

A GUIDE TO THE LAW FOR COUNCILLORS AND OFFICERS ON OUTSIDE ORGANISATIONS

This advice is for councillors and officers who represent the Borough Council on organisations outside the Council, whether as a company director, the trustee of a charity or a representative on a management committee. It simply sets out some of the most important responsibilities. It is not meant to be a comprehensive guide. If councillors or officers have queries then advice should be sought from the Solicitor to the Council.

1 GENERAL

- 1.1 There are some general provisions which apply to councillors and officers who act in the role of company director, trustee or member of an incorporated body, such as the committee of management of an unincorporated voluntary organisation.
- 1.2 Members are under a duty to exercise independent judgement in the interest of the organisation in which they are involved. Whilst it is recognised that councillors and officers may have a commitment to representing 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, he/she must declare that fact to the organisation. There will be a fine line to tread between his/her duty to the organisation and to the Council.
- 1.3 Generally the councillor or officer in acting as a director/trustee or member of a management committee of an organisation, must act in accordance with the interests of that organisation. A mandate from the Council to vote one way or the other might well put the councillor or officer in breach of the duty to the organisation. It is permissible (and, very often, appropriate) to take account of the Council's wishes, but not always to vote simply in accordance with them. The normal duty in considering an item before the outside organisation is to vote in accordance with the interests of that organisation. If the councillor or officer feels this will lead to conflict with his/her duties to the Council, then the best course is to abstain.
- 1.4 Councillors and officers 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 to seek professional advice where appropriate.

2 COMPANIES

- 2.1 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. The company is distinct from its shareholders and members. In the case of a limited liability company, the liability of members of the company is limited to the amount they paid or agreed to pay when they joined the company. This can be as little as £1.
- 2.2 Companies limited by shares are those which have a share capital (eg 1,000 shares of £1 each). Each member holds shares and receives a share in the profits made by the company according to the value of the shares held. Shares can be sold. Companies limited by guarantee are those where there is no shareholding. Instead each member agrees that in the event of the company being wound up they will agree to pay a certain amount. This may also be as little as £1. This form of company is the

most usual in the public and voluntary sector particularly where charitable status is sought.

2.3 The management of a company 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 committee of management, 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.

2.4 Directors' Duties

A director is an agent of the company. His/her prime duties are as follows:

- (1) A fiduciary duty to the company (not individual shareholders) to act honestly and in good faith and in the best interests of the company as a whole. Directors are therefore in a position of "quasi trustees" who must take proper care of the assets of the company. The fiduciary duty of the director towards the company is very similar to the fiduciary duty of councillors to the Council tax payer of the Borough of Havant.
- (2) A general duty of care and skill to the company, but a director requires no greater skill than might reasonably be expected of someone of that individual's particular knowledge and experience. A director is not deemed to be an expert, but is expected to use due diligence and to obtain expert advice if necessary.
- (3) Like a councillor in respect of Council decisions, the director is under a duty to exercise independent judgement, though it is permissible for him/her to take account of the interests of a third party which he/she represents. In such a case the director must disclose that position and treads a fine line between the interests of the company and the party represented (in this case the Borough Council). The director cannot vote simply in accordance with the Council mandate. To do so would be a breach of duty.
- (4) No conflict. There may be actual or potential conflicts between the interests of the Council and the interests of the company. In such circumstances and in the event that the actual or potential conflict cannot be resolved the councillor or officer may need to consider resigning from the company. Advice should always be sought from the Solicitor to the Council where such cases arise.
- (5) Directors are not allowed to make a profit from their position. They must therefore disclose any interests they or their family may have in relation to the company's contracts. Whether they are then allowed to vote will depend on the Articles of Association.
- (6) Directors must ensure compliance with the Companies Acts 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.

2.5 Directors' Liabilities

- (1) 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.

- (2) 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 set out in the Memorandum will be liable personally. In very limited circumstances it is possible for the actions of the directors to be ratified by the members of the company.
- (3) 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 by a co-director of which they are aware.
- (4) 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.
- (5) 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 excuse the director the liability.
- (6) If a director knows or ought to know that there is no reasonable prospect of the company avoiding liquidation, a Court may require that director to contribute to the company's assets on liquidation if the company continues to trade. This is known as wrongful trading. 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. He/she should try to ensure that further debts are not incurred.
- (7) A director will also be liable if to his/her 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.
- (8) 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 (eg Director, for and on behalf of).
- (9) 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 contracts are approved by the board and that the authority to enter into any contract has been properly delegated before signing it.

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

2.6 Indemnities

Directors cannot be indemnified by either the Council or 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. 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.

2.7 Local Authorities (Companies) Order 1995

- (1) This Order, made under the Secretary of State's powers contained in Part V of the Local Government and Housing Act 1989, sets out rules concerning local authorities' involvement in "regulated companies" which are subject to extensive controls, and their involvement in other companies where a number of rules apply.
- (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 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.
- (3) The original concept of controlled, influenced and minority interests in companies was introduced by the 1989 Act. "Influenced" means at least 20% local authority interest plus a business relationship with the company accounting for over 50% of the company's turnover and/or the company was located on local authority land leased or sold for less than best consideration. "Controlled" means over 50% local authority interests, and "minority" less than 20% interest. The concept in the 1989 Act stands, but the Order introduces the term "regulated".
- (4) Councillors or officers who are directors of outside companies to which they have been nominated by the Council are under the following obligations:
 - (a) (councillors only) that the remuneration they receive from the company should not exceed that received from a local authority and should be declared;

(officers only) that they shall not receive any fee or reward other than their Council salary, unless so agreed with the Council;
 - (b) to give information to councillors about their activities as required by the local authority (save for confidential information); and
 - (c) to cease to be a director immediately upon disqualification as a councillor or termination of their employment by the Council.

3 CHARITIES

3.1 To be a charity an organisation must operate for a charitable purpose. There are four such charitable purposes:

- the relief of poverty and human suffering
- the advancement of education
- the advancement of religion
- another purpose for the benefit of the community.

It must operate for the public benefit and have exclusively charitable purposes. An organisation which operates for political purposes will not qualify for charitable status.

3.2 To register as a charity the organisation must subject its completed constitution (usually Certificate of Incorporation and the Memorandum and Articles of Association of a company limited by guarantee) to the Charity Commissioners for approval. If they are satisfied that the organisation is charitable it will be registered as such.

3.3 Those who are 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.

3.4 Trustees' Duties

- (1) Trustees must take care to act in accordance with the constitution and to protect the charity's assets. They are also responsible for compliance with the Charities Act, and should note the particular requirements of the Acts in respect of land transactions.
- (2) Trustees must not make a private profit from their position. They cannot receive remuneration without the sanction of the Charity Commission. They must also perform their duty with the standard of care which an ordinary, prudent business person would show. Higher standards are required of professionals, and in relation to investment matters.
- (3) Charitable trustees must ensure that the information relating to the charity and trustees is registered with the Charity Commissioners and the annual accounts, reports and returns are completed and sent.
- (4) If charitable income exceeds £10,000, the letters, adverts, cheques, etc must bear a statement that the organisation is a registered charity.
- (5) Trustees are under a duty to ensure compliance with all relevant legislation (eg in relation to tax and land matters).

3.5 Trustees' Personal Liability

- (1) If in doubt, always consult the Charity Commissioners. A trustee who does so can avoid personal liability for breach of trust if he/she acts in accordance with the advice given.
- (2) Generally though, a trustee incurs liability if he/she:

- acts outside the scope of the trust deed
 - falls below the required standard of care
 - acts otherwise than in the best interests of the charity, in a way which causes loss to the charity fund
 - makes a personal profit from the trust assets.
- (3) In such circumstances the trustee will incur personal liability for losses incurred.
- (4) Trustees of a trust can be liable personally to third parties because unlike a company, a trust has no separate identity from the trustees. The constitution will normally provide for trustees to be given an indemnity from the trust assets, provided they act properly in incurring the liability. Trustees remain personally liable for their own acts and defaults once they have retired. If they have entered into any ongoing contracts on behalf of the trust they should seek an indemnity from their successors. If the charity is a company, the trustees will be protected from liabilities incurred in the day-to-day running of the charity in the normal course, but will be personally liable if they commit a breach of trust (see (2) above).
- (5) Trustees may be liable to fines if they do not comply with the duty to make returns etc.

3.6 Indemnities

An indemnity can be given from the trust fund provided the trustee has acted properly and within his/her powers. Trustees may take out insurance to protect themselves against personal liability but not for criminal acts, fraud etc. There will be no problem if the trustees themselves pay the premiums but if they are paid out of the charitable funds the trustees will need the consent of the Charity Commissioners first, unless the trust deed allows it.

4 COMMITTEES OF MANAGEMENT

4.1 Unincorporated Associations

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.

4.2 Property will have to be held by individuals as the organisation has no existence of its own.

4.3 Duties

Broadly, management committee members must act within the constitution, and must take reasonable care in exercising their powers.

4.4 Liabilities

- (1) 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.
- (2) 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.
- (3) Members of the committee of management will have personal liability if they act outside the authority given to them or if they do not comply with statute eg the payment of employees' tax etc.

4.5 Indemnities

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.