

Trustee Liabilities – Over-exposed?

Changes introduced under the new Charities Act have highlighted the personal risks trustees face in undertaking their duties. Andrew Studd takes a look.

When the new Charities Act 2006 was making its way through Parliament last year, a key issue to which the politicians, the lords and respondents from all corners of the charitable sector returned to again and again was the liability of trustees.

For charities, much like their peers in the corporate boardroom, recruiting new trustees is not an easy task, particularly if potential appointees are worried that they may be personally liable for mistakes they make which put the charity's assets at risk.

In truth, there are more than 200,000 charities and similar voluntary organisations in the UK, and a quick glance at the cases going through the courts will show that claims against trustees are not exactly filling up their workload. Most people within the sector would be hard put to name a single situation in which a trustee had actually suffered personal loss or liability – although they would be less hard put to name situations where they knew trustees had been anxious about the outcome of various activities. The Charity Commission too looks to punish trustees only in the most serious cases of fault or neglect.

It is nevertheless a fact of life that all who try to achieve something worthwhile will occasionally find their efforts rewarded with difficulty, and with worry. For that reason it is important that those individuals who voluntarily give of their time to run charities and similar voluntary organisations should be aware of – and feel comfortable with – the limited risks involved.

A trustee's undue anxiety about personal liability can often interfere with the proper running of the organisation, which is why managing that anxiety is a key skill for the company secretary and other senior staff. Trustees can become very concerned about personal exposure in circumstances where, for example, the organisation faces financial difficulties or is moving into unfamiliar territory. Other typical sources of anxiety include the threat of litigation, accusations of discrimination from a member of staff, or work on a major new contract.

If the company secretary does not or cannot address these concerns, he or she may find that the board freezes up and key decisions go untaken.

Board members need to have enough concern about their legal duties to ensure they do the job properly, but to avoid becoming unnecessarily anxious. The new Charities Act offers some relief in that if trustees act on formal Commission advice, they will not be liable and they can obtain relief from personal liability for a breach of trust where the trustee has acted honestly and reasonably. Previously, only the courts could relieve them of this sort of liability.

Personal liability

One way of understanding trustee liabilities is to say some of them arise from what the organisation does – what we might call ‘operational liabilities’ for which, for various reasons, the trustees can find themselves personally responsible – and others from the specific trustee role – what we might call ‘governance liabilities’.

Governance liabilities

These liabilities arise out of the duties that the trustee owes the organisation – the personal obligations that come with being a trustee.

When one accepts the job of trustee, one agrees to do the job properly. Rules set out the minimum standards and if one falls below that minimum, the charity itself, the Charity Commission, the courts or Companies House may take action which may result in personal liability. Such action is, however, very rare. Liability generally only arises if the failure to discharge duties actually causes loss to the charity or improper gain to the trustee.

One of the key duties of a trustee is to manage conflicts of interest. He or she should act with integrity and should disclose any conflict of interest to the organisation, and avoid being involved in any decision relating to that conflict. Where a conflict is substantial, the source of the conflict should be removed by the trustee giving up the potential benefit or other source of conflict – or resigning as a trustee. Even having resigned, however, he or she cannot take advantage of information gained as a trustee or take a job within the same charity without consent from the Charity Commission.

A trustee who is also a local councillor will clearly have a conflict of interest if he or she votes on the level of fees the charity will receive for a service provided to the local authority. Also, where the charity is a company, the Companies Act 2006 imposes its own detailed conflict management duties.

A trustee is also under an obligation not to obtain any personal benefit from his or her role, unless authorised by the governing document or as an order of the Charity Commission. While repayment of expenses actually and reasonably incurred is always allowed, a trustee needs to be absolutely sure that it is authorised before receiving anything beyond that.

The obligation not to receive a benefit direct or indirect is broad. In particular, there are problems where individuals are involved in payment for work or goods and services supplied but at a lower rate than they would have normally expected, or honorariums or payments labelled in some non-standard way. Similar problems arise in relation to payments to a spouse of the trustee or someone else with whom he or she shares a common purse, when the charity makes a trustee a paid director of the charity’s trading subsidiary, and if and when a trustee applies for and is awarded the job of Chief Executive in an organisation for which he has acted as trustee over many years.

One difficult area is where the beneficiaries themselves are trustees. For example, if you are a trustee of a village hall trust, you are also likely to be a user of that building. And again, where trustees are also directors separate Companies Act duties will apply.

Trustees must also ensure that the charity’s governing document is followed. That document, of course, sets out the charity’s objects, powers and restrictions. An organisation can only do what its constitution authorises it to do, or what it is authorised by statute to do – not simply do anything that seems sensible to achieve its objects. In other words, trustees must understand what the charity’s ‘objects’ are, exactly what it is the charity is there to do, and exactly what it is the charity can and cannot do.

If a trustee authorised the charity to do something which was not specified in its governing document, he or she could be liable. If the governing document contained restrictions that are now inappropriate, trustees ought to put in hand the steps necessary to amend those objects – which would normally require Charity Commission consent.

Finally, there is a duty to safeguard assets. Trustees must ensure that the charity's money is not lost and is invested prudently. A trustee should not simply give money away just because he or she thinks it was a nice idea, if it does not actually advance the purposes of the charity. This means, for example, that if as a trustee one agrees to committing the charity to an investment project that subsequently turns bad, assuming one did so without possessing the expertise to judge the risks involved, one will be liable in not having exercised sufficient care in selecting the investment (in this instance, failing to take professional advice).

Refusing money or property given to the charity may also breach this duty.

The Charity Commission takes the view that 'if trustees act prudently, lawfully and in accordance with their governing document then generally liabilities they incur as trustees can be met out of the charity's resources'. Therefore, normally only where a trustee has acted dishonestly or recklessly is it actually likely to enforce personal liability.

Operational liabilities

Operational liabilities may arise for a number of reasons – perhaps because trustees are held responsible for any criminal offence that the organisation may commit, or likewise held responsible for some breaches of statutory duty in, say, health and safety. They may be liable under covenants, obligations or mortgages affecting land or other property. It may be perhaps that certain contractual obligations have been broken – because the organisation cannot meet the final payment on a building contract, say, or has delivered faulty services – or committed some wrongdoing (tort) or authorised others to do so.

If an organisation cannot discharge its operational liabilities like these, then where liability falls would depend on the constitutional structure of the charity. If the charity is incorporated, then operational liabilities generally fall on the organisation – and if it cannot meet the liability, it may have to be wound up.

Members' liability is also limited to the amount of their guarantee for a company limited by guarantee or to loss of the money paid for their shares in an industrial and provident association.

If the charity is not incorporated and cannot meet its obligations, the trustee is liable (and here, the members of an association may also be liable). Therefore, where a charitable trust or unincorporated association loses its grant, closes and cannot pay further instalments on, say, its photocopier hire agreement, the photocopier company can ask the trustee to pay what is due.

Since operational liabilities arise out of what the charity does or does not do, there are an enormous range of acts or omissions which could cause liability. The services the charity provides, the property it owns, the staff it employs, the statements and publications it produces, the people with which it interacts, the co-operative and collaborative relationships it enters into, the contracts it signs, the funding agreements it enters into and the advice it gives all carry potential liability for the organisation.

Liability can be generated in as many different ways as there are risks. It could be to a statutory or government regulator – such as the Health and Safety Executive – or to the other party to a contract. It could be to a funder – when, for example, a project is left incomplete or the money diverted for other uses – or to a client for the negligent advice given

which resulted in financial loss. It could even be to a third party in the event, for example, that the charity's mini bus is involved in an accident.

The voluntary sector does too many different things – from international aid to promoting poetry – for one to be able to specify all the possible risks. In most cases, though, incorporation, care and insurance are the answers to reducing the risk of personal liability.

Staff Risks

There are, finally, liabilities with regard to staff and volunteers. As soon as an organisation moves from being a purely voluntary body to one that employs staff, the level of risks that it faces goes up very substantially. While the organisation, whether incorporated or not, owes its volunteers a duty of care (amongst other obligations), the range of obligations it owes to its staff is much larger, more complex and rapidly changing. Its financial obligations, for one, will include salary, pension, holiday and redundancy pay, as well as procedural duties such as the need to provide disciplinary grievance and other appropriate procedures.

There will also be paperwork requirements, such as the obligation to provide a contract or terms and conditions of employment setting out required statutory information. There will, too, be other duties and potential liabilities such as the need to take out employer's insurance, the need to comply with health and safety and equal opportunities legislation, and a variety of other statutory obligations.

Since there are a large number of obligations which very frequently lead to claims, employment of staff is one of the key indicators that an organisation should very seriously consider incorporating. And even following incorporation, personal liability can arise – for example, a staff member may make a claim against a trustee in the employment tribunal alleging discrimination. Trustee indemnity insurance will cover this sort of claim.

Insurance

Obtaining insurance for the organisation, its activities and assets is a vital duty for trustees – all the more so if the organisation is not incorporated, since uninsured liabilities which are not met by the organisation will become trustee liabilities.

It is possible for charities to obtain an insurance policy that covers some of the governance and operational liabilities of trustees and of directors. Previously, insuring a trustee because it conferred a benefit on the trustee, not the organisation breached the rules against trustee benefit.

However, Section 39 of the new Charities Act allows trustees to take out trustee indemnity insurance using charity funds without permission, so long as there is no provision in the governing document that expressly forbids it. This provision came into force on 27 February.

As with any insurance, it is vital to recognise what the policy actually covers. Typically, it will cover omission or negligence; breach of statutory duty; errors in investment decisions; breach of trust; libel and slander; wrongful trading and any a wrongful act in respect of an employee (discriminatory behaviour, for example). Clearly, this does not cover a wide range of risks that may well worry trustees. Generally, for example, it will not cover personal liability of trustees for claims under contracts or leases or provide protection against financial claims or debt which the organisation cannot meet. It is also very unlikely to protect against situations where the trustee was reckless.

Trustees may be surprised at how limited a range of cover they will get for their premium, and for that reason many organisations do not take out trustee indemnity insurance. Even so, one advantage that comes from having this type of insurance is that people whose skills

a charity need may not join the board unless such insurance is in place. It may prove to be a worthwhile premium to pay to get that person to agree to join the board of trustees.

Managing liabilities: a checklist

There are a number of key tools charities can bring into play so as to manage organisational liabilities. They include the following:

- Incorporating the charity
- taking out insurance;
- acting carefully and thinking about risk;
- building financial reserves;
- excluding personal liability in agreements and leases where possible;
- not taking on long-term commitments;
- taking professional advice;
- having effective risk management procedures;
- seeking Charity Commission or Court relief;
- resignation from the board of an organisation that does not take managing risk seriously; and
- reviewing the governing document to ensure it contains the widest permitted indemnity provisions.

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