Conflicts of interest: are your trustees aware of their duties?

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Between June and August 2013 the Charity Commission sought comments on its new draft guidance Managing Conflicts of Interest: A guide for trustees. Although trustees’ legal duties have not changed in respect of their obligations to identify and manage conflicts of interest, the Charity Commission is seeking to explain its understanding of the principles and the practical steps trustees should take in a clearer way.

Final guidance will be published in due course, but we are finding that the Charity Commission is increasingly requiring charities to demonstrate that any conflicts that arise for their trustees are being appropriately managed. We thought this would be a useful opportunity to remind trustees of their duties.

Obligations under charity law

All charity trustees owe an obligation of undivided loyalty to their charity. The principal components of the obligation are:

- the "no conflict" rule: a trustee must not put himself in a position where his duty to the charity and his interest conflict; and
- the "no profit" rule: a trustee must not make a profit from his position as trustee.

The "no conflict" and "no profit" rules are strict rules. This means that they apply even where a trustee has acted honestly and in good faith and the charity has not been disadvantaged.

The duty of undivided loyalty also means that trustees must be aware of situations where a conflict arises or may arise between their duties to the charity and to another person or entity (charitable or otherwise) This creates particular issues for charities where trustees sit on the board of subsidiary trading companies, or charities which are the corporate trustee of other charities (for example, where a charity has incorporated and is the corporate trustee of a trust which holds its permanent endowment).

The rules can be modified by way of express provision in the charity's governing document, but only to the extent that any private benefit that arises for the trustee or a person or entity connected to him is incidental to the charity carrying out its charitable purposes. The key areas where the rules are usually modified are in relation to trustees benefitting from trustee indemnity insurance, trustee expenses and trustees or connected persons being remunerated for providing services to the charity.

If a transaction arises which may infringe these rules and there is no express provision in a charity's governing document permitting the other trustees to authorise the conflict, the charity should seek an order of the Charity Commission to authorise the transaction. In some cases, such as the disposal of charity land to a trustee or connected person, the trustees are prohibited from acting unless the permission of the Charity Commission has first been obtained.

If the rules are breached without prior sanction from the Charity Commission, possible consequences include:

- the trustee being liable to compensate the charity for loss caused by the breach;
- the trustee being required to pay back to the charity any benefit received as a result of the breach; and/or
- a disposition of charity property being set aside.

The Charity Commission or court can grant relief in appropriate cases, but it may require undertakings from the trustee and/or from the charity. Our experience is that the Charity Commission is taking an increasingly strict line on conflicts and so charities should not assume that relief will be available, making it all the more important that trustees are aware of and comply with the rules.
Identification of conflicts

A large part of trustees’ uncertainty around conflicts involves identifying what is a relevant interest that conflicts with a trustee’s duty. For example, just because a trustee is a member of a large nationwide charity, it does not follow that he would necessarily be conflicted in a decision by the charity of which he is a trustee to make a grant to the charity of which he is a member.

In identifying conflicts, charity lawyers sometimes refer to the “Tabloid test”. This is not in any way a legal test, but simply involves trustees asking themselves whether they would be embarrassed to see their interest being reported in the national press. It will not be appropriate in every case, but in the absence of any more practical guidance it can serve as a useful rule of thumb.

Management of conflicts under charity law

The Charity Commission accepts that in some situations conflicts are difficult or impossible to avoid. It does, however, require charity trustees to manage conflicts appropriately. This usually means that a trustee must first declare the nature of any interest he has which may give rise to a conflict and not vote on the matter in which he is conflicted. Sometimes a charity’s governing document will require that the trustee withdraws from the meeting altogether or must not participate in the debate unless asked to provide information.

It is important to note that trustees must be as alert to perceived and potential conflicts of interest as to actual conflicts. One of the duties of charity trustees is to safeguard their charity’s reputation. The perception of a conflict even where one does not actually exist must therefore also be managed appropriately.

In some situations it may not be possible to manage a conflict in this way. For example, where a charity is the corporate trustee of a permanent endowment trust, all of the trustees of the charity are likely to be conflicted in relation to a decision where the charity’s interests conflicted with those of the trust. In such circumstances, specialist advice will always be needed.

Additional obligations under company law

If your charity is a charitable company, you are also bound by company law requirements on conflicts of interest. The Companies Act 2006 imposes a statutory duty on directors (ie trustees) to avoid conflicts of interest unless the conflict has been authorised by the other directors. This is only possible where such authorisation is permitted under the charity’s governing document. If no such power is contained in the governing document, the conflict cannot be managed. This can result in the conflicted director being required to resign, although in some circumstances steps can be taken to amend the charity’s governing document (subject to Charity Commission consent) to give the other directors power to authorise the conflict or the conflict may be capable of being resolved by a vote of the charity’s members.

The operation of company law in this area is complex and if you are concerned that your charity’s governing document does not provide sufficient authority to manage a trustee’s conflict you should take specialist advice.

Practical steps to take

Conflicts of interest are a more complex area than is often understood. However, proper management of conflicts of interest is much easier and less potentially disruptive if a charity is prepared and can anticipate where conflicts might be an issue. Steps charities should consider taking include:

- reviewing the terms of their governing document to ensure that it contains appropriate provisions to deal with conflicts;
- requiring new trustees to declare their actual, potential and perceived conflicts prior to appointment;
- maintaining a register of interests and asking trustees periodically to review their interests; and
- having and implementing a robust conflicts policy.
Generally, good transparency amongst trustees and between trustees and the charity will help in identifying, avoiding or eliminating and managing conflicts of interest.

The Charity Commission is currently considering comments on its draft guidance and will be issuing final guidance in due course. Commentators have recommended that the guidance should be revised to include common situations where conflicts arise, such as trading subsidiaries, corporate trusteeships, local authority trustees, corporate foundations, groups of charities and those in particular sectors, such as the NHS, housing associations or academies. It has also been recommended that the guidance should be expanded (or separate guidance issued) to address how conflicts of interest may affect chief executives and other senior charity employees.

This publication is a general summary of the law. It should not replace legal advice tailored to your specific circumstances.

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