

A GUIDE TO THE LAW FOR MEMBERS AND OFFICERS APPOINTED TO OUTSIDE BODIES

This advice is for Members and officers who represent the Council on organisations outside the Council, including as a company director, the trustee of a charity or a representative on a management committee. It sets out some of the most important responsibilities for individuals in such roles. It is not meant to be a comprehensive guide. If Members or officers have queries then advice should be sought from the Director of Democratic & Legal Services.

- 1.1 Local authorities are often asked to nominate Members, co-opted Members and officers to take part in organisations outside the Council. It may be as a company director on a local trust, a voluntary organisation, trustee of a local charity, a member of a housing association or as a school governor. In this guide “Member” includes a co-opted member of the Council. Much in this guidance also applies to those who are appointed by the Authority to represent it on outside bodies but who are not Members themselves.
- 1.2 This brief guidance cannot provide a complete or authoritative statement of the law, but is intended to highlight some of the key duties, responsibilities and potential liabilities.
- 1.3 A Member, who is asked to take part on an outside body, should ask the organisation for a clear statement of what will be expected of him/her. Members should be aware that the rules of the outside body and the Council might limit their ability to take an active part in discussions on particular topics within the Council.
- 1.4 As a member of the outside body, the Member will be expected to participate fully in that organisation. If the Member’s commitments mean that he/she will regularly have to miss meetings of the organisation, or be required to withdraw from meetings because of conflicts of interest, it will reflect badly on the Member and the nominating authority. If the Member neglects his/her responsibilities to that outside body it is possible to incur a personal liability.
- 1.5 Members are appointed by the Council annually to serve on a range of outside bodies, including voluntary organisations, local government associations, and companies formed to provide local services. In carrying out that role, they act both as individuals and as representatives of the Council.
- 1.6 What does that entail?

It entails:

- acting according to the rules, constitution and framework set by the outside body.
- making independent and personal judgements in line with their duty of care to the

- outside body.
- behaving ethically and complying with the ~~Council's Members'~~ Code of Conduct ~~for Members~~ except and insofar as it conflicts with any other lawful obligations to which that outside body may be subject.
- taking an active and informed role in the management of the outside body's affairs.

It does not entail:

- representing the political party to which Members owe their political loyalty.
 - looking at things simply from the Council's perspective.
- 1.7 The role of Members on outside bodies may give rise to occasional uncertainty and perhaps to conflicts of interest. In essence, if the outside body comes into conflict with the Council and the Member is a director, trustee or on the management committee of the outside body, it is likely that their prime duty would be to the outside body in the conduct of the outside body's affairs.
- 1.8 If there is a major dispute between the Council and the outside body, then the Member may be placed in an untenable situation. Ultimately, it is possible that the Member may find they are unable adequately to carry out their responsibilities properly, both as a Member and as a director, trustee or voting member on the management committee of the outside body. In such circumstances there is no alternative but to resign from one of the positions, however this would be an exception and should not deter Members from being prepared to participate in and contribute to the outside organisation. Should a Member, in these circumstances, decide to resign their position on the outside body, then this would result in a vacancy on the body which the Council would need to fill by nominating another Member. If however a Member decides to resign from their role as a Member, they could not continue on as a representative of the Council on the outside body in question and the effect would be that there would be a vacancy on the outside body.
- 1.9 Members are urged to seek advice at an early stage if they are unsure of their responsibilities.

2. GENERAL

- 2.1 There are some general provisions which apply to Members and officers who act in the role of company director, trustee or member of an incorporated body, such as the management committee of an unincorporated voluntary organisation.

Exercise of independent judgement

- 2.2 Members and officers on outside bodies are under a duty to exercise independent judgment in the interest of the organisation in which they are involved. Whilst it is recognised that Members and officers may have been appointed to represent the Council on the outside organisation, they must be aware that it is their responsibility to decide what view to take on any question before that organisation. Where a Councillor or officer is partaking in an outside organisation in a representative capacity, they must declare that fact to the organisation on taking up the appointment. If it is not possible to bring this to the attention of the organisation before the first meeting, then this should be done at the first meeting of the

organisation in question. There will be a fine line to tread between the duty to the organisation and to the Council.

- 2.3 Ultimately, the Member or officer in acting as a director/trustee or member of a management committee of an outside organisation must act in accordance with the interests of that organisation. A mandate from the Council to vote one way or the other would put the Member or officer in breach of duty to the organisation. It is permissible to take account of the Council's wishes, but not to vote simply in accordance with them. **The overriding duty in considering an item before the outside organisation is to vote in accordance with the interests of that organisation. If this is not possible then the Member/Officer should absent themselves from the consideration of the item and not participate in the decision on the matter.**
- 2.4 Members and officers on outside bodies must also ensure that avoidable loss is not incurred in managing the organisation. They cannot avoid this responsibility by not reading the papers or failing to ask for appropriate reports. They will be expected, where appropriate, to seek professional advice.
- 2.5 Under the Members' Code of Conduct, a Member appointed as the Council representative to a specific body will have a Disclosable Pecuniary Interest (DPI) if that office is carried on for profit or gain has a personal interest and which must be declared and forms part of that Member's register of interests held by the Council. A Member may also have a Disclosable Pecuniary Interest in relation to a body, where they have a beneficial interest in that body within the meaning of the Relevant Authorities (Disclosable Pecuniary Interests) Regulations 2012 ("The Regulations"). Such an interest occurs where the Member or their Spouse/Partner is a partner of a firm or director of a body corporate or where it relates to securities in which the Member or their Spouse/Partner has a beneficial interest This also requires the Member to disclose the existence and nature of the interest whenever the Member wishes to speak on the matter at a meeting of the Council. Members will also need to consider whether the personal interest also gives rise to a prejudicial interest in the circumstances. Where a DPI exists, the Member may not participate in any discussion or vote on the matter unless they have been granted a dispensation to do so.
- 2.6 Member duties as directors, or trustees or as members of a Management Committee may well be regarded, on an objective appraisal, as giving rise to a legitimate perception of lack of impartiality, especially having regard to the desirability of maintaining public confidence. Members will be aware that participation in the making of a decision by a Member disqualified by bias vitiates the decision. In these circumstances legal advice should be sought prior to participating. If for example the Member simply participated in a decision making forum, bias is unlikely to arise. Similarly for membership of an advisory or consultative body a Court is unlikely to assume bias unless that body had determined a line which is being advocated by the Member.

Reasonable Diligence

- 2.7 Members must also exercise reasonable diligence in managing the affairs of the organisation, and not expose the organisation or its creditors to avoidable loss by

failing to do so. As indicated above, this responsibility cannot be avoided by irregular attendance at meetings, not reading the papers or failing to ask for appropriate reports.

Observers

- 2.8 The same rules do not apply to Members who attend meetings of outside bodies unambiguously as observers. Observers can participate in discussions but will not have a vote. Whilst the result of the observer's participation may influence the outcome of discussions, they should avoid purporting to issue instructions or directions to the directors of the company. This could lead to the observer assuming the status of a "shadow director", in which case they, or the Council, could assume the responsibilities and liabilities of an ordinary director.

3. TYPES OF OUTSIDE BODY: SUMMARY

Companies

- 3.1 On incorporation a company becomes a separate legal entity, which can hold property in its own right, enter into contracts and sue and be sued in its own name. Companies are separate legal entities, which are set up by their members, who may be either shareholders or guarantors. The company is distinct from its shareholders and members. The structure of the company, and its powers, in terms of the activities, which it may undertake, and its powers to buy and sell land, employ staff or enter contacts are defined in its Memorandum and Articles. Directors of companies can incur personal liability, particularly if the company becomes insolvent.
- 3.2 Industrial and Provident Associations (IPAs), are similar to companies, but the member's liability is limited to their annual subscription to the association. Where a company is a trust, it is not permitted to distribute any profit to its shareholders, but must ensure that any profit is ploughed back into the business. Trust companies are normally limited by guarantee, and this form of company is the most usual form in the public and voluntary sector, particularly where charitable status is sought.

Company limited by shares

- 3.3 Companies limited by shares are those, which have a share capital (e.g. 1000 shares of a £1 each). Each member of the company holds shares, which entitle the holder to a share of the profits that the company makes. Shares are assets, which can be sold on.

Company limited by guarantee

- 3.4 In a company limited by guarantee, the personal liability of a member is limited to the value of their guarantee which may be as little as £1. The majority of the companies that the Council makes nominations to are "not for profit" organisations and as such are usually limited by guarantee. There are no shareholders in this type of company. Instead each member agrees that in the event of the company being wound up, they will agree to pay a certain amount. Membership is not an

asset, which can be sold on to someone else.

Industrial & Provident Societies

- 3.5 Industrial & Provident Societies (IPS) are ~~corporations under the jurisdiction and control of the Registrar of Friendly Societies. They are~~ organisations formed to carry out industry, trade or business, which are either bona fide co-operative societies or intended to be conducted for the benefit of the community. Mainstream company law does not govern them but they share certain similar characteristics. IPS members have limited liability, in the same way as directors of companies. Board members also have an overriding obligation to act at all times in accordance with the interests of the organisation. Their duties and liabilities are comparable to those of company directors. Housing Associations are typically incorporated as Industrial & Provident Societies and Members serving on these organisations are advised to ensure that they are familiar with the National Federation of Housing Association's Code of Governance entitled Competence and Accountability.

Unincorporated Associations

- 3.6 Unincorporated associations are more or less informal organisations, in which the members regulate their relationship by a contract, such as a membership agreement or the rules of the club or association. The association has no legal existence separate from its members so there can be no limited liability. Each member incurs full personal liability for his/her own actions, and relies on the membership contract to be able to recover his/her costs from the other members.

Statutory Corporations

- 3.7 These are bodies which are set up under statutes. There is a wide range of such statutory corporations, including school governing bodies, universities, NHS Trust, combined Police and Fire Authorities and many "quangos" (Quasi Governmental Organisations). The members of the statutory corporation, such as governors of a school and the board of a care trust, and how they are appointed is set out in the statute, as are the powers of the statutory corporation. That statute will also set out the responsibilities and liabilities of members of the corporation.

Charities

- 3.8 Some companies and unincorporated associations are also charities. Charities are organisations set up for the benefit of the community. They enjoy some tax advantages from the government. While they can in certain circumstances trade for profit, they must use any such profit for the purposes of the charity. To qualify as a charity, an organisation has to meet strict conditions about its overall purposes, also referred to as its objects, including demonstrating that its purposes are for the public benefit. The organisation also has to be set up with a constitution or rules which meet certain conditions. These rules are usually referred to as a charity's governing document.

Charitable Incorporated Organisation

- 3.9 The Charities Act 2006 introduced the charitable incorporated organisation (CIO), a

new incorporated vehicle specifically designed for charities. It provides a legal identity separate from the members of the organisation (whose liability will be limited). Conversion from a corporate entity to a CIO will not be compulsory.

- 3.10 The 2006 Act specifies formal requirements for a CIO, such as a full written constitution, and provisions regarding name and status, together with the procedure for registration.
- 3.11 Also included are provisions which allow charity trustees to receive payment for providing additional or business services to the charity (subject to safeguards to ensure the principle of voluntary trusteeship remains) and a power for trustees to take out indemnity insurance without seeking permission.

4. COMPANIES

- 4.1 The management of a company (whether limited by share or guarantee) is generally the responsibility of a board of directors. The powers of the directors are usually set out in the company's Articles of Association (the rules each company has to govern its internal management). Sometimes even though a company has been incorporated the directors may be referred to as members of the management committee, governors or even trustees. However this does not change their status as directors. Conversely, sometimes officials are called directors but they are not members of the board. Again their status will not be affected. Directors are those who are appointed by the company to act in that capacity.

Director's General Duties

- 4.2 A 'director' is defined to include any person occupying the position of director by whatever name called. A director is an agent of the company. The duties are owed to the company. Where more than one duty applies, the directors must comply with each applicable duty.
- 4.3 The law relating to companies was recently changed by the Companies Act 2006. This had the effect of putting director's duties on a statutory footing, clarifying what had previously been referred to as the common law and fiduciary duties.
- 4.4 The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles.
- 4.5 The duties are contained in Sections 171 – 177 of the Companies Act 2006 and are as follows:

Duty to act within powers (Section 171)

- 4.6 A director of a company must act in accordance with the company's constitution, and only exercise powers for the purposes for which they are conferred.

Duty to promote the success of the company (Section 172)

- 4.7 A director of a company must act in the way he considers, in good faith, would be most likely to promote the *success* of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
- the likely consequences of any decision in the long term,
 - the interests of the company’s employees,
 - the need to foster the company’s business relationships with suppliers, customers and others,
 - the impact of the company’s operations on the community and the environment,
 - the desirability of the company maintaining a reputation for high standards of business conduct, and
 - the need to act fairly as between members of the company.
- 4.8 The duty will apply to all decisions made by a director, not merely formal decisions made by the whole board.
- 4.9 The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

Duty to exercise independent judgment (Section 173)

- 4.10 Like a Member in respect of Council decisions, the director is under a duty to exercise independent judgment. This will not prevent directors relying on advice, as long as the directors exercise their own judgement in deciding whether or not to follow the advice.
- 4.11 The director cannot vote simply in accordance with the Council mandate. To do so would be a breach of duty.

Duty to exercise reasonable care, skill and diligence (Section 174)

- 4.12 A director of a company must exercise reasonable care, skill and diligence. This duty has both an objective and subjective aspect and means the care, skill and diligence that would be exercised by a reasonably diligent person with—
- the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
 - the general knowledge, skill and experience that the director actually has.

Duty to avoid conflicts of interest (Section 175)

- 4.13 A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.
- 4.14 This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity). Interests in contracts will need to be declared.
- 4.15 Reference in this section to a conflict of interest includes a conflict of interest and

duty *and* a conflict of duties. Where there is a conflict of duty or a conflict of interest not authorised by the Board, the only proper way for the conflict to be resolved may be for the Councillor or officer to resign either from the company or from the Council and specific legal advice should be sought on this aspect.

Duty not to accept benefits from third parties (Section 176)

- 4.16 A director of a company must not accept a benefit from a third party conferred by reason of his being a director, or his doing (or not doing) anything as director.
- 4.17 This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.

Duty to declare interest in proposed transaction or arrangement (Section 177)

- 4.18 If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors.
- 4.19 Unlike Council Members in relation to Council business, this matter does not only arise when the Director attends a meeting at which such business is discussed but is a general requirement. However, this section does not require a declaration of an interest of which the director is not aware or where the director is not aware of the transaction or arrangement in question. For this purpose a director is treated as being aware of matters of which he ought reasonably to be aware.
- 4.20 The director need not be a party to the transaction for the duty to apply. An interest of another person in a contract with the company may require the director to make a disclosure under this duty, if the other person's interest amounts to a direct or indirect interest on the part of the director.
- 4.21 Any declaration required by this section must be made before the company enters into the transaction or arrangement.

Other

- 4.22 Directors must ensure compliance with the Companies Act in relation to the keeping of accounts, and that the relevant returns are made to the Registrar of Companies. Failure to do so incurs fines and persistent default can lead to disqualification as a director.
- 4.23 If the Company employs staff or contractors then directors should ensure compliance with other legislation including health and safety etc.

Directors' Liabilities

- 4.24 The main instances when directors can be personally liable are as follows:

Ultra vires acts

- 4.25 A company can only act within the scope set out in its Memorandum of Association (the document which sets out the objects of the company). Those directors knowingly causing the company to act beyond the activities (i.e. acting *ultra vires*) set out in the Memorandum will be liable personally. In very limited circumstances it is possible for the *ultra vires* actions of the directors to be ratified by the members of the company.

Breach of trust

- 4.26 A director may also be liable for breach of trust, if he/she misapplies the money or property of the company. Directors may also be liable if they fail to take action to prevent the breach of a co-director of which he/she is aware.

Breach of duty

- 4.27 In the event of failure to act in accordance with the best interests of the company, or if a director uses his/her powers improperly or makes a personal profit from his/her position as director, then the director may be personally liable for loss to the company and may be required to give to the company the personal profit made.

Negligence

- 4.28 If the level of skill and care shown by a director falls below that which could be reasonably expected and the company suffers loss, the director will be liable for the loss incurred. However if it believes the director acted honestly and reasonably, a Court may waive the liability of the director.

Wrongful trading

- 4.29 If a company continues to trade despite the fact that the directors know or ought to know that there is no reasonable prospect of the company meeting its liabilities, there will be "wrongful trading". Where a director participates in wrongful trading, a Court may require that director to meet any creditors additional losses resulting from the failure of the company to cease trading as soon as it knew that it could not remain solvent. No such order will be made if the Court is satisfied that the director took all reasonable steps to minimise the loss to the creditors. If a director has concerns about the company's financial position he/she could be well advised to inform the other directors and seek advice from the company auditors. The directors should try to ensure that further debts are not incurred.

Fraudulent trading

- 4.30 A director will also be liable if to their knowledge the company carries on business with intent to defraud creditors or any other person, or for any other fraudulent purpose. Fraudulent trading can also lead to disqualification from acting as a director.

Liability as signatory

- 4.31 All cheques and similar documents, which purport to be signed on behalf of the

company, must bear the company name. Where they do not the director signing on behalf of the company may be liable to a fine and may also be liable to the payee if the company fails to honour the cheque. It is therefore wise for directors to make sure that all documents they sign on behalf of the company state very clearly that they act as agent for the company, (e.g. Director, for and on behalf of...).

Breach of warranty of authority

- 4.32 A third party who enters into a contract on the assumption that a director has power to bind the company, may be able to claim damages against the director if it subsequently transpires that the director had no such power. Directors would be well advised to ensure that the board approves contracts and the authority to enter into any contract has been properly delegated before signing it.

Failure to comply with Companies Acts and other legislation

- 4.33 For example, the company's identity must clearly be shown on its stationery. The company number, place of registration, registered office address and if any of the directors' names are shown then they must all appear. Non-compliance is an offence and the directors and company officers can be fined.

Liability after dissolution

- 4.34 Though company liability ceases on dissolution the liability of the directors (if any) may still be enforced after dissolution.

Shadow Director or Observer?

- 4.35 A shadow director is someone who whilst not being a properly appointed director of the company, is someone in accordance with whose directions or instructions the directors of a company are accustomed to act. If deemed to be a shadow director the individual, or the organisation they represent (in this case the Council), could assume the responsibilities and liabilities of an ordinary director.
- 4.36 Provided that Council representatives who attend as an observer do not purport to issue instructions or directions to the directors of the body in question there should be little or no risk of them being held shadow directors. It is clear that a person is not deemed to be a shadow director by reason only that the directors act on advice given by them in a professional capacity.
- 4.37 In order to show that to establish that a person is a shadow director it is necessary to prove that:
- a. the person directed the directors of the company how to act in relation to the company;
 - b. the directors acted in accordance with such direction; and
 - c. that they were accustomed to so act.

4.38 Accordingly, it is not considered that an observer would be held to be a shadow director merely on account of the fact that he/she participated in a discussion and expressed an opinion or offered advice.

5. INDEMNITIES AND INSURANCE

5.1 Members who are directors cannot be indemnified by the company against liability arising out of negligence, default, or breach of duty or trust. However the company's Articles of Association may allow for directors to be indemnified by the company in respect of the cost of defending such proceedings if the director is granted relief by the Court or acquitted. Equally, in making the appointment, the Council can offer an indemnity against losses which the Councillor may suffer through acting conscientiously as a director. **But note that it is lawful for companies to purchase insurance to protect its directors against claims of negligence, breach of duty, trust, default. Directors would be well advised to ensure that such a policy of insurance is maintained at all times.**

5.2 Under the Local Government Act 2000, and The Local Authorities (Indemnities for Members and Officers) Order 2004 it is possible for the Council to provide indemnities for Members or officers when appointing them to act as directors, and to buy insurance to cover any losses which they may suffer through acting conscientiously as a director. The Order does place certain restrictions on what may be indemnified and cannot include acts or omissions which constitute a criminal offence or fraud, deliberate wrongdoing or recklessness. The first recourse should, however, be to ensure that the Company had provided such insurance.

6. LOCAL AUTHORITIES (COMPANIES) ORDER 1995

6.1 This Order, made under the Secretary of State's powers contained in Part V Local Government and Housing Act 1989, set out rules concerning local authorities' involvement in "regulated companies" which were subject to extensive controls.

6.2 "Regulated companies" are so defined if they are controlled or influenced by the local authority. "Influenced companies", under the effective control of the local authority, will be subject to capital finance regime and special propriety controls. In broad terms, the test as to whether companies are local authority influenced is whether the local authority has the right to or in fact does exercise a dominant influence over the company in question. These provisions will be replaced by provisions in the Local Government and Public Involvement in Health Act 2007 when they come fully into force, see section 7 below.

6.3 The definitions of "controlled and "influenced Companies now only apply in respect of payment to "regulated directors" ("Councillors/Members") who are directors of outside companies to which they have been nominated by the Council.

6.4 Members are under the following obligations:-

(a) that the remuneration they receive from the company should not exceed that

which they could have received from a local authority for performing a comparable duty less any amount paid by the authority in respect of the relevant duty to the councillor in question, and should be declared;

- (b) that travel and subsistence is paid at the authority's rates and
- (c) to cease to be a director immediately upon disqualification as a Councillor or termination of their employment by the Council.

6.5 Officers shall:

- (a) not receive any fee or reward other than their Council salary, unless so agreed with the Council; and
- (b) cease to be a director immediately upon termination of their employment by the Council.

7. LOCAL GOVERNMENT AND PUBLIC INVOLVEMENT IN HEALTH ACT 2007

7.1 Part V of the 1989 Act has been replaced by Part 12 of the Local Government and Public Involvement in Health Act 2007 (LGPIHA). Sections 212 – 215, 216(3) to (5), 217-218 came into effect on 30 December 2007. The Commencement Date for the remaining provisions which revoke Part V of the Local Government and Housing Act 1989, has still not been published.

7.2 Section 212 gives the power to the Secretary of State to make an order regulating specified actions by entities connected with a local authority; or regulating specified actions by a Council in relation to such an entity or certain members or officers of a local authority; or relating to all local authorities or particular types of local authorities and/or all entities or particular types of entities.

7.3 The LGPIHA inserts a number of new definitions. An "Entity" means "any entity whether or not a legal person" and includes unincorporated entities, all types of delivery vehicles and trusts. An entity is regarded as being "Connected with the local Authority" if it is an entity which "according to proper practices in force at that time, the financial information about the entity must be included in the Local Authority's statement of accounts (Section 212 (6)). Reference to "Proper Practices" is reference to the Code of Practice on Local Authority Accounting in the UK – A Statement of Recommended Practice ("SORP") as published by the Chartered Institute of Public Finance and Accountancy (CIPFA).

7.4 An entity would have to appear in the Local Authority's accounts if it is a "subsidiary" and "associate" or a "joint venture" Each of these terms is defined in turn. An entity is a:

- (a) "Subsidiary" if the local Authority is about to exercise "control" (i.e. "dominant influence") over operating and financial policies of the entity and gains benefits from the entity or is exposed to risk of potential losses;
- (b) "Associate" if the local Authority has a participating interest in the entity and is able to exercise "significant influence" over the entities' operating and financial policies;

- (c) “Joint Venture” if the local Authority has a long term interest and jointly controlled by the local authority and another/others.
- (d) “Simple investment” if the local Authority has a limited influence or interest.

8. CHARITIES AND TRUSTS

- 8.1 Charities are organisations set up for the benefit of the community. While they can in certain circumstances trade for profit, they must use any such profit for the purposes of the charity.
- 8.2 To qualify as a charity, an organisation has to meet strict conditions about its overall purposes, also referred to as its objects, including demonstrating that it operates for the public benefit and have exclusively charitable purposes¹. An organisation which operates for political purposes will not qualify for charitable status.
- 8.3 These requirements are set out in the Charities Act 2006. The organisation also has to be set up with a constitution or rules which meet certain conditions. These rules are usually referred to as a charity’s governing document.
- 8.4 Several kinds of organisation can qualify as a charity. For instance, some charities are also registered companies, while others are trusts. Some charities are also setup by special legislation. All are subject to the general principles of charity law.
- 8.5 Those responsible for the control and administration of a charity are referred to as its trustees, even where the organisation is a company limited by guarantee even though they are not strictly trustees. Trustees of a charity retain personal liability, and can only delegate to the extent that the constitution authorises them so to do.

Trustees Duties

- 8.6 Trustees must act reasonably and prudently in all matters relating to the charity and must always bear in mind that **their prime concern is the charity’s interests**. The charity’s income and property must be applied only for the purposes set out in the governing document.
- 8.7 Although there are many names for trustees, their central responsibilities are the

¹ The charitable purposes must be one of the following:

- the prevention or relief of poverty
- the advancement of education
- the advancement of religion
- the advancement of health or the saving of lives
- the advancement of citizenship or community development
- the advancement of the arts, culture, heritage or science
- the advancement of amateur sport
- the advancement of human rights, conflict resolution or reconciliation or the promotion of religions or racial harmony or equality and diversity
- the advancement of environmental protection or improvement
- the relief of those in need by reason of youth, age, ill-health, disability, financial hardship or other disadvantage
- the advancement of animal welfare
- the promotion of the efficiency of the armed forces of the Crown

same in all cases. However, there are two main types of charity – unincorporated and incorporated. The exact legal position of trustees is slightly different in each.

8.8 **‘Unincorporated charities’**: These may be ‘trusts’ or ‘associations’. Their governing document will usually be a trust deed or a constitution or a Scheme of the Charity Commission. In an unincorporated charity, the property of the charity is usually held by the trustees or their nominees.

8.9 **‘Incorporated charities’**: Most of these are charitable companies registered with Companies House as well as the Charity Commission. Here, the Company is a legal entity in its own right, and the trustees are the directors of the company. There are also other types of special incorporated charities e.g. charities incorporated by Royal Charter or by statute. These are not regulated by Companies House.

8.10 Before becoming a trustee, councillors should find out whether the charity is incorporated or not, as this will affect their legal position and responsibilities.

8.11 Trustees have the following duties:

Compliance :

- Ensure that the charity complies with charity law, and with the requirements of the Charity Commission as regulator; in particular ensure that the charity prepares reports on what it has achieved and Annual Returns and accounts as required by law.
- Ensure that the charity does not breach any of the requirements or rules set out in its governing document and that it remains true to the charitable purpose and objects set out there.
- Comply with the requirements of other legislation and other regulators (if any) which govern the activities of the charity for example in relation to tax or land matters.
- Act with integrity, and avoid any personal conflicts of interest or misuse of charity funds or assets and not to make a private profit from their position.

Duty of prudence:

- Ensure that the charity is and will remain solvent.
- Use charitable funds and assets reasonably, and only in furtherance of the charity’s objects.
- Avoid undertaking activities that might place the charity’s endowment, funds, assets or reputation at undue risk and exercise care in relation to maintaining the value of permanent endowments
- Take special care when investing the funds of the charity, or borrowing funds for the charity to use.

Duty of care:

- Use reasonable care and skill in their work as trustees, using their personal skills and experience as needed to ensure that the charity is well-run and efficient.
- Consider getting external professional advice on all matters where there may be material risk to the charity, or where the trustees may be in breach of their duties.
- The Trustee Act 2000 sets out what it calls the 'duty of care' – to exercise

such care and skill as is reasonable in the circumstances having particular regard to any special knowledge or experience that the trustee has or professes to have; and where a trustee acts in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

- Narrowly speaking, the statutory duty of care only applies to trustees of unincorporated charities who are exercising specified powers conferred on them by the Trustee Act 2000. It also applies when such trustees exercise the same type of powers derived from a source other than that Act.
- The Trustee Act 2000 does not apply to incorporated charities, but the principles of general charity law impose similar duties and requirements on trustee directors to those set out above.

Fairness and objectivity:

- The charity's expenditure must be applied fairly among people who are properly qualified to benefit from it. The trustees of charities with permanent endowment must maintain a fair balance between the interests of present and future beneficiaries, for example when selecting investments.

Accumulation of surpluses:

- The income of a charity must be applied for its purposes within a reasonable period of receipt, unless the trustees have an explicit power to accumulate it. Without such a power, the trustees should not allow the charity's income to accumulate unless they have a specific use for it in mind. If the trustees are allowed discretion about the use of the charity's property, but are in any doubt about the proper use of that discretion, they should ask us for advice

Personal conduct of trustees:

- Trustees must not let any personal views or prejudices affect their conduct as trustees.

Conflict of interest:

- Where trustees are required to make a decision that affects the personal interests of one of the trustees, the charity's governing document may require that that person should not be present at any discussion or vote on the matter. Even if the governing document does not require this, trustees should follow this procedure as a matter of good practice.

Personal Liability of Trustees

- 8.12 The Charity Commission offers information and advice to charities on both legal requirements and best practice to help them operate as effectively as possible and to prevent problems arising.
- 8.13 If trustees act prudently, lawfully and in accordance with the governing document, then any liabilities (i.e. debts or financial obligations) that they incur as trustees can normally be met out of the charity's resources. However, if trustees incur liabilities or debts that amount in total to more than the value of the charity's assets they may not be able to cover themselves in full out of the charity's property, even if the liabilities have been properly incurred.

- 8.14 If the trustees act imprudently, or are otherwise in breach of the law or the governing document, they may be personally responsible for liabilities incurred by the charity, or for making good any loss to the charity. Since trustees act collectively in running a charity, they will usually be collectively responsible to meet any such liability.
- 8.15 In respect of incorporated charities, different rules apply to the directors of charitable companies, as company law also applies; this confers limited liability on trustee company directors. The general principles of prudence are, however, the same.
- 8.16 In the few cases where serious problems occur the commission has wide powers to look into them and put things right. Trustees may be personally liable for any debts or losses that the charity faces as a result. This will depend on the circumstances and the type of governing document for the charity. However, personal liability of this kind is rare, and trustees who have followed the requirements will generally be protected. If in doubt, always consult the Charity Commissioners. A trustee who does so will avoid personal liability for breach of trust if they act in accordance with the advice given.

Resigning

- 8.17 **Incorporated charities:** It is generally straightforward for a trustee of an incorporated charity to resign, unless the number of trustees would then drop below the minimum set out in the governing document. In such cases, a new trustee must first be appointed to replace the outgoing one. In all cases the trustee should check the terms of the governing document.
- 8.18 **Unincorporated charities:** In the case of an unincorporated charity, the situation can be more complicated. As above, any resignation must be handled as set out in the governing document. If the governing document does not say anything about this, a legal framework is set out (in the Trustee Act 1925), for how trustees may deal with the situation. Trustees should get proper advice to ensure they act correctly.

Can a charity insure trustees against personal liability?

- 8.19 Where it is in the interests of the charity, trustees can be insured by their charity against personal liability.
- 8.20 Where reasonable to do so, trustees can insure the charity out of the charity's funds against liabilities to third parties arising from acts properly undertaken in the administration of the charity. This is not a trustee benefit, and explicit authority to buy this type of insurance is not required.
- 8.21 The Charities Act 1993 (as amended) allows almost all charities to buy trustee indemnity insurance policies. There are certain limitations – for example, the policies cannot include cover for criminal fines or penalties, a trustee's costs in defending criminal proceedings if he or she is convicted of fraud, dishonesty or reckless conduct, or where the trustee's liability results from a deliberate disregard of the interests of the charity.

Local authorities nominating trustees

- 8.22 Persons who are appointed trustees of a charity must exercise their own judgement as to the best interests of the charity. It is not part of their function to represent the body appointing them or to carry out the wishes or discharge the statutory duties of the body appointing them. In exercising a power of appointment a local authority's sole concern is to ensure that it selects a fit and proper person to act. A power to appoint trustees is considered to be a fiduciary power: this means that it must be exercised in the interests of the charity and not in the interest of the person who exercises it.

9. MANAGEMENT COMMITTEES

Unincorporated Associations

- 9.1 Groups which are not charitable trusts or limited companies are "unincorporated associations" and have no separate legal identity from their members. The rules governing the members' duties and liability will be set out in a constitution, which is simply an agreement between the members as to how the organisation will operate. Usually the constitution will provide for a management committee to be responsible for the everyday running of the organisation. An unincorporated organisation may be charitable and may register as a charity.
- 9.2 Property will have to be held by individuals as the organisation has no existence of its own.

Duties

- 9.3 Broadly, Management Committee members must act within the constitution, and must take reasonable care in exercising their powers.

Liabilities

- 9.4 Generally, the Management Committee members are liable for the acts of the organisation, but are entitled to an indemnity from the funds of the organisation if they have acted properly. If there are not enough funds, the Committee members are personally liable for the shortfall.
- 9.5 If one person is appointed by the constitution to act as the agent of the organisation for certain purposes, then that person acts as the agent of all the members, who have joint liability for the agent's actions.
- 9.6 Members of the Management Committees will have personal liability if they act outside the authority given to them or if they do not comply with statute e.g. the payment of employees' tax etc.

Indemnities

- 9.7 Members will be entitled to an indemnity if they act in accordance with the constitution and are not at fault. It is possible to obtain insurance but if the

organisation is to pay the premium it must be permitted by the constitution.

Fraud, Misappropriation or Poor Financial Control

- 9.8 Some of the organisations that Members find themselves serving on may receive funds directly for the Council, usually via a grant. Where this is the case, the Council has a statutory responsibility to ensure the proper administration of the funds made available to such groups or organisations.
- 9.9 Members who suspect fraud, misappropriation or poor financial control in organisations supported by Croydon should contact the Head of Audit and Anti-Fraud.
- 9.10 Those Members who suspect fraud, misappropriation or poor financial control in organisations not supported by Croydon should contact the appropriate regulatory body such as the Charity Commission or the body providing funds for the organisation.

10. SCHOOL GOVERNORS

- 10.1 Local Education Authority (LEA) governors are the appointed representatives of the LEA on a school's governing body. They may present the LEA's view in the same way as other categories of governors represent the views of their constituency.
- 10.2 However, LEA governors are not delegates and will not be mandated by the LEA to take any particular line. Governors' first loyalty should be to their school and the community it serves. LEA's should appoint governors who are best qualified to help schools improve. Once appointed a governor's priority is to contribute to raising standards at the school.
- 10.3 All prospective governors other than those put forward by Members, must attend a pre-appointment induction seminar as a condition of appointment.
- 10.4 Each newly appointed governor is provided with a 'starter pack' containing the governor training programme, newsletter, Trigger information pack, telephone helpdesk phone numbers and information on the governor resource library. Governors can obtain the 'Guide to the Law' from their school and the Good Governance Resource Folder is held in the school for governors to refer to.
- 10.5 Please address any queries you may have to the Governor Services.

11. FURTHER INFORMATION

- 11.1 There are numerous useful websites available to consult including those of:-

The National Council for Voluntary Organisations
The Local Government Association
The Charity Commission
Companies House

Julie Belvir

Director of Democratic & Legal Services
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