

# Be prepared

*Michael Colledge and Chris Rowse advise charity trustees on best practice when faced with litigation*



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**'Charity trustees must act in the best interests of their charity, protect and secure its assets, and ensure that charity funds are expended in furtherance of the charity's aims, principles that must guide any decision as to whether to engage in litigation.'**

Every organisation will face legal issues at some point, whether that is the sale or purchase of property, or a dispute with another party. Charities are no different, but in the case of disputes charity trustees will have some different considerations to take into account when considering whether to enter into litigation, including the duty to preserve charity assets.

### Types of proceedings

There are two main ways in which a charity may become involved in litigation:

- disputes with third parties, such as supplier disputes, property disputes, breach of contract or employment-related claims (referred to in this article as 'general litigation'); and
- disputes concerning the internal affairs of a charity, such as trustee misconduct or internal decision making, known as 'charity proceedings'.

There are other types of charity litigation, including challenging decisions of the Charity Commission (the Commission) and criminal proceedings, and also the Commission may take regulatory action against charities, for example, by carrying out statutory inquiries under s46 of the Charities Act 2011 (the Charities Act), but these are outside the scope of this article.

The Commission recently released guidance for charity trustees in this area: 'Charities and litigation: A guide for trustees (CC38)', incorporating a guide, checklist and 'legal underpinnings' document (August 2016). The guidance contained within these documents

applies to all types of charity and all types of litigation, except criminal cases and challenges to Commission decisions. The legal underpinnings document is particularly useful for charities, as it sets out the basic law in respect of the guidance and trustee duties.

Charity trustees are expected to comply with their legal duties and engage in litigation only when all other options have been either exhausted or sensibly discounted. The charity trustees must demonstrate that they have applied the Commission's guidance. The Commission advises that legal proceedings should be considered a 'last resort' where other options have failed, but not avoided at all costs. Clearly, given that charity trustees must act in the charity's best interests, litigation in some circumstances will be justified.

Both the Commission guidance in CC38 and the legal underpinnings document suggest that: 'Trustees should take legal advice before taking or defending legal proceedings'. This statement represents good practice but note that the word 'should' is used rather than 'must'. Where a charity does not have an internal legal team, the charity trustees may consider it appropriate to obtain external advice to address the circumstances in which proceedings may be necessary to comply with the trustee duties, but a prudent trustee will instruct legal advisers on a case-by-case basis, not only to advise but to act on the litigation. However, there will be circumstances, for example basic debt recovery, which may be dealt with more appropriately and cost effectively by a debt recovery agency, without legal advice.

The requirement that charity trustees consider the merits of litigation, the

prospect of success, the value of the claim and the cost, the recovery of cost and reputational issues, is something that is expressed within the Commission guidance in CC38 and the legal underpinnings document as arising when considering whether to take proceedings. However, the charity trustees will need to keep this decision under review, as the merits of proceedings may evolve as a case proceeds. While legal proceedings should be avoided where possible, they do not prevent the continuation of settlement discussions or resolution of the dispute by other means during the course of those proceedings.

### General litigation

There are many circumstances in which it may be necessary for a charity to become engaged in general litigation. For example, a charity may need to pursue a supplier for breach of contract if the supplier does not deliver goods, or it may be necessary to defend a claim for unfair dismissal in the employment tribunal. The list of litigation is non-exhaustive and can cover the whole range of different disputes in which individuals or corporate entities may ordinarily be involved in. Some examples are set out in para 2.1 of CC38. Other examples include public procurement issues, judicial review, data protection issues, defamation/reputation management and tax tribunal cases.

Charity trustees must act in the best interests of their charity, protect and secure its assets, and ensure that charity funds are expended in furtherance of the charity's aims, principles that must guide any decision as to whether to engage in litigation. It is clearly a breach of duty to commence frivolous or vexatious litigation, or litigation likely to result in financial loss, or to defend an obviously meritorious and justified claim. However, there will be cases that are not clear cut and which require charity trustees to take a view. It is unlikely that any claim against a charity will be so clear cut that the charity trustees will not need to protect their position by filing an acknowledgment of service or defence in the proceedings. If a case against a charity is meritorious, arguably it should be dealt with before the need for litigation arises to ensure that the charity's reputation is not adversely

affected or costs unnecessarily incurred by the charity.

Where a charity is incorporated, for example, as a company or charitable incorporated organisation, legal action is taken or defended in the name of the charity and the charity is responsible for any liabilities that arise as a consequence of the litigation, although the trustees may be personally liable for any costs if they breach their legal duties. Where a charity is not incorporated, for example, trusts and unincorporated associations, legal action is taken or defended in the names of the trustees, who should

charity trustees should be pursuing in order to comply with their legal obligations.

The Commission expects trustees to comply with their legal duties and apply the principles set out in the guidance in CC38 and the legal underpinnings document. Charity trustees should usually take legal advice, consider the risks, benefits and proportionality of litigation, consider approaching the Commission for consent or advice, consider insurance, funding, consider other relevant Commission guidance (for example; trustees and decision

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be entitled to be indemnified in respect of costs and expenses properly incurred, but may be personally liable if the charity has insufficient assets or the trustees are in breach of duty.

In more risky and expensive litigation charity trustees may need to apply to the court for a *Beddoe* order. This involves an application to court to ask whether the issue should be pursued or abandoned.

If the court gives permission to bring or defend proceedings the charity trustees will be entitled to an indemnity for legal costs from the charity's funds, whether or not the case is won (provided the charity's funds are sufficient). Trustees of charitable trusts must first approach the Commission before applying for a *Beddoe* order.

The Commission's guidance in CC38 suggests that litigation should be avoided, if at all possible. An initial draft of CC38, in November 2015, faced some criticism, for example, from The Charity Law Association, for strong emphasis on the idea that litigation should only be taken by charities as an absolute last resort. The Charity Law Association made representations that litigation may be in the best interests of a charity and therefore something which the

making) and consider alternatives to litigation. The guidance outlines possible alternatives to litigation, including negotiation, mediation and compromise agreements.

When taking decisions on matters relating to litigation, it is particularly important that trustees keep a full record of their discussions, which covers the reasons for their decision, the factors they considered, the advice received and any main points of discussion. They should also deal appropriately with any conflicts of interest.

### Charity proceedings

Again, just like a non-charitable company where the directors or shareholders may disagree on something, so too may the trustees and members of a charity. If the disagreement is substantial or incapable of resolution, legal proceedings may become necessary. Legal proceedings involving the charity and its members and trustees may result in a breakdown of the day-to-day management and governance or the charity with potentially significant consequences to the beneficiaries or financial stability of the charity. As a consequence, these type of proceedings are subject to a special rules applicable to any

type of proceedings falling within the definition of 'charity proceedings'.

Charity proceedings are defined in s115 the Charities Act and relate to the internal administration of charities. For example, charity proceedings could arise from issues with AGMs, appointment and removal of trustees, trustee decision making, breaches of trustee duties or misuse of charity property or resources.

greater than, or different from, that possessed by ordinary members of the public' (*Re Hampton Charity* [1989], Nicholls LJ at p494). There is no comprehensive definition, but case law provides examples of when persons have and have not been found to have such status (see CC38 Legal Underpinnings, paras 5.11-5.15).

If the Commission consents to proceedings then it will inform the Attorney General, who is made party to the proceedings. Under Practice Direction 64A.7, the Attorney General must be a party to charity proceedings, other than those commenced by the Commission, although this is not an absolute rule.

### *The Commission must refuse permission if it can deal with the issue itself using its statutory powers, unless special reasons apply.*

Issues relating to charitable status are not charity proceedings. This type of litigation is subject to additional rules and non-adherence to these could have negative consequences for the litigation and therefore the client. A common pitfall is a failure to obtain the Charity Commission's consent to bring charity proceedings, as the Charities Act provides that charity proceedings can only be commenced with the Commission's permission. The Commission must refuse permission if it can deal with the issue itself using its statutory powers, unless special reasons apply. The Commission will only grant permission where it considers that the proceedings are in the charity's best interests and generally only where matters are 'contentious, intractable and difficult and cannot be resolved in any other way' (CC38 para.3.4).

The Commission therefore has a screening role, in place firstly to protect charities against unwarranted claims and secondly to avoid recourse to the expense of the courts when the Commission can deal with the dispute. Refusal by the Commission to grant permission can be challenged by appeal to a High Court judge.

Only a charity, any trustee(s), any person interested in the charity or, in the case of a local charity, two or more inhabitants of the area, can bring charity proceedings (the Charities Act s115(1)). A person is 'interested in the charity' if they have an interest 'materially

In addition, the attorney general or the Commission (with the attorney general's consent) may bring proceedings akin to charity proceedings but these are excluded from the ambit of the Charities Act.

If litigation amounting to charity proceedings is commenced without the Commission's consent, the proceedings are not a nullity but the court will generally stay proceedings until the relevant consent is obtained. In *Park v Cho* [2014] the Commission granted the claimant permission to enforce a costs order but suggested that it could not retrospectively authorise the initial proceedings giving rise to that order. The court agreed that the Commission was entitled to grant permission to enforce the costs order but also held that it could have retrospectively authorised the proceedings from their inception. However, while it may be possible for the Commission to give consent retrospectively to proceedings, if a court order is made without such consent having been obtained, then the order itself is vulnerable to challenge upon appeal.

A further question arises around issues of limitation and court deadlines more generally, as clearly obtaining permission from the Commission will take time. The CC38 guidance states that if there is a limitation issue or deadline then the steps necessary to meet this can be taken, but that the court would then usually stay the proceedings until permission is obtained (para 3.4).

### **Good governance: avoiding and settling disputes**

Is it in the best interests of the charity to engage in litigation or should disputes be avoided through settlement discussions or alternative dispute resolution? The answer will depend on the facts of the case. In simple debt recovery cases the legal merits may be very strong but the assets of the defendant may mean it is uneconomic to pursue the case. In other instances, the legal merits or facts may require the trustees to take more detailed legal advice.

The Commission's guidance requires charity trustees to explore and, if necessary, rule out other options to resolve any dispute and to be able to justify their decision to proceed with litigation. In order to do so charity trustees should:

- take stock;
- take and consider legal advice;
- consider the economic prospects of success and the impact;
- consider whether the action is proportionate; and
- decide whether it is necessary to ask the Commission for consent.

However, trustees can take steps to avoid litigation even before it becomes an issue. Good management of accounts and credit control can avoid payment disputes. Clear lines of delegated authority as to who within the organisation has power to enter into agreements on behalf of the charity can avoid any disputes as to whether a contract has been concluded. Similarly, negotiating on a 'subject to contract basis' can avoid the inadvertent conclusion of a contract.

In addition, when considering the expectation of any negotiation, sale or purchase employees can be trained to check payment terms and ensuring that overall cost has been established and where appropriate passing the matter to a more senior colleague (with the required authority) to conclude the contract.

Taking legal advice on the terms of proposed agreements can also avoid disputes as to the meaning of particular terms or the obligations of the parties. If an entire agreement clause is included, checking that all representations, including financial performance, relied upon are recorded in the contract.

The inclusion of dispute resolution clauses within agreements can also ensure that future litigation is minimised.

The Commission, in the CC38 legal underpinnings document, states that:

... charities should consider including in their governing documents procedures for dealing with internal disagreements and disputes.

The same principle applies to dealings with third parties; trustees should consider whether it is appropriate to have an alternative dispute resolution (ADR) clause.

Many providers of mediation or arbitration services such as CEDR and the Chartered Institute of Arbitrators provide model clauses. These are not a one-size-fits-all solution and there

a time limit should be imposed in any ADR clause to avoid delays in resolution. Additionally, if injunctive relief (the emergency intervention of the court to order a party to do or refrain from doing something) is or may be required trustees will not want to be restricted to ADR procedures which may not fully protect the charity's position pending resolution of the dispute.

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may be many pitfalls such as choosing the wrong one, for example, choosing arbitration instead of mediation or a lack of clarity rendering the clause unenforceable.

Charity employees, managers and trustees involved in the negotiation of terms should also consider whether

To supplement any model ADR clause, it is worth considering an 'escalation clause' which requires negotiation in good faith for a period of, say, 14 days thereafter the parties are to attempt mediation within 30 days.

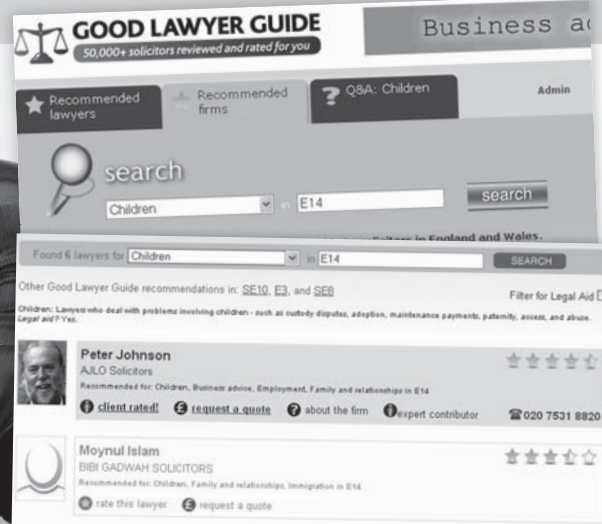
In light of the Commission guidance in CC38 requiring charity trustees



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to consider whether or not another course of action is available, they may be faced with a bewildering array of options relating to ADR. These options may include mediation, arbitration (third-party determination), expert determination, ombudsman schemes and adjudication (usually within the context of construction disputes). However, the primary method of resolving disputes is by direct negotiation. Direct negotiation is usually by way of without prejudice discussion.

Unfortunately, neither the Commission guidance nor the legal underpinnings document adequately mentions without prejudice communications.

### *Mediation is a consensual dispute resolution procedure in which a third party assists the parties in coming to a mutually acceptable compromise.*

This is particularly important, as charities may engage in negotiations prior to commencing legal proceedings and prior to taking legal advice. Depending on the complexity of the dispute, legal advice may be appropriate even before a decision is to be taken as to whether legal proceedings are appropriate.

During negotiations a charity may want to make concessions to resolve the dispute, particularly since the legal underpinnings document requires charities to consider alternatives to litigation.

Obviously, a charity will not want to make an unduly generous concession (if it is considered an *ex gratia* payment it may need authorisation by the attorney general under the Charities Act). In addition, a charity will not want a concession or offer to be made and then used against them as evidence of an admission or concession as to their legal rights if negotiations fail.

It is advantageous for both parties to explore settlement of all or some of the issues in any case. Therefore, the law recognises that offers or correspondence marked 'without prejudice' or 'without prejudice save as to costs' are privileged (not available for inspection by others).

This means that any admissions or offers within such correspondence cannot be used as evidence before a court, provided the offers are made as a genuine attempt to settle.

The principle of without prejudice communications is described as follows (per Lord Griffiths in *Rush & Tompkins Ltd v Greater London Council* [1988]):

... if it is clear from the surrounding circumstances that the parties were seeking to compromise the action, evidence of the content of those negotiations will, as a general rule, not be admissible at the trial and cannot be used to establish an admission or partial admission.

Accordingly, there may be two types of correspondence passing between the parties:

- the open position reflecting the arguments to be put before the court; and
- the without prejudice position, in which concessions can be made by either party without affecting the open position. If an offer is marked 'without prejudice save as to costs', the court can consider the reasonableness of refusing this offer and can exercise a certain amount of discretion against the unreasonable party when making an order for costs.

Without prejudice proposals only become binding once agreed by both parties. Once a binding agreement to settle has been achieved, the privilege in respect of the agreed terms falls away. This existence of this principle provides a mechanism whereby parties are encouraged to make early concessions or offers to resolve disputes. When utilised effectively it can reduce legal costs and time in dealing with disputes.

If direct negotiation fails, the usual next step is to consider mediation.

Mediation is a consensual dispute resolution procedure in which a third party assists the parties in coming to a mutually acceptable compromise. The third-party mediator does not advise the parties or make a determination of the dispute and will simply try to assist the parties in finding common ground. This can often be helpful in providing someone to diffuse tension in a dispute and bring a fresh perspective to the parties' positions.

It is worth noting that, in addition to charity trustee duties to consider dispute resolution, the court's pre-action protocols dealing with best practice before the commencement of proceedings encourage the parties to exchange information and documents at an early stage and to indicate their willingness to participate in ADR. The court will also encourage the parties to settle by giving the parties an option to stay the proceedings (usually for one month) to consider settlement opportunities.

### **Conclusion for practitioners**

When read together, CC38, the legal underpinnings, the checklist and guide provide charities with a new and informative approach to court proceedings. However, the focus on taking legal advice before commencing proceedings and the need to exhaust all other remedies, highlights the need for charities to have robust dispute resolution procedures. Not only will these procedures reduce overall legal costs but they will reduce management and trustee time dealing with unnecessary disputes and ensure the protection of charity assets.

Good dispute resolution procedures include an informed approach to the negotiation of contractual terms and where disputes arise, following a course of negotiated settlement and if necessary mediating disputes at an early stage. ■

*Re Beddoe, Downes v Cottam*  
[1893] 1 Ch 547

*Re Hampton Charity*  
[1989] 1 Ch 484

*Park v Cho & ors*  
[2014] EWHC 55 (Ch)

*Rush & Tompkins Ltd v Greater London Council & ors*  
[1988] UKHL 7