Academy Trust Governance: Fiduciary Role of Member

Background

All academy trusts are private companies limited by guarantee and are therefore subject to company law and specifically the provisions of the Companies Act 2006. The Articles of Association form the trust's constitution and governing document. As an exempt charity (i.e. exempt from registration) the trust is also subject to charity law and the provisions of the Charities Act 2011. Whilst the "principal regulator" of academy trusts is the Secretary of State for Education, the trust is also subject to a certain degree of oversight by the Charity Commission.

For many years and certainly predating the Academies Act 2010, there has been a lack of clarity as to the overlapping role of the Commission, the Regulator and the Courts particularly in the context of the role of members of a charitable company and the precise extent of the duties of the members. This has now been clarified following the publication of the Supreme Court ruling in the monumental case of Lehtimaki v Cooper.

Identifying the Members

All companies must have at least one member (shareholder in corporate speak). Academy trusts, according to their Articles, must have at least three. The Department for Education's policy is that academy trusts should have at least five to avoid deadlock when passing a special resolution requiring a 75% majority. The members are those individuals (or companies) who have agreed to be members and whose names have been entered onto the Register of Members, a register which must be kept by the trust. Members' details are not filed with Companies House. The subscribers or signatories to the original Memorandum of Incorporation will automatically be the initial members, but may subsequently be replaced with new appointments.

In some cases, particularly for academy trusts established to operate academies with a religious character or trusts founded by a sponsor or other non-religious foundation, the members will either be individuals appointed by the religious authority, foundation or sponsor (such as a Diocesan Board of Education (DBE) or the Diocesan Bishop in a Catholic Diocese) or in some cases they will be the member themselves i.e. in their corporate capacity. Certainly members can be either individuals or other corporate or statutory bodies. It would be usual for the Articles to be explicit where an individual or body is to be a member and/or to have the right to appoint both other members and trustees/directors.

In view of the fact that the academy trust is a limited liability company, any financial liability of the members is in theory limited to the extent of the guarantee (to contribute to the trust's capital on winding up) set out in the Articles, being typically £10.

Members of charitable companies (e.g. academy trusts) usually provide an additional layer of accountability (for the fulfilment of the charitable object) and can scrutinise the actions of the directors/trustees but do not have rights to become actively involved in the management of the trust (having delegated that responsibility to the trustees/directors).

In the words of the Academies Financial Handbook:

"There should be significant separation between the individuals who are members and those who are trustees. If members sit on the board of trustees this may reduce the objectivity with which the members can exercise their powers. As responsibility to conduct the trust's business sits with the trustees, members should be "eyes on and hands off" and avoid compromising the board's discretion."

Our advice has always been that if a member does become involved then it is likely they will be bound to act in a fiduciary capacity (i.e. in the best interest of the trust) but there is no obligation on them to become involved. The fiduciary nature of the role and the implications of this have now been more fully explored in the case of Lehtimaki v Cooper. Although clearly helpful, this judgment has still left some important questions unanswered such as what is the extent of the duty, what financial liability and risk will attach to members and is there now an active duty on members to become involved not just in the circumstances of a governance (or more accurately board) failure.

An analysis of the lengthy and detailed comments of the Lord and Lady Justices is helpful.

Supreme Court Ruling in Lehtimaki v Cooper

It's probably worth noting at the outset that litigation on the duties of members of a charitable company is extremely rare and certainly not in circumstances where the parties are motivated and have the financial means to pursue remedies and guidance to the ultimate arbiter. Unusually, whilst this case dealt with a personal settlement (or charitable trust/foundation), the settlor chose a corporate vehicle to organise matters. Like academy trusts, the company had a separate membership from the board of trustees. The Court commented several times about "mass membership charities" (like the National Trust) and distinguished those from the more typical "foundation model" (or charitable companies without separate membership), but clarified that whether a charitable company had just a few members (independent of the trustees) or lots, it didn't matter for the purposes of assessing the role of the member.

Interestingly also, the issue in dispute did not come about because of a breach of trust but because of uncertainty regarding the extent to which a member could act not purely in the interest of the charity (having regard to the "no-conflict" and "no-profit" principles applicable to fiduciaries) and whether the courts have the power to direct a member in the exercise of their functions (having regard to the "non-intervention principle", i.e. that (in the absence of evidence of a breach of duty) the courts do not intervene in the exercise by a fiduciary of a discretion).

The particular issue upon which guidance was sought is also of relevance to academy trusts and related to the little known requirement, in charity circles at least, of section 217 of the Companies Act 2006 which requires members to approve of any payment for loss of office to a director of the company or to any person connected with a director.

After much deliberation and a review of case law going back to the 19th century, the Court decided the following:

- That members act in a fiduciary capacity and must act honestly and in good faith;
- That the fiduciary duty relates to the charitable purposes of the trust (and is not owed to the trust per se or the trustees collectively);
- That a fiduciary must not put themselves in a position where their interest conflicts with those of the beneficiary of the trust;
- That a fiduciary must not make a profit out of the trust;
- That the extent of the fiduciary duty will depend on the particular context in which the duty arises and can be ***"fashioned to a certain extent by the arrangements between the parties"*** i.e. by the Articles;
- That the courts can in exceptional circumstances where a dispute in effect is preventing the trust from properly functioning intervene by directing the parties including the members (without making a "scheme" which is the normal power of the court) in order to give effect to the charitable purpose.

In the words of Lady Arden:

"In the cases where the court is not precluded by statute, the court can, if on the application of the trustees it has decided that a particular transaction is in the best interests of the charity, make a consequential direction against not simply the applicants but also any other organ of the charity, which would clearly include the members in the case of a charity."

Impact for Members

These findings will have a significant impact on members of academy trusts. A fiduciary duty cannot be entirely passive, it presupposes that the members take an interest and act when it is clear the charitable purpose is being threatened. And it suggests that the trustees can take action if the members are not fulfilling their responsibilities (for example by removing trustees who fail to act in the best interests of the trust).

Members can reduce those responsibilities by agreement but not below the basic obligation to act honestly and in good faith to serve the charitable purpose. The Court accepted that the duty still allows the members to be interested in the actions of the trust and to act, for example, where there might otherwise be a conflict of interest or some personal

"incidental benefit" if the Articles permit this. This will allow members to freely make trustee appointments as provided for in the Articles and to put restrictions on how the objects are to be delivered (for example in accordance with the tenets of the relevant faith). However, anything more than an incidental benefit and there is a risk that a charge will be made that the member is not acting in good faith. The Court noted that there are circumstances when the fiduciary duty involves a single-minded loyalty and those which do not. But where the line is drawn will depend on the circumstances and clearly advice will be needed if anything beyond the usual is contemplated.

This is particularly important when one considers the flip side of a fiduciary duty which is that if a trustee and now also a member acts in breach of their fiduciary duty, they can be required to make restitution, i.e. to restore the loss suffered by the trust in consequence of their actions. It also opens up the possibility that legal action (by beneficiaries or third parties) may be taken against the members and as a consequence it is advisable for the trust to ensure any trustee indemnity insurance or risk protection cover is extended to the members as well as the trustees (and governors).

We are left in no doubt that navigating these issues and the **"mosaic of statutory provisions"** applicable to charitable companies, with academy trusts being a unique sub set, will be challenging for most trusts.

Important Considerations for Dioceses, Foundation Bodies and Sponsors

There are going to additional concerns and anxieties for members appointed or representing dioceses and foundation bodies, particularly when considering the requirement to act entirely selflessly in the pursuit of the charitable purpose of the trust.

Whilst in most cases it is likely there will be a significant degree of overlap, for example where the charitable object of the member (assuming it is also a charity) is the same as the object of the academy trust, the judgment leaves open the possibility that there may be a difference (or a difference in how it must be fulfilled). When presented with a conflict of interest or indeed loyalty a fiduciary should recuse themselves and take no part in any decision making. Whilst this may encourage parties to bring in more variety and independence, in reality this simply increases the scope for conflict and disagreement. When this hits at the heart of the very purpose of the trust, it can be a problem.

It also begs the question, who is the best determiner of matters of faith. It seems hard to imagine a court would intervene where a dispute concerns matters typically decided by the recognised religious authority, but this judgment leaves open that possibility too. The court must defer to Parliament and cannot by any direction ***"short-circuit"*** statutory provisions and so it may be that there will be increasingly regulation as to the role of members and religious authorities. We would certainly recommend that the appropriate diocesan authority seeks to join any action involving a dispute as to the fulfilment of the charitable purpose which they are not automatically a party to, to ensure that the court hears evidence of what the religious authority considers to be in the best interest of a religious charitable purpose.

It was significant here that the purpose of s217 CA2006 was not to provide members with a veto of any decision by the trustees in respect of which they were conflicted, but to ensure that the members had sufficient information to enable approval in a general meeting. What set this case apart perhaps from others is that the dispute had rendered the charity stymied and so the court really had no choice but to find it had jurisdiction and to exercise it, finding in the words of Lady Arden:

"an existential threat to the operation of the charity".

The need for information (to enable effective oversight) is a running theme for academy trusts and this judgment is likely to encourage members to review again whether trustee reporting is sufficient.

Finally, we would hope that these were exceptional circumstances and it remains to be seen how far reaching this judgment will be. Are there likely to be similar challenges involving disputed decisions about the removal of trustees, winding up trusts, changes to charitable objects, failures to fully deliver a charitable purpose, fundamental shifts in emphasis such as changing the designation of schools or restrictions on satisfying a key characteristic of a belief system?

Further Information

The team at Winckworth Sherwood regularly advise dioceses, diocesan boards of education, sponsors, foundations, academy trusts and schools on governance good practice. We regularly undertake governance reviews and occasionally are asked to advise on governance challenges and regulatory enforcement. For further information and advice, please contact Andrea Squires, Partner, on 020-7593-5039 or asquires@wslaw.co.uk. For more general advice, please contact a member of our School Support Service team on 0345-070-7437 or schoolsupport@wslaw.co.uk.