

## The Best Interests Duty and Corporate Charities — The Pursuit of Purpose

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*Most Australian charities are incorporated. Yet most directors, legal advisers and commentators are hard pressed to articulate a fairly fundamental obligation of charity directors: to act in good faith in the best interests of their corporation. At a time when shareholder primacy is being increasingly questioned for for-profit corporations and consideration of stakeholders or purposes is being written into corporations legislation in other jurisdictions, there is even greater need to think about what interests ought to be considered by charity directors. We argue that to act in the best interests of an incorporated charity means to act in a way that the directors genuinely believe will advance its purposes. As this is still a fairly amorphous standard, we suggest that it can be given content by means of directors' obligations to give genuine consideration in the exercise of their powers in seeking to advance the corporation's purposes.*

### I Introduction

This article investigates what it means to owe a duty to act in good faith in the best interests of a corporation when that corporation is a charity. That is, in broad terms, a body corporate that meets the definition of charity under the *Charities Act 2013* (Cth) which applies for most federal purposes, or that satisfies the general law test which is the basis of most state and territory legislation.<sup>1</sup> The background to this inquiry is the intense focus on purpose that is occurring in the for-profit and not-for-profit spheres,<sup>2</sup> as well as the rise of social enterprise models and the blurring of boundaries between charitable and for-profit entities.<sup>3</sup> This raises the question of what it means to act in good faith in the interests of an entity that exists to pursue purposes.

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<sup>1</sup> Albeit such tax, fundraising, association incorporation, charity proceedings and other such state legislation frequently – and with great variability – modifies the general law. As to the various definitions and their essential commonality in the face of multiple idiosyncratic variations, see, eg, Ian Murray, 'Regulating Charity in a Federated State: The Australian Perspective' (2018) 9(4) *Nonprofit Policy Forum* 1.

<sup>2</sup> See, eg, The British Academy, *Reforming Business for the 21<sup>st</sup> Century: A Framework for the Future of the Corporation* (2018); Business Roundtable, 'Statement on the Purpose of a Corporation' (19 August 2019) <<https://opportunity.businessroundtable.org/ourcommitment/>> accessed 3 April 2021.

<sup>3</sup> See, eg, Australian Law Reform Commission, *The Future of Law Reform: A Suggested Program of Work 2020–2025* (December 2019) paras 2.124–2.147; Australian Government, The Treasury, *Strengthening for Purpose: Australian Charities and Not-for-profits Commission Legislation Review 2018* (2018) 17 (**ACNC Review**); Dana Brakman Reiser and Steven Dean, *Social Enterprise Law* (Oxford University Press 2017).

In a for-profit context, while the duty is owed to the corporation, it has traditionally been interpreted as meaning to act in good faith in the best interests of the members (as a whole) of the corporation, with due regard to other interests in some circumstances, such as creditor interests when the company is close to insolvency. However, identity between member interests and the interests of the corporation is increasingly being questioned.

A charity context raises such questions to a deafening roar. Charities are required to pursue their particular charitable purposes and to do so for the benefit of a section of the public, so that if members receive benefits they do so only in a capacity **other** than as a member. What does it mean then to act in good faith in the best interests of a charitable corporation? One possibility is that directors<sup>4</sup> are required to act in good faith in the interests of the charity's potential beneficiaries, or for the public benefit. Other possibilities contemplate a separate role for the interests of the entity or for donors. However, we argue that it means acting in the best interests of the **charitable purposes** of the corporation. This is a purpose-based governance approach that views directors' duties as a means to support action by directors to further the achievement of the corporate purpose.

Some overseas jurisdictions have confronted this issue when drafting legislation to facilitate special-purpose charitable entities. For example, in England and Wales each charity trustee of a charitable incorporated organisation (CIO) must exercise the powers and perform the functions that the charity trustee has in that capacity in the way that the charity trustee decides, in good faith, would be most likely to further the purposes of the CIO.<sup>5</sup> This formulation replaces the interests of the entity with the purposes of the entity. In Scotland, by contrast, a charity trustee of a Scottish charitable incorporated organisation (SCIO) must, in exercising functions in that capacity, act in the interests of the charity and must, in particular 'seek, in good faith, to ensure that the charity acts in a manner which is consistent with its purposes'.<sup>6</sup> This model still retains a role for the interests of the charity. The models provide examples of different ways in which the best interests duty could be framed in a charities context.

Flowing from the above questions about how the duty is to be characterised are questions about when this will make a difference in practical terms. One situation where it will make a difference is charity mergers. In such situations a question arises as to whether directors (or other responsible persons) can be said to be acting in the best interests of the charitable entity if they let the entity come to an end in order that the merged entity can better fulfil the charitable purpose. A second situation is where a charity pays funds to another charity to pursue the same purposes, thus diminishing the first charity's assets and resources. This occurred in the very recent UK Supreme Court case of *Lehtimäki v Cooper*.<sup>7</sup> A third example is where charity directors attempt to determine how to prioritise the interests of members or benefit recipients, where changed circumstances mean that benefit recipients call for changes to a charity's activities that conflict with its purpose. Fourth, directors may need to determine whether they can support an action that advances the charity's particular charitable purpose, even if the proposed action may itself be detrimental to the public benefit or to a more

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<sup>4</sup> We use the term 'directors' to refer generally to the directors, management committee members or governing body members of the various forms of incorporated charities.

<sup>5</sup> Charities Act 2011 (UK) s 221(1).

<sup>6</sup> Charities and Trustee Investment (Scotland) Act 2005 (Scot) ss 51, 66(1)(a).

<sup>7</sup> *Lehtimäki v Cooper (Lehtimäki)* [2020] UKSC 33, [2020] 3 WLR 461.

generalised articulation of the charity's specific charitable purpose. An example would be where an educational institution which has the purposes of furthering tertiary education pays its chief executive officer a sum of money not to work for a competitor for a year upon resignation. This may further the way in which that particular institution furthers the purpose but it may not have the effect of furthering tertiary education more generally given that the officer cannot work at another tertiary institution and further the purposes of tertiary education as pursued by that second institution.<sup>8</sup> Finally, answers should also help clarify whether directors can promote the amendment of a corporation's purposes — including converting a charity into a for-profit corporation.

The issue is examined as follows. Part II briefly outlines key sources of the duty to act in good faith in the interests of the entity (the **best interests duty**) for directors or management committee members (for brevity, hereafter collectively termed directors) of incorporated charities in Australia. The subsequent discussion is relevant to all these forms of incorporated charities, though much of the focus is on companies limited by guarantee. Part III discusses the normative bases of several key conceptualisations of the best interests duty. Part IV then examines the extent to which the law on the best interests duty for charity directors can be explained or justified by reference to these normative bases. In particular, this Part examines whether the duty can be conceived as acting in the best interests of residual claimants; in the general public interest; in the best interests of the corporation as a separate and on-going entity; or as advancing the corporation's purposes. Finding that advancement of the charitable purpose best explains the law, Part V investigates what this actually means and whether it imposes any meaningful bounds on charity directors. Part VI concludes.

## II Sources of the Best Interests Duty

Incorporated charities come in various forms. In Australia, of those registered with the federal charities regulator, the Australian Charities and Not-for-profits Commission (ACNC), the most common are incorporated associations (41% of all charities), followed by companies limited by guarantee (12% of all charities).<sup>9</sup> Unincorporated associations and trusts comprise a further 43% of charities. There are comparatively few charities that take other incorporated forms, such as cooperatives, and those incorporated under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth) or by royal charter or Act of Parliament, although such charities may control significant assets.

### A Companies limited by guarantee

Companies limited by guarantee are bodies corporate with distinct legal personality established as public companies under the *Corporations Act 2001* (Cth) (*Corporations Act*). Prior to the commencement of the ACNC, the Australian Securities and Investments Commission (ASIC) was the chief regulator of such companies. Duties are imposed under the

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<sup>8</sup> See University of Exeter, *Annual Report 2017/18 and Financial Statements to 31 July 2018* (2018) 48. We thank Mary Synge for this example. Compare a severance payment for Aberdeen University's Principal that included 12 months of gardening leave which seems not to have provided meaningful non-compete benefits for the University: Office of the Scottish Charity Regulator, *Inquiry Report made under Section 33 of the Charities and Trustee Investment (Scotland) Act 2005* (July 2020).

<sup>9</sup> Natasha Cortis and others, 'Australian Charities Report 2015' (Centre for Social Impact and Social Policy Research Centre, UNSW, December 2016) 49, 104. Subsequent reports do not break the sector down by legal form.

*Corporations Act* and at general law upon directors, along with provision of members' remedies to support member participation and limit oppressive or prejudicial conduct against members.<sup>10</sup> Directors' core duties include:

- Acting with care, skill and diligence,<sup>11</sup> including a duty to prevent insolvent trading.<sup>12</sup>
- Acting in good faith in the best interests of the company.<sup>13</sup>
- Exercising powers for a proper purpose.<sup>14</sup>
- Avoiding conflicts of interest and unauthorised profits, with related statutory duties of disclosure and avoiding misuse of position and misuse of information from position.<sup>15</sup>

The above duties include extensive statutory encapsulation. However, for companies limited by guarantee that are registered with the ACNC, governance standard 5<sup>16</sup> (indirectly — see Part IIF below) replaces many of the statutory duties in the *Corporations Act*, but not the general law duties.<sup>17</sup> A review of the ACNC legislation recommended 'turning back on' the *Corporations Act* directors' duties,<sup>18</sup> a matter on which the government has committed to conduct consultation.<sup>19</sup> This article continues to consider the *Corporations Act* best interests duty for this reason, as well as the fact that analysis of the duty helps inform the general law equivalent (that continues to apply) and the other duties set out below.

## **B Incorporated associations**

Incorporated associations are bodies corporate with a separately recognised legal existence from their members. Such organisations are created under state and territory associations legislation that (excepting the Northern Territory) requires associations to be not-for-profit bodies.<sup>20</sup>

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<sup>10</sup> See, eg, Robert Austin and Ian Ramsay, LexisNexis, *Ford, Austin and Ramsay's Principles of Corporations Law*, paras 6.010–6.011 (Last reviewed: November 2018). Directors are not immune because they act in a voluntary capacity for a not-for-profit company: *Commonwealth Bank v Friedrich* (1991) 9 ACLC 946 (VSC) 1011–12 (Tadgell J).

<sup>11</sup> *Corporations Act*, s 180(1); *Daniels v Anderson* (1995) 37 NSWLR 438 (NSWCA).

<sup>12</sup> *Corporations Act*, s 588G.

<sup>13</sup> *ibid* s 181(1)(a); *Re Smith & Fawcett Ltd* [1942] Ch 304 (CA) 306 (Lord Greene MR); *Westpac Banking Corporation v Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1 (WASCA) 169 [923] (Lee J); [2772] (Carr AJA).

<sup>14</sup> *Corporations Act*, s 181(1)(b); *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC) 835.

<sup>15</sup> See, generally, Austin and Ramsay (n 10) ch 9 (Last reviewed: July 2020); *Corporations Act*, ss 182, 183, 191, 195. Note also the related party provisions in *Corporations Act*, ch 2E.

<sup>16</sup> See *Australian Charities and Not-for-profits Commission Regulation 2013* (Cth) reg 45.25(2) (**ACNC Regulation**).

<sup>17</sup> *Corporations Act*, pt 1.6. For instance, ss 180–183 and 191–194 no longer apply. These provisions require directors to act with care, skill and diligence; in good faith in the best interests of the company and for a proper purpose; to make disclosure; and to avoid misuse of position and of information from position.

<sup>18</sup> ACNC Review (n 3) recommendation 11.

<sup>19</sup> Australian Government, The Treasury, *Government Response to the Australian Charities and Not-for-profits Commission Legislation Review 2018* (2020) 12.

<sup>20</sup> See, eg, Gino Dal Pont, *Law of Charity* (2nd edn, LexisNexis Butterworths 2017) para 17.63.

The duties applying to management committee members have been described as ‘minimal’.<sup>21</sup> However, this may reflect the practical extent of regulatory oversight<sup>22</sup> or the typically limited degree of statutory enunciation (though see below), rather than the scope of the underlying duties. Indeed, where an association manages its operations by way of a management committee, the nature of the position occupied by a management committee member has been said to be similar to that of a company director, such that similar general law duties would be expected.<sup>23</sup> For instance, it seems that officers of most types of corporate bodies would be required to exercise powers for proper purposes.<sup>24</sup> Committee members would also typically be expected to act in good faith in the best interests of the association and to avoid conflicts of interest and unauthorised profits,<sup>25</sup> although the scope of those duties might vary depending upon the circumstances.<sup>26</sup> Their position as controllers should also subject committee members to a duty of care and diligence.<sup>27</sup> Some states and territories now also encapsulate the majority of these duties of loyalty and of care, in statutory form,<sup>28</sup> with statutory best interests duties often expressly leaving general law duties in place.<sup>29</sup> The Victorian provision provides a representative example for Victoria, Western Australia and the soon to commence Queensland provisions:<sup>30</sup>

(1) An office holder of an incorporated association must exercise his or her powers and discharge his or her duties—

(a) in good faith in the best interests of the association; and

(b) for a proper purpose.

The New South Wales provision is differently worded:<sup>31</sup>

It is the duty of each committee member to carry out his or her functions for the benefit, so far as practicable, of the association and with due care and diligence.

## C Co-operatives

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<sup>21</sup> Australian Government, The Treasury, ‘Scoping Study for a National Not-For-Profit Regulator’ (Consultation Paper, January 2011) 11.

<sup>22</sup> *ibid*; Senate Standing Committee on Economics, Parliament of Australia, *Disclosure Regimes for Charities and Not-for-profit Organisations* (2008) 70.

<sup>23</sup> See, eg, *Lai v Tiao (No 2)* [2009] WASC 22, [84] (Johnson J); *Pine Rivers, Caboolture & Redcliffe Group Training Scheme Inc v Group Training Association Queensland & Northern Territory Inc* [2015] 1 Qd R 542 (QCA) [37]–[39]. See also *Stratford Racing Club Inc v Adlam* [2008] NZCA 92, [2008] NZAR 329, 342 [58]; Gino Dal Pont, *Law of Associations* (LexisNexis Butterworths 2018) para 8.39.

<sup>24</sup> Austin and Ramsay (n 10) para 8.200 (Last reviewed: July 2020).

<sup>25</sup> AS Sievers, *Associations and Clubs Law in Australia and New Zealand* (3rd edn, Federation Press 2010) 146–47.

<sup>26</sup> cf Dal Pont, *Law of Associations* (n 23) paras 8.35–8.39.

<sup>27</sup> AS Sievers, ‘What is the Future for Honorary Directors and Committee Members? — Their Duties and Liabilities’ in Myles McGregor-Lowndes, Keith Fletcher and AS Sievers (eds), *Legal Issues for Non-profit Associations* (Law Book Company 1996) 22, 31, 33–38.

<sup>28</sup> For the best interests duty, see especially *Associations Incorporation Reform Act 2012* (Vic) s 85; *Associations Incorporation Act 2015* (WA) s 45; *Associations Incorporation and Other Legislation Amendment Act 2020* (Qld) s 31; *Associations Incorporation Act 2009* (NSW) s 30A.

<sup>29</sup> *Associations Incorporation Reform Act 2012* (Vic) s 85(2); *Associations Incorporation Act 2015* (WA) s 48.

<sup>30</sup> *Associations Incorporation Reform Act 2012* (Vic) s 85.

<sup>31</sup> *Associations Incorporation Act 2009* (NSW) s 30A.

Co-operatives formed under the Co-operatives National Law that applies in each state and territory also expressly subject directors and officers to a duty to ‘exercise their powers and discharge their duties ... in good faith in the best interests of the co-operative’ and ‘for a proper purpose’.<sup>32</sup> These duties do not derogate from those also applying at general law.<sup>33</sup>

#### **D Corporations (*Aboriginal and Torres Strait Islander*) Act 2006 (Cth)**

Directors of corporations formed under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth) are subject to a similar best interests duty to that applying to directors of companies limited by guarantee, namely to:<sup>34</sup> ‘exercise [their] powers and discharge [their] duties: (a) in good faith in the best interests of the corporation; and (b) for a proper purpose’. The duties do not derogate from the general law.<sup>35</sup>

#### **E Royal charter and Act of Parliament charities**

The directors’ duties for charities incorporated by royal charter or Act of Parliament are more mixed and are likely to depend very much on the circumstances with, for example, legislation for incorporated religious bodies in particular assigning the content of duties to the relevant religious authority.<sup>36</sup> However, a general law best interests duty would apply in some instances and a best interests duty is sometimes found in statutes. For instance the statute incorporating the University of Western Australia requires each member of the university senate to ‘act in the best interests of the University and give precedence to the interests of the University over the interests of any person appointing or electing a member of the Senate’.<sup>37</sup> Section 46 of the *Hospital Foundations Act 2018* (Qld) requires hospital (support) foundation board members to ‘act impartially and in the interest of the foundation in performing the member’s functions’.

#### **F Overlay of ACNC Governance Standards**

Most economically significant charities have chosen to register with the ACNC, with one of the key reasons being that registration is necessary in order to access most Commonwealth charity tax concessions.<sup>38</sup> Where a charity has done so, it is subject to the additional regulatory framework under the *Australian Charities and Not-for-profits Commission Act 2012* (Cth) (*ACNC Act*), including the ACNC governance standards.<sup>39</sup> The governance

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<sup>32</sup> *Co-operatives (Adoption of National Law) Act 2012* (NSW), Appendix, Co-operatives National Law, s 193 (**Co-operatives National Law**). The duties may be altered to some degree by construction in accordance with the cooperative principles (s 11), which include a focus on member needs and community development (s 10). See also the expression of the business judgment rule in s 192(2)(a).

<sup>33</sup> Co-operatives National Law, s 197.

<sup>34</sup> *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth) s 265-5(1). This is subject to an additional exception for acts the director believes are necessary to comply with Native Title legislation obligations.

<sup>35</sup> *Corporations (Aboriginal and Torres Strait Islander) Act 2006*, s 265-30(1).

<sup>36</sup> *Anglican Church of Australia (Bodies Corporate) Act 1938* (NSW) s 6. Note that there is no best interests duty in the recent Institution of Engineers Australia royal charter of 2015.

<sup>37</sup> See *University of Western Australia Act 1911* (WA) sch 1, s 1.

<sup>38</sup> As to reasons for registration and the tax/ACNC regulatory regime overlaps, see Ian Murray, ‘Fierce Extremes: Will Tax Endorsement Stymie More Nuanced Enforcement by the Australian Charities and Not-for-profits Commission?’ (2013) 15 *Journal of Australian Taxation* 233.

<sup>39</sup> The standards do not apply to basic religious charities: *Australian Charities and Not-for-profits Commission Act 2012* (Cth) (*ACNC Act*) s 45-10(5).

standards enshrine minimum outcomes in respect of the processes adopted by an entity to govern its operations so as to enable it to carry out its purposes.<sup>40</sup> Governance standard 5 obliges registered charities to ensure that charity controllers comply with a broad range of core duties, including:<sup>41</sup>

- (2) A registered entity must take reasonable steps to ensure that its responsible entities are subject to, and comply with, the following duties:

...

- (b) to act in good faith in the registered entity's best interests, and to further the purposes of the registered entity; ...

The governance standard demonstrates the interaction between best interests and purposes referred to in the introduction. The Explanatory Statement accompanying the governance standards states that the duties 'have been derived from the common law and the *Corporations Act* and they have well established meanings. Consequently, it is intended that the meaning of these duties be interpreted with reference to the existing common law and legislation'.<sup>42</sup> Should the word 'proper' therefore be implied before the reference to 'purposes' in accordance with this legislative purpose?<sup>43</sup> Or, is there now a duty to act in the best interests of the incorporated charity and a separate duty to further its purposes – and what happens if the two duties conflict? Alternatively, the phrase might be interpreted as an explicit statement of what the best interests duty means in the context of a charity — a duty to further the purposes of the charity.<sup>44</sup> However interpreted, the discussion in this article helps elucidate the range of interests of an incorporated charity and how directors might act so as to further its purposes.

## G Overlay of trustee duties?

In addition to the above duties, there is uncertainty about whether property held for the general purposes of an incorporated charity is nevertheless held subject to obligations 'analogous' to those of a charity trustee.<sup>45</sup> This approach would impose trustee or analogous obligations on the corporation and could thus affect the directors' obligations.<sup>46</sup> The

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<sup>40</sup> See ACNC Regulation, reg 45.1.

<sup>41</sup> ACNC Regulation, reg 45.25.

<sup>42</sup> Explanatory Statement to the Select Legislative Instrument 2013, No 23 (Cth) 11.

<sup>43</sup> As noted by Ramsay and Webster, the text suggests that some different meaning is intended: Ian Ramsay and Miranda Webster, 'Registered Charities and Governance Standard 5: An Evaluation' (2017) 45 *Australian Business Law Review* 127, 156.

<sup>44</sup> This construction would collapse the two requirements into one and is consistent with the description of the duty in Explanatory Statement to the Select Legislative Instrument 2013, No 23 (Cth) 12. A construction that renders part of a provision redundant is not generally favoured, but courts should be mindful of the possibility of 'surplusage' where a literal construction would be at odds with the purpose or broader context: *Western Australian Planning Commission v Southregal Pty Ltd* (2017) 259 CLR 106 (HCA) 122 [55]; Dennis Pearce, *Statutory Interpretation in Australia* (9th edn, Lexis Nexis 2019) 67–69.

<sup>45</sup> The circumstances in which property is given to a charitable company may give rise to a separate charitable trust (see, eg, *Harmony – The Dombroski Foundation Ltd v Attorney-General (NSW)* [2020] NSWSC 1276), but the focus here is on situations where no such separate trust has been created.

<sup>46</sup> See, eg, Dal Pont, *Law of Charity* (n 20) paras 17.71–17.72; *Re Padbury* (1908) 7 CLR 680 (HCA) 695–96 (O'Connor J); *Re French Protestant Hospital* [1951] Ch 567 (Ch D) 570 (Danckwerts J).

authorities are inconsistent,<sup>47</sup> with some cases referring to incorporated charities holding their property subject to trustee or ‘analogous’ obligations,<sup>48</sup> while some insolvency cases have proceeded on the basis that there is no trust.<sup>49</sup> Others have seen the relevant jurisdiction enlivened in the case of an incorporated charity on the basis of the obligation under its constitution to apply its assets to charitable purposes.<sup>50</sup> Whatever the position, the fact that a corporation is charitable affects and shapes the duties of the directors of that corporation.

### III The Normative Approach to the Content of the Best Interests Duty

The foundation for the best interests duty of company directors is the fiduciary relationship between director and company, which gives rise to a number of fiduciary and equitable duties.<sup>51</sup> A key debate concerning the normative modelling of directors’ duties, such as the best interests duty, is that between shareholder primacy theories and stakeholder theories. The former are typically based on economic analysis that views directors’ duties as standard form contracts that are the most efficient means for shareholders to protect their residual claim on corporate assets and maximise their wealth.<sup>52</sup> The latter are focussed on recognising and balancing the interests of shareholders, employees, customers and the broader community.<sup>53</sup>

However, this normative discussion typically takes place in relation to for-profit corporations. It is an odd starting point from which to consider charity regulation for a number of reasons. First, it is implicit that many of these theories view corporate governance primarily as a

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<sup>47</sup> For a recent overview, see, eg, Gino Dal Pont, ‘“Charity” and Trusts: Mutuality or Intersection?’ (2016) 10 *Journal of Equity* 26, 42–49.

<sup>48</sup> See, eg, *Sydney Homoeopathic Hospital v Turner* (1959) 102 CLR 188 (HCA) 221 (Kitto J) (trust); *Sir Moses Montefiore Jewish Home v Howell & Co (No 7) Pty Ltd* [1984] 2 NSWLR 406 (NSWSC) 416 (Kearney J) (trust); *Liverpool and District Hospital for Diseases of the Heart v Attorney-General* [1981] Ch 193 (Ch D) 209–11, 214–15 (Slade J) (‘position analogous to that of a trustee in relation to its corporate assets’). See also Ian Dawson and John Alder ‘The Nature of the Proprietary Interest of a Charitable Company or a Community Interest Company in Its Property’ (2007) 21 *Trust Law International* 3, 3.

<sup>49</sup> See, eg, *Re Australian Elizabethan Theatre Trust* (1991) 30 FCR 491 (FCA) 505–7, 510 (Gummow J); *Re Wedgewood Museum Trust Ltd (In Administration)* [2013] BCC 281 (EWHC).

<sup>50</sup> This is an alternative construction of the leading case, *Liverpool and District Hospital* (n 48). See, eg, Dal Pont, ‘“Charity” and Trusts’ (n 47) 45–47.

<sup>51</sup> For discussion, see Rosemary Teele Langford, *Company Directors’ Duties and Conflicts of Interest* (Oxford University Press 2019) ch 2; Geoffrey Nettle AC, ‘Trust and Commerce in Historical Perspective’ (2021) 15 *Journal of Equity* 2. The fiduciary basis of the relationship between management committee members and associations, and between directors of co-operatives and co-operatives, is less clear but for discussion of the latter, see Bruce Cowley and Stephen Knight, *Duties of Board and Committee Members* (Lawbook Co 2018) para 11.600. For discussion of associations, see nn 23–26.

<sup>52</sup> See, eg, Jean du Plessis, Anil Hargovan and Jason Harris, *Principles of Contemporary Corporate Governance* (4th edn, Cambridge University Press 2018) 6–11; John Farrar and Pamela Hanrahan, *Corporate Governance* (LexisNexis 2017) 30–33. Stephen Bainbridge’s ‘director primacy’ theory is similarly based on a contractarian economic analysis and has shareholder wealth maximisation as its objective: *The New Corporate Governance in Theory and Practice* (Oxford University Press 2008). Bainbridge, however, notes that, especially in the US, shareholders have (and should have) very limited control rights over directors, so that directors have broad discretionary powers, albeit they should be exercised toward the goal of shareholder wealth maximisation. This approach is strongly influenced by Ronald Coase and Oliver Williamson’s transaction cost economics and the theory of the firm. It thus starts to shade into stakeholder approaches in that the board of directors may consider the interests of a range of stakeholders, but only if that would aid shareholder wealth maximisation: see especially 60–72.

<sup>53</sup> See, eg, Farrar and Hanrahan (n 52) 30–33. Blair and Stout’s team production model provides an economic theory basis for stakeholder theory: Margaret Blair and Lynn Stout, ‘A Team Production Theory of Corporate Law’ (1999) 85 *Virginia Law Review* 247.



means to facilitate private ordering between the various stakeholders.<sup>54</sup> By contrast, charity law is not purely a matter of private ordering. Rather, it is a hybrid of private and public law.<sup>55</sup> After all, charity law comprises a framework of rights and obligations that a donor/creator selects when creating a charity. Moreover, that framework reflects a tension between respecting donor and charity controller intent and overriding donor/charity controller intent to achieve a greater or fairer public benefit in some, albeit limited, circumstances.<sup>56</sup> Indeed the point of charity law is public benefit. This can be seen in the fact that the subsidy rationale for charity tax exemptions reflects a public interest in increasing the positive externalities — the public benefit — of charities.<sup>57</sup> These positive externalities encompass the public benefits not just from inducing charities to produce goods and services such as health care, education and welfare, but also process benefits from the manner in which charities operate. Examples include charities' role as sites of collective and political action, as well as in the promotion of pluralism or altruism.<sup>58</sup> The starting point of the regulation of incorporated charities should be to influence behaviour so as to achieve and maximise public benefit. However, it should be acknowledged that charities are private means to pursue such public ends and that the public benefit achieved by charities also inheres in the processes that they adopt.<sup>59</sup>

Second, charities, even corporate charities, are to be carried out for a charitable purpose, not to maximise the wealth of the members. Indeed members would typically — by definition as a not-for-profit — have no residual claim to the corporate assets of not-for-profit charities.<sup>60</sup> Thus, giving primacy to the interests of members or balancing the interests of various stakeholders makes no sense unless that is consistent with, and a means to achieving, the charitable purpose. To be fair, a number of authors have recently emphasised that this is also true more broadly for corporations,<sup>61</sup> in that they may typically exist for a range of lawful

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<sup>54</sup> Note, however, that this is less true of communitarian strains of stakeholder theory, which emphasise the public dimensions of the company - see, eg, Marc Moore, *Corporate Governance in the Shadow of the State* (Hart Publishing 2013); Beate Sjøfjell, 'Regulating for Corporate Sustainability: Why the Public-Private Divide Misses the Point' in Barnali Choudhury and Martin Petrin (eds), *Understanding the Company: Corporate Governance and Theory* (Cambridge University Press 2017) 145, 145–46. These communitarian strains highlight the fact that company law is in some ways a hybrid of private and public law – see Sjøfjell (n 54) 145, 147; Asaf Raz, 'A Purpose-Based Theory of Corporate Law' (2020) 65 *Villanova Law Review* 523, 523–29, 565; Hillary Sale, 'Fiduciary Law, Good Faith, and Publicness' in Evan J Criddle, Paul B Miller and Robert H Sitkoff (eds), *Oxford Handbook of Fiduciary Law* (Oxford University Press 2019) 763.

<sup>55</sup> See generally, Kathryn Chan, *The Public-Private Nature of Charity Law* (Hart Publishing 2016).

<sup>56</sup> In the context of *cy-près*, see Ian Murray, *Charity Law and Accumulation: Maintaining an Intergenerational Balance* (Cambridge University Press 2021) (forthcoming). See, generally, Chan (n 55) 12–13.

<sup>57</sup> OECD, *Taxation and Philanthropy: OECD Tax Policy Studies No 27* (OECD Publishing 2020) 22–25; Rob Atkinson, 'Theories of the Federal Tax Exemption for Charities: Thesis, Antithesis, and Syntheses' (1997) 27 *Stetson Law Review* 395.

<sup>58</sup> Ann O'Connell, 'Taxation and the Not-for-profit Sector Globally: Common Issues, Different Solutions' in Matthew Harding (ed), *Research Handbook on Not-For-Profit Law* (Edward Elgar 2018) 388, 395; Atkinson (n 57) 403; Estelle James and Susan Rose-Ackerman, *The Nonprofit Enterprise in Market Economics* (Harwood Academic Publishers 1986) 86–87; Daniel J Hemel, 'Tangled up in Tax' in Walter W Powell and Patricia Bromley (eds), *The Nonprofit Sector: A Research Handbook* (3rd edn, Stanford University Press 2020) 144, 147–48.

<sup>59</sup> Making a related point in the context of charity members, see *Lehtimäki* (n 7) 487 [91] (Arden LJ).

<sup>60</sup> This includes no right to a distribution of profits while the charity is a going concern.

<sup>61</sup> Raz (n 54); Rosemary Teele Langford, 'Purpose-Based Governance: A New Paradigm' (2020) 43 *UNSW Law Journal* 954; Rosemary Teele Langford, 'Use of the Corporate Form for Public Benefit — Revitalisation of Australian Corporations Law' (2020) 43 *UNSW Law Journal* 977; Lyman Johnson, 'Relating Fiduciary Duties

purposes, not just maximising wealth. This fact has been emphasised by the social enterprise movement.

Recently, governance approaches described as ‘purpose-based governance’<sup>62</sup> For corporations with purposes such as charities, these theories put purpose ‘at [the] center’ of corporate law, such that directors’ duties are seen as ‘emanating from’ that purpose and are a means to support action by directors to further the achievement of the corporate purpose.<sup>63</sup> Thus the directors of a charity must exercise their discretions in a way that furthers the charitable purposes — purposes, eg of advancing education, health etc, that must themselves be for the public benefit. As has previously been identified by Langford, focussing on purpose can help us reframe our sense of the corporation’s best interests in a way that extends beyond the corporation itself and beyond its members and current benefit recipients.<sup>64</sup> Some purpose-based governance approaches centre on the fiduciary concept of loyalty to the corporation as a separate legal entity.<sup>65</sup> These approaches also remind us that a charitable corporation has interests as a ‘commercial entity’.

#### IV What Normative Approaches Can Explain the Law?

The duty to act in good faith in the interests of the corporation is an obligation that regulates the exercise of powers by directors.<sup>66</sup> The same is true of the duty to act for proper purposes.<sup>67</sup> The best interests duty requires directors to give genuine consideration to the exercise of their powers,<sup>68</sup> but is not an absolute duty to achieve a positive outcome — such as achievement of a charity’s purpose.<sup>69</sup> As outlined by Lord Greene MR in *Re Smith & Fawcett Ltd*: ‘[D]irectors must exercise their discretion bona fide in what they consider — not what a court may consider — is the interests of the company’.<sup>70</sup>

The question is, to what interests should directors have regard when exercising their powers? In other words, what are the interests of the corporation where the corporation is charitable? In the for-profit-sphere it is recognised that corporations have a number of interests including the interests of members (which, as residual claimants, are often seen as the overriding interests), interests of creditors (as the residual claimants where the company approaches

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to Corporate Personhood and Corporate Purpose’ (2016) Washington & Lee Public Legal Studies Research Paper Series, No 2016-19; David A Ciepley, ‘Corporate Directors as Purpose Fiduciaries: Reclaiming the Corporate Law We Need’ (29 July 2019) <<https://ssrn.com/abstract=3426747>> accessed 4 April 2021.

<sup>62</sup> See, eg, Langford, ‘Purpose-Based Governance’ (n 61) esp 956; Ciepley (n 61) 13–15.

<sup>63</sup> Langford, ‘Purpose-Based Governance’ (n 61) 956; Raz (n 54) 535.

<sup>64</sup> Langford, ‘Purpose-Based Governance’ (n 61) 957–58.

<sup>65</sup> See, eg, Raz (n 54).

<sup>66</sup> See, eg, Langford, *Company Directors’ Duties* (n 51) para 2.19; Lusina Ho, ‘Good Faith and Fiduciary Duty in English Law’ (2010) 4 *Journal of Equity* 29, 37–38. cf M Scott Donald, ‘“Best” Interests?’ (2008) 2 *Journal of Equity* 245, 248.

<sup>67</sup> See, eg, *Eclairs Group Limited v JKX Oil & Gas plc* [2015] UKSC 71, [2016] 3 All ER 641, 657 [30].

<sup>68</sup> See, eg, *Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 39 WAR 1 (WASC) 583–84 [4619]; *Westpac v Bell* (n 13) 169 [923] (Lee J), 372 [2079] (Drummond AJA); Geraint Thomas, *Thomas on Powers* (2nd edn, Oxford University Press 2012) 540, 572–87. See also *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296 (FCAFC) 344–45 [174] (Finn, Stone and Perram JJ).

<sup>69</sup> *Australian Securities and Investments Commission v Lewski* (2018) 266 CLR 173 (HCA) 202 [71] (Kiefel CJ, Bell, Gageler, Keane and Edelman JJ) (managed investment scheme case); Langford, *Company Directors’ Duties* (n 51) 18, 332.

<sup>70</sup> *Re Smith & Fawcett* (n 13).

insolvency), and interests of the corporation as a commercial enterprise. Stakeholder interests must also be considered (and at times protected) in many circumstances.<sup>71</sup>

The normative approaches examined in Part III suggest potential interests of the corporation in a charity context. They are:

- residual claimants/owners pursuant to the member primacy view (characterising charity residual claimants/owners as either members, donors or the section of the public intended to be benefited by the charity);
- a broad group of stakeholders, including the general public under stakeholder theories;
- the corporation as a commercial entity; and
- a charity's purpose or purposes.

Parts IVA to IVD examine the extent to which each of these approaches underpin the law. Our analysis is that the law can be explained both by a focus on a charity's purposes and on the corporation as a commercial entity, but that the focus on purpose is paramount.

Given the paucity of charity cases, some reference is made to authorities in the US and the UK, where courts have had to consider similarly constituted best interests duties. This is not to deny the differences in the content and application of fiduciary and directors' duties across jurisdictions.<sup>72</sup>

### **A Best interests of owners or residual claimants?**

On one view, there are no residual claimants in a charity context, as members are not permitted to hold rights to profits either while the charity is a going concern or on a winding-up.<sup>73</sup> Nevertheless, from an agency cost perspective, some law and economics writers emphasise charity members, and sometimes donors,<sup>74</sup> as 'owners' and hence the principals to

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<sup>71</sup> For discussion, see Langford, 'Use of the Corporate Form' (n 61). Note also a corporation's interests in its reputation and in the lawful and legitimate conduct of its activity — see *Australian Securities and Investments Commission v Cassimatis (No 8)* (2016) 336 ALR 209 (FCA) 301–2 [482]–[483]; upheld on appeal in *Cassimatis v Australian Securities and Investments Commission* (2020) 376 ALR 261 (FCAFC).

<sup>72</sup> For a discussion of differences and similarities, see Matthew Conaglen, 'Fiduciary Principles in Contemporary Common Law Systems' in Evan J Criddle, Paul B Miller and Robert H Sitkoff (eds), *Oxford Handbook of Fiduciary Law* (Oxford University Press 2019) 565.

<sup>73</sup> See, eg, Fama and Jensen who suggest that there are no residual claimants for non-profit organisations: Eugene Fama and Michael Jensen, 'Separation of Ownership and Control' (1983) 26 *Journal of Law and Economics* 301, 302–3, 318

<sup>74</sup> For some writers, this characterisation relies, to an extent, on the somewhat controversial characterisation of donors as 'purchasers' of not-for-profit services. See, eg, Henry Hansmann, 'Reforming Nonprofit Corporation Law' (1981) 129 *University of Pennsylvania Law Review* 497, 504–7; Geoffrey Manne, 'Agency Costs and the Oversight of Charitable Organizations' [1999] (2) *Wisconsin Law Review* 227, 231–36. Other commentators focus on the relationship between management and donors and are largely based on an assumption that most not-for-profit boards include substantial donor representation: Fama and Jensen, 'Separation of Ownership and Control' (n 73) 318–21; Eugene Fama and Michael Jensen, 'Agency Problems and Residual Claims' (1983) 26 *Journal of Law and Economics* 327, 342–45. To the extent that this was true in the 1980s in the United States, it is questionable how valid such assumptions are for contemporary Australian charities. At the sector level, only 7% of charity revenue comes from donations, with the vast bulk in the form of government grants and self-generated income: Australian Charities and Not-for-profits Commission, *Australian Charities Report 2018* (2019).

whom responsible persons owe duties.<sup>75</sup> A ‘member primacy’ approach would thus emphasise the interests of these owners, even if such interests are viewed through the lens of the owners having agreed a charitable purpose for the corporation. This brings a degree of alignment between member interests and pursuit of the agreed charitable purposes.<sup>76</sup> Alternatively, the section of the public that the charity is intended to benefit might be thought of as the residual claimant, with an office-holder such as an Attorney-General or the ACNC Commissioner representing the residual claimants.<sup>77</sup>

In a for-profit context, such a member primacy approach was the traditional interpretation of the ‘interests of the corporation’, with Evershed MR in *Greenhalgh v Arderne Cinemas Ltd*, stating:<sup>78</sup>

[T]he phrase, ‘the company as a whole’, does not (at any rate in such a case as the present) mean the company as a commercial entity, distinct from the incorporators: it means the incorporators as a general body. That is to say, you may take the case of an individual hypothetical member and ask whether what is proposed is, in the honest opinion of those who voted in its favour, for that person’s benefit.

Although expressed in the context of the exercise of shareholder (not director) voting rights, Evershed MR’s view of the company as a whole has been applied to directors’ duties in subsequent cases, including *Ngurli Ltd v McCann*.<sup>79</sup> Subsequent cases and commentary have emphasised exceptions to this broad statement that recognise that companies have interests in addition to those of the members, that members may have short and long-term views and that other stakeholder interests may sometimes need to be considered. It is now well established that creditors’ interests must be considered when a company is approaching insolvency.<sup>80</sup>

Charity cases have also sometimes adopted a focus on members in describing the best interests of an incorporated charity:<sup>81</sup>

The question, then, is whether that power of deprivation of membership has been exercised by the council in good faith for the purpose for which it was conferred. Such a power is, I think, plainly conferred in order that it may be exercised in the best interests of the association. The association is, of course, an artificial legal entity, and it is not very easy to determine what is in the best interests of the association without paying due regard to the members of the association. The interests of some particular section or sections of the association cannot be equated with those of

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<sup>75</sup> See, eg, Fama and Jensen, ‘Separation of Ownership and Control’ (n 73) 318–19; Manne (n 74) 234–35. As a matter of law, of course, the duties are owed to the corporation not directly to its members.

<sup>76</sup> See, eg, Langford, ‘Purpose-Based Governance’ (n 61) 975.

<sup>77</sup> For treatment of benefit recipients from charities as residual claimants, see, eg, Oliver Williamson, ‘Organization Form, Residual Claimants and Corporate Control’ (1983) 26 *Journal of Law and Economics* 351, 358–59; Raz (n 54) 557–58.

<sup>78</sup> [1951] Ch 286 (CA) 291.

<sup>79</sup> (1953) 90 CLR 425 (HCA) 438–40 (Williams ACJ, Fullagar and Kitto JJ).

<sup>80</sup> *Walker v Wimborne* (1976) 137 CLR 1 (HCA) 6–7; *Darvall v North Sydney Brick & Tile Co* (1987) 16 NSWLR 212 (NSWSC); *Westpac v Bell* (n 13) 168 [910] (Lee AJA); *Pilmer v Duke Group Ltd (in liq)* (2001) 207 CLR 165 (HCA) 178–79 [18] (McHugh, Gummow, Hayne and Callinan JJ); *ASIC v Cassimatis (No 8)* (n 71) 301–2 [482]–[483] (Edelman J), upheld on appeal in *Cassimatis v ASIC* (n 71).

<sup>81</sup> *Gaiman v National Association for Mental Health* [1971] Ch 317 (Ch D) 330 (Megarry J) (charitable company limited by guarantee). The reasoning has been applied in Australia in *Australian Securities and Investments Commission v Multiple Sclerosis Society of Tasmania* [1993] TASSC 36, [51]–[52] (Zeeman J).

the association, and I would accept the interests of both present and future members of the association, as a whole, as being a helpful expression of a human equivalent ...

Alternatively, some cases have focussed on potential benefit recipients. An example of this type of thinking can be found in *Andrews v M'Guffog*,<sup>82</sup> a charitable trust context, but one where the trust was for the erection and operation of a school. The House of Lords referred to the appellants as bringing the action, not

in their own private interest, but in the interest of all members of the public who have, or may have, occasion to avail themselves of the means of education afforded by the high school of Newton Stewart. The Court must, therefore, have exclusive regard to the interest of the general community; and that, in other words, is the interest of the school.<sup>83</sup>

In considering whether the trustees should be excused from liability for accessing capital that should have been retained, Lord Watson further stated that:<sup>84</sup>

There does not appear to me to be any reasonable ground for supposing that the interests of those classes of the community for whom the high school was to be established have suffered through the respondents' error.

Despite the consistency of the above cases with the member primacy approach to the best interests duty, a number of further cases indicate that the interests of a charitable corporation are not truly the interests of its members or potential benefit recipients, but rather its charitable purposes.

First, applying charity assets for the benefit of members or potential benefit recipients in breach of the purposes set out in the charity's constitution (and likely also in breach of non-distribution provisions in the constitution) is not in the interests of the corporation. That is because the best interests duty has been seen to require directors to act in accordance with the company constitution.<sup>85</sup> This reflects the fundamental duty of trustees to ascertain the terms of the trust and to execute the trust according to its terms and the general law.<sup>86</sup> A body of UK charitable trust cases relates to changes by the members of religious bodies/congregations to the religious doctrines of those bodies/congregations and the corresponding attempt to apply the property of charitable trusts for religious worship by the religious body to the benefit of the altered religious body. The cases, many of which apply to proposed mergers of religious bodies, hold that such an attempt amounts to a breach of duty by the trustees. This is

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<sup>82</sup> (1886) 11 App Cas 313 (HL).

<sup>83</sup> *ibid* 323–24 (Lord Watson). For a similar focus on the interests of potential benefit recipients, in this case of charitable corporations, see Lloyd Mayer, 'Fiduciary Principles in Charities and Other Nonprofits' in Evan J Criddle, Paul B Miller and Robert H Sitkoff (eds), *Oxford Handbook of Fiduciary Law* (Oxford University Press 2019) 103, 108.

<sup>84</sup> *Andrews* (n 82) 326 (Lord Watson).

<sup>85</sup> See, eg, Austin and Ramsay (n 10) para 8.160 (Last reviewed: July 2020) who state that the duty to act in accordance with the corporate constitution 'may be analysed as an aspect of the duty to act in good faith in the interests of the company, because the corporate constitution can ... set limits to the company's interests'. As to 'intertwining' of the duty of loyalty and the duty of obedience to the instructions of a principal, such as set out in a constitution, see Paul Miller and Andrew Gold, 'Fiduciary Governance' (2015) 57 *William and Mary Law Review* 513, 559–61.

<sup>86</sup> *Re Church of England Trusts Corporation (Wangaratta)* [1924] VLR 201 (VSC) 206–7 (Weigall AJ) (charity case); JD Heydon and MJ Leeming, *Jacobs' Law of Trusts in Australia* (5th edn, LexisNexis, 2016) paras 17-01, 17-04.

so even in circumstances where the whole<sup>87</sup> or a majority<sup>88</sup> of the religious congregation (being the potential benefit recipients) approve of the change.<sup>89</sup> This approach has been followed in Australia.<sup>90</sup>

Second, while members can potentially amend a charity's objects, it is likely that attempts to convert a charity to a for-profit and distribute its assets to members could typically be stopped by the ACNC or ASIC.<sup>91</sup> Directors could therefore be in breach of the best interests duty by proposing such a change. In other words, although it may be possible to change a charity's purposes, there are limitations to how fundamental a change can be made. The reasoning and authorities for this are as follows. A number of charitable trust decisions recognise that the trust deed may permit alteration to the charitable purposes of a body on whose behalf the trust property is held (and hence alteration to the charitable trust's purpose) without the need for a *cy-près* scheme.<sup>92</sup> It is also possible for a charitable trust to provide an express power permitting variation to trust terms. While the cases focus on variations to the administration of the trust, the reasoning would apply also to changes to purpose. That is, provided those changes do not render the purpose non-charitable, and subject to a conservative approach to construing the width of the variation clause.<sup>93</sup> Thus, it should also be possible for incorporated charities to modify their purposes in accordance with the alteration procedures set out in the constitution<sup>94</sup> and as required in terms of notification and *de facto* approval by the ACNC for charities registered under the *ACNC Act*.<sup>95</sup> That directors

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<sup>87</sup> *A-G v Aust* (1865) 13 Law Times Reports 235. See also *A-G v Pearson* (1817) 3 Mer 353, 400–1, 419 (Eldon LC).

<sup>88</sup> *Free Church of Scotland (General Assembly of) v Overtoun* [1904] AC 515 (HL); *Craigdallie v Aikman* (1813) 1 Dow PC 1 (HL); *A-G v Welsh* (1884) 4 Hare 572.

<sup>89</sup> There is some basis for a *de minimis* exception for changes to religious practices that are consistent with the religious doctrines of the charitable purpose: *A-G v Murdoch* (1852) 1 De GM&G 86, 114 (Bruce LJ).

<sup>90</sup> *Attorney-General (NSW) v Grant* (1976) 135 CLR 587 (HCA) 600–3 (Gibbs J, Stephen, Mason and Jacobs JJ agreeing); *Wylde v A-G* (1948) 78 CLR 224 (HCA) 257, 271 (Latham CJ), 295 (Dixon J) (though Dixon J did not find a breach on the facts).

<sup>91</sup> The Australian Taxation Office may also be able to take action that would dissuade these activities, such as assessing members for tax on the distributed assets.

<sup>92</sup> *A-G v Grant* (n 90) 602–7 (the trust was reconstituted by statute at the same time that a variation power was incorporated in the constituent documents of the Presbyterian Church of Australia); *Dobrijevic v Free Serbian Orthodox Church Diocese for Australia and New Zealand Property Trust* [2015] NSWSC 637, [138]–[139] (White J) (undisturbed on appeal); *Free Serbian Orthodox Church Diocese for Australia and New Zealand Property Trust v Dobrijevic* (2017) 94 NSWLR 340 (NSWCA) esp 360 [108]. The way that this is expressed in the decisions suggests that courts will narrowly construe alteration provisions so as to retain some link with the initial purpose: *A-G v Grant* (n 90) 602–7. Although no such variation power was found to exist, see also *Free Church of Scotland* (n 88) 617, 626 (Lord Halsbury); *Craigdallie* (n 88) 15–16 (Lord Eldon); *Radmanovich v Nedeljkovic* (2001) 52 NSWLR 641 (NSWSC) 667 [152] (Young CJ).

<sup>93</sup> *Re Jewish Orphanage Endowments Trusts* [1960] 1 All ER 764 (Ch D) 767 (Cross J).

<sup>94</sup> cf *Soldiers', Sailors' and Airmen's Families Association v A-G* [1968] 1 All ER 448 (Ch D) 450 (Cross J). This case concerned an incorporated body (by charter) and while Cross J found that a variation power did not exist, Cross J approved the applicability of the approach in *Re Jewish Orphanage Endowments Trusts* (n 93). While Dal Pont leaves open whether the members of an incorporated charity can change its purpose to another charitable purpose without also seeking a *cy-près* scheme, his reasoning is based on the uncertainty in the case law about whether and when an incorporated charity will be viewed as holding its assets on trust for its charitable purpose (see Part IIG): Dal Pont, *Law of Charity* (n 20) para 17.70. But as we have explained, charitable trust purposes can be varied without recourse to a *cy-près* scheme.

<sup>95</sup> This corresponds to the position adopted in Law Commission (UK), *Technical Issues in Charity Law* (Law Com No 375, 2017) 24–6. However, unlike the Charity Commission's extensive statutory powers to approve or deny variations to charity constitutions, while the ACNC must be notified of changes to a charity's constitution

can propose such a course of action and that a charity can so amend its purposes also suggests that directors need not act in donors' interests, at least as a matter of priority over the interests of the members, the charity or its purposes.<sup>96</sup>

There are, however, limits. Although differing bases are provided (see Part IIG), it seems likely that members cannot change an incorporated charity's purpose to being a for-profit purpose and appropriate the surplus assets: 'once charitable, always charitable'.<sup>97</sup> *Liverpool and District Hospital for Diseases of the Heart v A-G (Liverpool)*<sup>98</sup> provides a potential rationale for this statement that is rooted in the corporate nature of incorporated charities. That case involved an application for directions by the liquidator of the Liverpool District Hospital. Slade J held that the surplus assets of the Hospital had to be applied cy-près to another charitable purpose, and could not be distributed to the members on a winding up. The Hospital was an incorporated charity that had been formed to operate both a hospital and a research institute into heart disease. The hospital was subsumed into the National Health Service and subsequently the research institute activities ceased. On winding up the Hospital, the question was whether the surplus research institute assets should be distributed to members under the relevant companies legislation. As noted in Part IIG, the obligation set out in the Hospital's constitution to apply the assets for charitable purposes resulted in the application of a cy-près scheme. Slade J pointed out that the relevant companies legislation provided for a distribution of surplus assets among the members 'according to their rights and interests in the company' and that the effect of the charitable purpose in the constitution was that the members held rights against, and owed duties to, each other to apply the surplus to the charitable purpose by way of distribution to another charity with a similar purpose.<sup>99</sup> In this way Slade J sought to achieve coherence between charity law and the companies legislation, an approach endorsed by Arden LJ in *Lehtimäki*.<sup>100</sup>

In doing so, along with emphasising the court's supervisory jurisdiction over incorporated charities, Slade J evinced courts' general desire to ensure that assets dedicated to charity remain dedicated to charitable purposes. In the context of members first seeking to change an incorporated charity's constitution, it is likely that courts would be attuned to the ability of regulators to apply for a winding-up under incorporation legislation on two key grounds. The first is the public interest, the second is the just and equitable ground.<sup>101</sup> These grounds could

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(ACNC Act, div 65), the ACNC's powers to approve changes to purposes are fairly limited, though it may refuse to deregister an entity under div 35; for instance if an entity seeks to convert from a charity to a for-profit.

<sup>96</sup> Here, donors' interests are equated with continued pursuit of the charity's historic purpose, which is probably true to an extent, including based on Andreoni's demonstration that most donors give for a mix of altruistic and egoistic reasons: James Andreoni, 'Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving' (1990) 100 Economic Journal 464; Jeremy Benjamin, 'Note: Reinvigorating Nonprofit Directors' Duty of Obedience' (2009) 30 Cardozo Law Review 1677, 1679.

<sup>97</sup> cf Dal Pont, "'Charity' and Trusts' (n 47) 47; *Lehtimäki* (n 7) 479 [59], 483 [72] (Arden LJ).

<sup>98</sup> *Liverpool and District Hospital* (n 48).

<sup>99</sup> *ibid* 212.

<sup>100</sup> *Lehtimäki* (n 7) 483 [72].

<sup>101</sup> As to winding up: *Corporations Act*, s 461(1)(h), (k) (applied under *Associations Incorporation Act 1964* (Tas) s 32 and *Associations Act 2003* (NT) s 72); *Associations Incorporation Act 2009* (NSW) s 63(1)(i); *Associations Incorporation Act 1981* (Qld) s 91(i); *Associations Incorporation Act 1985* (SA) s 41(3)(g); *Associations Incorporation Reform Act 2012* (Vic) ss 126(1)(g), 127(2)(j); *Associations Incorporation Act 2015* (WA) sch 4 item 10. cf *Associations Incorporation Act 1991* (ACT) s 90(i); Co-operatives National Law, s 455(2)(h); *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth) s 526-5(m), (n).

apply due to: a failure of substratum because the proposed amendment to objects is outside the common understanding of members as being too distinct from the existing purposes,<sup>102</sup> or in order to maintain public confidence that funds donated will be applied to charitable purposes.<sup>103</sup> Some associations incorporation legislation also specifically provides for winding up on the ground that a charity is engaging in activities inconsistent with, or outside the scope of, the charity's objects.<sup>104</sup> The ACNC could potentially also refuse deregistration and seek to enforce governance standard 1, which requires that the charity must 'comply with its purposes and its character as a not-for-profit entity'.<sup>105</sup> For charity directors to propose a resolution to amend purposes to non-charitable purposes in circumstances where a regulator might seek a winding-up order or injunction to ensure that surplus assets are passed on to another charity with similar purposes or used for charitable purposes, would often not be in the best interests of the charity. That is because it may result in additional expenses and no ultimate change to the purposes for which the charity's assets can be used.

The *Grain Technology Australia Ltd v Rosewood Research Pty Ltd (No 2)* litigation (*Bread Institute litigation*) provides an Australian example of this situation. Directors and some members sought to convert a company limited by guarantee to a proprietary company and to then wind up and distribute its surplus assets to themselves, despite that entity and its subsidiaries being claimed to hold those assets for a charitable purpose or under a charitable trust.<sup>106</sup> The directors were pursued for breach of fiduciary duties, but these claims appear to have ultimately been settled and the agreed basis for this appears to have been that the companies held their assets under charitable trusts.<sup>107</sup> While the route differs, the result is as suggested above: members' interests are relegated to the charitable purpose.

## **B The general public interest?**

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<sup>102</sup> See, eg, *Re Tivoli Freeholds Ltd* [1972] VR 445 (VSC) 468–69 (Menhennit J). In a US context, reasoning along these lines, but applied through a lens of trustee-like obligations, was applied to a charitable corporation in *A-G v Hahnemann Hospital*, 397 Mass 820 (1986) to permit a change of objects to a broader set of new objects, but to find that directors would breach their duties if they applied assets received before the change for new purposes that were broader than the old purposes. There is also the possibility of an oppression action by members for similar reasons – see, eg, *Szencorp Pty Ltd v Clean Energy Council Ltd* (2009) 69 ACSR 365 (FCA) 379 [59]; Langford, 'Use of the Corporate Form' (n 61) 1002–4. Contrary demutualisation cases exist, though they might be distinguished to some degree on the basis that a common understanding as to charitable purposes might be easier to establish for a charity, rather than distinction between distribution of profits and provision of reduced price services for mutuals: *Re NRMA Ltd* (2000) 33 ACSR 595 (NSWSC) 619–21 [91]–[101] (Santow J). The case might also be rationalised as reflecting the breadth of the *Corporations Act* scheme of arrangement provisions and the difficulty in identifying a common understanding in the case of millions of members.

<sup>103</sup> *Australian Securities and Investments Commission v AS Nominees Ltd* (1995) 62 FCR 504 (FCA) 532–33 (Finn J — investor confidence); *ACNC Act*, s 15-5(1).

<sup>104</sup> *Associations Incorporation Act 1991* (ACT) s 90(g); *Associations Incorporation Act 2009* (NSW) s 63(1)(e); *Associations Incorporation Act 1981* (Qld) s 91(e); *Associations Incorporation Reform Act 2012* (Vic) s 126(1)(f); *Associations Incorporation Act 2015* (WA) sch 4 item 6.

<sup>105</sup> ACNC Regulation, s 45.5(2)(c). With enforcement potentially by way of an injunction or the suspension or removal of directors.

<sup>106</sup> [2019] NSWSC 1744.

<sup>107</sup> *ibid.* A further hearing is still required to approve schemes of arrangement for the future administration of the trusts.



Communitarian stakeholder approaches highlight the broad range of stakeholders in a corporation, including the broader community.<sup>108</sup> Such an approach might suggest that directors should sometimes give more consideration to — and perhaps prioritise — the general public interest, regardless of the impact on the charity’s specific charitable purposes.

References to the courts, attorneys-general or regulators acting in the supervision of charities are replete with statements about such supervision being undertaken in the public interest or to achieve public benefit.<sup>109</sup> However, such general statements are not licence for directors to adopt a communitarian stakeholder approach and act in a way that is socially beneficial and within the bounds of charitable purposes, but yet not within the specific purposes of their own charity. That is clear from the discussion in Part IVA. Thus, Brody’s comment about general societal interests can equally apply to incorporated charities:<sup>110</sup>

Charitable trustees owe their duty to the ‘charitable purpose’; corporate directors owe their duty to the corporation. Are these statements different? While some observers seek a legal obligation for charity fiduciaries to further social goals even at the expense of a given charity, it should not make a legal difference whether duties are owed to the charitable purpose or to the charity itself. In either case, the fiduciaries must interpret that purpose in light of settlor or donor instruction, but are otherwise free to exercise their discretion. What the trust approach should not suggest, though, is that general societal interests, or charitable goals extraneous to the charity, override the fiduciaries’ good faith interpretation of the charity’s mission.

Further, there are some US authorities where courts have countenanced a breach by directors of their fiduciary duties in attempting to change a charity’s purpose, even though the relevant Attorney-General has not challenged the change on the basis that the change is in the broader public interest.<sup>111</sup>

The cases and commentators thus indicate a focus on charitable purposes, rather than stakeholders such as the general public.

### **C The corporation as a commercial entity?**

As noted in Part III, some corporate governance approaches emphasise the interests of the corporation as a commercial entity.<sup>112</sup> In a for-profit context it is increasingly recognised that,

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<sup>108</sup> See, eg, Amitai Etzioni, ‘A Communitarian Note on Stakeholder Theory’ (1998) 8 *Business Ethics Quarterly* 679.

<sup>109</sup> See, eg, Dal Pont, *Law of Charity* (n 20) ch 14; William Henderson, Jonathan Fowles and Julian Smith, *Tudor on Charities* (10th edn, Sweet & Maxwell 2015) para 13-005. See also *ACNC Act*, s 15-10, which refers to the ACNC Commissioner performing the Commissioner’s regulatory function having regard to, amongst other things, ‘the maintenance and promotion of the effectiveness and sustainability of the not-for-profit sector’.

<sup>110</sup> Evelyn Brody, ‘Charity Governance: What’s Trust Law Got to Do with It?’ (2005) 80 *Chicago-Kent Law Review* 641, 644.

<sup>111</sup> *Holt v College of Osteopathic Physicians and Surgeons*, 394 P 2d 932, 936–7 (Cal 1964); Thomas Hazen and Lisa Hazen ‘Punctilios and Nonprofit Corporate Governance — A Comprehensive Look at Nonprofit Directors’ Fiduciary Duties’ (2012) 14 *University of Pennsylvania Journal of Business Law* 347, 390.

<sup>112</sup> In *Pilmer* (n 80) 178–79 [18], McHugh, Gummow, Hayne and Callinan JJ stated: ‘It is of the first importance to keep at the forefront of consideration that the claim which was made is a claim by the company, not a claim by or on behalf of its shareholders. It may be readily accepted that directors and other officers of a company must act in the interests of the company as a whole and that this will usually require those persons to have close regard to how their actions will affect shareholders. It may also be readily accepted that shareholders, as a group, can be said to own the company. But the company is a separate legal entity and the question raised in this matter is what damage (if any) did it suffer by issuing new shares.’

even where the corporation is a solvent going concern, the interests of members or residual claimants will often intersect with — but may not be identical to — those of the corporation.<sup>113</sup> This may be rationalised on the basis that members may hold a range of views on short-term and long-term value maximisation, but one practical effect is that there is more focus on the corporation as a separate, commercial entity.

To the extent this is also the case in a charity context, then it may be that the best interests duty is breached by harm to a charitable corporation, regardless of the impact on its purposes or class of potential benefit recipients. Below, we examine charity cases which demonstrate just such a focus on the incorporated entity, but we argue that these cases emphasise the interests of the entity only where they do not conflict with its purposes.

For example, *American Baptist Churches of Metropolitan New York v Galloway*<sup>114</sup> involved a New York not-for-profit corporation. American Baptist Churches operated an outreach service for AIDS patients and wished to establish a second outreach service, the ‘Noah House’ project. A senior officer of American Baptist Churches who had been involved in negotiating the Noah House project attempted to take over the project using a different not-for-profit that he had helped establish. American Baptist Churches pursued the officer for breaches of fiduciary duties, including the duties of good faith and loyalty,<sup>115</sup> related to the loss of opportunity. The case was the result of a strike out motion that asserted that a not-for-profit could not sustain compensable damages from such a loss of opportunity, especially where another not-for-profit was to operate the same project.<sup>116</sup> The Court held that:<sup>117</sup>

A not-for-profit corporation is not the same as a corporation that loses money. It is simply a corporation that devotes whatever proceeds it receives from its operations to charitable causes rather than disbursing the funds as dividends to shareholders and compensation to executives. Just as the goal of a for-profit corporation is to make money for its investors, the goal of a not-for-profit is to make money that can be spent on furthering its social welfare objectives. Both types of companies have suffered an injury when a fiduciary’s misconduct frustrates these goals.

Even in this context, the link between harm to the corporate entity and harm to its particular purposes (even if another not-for-profit might have been able to pursue related purposes) is notable. That is, harming a charitable corporation as a commercial entity will harm its pursuit of its purposes.

*Bronx-Lebanon Hospital Center v Wiznia*<sup>118</sup> likewise concerned the taking of a corporate opportunity from a charity (Bronx-Lebanon Hospital Centre). Wiznia and several other

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<sup>113</sup> For a recent and useful overview, see *Bell v Westpac (No 9)* (n 68) 533–34 [4388]–[4395]; *ASIC v Cassimatis (No 8)* (n 71) 308 [514]–[515].

<sup>114</sup> 271 AD 2d 92 (NY Sup Ct App, 2000).

<sup>115</sup> NY Not-for-Profit Corporation Law §717(a) provides that: ‘Directors, officers and key persons shall discharge the duties of their respective positions in good faith and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. ...’ It appears this phrasing incorporates the duty to act in good faith in the best interests of the corporation: *Fitzgerald v National Rifle Association of America*, 383 F Supp 162 (D NJ, 1974).

<sup>116</sup> Ultimately, neither not-for-profit operated the project, so it could be said that the purposes had been harmed, albeit that if the second not-for-profit had operated Noah House, then it might be said that the purposes had not been affected.

<sup>117</sup> *American Baptist Churches* (n 112) 97–98.

<sup>118</sup> 284 AD 2d 265 (NY Sup Ct App, 2001).

doctors worked together to move the paediatric AIDS department staff, patients and government funding from Bronx-Lebanon to another hospital, while still employees. The case involved the dismissal of an appeal against a summary judgment for breach of the fiduciary duty of loyalty on the part of Wiznia. Interestingly, Wiznia asserted that he had done so to achieve better care outcomes for patients rather than higher pay,<sup>119</sup> but the First Department, Appellate Division of the NY Supreme Court appeared to reject the factual basis for this claim.<sup>120</sup>

The possibility of a better outcome for patients (if it had been established), or in other words, better effectuation of charitable purposes, does suggest that there is a limit to the interests of an incorporated charity as an ongoing entity. In particular, the fact that the *Corporations Act* and other incorporation legislation typically expressly permit corporations to be wound up means that acting in the best interests of the corporation cannot always mean preserving its existence. Indeed, the *Bread Institute litigation* discussed above included proceedings brought by the receiver of the Bread Institute assets for directions from the Court justifying the receiver in not selling those assets. Not selling involved a material risk that the amount of money that would be received upon a sale of the assets might markedly decrease, but selling a property containing a test mill would have materially undermined the claimed education and research charitable purposes. While a determination of the existence of a charitable trust or other charitable purpose obligations had not yet been made, Slattery J directed that the receiver would be justified in not selling the property in order to preserve the charitable purpose, pending the ultimate determination.<sup>121</sup>

A recent UK Supreme Court case also suggests that if it will advance a charity's purposes, harm can be done to the corporate entity itself in the form of giving money away to another charity with purposes that fall within the ambit of the first charity's purposes. *Lehtimäki v Cooper*<sup>122</sup> concerned the fiduciary duties of a member (not director) of a charitable company limited by guarantee: the Children's Investment Fund Foundation. The Foundation held over \$4bn and had a catch-all purpose of 'the general purposes of such charitable bodies or for such other purposes for the benefit of the community as shall be exclusively charitable as the Trustees may from time to time determine'.<sup>123</sup> It was founded by a husband and wife, but when their marriage broke down, they agreed that the wife would retire as a member and director in return for the Foundation making a grant of \$360m to another charity founded by her, Big Win Philanthropy. Dr Lehtimäki was the third member of the Foundation, in addition to the husband and wife. At issue was the way in which his fiduciary duties to the Foundation (if any) affected his ability to vote on a members' resolution approving the grant

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<sup>119</sup> See also Randy Kennedy, 'Doctor's Effort to Move Practice Leaves Patients in a Tug of War' *The New York Times* (8 April 1999) <<https://www.nytimes.com/1999/04/08/nyregion/doctor-s-effort-to-move-practice-leaves-patients-in-a-tug-of-war.html>> accessed 4 April 2021; 'Hospital Challenges Physicians' Right to Jump Ship with Program, Patients' *Relias Media* (1 June 1999) <<https://www.reliasmedia.com/articles/41851-hospital-challenges-physicians-8217-right-to-jump-ship-with-program-patients>> accessed 4 April 2021).

<sup>120</sup> *Bronx-Lebanon Hospital Center* (n 118) 266.

<sup>121</sup> *Grain Technology Australia Ltd v Rosewood Research Pty Ltd* [2019] NSWSC 1111, [23]–[24]. Ultimately, it appears that the parties settled their dispute by agreeing that the property was held on charitable trust and that a scheme of arrangement should be entered into for the administration of the trust property, with that scheme 'approved' by the court: *Grain Technology (No 2)* (n 106).

<sup>122</sup> *Lehtimäki* (n 7).

<sup>123</sup> *Children's Investment Fund Foundation (UK) v A-G* [2017] EWHC 1379 (Ch), [2018] Ch 371, 385 [22].

to Big Win Philanthropy — as required by the Companies Act 2006 (UK) (**Companies Act**) for payments made for loss of office. The Supreme Court ultimately held that Dr Lehtimäki was a fiduciary as a member of the Foundation and that the Court could direct him to vote in favour of the resolution approving the grant because the High Court, at first instance, had determined that the grant was in the best interests of the Foundation.

At first instance, the High Court provided three key reasons for determining that the grant was in the best interests of the Foundation.<sup>124</sup> Two appear related to the governance and management of the Foundation, namely that the grant was a result of a good faith agreement between the husband and wife directors and members of the Foundation and that it would thus resolve the acrimonious governance relationship and stop further legal costs.<sup>125</sup> The third reason appears related to the purposes that could be fulfilled by the making of the grant as it was that the wife would contribute an additional \$40m to Big Win Philanthropy in addition to the grant.<sup>126</sup>

While Arden LJ noted that the content of members' fiduciary duties will need to be worked out bit by bit as the circumstances arise in subsequent cases,<sup>127</sup> she clearly viewed Dr Lehtimäki's fiduciary duty as focussed on the Foundation's purposes, not the benefit of the Foundation itself.<sup>128</sup>

I should add here that *Tudor* ... criticises a learned article by Professor J Warburton, 'Charity Members: Duties and Responsibilities' [2006] Conv 300 for overlooking the fact that any fiduciary duty owed by a member of a charitable company is owed to the company itself. The Court of Appeal in this case also expressed that view. As will hereafter become clear, I take the view that any fiduciary duty is owed not to the company (viz CIFF in this case) but to the charitable purposes or objects of the charity. The Attorney General or a duly qualified individual can bring charity proceedings to enforce this duty: see section 115 of the 2011 Act. (That section imposes limits on the bringing of proceedings: see section 115(2), which requires an order of the court or of the Charity Commission, and the case law on section 115). My conclusion is consistent with section 172(2) of the [Companies Act] which provides that directors of companies set up for altruistic purposes owe their fiduciary duty to promote the purposes of the company:

Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

That this is so is evident from the result of the decision, being that the Foundation 'lost' an enormous sum of money: \$360m. Payment to Big Win Philanthropy may have furthered the Foundation's purposes, but it seems hard to view the governance benefits (reduced tension between directors/members and reduced legal costs) as resulting in a net benefit for the Foundation viewed purely as a separate entity when viewed against the \$360m.<sup>129</sup> This

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<sup>124</sup> *ibid* 414 [128].

<sup>125</sup> *ibid*.

<sup>126</sup> *ibid*.

<sup>127</sup> *Lehtimäki* (n 7) [101].

<sup>128</sup> *ibid* 477 [50]. See also 484–85 [78]. Lord Briggs (Wilson and Kitchin LJJ agreeing) agreed with this portion of Arden LJ's reasoning (the difference in reasoning relating to the basis for directing Dr Lehtimäki how to vote) and also referred to acting in the best interests of the Foundation's purposes at 513 [206]–[207], 515 [213], 517 [222].

<sup>129</sup> Indeed, this reflects Dr Lehtimäki's position as reflected by Arden LJ at *ibid* 491–92 [106].

(furthering of purposes basis) was the basis upon which Vos VC at the High Court level determined that the grant was in the Foundation's best interests, and references to it being for the 'benefit of charity' generally simply reflect the Foundation's incredibly broad purposes.<sup>130</sup>

However, before seeking to apply *Lehtimäki* too broadly, it must be acknowledged that there are some differences between Australia and England and Wales. In particular, as extracted above, s 172(2) of the Companies Act expressly links the best interests duty to the purposes of a company where the purposes of the company consist of or include purposes other than member benefit. There are even further distinctions when it comes to members (and the concept of member duties) as there is no Australian equivalent to s 220 Charities Act 2011 (UK) which imposes a similar duty on members of Charitable Incorporated Organisations and there is no charity commission guidance in Australia (unlike in England and Wales) suggesting that members owe fiduciary duties.<sup>131</sup>

#### **D Advancement of purposes**

The preceding discussion of a charity as a commercial entity already intimated the fourth possibility: that the interests of a charitable corporation are equated with the advancement of its charitable purpose. The charitable purpose is not always identical to the charitable objects set out in an incorporated charity's constitution. In construing an entity's purpose, the courts typically examine the objects stated in its constitution, its activities and the circumstances of its formation.<sup>132</sup> The identity and nature of the entity thus shape its purposes.

The focus on purposes derives from the purpose-based governance approach and is reflected in the case law. As charitable purposes must be for the benefit of the public or a section thereof (or in the case of relief of poverty, a narrower class of persons),<sup>133</sup> there is typically a link between purposes and the provision of benefits to a class of people.<sup>134</sup> The point is made in *Flynn v Mamarika*:<sup>135</sup>

Charitable trusts exist for the benefit of the public or a section of the public as understood in accordance with the law. The section of the public defined in the trust deed, being the Aboriginal persons referred to, is a section of the public for these purposes. (That section of the public is referred to as 'the community'.) The reference in par 4 to the purposes of the trust as including the use of the trust fund for the education, benefit, welfare, comfort and general advancement in life of the community, is subject to the requirement that the trust funds be applied for charitable purposes. The funds are only to be used in such a way as will benefit the community as a whole. Use of the trust funds for the benefit of a particular Aboriginal person or persons (falling within the description contained within the trust deed), which is not beneficial to the community, will be in breach of the terms of the trust.

Likewise, in *Lehtimäki v Cooper*:<sup>136</sup>

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<sup>130</sup> *Children's Investment Fund* (n 123) 414–15 [128]–[130].

<sup>131</sup> See Charity Commission, *RS7 — Membership Charities* (March 2004).

<sup>132</sup> *FCT v Word Investments Ltd* (2008) 236 CLR 204 (HCA) 216–17 [17]–[18], 220–1 [25]–[26] (Gummow, Hayne, Heydon and Crennan JJ). See also *Charities Act 2013* (Cth) s 5, note 1, referring to 'the entity's governing rules, its activities and any other relevant matter'.

<sup>133</sup> See, eg, *Charities Act 2013* (Cth) ss 5, 6(3), 8.

<sup>134</sup> See, eg, Dal Pont, *Law of Charity* (n 20) para 3.32.

<sup>135</sup> (1996) 130 FLR 218, 223–24 (Martin CJ).

<sup>136</sup> *Lehtimäki* (n 7) 487 [90] (Arden LJ).

[I]n my judgment a member of CIFF owes a fiduciary duty to the charitable purposes, and that duty is one of singleminded loyalty. What does that involve in the present context? In my judgment, it requires that he considers whether the resolution should be passed and that he do so only by considering the best interests of the objects of the charity. That is because the resolution involves a disposition of assets that would otherwise be available for application by CIFF towards those objects ... On Dr Lehtimäki's case he neither provided those assets nor has any legitimate competing interest in the application of those assets. That does not mean to say that he would be bound to approach every members' resolution of CIFF with only the charitable beneficiaries in mind. There may be some resolutions where a member may be able to take other interests into account as well.

However, the emphasis is on the advancement of purposes, not the maximisation of benefits for potential benefit recipients, as is clear from Arden LJ's reference to taking other interests into account. Further, as discussed in Part IVA, providing benefits to the section of the public intended to be benefitted, but not so as to advance the charitable purpose, will be a breach of the best interests duty.

A topical example of this in a US setting is the Donald J Trump Foundation Inc, a charitable corporation formed under New York's Not-for-profit Corporation Law.<sup>137</sup> The Foundation's purpose was to 'collec[t] and maintai[n] money "exclusively for charitable, religious, scientific, literary or educational purposes", either directly or by donating to other organizations'.<sup>138</sup> Amongst many apparent breaches of directors' duties, the Foundation raised funds for war veterans' charities, but in providing those funds to war veterans' charities, disbursed them in a way that promoted Donald Trump's presidential political campaign. While, in one sense, there was no detriment to the potential benefit recipients, the actions were nevertheless held to be a breach of fairly nebulously articulated<sup>139</sup> directors' duties of care and of good faith.<sup>140</sup>

Another way of looking at this issue is by way of Lady Arden LJ's reasoning in *Lehtimäki v Cooper* that:<sup>141</sup>

A major reason for a distinction between the court's jurisdiction over fiduciaries who owe duties to the purposes of a charity and its jurisdiction over those who owe duties to the beneficiaries under a private settlement is in relation to schemes, which are not available for private trusts.

In other words, those who may benefit from the charity may change due to the settlement of a cy-près scheme. We discussed in Part IVA a change of purpose under the corporate constitution variation procedures or by way of cy-près scheme. We did so there to highlight the limits on changes to a charity's purpose. However, another way of looking at a change of

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<sup>137</sup> See Candid information: 'Donald J Trump Foundation Inc' *GuideStar* <<https://www.guidestar.org/profile/13-3404773>> accessed 4 April 2021; Vivian Wang, 'The Donald J Trump Foundation, Explained' *The New York Times* (14 June 2018) <<https://www.nytimes.com/2018/06/14/nyregion/attorney-general-trump-lawsuit.html>> accessed 4 April 2021.

<sup>138</sup> Wang (n 137).

<sup>139</sup> See n 115.

<sup>140</sup> *A-G (New York) v Donald Trump & Ors* (Decision and Order on Petition, New York Supreme Court, 11 July 2019, Scarpulla J) <<https://www.courthousenews.com/wp-content/uploads/2019/11/trump-foundation-order.pdf>> accessed 4 April 2021.

<sup>141</sup> *Lehtimäki* (n 7) 474 [37].

purpose is to acknowledge that the charity's purpose could be changed to benefit a different class of potential benefit recipients even if the extent of change is restricted to similar purposes by *cy-près* limits<sup>142</sup> or by a narrow approach to construction of variation powers. This emphasises the focus on purposes, not potential benefit recipients.

For a clear statement that best interests means the 'charitable purposes' of an incorporated charity, it is difficult to look past Lady Arden LJ's statement set out above, that a member 'owes a fiduciary duty to the charitable purposes' (albeit, as noted above, in the context of s172(2) of the Companies Act).<sup>143</sup> This description is remarkably similar to that adopted by the American Law Institute in its description of the duty of loyalty for charity fiduciaries.<sup>144</sup> The comments explicitly note the focus on purpose, not the entity.<sup>145</sup>

The provisions of this Restatement, however, differ from the Principles [of Corporate Governance] in two respects. First, under contemporary for-profit, corporate law, directors and principal officers are considered to owe the duty of fair dealing [the duty of loyalty, including the duty to act in the best interests of the corporation] to their corporation. In contrast, the duty of loyalty of charitable fiduciaries is to the charity's purposes, and thus by extension to the indefinite beneficiaries of those purposes. In some instances, advancing the charitable purposes may be to the detriment of the charitable entity and thus result in the discontinuation of that entity. Accordingly, in this Restatement, the duty of loyalty owed to all charities is to their purposes, regardless of the legal form in which they were established.

This approach is broadly consistent with what has sometimes been described in the US as a duty of obedience to act in accordance with a charity's constitution, including its stated objects and its charitable mission.<sup>146</sup> For instance, in *Manhattan Eye, Ear & Throat Hospital v Spitzer (Spitzer)*,<sup>147</sup> the Supreme Court, New York County considered an application under New York's Not-for-profit Corporation Law<sup>148</sup> for court approval for a New York nonprofit

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<sup>142</sup> At common law, the charity property must be applied to purposes as near as reasonably possible the original purposes. Even under a number of the statutory extensions that adopt broader wording, judicial interpretation has resulted in a similar test, or else the statute requires accordance with the spirit of the original gift where practicable: Dal Pont, *Law of Charity* (n 20) paras 16.1–16.14.

<sup>143</sup> *Lehtimäki* (n 7) 487 [90].

<sup>144</sup> *Restatement of the Law of Charitable Nonprofit Organizations* (American Law Institute, Tentative Draft No 1, 2016) §2.02:

'A fiduciary has a duty to:

- (a) act in good faith and in a manner the fiduciary reasonably believes to be in the best interests of the charity in light of its purposes;
- (b) address reasonably situations that involve the potential for self-dealing in which the interests of a fiduciary or related person may conflict with the interests of the charity; and
- (c) seek court application of the doctrine of *cy pres* or deviation when such relief is appropriate.'

<sup>145</sup> *ibid* cmt (a).

<sup>146</sup> Rob Atkinson, 'Obedience as the Foundation of Fiduciary Duty' (2008) 34 *Journal of Corporation Law* 43; Benjamin (n 96) 1679–80, 1688–89. There is much debate about (a) whether the duty of obedience is a separate duty or else exists as a component of the duty of loyalty and the duty of care, (b) the extent of the duty beyond stated objects to a more specific mission and (c) the application of the duty to attempts to vary the stated objects or mission: Evelyn Brody, 'The Limits of Charity Fiduciary Law' (1998) 57 *Maryland Law Review* 1400, 1406; Johnny Rex Buckles, 'The Federalization of Fiduciary Obedience Norms in Tax Laws Governing Charities: An Introduction to State Law Concepts and an Analysis of their Implications for Federal Tax Law' (2012) 4 *Tex Tech Est Plan Com Prop Law Journal* 197, 202–4; Marion Fremont-Smith, *Governing Nonprofit Organizations* (Harvard University Press 2004) 225–26; Benjamin (n 96) 1679–80, 1687–92.

<sup>147</sup> 715 NYS 2d 575 (NY Sup Ct, 2000) (*Spitzer*).

<sup>148</sup> NY Not-for-Profit Corporation Law § 511 required court approval for a not-for-profit corporation to sell a substantial part of its assets, with that approval to be based on whether the court is satisfied that 'the terms of the

corporation (MEETH) to amend its objects. The proposed amendment was from operating a hospital for eye/ear/nose/throat patients and educating students in relation to treating these diseases, to objects of selling the hospital and operating a series of stand-alone diagnostic and treatment centres. In considering whether to grant approval, the Court discussed whether the board had complied with a duty of obedience in taking a number of steps that effectively committed MEETH to the changes before any variation to the constitution had actually occurred.<sup>149</sup>

It is axiomatic that the board of directors [of a charitable corporation] is charged with the duty to ensure that the mission of the charitable corporation is carried out. This duty has been referred to as the ‘duty of obedience’. It requires the director of a not-for-profit corporation to ‘be faithful to the purposes and goals of the organization’, since ‘[u]nlike business corporations, whose ultimate objective is to make money, nonprofit corporations are defined by their specific objectives ...’.

The Court also noted that while the new proposed use of assets to operate diagnostic and training centres might possibly come within the wording of the corporate objects, given the history and current activities of the nonprofit corporation in operating a hospital, there was a clear change of purpose.<sup>150</sup> This reflects what was said at the start of this Part IVD about the specific charitable purpose of an incorporated charity and emphasises that it is this purpose that directors should seek to advance.

The benefit of a focus on purposes is that it has the potential to increase coherence with charitable trusts law and the articulation of duties as they apply to the trustees of charitable trusts — albeit many view a best interests ‘duty’ for trustees as more of an organising principle — in that those duties as a whole focus on achievement of the trust purpose. As noted in *Wangaratta*.<sup>151</sup>

As to any trust, whether charitable or non-charitable, the duty to effect, so far as possible, the purpose of the trust as originally created, and as closely as possible in the manner then prescribed, and to avoid any unnecessary departure from the terms of the trust, must always be the dominant consideration as well for the Court as for the trustee.

## **V What does it mean to have a duty to advance the charitable purposes of an incorporated charity?**

Highlighting the centrality of a charitable corporation’s purpose advances an understanding of the content of the best interests duty, especially by identifying interests that may need to be relegated where they conflict with the purpose. These include the interests of the existing benefit recipients of a charity, the interests of charity corporation members, the general public interest and the interests of the corporation as a commercial entity. In particular, relegating the general public interest highlights that it is the specific purposes of the incorporated charity to which the directors must have regard, not general ‘charitable’ purposes. Thus, for example, if an entity’s purpose is to provide treatment to those with autism the directors cannot pursue

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transaction are fair and reasonable to the corporation and that the purposes of the corporation ... will be promoted’.

<sup>149</sup> *Spitzer* (n 147) 593. See also 595–96.

<sup>150</sup> *ibid* 595.

<sup>151</sup> *Re Church of England Trusts Corporation* (n 86) 206 (Weigall AJ). See also *Harries v Church Commissioners* [1992] 1 WLR 1241 (Ch D) 1246 (Sir Donald Nicholls VC).



any action that advances health generally. Or, to take the more extreme example contained in the introduction, if a tertiary education institution pays its former Chief Executive Officer not to work for a competitor and this truly helps the institution pursue its own educational purposes,<sup>152</sup> there may well be no failure of the best interests duty just because this particular action may be of net detriment to education generally.

The educational institution scenario will depend in part on the level of generality with which the entity's objects are expressed, since if the institution's object is the advancement of education (generally) then the non-compete payment may detract from the pursuit of its purpose. However, objects are often expressed, at least to some extent, by reference to a means of achieving a particular end.<sup>153</sup> Further, because the construction of purpose requires courts to look not just at corporate objects, but also at corporate activities and at the circumstances of formation, a charity's specific purposes will often incorporate particular means within purpose, at least to some extent.

To the extent that purposes can be identified in this more textured way, directors may be able to obtain material guidance on the best interests of the corporation. However, even with some texture or specificity included in the purpose, many charitable purposes will still be very broad, with many potential persons who could benefit. There might also be multiple charitable purposes. For instance, the first and seventh objects of the University of Melbourne are:<sup>154</sup>

(a) to provide and maintain a teaching and learning environment of excellent quality offering higher education at an international standard; ...

(g) to provide programs and services in a way that reflects principles of equity and social justice;

What does it mean to advance purposes in this context? Further, what does it mean to act in the best interests of the charitable purpose when directors propose to amend a charity's objects in accordance with lawful variation procedures?

As outlined in Part III, an approach based on purpose is grounded in the fiduciary principle. Miller and Gold's distinction between 'fiduciary governance' mandates (involving loyalty to an abstract purpose) and 'fiduciary service' mandates (involving loyalty to specific persons) is relevant here. Miller and Gold suggest that a fiduciary governance mandate is particularly suited to charitable trusts and charitable corporations, as well as state-owned corporations.<sup>155</sup> However, they note the problem that we have started to unpack above — 'best interests' loyalty standards do not translate that well from fiduciary service scenarios (where it is clear who are the specific persons whose interests are to be advanced) to fiduciary governance settings (where the purpose may relate to an indeterminate set of persons stretching over

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<sup>152</sup> Views may differ as to whether this action advances the institution's purpose or simply harms its competitor without advancing the institution's purpose.

<sup>153</sup> See, eg, Jonathan Garton, 'Charitable Purposes and Activities' (2014) 67 *Current Legal Problems* 373, 387–88.

<sup>154</sup> *University of Melbourne Act 2009* (Vic) s 5(a).

<sup>155</sup> Miller and Gold (n 85).

generations).<sup>156</sup> Miller and Gold thus turn to Lionel Smith and analysis of charitable purpose trusts to suggest that:<sup>157</sup>

In lieu of a best interests standard, one could, for example, argue that fiduciaries are obliged to act in a manner that would be most likely to advance the purposes specified for their mandates. ...

Smith's comments are made in the context of discussing fiduciary loyalty as modulating the exercise of judgment or choice by the fiduciary:<sup>158</sup>

When loyalty is viewed as a required manner of exercising judgement, it is easier to understand how it can be exacted by the law in a wide range of circumstances, within and without private law. There are elements that are common to all situations in which a person is bound to exercise judgement in an unselfish way, but the law may require different kinds of loyalty in different situations. For example, trustees of charitable trusts do not have to take account of the best interests of any person or persons in order to act loyally; they must take account of the best way to achieve a *purpose*. This is also true in the case of many dispositive powers held in a fiduciary capacity, a point to which we will return. These examples show that the requirement of loyalty is not always one that requires decisions to be made in the interests of a person. A wholly general articulation of the requirement of loyalty, capturing all situations where a person is required to exercise judgement in an unselfish way, would therefore have to be formulated more widely.

This is obviously relevant to the best interests duty as one that regulates the exercise of discretions, especially as Smith poses the open question:<sup>159</sup>

There are two possible dimensions to the requirement: first, by what (unselfish) considerations must the decision-maker be guided in the exercise of judgement; secondly, who can enforce the requirement so to be guided?

The second of these questions is beyond the scope of this article, but the first returns us to thinking about how a director might act in the best interests of a charitable purpose.

Readers may ask at this point whether it is appropriate in an Australian context to apply the above conceptions of fiduciary duties which appear prescriptive as well as proscriptive. While the question of whether the best interests duty is fiduciary or not remains controversial in Australia,<sup>160</sup> the reasoning relates specifically to the restrictions that apply to fiduciaries in the manner of exercising their discretions and thus remains relevant, whether or not the best interests duty is characterised as a fiduciary 'duty'.<sup>161</sup>

Returning to the exercise of discretionary powers, perhaps there is more work that can be done by the need to give genuine consideration in the exercise of those powers. As identified

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<sup>156</sup> *ibid* 564.

<sup>157</sup> *ibid*.

<sup>158</sup> Lionel Smith, 'Fiduciary Relationships: Ensuring the Loyal Exercise of Judgement on Behalf Another' (2014) 130 *Law Quarterly Review* 608, 611.

<sup>159</sup> *ibid*.

<sup>160</sup> See, eg, Langford, *Company Directors' Duties* (n 51) paras 2.04–2.61; Conaglen (n 72) 565, 579–80. This debate also bears some congruence with Johnson's discussion of the maximum and minimum conditions that might be demanded by loyalty to corporate purposes: Johnson (n 61) 27–34.

<sup>161</sup> See, eg, Rosemary Teele Langford, 'Best Interests: Multifaceted but Not Unbounded' (2016) 75 *Cambridge Law Journal* 505, 520–1.

in the Bell litigation at first instance and on appeal,<sup>162</sup> the best interests duty provides some scope for looking at objective evidence of the degree of consideration that directors have given, whether in judging the credibility of statements about their subjective beliefs, or in applying a type of *Wednesbury* unreasonableness test.<sup>163</sup> On appeal, Lee AJA indicated that in a context of the Bell Group nearing insolvency, the Australian directors did not act in the best interests of each Bell Group company because they failed to identify the creditors each company in the group might have and failed to consider what effect the proposed securities might have on the creditors and shareholders of that company.<sup>164</sup> In addition, it will be difficult for directors to prove that they have acted in good faith in what they consider to be the interests of the corporation if they cannot show that they considered those interests. It may be that in the UK, a failure on the part of directors to ascertain material considerations could amount to a failure to consider the interests of the company and so result in the application of the objective test in *Charterbridge Corp Ltd v Lloyds Bank Ltd*.<sup>165</sup> This test asks ‘whether an intelligent and honest [person] in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company’.<sup>166</sup>

Nevertheless, such an approach has some support in the charity authorities, even if that support does not always explicitly spell out that it is the best interests duty under consideration. For example, in the UK case of *Scott v National Trust for Places of Historic Interest or Natural Beauty*, an incorporated charity case, Robert Walker J referred to the exercise of discretionary powers by charity ‘trustees’, being a common UK term for charity decision-makers:<sup>167</sup>

I have heard a lot of submissions about the duties of trustees in making decisions in exercise of their fiduciary functions. Certain points are clear beyond argument. Trustees must act in good faith, responsibly and reasonably. They must inform themselves, before making a decision, of matters which are relevant to the decision. These matters may not be limited to simple matters of fact but will, on occasion (indeed, quite often) include taking advice from appropriate experts, whether the experts are lawyers, accountants, actuaries, surveyors, scientists or whomsoever. It is however for advisers to advise and for trustees to decide: trustees may not (except in so far as they are authorised to do so) delegate the exercise of their discretions, even to experts. This sometimes

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<sup>162</sup> *Bell v Westpac (No 9)* (n 68) 583–84 [4619]; *Westpac v Bell (No 3)* (n 13) 169 [923], 180–81 [1000]–[1007] (Lee AJA). See also *Grimaldi (No 2)* (n 68) 344–45 [174] (Finn, Stone and Perram JJ).

<sup>163</sup> See Rosemary Teele Langford and Ian Ramsay, “Directors’ Duty to Act in the Interests of the Company: Subjective or Objective?” (2015) *Journal of Business Law* 173, 182–83. For a discussion of best interests and unreasonableness, albeit in an oppression setting, see *ASIC v Multiple Sclerosis Society* (n 81) [52]–[53].

<sup>164</sup> *Westpac v Bell (No 3)* (n 13) 180–81 [1000]–[1007]. Drummond AJA concurred with Lee AJA’s reasoning (at 372 [2079]), but appeared to emphasise the proper purpose duty.

<sup>165</sup> [1970] Ch 62 (Ch D)

<sup>166</sup> *Ibid* 74 (Pennycuik J). cf *Lehtimäki* (n 7) 516 [218], 519–20 [232]–[233] (Lord Briggs, Wilson and Kitchen LJ agreeing). The plurality applied an objective component to the test, while Arden LJ emphasised its subjective nature, but still acknowledged that the Court could intervene in the exercise of a power by a fiduciary where they have acted ‘improperly or unreasonably’: 489–90 [100], 494–95 [120]–[121]. As to the subjective and objective tests and the current approach in Australia and the UK, see Langford, *Company Directors’ Duties* (n 51) paras 5.64–5.72; John Picton, ‘*Lehtimäki v Cooper*: Duty and Jurisdiction in Charity Law’ (2021) 84 *Modern Law Review* 383.

<sup>167</sup> [1998] 2 All ER 705 (EWHC) 717 (*Scott*). These comments were approved in *Pitt v Holt* [2013] 2 AC 108 (UKSC) 122–23 [10] (Lord Walker, delivering the judgment of the Court). Lord Walker noted that ‘the same principles, at least in a modified manner’ apply to other non-trustee fiduciaries: at 122–23 [10].

creates real difficulties, especially when lay trustees have to digest and assess expert advice on a highly technical matter (to take merely one instance, the disposal of actuarial surplus in a superannuation fund).

So the general principle is clear. In *Dundee General Hospitals Board of Management v Walker* [1952] 1 All ER 896 (a Scottish appeal in the House of Lords, which nevertheless seems also to reflect the law of England) Lord Reid (at 905) said that even where trustees are expressed to have an absolute discretion—

If it can be shown that the trustees considered the wrong question, or that, although they purported to consider the right question they did not really apply their minds to it or perversely shut their eyes to the facts or that they did not act honestly or in good faith, then there was no true decision and the court will intervene.

And in the company limited by guarantee charity oppression case of *Australian Securities and Investments Commission v Multiple Sclerosis Society of Tasmania*, Zeeman J noted:<sup>168</sup>

Once one accepts what I have held to be the situation in the present case, and which in effect his Lordship held as being the situation in the case being determined by him, namely that the power to expel a member, although expressed in absolute terms, is limited to the board acting bona fide in what it reasonably believes to be the interests of the company, then the power no longer is absolute because the board must act on facts relevant to what are the best interests of the company and must exercise a discretion informed by those matters which it sees as being relevant to those best interests.

Of course, not all failures to fully take account of information or the taking into account of irrelevant information would amount to a breach.<sup>169</sup> And acknowledging this could mean that the approach is still broadly consistent with the United Kingdom Supreme Court's re-articulation of the so-called rule in *Hastings-Bass*.<sup>170</sup> In *Pitt v Holt*, the Supreme Court confirmed that having regard to partial or incorrect information, failing to take matters into account or having regard to extraneous matters will not, of itself, vitiate an exercise of power.<sup>171</sup> Placing the rule within the context of the fiduciary duties applying to the exercise of a power, the decision-maker only has a duty to identify relevant considerations (if any), to use care and diligence in obtaining information and advice relevant to those considerations and to then deliberate on those considerations.<sup>172</sup> The content of giving genuine consideration will thus depend on the circumstances and there is clearly an overlap here with the duty of care and diligence.

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<sup>168</sup> *ASIC v Multiple Sclerosis Society* (n 81) [65].

<sup>169</sup> *Scott* (n 167) 718.

<sup>170</sup> *Re Hastings-Bass* [1975] Ch 25 (CA) 41 (Buckley LJ): The rule had suggested that a power might be exercised improperly in circumstances where the trustee would have acted differently had they taken relevant considerations into account or not taken irrelevant considerations into account.

<sup>171</sup> *Pitt v Holt* (n 167) 131 [41] (Lord Walker). *Pitt v Holt* concerned the power to deal with property of a receiver appointed by the Court of Protection under mental health legislation and also powers of advancement under discretionary trusts.

<sup>172</sup> *ibid* 131 [41], 138 [68], 139 [73] (Lord Walker). See also Thomas (n 68) 520–22 (commenting on the preceding Court of Appeal judgment); *Masters v Stewart* [2014] NZHC 2419, [2018] NZAR 233, 250 [72], 252 [82]–[85]. This approach is broadly consistent with that adopted by Arden LJ in *Lehtimäki* (n 7), except that Arden LJ proceeded on the basis that the court could intervene in the exercise of discretionary powers in such circumstances even where the fiduciary was not in breach of any duty (at 494–95 [121]–[123], 498–99 [137]). The plurality, while agreeing that this reasoning could apply if there was no breach, found that a breach of duties had occurred (applying a slightly more objective test, see n 166), justifying intervention: at 516 [217].

How might this play out? When considering the exercise of powers to recommend a resolution to amend the charitable purposes of an incorporated charity, directors might be expected to inquire into several matters. They are, the factors relevant to the members' initial choice of purpose, the reasons for the proposed change of purpose and, given that the members had agreed a certain purpose, to enquire whether those reasons are linked to some change in circumstances that might materially undermine the achievement of that initial purpose. Failure to do so would be evidence suggesting that the directors do not subjectively believe that the proposed change is in the best interests of the charity, or may go toward demonstrating that the decision is one which no reasonable board of directors could have reached.

We think that this approach, focussed on ensuring genuine consideration in the exercise of powers, will often be more helpful than an approach that seeks to 'balance' the pursuit of multiple objects. In *Stimpson v Southern Private Landlords Association*,<sup>173</sup> in discussing the application of s 172 Companies Act to a company with purposes of benefitting members and of pursuing other purposes, Pelling J does refer to the need to avoid subordinating one purpose to the other and to the need for balance:<sup>174</sup>

Section 172(1) is to be construed as meaning that a director of a company with mixed objects must act in a way that he considers in good faith would most likely promote the success of the company for the benefit of its members as a whole whilst at the same time achieving its other purposes. Where there is a conflict between promoting the success of the company for the benefit of its members and the achievement of the other objectives, a balancing exercise will be required.

*Stimpson* can be distinguished on the basis that multiple charitable purposes would not involve weighing a purpose against the benefit of members. However, the more important observation is that once we move beyond whether a charity pursues each of its purposes in some meaningful (even if small) way, it starts to become less meaningful to conceive of 'balance', or by implication — 'impartiality' as between charitable purposes. By way of analogy, in the context of a superannuation fund that involved very wide discretionary powers to select which beneficiaries or classes of beneficiaries would receive certain benefits, an English trial judge has observed that:<sup>175</sup>

In relation to a discretionary power of that character it is, in my opinion, meaningless to speak of a duty on the trustees to act impartially. Trustees, when exercising a discretionary power to choose, must of course not take into account irrelevant, irrational or improper factors. But, provided they avoid doing so, they are entitled to choose and to prefer some beneficiaries over others.

This focus on the general rules applying to the manner of exercise of a power was also emphasised when the case in question went on appeal:<sup>176</sup>

Properly understood, the so-called duty to act impartially — on which the ombudsman placed such reliance — is no more than the ordinary duty which the law imposes on a person who is entrusted with

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<sup>173</sup> [2009] EWHC 2072 (Ch).

<sup>174</sup> *ibid* [26].

<sup>175</sup> *Edge v Pensions Ombudsman* [1998] Ch 512 (Ch D) 533 (Scott VC). The issue was how to allocate an actuarially determined surplus in funds between existing and future members of a defined benefit superannuation scheme.

<sup>176</sup> *Edge v Pensions Ombudsman* [2000] Ch 602 (CA) 627 (Chadwick LJ).

the exercise of a discretionary power: that he exercises the power for the purpose for which it is given, giving proper consideration to the matters which are relevant and excluding from consideration matters which are irrelevant.

In exercising powers in relation to a broad and ongoing purpose, some guidance can arguably be obtained from cases considering wide classes of potential objects under large discretionary trusts.<sup>177</sup> For instance, a trustee who holds a power to appoint property to a class of discretionary objects, even an extraordinarily large class, is obliged to consider the range of objects of the power. In a broad sense, this means the general size and composition, including classes, of the field of objects.<sup>178</sup> There is likely also a need to consider, at least in very broad terms, the personal and financial characteristics of sub-classes of objects even under very broad powers.<sup>179</sup> These considerations appear relevant to the pursuit of the first and seventh objects of the University of Melbourne identified above. The need to ‘provide’ (now) and ‘maintain’ (in future) an excellent teaching and learning environment indicates that different classes of education recipients should be considered: current students, potential future applicants, domestic and international students etc. In addition, reference to principles of equity and social justice indicate that University controllers might be expected to consider the approximate size of such classes, along with the degree of financial and educational needs of persons within those classes and within sub-classes such as students and applicants from socio-economically disadvantaged backgrounds. Failure to consider such matters might suggest that university council members or university officers do not subjectively believe that a decision is in the best interests of the University of Melbourne or that the decision is one that no reasonable council or officer could make.

What about proposals to amend charitable objects? We suggest that a very significant consideration is whether the amendment would fall materially outside the entity’s particular charitable purpose. In the cases of *Spitzer*<sup>180</sup> and *Hahnemann Hospital* referred to earlier, the courts were highly attuned to whether proposed amendments were consistent with or extended beyond charitable purposes.<sup>181</sup> If proposed amendments materially extend beyond the existing charitable purpose, then *Spitzer* is helpful. In *Spitzer*, in the context of considering whether the proposed sale promoted MEETH’s purpose, the Court commented on the following actions that the board failed to take in considering changing MEETH’s purpose, in order that it could be said to be promoting that purpose, noting that the board:<sup>182</sup>

- Should have arranged ‘a reasoned and studied determination that there was a lack of need for MEETH as a hospital, or that the financial difficulties made it impossible to ensure the survival of MEETH’.
- ‘[F]ailed to properly consider the various alternatives submitted which would have preserved MEETH’s mission’.

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<sup>177</sup> See, eg, Thomas (n 68) 540.

<sup>178</sup> See, eg, *Re Hay’s Settlement Trusts* [1982] 1 WLR 202 (Ch D) 209–10 (Megarry VC) (power to appoint to anyone in the world except a handful of specifically excluded persons); *Re Baden’s Deed Trusts (No 1)* [1971] AC 424 (HL) 449 (Lord Wilberforce, Lord Reid and Viscount Dilhorne agreeing) (mere powers). A trust power likely requires a more systematic survey of potential distributees: *Re Baden’s (No 1)* (n 178) 449, 456 (Lord Wilberforce).

<sup>179</sup> cf *Re Hay’s* (n 178) 210 (Megarry VC), citing *Re Gestetner Settlement* [1953] Ch 672 (Ch D) 688 and *Re Baden’s (No 1)* (n 178) 453; contra *Re Manisty’s Settlement* [1974] Ch 17 (Ch D) 25 (Templeman J).

<sup>180</sup> *Spitzer* (n 147).

<sup>181</sup> See n 102 and n 147 and accompanying text.

<sup>182</sup> *Spitzer* (n 147) 595–96.

- Should have conducted a feasibility study for the proposed diagnostic and treatment centres and developed a proper business plan.

The first two matters relate to whether it was possible to apply MEETH's assets to its charitable purpose or a similar charitable purpose. The third examines the practicability of the proposed new purpose. These would appear generally applicable considerations. In addition, the decision in *Liverpool* and the reasoning as to winding-up grounds suggest that a further consideration will be whether the proposed amendment is consistent with the common understanding of the members or is so distinct from the charitable purpose that the change might undermine public confidence.

## **VI Conclusion**

In critically analysing the meaning of the duty to act in good faith in the interests of an incorporated charity, this article suggests that the law expresses a strong focus on the incorporated charity's purpose and that an approach based on purpose is therefore the most convincing. This is consistent with the regulation of charities to achieve public benefit, given that charitable purposes must be for the public benefit. However, where purpose is not harmed, such as in a loss of opportunity scenario, then there can be some focus on protection of the incorporated entity itself as its longevity can help achieve the purposes. This interpretation of the best interests duty in the context of incorporated charities does not require legislative amendment. Indeed, legislative amendment could prove problematic given the number of sources of the best interests duty. It will, nevertheless, be instructive to monitor the application, and success, of overseas legislative provisions in this regard.

A further question, however, is how to give meaningful content to the duty to act in good faith in the interests of an abstract purpose. It has been suggested that the requirement to give genuine consideration in exercising a discretionary power can provide some practical content to fiduciary governance to a purpose as opposed to fiduciary service to a person. The requirement to give genuine consideration also helps determine how charity directors should act toward potential benefit recipients, especially where there are multiple purposes. In addition, this approach can help directors in thinking about whether to propose a change to a charity's objects. It does so by effectively imposing process obligations on directors, all the while leaving the decision with the directors and so maintaining the independence of the charity sector.