

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 articles of association of the company (the "articles"). The guarantee can be for any amount per member, usually 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 articles which requires the member to pay money to the company.

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 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 the articles do not permit transfer to another.

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 in accordance with the guarantee. Companies limited by guarantee and having a share capital can no longer be registered.

Rights and obligations of members

Members have rights and obligations by virtue of their membership. The rights and obligations derive from the articles, general company law and any rules or by-laws 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 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 (such as the constitution, the composition of the 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

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.

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 director is properly appointed and aware of his duties.

The main duties of a director are contained in the Companies Act 2006 and can be summarised as follows:

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.

Directors 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. (Or, if the company does not hold annual general meetings, to send a copy of the accounts to members.) 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 any audit of the company's accounts.

Duty to promote the success of the company

A director must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In so doing, the director must act fairly and consider the likely consequences of any decision in the long term. Many guarantee companies, however, exist not for the financial benefit of their members but for other purposes, for example charitable companies. In those cases the directors' duty is to seek to achieve those purposes.

Duty to act within powers

A director must act in accordance with the company's articles and must only exercise his powers for their proper purpose.

Duty to exercise reasonable care, skill and diligence

A director is under a duty to the company to use reasonable skill and care in carrying out his 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 job and his own knowledge and experience. In particular, a director's performance will be judged by the way in which he applies the skills and knowledge which he 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.

Duty to exercise independent judgment

A director must exercise independent judgment. However, this duty will not prevent directors relying on advice, as long as the directors exercise their own judgment in deciding whether or not to follow the advice.

Delegation and committees

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.

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.

Duty to avoid conflicts of interest

A director must not, without the company's consent, place himself in a position where there is a conflict (or possible conflict) between the duties he owes the company and either his personal interests or other duties he owes to a third party.

Similarly, a director must not accept any benefit from a third party which is conferred because of his being a director or his doing or not doing anything as a director. The duty will continue to apply after a person ceases to be a director in relation to things done or omitted by him before he ceased to be a director. However, the duty will not be infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.

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 such a conflict arises and cannot be resolved, it may be necessary for the director to resign from the board.

Disclosure of interests in contracts

Directors must declare to the other directors the nature and extent of any interest, direct or indirect, in a proposed transaction or arrangement with the company. However, no declaration will be required:

- Where the director is not aware of his interest or where the director is not aware of the transaction or arrangement.
- If the interest cannot reasonably be regarded as likely to give rise to a conflict of interest, if the other directors are already aware of it, or if it concerns the terms of the director's service contract.
- Where the company has only one director.

Directors have a separate duty to declare the nature and extent of their interest in any existing transaction or arrangement with the company, to the extent that it has not already been declared.

Loans to directors

A company may not make or guarantee a loan to one of its directors or a director of its holding company unless the transaction has been approved by the members of the company.

Property transactions involving directors

The Companies Act 2006 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% of the company's net asset value (down to a minimum of £5,000).

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 £5,000 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.

Other duties

In addition to the duties codified by the Companies Act 2006, directors owe equitable and common law duties to the company, such as the duty of confidentiality and the duty to consider or act in the interests of creditors when the company is insolvent.

Risks

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

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.

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 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.

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, please contact Derek McCulloch or Christopher Smith in our Corporate Team.

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