



## Case study

# Conflicts of interest

## Trading subsidiaries

This example describes the approach that trustees should take, in line with our guidance, when faced with conflict of interest issues that can typically arise with trading subsidiaries of charities where all or most of the charity's trustees are also directors of the trading subsidiary.

Although it is based on our experience of these issues, it does not relate to any specific case that we have dealt with.

## Situation

This unincorporated charity has a wholly owned trading subsidiary which sells merchandise to raise funds for its charitable work. All of the trustees are directors of the trading company.

The Commission received a complaint because one of the charity trustees was, without authority, receiving payments for work at the trading company.

Questions put to the charity also revealed that, although it had worked well in the past, the trading company's performance had begun to suffer. At the point the Commission became involved the trustees were about to meet to decide what to do about the trading company.

The charity had no governing document or policy provisions which the trustees could follow to address conflicts of interest.

## Overview

Many charities operate subsidiary trading companies which are owned and controlled by the parent charity. They are usually set up by charities as a means of raising funds, but can also help protect the charity from risk. Any funding of the trading company by the charity must be made in the best interests of the charity and be justifiable as an investment of the charity's assets.

It is common for some of the trustees of a parent charity also to be directors of a trading company so that the charity trustees can monitor the performance of the trading company and ensure that it is managed in the interests of the charity.

This example shows that whilst it is generally straightforward for the directors of a trading company to run it in a way which is consistent with the aims and strategy of the charity, there are some decisions where the interests and priorities of the company and the charity will be different or at odds with each other. Where trading subsidiary governance is not sufficiently independent from the parent charity, trustees are not well placed to meet their legal duty to avoid conflicts of interest and act only in the best interests of their charity.

## Identifying conflicts of interest

There were two conflicts of interest in this case which the trustees needed to identify.

The first concerned the payment by the trading subsidiary of one of the directors. Although the payments were made by the trading subsidiary, this was a conflict of interest because:

- the director was also a charity trustee
- the trading subsidiary's purpose is to support the charity
- the decision to pay the director created a conflict between the personal interest of the director and the interests of the charity

The second concerned the future of the trading subsidiary and affected all the trustees because they were also directors of the trading company.

This was a conflict of loyalty because the charity trustees were likely to be discussing and deciding issues such as the poor performance of the trading company and whether the charity could justify any further funding for the company or if, in the interests of the charity, the company should be liquidated or sold. In their capacity as directors of the subsidiary the trustees of the charity may have perceived that they had competing duties to the company, and/or feel a sense of obligation or loyalty to the company and/or its employees.

The paid director also had a personal interest in the decision about the future of the company, as the outcome may have determined whether her paid employment continued.

## 1. Payment of the director - preventing conflicts of interest from affecting decision making

### What the director/trustee should have done

It was the primary responsibility of the director to declare her conflict of interest to the other trustees at an early stage.

### What the other trustees should have done

- before making their decision to pay the trustee colleague the other trustees were under a duty to consider the conflict of interest and how to eliminate any potential effect on the decision - this may have meant considering removal of the conflict of interest such as by deciding to employ someone who was not a trustee to undertake the paid work, so that a conflict did not arise

- if they had decided the conflict didn't need removing, the trustees should have
  - ensured that a proper authority was in place for the trustee benefit
  - prevented the conflict of interest from affecting their decision by following the conditions attached to any authority for payment and any relevant provisions of their governing document - it is likely that any conditions or provisions would require the trustees to ensure that the affected trustee/director withdrew from the all aspects of the discussion and decision making about the payment - if there were no specifications to guide them the trustees should have required the withdrawal of the conflicted trustee

## Recording conflicts of interest

The trustees should have kept a written record of their decision, covering the conflicts of interest and how the trustees dealt with them. This would help them to explain and evidence their actions.

## What the Commission did

Here, the Commission advised that payment of a charity trustee for services as a director or employee of the charity's trading subsidiary without authority was a breach of trust. We applied the principles of our policies on **restitution** and on unauthorised trustee payments.

This example shows that failure to properly identify and respond to conflicts of interest can open trustees' decisions to challenge and damage the charity's reputation.

## 2. Future of the company - preventing conflicts of interest from affecting decision making

### What the trustees should have done

Before they could make their decision about the future of the trading company the trustees

- had a responsibility to recognise and declare their conflict of interest - the trustee who had been working at the trading company was affected by both a loyalty conflict and her personal interest as a person paid by the company - she had a responsibility to identify and declare both aspects
- the trustees needed to take action to prevent the conflict of loyalty from affecting their decision so that it was taken only in the best interests of the charity - this was more complicated here because all of the trustees were operating in a dual capacity
  - one potential solution was for the trustees to consider restructuring the Board of the trading company so that there was a quorum of unconflicted trustees to take both the immediate decision about the trading company, and so that similar conflicts of interest could be prevented from affecting decision making in the future
  - they may also have decided to take independent expert advice on behalf of the charity to inform their decision about how to proceed - given the recent formal connection of all of the trustees to the trading company, this would have helped them to avoid even the impression that the decision could have been influenced by those with competing duties and loyalties to the trading company

## Recording conflicts of interest

The trustees should keep a written record of their decision, covering the conflicts of interest and the trustees' handling of them.

## What the Commission did

Having ensured that the trustees' actions and decisions in handling the conflict of interest were consistent with their duties to the charity, the Commission advised that, in order to better identify and properly address any conflicts of interest arising in the future, the trustees should draw up a conflicts of interest policy and ideally include provisions for handling conflicts of interest in their governing document.