

# Third sector protector

Natasha Jackson & Katharine Bailey explore the implications of the Kids Company litigation for charities & their directors



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## IN BRIEF

► In February, the High Court dismissed the disqualification case against the trustees and CEO of the charity Kids Company, finding that its founder was not a director and that none of the defendants were unfit to be directors.

► This was the first case in which the court had to decide whether a CEO of a charity would be a de facto director of that charity.

► The decision has crucial implications for the charity sector and the volunteers upon which it depends to function.

Kids Company was founded in 1996 by Camila Batmanghelidjh (pictured) to support the most vulnerable children who fell through the cracks in mainstream services. Despite securing hundreds of millions of pounds in donations from celebrity donors and winning more than £42m in government grants, the ever-increasing demand for Kids Company's services led to financial difficulties for the charity. It collapsed in 2015 in the wake of unfounded allegations of sexual abuse.

As a charitable company, Kids Company was registered under the Companies Act 2006 (CA 2006) and the trustees of the charity were company directors. After a lengthy investigation, the Official Receiver commenced disqualification proceedings under s 6 of the Company Directors Disqualification Act 1986 (CDDA 1986) against Camila, alleging that she was a de facto director of the charity, and the trustees. A ten-week 'hybrid' trial took place before Mrs Justice Falk during the COVID-19 pandemic.

In a decision that has a significant impact for the charitable sector, Falk J roundly dismissed the case, finding that Camila was not a director and that none of the defendants were unfit to be directors (*Re Keeping Kids Co, Official Receiver v Batmanghelidjh and others* [2021] EWHC 175 (Ch)). This case is particularly notable for the strongly-worded judicial observations on the requirement for fairness and balance towards defendants, and the stark recommendations issued to the Official Receiver on case presentation.

## De facto directorship

This is the first case in which the court had to decide whether a CEO of a charity would be a

de facto director of that charity.

It is common for CEOs of commercial companies to also be company directors, but s 185 of the Charities Act 2011 prevents trustees of charities from being remunerated for their role. While many smaller charities have board members who take on day-to-day management roles, larger charities like Kids Company routinely require full-time salaried management teams to function.

Falk J rejected the Official Receiver's submission that any CEO of a charity performing a role akin to that of a commercial CEO must be a director. Whether a person is a de facto director will depend on the corporate governance structure and decision-making in the company in question. The fact that the trustees were non-executive is relevant to this context, as it required that the CEO was accorded a significant degree of delegated authority and her views were correspondingly respected.

This judgment has crucial implications for the charitable sector, which is reliant upon volunteer board members and paid executives. It would have been highly disruptive if all charity CEOs, who are often the face of their charities and bear heavy executive responsibilities, ran the risk of being held to be directors for excelling at their jobs.

## Duties & fitness of non-executive directors

Directors of charitable companies are subject to the same duties as directors of other trading companies and the same test for disqualification under CDDA 1986 applies.

That said, Falk J agreed with the defendants that the charitable context is crucial to the factual circumstances that must be considered. The fact that the board were all non-executive and unpaid was relevant to determining the duties assigned and assumed by the trustees. Falk J further held that there are strong policy reasons favouring a benevolent approach to charity trustees who volunteer their time, to avoid deterring capable people from taking on these valuable roles.

The effect of this could mean that incompetent conduct that would render a commercial director unfit would not necessarily do so in a charitable context.

## Insolvency vs Charity Commission jurisdiction

A key takeaway from the Kids Company litigation is that the insolvency jurisdiction is not well-placed for the investigation and regulation of charity trustees if the money runs out.

Charitable companies are regulated not only under CA 2006 but also by the Charity Commission, which has wide-reaching powers—including powers of investigation and disqualification—under charity law. This overlapping jurisdiction raises obvious concerns that trustees may be subject to differing standards and parallel proceedings depending on whether the charity is incorporated.

Falk J observed that, in practice, the primary means of regulating trustees' behaviour should be the standards set by and the enforcement powers of the Charity Commission, this being the regulator with the appropriate expertise.

This recommendation is particularly relevant at present, given the number of charities that have unfortunately collapsed as a result of the COVID-19 pandemic.

## Conclusion

The importance of this judgment for the charitable sector, which depends on the generosity of skilled and experienced volunteers, cannot be overstated. Falk J concluded: 'It is vital that the actions of public bodies do not have the effect of dissuading able and experienced individuals from becoming or remaining charity trustees. Disqualification proceedings, or the perceived risk of them, based on wide ranging but unclear allegations of incompetence rather than any want of probity, carry a high risk of having just that effect, and great caution is therefore required' (para [911]).

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**Key takeaways:** *Re Keeping Kids Co, Official Receiver v Batmanghelidjh and others* [2021] EWHC 175 (Ch).

► A charity CEO will not be a de facto director if they are performing a properly delegated role and do not have trustee-level decision-making power.

► The charitable context is key when identifying the scope of charity directors' duties, which will often be different to those owed by a director of a commercial company.

► Non-executive status and the fact that trustees will be unpaid volunteers can be taken into account when defining the scope of a trustee's duties.

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