study 5, and Case Study 6.
[123] Case Study 9 and Case Study 20
[124] Case Study 9
[125] Case Study 17
[126] Runacares F., in a talk to the Charity Law Association – 13th March 1997
[127] N.C.P.T.A. [1998] Ch. Comm. Rep. p.20
[128] Tracheotomy Patients Aid Fund, Charity Commission Press Release February 1999.
[129] under Charities Act 1993 s.19(4)(a) and s.29.

also may mean that opportunities for clarifying the law on some point may be lost, although it is possible, however, for the Commissioners to apply to the High Court for directions.[130] Secondly, the absence of a moratorium was of great concern to early receiver-managers. It would appear that, as time has passed and creditors have not taken action against the charity to recover debts, this now gives less cause for concern. A further difficulty is that, although the trustees do not have advance warning of the appointment of a receiver-manager, the charity has already been subject of an inquiry and one of the practitioners appointed commented that trustees had time to 'export' the charity's assets to the disadvantage of the charity. That said, however, once it has been decided to appoint, the tender process and actual appointment of the receiver-manager is very speedy.

Receiver-manager appointments are only likely to be made in reasonably well-resourced charities. The Charity Commission has recognised this and comments that as a result receiver and manager appointments will only be appropriate in a minority of cases.[131] Although by 1996 a limited number of receiver and managerships had been concluded, the Charity Commission were clear that they had demonstrated excellent value for money and have contributed to rejuvenating a number of very valuable charities.[132]

The receiver-managers have tended to be appointed with the same powers as the trustees, although in at least two cases they have not had to have the same personal qualifications in terms of belief or membership of an organisation that a trustee would be required to have.[133] This would have prevented both of them from taking on a permanent trustee role with those charities.

The Charity Commission feels that they have made innovative use of these new powers,[134] in situations where trustees interests and duties conflicted. From the limited consideration of receiver-managerships in this study it would appear that the Commission has used these powers to support or rescue charities in a wide range of

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[130] Charities Act 1993 s.19(4)(b)
[131] [1996] Ch.Comm. Rep. para. 168
[132] [1996] Ch.Comm. Rep. para. 168
[133] Case Study 5, Case Study 9

situations and produce positive outcomes for the charity.

This does not, however, mean that receiver-manager appointments are free of controversy and there have been legal challenges in several of the cases where appointments have been made.[135] However, no appointment has been upset by such proceedings.

D. When a Court-Appointed Receiver and Manager Might Be Preferable To a Charity Act Appointment

There may still be situations in which it is necessary for the court to appoint a receiver, for example, if other areas of law than charity law, on which the Commission advises, were involved or, indeed, if unresolved legal principles were at stake. It is conceivable that a charity might have considerable endowment producing little income and as the remuneration of the receiver-manager is from the charity's income[136] court involvement might be necessary. However, the Charity Commission would be likely to retain control in respect of applications for the appointment of a receiver. First, they have the same powers to bring charity proceedings[137] with reference to the affairs of charities as are exercisable by the Attorney General.[138] Secondly, charity proceedings[139] brought by other persons would require their prior authorisation or that of a High Court (chancery) judge[140] and the Commission must not, without special reasons authorise charity proceedings to be taken where the case can be dealt with by them under the powers of the Charities Act 1993.[141]

It seems likely, therefore, that court-appointments of receivers and managers in respect of charities are only likely to be made if there are exceptional legal difficulties.

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[134] [1995] Ch. Comm. Rep. p.9 para. 28

[135] *Weth & Ors v Att.-Gen.& Ors* (Unreported) November 1997, (Unreported) March 1998, [1999] 1 W.L.R. 686(CA) (Oct. 98), (Unreported) April 1999; *Rezafard & Ors.v Runacres & Or.* (Unreported) Nov 1998

[136] S.I. 1992 No. 2355 r.3(2)

[137] Charities Act 1993 s.32(1)

[138] except to petition for the winding up of a charitable company . Only the Att.-Gen. may present the petition (Charities Act 1993 s.32(2)) unless there has been a s.8 enquiry and there has been misconduct or it is necessary to act to protect charity property. (Charities Act 1993 s.63(2))

[139] i.e. proceedings in any court ... brought under the court's jurisdiction with respect to charities, or brought under the court's jurisdiction to trusts in relation to the administration of a trust for charitable purposes – Charities Act 1993 s.33(8)

[140] Charities Act 1993 s.33 (2) and (5)

IV. MERGERS - INCLUDING APPLICATION OF SCHEME MAKING POWERS

Charities may consider merger for a number of reasons. It may bring together two or more organisations with similar objects and operations which could more usefully and effectively operate together.

Potrani[142] notes that the mechanism for such a merger may differ according to the legal structure of the charities and sometimes it may be necessary for the merging charities to go into liquidation and form a new charity. She points out that mergers do not necessarily take account of ideological differences which may or not be able to be resolved and that there are likely to be financial costs associated with merger. Loss of identity and change of ethos were concerns identified by one of the corporate charities removed from the register when it merged.[143]

Merger may operate as a rescue mechanism. In 1995, the Charity Commission referred to assisting trustees by facilitating co-operation or merger. They refer to an almshouse charity at Bucklehaven which entered into an arrangement with another housing association enabling existing accommodation to be refurbished and new units to be built. In this case the Charity Commission made a scheme to enable the project to go ahead.[144] The amalgamation of three charities resulted from one of the receiver-managerships (C.L.I.C.).[145] The Charity Commission again used scheme making powers in 1997 when the Rainer Foundation and Royal Philanthropic Society, whose objects were similar, amalgamated because they felt that they could operate more effectively together.[146] However, in the case of the Combined Childrens' Services, there were concerns regarding financial irregularities and their bank accounts were frozen. A receiver and manager was appointed following which a merger was agreed with NCH Action for Children.[147]

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[141] Charities Act 1993 s.33(3)
[142] Potrani M., *Love Match or Shotgun Wedding* , Charity, February 1997 pp 26/27
[143] CCR – record 76
[144] [1995] Ch. Comm Rep. Paras. 16-19
[145] [1996] Ch. Comm. Rep. Paras. 172-175
[146] [1997] Ch. Comm. Rep. Para. 76
[147] [1997] Ch. Comm Rep para. 83

Some charities have merged for greater effectiveness. It has been suggested that community care was leading to greater competitiveness in the voluntary sector and several Jewish Charities, one of which had a substantial deficit, had come together to ensure greater effectiveness.[148]

Several national charities have encouraged the merger of some of their local branches in order to facilitate the more effective management of the charity's work and to ensure that there was a sufficient population from which to recruit suitable calibre trustees.[149] There can be problems with this kind of merger. For example two Relate branches[150] covering adjoining counties merged. At the time of merger both branches were significantly dependent on local authority funding. Subsequent to the merger, local government in one of the counties was re-organised by the establishment of a new unitary authority. The old county then withdrew its grant. The unitary and the second county were reluctant to pick up the shortfall in funding (since none would benefit their area) but that would put the whole of the service for the combined area in jeopardy since the new Relate was then technically insolvent on the cash flow test.

A further problem was identified in Case Study 18 in which three charities, members of the same national association, sought to merge. Two were companies limited by guarantee; the third was an unincorporated association. The merger was intended to take place by the winding up of the three branches and transfer of their assets to a new charitable company. The merger was delayed because of the possibility that future legacies to the three branches might be lost.

It has been suggested that charities may derive the benefits of working together without going to the extent of merger. Wethered[151] examines some possible options such as agency arrangements, joint venture or mutual support agreements and becoming a subsidiary of another charity which, he advises, should all be considered

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[148] Ceresdale G., *Jewish Care : Don't Take us for Granted*, Charity, October 1993, p.10

[149] e.g. Victim Support Scheme and Relate branches.

[150] Author's knowledge

[151] Wethered S., *Stopping Short of Wedding Bells But Getting Acquainted for Mutual Benefit*, NGO Finance July/August 1998 pp.22-23

before merger. In a subsequent article[152] he looks at some of the principal issues which arise if merger cannot be avoided, including the capacity of the merging organisations to amalgamate and the compatibility of their respective objects. He also considers the various merger mechanisms, namely, take-over or starting a new entity together, and the complexity of bringing organisations together which may have diversely managed operations.

Mergers also have implications for accounting. Framjee[153] considers the implications of FRS 12[154] on the restructuring of charities. He advises that restructuring provisions should include only direct expenditure and not costs associated with on-going activity so that retraining and relocation costs should be excluded. Even if the charity has no provisions to disclose at its balance sheet date, a disclosure under SSAP 17, *Accounting for Post Balance Sheet Events*, may be appropriate.

V. Non-Legal Rescue Mechanisms – ADR[155] and Consultancy

It is clear from the, albeit limited, information available from the case studies and from the survey of charities coming off the Register that internal disputes within charities are detrimental to the effectiveness of a charity and serve as a distraction from the achievement of the charity's main purpose. When the charity is already in financial or other difficulties disputes can be the 'last straw' and a significant factor in the failure of the charity.

The Charity Commission has remarked on the difficulties of internal disputes. In 1996 they discussed this at some length and commented that they were amongst the most intractable problems faced by the Commission. Disputes are demanding of resources, both of the Commission and the charity, demoralise those involved and, conducted in the public arena, corrode public confidence in charities. This is equally true of disputes internal to a charity and of 'external' disputes (that is, those between

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[152] Wethered S., *Charity mergers – Steering a Safe Course Through The Legal Waters*, NGO Finance May 1999, pp32-33

[153] Framjee P., *Timing it Right on Restructuring*, NGO Finance May 1999, pp.24-25

[154] Financial Reporting Standard 12, *Provisions, Contingent Liabilities, and Contingent Assets.*

[155] alternative mechanisms for the resolution of disputes

a charity and another person or organisation, which might itself be a charity).[156] The Commission commented that many of the complaints arise from personality clashes, disputes over policy, or disagreements over constitutional requirements and many complaints are made with a view to discrediting opponents. As a result, in 1996, the Commission began research on the 'early warnings of disputes.[157] They also considered to what extent they themselves could properly engage in any of the dispute resolution techniques such as arbitration, adjudication and mediation[158] and concluded that whilst they had no power to arbitrate or adjudicate they do have power to mediate.[159] They welcomed initiatives by N.C.V.O. and the Centre for Dispute Resolution and saw no objection to a charity paying the reasonable costs of a mediation service if, without it, the dispute would be likely to continue and result in even greater loss to the charity in the long run.[160]

Two broad possibilities exist which could enable internal disputes to be resolved outside the courts namely, alternative dispute resolution and consultancy.

A. ADR

There have been recent developments in the field of alternative mechanisms for the resolution of disputes, ADR,. and services are now available to voluntary and charitable organisations. The N.C.V.O.'s mediation service began in 1995 with the establishment of a panel of experienced mediators working on resolving conflict within the voluntary sector.[161] This has been increasingly used to deal with difficult areas where "the demands of efficiency, practicality and values" seem to clash. There are also financial benefits from using mediation where there are difficult staff relations.[162] When the service is first contacted, the first stage is to attempt to discover the source of the problem. Mediators then facilitate a day-long session away from the organisation's base when all the parties have agreed the process and

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[156] [1996] Ch. Comm. Rep. Para. 146
[157] [1996] Ch. Comm. Rep. Para. 147
[158] [1996] Ch.Comm. Rep. Para. 150
[159] [1996] Ch.Comm. Rep. Para. 152
[160] [1996] Ch.Comm. Rep. Para. 152.
[161] Information from N.C.V.O.
[162] Pollock L., *Taking the Sting Out Of Conflict*, N.C.V.O. News, May 1997 p.9

the format, the aim being to help the parties arrive at an agreed solution. It has been reported[163] that 85% of mediations are settled in one day of mediation and it is suggested that subsequent negotiation often produces a settlement with the remainder. Mediation can be used in parallel with litigation or arbitration. In 1999 N.C.V.O. entered into partnership with the Centre for Dispute Resolution which, it is said, will provide the voluntary sector with a wider group of mediators. The costs of mediation are calculated on a sliding scale.

Singh,[164] who considered the N.C.V.O. service, suggests that one of the reasons for the growth of ADR in this sector is that charity funds are in short supply, and can be better used than in litigation. The associated publicity of a court case is also avoided.[165] It seems clear from Singh's analysis that ADR can be valuable in resolving internal disputes between staff and trustees, and between charities and outside organisations[166] particularly through mediation. ADR is still in its early days and it is, as yet, difficult to see how or the extent to which it could be used to resolve disputes between trustees.

In 1998 the Charity Commission again commented on disputes as providing a persistent threat to the effectiveness of charities but they reported their establishment of a small team aiming to provide a more specialised service benefiting from the secondment of a trained mediator.[167]

B. CONSULTANCY

Over the last twenty years or so, there has also been a considerable development in consultancy services available to voluntary organisations.[168] Consultants are appointed to assist in a variety of situations – to support new members of staff; to

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[163] Moran J., *Cutting the Cost of Conflict*, N.C.V.O. News, February 1999 p.22
[164] Singh R., *Alternative Dispute Resolution : A Gift to Charities* 4 (1996/7) CL&PR 73
[165] Singh R., 4 (1996/7) CL&PR 73 at 74
[166] Singh R., 4 (1996/7) CL&PR 73 at 80-81
[167] [1998] Ch. Comm. Rep. p.16
[168] N.A.C.V.S. established a consultancy scheme for cvs in 1985 and trained a group of management/organisational consultants for Councils for Voluntary Services. Charities Aid Foundation also established a consultancy service, CAFCERT, and there are many others. N.C.V.O. now produces an annual directory of approved consultants which currently lists 83 consultants offering a range of services and expertise across the country. (*Directory of N.C.V.O. Approved Consultants 1999*)

help an organisation take a step forward; to deal with 'problems', or to support particular areas of new work. The 'problems' encountered by consultants include trustees and key staff having different aspirations for themselves or the organisation; trustees being uninvolved, too involved, interfering in day to day activities, or having formed into factions.[169] There is much that a skilled consultant can do to enable organisations to move forward but at the end of the day where attitudes are intractable and individuals are prepared to sacrifice the future of the organisation because they believe themselves to be in the right (usually wrongly), the Charity Commission or Courts may have to be involved to resolve the issues. Difficulties with trustees and members are considered in chapter seven.

VI. COMMENT ON RESCUE MECHANISMS GENERALLY

For charities which are companies, the rescue mechanisms available under the insolvency legislation considered in chapter three, particularly voluntary arrangements used in conjunction with administration have proved successful in two cases of which the author is aware. This may be the result of fairly pragmatic attitudes by creditors. They were unlikely to recover significant funds in any winding up, the charity itself was a 'worthwhile cause', so they effectively converted their debt into a donation. The administration appears to have benefited the charity in that 'kindly but woolly minded' trustees came to realise that business principles, if not the profit motive, had to be applied to the running of their charity, and the administrator seems to have developed new funding sources for the charity.[170] In a third case the purposes of the administration could not be achieved and the charity was wound up.[171]

Administrative receivership is capable of offering rescue to the company itself. Fletcher[172] suggests that prior to the regime under the Insolvency Acts (1985 and 1986) it was possible for the receiver and manager of a company's entire undertaking, making full use of the extensive powers conferred on him by a well drawn floating charge debenture, to initiate a corporate rescue and leave the company

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[169] Author's own experience as a consultant in the C.V.S. scheme
[170] Case study 3
[171] *Re ARMS (Multiple Sclerosis Research) Ltd (Alleyne v Att.-Gen. & Or)* [1997] 2 All ER 679

in a better economic condition than that in which he found it whilst at the same time safeguarding the interests of the secured creditor. This continues to be possible.

It is not known whether there have been cases of the appointment of administrative receivers in the charity sector but the pressures on local authority budgets, and social care funding may mean that more residential and nursing homes become insolvent. The appointment of administrative receiverships in the non-charitable part of the 'independent sector' appear to be increasing.[173]

The intervention of the Charity Commission, at the simple level of asking questions and offering advice to trustees, is of itself an important rescue mechanism for many charities. Where it fails, it would appear that the Commission's power to appoint a receiver-manager is useful. Indeed, in 1996 the Charity Commission commented on the increase of receiver and manager appointments made, because past appointments had shown them to be effective in cases where trustees can not or will not act in the management of their charity.[174]

Alternative methods of resolving disputes are becoming increasingly important in the charity sector and, hopefully will reduce the numbers of charity disputes which become public knowledge thus maintaining the good name of charity. Consultancy is similarly important where a charity has recognised that it has a problem, which is a positive step in itself. It can also be valuable where a charity is moving into a new area since it can provide a means of bringing additional expertise into the charity for a specific purpose, thus enabling the charity to develop.

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[172] Fletcher Ian F., *The Law of Insolvency*, 1990 at p347
[173] From knowledge of 'mapping the market' exercise in Shropshire – experience of author
[174] [1996] Ch.Comm. Rep. Para. 168

CHAPTER 10 : CONTRACT CULTURE : TRADING, TAX AND ACCOUNTING ISSUES

I. INTRODUCTION

It was not necessary to conduct this research in order to demonstrate that trading, contracting and the operation of various fiscal arrangements cause problems for charities. That is clear, from the various books and articles which have been written on this subject in recent years[1] if from nothing else. However, this research does confirm the vulnerability of charities in the contracting or trading situation. What follows relies for case material both on the research material and the author's own experience.

The changing environment, described in chapter one, in which charities are exploring alternative and novel fund raising methods, as well as the 'contract culture' have brought many changes for charities. Charities engaging in trading or fund raising to a significant extent or involved in contracting face a number of pitfalls including breach of trust and tax liabilities. This chapter explores some of these difficulties. In addition to the specific charity-orientated matters considered below, it is important to remember that charity trustees are likely also to be required to engage with all the other legislation relating to employing staff, health and safety, et cetera that may be relevant to their situation.

This chapter, however, is not intended to explore fiscal and related matters in depth. They are major topics in their own right. Rather, it aims to point up the problems encountered.

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[1] See e.g. Lloyd S., *Charities, Trading and The Law*, Charities Advisory Trust 1995; Framjee P., *Charities and Trading. Law, Accounting and Tax Issues*, Charities Advisory Trust, 1996; *Managing Your Solvency*, Ed. Norton M., Directory of Social Change, 1994; *Charities Practical Tax Planning*, Ed. Frost D., Sweet & Maxwell, 1994; Hawley K, *From Grants to Contracts*, NCVO / Directory of Social Change, 1992; Sayer K., *VAT for Charities*, Directory of Social Change (in association with Sayer Vincent) 1992 and monthly articles in NGO Finance on VAT in particular.

II. "THE DREADED TRADING"[2]

A. INTRODUCTION

Adirondack and Taylor[3] assert that trading raises some of the most complex legal issues that charities will face. These issues involve the interaction of constitutional matters, the different areas of the law relating to charity, direct taxation, and Value Added Tax (VAT), liabilities around the risks involved as well as practical and management issues. They suggest that each issue is complex, mistakes can be devastating and can lead to significant losses and the interrelationship of the issues is "hugely complex".[4]

There are perhaps four key issues for charities. What constitutes trading? What effect does it have on charitable status? Does the charity have the necessary powers to trade? What effect will it have on the charity's liability for tax?

B. TRADING

Trading is less than helpfully defined by the Income and Corporation Taxes Act 1988[5] as including every trade, manufacture, adventure or concern in the nature of trade. At first glance the definition might appear straightforward. The following examples may demonstrate why that is not so, not least, because of the nexus of the various rules relating to tax and VAT exemptions for charities.

- A typical charity shop would seem to be trading – but the sale of donated goods alone is not trading.[6]

- A lay person might think that the provision of a non-profit service is not trading but "it is not essential to... trade that the persons engaged in it should make, or

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[2] from Framjee P., *Charities and Trading, Law Accounting and Tax Issues*, Charities Advisory Trust, 1996
[3] Adirondack S., and Sinclair Taylor M., *Voluntary Sector Legal Handbook*, Directory of Social Change, 1996
[4] Adirondack S., and Sinclair Taylor M, 1996 at 549/550
[5] Income and Corporation Taxes Act (ICTA) 1988 s.832(1)
[6] [1980] Ch. Comm. Rep. para. 8; Leaflet CC 35 *Charities and Trading* Charity Commission, Feb. 1997 para. 26

desire to make a profit from it."[7]

- A religious charity selling new books is trading, unless it happens to be selling religious books in furtherance of its primary purpose. Even then the sale of post cards, communion wafers, or small items of stationery do constitute trade!

C. CHARITY LAW AND EFFECT ON CHARITY STATUS

Trading is not, of itself, a charitable activity. The Charity Commission indicates that "trading simply as a means of fund-raising is usually taxable and may also be a breach of charity law."[8]

The Charity Commission recognises that charities need a regular source of income and that trustees may wish to increase revenues through trading. However, the trustees of a charity undertaking trading without having the power to do so will be in breach of trust, could therefore be made personally liable, and any profits made will taxable.[9]

A charity may trade, however, if carrying out a primary purpose[10] or one that is ancillary to a primary purpose[11] (that is, trading which whilst not directly furthering a primary purpose, is exercised in the course of actually carrying out that purpose[12]) and which is therefore treated as primary purpose trading for charity and tax law purposes.[13]

D. INCOME AND CORPORATION TAXES

Under the Income Tax and Corporation Taxes Act 1988[14] charities are exempt from the liability to pay corporation tax on their income provided that it is applied for

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[7] *Re Duty on Estate of Incorporated Council for Law Reporting for England and Wales* (1888) 22 QBD 279, 293 Per Lord Coleridge C.J.

[8] Leaflet CC 20, *Charities and Fund Raising*, Charity Commission, May 1995 para.. 57

[9] CC 35, *Charities and Trading*, Charity Commission, February 1997 paras. 4, 5. Trustees may be in breach of trust if unnecessary tax liabilities are incurred - [1988] Ch. Comm. Rep. para. 44

[10] CS2, *Trading by Charities*, Inland Revenue, 1995 paras. 4.2 and 4.3; CC 35, 1997 para. 6 and 13

[11] CS2, 1995 para. 4.4; CC 35, 1997 para. 15

[12] CC 35, 1997 para. 16 and CS2, 1995 para 4.3

[13] CS2, 1995, para 4.4 and CC 35, 1997 para. 15

[14] ICTA 1988 s.505(1)

charitable purposes only. However, if a charity undertakes any form of trade, the profits will be subject to income tax [15] unless it is exempt,[16] that is, it constitutes primary purpose trading,[17] or the work in relation to the trade is undertaken mainly by the charity's beneficiaries.[18] There is a further extra-statutory concession[19] where the trade is not undertaken regularly, is not in competition with other traders, it is generally understood that the profits go to charity and that is why the activity is supported; AND[20] the profits are applied to charitable purposes.

The Inland Revenue also operates a non-statutory, informal, *de minimis* exemption[21] if the turnover from non-primary purpose trading is not more than 10% of the total primary and non-primary purpose trading and the trading is small scale overall. There is no right of appeal against a refusal to grant a concession by the Inland Revenue.

E. VALUE ADDED TAX : VAT

1. Introduction

It is a common misconception that registered charities are exempt from the implications of VAT.

VAT is a tax on turnover in respect of the supply of goods or services rather than profits and whether VAT is payable depends on the nature of the supply and the status of the supplier. Charities pay VAT when they purchase goods or supplies, namely, input tax. This can only be recovered if the charity is registered for VAT, and the purchase is not in connection with an exempt supply or non-business activity,[22] or indeed, the VAT may be only partially recoverable.

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[15] ICTA 1988 Sched. D
[16] ICTA 1988 s.505(1)(e)
[17] Trade which it undertakes in furtherance of its main objects. For example, the rental income from an alms house is exempt; private charitable hospitals may charge fees which are exempt from tax.
[18] The income from the sale of goods made by the poor, or people with disabilities in a workshop run by a charity is exempt from tax.
[19] Extra Statutory Concession C4 1994 (revised 1996). See CS2, 1995 Chap. 6
[20] All the conditions must apply.
[21] CS2, 1996 para 4.6
[22] Value Added Tax (VAT)Act 1994 ss..25, 26

A charity is required to register for VAT if it makes taxable supplies above the VAT registration threshold (£51,000 from 1st April 1999[23]) in any year, or it is likely to do so within the next 30 days.[24] Once registered, a charity must then charge output VAT on the taxable supplies of goods and services that it makes, and can then reclaim the input VAT it has paid. All supplies of goods and services are taxable unless they are exempt supplies.[25]

Exempt supplies include the provision of education, research, vocational training, health and welfare, and fund-raising events. For those supplies no VAT is chargeable and they do not count towards the 'turnover' threshold. Many charities are involved in these areas of work. If they are only making exempt supplies there will be no requirement to register for VAT, no matter what the turnover.

Some supplies are zero-rated[26] in which case VAT will not be added to the cost to the charity. Similarly, a charity making zero-rated supplies to a beneficiary will not be required to charge VAT on those supplies. However, the charity may recover input tax in relation to that supply.

Examples of specific zero-rated supplies for charities include, the purchase of recording and play-back equipment used by talking newspapers for blind people;[27] aids to daily living for chronically sick or disabled people;[28] the provision of appropriate bathing facilities or lifts in residential facilities run by charities[29] and supplies to an eligible body in respect of providing care, or treatment for handicapped people.[30]

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[23] S.I. 1999 No.595
[24] VAT Act 1994 Sched. 1 para..5
[25] VAT Act 1994 s.3(2) and Sched. 1
[26] VAT Act 1993 Sched. 8
[27] VAT Act 1994 Sched. 8 Group 4 items 1 and 2
[28] VAT Act 1994 Sched. 8, Group 12, item 2
[29] VAT Act 1994 Sched. 8, Group 12, items 9, 16 and 17
[30] VAT Act 1994 Sched. 8, Group 15 item 5

2. Problems with VAT

(a). Applicability of Detailed Rules

There are problems of the applicability of very detailed rules in respect of VAT. For example, the provision of education[31] is exempt from VAT if provided by an eligible body which would, for example, include a school, university, or other eligible institution. If the charity has wider objects than education, any surplus derived from the educational activity must be ploughed back into that side of the charity; if it goes into another activity the exemption is lost. Such charities must therefore monitor their activities closely.

The provision of vocational training is exempt if provided by an eligible body. Thus, courses and seminars would be exempt, as would the provision of incidental services such as materials, catering and accommodation, providing the eligible body is supplying it and the recipient is either a student or another person providing such training (so long as the supplies are directly used by students of the latter). For example, an educational charity providing a seminar for New Deal participants, in its own accommodation, with food provided by an outside caterer will find that the training supply, and accommodation are exempt, but the supply of food will be subject to VAT. Had the charity provided the food itself, it would not be subject to VAT, nor would it be subject to VAT if food only were supplied without a catering service – cold food is zero-rated! Lloyd[32] asserts that food supplied packed to be set out by the conference organiser is exempt; if arranged on platters covered with cling film by the caterers it is not!

(b). Problems with Evolving Definitions and Interpretation

Definitions for the purposes of VAT appear to be evolving. One example of this is the definition of 'care' which has recently been explored in the courts in connection with the VAT liability associated with the purchase or servicing of tail-lift vehicles for

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[31] VAT Act 1994 Sched. 9 Group 6
[32] Lloyd S., 1995 p.36

use by disabled people.[33] Help the Aged have, for many years, purchased standard vans and had them adapted for supply to charitable organisations around the country and applied zero-rating. This was challenged in 1996 by Customs and Excise[34] who argued that the provision of specialist care was essential to the definition of an eligible body in this context although the tribunal adopted a wider construction of 'care'. Subsequently, the VAT Act was amended limiting the definition of 'care'.[35] However, an extra-statutory concession has since been agreed[36] which enables two categories of charity – those whose sole purpose is to provide a range of care services or which provide transport predominantly for chronically sick or disabled people- to acquire, for example, adapted vehicles[37] at zero rate VAT.

The extra-statutory concession is important to charities providing transport. For example, the VAT on two tail tail-lift vehicles (£60,000) would be £10,500, a considerable extra burden for a charity to find.

The *Help The Aged*[38] case also highlights the potential difficulty for the supplier of goods or services to a supposedly eligible-body charity. Help The Aged supplied zero-rated goods on the basis of a customer's (another charity) declaration that it was an eligible body for zero rating. Nevertheless, it remains the supplier's responsibility to determine the liability of the goods he supplies. There is an extra statutory concession,[39] which offers such suppliers protection where the customer gives them an incorrect declaration of eligibility. If the supplier, despite taking reasonable steps to check the validity of the declaration, fails to identify the inaccuracy and makes the zero-rated supply in good faith, Customs and Excise will not seek to recover the tax due from him.

Lloyd suggests that, for a charity, making zero-rated supplies is the most favourable position for VAT purposes because a supplier can claim back input tax from Customs

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[33] under VAT Act 1994 Sched. 8, Group 15, item 5
[34] *Help the Aged* (14180) 24 May 1996, *Customs & Excise v Help The Aged* [1997]STC 406
[35] Finance Act 1997 s.34 inserting Clause 4A into VAT Act 1994 Sched. 8 Group 15
[36] see Notice 48 para. 2. 12 Sept 1997 and VAT Information Sheet 8/98 July 1998
[37] as in Group 15 note(s) VAT Act 1994 – e.g. adapted vehicles, repair and maintenance
[38] *Help the Aged* (14180) 24 May 1996; *Customs & Excise v Help The Aged* [1997] STC 406
[39] Extra Statutory Concession A16

and Excise but does not have to charge output tax.[40] However, it is important to note that zero-rated supplies do 'count' towards the VAT threshold.

(c). Failure To Recognise The Need For VAT Registration

A person who is making taxable supplies, even if zero-rated, must register for VAT if those supplies exceed the VAT registration threshold in any year. Severe penalties are associated with failure to register. First, there is a criminal liability.[41] The penalty is the greater of £50 or the specified percentage of relevant tax. The relevant tax is the net VAT which should have been paid to Customs and Excise calculated from the period when the trader should have registered, to the point when non-registration was discovered and the specified percentage is 5% if the delay in registration was less than nine months, 10% where the delay was between nine and eighteen months, and 15% is the delay was longer than 18 months.[42] The organisation also has to pay the VAT arrears. Little surprise then that failure to register for VAT has been identified as a significant factor in the insolvency of charities.[43]

(d). VAT Avoidance Schemes

Charities may seek to establish schemes in order to limit their liability to pay VAT. These can pose difficulties in that a scheme to avoid the payment of a relatively modest amount of VAT can result in a much greater liability in respect of another tax. One example is new building projects for educational establishments. Some colleges have recently discovered difficulties with their VAT avoidance schemes[44] and as a result all colleges were advised to seek clarification from their auditors.[45]

3. Practical Comment

As a result of these problems charities almost always need expert advice on VAT and

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[40] Lloyd S., 1995 pp.38-39

[41] VAT Act 1983 s.39 and Customs & Excise Management Act 1979 ss.145-155 ; see VAT Notice 700 para. 12.3

[42] VAT Notice 700/41/95 paras 3,4

[43] Seminar on insolvency of charities organised by Directory of Social Change 1993

[44] See *C & E v Robert Gordon's College* [1995] STC 1093; *University of Wales Newport College v C&E* (1997) VAT tribunal decision 15280 discussed 5(1999) CL&PR 239; and Dinsmore N., *Constructing an Escape Route,* NGO Finance, April/May 1996 for a discussion of this area.

charities need to be constantly asking themselves whether their activities generally, or some activity in particular are affecting their current VAT status.

F. SHOULD A TRADING SUBSIDIARY BE SET UP?

It is common for charities to establish subsidiary trading companies so that activities outside the charity's powers can be pursued; to separate areas of risk (including risky primary purpose trading[46]) from the main charity; to separate different areas of work within the charity's overall objects or to enable it to avoid dealing with trade and taxation issues. Where a charity is engaging in mixed trade[47] which would result in the whole of the profits being taxed[48] the Charity Commission recommend that significant non-primary purpose activity be conducted by a subsidiary trading company.[49] The advantage perceived is that where the profit is paid to the charity, whether through covenant,[50] gift aid,[51] or by way of dividend there is neither tax liability on the company, nor the charity.

Trading companies may be established to complement the work of the charity. For example Oxfam's trading subsidiary sells products manufactured by Oxfam's third world projects. This was also the case in one of the CCRs[52] which was promoting labour intensive industries in developing countries. The difficulties associated with trading subsidiaries are considered in what follows.

Adirondak and Sinclair Taylor[53] suggest that the question of establishing a trading company needs to be kept under review. For example, in *Grove v Y.M.C.A.*[54] a change in opening policy resulted in a liability to tax. It is also important to monitor existing work to ensure that it can still be carried out by the charity. When new activities are being considered charities should consider whether a trading company

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[45] Author's knowledge as F.E. college governor.
[46] See record 14 , Case Study 1
[47] where only some of the trade is primary purpose or ancillary trading
[48] CS2, 1995 para 4.7
[49] CC 35, 1997 para 36 - 39
[50] Income and Corporation Taxes Act 1988 s.577(8)
[51] Finance Act 1990 s.25(1)
[52] Record 98. CCR – corporate charity removed from the register – see Chapters one and eleven for further information.
[53] Adirondak S., and Sinclair Taylor J., 1996 at p.552

should be established for legal or practical reasons. If the nature or degree of the trade changes and the profits cease to be exempt the charity can be assessed for up to six years previous trading.[55] Since trustees are under a duty not to incur unnecessary tax[56] this must be an important consideration.

The Charity Commission suggests that where charities wish to trade as a means of fund raising it may be necessary to set up a separate non-charitable trading company.[57] In this way the risk of committing a breach is avoided and the profits of trade can be passed to the charity in a tax-efficient way.[58]

G. PROBLEM AREAS REGARDING TRADING COMPANIES:

1. Investment in Subsidiary

Charity funds have been lost as a result of ill-considered or unfortunate investment in trading subsidiaries. For example, in 1988 the Charity Commissioners' Report identified that two charities had lost £700,000 and £2-£3M respectively.[59] One of the CCRs, the subject of an Inquiry, had lost £64,000 loaned to subsidiaries.[60] The Charity Commission now recommends, *inter alia*, that the financial structures of the charity and subsidiary be kept separate; that they have separate identities and distinguishable names; and that the board should not be the same as the charity's trustees.[61] The charity needs to consider whether it has the necessary investment powers to allow it to make an investment in a trading subsidiary; whether such an investment is too speculative; and whether such an investment is in line with the charity's current investment policy.[62] Charities also need to be aware of the tax implications that apply to a charity's investment in a trading company.[63]

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[54] [1903] 4 TC 613
[55] See [1980] Ch. Comm. Rep. para. 12, [1991] Ch. Comm Rep. pp. 41-42 for examples of these difficulties
[56] [1988] Ch. Comm. Rep. para. 44
[57] CC 20, Charities and Fund-raising, Charity Commission, May 1995 para. 57
[58] CC 35, 1997 para. 39
[59] [1988] Ch.Comm. Rep. para. 45.
[60] Record 4
[61] CC 35, 1997 para. 68
[62] CC 35 1997 para. 41
[63] See CS2, 1995 chap. 13; CC 35, 1997 para. 58

If a charity makes a loan (that is, invests in) a trading company, (unless it is in respect of primary purpose trading) it must charge interest and the subsidiary must actually pay the interest.[64] The Charity Commission also expects the charity to secure the loan and establish a proper programme for repayment.[65] A charity would not be able to guarantee a trading subsidiary's borrowings[66] and the Charity Commission does not approve of charities providing letters of comfort.[67] It is recommended that trading companies be funded commercially.[68] It would appear that the Charity Commission's monitoring programme is identifying and following up issues related to funding subsidiaries.[69]

2. Payment of Profits to the Charity

Trading companies will be liable for tax although, as charities are exempt from corporation tax, any profits from trading are tax-free provided they are paid back to the charity. As the trading subsidiary may reduce its liability for corporation tax by paying some or all of its profits to the charity it is usual for this to be done.

Commercially, the arrangements for profit shedding might be by way of management charges. This is not likely to be used in the charity context since any profit from the arrangement by the charity will be taxable, and the rendering of management services may be outside the charity's capacity.

A commercial subsidiary might pay dividend on shares to its parent. As this is generally not the most tax-effective[70] method for charities this mechanism for profit shedding is unlikely to be used by trustees who could become liable for unnecessary taxation penalties.[71]

The usual methods of effecting a tax efficient transfer of profits to the parent charity

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[64] *Minsham Properties Ltd v Price (Inspector of Taxes)* 1990 STC 718
[65] CC 35, 1997, paras. 56,57
[66] *Rosemary Simmons Memorial Housing Association Ltd v United Dominion Trust Ltd* [1986] 1 W.L.R. 1440. See also CC 35, *Charities and Trading*, Charity Commission, February 1997.
[67] *Royal British Legion :Report of the Inquiry under s.6 of the Charities Act 1960*, para. 9.35, Charity Commission 1992
[68] CC 35, 1997 para. 69,70
[69] [1998] Ch. Comm. Rep. p.13
[70] CS2, 1995 para 12.16

are by Gift Aid[72] and covenants.[73] There is no mechanism for the charity to repay the gift if the subsidiary miscalculates the profit. Because the sale of donated goods is only zero-rated where the covenant is used for profit shedding, covenants tend to be more commonly used.[74]

Prior to 1997 the covenanted payment had to be made, and the payment cleared, by both subsidiary and charity before the end of the trading company's financial year. It was necessary to over-estimate the profits slightly[75] because whilst over-payments could be refunded by the charity, underpayments by the subsidiary resulted in liability for tax. This caused difficulties for many subsidiaries and their parent charities. These arrangements, but particularly the repayment of covenanted income caused difficulties for charities. In two CCRs[76] removed from the Register prior to 1997, there were problems associated with the repayment of covenanted income to the trading subsidiary. In one, there was a repayment of over £1,000 (around 5% of retained surplus) in two successive years after which the trading company became dormant. A second also had problems with the writing-back of significant covenanted income to its subsidiary and a year later carried forward an adverse balance.

Since 1997 subsidiaries have nine months from the end of the accounting period during which an underestimate in the profit payable to the charity can be 'topped up' and that payment set against the period in which the tax payment would otherwise have been due.[77] The *Review of Charity Taxation,*[78] published in February 1999, seeks views as to whether charities' subsidiaries would welcome the option to carry back Gift Aid donations in the same way.[79]

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[71] [1988] Ch. Comm. Rep. para. 44
[72] See CS2, 1995 paras. 12.8 – 12.10
[73] See CS2, 1995 paras. 12.4-12.5
[74] VAT Notice 701/1/95, *Charities*, para. 9(a)
[75] Lloyd S., 1995 p.156/7. See also Inland Revenue Statement of Practice (relating to profit shedding covenants) SP3/87 para. 7
[76] records 40 and 128
[77] ICTA 1988 s.339 (7AA), (7AB), (7AC) as inserted by s.64(1) Finance Act 1997
[78] *Review of Charity Taxation : Consultation Document*, H M Treasury, March 1999
[79] *op.cit* p. 20 point (xiv)

3. Profit-Shedding And On-Going Funding Of Subsidiary

Profit shedding causes other difficulties for trading companies. First, as Lloyd[80] indicates, the actual handing over of the cash can cause cash flow problems to the trading subsidiary, which it may have to resolve by borrowing from its bankers or the charity.

Secondly, if the trading subsidiary sheds all its retained profits what is it to do for working capital? The Charity Commissioners note that it is usually necessary for the charity to lend cash to the subsidiary so that it can continue. These payments must be regarded as investments but as the subsidiary has little or no substance if it is unable to retain profits, the investment can not be justified under trust law.[81] Lloyd asserts that this recycling of cash which is now common practice makes advisors and finance officers nervous[82] because of concerns that the Inland Revenue may attack loan-back arrangements as tax evasion and any loan arrangement of this kind should be set up in accordance with the Commissioners' guidelines.[83] The Commissioners suggest that some charities may prefer to accept the tax consequences of a limited amount of profit retention.[84] Where whole-profit shedding is adopted the Commissioners recommend that trustees take advice. They should also give careful and objective consideration as to whether they should continue to make loans to the company, whether they have the power to make the investment and as to how the investment can be structured so as to minimise the risk to the charity's funds.[85]

Thirdly, if the trading company is planning to retain some profits, unnecessary retentions should not be made because of the reduction in tax relief.[86]

A further difficulty arises if the subsidiary is selling donated goods, or is running fund raising events because zero-rating for VAT is only applicable, in either case, where

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[80] Lloyd S., 1995 p.158
[81] CC 35, 1997 para. 59
[82] Lloyd S., 1995 p.159
[83] CC 35, 1997 paras. 55-58
[84] CC 35, 1997 para. 61
[85] CC 35, 1997 para. 62, 63
[86] CC 35, 1997 para. 64

the subsidiary covenants *all* its profit to the charity.[87]

4. VAT And The Subsidiary Or Group – The "Veritable Nightmare"[88]

One of the potential advantages of establishing a subsidiary is that the charity, if a corporate body (including chartered corporations and industrial and provident societies), and subsidiary may operate together as a VAT group. If both are separately registered for VAT, then VAT must be included on any inter-company charges. Where the group is VAT registered, internal charges are outside the scope of VAT. However, in this situation all the members of the VAT group are jointly and severally liable for the group's VAT.[89] Thus if the subsidiary went into liquidation owing VAT, the parent charity would be responsible for paying it.

Randall suggests that providing the problems of joint and several VAT liability can be overcome, a VAT group could be advantageous to the charity. He gives the example of computing services provided by the subsidiary to the charity not attracting a VAT liability whereas if both were registered VAT would be charged which the charity could not recover.

VAT groups are currently being reviewed and the discussion paper, *Restriction of VAT Groups to Fully Taxable Corporate Bodies*,[90] proposes that corporate bodies would not be permitted to form, join or remain in a VAT group if they are involved in exempt activities above a *de minimis* level (including intra-group transactions); or have neither a liability nor an entitlement to register for VAT in the UK.[91] As yet, this remains a proposal which, if implemented, could have a significant impact on the charity sector.[92]

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[87] VAT Notice 701/1/95 *Charities*, para 9(a); CC 35, 1997 para. 64

[88] Randall A., *The Loneliness of the Long Distance Taxpayer Groups Run Out of Town*, NGO Finance July / August 1998 p.32/33

[89] VAT Act 1994 s.43(1)

[90] *Restriction of VAT Groups. to Fully Taxable Corporate Bodies.*, a discussion paper published by H.M. Customs. and Excise, summer 1998

[91] *op.cit.* section 7

[92] See Charity Law Association letter to H.M. Customs & Excise 29.9.98

5. Corporation Tax And 'Groups'

It is often the case that the charity and its subsidiary operate out of the same premises and are managed by the same personnel so that one of the bodies provides some services for the other through a management agreement. It is important that the charity ensures that it recovers the appropriate charges for staff, and overheads from the company, bearing in mind, however, that any profit made by the charity on this arrangement will be subject to corporation tax![93] Such charges may also affect the charity's VAT liability.

6. Fund Raising Companies

Sometimes charities establish subsidiary companies to undertake potentially high risk fund raising, for example, high profile fund raising events which the charity could undertake itself. There can be difficulties where such companies go into liquidation leaving creditors unpaid. Creditors may believe that they were dealing with the charity and pressurise trustees for payment. Despite any moral feelings of liability on the part of the trustees, the liability is not the charity's and they would require the authority of the Commissioners to make an *ex-gratia* payment to the fund-raising company's creditors.[94]

7. Subsidiaries Are Not Always Successful

ARMS (Multiple Sclerosis Research) Ltd[95] was one of the corporate charities removed from the register (CCR) in 1995. The last accounts on file showed an income of £1,993,334. It had previously reported (1987) as a post balance sheet event, that its wholly owned subsidiary had gone into liquidation and that it had written off excess expenditure of £205,962 against the previous year's surplus. The charity subsequently got into financial difficulties through overspending and was wound up in 1993 owing £1,466,000 of which £36,000 was to preferential

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[93] Case Study 2, 1995 Chap 9

[94] Charities Act 1993 s.27. See also [1988] Ch. Com. Rep. paras. 45-48

[95] *Re Arms (Multiple Sclerosis Research) Ltd (Alleyne v Attorney General & Or)*, [1997] 2 All ER 679

creditors.[96] Subsequent bequests before the charity was completely wound up were held to be in favour of the charity and consequently were available to the charity's creditors. As Lloyd pointed out "[t]his judgement underlines a proposition that many involved in charities may find difficult to accept, namely that the creditors of a charity are as important as its beneficiaries."

Another of the CCRs[97] established its subsidiary to undertake financially risky primary purpose trading. The manufacturing subsidiary was wound up in 1990 and the Charity Commission allowed the waiver of the £100,000 or so owed to the parent. Although this did not render the parent charity insolvent, it was subsequently wound up by a members' voluntary liquidation (solvent). Another CCR[98] identified in the research had established a wholly owned subsidiary at a time when the charity had made a loss for the year, but the subsidiary had not traded.

One of the CCRs, the subject of an inquiry, had been advised to set up subsidiaries to attract funds and had loaned funds for this purpose. Both subsidiaries failed before the charity could recoup the loans. The enquiry report expressed "sympathy with the directors who are to some extent victims of circumstance."[99]

8. Some Other Uses of Subsidiaries

Occasionally subsidiaries are established in order to protect assets from creditors. For example in the Case Study 5 the Charity Receiver and Manager was ready to transfer the charity's assets to another company in order to preserve a moratorium whilst he attempted to sort out the charity's affairs. In another charity,[100] in which the auditor had commented on the 'going concern' basis of the accounts, (that is, it depended on on-going grants and the goodwill of creditors) the assets were transferred to a pre-existing subsidiary.

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[96] [1997] 2 All ER 679
[97] Case Study 1 and record 14
[98] record 50
[99] record 4
[100] record 72

III. CONTRACTING / SERVICE LEVEL AGREEMENTS

A. INTRODUCTION

The contracting environment has brought many changes for charities. Norton[101] suggests that changes in funding have created an often under-resourced voluntary sector at the time when the sector faces great changes and challenges and Bashir[102] asserts that the changes taking place within legal, accounting and fiscal frameworks will have a profound effect on how voluntary organisations are managed. As Epton suggests[103] one particular difficulty with the contract culture is that charities are victims of a monopoly environment in which the public body is often the single source of funding for a particular service.[104] Clearly, these problems can be proportionally greater for smaller charities.[105] The present Government envisages a greater part for the voluntary and private sector in service provision when the Local Government Bill 1998 becomes law and "best value" is introduced for local authorities. The White Paper,[106] on modernising local government, makes it clear that local authorities delivering, rather than procuring services, will be unusual so the process of externalisation of local authority services to the private and voluntary sectors can be expected to continue.

For its part Government, in the Compact[107] recognises the need for strategic funding to ensure the continued capacity of the voluntary and community sectors to respond to Government initiatives, as well as the need to support voluntary sector infrastructure. Specifically, Government hopes to promote transparent arrangements for common arrangements for agreeing objectives; facilitating prompt payment; reviewing financial support; consulting upon changes to the funding position and informing organisations about future funding as early as possible and normally before

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[101] Norton M., Ed. 1994, Foreword

[102] Bashir H., *Managing for Financial Change*, N.C.V.O. News, March 1999 p.14

[103] Epton A., *Bound to Serve - Are Your Hands Being Tied*, NGO Finance February 1999 p.40

[104] See also *Guidelines for Funders of Voluntary Organisations*, Association of Charitable Foundations, *Risky Business – A Contracting Survival Guide*, G.M.C.V.S.

[105] Anderson B., *Care Contracts*, NGO Finance, February 1993 p.15

[106] *Modern Local Government In Touch With The People*, Cm. 4014 1998 Chapter 7

[107] *Compact on Relations Between Government and the Voluntary and Community Sector in England*, Cm.4100, 1998

the end of the current grant period. It also hopes to promote long-term, multi-year funding to assist longer term planning.[108]

B. The Status Of The Agreement.

The service level agreement is a relatively new type of arrangement, which has not been legally tested. The Charity Commission identifies the test of a service level agreement, as being one that is not intended to be legally binding.[109] Whilst it may thought that there are benefits from this, in that should the charity default there can be no contractual liability on the trustees, there are potential disadvantages. Apart from the fact that the contribution of funds is 'earmarked' and the possible danger of distorting the charity's activities in order to gain funding, the charity may have difficulty seeking legal redress if the authority defaults on payment, although there may be other ways in which it can seek satisfaction.[110]

C. The Dangers Of Output Related Funding

Much voluntary sector funding from central government is output related. With the introduction of a duty on local authorities to seek "best value"[111] with its focus on 'outcomes,' output related funding could spread to local authority funding.

There are clear dangers in contracts where payments to the charity are output related. Charities frequently work, for example, with less able or 'excluded' individuals who are less likely to achieve targets. However, the charity may have no choice but to accept that form of funding if it wishes to do the work. For example, the funding for New Deal Voluntary Sector Option is output dependent. The payments are divided into start fee, programme (on-going) fee, and a final fee for young people who "succeed" (by achieving their Personal Development Plans (PDP), or Training Plans, or who get a job). The start fee is dependent on getting the PDP signed by the participant and approved by the Employment Service (20% of fee). It would be a

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[108] Cm.4100, 1998 para. 9.3
[109] Leaflet CC 37, *Charities and Contracts*, Charity Commission 1998 para.. 9
[110] e.g. the threat of bad publicity, pressuring councillors etc.

very foolish provider, or one who had not fully understood the implications of the contract, who did not get at least an outline of the PDP signed before the participant left his initial induction interview. Similarly, the calculation of the final payment (up to 20%) is dependent on various factors together with the assessment of the adviser at Employment Services, but by now the participant has completed his period on New Deal and the provider together with placement hosts have done everything they could. All of the New Deal funding to providers is output related.[112] To mitigate the risk charitable Voluntary Sector Option providers were offered 'up-front' funding – 25% of contract price, which would not have to be repaid if minimum targets were not achieved. The concept of up-front funding was not agreed until mid-summer 1998, after the programme had commenced and claims are monthly in arrears so the funding was not quite so up-front as perhaps intended!

D. Terminations Of Agreements At Short Notice And How Safe Is The Funder?

Another difficulty, particularly with TEC (Training and Enterprise Council) funding is that the provider may well have a contract, which terminates at a given period, but to provide a service that is expected to continue beyond the life of that contract. Until the TEC knows what its allocation will be for the forthcoming financial year, which is not usually until the spring, and sometimes late-spring, it cannot begin the contracting for the next financial year. This can lead to the situation which occurred in Case Study 1, where the TEC told the charity in the last week of March that it did not intend to continue to contract from April onwards (although that particular change resulted from a change in TEC policy rather than their own funding).

Charities may feel that they are financially safe in dealing with 'externalised' central or local government departments or 'quangos' but that may not necessarily be the case. The externalised agencies are in a different financial and legal position from local or central government departments. The South Thames Training and Enterprise

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[111] *Modern Local Government In Touch With The People*, Cm. 4014, 1998 Chapter 7; Local government Bill 1998 ss.2.3

[112] Author's experience as a provider of New Deal Voluntary Sector Option.

Council (STTEC), referred to in chapter one, which went into receivership in December 1994, provides a case in point. The voluntary sector perspective of that receivership is chronicled in *From Flagship to Shipwreck.*[113] The report describes the problems faced by the voluntary sector in 1992, which included "swingeing cuts following the abolition of the GLC and ILEA"[114] and community charge capping which N.C.V.O. had calculated as a loss of £29.3 M in real terms across London." In 1994 the government cut the TEC's budget and training providers, especially those dealing with individuals with special needs, were unable to adhere to stricter contract restrictions on outputs. The 'receivership' was somewhat unusual in that instead of the company being sold to the highest bidder, only two other TECs were invited to bid; as a result the STTEC was broken up. It was also of interest that the TEC's only funder, the Government, was also the TEC's main creditor. The report comments:

> "The spectacle of the Government exercising their right as secured creditors to pocket the entire proceeds of the disposal of the TECs assets and leave South Thames voluntary groups, colleges, businesses, local authorities and individuals with an irrecoverable loss of several million pounds has been truly gut wrenching to many observers of the crisis and to local people".[115]

Subsequently, payments made to training providers (creditors) earlier in the year were reviewed by the receivers and retrospective deductions made – in some cases from money that creditors had never received and voluntary sector providers were hit by a refusal to pay for outcomes for people with special training needs, despite being explicitly written into the contracts. Creditors were advised that the debts of the STTEC would die with the company when finally wound up.

The STTEC insolvency had a considerable impact on the local voluntary agencies and two of the affected charities owed funds by the TEC feature as case material in this study having been in successful administration. One of those which featured as case material was 'rescued'[116] (through voluntary arrangements linked with administration) in the main, by virtue of their creditors waiving the debt because of the charity's name and cause. It is questionable whether it is appropriate for quasi-

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[113] Routledge J., *From Flagship to Shipwreck*, Voluntary Action Lewisham, July 1995
[114] Routledge J., 1995 p.2
[115] Routledge J., 1995 p.5

public agencies to be able to escape from liabilities in this way and put the responsibility for the future existence of creditor voluntary groups onto other organisations. Not all of the voluntary projects which the STTEC has funded were charities but with one exception,[117] those which were remain on the register. Those organisations which were charities, however, and which are identified in *From Flagship to Shipwreck* remain on the Register at the end of February 1999 although one[118] of them was 'rescued' through administration linked with a voluntary arrangement with creditors..

This type of problem may perhaps be less likely to occur where the charity is providing care, not least because some alternative arrangements will need to be in place and, as the charity will have some notice of the impending change it will perhaps be in a position to find alternative sources of funds. Primarily, however, these charities are likely to be contracting with a local or health authority to provide care for very vulnerable people so unless the care provided by the charity is below par, all parties, including the local authority will wish to have an orderly wind-down of that particular project. It is worth noting, however, that there have been receiverships amongst providers of residential care.[119] Authorities struggle to balance their books and hold down their fees to these establishments, resist block contracting and, at the same time, purchase more domiciliary care. Such trends are likely to increase the possibility of insolvency in the residential care sector where many providers are charities. In the restructuring of the 'care market' it is almost inevitable that some charitable providers of residential care will close.[120]

It is worth commenting that the Government's *Compact* [121] intends to develop good practice to address the principles of good funding, including consulting on changes in the funding position and informing voluntary and community organisations about future funding as early as possible, normally before the end of the current grant

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[116] Case Study 3
[117] Case Study 2
[118] Case Study 3
[119] The author is at present unaware of any charity in this position
[120] based on information gained from Mapping the Market in Shropshire
[121] *Compact on Relations Between Government and the Voluntary and Community Sector in England*, Cm.4100, 1998 para. 9.3

period. It is also worth noting that the Association of Charitable Foundations has produced guidelines for funders which suggests that funders should give as much notice as possible of changes; there should be consultation with the organisation being funded and decisions about future funding should be taken well before arrangements have to be made to terminate employment contracts et cetera.[122]

E. Corporate Charities Could Become 'Regulated' Companies

There is a possibility that a charitable company could be regarded as 'regulated' under the Local Government and Housing Act 1989 and its associated delegated legislation[123] where one or more local authorities have a right to nominate more than half the charity's members or directors, or where a charity undertakes more than half its business with one or more local authorities which also have members or officers of the same authorities on its board.[124] A regulated company is treated in many ways as if it is an extension of the local authority(ies) (that control or influence it) which is required to use its influence or control to ensure compliance with the general and financial regulations.[125] This situation is probably best avoided by charities!

F. The Charity's Activities May Come Within The Scope Of VAT

It is unlikely that the receipt of a grant from a public authority will affect a charity's VAT status. The same cannot be said of contracts, because the 'business case' is likely to be more easily made out,[126] and possibly service level agreements where Customs and Excise may attempt to use the same arguments. There may also be implications for income and corporation tax if the charity is viewed as trading.

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[122] *Guidelines for Funders*, Association of Charitable Foundations.

[123] Local Government and Housing Act 1989 Part V, ss. 67-73, and The Local Authorities (Companies) Order 1995 No 849

[124] For a detailed consideration of this topic see Yates E., *Local Authorities and Outside Organisations : A Legal Perspective*, Sweet & Maxwell 1996, Chapters 1-4; and *Charitable Companies : Regulated Companies?* 3 (1995/1996) C.L.& P.R. 123

[125] S.I. 1995 No 849

[126] See the discussion on VAT earlier this chapter.

G. OTHER DANGERS

The Charity Commission Leaflet, *Charities and Contracts*,[127] and the literature referred to in the sections above, describes other pitfalls of which charities need to be aware when considering entering into contracts. Lynch[128] identifies five such areas associated with the development of contracting, namely, financial issues, charity law concerns, employment issues, contractual issues and governance.

The difficulties he identifies are the possibility of having to lease property for a longer period than the contract period; payments in arrears (in particular where the scheme is funded by the European Community); and the possibility that the loss of the contract might result in insolvency. In respect of charity law, he highlights the question as to whether the contract is primary purpose trading, or should be conducted through a trading company to which the resources of the charity are charged. Where the contract will involve the employment of additional staff, Lynch suggests that the term of their employment contract might be related to the period of the contract. He advises that where a charity is taking over operations previously undertaken by a local authority, this can be fraught with difficulty and requires expert advice. With regard to contracting Lynch identified two other interesting areas. First, whether the charity's intellectual property needs to be protected under the contract and, secondly whether any exclusion clause which it seeks to incorporate into the contract is properly applicable and effective. In respect of governance he suggests that care needs to be taken where there is the possibility of continued local authority involvement in the membership of the committee of the charity.

IV. ACCOUNTING STANDARDS

A. INTRODUCTION

Accounts should be produced in such a way as to meet the standards laid down by the Accounting Standards Board Ltd which is recognised as a prescribed body under

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[127] Leaflet CC 37, 1998

[128] Lynch M., *Don't Look Back in Anger*, NGO Finance 6th December 1996 p.64/65

the Companies Act, for the purpose of issuing accounting standards.[129] The standards produced are in the form of Statements of Standard Accounting Practice (SSAPs) or Financial Reporting Standards (FRSs), which are applicable to all financial statements intended to give a true and fair view of an organisation's financial state of affairs at the date of the balance sheet irrespective of legal vehicle.[130] The following paragraphs explore the effects of some of the application of these standards.

B. EFFECTS OF APPLICATIONS OF STANDARDS

SSAP 2, *Disclosure of Accounting Policies* requires the accounting policies to be disclosed in the accounts. In particular it refers to the accounting concept of a 'going concern'. This concept is important because, as was explained in chapter one, should the organisation cease to be a going concern, other liabilities, such as redundancy costs need to be included, and adjustments may be needed to the balance sheet because asset values may achieve lower prices in a forced sale.

In one of the CCRs[131] shortly before the charity was wound up the auditor had drawn attention to the validity of the 'going concern' basis being dependent on continued funding by the Arts Council and the availability of overdraft facilities.

FRS 2 *Accounting for Subsidiaries* is relevant to all charities that have subsidiaries whether or not the parent is incorporated. Its object is to require parent undertakings to provide consolidated financial statements[132] for themselves and their subsidiaries unless excluded from consolidation.[133] Subsidiaries may be excluded from the consolidation, *inter alia*, where the interest in the subsidiary is held with a view to subsequent resale and its activities have not previously been consolidated;[134] or where the subsidiary's activities are, exceptionally, so different from the others included in the consolidation that its inclusion would be incompatible with the obligation to give

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[129] Companies Act 1989 s.19 inserting Companies Act 1985 s.256(1) and (3), and S.I 1990/1667
[130] see discussion in chapter 4 – section on certainty and SORP
[131] record 72
[132] FRS 2 *Accounting for Subsidiaries* paras. 1 and 20
[133] FRS 2 paras. 20, 21(exemptions), and 25(exclusions). The exemptions in clause 21 are unlikely to apply to charitable companies' subsidiaries

a true and fair view.[135] But the contrast between profit and not-for-profit undertakings is not of itself sufficient to justify non-consolidation.[136] The financial activities of quasi-subsidiaries (a legal vehicle or entity which does not meet the definition of a subsidiary[137]) should also be included in the consolidation.[138]

The *liability to account for contingencies*[139] is important from the perspective of this study. For example, if a charity holds a grant on terms that all or part of which may have to be repaid if certain conditions have not been fulfilled, that contingent liability must be identified in the accounts according as to the probability of conditions' occurrence. It is important that these are properly weighed up as such a liability could affect an organisation's technical solvency and clearly raise a management issue in respect of future monitoring of progress in respect of such liabilities. It is suggested that some of the factors identified in the CCRs, for example, return of grant money[140] should have previously been identified as contingent liabilities.

The *reporting of post-balance sheet events*[141] is required if they provide additional evidence of conditions that existed at the balance sheet date and materially affect the amounts included. Although the post balance-sheet events to be reported may be favourable, the unfavourable ones are most relevant to this study! One of the CCRs[142] had repaid £201,000 to a health authority and identified a further similar repayment the following year. Another[143] notes the transfer of its net assets to another charity as a post-balance sheet event.

Adjustments should be made in the accounts,[144] for example, if covenantors cannot be contacted to sign the necessary tax documents or reflecting any changes in taxation rates. Framjee points out that these adjustments may cause the charity's solvency

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[134] FRS 2 para. 25b
[135] FRS 2 para. 25c
[136] FRS 2 para. 78e
[137] FRS 5 *Reporting the Substance of Transactions* para. 1
[138] FRS 5 para. 15
[139] SSAP 18, *Accounting for Contingencies*; and S.O.R.P. – *Statement of Recommended Practice-Accounting by Charities*, Charity Commission, October 1995
[140] record 25
[141] SSAP 17, *Reporting Post Balance Sheet Events*
[142] record 30
[143] record 121
[144] SSAP 18, *Accounting for Contingencies*

position to be reassessed.[145] Two CCRs[146] reported problems with the repayments of covenants and writing back of funds.

The requirement to *account for pension costs*[147] is also relevant. Seinkiewicz and Campbell explain that prior to the introduction of SSAP 24 in 1988, the accounting treatment of pension costs tended to be on the basis of the employer's contribution to the pension fund so that the cost, which could fluctuate from year to year, did not match the provision of benefits with the employee's service. These distortions became increasingly evident as many pension schemes moved into surplus in the 1980's.[148] SSAP 24 requires the employer to recognise the expected cost of providing pensions on a systematic basis over the time that he derives the benefit of the employee's service.[149]

There are two types of pension scheme, the final salary scheme in which pension rights are usually defined as a proportion of the employee's final salary, and the money purchase scheme in which the benefits are determined by the size of the employee's fund on retirement. Problems have occurred particularly in relation to two areas, namely, final salary pensions and enhanced benefits in early retirement.

One national association of charities[150] established a final salary pension scheme for the managers of member charities. This posed considerable problems partly because each charity might only have one or two members of the pension fund and the contributions that the individual charity was required to make varied according to the age and pay of their particular employee. Some of the member charities were required to contribute substantial funds in order to meet the workers' future pension requirement. It is not thought that any of the member charities became insolvent as a result of this, but it did cause considerable difficulties for many, and it was necessary to establish new pension fund arrangements have been established for that national

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[145] Framjee P., "Going Concern Status," in *Managing Your Solvency*, Ed. Norton M., Directory of Social Change 1994

[146] records 40 and 128

[147] SSAP 24, *Accounting for Pension Costs*

[148] Seinkiewicz T., and Campbell D., *Accounting for Pension Costs - A detailed explanation of the operation and effects of SSAP 24* , Tolley, 1990 p.1

[149] SSAP 24 para. 16

[150] author's knowledge

association

With regard to discretionary or *ex gratia* pensions the cost should be charged to the profit and loss account.[151] Employers must, therefore, make a provision in their accounts with regard to early retirement of employees, particularly if they make enhanced provision. In the early 1990s, many colleges of further education faced with the Further Education Funding Council's requirement to restructure, allowed older and 'more expensive' staff to take early retirement, often with enhanced payments which reduced the need for redundancies. Some colleges were surprised at audit when required to make provision for this in the accounts because, in some cases, the cost was several hundred thousand pounds.[152]

V. POSSIBLE DEVELOPMENTS : DIRECT TAX AND VAT

The Government has identified the possibility of improving tax reliefs for charity businesses[153] by

- introducing a new tax relief to exempt the profits of small businesses carried on by charities without having to establish a trading subsidiary;
- considering extending the scope of the concession for charity fundraising events so that it applies to a wider range of events;
- making arrangements more flexible for those running a subsidiary company and
- producing clearer guidance for charities on the tax treatment of income from sponsorship and licensing their name.

Whilst not able to create new VAT reliefs the Government is seeking ways to improve or update VAT for charities, and extend VAT relief to reflect new approaches to fund raising alongside extending the Inland Revenue concession,

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[151] SSAP 25 paras.35,38
[152] author's knowledge.
[153] *Review of Charity Taxation : Consultation Document*, H.M. Treasury, March 1999 para. 4.12

aligning both reliefs.[154]

The suggestion of the development of a common, integrated approach for VAT and direct tax, obviating the need for charities to deal with two sets of rules and two Government Departments[155] is perhaps the most useful from the perspective of this study.

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[154] *op.cit.*, paras. 5.13 and 5.14
[155] *op.cit.*, para. 5.18

PART THREE:

Chapter 11 : Research Findings

Chapter 12 : Conclusions

CHAPTER 11 : RESEARCH FINDINGS

I. INTRODUCTION

The purpose of this study was to identify factors and trends that might lead to the winding up or dissolution of registered charities and to identify the legal and practical difficulties associated with that process. This chapter seeks first, to pull together the findings from the case studies examined, the charities removed from the register and the research generally. Chapter twelve seeks to draw threads together.

The methodology for this study was outlined in Chapter One. The research material has been treated in various ways. First, much of the case material, derived from the twenty case studies, has indicated topics to be covered by the 'legal' research and informed the discussion of them. For example, the difficulties expressed by practitioners concerning endowments and members' rights suggested these topics for exploration and the relevant case material is incorporated in chapters four and seven respectively. Similarly, much of the case material from the receiverships studied is considered in chapter nine.

The material derived from the examination of charities removed from the Register between January 1995 and March 1996 has, in part, been treated in the same way, in that it has been woven into the relevant section of the study. However, one of the questions posed in the study proposal was why charities are being removed from the register, and whether there is any indication that service-providing charities in particular, are vulnerable to economic, governmental, or societal changes. At the outset, it was thought that an examination of the charities being removed from the register might provide some indication of trends or factors associated with their dissolution. Accordingly, for fifteen months from January 1995 to April 1996 five, quarterly-reports, of charities that had been removed from the register were sought from the Charity Commission. The status of the charities studied was "ceased to exist."[1]

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[1] Other reasons for removal included, e.g., that the charity had become, or had always been an exempt charity and was no longer required to be, or had wrongly been registered.

It is worth making two preliminary points. First, the study of charities removed from the register identified 4,373 charities removed over fifteen months, of which 130 corporate charities were studied in detail. Whilst some general conclusions can be drawn from the whole sample, the number studied in detail is not substantial overall, being 2.9%. Nevertheless, the 130 charities represent 45% of all *corporate* charities removed, of which there were 287 in total, during that period and is therefore a more significant sample. Secondly, despite the time lag between events that had led to the removal of the corporate charities, their examination, and the writing up of this study, many of the issues and trends identified from the case material are still relevant.

In relation to the general study all the reports were analysed for 'clues' as to why the charity was removed and the destination of any remaining assets. There was some inconsistency both in the type of report that was provided and in how the records were completed. All, however, contained the name of the charity, details of its governing instrument, and the income in the last accounts; and some contained clues as to what might have happened, for example, there were occasional references to resolutions under sections 74 (or 44) or 75.[2] As some recently established charities had been removed, the first four quarters' returns (1995) were examined in respect of charities established since 1990 to see whether any trends were discernible, for example, whether particular types of charity were involved. Certain categories of charity, such as Guides, Scouts, and Masonic charities were identifiable throughout the five quarters. Although it would have been disproportionately time consuming to analyse all the records for this information, it was thought that a snapshot might prove useful. The final quarter was therefore analysed on the basis of types of charity being removed.

The 4,373, reports from the Charity Commission were analysed. A general study was made of all the returns of charities coming off the register. The Corporate Charities Removed from the Register, referred to in what follows as "**CCRs**", were then examined in more detail.

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[2] Charities Act 1993 ss.74, 75, or Charities Act 1992 s.44 – provisions relating to expending endowment or handing it to another charity.

The general analyses above had proved to be something of a blunt instrument from which disappointingly little useful information could be discerned. Among the four thousand or so charities removed from the general register were many small 'sick and poor' charities, advowsons, rent charges and ancient endowments. However, in some of the reports there was reference to the 'company' having been wound up or ceasing to trade, and some of these companies had a significant figure in the 'income' category.

From a cursory look at the charities whose governing instrument consisted of a memorandum and articles of association, that is charitable companies, it seemed that it might be more fruitful to consider this group of charities in some detail. It was thought that, although some financially risky ventures are carried out by unincorporated associations or trusts (for example, Case Studies 5 and 8), recent trends have been for such charities to incorporate. The incorporated charities may, therefore, be more likely include charities potentially vulnerable to the changes identified above associated with service provision. Further, these charities are likely to be of relatively recent origin, probably since the end of the last century and, because their activities are monitored not only by the Charity Commission but also by the Registrar of Companies and potentially the D.T.I., there would perhaps be greater opportunity to obtain information. Whilst numerically a reasonable size, the sample of charities in this category was such as to make it feasible to examine each record in detail.

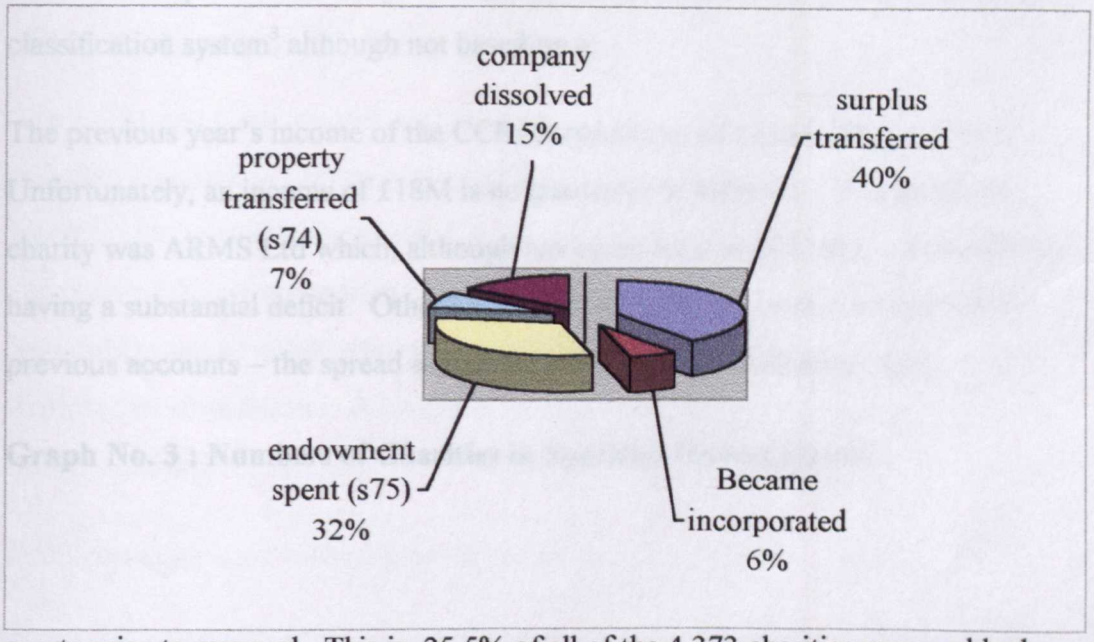
II. Analysis of The 4,373 Charities Removed

Where it adequately represents the information, data is presented in tabular or graphic form in this section.

During the five quarters studied 4,373 charities were removed and some reason for removal was identifiable in 1313 of them.

Graph No. 2 : Outcome Shown Graphically For The 1313 Charities In Which The Reason For Removal Was Identifiable

Out of those 1313 charities where the reason for removal was identifiable, 1,119 had



assets prior to removal. This is, 25.5% of all of the 4,373 charities removed had assets immediately prior to removal.

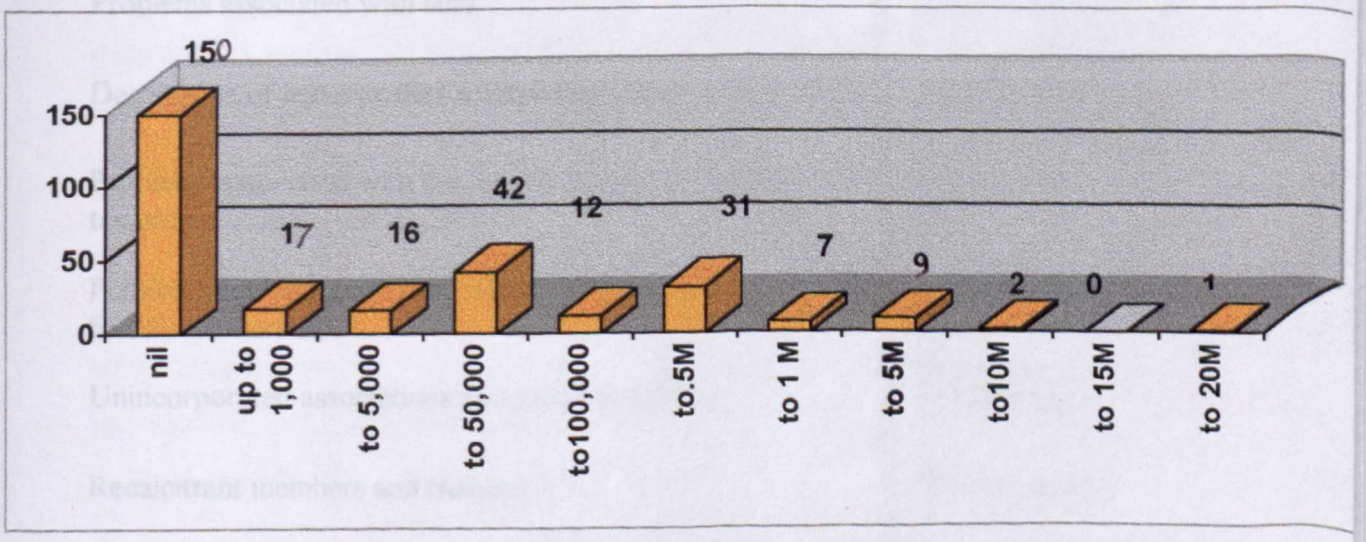
Overall, the information available from these statistics is not particularly helpful apart from providing contextual material, not least because many charities removed in the period had been defunct for some time or were duplicate registrations. There was also clear evidence that national charities were tidying their branch structures. The 'snapshot' of quarter five indicated that 204 out of 1,218, 17%, of the charities removed during that quarter were branches of national charities.

The 287 CCRs, during the five quarters were studied in two broad ways. First, some general information was gathered from the whole group as part of the general study of the quarterly reports. Whilst 150 showed 'nil' income in the previous year, 137 showed a positive income and it was thought that these would represent recently active charities. Secondly, and with the very considerable assistance of staff at the Charity Commission, the public files of 131 out of 137 of these 'active' corporate charities were collected at the Liverpool Office of the Commission and were subjected to a more in-depth study. As one had been removed by mistake and re-instated on the register the number of CCRs studied in depth was 130.

The income of the charities was analysed into broad bands and their activities were examined. The activity was not determined according to the Charity Commission's old beneficiaries or purposes code which was objects-based and its use would not have been helpful to this study. The analysis used in this study is nearer to the new classification system[3] although not based on it.

The previous year's income of the CCRs ranged from nil (150 CCRs) to £18M. Unfortunately, an income of £18M is no guarantee of solvency. That particular charity was ARMS Ltd which, although having an income of £18M, was wound up having a substantial deficit. Other CCRs also showed substantial income in their previous accounts – the spread of income is shown in the following chart.

Graph No. 3 : Numbers of Charities in Specified Income Bands:



There was a wide range of activities undertaken by the CCRs. Some were active abroad, twenty two were related to a particular religion, eighteen were housing related, thirty-four had an involvement with the arts, seventeen were schools, twenty were associated with museums or conservation, and thirty-nine were associated with

[3] The *Charity Commission Classification System*, Charity Commission, March 1997

training. Also in the group were three examination boards, together with UCCA, PCAS, and STAR, the admissions systems for universities and polytechnics prior to the establishment of the Universities Central Admissions Service.[4]

ISSUES RAISED BY THE CCRS AND CASE STUDIES

The CCRs and Case Studies raise a number of factors that may affect the viability or solvency of charities. Some of the factors such as staffing or trustee problems are internal. Others reflecting societal, economic or governmental change are external to the charity but impact upon it. In addition, the research material raises a number of legal and practical issues relating to winding up of charities. These topics are explored in what follows. Material from the cases has informed other parts of this study, dealt with as follows:-

Problems associated with permanent endowment	Chapter four
Problems associated with land	Chapter four
Destination of legacies after a corporate charity is wound up	Chapter five
Problems associated with the 'contract culture', trading and taxation	Chapter ten
Possible problems associated with striking off as a mechanism for dissolution	Chapter three
Unincorporated associations and property holding	Chapter six
Recalcitrant members and trustees	Chapter seven
Liability to contribute in the winding up	Chapter eight

[4] arising from changes in higher education resulting from Education Reform Act 1988 and Higher and Further Education Act 1992 Part II ss.121-161

A. General Comments

1. The State Of The Accounts and Reports.

The charities in the sample had been sending their accounts to the Commission at different intervals. Some were sent on an annual basis, others three yearly, whilst others seemed to have no regular pattern. Recent companies legislation[5] tightened the requirements for company accounts but many of the older filed accounts were, at best, shoddy or were prepared before legislation prescribed the qualifications required for a company auditor[6] which may account for some of the 'odd', commercially orientated, or inappropriate comments in the accounts. Some contained little more than an income and expenditure sheet of the kind produced by the smallest unincorporated association and the accounts together with the accompanying reports seemed to have been drawn up on the basis of providing minimal information. In many there was little, if any, narrative. In these the company's story, if it could be discerned at all, had to be inferred from the accounts. For example, a charity may have made a year on year loss; there may have been a clue in the director's comments on the results; or an auditor's comment as to the uncertainty in preparing accounts on a going concern basis! Nevertheless, in most cases, something of the charity's story could be gleaned from the information that was reported and, indeed, many of the charities produced more informative reports.

Given the requirements of the Statement of Recommended Practice on Accounting by Charities (S.O.R.P.),[7] a researcher undertaking this task in a few years time would, hopefully, find it less of a detective activity.

2. The Use Of Corporate Status And Avoidance Of Personal Liability

There was a, perhaps, surprising number of CCRs with a recurrently small turnover (less than £1,000) and seemingly little risk attached to their operations so one wonders what had been perceived as the advantages of incorporation. Indeed three

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[5] Companies Act 1985 Part VII Chap 1 ss.221-256 as amended by Companies Act 1989 Part I.
[6] Companies Act 1989 s.32 and Sched. 12

CCRs[8] had chosen to revert to being unincorporated associations. These included a mosque, an AIDS trust and an organisation involved in psychiatric recovery.

On the other hand, there were charities which had a pre-incorporation history and one might suspect that, in incorporating, some had anticipated the possibility of financial problems and personal risk. Indeed, one CCR had never functioned because the unincorporated association, which was intending to convert to a company, "was in serious financial difficulties and in no position to make this change."[9] Even in those that had effected incorporation, the avoidance of personal risk was not always possible and in several CCRs the continued viability of the charity was dependent on personal loans and guarantees given by directors.[10]

3. Information About Solvency, Project Success or Failure

The information about charities' solvency was, largely, inferential. This section attempts to make an educated guess as to how many charities wound up because the possibility of insolvency was apparent to them even if there was a small net balance after dissolution, as distinct from charities which appeared to have wound up for other reasons. For example, some grant making charities, although making an accounting loss year on year, were clearly expending a fund; others transferred their funds or activities to another charity, or returned the proceeds of a failed appeal to donors.

Of the 130 CCRs examined, 89 had been wound up only marginally solvent, insolvent, or had suffered a deficit in one or more of the previous six years. Six CCRs had been wound up because they succeeded, three of them having been granted a Royal Charter and the others having fulfilled their purpose by successfully raising funds for a scanner, making an environmental film and restoring a house respectively. A further 30 charities were wound up solvently, four with a significant surplus, two because they could not raise all the necessary funds, five were grant making funds apparently choosing to wind down, and in eight the purpose of the

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[7] Published by the Charity Commission, October 1995
[8] Records 86, 90 and 125
[9] Record 132

company failed. Eleven of the charities merged or their activities were transferred to another charity.

B. INTERNAL FACTORS

In a number of the CCRs and Case Studies there is evidence of malfunctioning, bad luck, or bad planning. "Malfunctioning" is deliberately chosen to avoid connotations of malpractice or wrongdoing by staff or trustees, but it is intended to identify internal problems associated with the running of the business of the charity. In some cases these internal factors were combined with external difficulties such as funding problems. This is perhaps not surprising since internal difficulties often become public knowledge which is likely to deter potential funders.

1. Difficulties With Staff or Trustees

One CCR,[11] which appeared to be running a day centre for the mentally ill, having reported a deficit following claims for unfair dismissal, subsequently reported almost a year of staffing problems. The third year the report commented on the loss of members of the management group. As the charity no longer conformed to its constitution the day care service had been transferred to another charity and was now reported to be running well.

Another charity[12] reported a four-year catalogue of difficulties. In 1987-88 major funding was lost, staff were weakened by illness, the director eventually resigned, there were problems with premises and staff redundancies. In 1988-1989 it was noted that the previous year's loss of grant had a profound effect on the charity and in the current economic climate it was increasingly difficult to attract funding. 1989-1990 was described as a difficult and traumatic year involving loss of staff, loss of chair, difficulties of balancing the budget, 40% cut in (what was left of) the grant and staff working 3/5 time. In Case Study 4 friction between the administrator and trustees was a factor in the appointment of a receiver –manager.

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[10] Records 15, 27, 32 (indemnity by health authority)
[11] Record 12
[12] Record 115

Reference has already been made to the Charity Commission's concerns about the effects of disputes on charities[13] which have been a factor in the several receiver-manager appointments under the Charities Act 1993. Within the receiverships included in the case studies there were disputes among the board and problems with management in Case Study 5 and, in Case Study 6, the religious and sectarian factionalism in the organisaton prevented the rescue and resulted in the winding up of the charity. During 1998 the Charity Commission indicated that they were exploring new ways of tackling disputes.[14] Opportunities for rescue for charities generally, are considered in chapter nine and for companies specifically in chapter three.

2. Multiple Difficulties – Bad Luck Or Bad Planning

One charity[15] reported a loss of £250,962 which was 'set against the previous year's surplus'. The fact that its wholly owned subsidiary had gone into liquidation was reported as a post balance sheet event and the charity went into liquidation owing £1.47M.[16]

Some charities seemed to have suffered a catalogue of disasters. A museum[17] reported that one particular year had been mainly devoted to 'legal priorities'. Two years later it was reported that numbers of visitors were up but the takings were down in the shop. At that point the charity was relying on European funding and council grants. The following year the charity reported that the combined effects of the recession and disruptions caused by lengthy repair work meant that the number of visitors had decreased by 3,000 so that revenue from admissions and the shop were down. At the end of that year there was a deficit on ordinary activities of £17,000 plus an exceptional item – a redundancy payment of £14,000 against net current assets of £4,000, £1,145 in cash at the bank, an £18,000 overdraft and a loan from the local authority of £15,000.

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[13] see chapters 7 (problems with trustees or members) and 9 (rescue mechanisms)
[14] [1998] Ch. Comm. Rep. p.15/16
[15] Record 10
[16] see *Re ARMS (Multiple Sclerosis Research) Ltd* [1997] 2 All ER 679
[17] Record 46

One[18] had had its paintings valued in 1980 and discovered them not to be authentic. Five years of accumulated deficits followed before the charity was eventually wound up.

Another,[19] having reported that income had not kept in line with increasing costs, particularly wages, went on to comment that building work was necessary and the charity was 'reviewing its options'. The review continued the next year, but in the third year it had been forced to pay for the repairs by borrowing against the building. The cumulative deficit at that point was £337,027 and the telling comment was made that "this act of faith cannot be sustained forever".

Some of the case studies suffered from cumulative problems. After the subsidiary of Case Study 1 had been made vulnerable by the breakdown of significant pieces of equipment, the loss of its largest contract created a position from which it could not recover. In Case Study 3 the changes in Government funding policies aggravated the already difficult position. In Case Study 5 the fundamental problem was the changed patterns of health care, leading to financial loss, but no doubt exacerbated by factional problems in the board, with the membership, and with management.

The Charity Commission have identified rapid expansion[20] and disaster appeals[21] as being areas which can lead to problems, rapid expansion because the trustees' lack of the necessary expertise and inadequacy of internal controls may lead to an eventual loss of funds or failure to achieve the purposes, and disaster appeals because problems can be overlooked in the enthusiasm to help.

3. Over Dependence On One Or Two Individuals

Over-dependence on one or two individuals has been identified by the Charity Commission as causing difficulties for charities. In 1996 they identified the problem of the dominant trustee and the fact that his or her personal qualities which had been valuable in bringing the charity into existence could also hinder its subsequent

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[18] Record 52
[19] Record 109
[20] [1995] Ch. Comm. Rep. para. 16; [1996] Ch. Comm. Rep. para. 26
[21] [1995] Ch. Comm. Rep. para. 17

progress, for example, by unwillingness to relinquish control of the trustee body, or there may be a conflict of interest.[22]

Three of the CCRs were dependent on one or two individuals. In one[23] the charity had already experienced problems but its future prospects were brought into question following the death of the chairman-patron. Another[24] referred to "consequences of accidents suffered by the chairman," in addition to lack of public support, as creating significant difficulties for the charity. The third[25] gives the impression of having been established to support a private research intrest or activity for one person and his wife, the only directors.

Occasionally the dependency is less obvious until the individual(s) leave. For example, in one CCR[26] staff within a university had, for several years, taken key positions and done much of the work in a charity. When the individuals left, their successors were not so committed to the society and, as a result, numbers dwindled until the charity was no longer able to fulfil its role. This is quite common in organisations and it perhaps has to be accepted that sometimes people just lose interest and, if successors cannot be found, the organisation comes to an end.

4. Problems With Trading Subsidiaries

Four charities reported losses or problems associated with subsidiaries. These are referred to in the chapter on contracting and trading. Two of these were also reliant on Manpower Service Commission or Training and Enterprise Council funding.

C. External Factors

1. Changing Expectations of Beneficiaries and Changing Patterns of Funding

Eighteen CCRs were providing *accommodation*, amongst which were three CCRs

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[22] [1996] Ch. Comm. Rep. para 28
[23] Record 34
[24] Record 99
[25] Record 81
[26] Record 5

(and seven in the wider sample) providing accommodation for older people and another CCR providing a facility similar to a mother and baby home. The charities providing accommodation for the elderly were providing bed-sitter accommodation with shared bathroom and kitchen facilities without support which means that residents who need care must move out. It has been recognised for some time that this kind of housing has decreased in popularity generally, and with older people in particular, thus rendering it more difficult to let. The same problem was identified in a charity[27] which provided such accommodation in the private rooms of minor stately homes.

Many residential facilities rely on various agencies, typically social service departments, to contribute to the costs of fees or sponsor residents. With the progressive tightening of local authority expenditure, coupled with the development of care in the community rather than residential care, many of these sponsorships have been curtailed. The mother and baby home may have become both outmoded and unsponsored.

Accommodation for former long-stay patients in mental hospitals is also of interest. Each of the six CCRs providing accommodation for mental health clients was reliant on health authority funding *and* DHSS benefits to its residents who contributed to their accommodation. Prior to the National Health Service and Care in the Community Act 1990 many statutory and voluntary organisations had begun experimenting with the establishment of supported hostels for these long stay patients. The funding frequently combined grants from the local health authority with individual DHSS allowances or benefits for the residents. Following a Social Security Commission decision not to pay benefits where health authorities were held to be subsidising costs,[28] the funding arrangements for such hostels were changed. Many were turned over to housing associations or similar bodies, which were offered increased funding by the Housing Corporation to provide additional support. This appears to have happened to several charities in this group.

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[27] author's knowledge

[28] See CS/168/90 for a review of Social Security Commissioner decisions in this respect. See also *Re Chief Adjudication Officer v Quinn* [1996] 1 W.L.R. 1184

There were nineteen *schools* in the 'snapshot' of charities removed from the register in Quarter 5 and a further sixteen development trusts associated with schools. The impact of the economic climate on schools is considered below, but it has been suggested[29] that boarding schools are more at risk partly because fees are higher but also because fewer parents are choosing to send their children away from home for education. In trying to turn the situation around, the trustees may then find that for non-boarders the school's location is too rural and distant from a centre of population.

The reports of some of the CCRs specified that they were dependent on grant aid or made some reference to it. In all thirty-five, 27%, expressed concern (others may have been concerned but did not report it) about the level or continuance of sources of funds.

Table No 2 : Concerns About Future Funding

Dependent on and concerned about funding sources as follows:	**Number**
From Manpower Service Commission / Training and Enterprise Council	10
The end of fixed term funding such as Urban Programme	8
The future of grants from particular trusts	6
The future of grants from Health Authority and DHSS allowances	4
Anticipated loss of sole sponsor	1
Loss of Sports Council funding	1

A further three[30] CCRs seemed to have funding problems relating to the economic climate but linked to external funding. Another[31] cited loss of donations which could have been related to the economic climate although the charity actually blamed the

[29] conversations with author
[30] Record 58, 96, 77
[31] Record 77

national lottery.

There were twelve CCRs, 8%, providing advice and information or offering welfare services to particular groups of individuals, ten of which had functioned, the other two having failed to secure funds. Three[32] were reliant on grants from the local authority and it would appear that reductions or loss of these contributed to the demise of the charities. One,[33] providing training for people with special needs, complained of "local authorities failing to meet their moral obligation to pay grant aid;" a severe decrease in the uptake of training resulting in a large drop in the income from courses and a proposed change in the method by which the regional association was funded appeared to have been the last straw. However, not all closures in the 'advice and welfare' group were funding related. In one case[34] a co-ordinating committee had been established to co-ordinate various AIDs agencies in this particular field and as a result this charity amalgamated with another.

2. Changing Policies of External Funders / Government Agencies

Within some of the governmental agencies there appears to have been a notion that 'big is more beautiful'. Housing Corporation policies appear to have favoured, whether or not by design, the larger associations and there has been a tendency for smaller housing charities to sub-contract or merge with larger associations. Two CCRs in the sample fitted this category. Similarly, some of the CCRs offering vocational training, particularly for individuals with special needs appear to have been affected by the same tendency in the Training and Enterprise Councils. Case Study 1 was particularly affected by this.

Manpower Services Commission (MSC), Training Agency and Training and Enterprise Councils (TECs), in succession, appear to have had considerable impact on the charities providing vocational training, education and employment preparation for disadvantaged and unemployed people. Ten per cent of the CCRs, each of the thirteen charities in this category, were to some extent reliant on this type of funding

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[32] Record 2, 89, 127
[33] Record 127
[34] Record 110

and three of the case studies found themselves in difficulty as a result of the same changes in TEC patterns of funding. One was the subject of an administration order linked with voluntary arrangements and was effectively rescued.

Some of the comments within the reports and accounts are very telling. In one charity,[35] where MSC had terminated the funding agreement, it was said that "finding sources of funding was almost impossible without a change in the economic and political climate." That charity was subject to an inquiry in which the reporter was sympathetic to the directors who were, to some extent, the victims of circumstance. Another charity[36] was given four days notice that the contract would not be renewed because the TEC wished to contract with a larger agency despite the fact that all the trainees, each of whom had special needs, had achieved a vocational qualification of some kind that year. Some charities reported year on year reductions in training related earnings.[37] One, having commented that trainees were achieving acceptable standards said, "the current funding structure operated by the TECs is creating instability" and the following year wound up because "limited funds and uncertainty of outcome did not justify the continued operation of the centre"[38]

Uncertainty and problems associated with MSC funding were referred to by another charity[39] in three successive annual reports. This was compounded by a "severe cut in Training Agency funding which had serious implications" the following year. The next year the charity referred to difficulties with output-related funding in respect of employment outcomes (it was operating in a region of very high unemployment and finding work for trainees was probably difficult) and in the final year of the charity's operation TEC funding had been reduced by a further £15,000. The problems of output related funding in respect of training facilities for disabled people was identified by the Spastics Society[40] (now SCOPE) in their survey in 1993.

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[35] Record 4
[36] Record 14 (Case Study 1)
[37] Records 25, 119
[38] Record 114.
[39] Record 11
[40] *Survey of Training for the Disabled*, Spastics Society, 1993

Two of the charities offering training suffered losses in subsidiaries. In one[41] this related to primary purpose trading, but did not affect the charity's ultimate solvency. The other, referred to above, was subject to a section 8 enquiry. The difficulties of a further three charities in this group were compounded by loss of grant income from other sources.

The impact of other Government inspired change can be seen from another CCR[42] which had been established to preserve historically important barns and farm buildings. This charity had been dependent on the Milk and Potato Marketing Boards for levies. With the demise of these boards the charity wound up and its assets (the preserved buildings) were transferred to another agriculture –related charity.

3. The Economy

(a). 'Heritage' Charities

Eighteen of the CCRs, 14%, were engaged in 'heritage' activities, that is work associated with museums, collections or otherwise preserving the heritage. One of the CCRs had been a substantial museum, another had been in the throes of establishing an aircraft museum, whilst a third was conserving an air compression station. It is clear that the museums that closed had been affected by the lack of spending power which was noted by one in connection with income from its shop.[43] In some cases, however, the combination of economic factors with other difficulties appears to have been significant. The charity which discovered its paintings to be valueless[44] presumably lost its raison d'être . Another even changed its name in the forlorn hope of attracting more income[45] and it seems likely that an air compression station would attract only limited support!

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[41] Record 14
[42] Record 24
[43] Record 46
[44] Record 52
[45] Record 80

(b). Beneficiaries Unable to Meet the Economic Charges

One charity's[46] language courses were reasonably well subscribed but the costs did not cover expenses. It is possible that they were not adequately costed although charges may have been set at what the market would bear. Similarly, a charity providing Duke of Edinburgh's Award leisure courses[47] found that it was necessary to top up existing training programmes otherwise costs would increase to the point where they would be unaffordable. Another charity suffered a loss in subscriptions and decrease in its turnover.[48] Having "shown a slight improvement" by making a surplus of £23, the charity wound up.

Several charities[49] were schools or associated with schools and there was comment in their reports about the adverse economic situation. In one[50] the head blamed the recession for the school's closure, coupled with the collapse of the property market. The school had purchased a property on a fixed rate mortgage and its value had subsequently dropped considerably. The mortgage was £392,000 on a property now expected to fetch £350,000.[51] Another school had difficulties with falling numbers.[52] Two years before it wound up it described itself as having been saved by a legacy. In 1995 Johnson[53] commented that four charitable schools in the South West had recently closed. Within the case studies there were two schools, but the economy was only a factor in Case Study 8. Charitable boarding schools in particular have continued to find their survival challenging. For example, despite the reported intervention of the late Princess of Wales, West Heath School closed in 1997[54] having made losses of over £300,000 for two successive years.[55]

One of the learned institutes was removed because it became chartered, but the chairman's comments are perhaps illustrative of general feelings about the economy

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[46] Record 33
[47] Record 34
[48] Record 44
[49] Record 92, 123, 76 and several of the case studies
[50] Record 123
[51] Sunday Telegraph 4.7.93
[52] Record 76
[53] Johnson R, Osborne Clark Solicitors, paper on Insolvency of Charities presented to Charity Law Association Conference, 1995
[54] Sunday Express 26.6.97

at the time: "What should one expect from an institute supporting two industries which have, in the past twelve months, in the U.K., shown accelerating collapse; facing a membership adversely affected by a relatively declined currency and high interest rates? Frankly, one should not expect too much".[56] He then went on to enumerate the Institute's successes!

(c). Economic Factors as a Trigger to Establishment of Charities

The economic climate may also have been a factor in the establishment of some of these charities. All the heritage charities were established since 1975 and all of the charities offering vocational training or work preparation in the sample were established since 1980. The various job creation schemes established to counter increasing unemployment since the late 70's required participants to be engaged in activities in which there was a 'community benefit'. Conservation projects were ideal in this respect since they were often both labour-intensive and useful to the community. A major museum in Shropshire used various Government 'job creation' schemes to the extent that it at its peak there were well over a hundred participants active at the museum. Perhaps as a result the museum was able to make considerable progress and is now a World Heritage Site. All of the training or employment preparation charities appear to have been involved in the various Government training programmes.

D. Additional Problems For Service Providing Charities

Many of the charities studied were providing a service on which beneficiaries were significantly dependant and which therefore could not simply be 'turned off'. This problem was explored in chapter ten.

The various regulatory regimes also appear to be a factor in respect of either the winding up of charities, or an additional issue for a 'rescuer' to handle. For example, in Case Study 7, the social services department's inspection and review division identified problems with the building (requiring a lift to be installed rather than the

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[55] At August 1999 the charity remains on the register.
[56] Record 124

stairlift) which was too expensive for the charity to consider but without which the charity's service would have to close. In Case study 8, the extra requirement for expenditure resulting from changing curricular demands was an additional factor for the school. In case study 10, again a school, the receiver and manager described his contacts with both social services and education as a 'plethora of officialdom'. In a similar way the receiver of a residential facility was very surprised to discover the extent to which his activities were limited by the requirements of the local social services department.[57]

E. LEGAL ISSUES

1. The Unincorporated Association

Apart from the other difficulties associated with unincorporated associations, which are explored elsewhere,[58] many practitioners spoke of difficulties associated with their dissolution. One, experienced in winding up charities, described the process as a nightmare. This is exacerbated by the fact that there are no statutory protections available during an attempted rescue so their assets are always vulnerable to creditor action.

2. Drafting Problems And The Choice of Vehicle

First, difficulties were encountered in several of the unincorporated charities in the case studies related to problems in the drafting of the constitution. In Case Study 5 there was confusion as to whether the charity's property could be sold for the purposes of winding up, or only for the purposes of replacement and there were apparently diverging views on this between the Attorney-General and the Charity Commission. In addition, the constitution had been so framed that there were 300,000 or so members, combined with rateable voting which elevated general meetings of the association to nightmare status and posed immense problems at the special general meeting at which the winding up was proposed. This particular

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[57] Conversation between the receiver and author. The facility happens to be commercially run, but the level of regulation is the same irrespective of this.

[58] See the chapters on property holding, recalcitrant members and trustees, and contributories (6,7,and 8).

constitution had not been reviewed since the charity was established many years previously.

In Case Study 7 it was only the fact that the constitution contained the power of amendment which prevented greater difficulties. As drafted, whilst the constitution envisaged the possibility that the association might be wound up by specifying what should happen to surplus assets in that event, it failed to identify the process by which the dissolution could be proposed. Further, the absence of an alternative destination for the surplus assets also brought problems. It was precisely the fact that the potential recipient of surplus was itself closed which precipitated the need to wind up the charity.

With more serious consequences for personal liability in Case Study 8, the trustees of an unincorporated charity, established over a century ago, had never been informed of the advisability of converting to a limited company, even though they had taken legal advice in the 1980's regarding the establishment of a scheme.[59] In the insolvency of the charity, the trustees had each had to provide £10,000, which they hoped would be refunded if the premises were sold for a satisfactory value.

3. Winding up or Striking Off for Corporate Charities

The method of winding up was only explicit in 29 records, and in 11 of these it was stated that the charity had been struck off the register of companies.[60] One of these charities[61] a heritage organisation, referred to dormancy in 1992 but, following the publication of the section 652 notice[62] by the Registrar of Companies, the Charity Commission showed cause why it should not be struck off. In 1993, the charity's accounts noted that the undertaking had been 'sold to new owners.'

In another,[63] the auditor's comments in his report for 1992 were interesting, if confusing. Despite the fact that the accounts were expressly for a limited company, it

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[59] Meakin R., and Ward J., *Trusting to Corporate Solutions- a lesson for charitable schools*, NGO Finance Sept 1996, explore the use of a corporate trustee in the school context to limit liability. See correspondence in reply in NGO Finance October/November 1996

[60] Records 30, 31,33,35,38,40,42,47,88,94,125

[61] Record 47

[62] Companies Act 1985 s652(3)

stated that the limited company had been struck off in 1986 "accordingly, any assets owned by the company at that date may be claimed by the Crown Service...since then, the legal status of the charity has been that of an unincorporated association."

This points to the difficulties regarding the use of striking off rather than winding up discussed in chapter three.[64]

4. Issues Around Merger

A number of articles have been written in the charity press[65] on the subject of merger between charities, and it is frequently used as a 'rescue' mechanism. In the case studies two charities were 'rescued'[66] by merger. Apart from possible employment issues around the transfer of undertaking[67] and concerns about changing ethos and identity,[68] there may be legal problems associated with the technicalities of merger. These were explored in chapter 9 where merger was considered as a rescue mechanism.

5. Permanent Endowment and Protection of 'Collections'

Five of the charities had permanent endowment. It was not clear in all cases what this comprised but in two cases it was related to property being held for posterity – a house and an item of industrial heritage. All the 'heritage' charities held a 'collection' of some kind, although the collection held by one of them was worthless. Those collections which do not comprise permanent endowment are perhaps more at risk in the event of an insolvency and the twin-trust concept has been recommended, by which museums divide their roles between two trusts, one which manages the building and business whilst the collection is vested in the other. It is not clear exactly how effective this would actually be in practice.[69]

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[63] Record 125

[64] One of the practitioners admitted to finding striking off a useful mechanism, although she admitted that fellow lawyers did not favour it.

[65] see e.g. *Ceresdale G., Jewish Care : Don't take Us For Granted*, Charity October 1993 p. 10; Wethered S., *Stopping Short of Wedding Bells*, NGO Finance July/Aug. 1998

[66] Case Studies 12 and 16

[67] Transfer of Undertakings (Protection of Employment) Regulations 1991, SI. 1981 No 1794

[68] Record 76

[69] See Griffiths A., *The 'Twin Trusts' Concept – Museums and Galleries* 14 [1998] I.L.P. 233

F. Practical Issues

1. Plotting A Critical Path, And Holding The Process Together

The case studies in particular highlight the value of having one person, whether a lawyer, accountant, receiver and manager, or a trustee who can ensure that critical decisions are able to be made by the charity at appropriate times. This also includes liaising with outside bodies on whose decisions the charity may depend and ensuring that they have adequate information about the charity's activities, or its position on which to base their decision. This process may be more complex if the charity is exploring several options. In Case Study 1, it was one of the trustees who, as part of their work, was in a position to undertake this role which often needs concentrated periods of time and good contacts. Similarly in Case Study 7 the process was held together by an advisor. Several practitioners have indicated that this role is important to the charity, but have commented that it can be quite a tricky role to fulfil. In Case Study 8, which was a particularly complex winding up, with several options and a good deal of contingency planning, the key person was the charity's solicitor. He also negotiated finance on behalf of the trustees, which they themselves had been unable to do, at better rates than lenders would have been willing to consider with the trustees, and generally held the process together. In Case Study 14, the receiver-manager was able to negotiate the surrender of leases.

Clearly, where a charity is going through one of the insolvency processes, such as administration, an insolvency practitioner must be involved. In Case Study 3, the administrator negotiated with creditors, persuading them to waive their claims so that the charity could then raise grants and donations and attract Government funding. In Case Study 4 the receiver and manager obtained credit for the charity. It is perhaps understandable if creditors and lenders take more notice of professional advisers. This is clearly beneficial to the charity. For example, in case study 5 which was a receiver and managership in an unincorporated association, no statutory moratorium was possible but the receiver negotiated an effective moratorium with the charity's creditors on a voluntary basis (although he was ready to transfer the charity assets to a subsidiary if they had been attacked by the creditors).

2. General problems – Orderly Wind Down

Where charities are going through an 'orderly wind down' there can be delays whilst the charity attempts to clarify and negotiate away its liabilities, for example, under leases or hire purchase agreements. In case study one, there were discussions with the landlord regarding the waiver of liabilities under the lease in addition to negotiations with companies with which the charity had H.P. agreements. The terms in respect of termination of H.P. agreements can be onerous for charities in respect of the termination fees and it may be possible to persuade lessors to waive their claim. One of the CCRs[70] commented that the company which supplied the photocopier had now agreed to drop their claim.[71] This had clearly been the single factor, which delayed the winding up of that charity.

Another,[72] in 1978, stated that it continued to function in order to manage an African subsidiary. In 1984 it was stated that the scale of the charity's activities was to be reduced. The following three years were similarly described. In 1989 it was carrying out an orderly liquidation; in the following year there were some difficulties with the lease of the charity's premises and negotiations with a third party in an attempt to assign the lease.

Another charity, which managed property for a trust,[73] needed several years to wind down.

One of the charitable schools described other difficulties in winding up. Having been saved by the legacy in 1993, it was decided to wind up the company in 1994 during which year the deficit was £172,541. It was decided to combine two schools. Much was made in the charity's report respecting concerns and discussions about the loss of identity and ethos of the school as it came under the headship of another related school.[74]

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[70] Record 36
[71] It appears that the photocopier is the piece of equipment which charities most commonly have on lease or hire purchase terms.
[72] Record 98
[73] Record 101
[74] Record 76

IV. TRENDS SUMMARISED

It is clear that the economic situation, because it either resulted in reductions in donations or in the general lowering of spending power, was a significant factor for many of the charities removed from the register between January 1995 and March 1996.

The 1980's onwards have seen considerable legislative change. The impact of changes in higher education[75] and agriculture[76] are evident from the removals of charities from the register.[77]

The changing political climate also had an impact. First, during the 1980's public spending was increasingly restrained and, for local authorities, the introduction of rates or charge capping[78] sometimes resulted in reductions in the grants which they were able to make to charities. That same situation also meant that local authorities were increasingly unable to take over the funding of time-limited schemes such as Urban Programme or European funding. In this sample eight charities wound up after their fixed term funding ended. Secondly, the impact of governmental changes associated with the unemployment and training industry can be seen to be significant. The funding of Training and Enterprise Councils was cash limited and output related. As a result of the tendency to fund larger providers[79] many of the very specialist, smaller, often charitable providers (particularly catering for special needs) either did not have their contracts renewed, or were priced out of business arguably, to the considerable disadvantage of their beneficiaries. However, as this coincided with the removal of the universal training guarantee for young people (that is, there was no longer a guaranteed place for those judged unlikely to be able find a job) this went largely unnoticed.[80]

The trend towards output related funding, particularly in relation to employment and

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[75] under Education Reform Act 1988, Further and Higher Education Act 1992

[76] Agriculture Act 1993 c.37 ss.1, 26, Milk and Potato Boards revocations respectively

[77] from the removals of succeeding central admissions bodies for HE, and the removal of an agricultural charity dependent on levies from agricultural boards

[78] Rates Act 1984 s.2, now Local Government Finance Act 1988 Part VII – soon to be abolished by the Local Government Act 1999

[79] The same funding tendency was apparent in respect of housing associations.

training schemes has continued. The dangers from it to voluntary organisations are obvious from this study. The funding of 'New Deal' for 18-24 year olds, the most recent Government initiative in this sphere, is output related but at least where voluntary bodies are providers, there has been a limited attempt to spread the risk with some 'up-front' funding (although, in practice, it only became available after New Deal had been operating for four months!).

It is possible that output related funding may become more significant in respect of local authorities with the implementation of the proposed duty of "Best value"[81] to be imposed on local authorities encouraging authorities to measure outputs. Given that 'best value' also encourages the continued externalisation of services to private and voluntary sector agencies, local authorities need to learn from the TEC experience and beware of linking the measuring of outputs with the funding of these externalised services if damage to the voluntary sector is to be avoided.

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[80] but see *Survey of Training for the Disabled*, Spastics Society, 1993

[81] Local Government Bill 1998 ss.2,3

CHAPTER 12 : CONCLUSIONS

I. INTRODUCTION

This chapter aims, without unnecessarily re-iterating the conclusions drawn in preceding chapters, to identify and consolidate the common themes and recurring issues as well as highlighting points of good practice.

This study which is set against the background of considerable societal change; changes in the attitude of beneficiaries; and major government inspired change, such as the externalisation of services coupled with the contract culture, identifies a number of issues. Some relate to the capacity and ability of charities to keep pace: capacity – whether the charity has power to change, ability – whether its style, mode of operation and attitude enables it to respond to change. Inevitably there are legal issues raised.

In this fast changing environment, which affects charities and to which they must respond, the immutability of endowment stands out either as a rock underpinning a charity or as a brake on change. Areas of legal uncertainty are also raised, such as the applicability of the augmentation principle to bequests to corporations which have been solvently dissolved by the time the bequest becomes available. This may be a problem which particularly affects mergers. Drafting problems have been identified in several chapters, as has the choice of legal vehicle.

As charities are increasingly service providers in the modern welfare state, they may find themselves moving nearer to business in operation than the public sector and trustees are therefore also business managers responsible for the management of their charity, including dealing with the impact of those changes. Indeed, a receiver manager recently commented that charities are businesses which have to react like businesses, having taken appropriate advice, and as a result they may sometimes make a bad business decision.[1]

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[1] conversation with author.

The following section aims to link these changes with the other topics which have been considered in order to identify areas for development or good practice which would either enhance the effective operation of charities, or where appropriate and inevitable, at least smooth the process of dissolution.

II. TRUSTEES: GOVERNANCE, INFORMATION AND SUPPORT

Trustees[2] are essential if charity is to be other than a concept. Most charity trustees are not merely administering a charitable fund but are increasingly providing services to the public or some element of it and thereby running a business. As such, they are responsible for the governance of the charity and for ensuring that the charity is properly managed. The service providing charity is subject to a mass of legislation of general effect, for example relating to health and safety[3], minimum wages[4] working time[5] as well as regulation specific to its area of work.

Clearly, therefore, charities need good management appropriate to the charity. They need strategic management, an eye to the future with a good idea of changing trends amongst beneficiaries, new legislation and the like. They need good day to day management of the operations of the charity – an outmoded incompetent charity is unlikely to attract beneficiaries, volunteers or funders. They also need good financial management with robust accounting systems and reporting to management and trustees. Management systems need to be appropriate to the size and operations of that particular charity. The timely recognition of the need to change both systems and operations when a charity is growing (or should shrink) is extremely important.[6]

It is often said that charities need business people as trustees and/or staff. No doubt both groups need to be businesslike. On the other hand simply mirroring the commercial sector may not be wholly beneficial.[7] Experience suggests that trustees

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[2] The term includes directors of charitable companies.
[3] Health and Safety at Work Act 1974.
[4] National Minimum Wage Act 1998.
[5] Working Time Regulations 1998, S.I. 1998 No. 1833
[6] See e.g., [1994] Ch. Com. Rep. p.11; Wise D., *Beyond Financial Accounting*, NGO Finance June 1998; Hussell T., *Under Control – Keeping Internal Risks in Check*, NGO Finance, June/July 1996
[7] See *Danger of Management Overkill in the Charity Business*, Professional Manager, May 1999 p.46 reporting on Lilley S.'s recent research.

with a business background can be extremely valuable provided that they are able to apply their business knowledge in a charitable environment; if not they may be a source of friction.

By the nature of charity many of the recipients of services are vulnerable so that charities find themselves operating in fields which are heavily regulated by Government. For example, with regard to care, Richards[8] lists eleven Acts of Parliament and seven Regulations arising from them, which regulate care provision for older people alone. In addition she identifies twelve Directions and Circulars, four Implementation Letters, plus five Policy Guidance Documents[9] for the same care group and comments that the importance of these various documents is belied by their relative inaccessibility for those who advise on them! The Children Act 1989[10] provides a similar legislative framework from which a mass of regulation flows and which may well affect charities providing care for children. Where the charity is also a school, it will also be affected by educational regulations including the demands of the national curriculum.

The problem facing charities in this position is knowing enough, not only about its current position, but also about trends, developments or expected legislative change. For example, the implementation of the recent white paper *Modernising Social Services* will impact considerably on independent providers (including charities) amongst other things, in terms of changes to training, the development and inspection of quality standards, and the regulation of day care provision.[11] Depending on the charity's size, knowledge gathering may be shared with staff or could rest solely with the trustees.

Given that most charity trustees are constantly looking for new sources of funds, dealing with the complexities of contracting and trading and the ensuing issues of taxation and financial regulation, it is perhaps surprising that there are relatively so few charities in difficulty, or that they are so well run as most are.

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[8] Richards M., *Community Care for Older People*, Jordans, 1996.
[9] Richards *op.cit.* pp. 11-12,
[10] Children Act 1989.
[11] Cm. 4169, *Modernising Social Services*, Department of Health, 1998

A frightening amount of information is now available to trustees about their responsibilities and liabilities to the extent that trustees may become an endangered species. Interestingly at the same time as central and local government services have been externalised those responsible for the governance of, for example, health, social and housing services are paid as non-executive directors of N.H.S. Trusts, or claim an allowance as councillors. But those now running the same externalised social care or housing as charity trustees, are expected to provide their services for no recompense, a view re-iterated in the Commission's 1998 Report,[12] and may be required to fund their own insurance if they require full indemnity cover![13]

Trustees may also need access to complex technical, legal, and accountancy information all of which needs to take account of the charity context. The availability and quality of such advice is discussed below.

Change is presently occurring so quickly that it is very difficult for charities to keep pace. Many national charities and some more local charities are members of the National Council for Voluntary Organisations, N.C.V.O., the umbrella body for national charities which provides a range of advisory services. Others are part of a national network and receive support from their national body. Charities without a national network, or which work in a particular locality will not have this support, and even branches of national charities will find that there are local variations of which they need to be aware. Perhaps the role of local infrastructure support charities, typically councils for voluntary service and rural community councils could be enhanced in this context. This is considered below.

III. DIFFICULT LAW

Legal and practical difficulties are identified in chapters four to ten of this study. The law as it affects charities is complicated, difficult to understand, and obscure. It also suffers from the fact that charity matters infrequently come to court and even then are rarely reported except in the charity press. This is considered below. To some extent,

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[12] [1998] Ch. Comm. Rep. p.18

however, the difficulties in which charities find themselves are perhaps partly self-inflicted, or have been visited upon the charity as a result of inadequate technical advice earlier in its life.

The complexity and obscurity of charity law is evident in respect of endowments which figure amongst the charity cognoscenti as "an area of difficulty" perhaps because of their inherent complexity, obscurity of the law, or the mysterious phraseology used to denote them. Endowments and land also present particular problems at dissolution or winding up, not least because their status as permanent or expendable, functional or investment land must be confirmed with the Charity Commission, although it would appear that different staff there may differ in their views on the matter. Interestingly, a well respected charity lawyer seriously doubted whether those making gifts today actually regarded an endowment as anything more than a capital fund.[14] Concepts and motivations for philanthropy have undoubtedly changed over the centuries and it is unlikely that today's donor would have the same motivation as his predecessor centuries ago.

The relative lack of case law is a further bar to understanding the development of charity law, and endowments in particular. This is exacerbated by the fact that since 1960 many decisions are dealt with by the Commission and are not readily available for reference.

The key issue relating to endowment in this study is whether it can be available to meet debts in winding up. This was explored in chapter four. A recent case[15] indicates that it is not impossible that endowment could be available to meet debts but it could become more common if proposals outlined by the Trust Law Committee[16] bear fruit. The concept of endowment is, however, fairly well entrenched and the new proposals would require legislative change. The most likely precipitant of change would be a scandal involving a well endowed charity being

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[14] in a conversation with the author

[15] case information provided by a practitioner

[16] *Rights of Creditors Against Trustees and Trust Funds - Consultation Paper*, published by the Trust Law Committee in association with S.T.E.P. and Tolley's International, April 1997, paras. 1.1 and 1.2. The application of *Re ARMS* [1977] 2 All ER 679 – favouring creditors- to endowment could have similar effect.

unable to pay its debts without expending endowment, but these are precisely the circumstances in which the Commission would be likely to permit expenditure so it may not become public knowledge.

An area, which would benefit from clarification is the applicability of the augmentation principle in respect of bequests to corporate charities which have been wound up solvently for the reasons explained at the end of chapter five. The possibility of bequests being lost, which can be a brake on the process of winding up or merger of charities whilst a scheme is obtained, is a point not always considered when charitable corporations are wound up (particularly if a charity-lawyer is not involved!)

IV. CHOICE OF LEGAL VEHICLE AND DRAFTING

The governing instrument of a charity establishes it as an abstract entity and, by providing its trustees and managers with powers, it creates the practical mechanism by which the charity is put into effect. It is fundamental to the charity. It is important for the charity and its trustees that the appropriate choice of vehicle is selected in the first place and that it is reviewed in the light of developments and changes in the way the charity operates. Given the significance of the governing instrument it is surprising to discover so many drafting problems in such a relatively small sample of charities.

A. THE VEHICLE

One theme which recurs in several chapters of this study is the extent to which the badly drafted governing instrument of the charity, particularly where the legal vehicle is an unincorporated association, causes sometimes quite severe practical difficulties for the administration of a charity. Indeed, in some cases, the trustees' personal assets have been put seriously at risk as a result of the wrong choice of legal vehicle. In the charities studied, the unincorporated association provided the greatest number of problems in terms of the charity's ability to deal with internal disputes, the management of meetings and personal liability of trustees. These points may contribute to the view of several professionals that unincorporated associations are a

nightmare, especially when they are being dissolved. By comparison, because of the statutory framework and considerable body of case law there is more certainty as far as the charitable company is concerned[17] for example, in respect of some of the difficult situations such as removal of directors or members. Nevertheless, it is helpful for these matters to be included in the articles as is the case with the Charity Law Association's model documents.

Given the complexities and potential risks attached to service provision, it is unusual to find substantial charities operating today as unincorporated associations. Out of twenty case studies it is surprising to find two unincorporated associations running a hospital and a school respectively.[18] Interestingly, there is a tendency for agencies contracting with charities to select incorporated charities. For example, tenderers for New deal contracts were required to complete a legal structures and financial viability declaration.[19]

Other issues to be considered relate to certainty – about property holding, personal liability,[20] the limits to members' influence and directors' liabilities. From this perspective, the unincorporated association does not impress as a good legal vehicle. For some years the possibility of a new legal structure for charities has been under discussion. In 1996 the Charity Commission identified the long felt need for a corporate structure designed specifically for charities[21] and were supporting the Charity Law Association's working group investigating this. The goal was a vehicle offering limited liability to trustees, with suitable administrative arrangements, identifying core responsibilities and powers with some flexibility in the range of the latter, and with the exclusion of solely commercial powers and responsibilities. Any developments in respect of a wholly new legal vehicle are likely to be some way off, as there would need to be consultation and legislative change. Company structures are, however, capable of very considerable flexibility and it would appear that, for the

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[17] For example, the requirement for memorandum and articles of association are specified in statute and the articles for a company limited by guarantee are required to be as near Table A as circumstances permit - Companies Act 1985 ss.2 , 7 and 8.

[18] Case Study 5 and Case Study 8

[19] author's knowledge

[20] Although the cases studied demonstrate that trustees are not always protected, e.g., they may be required to guarantee loans.

time being, the Charity Law Association's model memorandum and articles of association for a charitable company limited by guarantee goes some way towards meeting this need.

B. Drafting for Flexibility and Change

Perhaps because of the traditional nature of charities established as endowed foundations and with a privileged capacity for perpetual existence, charity advisers may fail to recognise the need for change within charity and the speed with which change may have to occur. Experience suggests that most charities established over the last twenty years are not endowed, but were established to meet a set of social circumstances then existing. Charities are very adaptable, indeed, the Charity Commission's recent review of the register[22] suggests that the nature of charity itself is adaptable. Because the environment in which charities operate is also changing quite quickly, charities will need to change, some may become outmoded and cease carrying out their activities. This needs to be reflected in their governing instruments, which should include power to amend the constitution and power to dissolve them as well as clear methods for doing both of these.

C. Drafting for Practicality of Operation

It is not too strong to say that several of the charities were effectively crippled at some point in their lives by their governing instrument. With hindsight, who could have thought it sensible to construct a charity, unincorporated at that, in which there were potentially thousands of donors, each of whom were members, some of whom had more votes than others or were in different classes of voting, all of whom would be invited to general meetings?[23] If this ever worked in practice, it can only have been because few members were expected to be interested in attending annual general meeting and matters considered were never contentious. At the point when the charity needed to be able to rely on its governing instrument to provide it with

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[21] [1996] Ch. Comm. Rep. p.8 paras. 28,29

[22] RR1 – *Review of the Register of Charities*, RR2 – *The Promotion of Urban and Rural Regeneration*, and RR3- *Charities for the Relief of Unemployment*, Charity Commission, March 1999

clear guidance and procedures, it failed abysmally. Not only did it fail to create a clear role for members, but the making of arrangements for the general meeting at which the dissolution and sale of assets of the association was in question became fairly horrendous. This impracticability was compounded by the fact that the powers of sale of the property as set out in the constitution turned out to be ambiguous. It is, of course, possible that the charity's advisor identified the practical difficulties but the founders insisted on this form of democracy, or could not contemplate the possibility of a dispute amongst a brotherhood! Other inadequacies in drafting in the case studies included failure to provide a mechanism for dissolution and failure to identify alternative destinations for surplus funds on dissolution. Whilst these issues can be resolved by the Charity Commission, the correspondence with them necessary to clarify these matters takes some time during which the charity's assets may be dwindling.

Inadequate drafting can also result in conflict. For example, the Commission's Report for 1998[24], commenting on conflict within a particular charity noted that its constitution, in so far as it provided for elections, was inadequate and this was what the dispute was apparently about.

Those lawyers and others who help to establish charities must surely have a duty to provide a governing instrument which can be operated in practice and by the kinds of person that the charity is likely to attract. It is heartening, therefore, that the Charity Commission now declares one of its three objectives as being to ensure that charities are able to operate within an effective legal, accounting and governance framework.[25] At the time of registration, they aim to ensure that, amongst other things, charities meet basic standards of governance, and they provide the example of a governing document which is workable.[26] Although, no doubt, there are charities in existence with ill-drafted constitutions, given the variety of constitutional models that is now

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[23] e.g. Case Study 5
[24] [1998] Ch. Comm. Rep. p.16
[25] [1998] Ch. Comm. Rep. p.3
[26] [1998] Ch. Comm. Rep. p.5

available[27] this problem should, hopefully be reduced in the future.

D. Drafting to Avoid Conflict
Personnel and Personalities: Passions and Principles

The Charity Commission frequently makes reference in its Annual Reports to the problems that can result from difficulties between personnel whether from conflict between trustees, with staff, with members, or because there is over-dependence on one or two trustees. Those difficulties are echoed in this study. To some extent the application of good management practices could have dealt with these before they damaged the organisation. The difficulties associated with disciplining staff who are also beneficiaries were considered in chapter seven.

Those involved with charities as members or trustees are frequently individuals with strong principles stemming from personal religious or social values and the charity itself will also be likely to have a value base. Matters of principle can, however, frequently lead to erosive conflict within the trustee body, or between trustees and staff. The impact of these difficulties was explored in chapter seven and opportunities for rescue were considered in chapters three and nine. There is the possibility, however, that an individual or group will reject mediation and stand on principle which will result in time at court.

The governing instrument needs to be explicit about the position of members: how they apply and are vetted; what is expected of them in terms of subscriptions or behaviour; and the circumstances and processes by which they can be expelled.

The careful selection of trustees is also important. On the one hand equality of opportunity and openness of access are important in respect of trustee bodies, as is new and challenging thinking. But trustees must act together. In balancing these factors, it is important that, when selecting new trustees, care is taken to identify keenness and ability whilst avoiding the bigoted or pig-headed. In the event of a

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[27] See, e.g., GD1, GD2, and GD3 available from the Charity Commission. Similar constitutional models are available from the Charity Law Association and there are more specific models such as model documents for village halls, community centres, etc. from other national bodies.

mistake, however, it is important that the constitution is clear about the circumstances in which a trustee can be removed with the minimum of fuss and disruption to the charity.

The model constitutional documents referred to above provide mechanisms for dealing with a number of these matters.

The National Trust case[28] suggests that the process by which policy decisions (particularly those affecting beneficiaries or members) are made, consulted upon and implemented is also important. This could become more important for charities with service agreements as regulations affecting local authorities and social services in particular put greater emphasis on consultation, quality of service provision and transparency which may increase with the implementation of 'best value'. It may not be appropriate to define such processes in the governing instrument, but it might usefully be a topic for bye-laws.

IV. Availability, Quality and Cost of Advice

A. Legal Practitioners

To many, charity law appears to be fusty and complex and is not widely taught. Because of the reluctance to spend good charity money on legal fees, and the fact that few charities would have funds, there is 'no money in charity law' especially outside the metropolis or large cities so few practitioners have the incentive to become expert in it. These factors may explain to some degree why so few lawyers have a good grasp of the legal principles in respect of charity and sometimes provide less than adequate legal advice, for example, in respect of drafting matters.

It could be argued that because of the Charity Commission's role as advisers to charity this does not matter. However, they no longer provide pre-registration advice on the drafting of constitutions. It is also possible that the relative inaccessibility of the Commission's past and current decisions may be part of the problem. The

Charity Commissioners themselves recognised the need for their wider dissemination in launching *Decisions of the Charity Commissioners*[29] which was intended to cover a wide range of decisions on points of law, and on individual cases. The publication was intended to be produced twice-yearly and it is unfortunate that this has not continued. The Commission is interpreting the law, has concurrent jurisdiction with the High Court on a number of matters, yet its decisions are not readily available to the public or the professions. At least when decisions are published, there is the possibility of argument and discussion of the cases. This problem is compounded by the fact that some recent Annual Reports of the Commissioners have focussed more on Citizens' Charter issues than in reporting decisions on charity cases. Arguably, this focus of knowledge at the Commission is not good for the development of charity law or for the sector.[30] The Charity Law Association, *N.G.O.Finance*[31] and *Charity Law and Practice Review*[32] publish or review recent decisions but can it be appropriate that law which is central to a sector worth almost 2% of G.D.P. is so difficult to access and is disseminated largely by lawyers' gossip? Whilst it is good that there is free advice on charity and trustee matters available from the Commission, there is a danger that only Commission staff and lawyers formerly employed there will have sufficient knowledge of charity law as it develops to be able to give advice.

B. ACCOUNTANCY

The 'shoddy' nature of many of the CCRs' accounts was noted in chapter eleven. Hopefully, since the publication of the Charity SORP[33] and the reporting and accounting requirements in the Charities Act[34] this situation has now improved. However, not all accountants are familiar with the intricacies of the SORP and many would use commercial company terminology (such as cost of sales or profit on sales

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[28] *Scott v Ors v National Trust for Places of Historic Interest or Natural Beauty & Or* [1998] 2 All ER 705 See the discussion of this and similar cases in Chap. 7.

[29] [1993] D.C.C. preface.

[30] Similar points were made by Hill J., *Too Much Recreation at the Commission*, NGO Finance, November/December 1997 p.42

[31] NGO Finance – Incorporating CHARITY Magazine, Plaza publishing Ltd

[32] Published by Key Haven Publications plc.

[33] *Accounting by Charities - Statement of Recommended Practice*, Charity Commission, October 1995.

when a charity's sole income consists of grants and donations), if trustees were not to ask for more appropriate wording. Some areas, such as charity trading, taxation and VAT require perhaps greater technical knowledge and the average local charity might have difficulty locating the expertise.

C. THE SMALLER CHARITY

For larger charities there may be little difficulty in obtaining appropriate advice, mediation or consultancy. This will not necessarily be the case with the poorer charity. To put this into context. A local, provincial, solicitor with a reasonable expertise in charity law charges a '*pro bono*' rate of between £250-£500 to help an unincorporated charity to convert to a company or to establish a trading subsidiary. A London 'charity lawyer' charges £1,500 for similar work.[35] Few local charities would view that level of expenditure as appropriate.

D. INSOLVENCY PRACTITIONERS

From the perspective of this study, one difficulty which several practitioners identified was the uneven spread of insolvency practitioners throughout the country and then, for charities which were not insolvent, finding one who was sympathetic and understanding of the issues raised by the dissolution of charities.

V. PREVENTION AND CURE

The Charity Commission has indicated that, through the annual monitoring process, they are attempting to identify early warning signs of charities at risk or in difficulties. In 1993, the Commission identified charities in financial difficulties and continued to monitor them closely through 1994.[36] In 1997 an initiative was established to undertake risk assessments on organisations seeking registration[37]. The particular focus of this seems to have been to weed out sham charities and to reduce the risk of

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[34] Charities Act 1993 ss.41-48
[35] Author's recent experience.
[36] [1993] Ch. Com. Rep. p.13 para.43
[37] [1997] Ch. Comm. Rep. p.8 para.39

non-charitable activities being undertaken. More recently, the Commission claims to be increasingly able to identify problems and risks to charity assets that may not have been identified by trustees.[38]

The identification of charities in financial difficulty cannot, however, be a science. In 1994, using monitoring information, 69 charities were identified as being at risk of insolvency on the basis of standard accounting measures such as their current asset to current liability ratio, their net total assets, and gross income.[39] A small number of those charities have since been removed from the register, but interestingly a major grant making charity was on the list, albeit with a low risk rating. This seems to demonstrate that charities, unlike commercial companies, are not relying on 'sales' and unless they have some particular reason for accumulating funds, good grant making charities should be spending most of their income.

The opportunities for rescuing charities in difficulty are considered in chapters three and nine. With regard to statutory processes for rescue, the Charity Commission acknowledges the effectiveness of the appointment of receivers and managers[40] under the Charities Act 1993.[41] The only drawback is that the charity must usually have a level of resource available from which the receiver can be paid. Again this could present difficulties for the small charity. The Commission also acknowledges the benefit of mediation in disputes[42] and welcomed the initiatives by N.C.V.O. and the Centre for Dispute Resolution. Again, the appointment of a mediator may not be possible in a small charity with little resources. During 1998 the Commission established a small team to provide a more specialised service exploring new methods of tackling disputes and was able to report that they had helped resolve the dispute in many cases.[43] Since this is a Commission team, presumably the service is free to the charity.

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[38] [1998] Ch. Comm. Rep. pp.3 and 11
[39] information from a Charity Commission accountant
[40] see [1996] Ch. Comm. Rep. p. 25/26 para. 168
[41] Under Charities Act 1993 ss.18(1)(vii) and 19
[42] [1996] Ch. Comm. Rep. p.22 para.152;
[43] [1998] Ch. Comm. Rep. p.16

VI. Is Enough Use Made Of Local Intermediary Bodies?

Reference has already been made to the support offered by N.C.V.O. to national bodies. Councils for Voluntary Service (CVSs) and Rural Community Councils (RCCs) exist in most district or county areas, amongst other things, to provide support to local voluntary organisations. For charities which operate in a locality whether they are national, regional or local, RCCs and CVSs can be a very important source of local information. They will be familiar with, for example, local authority, health authority, or TEC views, policies and personnel, but will also know of people in the locality with particular knowledge and skills and, from their national information, will also be aware of new legislation, trends and services.

RCCs and CVSs help community and voluntary groups at all stages of their existence. As part of this function, many are prepared to help charitable organisations work to develop their constitution and to register as a charity if that is appropriate. They also provide training and support for trustees, both as trustees and as managers of a charitable business, and their help is frequently sought if there is conflict within a committee or if a charity is to be dissolved.[44] Generally speaking, they work with smaller groups[45] often unable to afford heavy legal fees and which do not attract so much attention from the Charity Commission. They have frequently been appointed by their local authority to maintain the index of charities and to review local charities.[46] Their expertise is variable, but many are able to offer a reasonably competent service in relation to the level at which they operate.

It would seem that better and, perhaps, more formal links could be developed between the Charity Commission and these organisations and others providing a similar support service to voluntary organisations, so as to provide a more extensive service to charities in their areas. Perhaps a way could be found of accrediting the competence of such organisations and, indeed, members of the professions (law,

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[44] Three of the case studies are drawn from the author's experience working in a CVS

[45] E.g. Telford and Wrekin CVS has around 100 organisations affiliated of which less than a handful have an income over £200,000.

[46] Under Charities Act 1993 ss.76 and 77.

accountancy etc) so that all claiming an ability to advise charities could demonstrate minimal competence. Interestingly, recent attempts to establish an association of independent examiners recognise the need for those fulfilling that particular role with charities to have specific areas of expertise.

The focus on supporting the voluntary sector infrastructure identified in the *Compact,*[47] which provides a framework for government – voluntary sector partnerships at national level, is welcome if it provides stability for the organisations set up to support charities. The Compact also recognised the need for greater consistence and transparency in funding frameworks.[48]

Problems of short-term and output-related funding were identified by the research are also relevant at local level. Whilst *The Compact* should assist at National level, it is likely that CVSs and RCCs will be important actors in the development of compacts at local level because of their 'umbrella' status. This, amongst other things, could ensure that the problems associated with contracting discussed earlier in this chapter and in chapter ten do not occur with local and health authority funding.

V. TAILPIECE

Whilst a charity is in the process of an orderly winding down, it is likely that there will be some drain on its assets. If assets are not to be wasted that drain needs to be minimised. The Charity Commission appears to make efforts to respond very quickly if particularly asked to do so but, in fact, their general response rate is quite good. As a result, some of the areas, which used to cause delay, such as receiving guidance from the Charity Commission, are no longer problematic. However, there may be ways by which the process of dissolution can be speeded up. Several of the practitioners commented that a charity, or its adviser, might have to be in touch with several departments at the Commission. There has, however, been re-structuring since those comments were made and the situation may have improved as a result.

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[47] Cm. 4100, *Compact on Relations Between Government and the Voluntary and Community Sector in England*, Home Office, 1998.

[48] Cm.4100, para 9.2

There have been a number of developments during the course of this study. For example, alternative dispute resolution services have become fairly well established for charities, receiverships are recognised as a means of rescuing charities and putting them back on track. The Department of Trade and Industry's Competitiveness White Paper[49] proposed changes in company and insolvency law, such as a 3-month stay in creditor action and the reassessment of relative rights of creditors in an insolvency, may provide further rescue possibilities for corporate charities in the future.

It has not been possible to plumb the depths of all the areas on which issues have been raised by the research largely because many of the areas considered in chapters four to ten could be the subjects of research in their own right.

Three of the cases studied and other material has been drawn from recent experience of the author in a council for voluntary service serving a population of 150,000 people. In two the author plotted the critical path and held the process together,[50] in one of them as a trustee, in the other as part of the CVS's role supporting trustees. In the third case study, a merger[51] the author is a trustee of each charity and expecting to be similarly involved in the newly formed charity. The point of noting this is to recognise that there is nothing particularly unusual in this particular CVS's area and none of those charities were, or will be insolvent when they dissolve. It would seem that dissolution is perhaps part of a healthy life cycle for charities. It is incumbent on those who can do so, to provide information and support a speedy dissolution, in order to preserve remaining charity assets and maintain the good name of charity.

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[49] *Our Competitive Future – Building the Knowledge Driven Economy, Department of Trade and Industry*, 1998 para.2.13. A major review of company law is also under consideration -*Modern Company Law for a Competitive Economy*, Consultation Paper, D.T.I., 1998.

[50] Case Study 1, Record 14

[51] Case study 18

APPENDIX 1

Corporate Charities Removed From The Register

Charity	Record No.
Abbeyfield Bolsover Society	43
Abbeyfield Northwich	23
Advance	115
Advancement of Research into Anorexia	55
Advice Centre in the Blue	57
Aircraft Museum Wales	47
ALL Association for Active Learning	33
All Souls Haley Hill Preservation trust	27
Anfield Foundation	34
Arab development Centre	70
ARMS	10
Ashford Theatre T	99
Ashton Gifford School	73
Balham Christian Centre	104
Beckisland Properties	101
Bell Endowment Trust Ltd	17
Bellingham & Downham Community Bereavement Sche	96
Bootstrap Swindon	67
British Reggae Artistes Famine Appeal	102
Bryan Robson Scanner Appeal	16
Building Society Training College	117
Careers for Women	132
Caring Together Foundation	32
Centre for International Studies Project	75
CFI International	124
Chandos Childrens Concerts	68
Child Mobility T	77
Cirencester epidemiology Research Unit	81
Citicare St Clements	105
Clerkenwell Heritage centre	116
Cleveland Alternatives for Young People	13
College of Law	71
Common Cause College	63
Community Action T (Worcs)	114
Community Opportunities Inner London	113
Cornelle Ltd	40
Courtney F	58
Create Development Trust Ltd	4
CSMH Camden Society for Mentally Handicapped	131
Dacorum Community Care Association	103
Dartmouth House Centre	109
Dietary Research F.	50
Disabled Persons Family Centre	100
Disabled Skills (Telford) Ltd	14
Drugs & Alcohol Rehabilitation T	48
ELPIS	7
Everybody's Music	38
Farm & Rural Buildings Centre	24
Fifty Plus Centre	37
Fightback T	90

Appendix 1 continued

Charity	Record No.
Frenchay mental Health T	59
Friends of New Mills Air Compression Station	97
Fund for Research & Investment for Devt of Africa	98
Gladstone Pottery Museum T	46
Gorstey Hill Housing Association	30
Heritage Brewery Museum	28
Highfields and Belgraave Law Centre	2
I.C. Educational Trust	9
Institute of Mathematics	21
Institute of Taxation	126
International Health & Biomedicine	49
Ironbridge & C'b'dale Buildings Preservation Soc	42
Islamic T Maidenhead	86
Jazz South	82
John Eastwood Water Protection T	85
Kupath Ramban	108
Leatherhead Christian Housing Company	112
Leeds Asian Families Counselling Service	26
Lentonscope	128
Lichfield Centre for Unemployed	6
Lincs. Aviation Soc. Ltd	41
London Philharmonic Orchestra	72
Love Loyalty T	78
Malvern Homeless Young Peoples T.	51
Marc Europe	93
Maya Project	88
Merseyside Everyman Theatre Co	15
Messianic Ministries Charitable T	107
Metanoia Education for Living	56
Migrant Support Unit	89
Milberry Information & Training Centre	66
Milbury Trust	22
N. Warwick's Group Homes	39
N. Westminster Charitable School	123
N.Hants Alcohol Advice	65
Neville Russell Challenge	69
Newham Special Needs Housing Consortium	106
North End Wirral Workshops	18
North Kensington Student Hostel	121
North West Archaeology Trust	5
Oldham Single Homeless	19
Open Air Christian Action	111
Orton Family Centre	64
P.C.A.S.	61
Palladian T	52
Pembroke Historic Building	129
Pilkington Community Programme	25
Plymouth Fishermen's Mission	79
Plymouth Rudolf Steiner School	84
Reproduction Research Information Service	44

Appendix 1. continued

Charity	Record No.
Ribblesdale Trust	45
Ridware Conservation Trust	35
Round Square International Service	83
S.T.A.R.	62
Salford Fellowship	31
Sefton Commercial Business Training Centre	11
Signpost T	53
Skelmersdale Day Centre	12
Society of Hearing Aid Audiologists	54
South Regional Association for Blind	127
Southwark Microtech	118
Southwell ITEC	119
St Judes Womens' Refuge	122
Stoke & Newcasttle Arts Project	36
Stratford House School	92
Stury & Dist Social Centre Association	91
Surrey Charity Group	130
Surrey Resettlement	125
Sussex Congregational Union	95
Sutton House Society	94
Swaythling Youth Centre	87
Tilehurst School	74
Transvestite / Transsexual Group	110
TS Tuna	29
U.C.C.A	60
Upper Chine School	76
Vauxhall Cross Amenity T	120
Wells Stone Preservation Centre	80
Wirral Womens' Safe Transport	1
Yorks TV Telethon T	8

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