

ETHICAL INVESTMENT BY CHARITY TRUSTEES: SOME ANSWERS, NEW QUESTIONS

IN *Butler-Sloss v Charity Commission for England and Wales* [2022] EWHC 974 (Ch), the High Court confirmed that two charities were entitled to adopt an investment policy which excluded investments deemed to be incompatible with the Paris Agreement, even though this risked reducing the charities' investment returns. The decision is significant because it establishes that charity trustees have a broader discretion to take ethical and other non-financial considerations into account when exercising their powers of investment than had been previously understood. The judgment provides much needed clarification of the law governing ethical investment, but also poses difficult questions for trustees.

The charities concerned were grant-making trusts established for general charitable purposes. Their trustees had chosen to focus the charities' grant-making on two purposes in particular: the advancement of environmental protection or improvement, and the relief of those in need. The trustees wished to avoid investing the charities' funds in investments which conflicted, or might conflict, with these purposes, prompting the development of the new investment policy. The policy significantly narrowed the universe of assets from which investments could be selected, which the trustees recognised was likely to result in diminished returns in the short term. For this reason, and because there was widespread uncertainty concerning the reach of the only previous reported case on ethical investment by charity trustees, *Harries v Church Commissioners* [1992] 1 W.L.R. 1241, the trustees asked the court to make a declaration blessing their decision.

In *Harries*, Sir Donald Nicholls V.-C. held that, when exercising their powers of investment, the "starting point" was to maximise financial return, since "[m]ost charities need money; and the more of it there is available, the more the trustees can seek to accomplish". However, trustees would be justified in departing from this starting point in certain "comparatively rare" cases, including where the trustees were satisfied that there was a direct conflict between the investment and the charity's purposes (p. 1246). The trustees in *Butler-Sloss* claimed that the proposed investment policy fell within this exception; they considered the policy was needed because any investments which did not align with the goals of the Paris Agreement directly conflicted with the charities' purposes. However, the scope of the direct conflict exception was unclear. Were the trustees *required* to divest from investments which they considered conflicted with their charity's purposes, or did they simply have a discretion to do so? What was meant by a conflict in any

event? The Vice-Chancellor gave the example of a cancer research charity investing in tobacco shares (p. 1246). But did the exception extend to less obvious conflicts? If it did, should the trustees consider the risk that divestment might cause financial detriment to the charity? How much weight should they give this?

The judge, Michael Green J., answered many of these questions in a helpful restatement of the law (at [78]). He explained, first, that trustees' powers of investment derive from the charity's trust deed or governing instrument (if any) and from the Trustee Act 2000. Second, trustees must exercise their investment powers in accordance with their "primary and overarching duty", which is to further the charitable purposes of the trust. Third, in most cases, this means trustees should seek to maximise the charity's financial returns. Fourth, social investments or impact or programme-related investments are made using distinct legal powers. Fifth, where the trust deed or governing instrument prohibits the trustees from making certain investments, they cannot make them. Sixth, if the trustees reasonably consider that particular investments may conflict with their charity's purposes, they have a discretion as to whether to exclude those investments. They should exercise this discretion by "reasonably balancing all relevant factors", including the "likelihood and seriousness" of both the potential conflict and the potential financial impact of excluding the investments. Seventh, when considering the potential financial impact, the trustees can take account of the risk that investments might cause the charity to lose support from donors or might otherwise damage the charity's reputation, in particular among its beneficiaries. Eighth, trustees must take care not to make investment decisions "on purely moral grounds", not least because the charity's supporters and beneficiaries may have a range of (legitimate) moral views.

In summary, this means that charity trustees are required to "act honestly, reasonably ... and responsibly in formulating an appropriate investment policy for the charity that is in the best interests of the charity and its purposes" (at [78(9)]). Where there are concerns that a particular investment, or class of investments, might conflict with the charity's purposes or cause it reputational damage, the trustees must balance the extent of the conflict against the risk of financial detriment resulting from the exclusion of particular investments. Provided this is properly done, the trustees will have complied with their legal duties and cannot be criticised, even if the court or other trustees might have taken a different decision (at [78(10)]). Applying this to the facts in *Butler-Sloss*, the judge found that the trustees had exercised their powers of investment properly and lawfully. Accordingly, he made a declaration blessing their decision to adopt the investment policy (at [88]).

There is a lot to like about this decision. First, and most importantly, the judgment makes it clear that trustees have a relatively wide discretion to

exclude potential investments on the ground that they might conflict with the charity's purposes. Conflicts need not be confined to those which are direct and obvious. Here, it was acceptable for the trustees to exclude investments deemed to be incompatible with the Paris Agreement, even though the charities concerned had general charitable objects.

Second, the judgment confirms that, although trustees must always consider the financial impact of making or excluding particular investments, they can balance this against any countervailing risk of reputational damage. Given the context – the Climate Crisis and the increasing pressure on investors to have regard to environmental, social and governance (ESG) factors – these two developments constitute a welcome step forward in aligning the legal framework for trustee investors with scientific, social and economic realities.

Third, the judgment makes clear that there is no automatic prohibition which prevents trustees from making investments which conflict with the purposes of the charity. This is significant because, in *Harries*, the Vice-Chancellor indicated that, in cases of direct conflict, the trustees “should not so invest” even if divesting “would be likely to result in significant financial detriment to the charity” (p. 1246). However, Michael Green J. clarified that, “‘should’ means something slightly less than ‘must’ and does not preclude consideration of other important factors” (at [72], emphases in original). The upshot is that trustees can make the investment decisions they reasonably consider to best advance the purposes of their charity. This preserves trustees’ discretion in a way that is essential given the wide differences in charities’ financial and other circumstances.

But there is also room for improvement. An obvious problem is that the judgment echoes *Harries* in identifying “maximising the financial returns” as the starting point for trustees when exercising their investment powers (at [78(3)]). This unhelpfully reinforces the misconception that taking non-financial considerations into account will necessarily result in financial detriment. It also oversimplifies the balancing exercise that trustees are required to conduct when exercising their investment powers, even if they do not take account of non-financial considerations. As the judgment goes on to recognise, trustees are obliged to consider the standard investment criteria in section 4 of the Trustee Act 2000, and to take appropriate advice. They are not required to maximise returns at the expense of risk factors. Rather, they should weigh expected returns against their associated risks, including long-term risks, so that they can identify the investments or investment policy that they consider most likely to further the charity’s purposes, now and into the future (Law Commission, *Fiduciary Duties of Investment Intermediaries* (Law Com No 350, 2014), paragraph 5.52).

The judgment also raises some difficult questions for trustees. “What counts as a conflict?” is perhaps the most challenging. Michael Green J. emphasised that trustees’ primary duty is to further the charity’s purposes, and warns against taking investment decisions “on purely moral grounds” (at [78(8)]). But the nature and degree of the required connection between the charity’s purposes and the investments the trustees wish to exclude is unclear. Here, the proposed policy excluded investments which the trustees considered conflicted with the advancement of environmental protection or improvement, and the relief of those in need. But the charities had general charitable objects. It is therefore arguable that the policy sought to exclude investments which conflicted with the charities’ *activities*, not with their purposes. Moreover, who is to say that the trustees were not, at least partially, motivated by the moral imperative to mitigate the effects of climate change? As Michael Green J. recognised, “[t]he boundaries of law and morality are sometimes difficult to define and perhaps even more so in the context of charities, which are often underpinned by a strong sense of moral imperative” (at [64]). In practice, legal and moral justifications may be difficult to distinguish.

REBECCA FRY

Email: [rebecca.fry@mail.utoronto.ca](mailto:rebecca.fry@mail.utoronto.ca)