

Public Benefit, Path Dependency and the Regulation of Philanthropy in the UK

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In recent years, reforming the legal framework for the regulation of philanthropy in the UK has been an important legislative priority. In 2002, Tony Blair's Strategy Unit published a report, *Private Action Public Benefit*, which set the agenda for reform of UK charity law. Following extensive consultation with the third sector and relevant professional bodies, the Charities Act 2006 was enacted with the aim of fundamentally recasting the regulatory regime for charities in England and Wales. In Scotland, however, the debate had taken on a constitutional dimension because the regulation of charities was part of the devolved competencies of the recently-created Scottish parliament. As a result, Scotland is subject to a separate regime under the Charities and Trustee Investment (Scotland) Act 2005, which differs from the English Act in a number of significant respects.

This paper seeks to examine the new regulatory regime in the round. It will look at what these Acts have changed and how the new regulatory regime can be understood. It will suggest that persistent deficiencies in UK regulation, even after the recent legislative reforms, can be explained by reference to the 'path dependency' of English (and Scottish) charity law. Path dependency is a concept used by economists to account for sub-optimal outcomes or decisions in a system which could be organised more efficiently or rationally. The current regulation is path dependent because the legislature has been deterred from radical reform by the perceived costs of introducing changes. Consistent with this analysis, it will be suggested that the reform process has been fudged, and that the new English Act regards as charitable any organisation or body recognised as such under the old regulatory regime. This paper will argue that the surest way to create a 'culture of giving' in the UK is to liberalise, simplify and rationalise the regulatory framework of philanthropy. Innovations from the domestic voluntary sector will surely create demand for new regulatory paradigms. Developments in the European and international contexts will also create new regulatory needs. It is thus likely that the UK legislature will have to address this issue again in the future. But it may perhaps be domestic innovations and international contexts which will do most to generate new paths for philanthropic activity, rather than the future policies of UK governments.

The Old Regulatory Regime

In his foreword to *Private Action, Public Benefit*, Tony Blair argued that, "...the legal context for charity and voluntary action is outdated...charitable purposes, for instance, were set out in a statute over 400 years ago. The current law is unclear, has not evolved in a way which best meets the needs of contemporary communities, and does not reflect the diversity of organisations which operate for the public

benefit.”¹ The common law has long recognised the social value of charitable activity. Current English legislation encourages charitable giving by creating “a formidable list of fiscal advantages.”² But underpinning any legal regulation of charity is a question freighted with policy issues and value-judgements: whether or not the purpose for which the organisation exists should be recognised as charitable at all. The former Prime Minister – himself a lawyer – recognised that the answer to this question in UK law is based on an ancient statutory list of charitable purposes and the precedential weight attached to the decisions of judges who have interpreted that list.

The Preamble to the Charitable Uses Act 1601, to which Tony Blair alluded in that quotation, contains an illustrative list of purposes recognised as charitable by English law. It is worth examining in full:

The relief of aged, impotent and poor people, the maintenance of sick and maimed soldiers and mariners, schools of learning, free schools and schools in universities, the repair of bridges, ports, havens, causeways, churches, sea-banks and highways, the education and preferment of orphans, the relief, stock or maintenance for houses of correction, the marriage of poor maids, the supportation, aid and help of young tradesmen, handicraftsmen and persons decayed, the relief or redemption of prisoners or captives and the aid or ease of any poor inhabitants concerning payment of fifteens, setting out of soldiers and other taxes.³

It is plain that the charitable purposes on this list are dated. Although ostensibly unified by a principle that each purpose is charitable in that it operates for the ‘public benefit,’ it is hard to resist the conclusion of one commentator that, “the legal concept of ‘charitable’ is shorthand for ‘saves public money.’”⁴ Yet the Preamble to the 1601 Act, although in fact repealed in the nineteenth century, remains the foundation of UK charity law until the 2006 Act comes into force.

The influence of the Preamble is pervasive in UK charity law. In the absence of explicit guidance by the legislature as to what constituted a charity, judges sought to develop the law by reference to the “spirit and intendment” or the “equity” of the Preamble. The main regulatory entity which was used to advance the law was the public or charitable trust. In one authoritative Victorian case, Lord MacNaughten organised the charitable activities listed in the Preamble under four categories or “heads” of charity.⁵ Accordingly, prior to the 2006 Act, English law recognised four broad categories of charitable trusts: the relief of poverty; the advancement of education; the advancement of religion; and a miscellaneous fourth category of “other purposes beneficial to the community.” In each case, the trust had to demonstrate to the court that it operated exclusively for the benefit of the public to

¹ *Private Action, Public Benefit*, (London, Strategy Unit, September 2002), pp. 5-6

² *Maudsley and Burn's Trusts and Trustees: Cases and Materials* (eds. EH Burn and GJ Virgo, 6th edn., Oxford, OUP, 2004), 385-6. Broadly, the most significant advantages for charities are exemption from income tax (as long as the income is only applied to charitable purposes), corporation tax, capital gains tax, and stamp duty. Donors also enjoy similar exemptions. But charities are still liable for value added tax on all goods and services purchased.

³ 43 Eliz. I (1601), c. 4

⁴ Gary Watt, *Trusts and Equity*, (Oxford: OUP, 2003), 225

⁵ *Commissioners for Special Purposes of Income Tax v. Pemsel* [1891] AC 531, 583

be validated as charitable. A case falling under the first three categories was presumed by the courts to exist for public benefit, unless the contrary could be shown. A case falling under the fourth category needed to prove to the court's satisfaction that its purpose was sufficiently similar or analogous to the existing ones listed in the Preamble to the 1601 Act. It would be a mistake, however, to conclude from this survey that the primary responsibility for regulating charities lay with judges and the courts. Another important innovation of the nineteenth century was the creation of a 'Charity Commission' to oversee the regulation of charitable activities in England and Wales.

Since the Charities Act 1960, the Commission has kept a Register of charities, on which most (but not all) organisations that are recognised to have charitable status were required to register. The registration process thus became the primary regulatory scrutiny of new organisations that wished to become charities. The 1960 Act also significantly reformed the responsibilities of the Commissioners. Prior to that Act, the Commissioners were appointed for life in a similar way to judges, in recognition of the quasi-judicial capacity in which they regulated charities. Following the Act, however, the Commissioners were now appointed directly by the Home Secretary and were endowed with administrative responsibilities to examine the accounts of charities, investigate their activities, propose schemes for their administration, and otherwise modify the organisation or operation of registered charities. As Professor Charles Mitchell has noted, the potential conflict of interest between the Commissioners' role as 'enforcer' and 'friend' to charities became a contested political question in the following decades. A debate ran between politicians who argued for a 'light' regulatory touch (predominantly right-wingers) and those who preferred a heavier approach (mostly left-wingers).⁶ Decisions and actions of the Commissioners were always subject to the scrutiny of the High Court, but most charities lacked the resources to mount a legal challenge.

A shock to this culture of regulation came with increased parliamentary scrutiny following the election of the Blair government. In March 1998, the Select Committee on Public Accounts strongly criticised the Commissioners for its "unsatisfactory" and "unacceptable" approach to regulation. Of particular concern were the facts that nearly a quarter of charities failed to provide annual returns; that over a third failed to provide annual accounts; and that the Register itself was only 76% accurate.⁷ Persistent problems were identified in the accurate update of registered organisations and their officials. This report prompted the Commissioners to conduct a widespread review process of their regulatory operations and the content of the Register, and a consultation process to seek out opinion on how the sector should be run.

Public Perceptions and the Potential for Regulatory Reform

The 1998 Select Committee report revealed the extent to which the Blair government was willing to subject the entire area of charity law and regulation to

⁶ Charles Mitchell, "Reviewing the Register," in Charles Mitchell and Susan R. Moody (eds), *Foundations of Charity* (Oxford: Hart Publishing, 2000), 179-180.

⁷ Select Committee on Public Accounts, *28th Report for 1997-1998 Session: Charity Commission – Regulation and Support of Charities*, in Mitchell, *ibid.*, 188-190.

scrutiny. The faults in both the administrative structures and the substantive law were apparent to all concerned. Key substantive problems were over-reliance on the formulaic application of a long-outdated statute, the weight of regulatory compliance for even small charities, and the idiosyncrasies and uncertainty of the law as it stood. The need to satisfy public perceptions was another matter which stood at the heart of the reform process. It had long been apparent that the popular understanding of the word 'charity' diverged significantly from the legal implications of that word. In its September 2001 Review of the Register, the Charity Commission acknowledged that:

The legal concept of charity alters; and its evolution is influenced by ideas about social values...whilst public opinion cannot determine what is or is not charitable, it is an important factor to be taken into account in the shaping of the legal understanding of charity.⁸

The poor regulatory 'fit' between public perceptions and the statutory regime was thus a potential justification for a more radical update of the law. It had been a source of much concern, for example, that the organisation Amnesty International had famously been denied charitable status because it existed for political purposes. In refusing the legal challenge to the Charity Commissioners, the judge Sir Christopher Slade upheld the textbook response of previous judges to such applications: because the court is apolitical, it has no way of judging whether a the proposed change in the law will or will not be for the public benefit. Therefore, an organisation which seeks to change the law – even one, like Amnesty, which was, "performing a function which many will regard as being of great value to humanity" – could not be registered as charitable in English law.⁹

In the post war period, commentators of different backgrounds had expressed dissatisfaction with the old regulatory framework. The eminent judge Lord Wilberforce emphasised in *Scottish Burial Reform and Cremation Society Ltd v. Glasgow Corporation* that the unreformed English charity law, although 'tolerably clear,' is 'not very satisfactory and in need of rationalisation.'¹⁰ Professor Michael Chesterman was the first academic to present a robust left-wing assault on such anomalies in the traditional concept of charity in his book *Charities, Trusts and Social Welfare*.¹¹ A 1994 report of the thinktank Demos, authored by Anita Randon and Professor Perri 6, argued that a distinction could be drawn between countries which recognised the charitable status of political organisations, and those which did not, broadly aligned to a distinction between those which had received the common law from the UK under the British Empire. The common law jurisdictions had evolved a peculiar concept of 'charity' which did not consider political change to be charitable. In legal systems based on Roman or civil law, such purposes were recognised as charitable. The Demos report was the first to recognise that the English concept of 'charity,' as it had evolved from the 1601 Act, was perhaps overly-reliant on prior paths, even

⁸ Charity Commission: *The Review of the Register of Charities (RR1)* (September 2001), para 23

⁹ Per Slade J, *McGovern v. Attorney-General* [1982] Ch 321, 354

¹⁰ [1968] AC 138, 332

¹¹ (London, Weidenfeld & Nicolson, 1979)

with the flexibility usually attributed to ‘judge-made’ precedent.¹² Given the close relationship between Demos and New Labour, it is surprising that this report did not have more influence on the reform process. It is noteworthy that the new regulatory regime, introduced in the 2006 Act, has not fulfilled the expectations of most of those advocating reform, and has broadly preserved (in England and Wales, at least) the distinctions of the old regulatory regime as to the categories of charity recognised in law.

Public Benefit and the New Regulatory Regime – England and Wales

Throughout the twentieth century, a persistent sticking point in proposals to reform the law of charities by statute was the question of ‘public benefit.’ The introduction of any new statutory test was thought to create unacceptable uncertainty in the law, and thereby to encourage wasteful litigation. As noted above, the courts advanced the law by recognising that the purposes listed in the Preamble to the 1601 Act were underpinned by a principle of public benefit. For the purposes of education, poverty and some forms of religion, public benefit was presumed; for the miscellaneous other purposes, and new purposes, the onus was on the applicant to show that the purpose went to the equity of existing purposes recognised to be charitable, or was analogous to those purposes. The new Act seeks to replace this regime with a number of important reforms. The principle of public benefit finds concrete expression within the new Act in section 2 (1) (b). This section provides that a charitable purpose is to be valid only if it exists for public benefit, even if the purpose of the organisation nominally falls within the purposes listed in s. 2 (2) (a new list of twelve charitable purposes) or (4) (purposes already recognised to be charitable under English law). All charities will thus have to justify their existence by reference to a standard of public benefit. Section 1 (1) (a) makes it clear that, in accordance with the present law, a charity is ‘established for charitable purposes *only*.’¹³ Ancillary benefits to individuals or a sector of the public do not count. An organisation will only be registered as a charity on the basis, therefore, that it operates exclusively for the public benefit. The onus is now on the organisation to prove that this is the case.

It is clear, therefore, that the law is modernised by making the new statutory principle of public benefit the sole principle upon which all charitable purposes are to be validated in law. Section 2 (2) lists twelve purposes which are now recognised to be charitable (2 (2) (a) to (l)). This new list makes an interesting comparison with the list of 1601:

(a) the prevention or relief of poverty; (b) the advancement of education; (c) the advancement of religion; (d) the advancement of health or the saving of lives; (e) the advancement of citizenship or community development; (f) the advancement of the arts, culture, heritage or science; (g) the advancement of amateur sport; (h) the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity; (i) the advancement of environmental protection or improvement; (j) the relief of those in need by reason

¹² Anita Randon and Perri 6, “Constraining Campaigning: The Legal Treatment of Non-Profit Policy Advocacy Across 24 Countries,” (1994) 5 (1) *Voluntas* 27; see also Anita Randon and Perri 6, *Liberty, Charity and Politics: Non-Profit Law and Freedom of Speech*, (Aldershot: Dartmouth, 1996)

¹³ [emphasis added]

of youth, age, ill-health, disability, financial hardship or other disadvantage; (k) the advancement of animal welfare; (l) the promotion of the efficiency of the armed forces of the Crown, or of the efficiency of the police, fire and rescue services or ambulance services.

Superficially, there is considerable change here. The language is modernised, and new charitable purposes enumerated. The advancement of human rights is now recognised as charitable under category (h); the provision relating to “arts, culture, heritage or science” is an innovative head, and admirably broad; “citizenship or community development” is another entirely new category. But, despite the far-reaching potential of the new regulation, the extent to which the list is clearer or more rational than the 1601 Act may be questioned. Is this list still just a list of purposes which merely save the government money?

To that question, the Charity Commission and the courts can now point to another important provision of the new Act, section 4 (4), which requires the Commission to carry out such public and other consultation “as it considers appropriate” before issuing or revising any guidance on what is charitable. This provision introduces a welcome element of participation into the regulatory process, and will go some way to dealing with poor public perceptions of charity law. It is reinforced by the discretion provided to reconcile existing charitable purposes with the new list. Section 2 (4) (b) of the new Act provides the court or regulator with a discretion to validate any purposes that “may reasonably be regarded as analogous to, or within the spirit of,” any of the purposes listed in s. 2 (2). In this way, the new Act does not seek to overturn any existing purpose purely on the basis that it is incompatible with the new Act as a matter of law. This is significant because it reveals the extent to which the new Act remains dependent on the English law which existed before, even with the new requirement to consult about changes in the law.

Public Benefit and the New Regulatory Regime – Scotland

The picture in England and Wales is very different to that in Scotland, which introduced delegated legislation containing a more rigorous definition of public benefit. Section 8 of the Charities and Trustee Investment (Scotland) Act 2005 similarly removes the presumption as to public benefit of the existing law (ss. 1) but goes on to provide that:

- (2) In determining whether a body provides or intends to provide public benefit, regard must be had to
- (a) how any
 - (i) benefit gained or likely to be gained by members of the body or any other persons (other than as members of the public), and
 - (ii) disbenefit incurred or likely to be incurred by the public,in consequence of the body exercising its functions compares with the benefit gained or likely to be gained by the public in that consequence, and
 - (b) where benefit is, or is likely to be, provided to a section of the public only, whether any condition on obtaining that benefit (including any charge or fee) is unduly restrictive.

This is the closest any UK legislative body has ever reached to providing a statutory definition of public benefit. The Act also introduces far reaching changes to regulatory structure, in the form of the Office of the Scottish Charity Regulator. It is, however, clear that the statutory definition of public benefit was not introduced with a clear regulatory policy as to philanthropic activity in mind, but rather to tighten up the law as it stood, with particular reference to fee-charging charities. It is clear from the parliamentary debates that traditional left-wing targets – fee-charging charities such as schools and hospitals – were intended to be excluded from the words of section 8 (2) (b). It is thus clear the section 8 (2) (b) is aimed at *restricting* charitable activity in the law as it stands, rather than liberalising or rationalising the regulation of philanthropy. The overwhelming impression is that fee-charging charities were singled out for this treatment in Scotland out of legislative spite, rather than for any clear regulatory policy.

The Path Dependency of UK Charity Law

A plausible explanation for the legislative fudging of the reform process in both England and Scotland could be based on path dependency. ‘Path dependency’ is a concept proposed by economists to account for outcomes or decisions that are sub-optimal in systems which could be more efficiently or rationally structured. Perhaps the paradigmatic example of path dependency is the QWERTY keyboard layout. The standard layout of a computer or typewriter keyboard in the English-speaking world is such that the first line of letters begins with the word QWERTY. This is the consequence of two arbitrary factors. Firstly, when typewriters were mechanical, letters which were commonly used in words needed to be placed on the far sides of the keyboard so that they did not jam together. Secondly, for the ease of the travelling salesmen who sold the typewriters, the word ‘typewriter’ could be written quickly using only the letters on the top letters line of the keyboard. There is thus no efficient or rational reason why a keyboard should be set out in this manner. The layout is not determined – as one might expect – by considerations as to where the keys can be most usefully placed for speed in touch-typing or for comfort to the human user. The keyboard is laid out in this way because it has always been done that way. QWERTY is path dependent.

Professor Mark J. Roe has argued that the QWERTY keyboard is an example of ‘semi-strong form path dependency,’ in that the costs of ‘rebuilding the system’ are disproportionate to the efficiencies gained by such reorganisation.¹⁴ It is of course possible to reorder the letters on a keyboard – and rival layouts do exist, such as the Dvorak Simplified Keyboard – but the costs of retraining typists, and of reconstituting the manufacturing process, are such that it does not make economic sense to do so. Applying these principles to legal rules and statutes, legal academics have studied, “...the path dependence of legal phenomena (i.e. to structural and behavioural barriers to departure from the existing ‘legal path’).”¹⁵ Professor Roe, for instance, distinguishes three forms of legal path dependence: ‘weak-form path dependence’ (“the original path does not have to be very strong for it to explain how we got to where we are,”); ‘semi-strong form path dependence’ (“we wish

¹⁴ Mark J. Roe, “Chaos and Evolution in Law and Economics,” 109 Harvard Law Review (1996) 641, 648

¹⁵ Reinier R. Kraakman (et. al.), *The Anatomy of Corporate Law*, (Oxford: OUP, 2004), 223.

things were different, but it is inefficient to do anything major about it now”); and ‘strong-form path dependence,’ (“the cost must be *created* by the path,”).¹⁶

In the context of the precedential development of rules in the common law, Professor Oona A. Hathaway has argued that, “path dependence occurs because once a court makes an initial decision, it is less costly to continue down that same path than it is to change to a different path.” This is the path dependency of “increasing returns,” which, in a common law system, “derive[s] directly from reliance upon precedent.”¹⁷ Professor Eva Micheler has also written of, “doctrinal path dependence” – “Legal doctrine causes the law to develop path dependently.”¹⁸ This paper would suggest that, in terms of English and Scottish charity law, the reliance on the prior decisions of judges by reference to the 1601 Act has created strong-form path dependency in the regulation of philanthropy. The costs of radical change are too great to be considered. So many institutions of the British state are recognised as charitable under the old regulatory regime (including fee-charging schools and hospitals), that it would cost too much in both financial costs and in political capital to rationalise the law in a clear or systematic way. It is thus a contention of this paper that the lack of clarity, the reluctance to embody clear regulatory policies in legislation and the anomalies of the present regulation are primarily – if not wholly – explicable in terms of the path dependency of the law.

To be sure, a move in the right direction is the way the new Act seeks to break the reliance on the charitable trust as the model regulatory entity. Section 1 (1) of the new Act refers to an “institution,” rather than a trust, perhaps clearing the way for new types of regulatory entity to become the norm in this area. At the same time, new regulatory entities have been introduced; notably the Charitable Incorporated Organisation (CIO) in the Charities Act 2006, as recommended by the Company Law Review; and the Community Interest Company (CIC) in Part 2 of the Companies (Audit, Investigation and Community Enterprise) Act 2004. The aims of the CIO and the CIC are meant to complement each other in the voluntary and social enterprise spheres. It is, for example, very clear that the CIC “is not a charity” (s. 26 (3) (a) of the 2004 Act) and charitable companies may not become CICs without the consent of the Charity Commissioners (s. 39 (1)). CICs are subject to a community interest test (s. 35 (2) and (3) of the 2004 Act) rather than the public interest test for charities in the 2006 Act.

However, it is suggested that the new English Charities Act, as a matter of law, takes the least ‘costly’ path of reform. Substantively, the new Act changes little to the content of the public benefit test. It is unlikely that any organisation which is recognised previously as charitable will be unable to satisfy the Commissioners, (or, ultimately, the Courts), that it is not still charitable under the new Act. The new statutory public benefit test will undoubtedly require an adjustment of focus amongst existing charities (and, to that extent, an adjustment of resources), but the institutions themselves should still be regarded as charitable as a matter of law.

¹⁶ [emphasis in the original] Mark J. Roe, “Chaos and Evolution in Law and Economics,” 109 *Harvard Law Review* (1996) 641, 647, 651

¹⁷ Oona A. Hathaway, “Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System,” 86 *Iowa Law Review* (2001), 602, 607, 627

¹⁸ Eva Micheler, “English and German Securities Law: A Thesis in Doctrinal Path Dependence,” 123 *Law Quarterly Review* (2007), 251, 254

Particularly given the specific exclusion of fee-charging charities from the public benefit test in Scotland, the absence of comparable provisions in the English Act means it is unlikely that the new Act will remove charitable status to organisations and institutions which are already recognised as such. Insofar as this reform may still provide charitable status to fee-charging charities, this can only be a beneficial maintenance of the status quo. But what can be criticised about the new Act is that there is still no clear policy as to the content of the law. If it is accepted as a non-partisan proposition that a culture of giving and a vibrant third sector is good in itself, any new Act should seek to break the path dependency of the present law by liberalising and simplifying the regulatory framework. As many organisations as possible which operate for the public benefit (fee-charging or not) should be given the opportunity to register as charities. Any future regulation should not seek to restrict current charitable activity on grounds of path dependency, but empower contemporary donors to generate their own paths to a philanthropic culture.

From ‘Charity’ to ‘Philanthropy?’

Perhaps the most important evidence of strong-form path dependency lies in the very words used to implement concepts and values within the regulatory regime. As noted above, the legal form is dominated by the idea of the trust, which may not prove appropriate to the more dynamic forms of voluntary activity and social enterprise. Professor Charles Mitchell and Susan Moody have made a notable criticism of the word ‘charity’ in precisely those terms:

The word increasingly carries with it somewhat antiquated and even unpalatable connotations of “do-gooding,” moral superiority, a patronising relationship between donor and recipient and the maintenance of inequality and power imbalances within society. It seems to offer little scope for reciprocity and inclusiveness.¹⁹

It is thus clear that the word ‘charity’ implies a normative value system which may not be appropriate for present society. The government’s Strategy Report, *Private Action, Public Benefit* also wrote of the need to develop a new critical vocabulary to describe the varieties of voluntary activity. It suggested as alternatives a number of phrases which enjoy currency in the present regulatory culture, including, ‘third sector,’ ‘social economy,’ ‘not-for-profit,’ and ‘social enterprise.’²⁰ Ultimately, however, the report concluded that,

Finding a brand name for the sector is important, but it is not something which it would be appropriate for the Government to do.²¹

Instead, *Private Action, Public Benefit* called for the emergence of a brand name from the sector itself.

In this spirit, this paper suggests that the word ‘philanthropy’ could be used as a descriptive word which is free of the normative implications of the word ‘charity’. ‘Philanthropy’ is also a word which enjoys popular usage to denote altruistic activity

¹⁹ Charles Mitchell and Susan R. Moody (eds), *Foundations of Charity* (Oxford: Hart Publishing, 2000),vi

²⁰ *Private Action, Public Benefit*, (London, Strategy Unit, September 2002), paras 2.1-2.8

²¹ *ibid.*, para 2.7

performed for the public benefit, and has been recognised as such by judges.²² It might, therefore, be more appropriate if future legislation or regulation used the word ‘philanthropy’ to encompass the varieties of voluntary activity in a value-free way. If the word ‘charity’ is no longer fit for purpose, it should be abandoned.

Against the use of the word ‘philanthropy,’ it could be said – perhaps with some truth – that the word in popular usage has connotations of the activities of wealthy people and even of wealthy American individuals. Professor Kathleen D. McCarthy’s study of contemporary and historical American philanthropy has acknowledged this point, and argued that:

...this coupling of lavish generosity with lavish wealth which has come to symbolize the essence of philanthropy would have puzzled most nineteenth-century Americans...for them, the term mean giving *and* volunteering, the personal excursions that large numbers of Americans regularly made into charity, communal self-help and social reform, mingling their donated time and often modest sums for public ends. Rather than the privilege of the few, it was the practice and prerogative of the many.²³

This vision of a pervasive ‘culture of giving’ amongst both rich and poor is attractive. Given a choice, therefore, between reclaiming the proper usage of the word ‘charity’ and the word ‘philanthropy,’ it is suggested that the latter term would be more useful because it is so different from the present language. Usage of a profoundly different word in future self-regulation and governance by philanthropic organisations, and in governmental regulation, would be a powerful signal to the public that the path dependency of the present regulatory regime is being broken. In this respect, it is again lamentable that the government did not recognise the need for path generation in this area itself. Whilst the present mismatch between the popular usage of the word ‘charity’ continues to jar with the legal regime, a new regulatory paradigm could emerge from current language to generate new paths for future philanthropic activity.

Governance and the European Context

At least to some extent, however, path dependency is a double-edged sword. Any future reform will need to be careful not to endanger some path dependent benefits of the present law. It was perhaps this concern which prevented more radical legislative reform in the current process. One important benefit of the present path dependency of the regulation of philanthropy is the use of fiduciary relationships as a governance mechanism. In charity law, as in companies and trusts, English law considers fiduciaries to labour under duties which impose strong duties of loyalty and selflessness in the management of the property under their care. There are strict remedial consequences for fiduciaries who create or exploit a conflict of interest or who indulge in self-dealing. Fiduciary duties are thus an important aspect of UK

²² “...the laws of this country [UK] place very few restrictions on the rights of philanthropic organisations such as this [Amnesty International]...” *per* Slade J, *McGovern v. Attorney-General* [1982] Ch 321, 354

²³ [emphasis in the original] Kathleen D. McCarthy, *American Creed: Philanthropy and the Rise of Civil Society 1700-1865*, (London: University of Chicago Press, 2003), 3

corporate governance, and also for the governance of charitable trusts and organisations.

The governance of the philanthropic sector has entered the European context due to concern of the European Union to prevent abuse by terrorist networks and other criminals that operate on a Europe-wide basis. In 2005, the European Commission circulated a document containing 'Draft Recommendations to Member States Regarding a Code of Conduct for Non-Profit Organizations to promote Transparency and Accountability Best Practices.' The Draft Recommendations recognised the need, "to acquire and maintain public trust and credibility of not for profit work," and, in particular, the prevention of, "misuse of NPOs to terrorist financing."²⁴ This process of consultation is still ongoing. But the tentative moves by the Commission sit in the broader context of the development of European-wide governance norms. One academic has understood the development of such a governance culture in these terms:

'governance' means the use of legal and political authority, wealth and information, to exercise control in the management of relationships and resources in the pursuit of social and economic ends.²⁵

Here, this broad definition of 'governance' is recognised to create an integrated governance regime which marries 'soft' self-regulation and codes of best practice with 'hard' criminal and administrative law. To the extent that any future European moves create such an integrated regime, this concept of governance can only be welcomed for the regulation of philanthropy.

It is unclear how the European context will develop after the farrago concerning the Constitutional Treaty. But what can be said is that the English law of fiduciaries has the potential to gel well with such governance norms that do emerge from the European context. Perhaps for this reason, significant aspects of the English company and insolvency law are now appreciated to lead academic and inter-governmental proposals for an integrated regime of European corporate governance. In the regulation of philanthropy, the English law of fiduciaries could also have the potential to lead Europe in the formulation of duties for officers of non-profit organisations. It may be that the European context will generate further paths for future philanthropic activity in the UK.

NGOs and International Investment Law

A final area in which new paths to new philanthropic regulation may be generated is the international context. In her influential book, *The Retreat of the State*, Professor Susan Strange has argued that "the shift away from states and towards markets is probably the biggest change in the international political economy," of contemporary times.²⁶ In a world dominated by global markets, the individual plays a greater role

²⁴ *Draft Discussion Document*, (22nd July 2005), A.2, A.4

²⁵ Tamara K Hervey, "The European Union and the Governance of Health Care," in Grainne De Burca and Joanne Scott (eds), *Law and New Governance in the EU and the US*, (Oxford: Hart Publishing, 2006), 179

²⁶ Susan Strange, *The Retreat of the State*, (Cambridge: CUP, 1996), 43

than the state in making value-judgments and determining policy. Particularly in a world where many High Net Worth individuals are wealthier than some countries, the international context of philanthropic activity is an important, if neglected aspect of the regulatory regime. As Dame Rosalyn Higgins (now President of the International Court of Justice) has argued, the NGO has become an important “participant” in international law, embodying a distinct set of objectives and values.²⁷ The international context is significant for a number of reasons. Firstly, from a domestic point of view, the UK is well-placed to engage in regulatory and cultural leadership of the global economy. The City of London enjoys a prominent status in the world financial system, and the wider area is home to colonies of highly-educated workers in the financial sector. These workers are often rewarded with high levels of remuneration. A more liberal regime for philanthropic activity in the UK (of both wealth and volunteering) could help to integrate these new London citizens within the domestic context, and deal with criticisms of the financial community that it is insular and awards itself disproportionately large remuneration. Greater philanthropic activity could also deal with criticisms which have been made of wealthy individuals who enjoy ‘non-domiciled’ status for tax purposes.²⁸

Secondly, and perhaps more importantly, philanthropic activity by NGOs in international law is moving far ahead of municipal law. This can be seen most clearly in the context of investment disputes. Typically, investment disputes concern privatised public utilities in developing countries, or concession agreements for the exploitation of natural resources or regulatory disputes as to the activities of a multinational enterprise within a developing state. Arbitration pursuant to investment treaties is intended to provide a direct remedy for multinationals against a foreign state which has expropriated the company’s property, thereby avoiding state-to-state confrontation. In this context, NGOs play an important role as advocates for environmental concerns or on behalf of local people affected by the privatisation or concession agreement. Such submissions to the tribunal are understood to be representative of a wider public interest. The recent procedural reforms of the International Centre for the Settlement of Investment Disputes (ICSID) are particularly illuminating. An editorial of the New York Times in 2004 criticised ICSID arbitrations for being, “secret trade courts,” that focused narrowly on investment questions, and ignored the public interest in proceedings involving states.²⁹ In response to this and other criticism, the Centre amended its procedure to provide for open justice in the form of compulsory public disclosure of awards and the public interest by allowing non-parties to make *amicus curiae* submissions.³⁰

²⁷ “...there are no ‘subjects’ or ‘objects’ [in international law] but only *participants*. Individuals are participants, along with states, international organizations (such as the United Nations, or the International Monetary Fund (IMF) or the ILO), multinational corporations and indeed private non-governmental groups.” Rosalyn Higgins, *Problems and Processes: International Law and How We Use With It*, (Clevedon Press: Oxford, 1994), 39

²⁸ See, e.g., Nick Mathiason, “Tax Loophole for Rich Costs £4.3bn,” *The Observer*, 9/9/07

²⁹ *The New York Times*, editorial of 27th September 2004, quoted in Andrew de Lotbinière McDougall and Ank Santens ‘ICSID Amends its Arbitration Rules,’ (2004) (4) *International Arbitration Law Review* 119

³⁰ *ibid.*, see also ICSID Secretariat, *Possible Improvements of the Framework For ICSID Arbitration* (2004), and the prescient analysis of the NAFTA decision (*Methanex Corp. v. United States of America, Decision of the Tribunal on Petitions from Third Persons To Intervene as ‘Amici Curiae’* (15th January 2001) which first permitted *amicus curiae* submissions by Patrick Dumberry, “The admissibility of *amicus curiae* briefs by

Rule 37 of the ICSID rules now provides for the admission of written submissions from non-disputing parties where it would (a) assist the tribunal; (b) address a matter in dispute; or where (c) the non-disputing party has a “significant interest” in the proceeding. Prior to the ICSID reforms in 2005, similar changes had already been made to the North American Free Trade Commission arbitral procedures. These were contained in the ‘interpretative statement’ issued in 2001.³¹ The statement allowed for the disclosure of awards and documents generated by the hearing, and for submissions from non-disputing parties.³² In para. B.6, it is stated that submissions from non-disputing parties are permitted where (a) they would assist the tribunal in the determination of an issue; (b) would address matters within the scope of the dispute; (c) the non-disputing party has a ‘significant interest’ in the proceedings; or, crucially, (d) “there is a public interest in the subject-matter of the arbitration.” The provisions are qualified to the extent that “neither disputing party is unduly burdened or unfairly prejudiced by such submissions.”³³ A precedent was set by the arbitral tribunal constituted under NAFTA in *Methanex v. USA*, which had been requested to accept submissions by NGOs as interveners. It was receptive to the idea. These developments reveal the freedom of movement of NGOs and other philanthropic organisations in the international context to be involved in investment disputes and the activities of sovereign states as a matter of the public interest.

Future Potential for Path Generation

It can only be concluded of the present law that the new Charities Act does not change as much as its opponents have feared nor as much as its proponents would wish. This paper has proposed an explanation of the deficiencies in the legal regulation of philanthropy in the UK based on the path dependency of the present regime. The new Act is arguably doctrinally path dependent on the old law for key concepts, values and legal precedents. The new Act seeks to build on the old regime, rather than to create a fresh start guided by a clear regulatory philosophy. Where more far-reaching change has been introduced in Scotland, the aim has been to *restrict* the present regulatory regime, rather than to introduce new regulatory policies to empower the future development of the philanthropic sector. It is contended that the surest way of creating a culture of giving in the UK is to liberalise, simplify and rationalise the regulatory framework of philanthropy.

In this respect, use of the word ‘philanthropy’ rather than ‘charity’ could do much to break the path dependency of the present regulatory regime. Liberalisation and simplification of the tax provisions affecting charities would also be a welcome move. The rationalisation of charitable purposes has not been achieved by the new Act, although the introduction of new regulatory entities can only be welcomed. On the assumption that any future UK government – regardless of political hue – will want to promote voluntary activity and social enterprise in order to cultivate a vibrant civil society and a socially engaged citizenry, it can hardly be denied that many

NGOs in investors-State arbitration: The precedent set by the Methanex Case in the context of NAFTA Chapter 11 proceedings,” (2001) 1 Non-St. Actors & Int’l L. 201

³¹ NAFTA Free Trade Commission Notes of Interpretation and Statements, 31st July 2001, in Charles H. Brower II, Jack J. Coe Jr., and William S. Dodge (eds.), *NAFTA Chapter Eleven Reports*, (2006), 138.

³² *Ibid.*, B.7 (b), 146.

aspects of the present regime fail to engage with the potential of contemporary philanthropy. The legal concept of ‘charity’ may have to evolve radically in the twenty-first century in order to accommodate the European and international contexts. Whilst in many respects the history of English and Scottish charity law is a great strength of the legal regulation – in that regulators, courts and legislatures have a rich seam of accumulated experience and case law to draw from – it can severely hinder the future development of the regulatory regime.

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John Townsend wrote this paper as an intern at the Institute for Philanthropy during the summer of 2007. He was called to the Bar in 2006 and will begin his period of training as a pupil barrister at a leading commercial Chancery set of chambers in the autumn of 2007. He hopes to develop expertise in charity law as part of a broad commercial Chancery practice in the near future.

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