

Companies Limited By Guarantee

A. MEMBERS LIABILITIES AND RESPONSIBILITIES

Liability of members

The liability of members of a company limited by guarantee is limited to the amount they have agreed to contribute, set out in the guarantee clause of the memorandum of association of the company (the “memorandum”). The guarantee can be for any amount per member. Usually this is a nominal sum of £1 or £10. This liability cannot be extended unless members have received an unlawful dividend. The company cannot increase the amount of the guarantee or alter any other provision in the memorandum or articles of association of the company (the “articles”) which requires the member to pay money to the company. Any liability which the company may have under legislation is not imposed on the members, as it may be on the directors.

Membership fees

The articles may provide for a member to pay a joining fee or an ongoing membership fee, but this is not essential. The charging of a membership fee is a useful way for a company limited by guarantee to generate income. If the fee is to be ongoing then the basis on which the renewals will be due should be stated in the company’s articles.

Ownership of the company

In general (although see below), the members of a company limited by guarantee do not have rights of ownership in the company because the profits of the company cannot be distributed to them. The surplus on winding-up is to be paid to another organisation rather than to the members. However, members can control changes in the constitution and other fundamental decisions relating to the company. Members have the right to remove a director by ordinary resolution.

Members’ rights where distribution of profits is permitted

If the memorandum and articles do permit distribution of dividends during the lifetime of the company or on its winding up then members can be said to have an interest in the assets of the company. This interest is akin to a member holding a share in the company like a shareholder in a limited company. However, a member’s interest cannot be treated as property or ownership of the assets of the company if it cannot be transferred to another. If the articles of the company limited by guarantee do permit membership to be transferred, then the rights of members appear to include interests in property.

Shares

Most companies limited by guarantee do not have any shares. If it does have shares then a member of such a company has two distinct liabilities. He is liable to pay the sum due on his shares and to contribute to the assets of the company if it is wound up, according to the guarantee in the memorandum. However, companies limited by guarantee and having a share capital cannot be registered today.

Rights and obligations of members

Members have rights and obligations by virtue of their membership. The rights and obligations derive from:

- The memorandum and articles of association of the company.
- General company law.
- Rules or by-laws which may be prescribed by the company from time to time.

Generally, the members of a company limited by guarantee have few obligations other than their obligations towards the company and the other members, as set out in the memorandum and articles and any other constitutional documents. The general management of the company is normally entrusted to the directors, but the members have the more important role in terms of making decisions about fundamental aspects of the company - for example: its constitution; the composition of its board of directors; winding up; or changing the company's name.

Data Protection Act 1998

The Data Protection Act 1998 provides an exception to the rule that liability is not imposed on members of a company limited by guarantee in the case of a company managed by its members. The members of such a company can be punished as if they were directors for offences under the Data Protection Act committed by the company.

Transfer of membership

Many companies limited by guarantee provide that membership is not transferable and ceases on death. It is not the case that membership is never transferable; it depends on the construction of the articles. If the articles allow for a method of transfer, this procedure should be followed.

Voting

At meetings of the company a member of a company limited by guarantee will have one vote unless the articles of the company make some other provision.

B. DUTIES AND RESPONSIBILITIES OF COMPANY DIRECTORS

In a company limited by guarantee, the directors are often called governors, members of the board of management, trustees, or committee members. The promoters of a company limited by guarantee should, however, be very clear as to who are the directors of the company and to make sure that each individual who takes on the role of directors is properly appointed and aware of his duties.

The main duties of a director can be summarised as follows:

- A duty to exercise such degree of skill and care when carrying out his or her duties as a director, as may be reasonably expected from someone of their skill and ability;
- Fiduciary duties to the company to act honestly and in good faith and in the best interests of the company; and
- Duties imposed by statute, including the statutory obligations imposed by the Companies Act 1985.

Duty of skill and care

A director is under a duty to the company to use reasonable skill and care in carrying out his or her functions. The basic standard of general knowledge, skill and care expected of any director is that which can reasonably be expected of a reasonably diligent person who has taken on the office of director.

The extent of this duty for any one director will vary according to the size and business of the company, his or her job and his or her own knowledge and experience. In particular, a director's performance will be judged by the way in which he or she applies the skills and knowledge which he or she actually possesses. For example, directors who are accountants by profession will be expected to exercise their knowledge, skill and experience and perform to a higher standard in relation to the company's finances than those directors not so qualified.

Directors must attend diligently to the affairs of the company to which they are appointed. The degree of diligence required will vary depending on the facts and circumstances of each particular case. It will depend, for example, on the role in the management of the company assumed by the director and the duties expected of a person in that role.

Subject to the articles of the company, the board of directors may delegate specific tasks and functions, but must be satisfied that they are delegating to a suitably qualified person who is honest, competent and reliable (whether this be to one or more directors or a third party). The exercise of the power of delegation will not absolve a director from the duty to supervise the discharge of delegated functions.

Fiduciary duties

All directors owe common law fiduciary duties to the company that appoints them. Broadly, they are duties which impose responsibility on the directors to act honestly and in good faith and in the best interests of the company.

The principal duties are generally recognised as:

- (i) to act in good faith in the best interest of the company;
- (ii) to exercise one's powers for a proper purpose;
- (iii) to avoid conflicts of interest;
- (iv) not to fetter one's discretion; and
- (v) not to make personal profit from opportunities arising from a directorship.

Duties under the Companies Act 1985

Accounting and financial duties

The legal duty of producing the company's accounts is placed upon the directors. They have two basic duties concerning the annual accounts. The first is to prepare, sign and lay before the company in general meeting financial statements comprising a balance sheet and a profit and loss account for each financial year. Their second duty is to deliver to the Registrar of Companies a signed copy of the accounts enclosing the supporting reports.

Directors must also assist auditors to supply the information required in the audit of the company's accounts.

Loans to directors

Complex rules prohibiting a company from making or guaranteeing a loan to one of its directors or a director of a holding company are set out in the Companies Acts. Various exceptions apply to these prohibitions, depending broadly on:

- the size of the loan;
- the purpose of the loan; and
- the type of company involved

If a company is to make or guarantee a loan to one of its directors, legal advice should be sought at the outset.

Property transactions involving directors

The Companies Act 1985 provides that members' approval is required before a director, or a person connected with a director, can acquire a non-cash asset from the company or a subsidiary of the company, where the value of the asset or assets to be acquired exceeds £100,000 or, if less, 10 per cent of the company's net asset value (down to a minimum of £2,000). The same restriction applies where the company or a subsidiary acquires a non-cash asset from a director. The asset value is determined by reference to the accounts for the last financial year. If no accounts are available then the asset value is equal to the called-up share capital. As a Company limited by guarantee has no shares it is recommended that the company should obtain members' approval to all property transactions with directors where the value of the asset is £2,000 or more.

If the approval of shareholders is not obtained, the director concerned, and all the directors who authorised the transaction, are liable to account to the company for any profit, and must indemnify the company against all loss or damage.

Disclosure of interests in contracts

If a director has any interest, direct or indirect, in a proposed arrangement with the company, he or she is obliged to disclose this at a meeting of the full board of directors. Normally, this declaration must be made at the first board meeting at which the matter is considered. The duty extends and includes interests of persons connected with the director. Failure to disclose an interest renders the director liable to a fine and may justify the company in refusing to honour the contract, or entitle it to require repayment of any money or other assets received by the director under such contract.

Administration

Directors are responsible for ensuring the company's due administration, that it keeps proper accounting records, maintains proper registers, makes its returns to the Registrar of Companies and prepares its annual accounts timeously.

Risks

Directors can be subject to various penalties for failing to meet their responsibilities. These range from fines to, in some cases, imprisonment.

Where a company becomes insolvent, the directors can be personally liable to make payments in a number of circumstances, such as allowing the company to continue trading when there is no reasonable prospect of it being able to meet its debts, or where the director has obtained some advantage at the expense of the company or its creditors.

Directors found to be in breach of their obligations can be disqualified from acting as the director of any company for up to 15 years.

Minimising the risks

Every director should take his role seriously and carry out the function of director to the best of his ability. In particular, regular board meetings should be held, the company's financial affairs kept under constant review and proper records kept.

Directors should make themselves aware of the rules which apply to their position and also to the company generally, including the company's memorandum and articles, and take care not to breach these.

Directors and officers' insurance is becoming increasingly popular. Many companies indemnify their directors against costs arising from their activities, and the company can insure itself against having to meet these costs. Directors can also insure themselves against liabilities they may incur. Such policies are normally subject to a number of exclusions, such as the director's own dishonesty or fraud.

Professional advice should be sought at an early stage if there are concerns as to any of these things, and particularly trading issues or possible insolvency.

Directors' powers

The directors of a company are the company's agents and have such powers as are delegated to them by the articles. The articles will almost always provide for the general management of the company to be in the hands of the directors. The directors are the company's agents and have such powers as are delegated to them in the articles.

Delegation to committees

In a company limited by guarantee, committees may be useful for deliberations on matters such as the admission of new members, setting membership fees, or deciding matters of policy in particular areas or where decisions need to be taken quickly. The articles will normally set out who is eligible for membership of the committees. To prevent a loss of control the board should ensure that clear reporting structures are in place and that the remit of the committee is clearly defined from the start. Committee meetings are subject to the general law so the rules of the committee should include a minimum number of board members as part of the quorum requirement. This type of rule does not have to be set out in the articles and can be set out in the company's rules or by-laws. The advantage of doing this is flexibility. The board of directors may alter the rules (in accordance with any procedure set out in the articles) as the need arises, whereas the articles may only be altered by a special resolution of the members of the company.

Nominee Directors

In some companies limited by guarantee, certain directors may be nominated to the board of a company by another organisation, by government, or by a particular group of members. These nominee directors may find that the wishes of their nominating body may conflict with their duties to the company. In this instance the director's duty to the company remains paramount, even if this would put him in breach of duty, or in breach of contract with the appointing body. If this situation arises it may be necessary for the director to resign from the board if the conflict cannot be resolved.

This is a general advice note giving an indication of the main responsibilities of both members and directors of Companies Limited by Guarantee. For further information Christopher Smith or Derek McCulloch in our Commercial Department.