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Ethical investment - latest for charities on striking the right balance

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How should charity trustees approach the thorny issue of avoiding investments that conflict with their charity's purposes whilst at the same time trying to maximise financial returns?

This was the dilemma at the heart of a recent High Court ruling about the proposed investment policies of two charities focused on environmental protection - *Butler-Sloss v Charity Commission*.

The case highlights the importance of trustees using good judgment when exercising their discretion about investment decisions, by balancing the extent of any conflict with their charity's purposes if they make a particular investment, or class of investments, against the risk of financial detriment if they don't.

In this briefing, we look at this ruling in more detail and what to expect next.

What was the case about?

Butler-Sloss v Charity Commission involved two charities - the Ashden Trust and the Mark Leonard Trust - whose main charitable purpose is protection of the environment. These charities were seeking the approval of the High Court to them adopting a new investment policy which would avoid investments which the trustees believed would conflict with their charitable purposes.

The way the charity trustees proposed to do this was to exclude investments that do not align with the Paris Climate Agreement and the goals for reducing global warming within that Agreement. The effect of this, however, would be to exclude many potential investments, possibly impacting financial returns.

The Charity Commission and the Attorney General were of the view that, in adopting this approach, the trustees were not adequately weighing in the balance the potential financial detriment that would be suffered by adopting the proposed investment policy. As explained below, however, the High Court disagreed.

What did the High Court decide?

One of the key points considered by the High Court was the correct interpretation of the only previous case dealing with ethical investments - *Harries v Church Commissioners for England (1992)*, known as the 'Bishop of Oxford' case and, specifically, whether or not that case places an absolute prohibition against investments that directly conflict with a charity's purposes. On that point, the High Court ruled that, as a matter of law, there is no such prohibition. Rather, how trustees decide to exercise their power of investment is a matter for their discretion, with the issue of conflict with their charity's purposes being a major, but not decisive, factor in the balancing process.

Summarising the legal position, the judgment highlights that trustees' primary and overarching duty is to further the purposes of the trust, which is normally achieved by maximising the financial returns on investments. However, where trustees are of the reasonable view that particular investments, or classes of investment, potentially conflict with the charity's purposes, they have a discretion as to whether or not to exclude such investments and they should exercise that discretion by *"reasonably balancing all relevant factors including, in particular, the likelihood and seriousness of the potential conflict and the likelihood and seriousness of any potential financial effect from the exclusion of such investments"*. If that balancing exercise is done properly, the trustees have complied with their legal duties and cannot be criticised, even if others might have come to a different conclusion.

Looking at the facts of this particular case, in carrying out the necessary balancing exercise, had the trustees taken adequate account of the financial effect of their proposed investment policy? The judge decided that, yes, the trustees had the potential financial impact very much in mind and, as such, they had acted reasonably. Indeed, the judge commented that the targeted rate of financial return within the proposed investment policy was in line with the published rates of return of other large charities. The approval sought for the investment policy was accordingly granted.

What next?

Trustees considering excluding potential investments on the basis that they conflict with their charity's purposes should familiarise themselves with this case and, in particular, the importance of being able to demonstrate that they have carefully weighed all factors in the balance, including both ethical and financial considerations.

The next step will be for the Charity Commission to finalise its revised guidance on 'responsible investments'. This was published for consultation in draft form in 2021 but finalisation of the guidance was put on hold pending the outcome of this case.

We can assist charities in advising on all aspects of their legal compliance and in particular give training on trustee duties and responsibilities.

Authors

Emma-Jane Dalley
Bristol
+44 (0) 117 366 2960
ejdalley@dacbeachcroft.com

Alistair Robertson
London - Walbrook
+44 (0)20 7894 6020
arobertson@dacbeachcroft.com

Anne-Marie Gregory
Bristol
+44(0)117 918 2324
amgregory@dacbeachcroft.com

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