



Guidance for Councillors & Officers on Outside Bodies

A guide to the law for Councillors and Officers who are appointed to represent Colchester Borough Council on another body.

October 2013

Contents

Page

| | | |
|-----|---|----|
| 1.0 | Introduction | 1 |
| 2.0 | General | 3 |
| 3.0 | Companies | 3 |
| 3.1 | Directors' Duties | 4 |
| 3.2 | Directors' Liabilities | 5 |
| 3.3 | Indemnities | 6 |
| 3.4 | Local Authorities (Companies) Order 1995 | 6 |
| 4.0 | Charities | 7 |
| 4.1 | Trustees' Duties | 8 |
| 4.2 | Trustees' Personal Liabilities | 8 |
| 4.3 | Indemnities | 9 |
| 5.0 | Management Committees | 9 |
| 5.1 | Unincorporated Associations | 9 |
| 5.2 | Duties | 9 |
| 5.3 | Liabilities | 9 |
| 5.4 | Indemnities | 10 |
| 6.0 | Insurance Indemnity provided by the Council | 10 |

GUIDANCE FOR MEMBERS ON OUTSIDE BODIES

This advice is for Councillors and officers who represent the 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 they must contact the Monitoring Officer for advice.

1.0 INTRODUCTION

Councillors are appointed formally by the Council annually to serve on a range of outside bodies, including voluntary organisations, local government associations and other organisations.

In performing that role, Councillors can act as individuals, representatives of the Council, directors or trustees. There are both positive and negative aspects to the role:

a) **Positive**

- 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;
- reporting back, at least annually, to the Council or relevant committee;
- behaving ethically and following as far as applicable the Council's Members Code of Conduct; and
- taking an active and informed role in the management of the outside body's affairs.

b) **Negative**

- not representing the political party to which Councillors owe their political loyalty;
- not avoiding taking part in the outside body's discussions and decisions;
- not looking at things simply from the Council's perspective; and
- not being there in name only and merely turning up to meetings.

The role of Councillors on outside bodies may give rise to occasional uncertainty and perhaps to conflicts of interest. This Guidance offers a simple legal guide on the responsibilities of Councillors and officers. Councillors are asked to read this guidance and if there are issues arising from their particular situation at any time, to contact the Monitoring Officer for advice.

Councillors (and officers) are under a specific obligation as a result of the Local Authorities (Companies) Order 1995 to report back to the Council on their involvement in outside companies to which they have been nominated by the Council. That obligation is best met by an annual report to the relevant Portfolio Holder. While the law now makes this a requirement for involvement in outside companies, it is self-evident that the requirement to report back should apply to involvement in all outside bodies.

This guidance and the Council's Members Code of Conduct addresses some of the issues around the possibility of conflicts of interest. **In essence, if the outside body comes into conflict with the Council and the Councillor is a director or on the management committee of the outside body, it is likely that the Councillor's prime duty would be to the outside body in the conduct of the outside body's affairs.** The Councillor is however also given specific dispensation in the Council's Members Code of Conduct to participate in the Council decision-making process in relation to the outside body to which he or she has been appointed.

If there is a major dispute between the Council and the outside body, then the Councillor may be placed in an untenable situation. Before taking precipitate action, the Councillor is advised to seek advice from either the Chief Executive or the Monitoring Officer.

In certain circumstances, it is possible that the Councillor may find he/she is unable adequately to carry out their responsibilities properly, both as a Member of the Council and as a member or director of the outside body. It is suggested that this would be an exception, and should not deflect Councillors generally from being prepared to participate in the management and running of outside organisations.

2.0 General

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.

Councillors are under a duty to exercise independent judgment 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.

The bottom line is that in the end, 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 would put the Councillor or officer in breach of the 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.**

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.

3.0 Companies

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.

Companies limited by shares are those which have share capital (e.g. 1000 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.

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.

3.1 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 the 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 payers of the Borough.
- (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 judgment**, 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 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 the only proper way for the conflict to be resolved is for the Councillor to resign either from the company or from the Council.
- (5) Directors are **not allowed to make a private 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.

3.2 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 of 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 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 action 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 (e.g. 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.

3.3 Indemnities

- (1) Directors cannot be indemnified 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) It is not possible for the Council to provide indemnities or insurance for Councillors acting as directors, except in a few circumstances outlined in Section 5 below.

3.4 Local Authorities (Companies) Order 1995

- (1) This Order, made under the Secretary of State's powers contained in Part V 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 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.
- (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 who are directors of outside companies to which they have been nominated by the Council are under the following obligations:-
 - (a) that the remuneration they receive from the company should not exceed that received from the local authority, and should be declared

- (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.

4. Charities

To be a charity an organisation must operate for a charitable purpose; i.e.:

- 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.

To register as a charity the organisation must submit its Trust Deed (usually the Memorandum and Articles of Association of a company limited by guarantee) to the Charity Commission for approval. If they are satisfied that the organisation is charitable, it will be registered as such.

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 if the trust deed authorises them so to do.

4.1 Trustees' Duties

- (1) Trustees must take care to act in accordance with the Trust Deed and to protect the charity's assets. They are also responsible for compliance with the Charities Acts.
- (2) Trustees must not make a private profit from their position. 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 trust and trustees is registered with the Charity Commission and that annual accounts and returns are completed and sent.
- (4) If charitable income exceeds £5,000, 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 (e.g. in relation to tax matters).

4.2 Trustees' Personal Liability

- (1) If in doubt, always consult the Charity Commission. A trustee who does so will avoid personal liability for breach of trust if he/she acts in accordance with the advice given.
- (2) Generally, though, a trustee incurs personal liability if he/she:-
 - acts outside the scope of the trust deed
 - falls below the required standard of care
 - makes a personal profit from the trust assets
- (3) In such circumstances the trustee will incur personal liability for losses incurred.
- (4) Trustees can be liable personally to third parties because unlike a company, a trust has no separate identity from the trustees. Trustees are, however, entitled to an indemnity from the trust assets, provided they act properly in incurring the liability. Trustees remain personally liable once they retire (e.g. if they have entered into a contract on behalf of the trust) and should therefore seek an indemnity from their successors. If the charity is a company however the trustees for the time being will be responsible.
- (5) Trustees may be liable to fines if they do not comply with the duty to make returns etc.

4.3 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 Commission unless the trust deed allows it.

5. Management Committees

5.1 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 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.

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

5.2 Duties

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

5.3 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) Management Committee Members 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.

5.4 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.

6. Insurance Indemnity provided by the Council

The Council's insurance cover only operates when Councillors are pursuing their Council duties. Generally, whilst the Council appoints Councillors to outside bodies, once appointed they act as members of the body rather than as Councillors.

In most cases where a Councillor is acting as a Director or as a Trustee, or indeed as a member of a Management Committee, he or she will be exercising judgement on behalf of the organisation and will therefore need to ensure indemnity is obtained from the organisation.

However, where the organisation is a joint committee of two or more local authorities, the Borough Council can provide indemnity.

Further, where the Councillor is clearly representing the Authority's interests as an observer or as an advisor, then the Borough Council can again provide indemnity.

If in doubt Councillors should seek advice from the Monitoring Officer.