

Bates Wells

# Ready, Set, Governance!

A handbook for good  
governance in starting up your  
new Mutual

# Aims

To help you understand:

Structure of a Community Interest Company



Directors' and Members' duties and responsibilities



Regulatory framework



Good governance principles

# Structure of a Community Interest Company

# Introduction

We have assumed the Mutual is a Community Interest Company, or “**CIC**”.

A CIC is a particular kind of registered company, and is subject to the following regulatory regime:

- *CIC Regulations 2005*
- *Companies Act 2006*
- *The Company, Limited Liability Partnership and Business (Names and Trading Disclosures) Regulations 2015 (SI 2015/17)*
- *The guidance of the CIC Regulator*



# Structure of a CIC

- A CIC is a type of limited company – and is limited either by shares or by guarantee.
- A CIC cannot be a charity.
- In a CIC limited by shares, the members are shareholders. In a CIC limited by guarantee, the members are the ‘guarantors’ of the company.
- Like an ordinary limited company, the CIC will have directors who run the company (and who may delegate activities to staff).
- A CIC has limited liability, which means that on a winding up or insolvency of the CIC, the members and directors will not be personally liable to any creditors or third parties (except to the extent provided later in this toolkit).

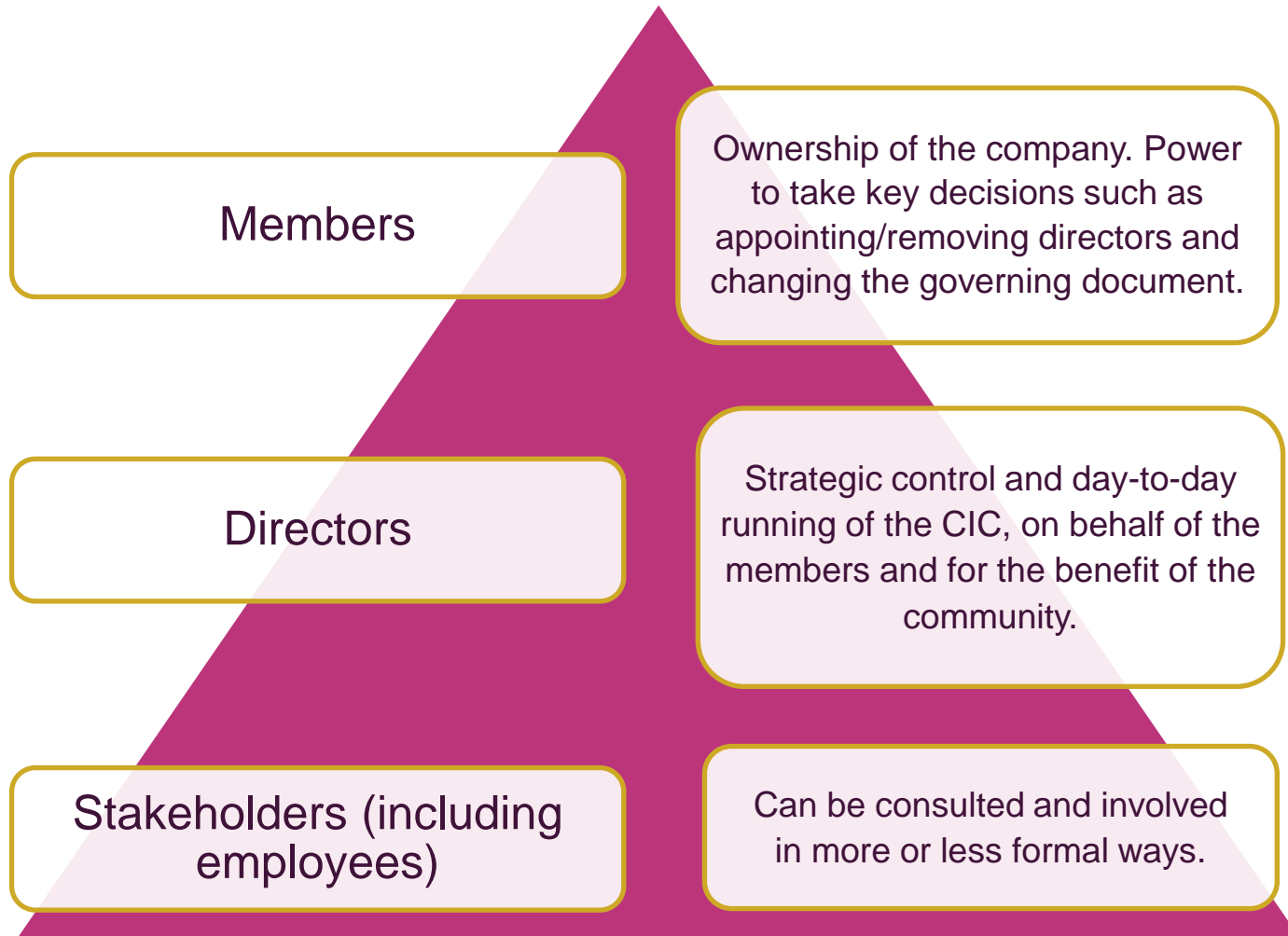
**NOTE:** More details on the various organisational structures available to a mutual are provided in *Becoming a Public Service Mutual*.

# Community Benefit and Purpose

- Unlike an ordinary company, a CIC must carry out its activities for the benefit of the community (rather than for the profit of its members).
- The principal of community benefit is secured by an “**asset lock**” which prevents the CIC from transferring any of its assets for less than market value.
- The exception to this is where assets are transferred to another CIC or charity, ensuring that they continue to be used for the benefit of the community or otherwise for the purpose of the CIC.



# Constitutional Structure 1



# Constitutional Structure 2

## Foundation

The directors are the only members of the CIC

Directors take some decisions in their capacity as members i.e. wearing a different 'hat' when the decision is made

The directors oversee the CIC and have the liabilities and duties as set out later in this toolkit

## Wide membership

The CIC may offer membership to the public, or to certain stakeholder groups

E.g. employees or service users might be members of the CIC

In this structure directors will usually also be members, but this is not required

## Sole member

The Local Authority (or another organisation) may be the sole member of the CIC

This enables the Local Authority/sole member to retain ultimate control over the CIC

The sole member can exercise the powers of a member (covered later) through decisions by its own board

### Considering Stakeholders

Using any of these structures, a mutual will usually wish to ensure that its stakeholders have a voice and an interest. This is often reflected at a constitutional level. For example, stakeholder representatives may have a seat on the board or stakeholder groups may form the membership of the company.



# Members of a CIC

# Role of Members

- The ultimate control of the CIC rests with its members, who have ownership of the CIC and who retain key decision-making powers.
- This section of the toolkit explains the role of the CIC's members in more detail.



**REMEMBER:** the 'members' we refer to here are members under Company Law, who have special rights and powers enshrined in law. The Articles of Association of your CIC may give the board of directors the power to create other types of membership, such as 'Associate' membership. 'Associate' members will not have the rights that Company Law members are entitled to under Company Law, but may have other non-constitutional rights to engage with the CIC, i.e. to sit on a an advisory panel or to attend meetings and events of the CIC. The directors may use these types of rights to give stakeholders a voice in the Mutual, for example by engaging with employees as 'Associate' members.

# Who can be a Member?

- Any natural person, company or charity can be a member of a CIC.
- The members may be employees, service users, or from the general public. The Local Authority (or consortium of local authorities) may be the member(s).
- In a CIC limited by guarantee, membership is not transferable (but new members can join, subject to the directors' approval, and old members can leave).



- Membership can be transferred in a CIC limited by shares by transferring a member's shares to another person, company or charity, but the directors have the right to refuse a share transfer.
- The CIC Regulations 2005 contain prescribed wording for the Articles of Association of a CIC about who the members are and how they are appointed.

# Rights of Members

Under Company Law, members of a CIC have the following rights:

- to ask for a copy of the Articles and certain other constitutional documents
- to receive notice of, attend and vote at all general meetings of the CIC
- to appoint a proxy to attend and vote on their behalf at general meetings of the CIC
- to be sent notice of a proposed written resolution
- to inspect minutes of general meetings and members' resolutions passed other than at general meetings, and receive a copy for which they may be asked to pay
- to inspect and take a copy of the register of members
- to inspect directors' service contracts
- to demand a hard copy form of any document or information provided in electronic form

# Powers of Members

Members collectively have powers to:

- amend the constitution of the CIC by a decision of 75% of the members (known as a special resolution)
- remove a director from the board
- prevent the deemed reappointment of the auditors
- remove the auditors
- petition for a compulsory liquidation
- insist on a circulation of a statement regarding a matter to be dealt with at a meeting or contained in a resolution
- requisition a general meeting. The percentage of members needed to support this varies depending on when the last general meeting was called. If the directors fail to call a meeting, the members have power to call a meeting at the company's expense;
- require a resolution of members holding 5% of the total voting rights (or such lower percentage as is specified in the articles) to be circulated as a written resolution together with an accompanying statement
- approve CIC contracts for more than 2 years at a general meeting of the CIC

# Limited Liability of Members

- The liability of members is limited to the amount specified in the Articles of Association.
- In a CIC limited by guarantee, liability will usually be limited to £1.
- In a CIC limited by shares, liability will be limited to the amount of any unpaid value of the member's shareholding. This means that if members are fully paid up, then they will not be liable for any amount.

**Remember:** if members have other roles, such as being a director, they may have personal liability in certain circumstances. We explain the liabilities of directors later in this toolkit.

# Directors of a CIC

# Role of the board of Directors

Directors should:

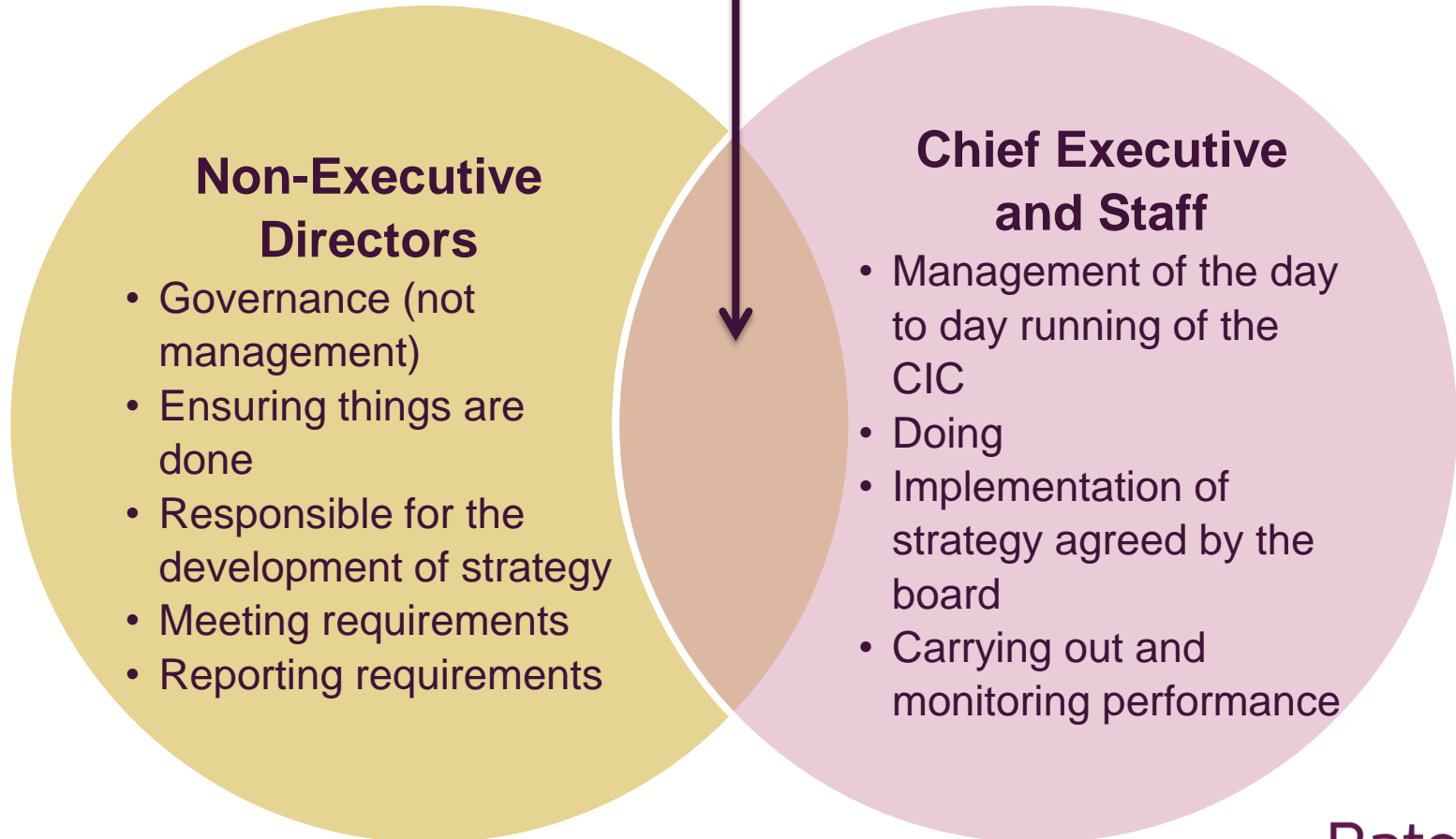
- Avoid day to day operational activities (except to the extent that they are employed as executives of the CIC).
- Delegate day to day management to staff and/or committees.
- Focus on setting policies, strategies and budgets.
- Focus on employing competent staff and monitoring performance.
- Ensure there is appropriate line management in place for staff.





# Relationship between Directors and senior staff

## Executive Directors

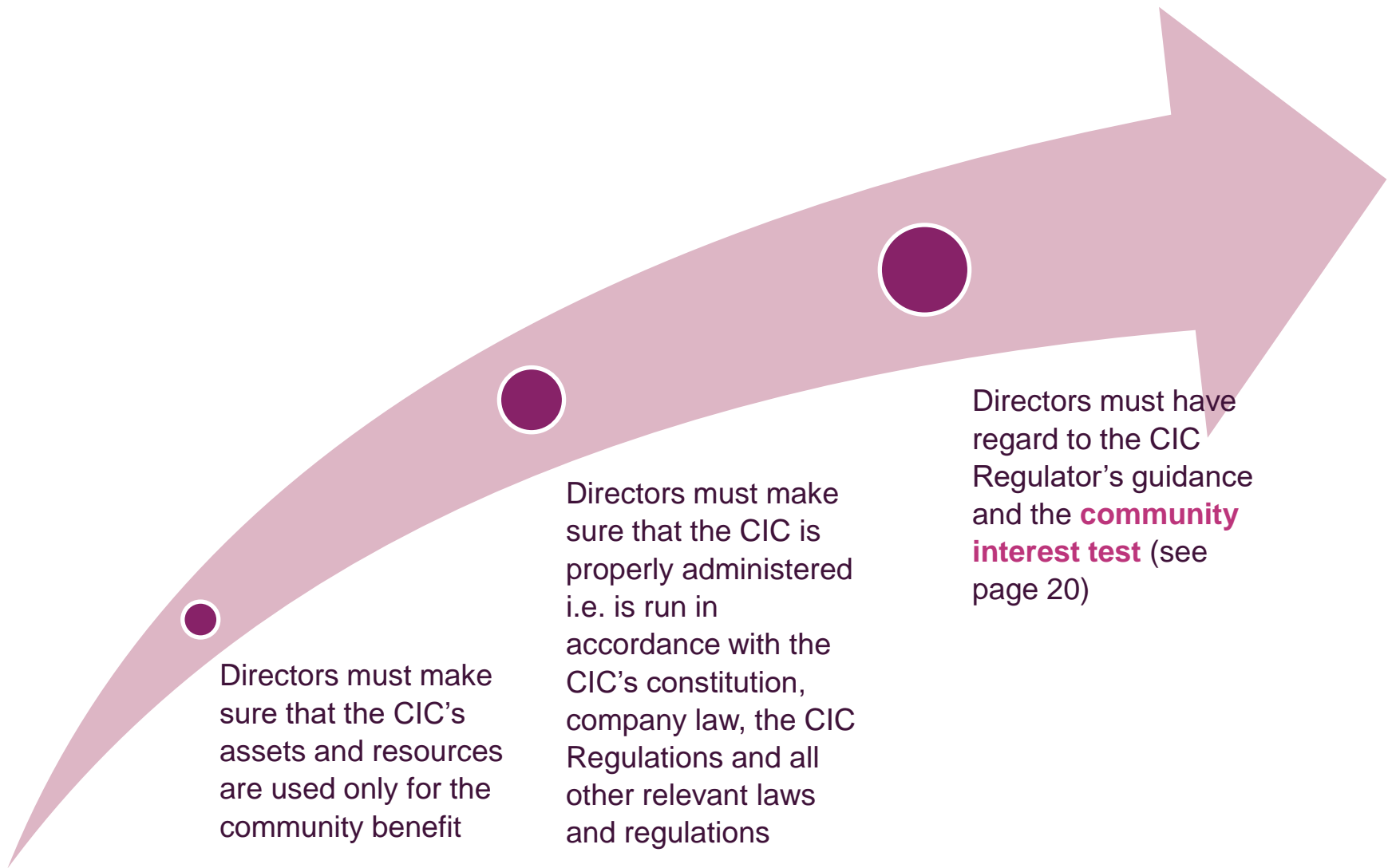


# Who can be a Director?

- There must be at least one **natural person** on the board. A director must be willing to carry out the role and not disqualified by law or under the Articles of Association.
- It is important to have a range of skills on the board, and the regulator's guidance on CICs recommends a combination of non-executive directors, who do not work in the business itself, and executive directors, who work in senior management roles and are also appointed to the board.
- As the CIC is a mutual, its Articles might provide for individuals from certain stakeholder groups (e.g. employees or service users) to be appointed to the CIC's board as directors, or for the local authority from which any public services provided by the CIC have been spun out from to nominate one or more representative(s) to the board.
- After the first directors on incorporation, future directors of the CIC will be appointed in accordance with the Articles of Association. This might be by a vote of the board, or a vote of the members. There may be specific methods of appointment for certain directors, e.g. a nomination by the local authority.

**Remember:** a person who acts as a director (taking major decisions, for example) can be liable in the same way as a director. This is known as a 'de facto' or 'shadow' director.

# Duty to operate CIC for community benefit



Directors must make sure that the CIC's assets and resources are used only for the community benefit

Directors must make sure that the CIC is properly administered i.e. is run in accordance with the CIC's constitution, company law, the CIC Regulations and all other relevant laws and regulations

Directors must have regard to the CIC Regulator's guidance and the **community interest test** (see page 20)

# The Community Interest Test

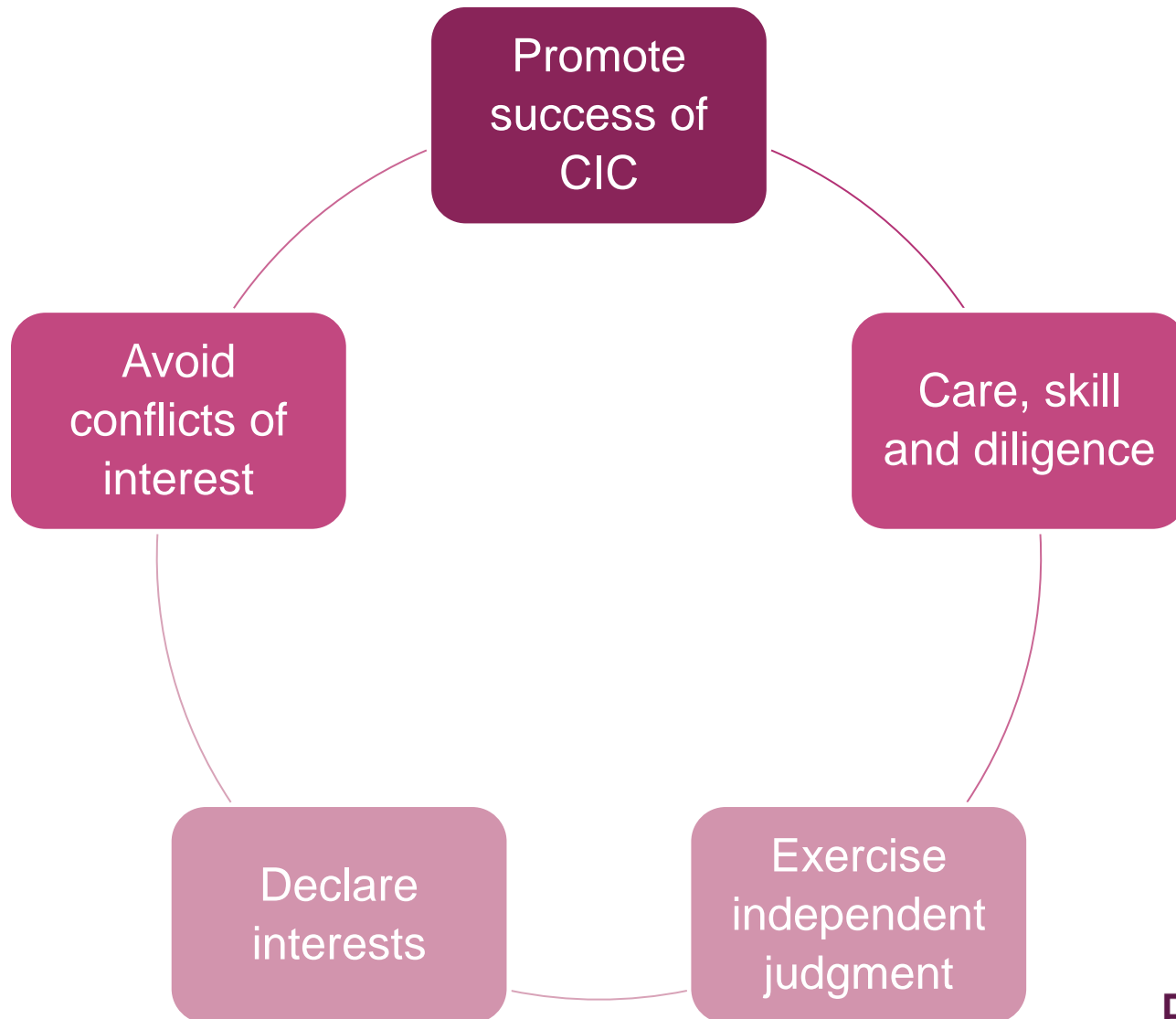
Directors must ensure that the CIC continues to satisfy the community interest test. This means:

- It should be able to show that a reasonable person would consider that the CIC's activities are being carried on for the benefit of the community.
- Not limiting benefit to members of a particular body.
- Not undertaking political activities.
- Not all of the CIC's activities need to have a direct benefit to the community but everything a CIC does should somehow contribute to benefiting the community.

## THINK ABOUT...

- *How the CIC engages with its stakeholders*
- *Balancing shareholder benefit with community benefit (e.g. sacrificing dividends) where necessary*
- *Compliance with the CIC's 'asset lock'*

# Directors' statutory duties under Company Law



# Directors' duties: 1. Duty to promote success of the company



## Directors' duties: 2. Duty to exercise care, skill and diligence

Directors must exercise the care, skill and diligence which would be exercised by a reasonably diligent person with:

1. The general knowledge, skill and experience that may reasonably be expected (objectively)
2. The general knowledge, skill and experience that the director actually has

The duty will be greater if a director has (or claims to have) any special knowledge or experience, or if their business or profession means they can reasonably be expected to have special knowledge or experience

## Directors' duties: 3. Duty to exercise independent judgment

Directors must make decisions with the best interests of the Mutual in mind – if the director is also on the board of (or employed by) the local authority, or any other company or charity, they must concentrate on **the best interests of the Mutual only** when acting as director of the Mutual.



**CIC**

**Third Party  
Organisation**



# Directors' duties: 4. Duty to declare interests (and avoid conflicts of interest)

## Legal duty to act in the interests of the CIC:

- A duty to disclose a potential conflict of interest
- A duty to manage an actual conflict of interest
- Directors should not allow their personal interests or those of their company to override this: they must exercise independent judgment

## Conflicts of interest tend to arise in two forms:

- Where there is a potential financial or measurable benefit directly to a director, or indirectly through a person connected to a director (e.g. parents, children, siblings, companies)
- Where a director's duty to the company may compete with a duty or loyalty he/she owes to another organisation or person

## Three-step approach:

- Identify potential conflicts of interest
- Declare any interests in proposed transactions
- Record the conflict of interest and how it was handled

## Directors' duties: 5. Duty to maintain confidentiality

- Directors have a duty to maintain confidentiality over information given to them as directors.
- They must consider the best interests of the company in all decisions as to whether to disclose information.
- This duty comes from a different legal source to the other duties listed in this toolkit, and if the duty of confidentiality conflicts with one of the other duties then these other duties may take precedence; it is advisable for directors to take legal advice where they are unsure on this issue.



# Payments to Directors

Directors can be paid for their services to the CIC, and for some working for the CIC may be their full-time job, provided the payment is reasonable.

## IMPORTANT POINTS

- Transparency
- Reasonableness (be able to justify the need for payment and the level of salary)
- Conflicts of interest (check your Articles and any conflicts policy)
- Need to explain any salaries and payments to the CIC regulator in the annual return

**NOTE:** Directors can also be paid for goods and services provided to the CIC from time to time, in accordance with the Articles of Association. Remember to comply with conflicts of interest provisions when making decisions about such payments.

# Directors' liabilities

## Wrongful and fraudulent trading

- Directors will commit an offence if they continue to trade when they are aware that the CIC is likely to go insolvent. They have a duty to minimise the potential loss to a CIC's creditors.
- Fraudulent trading is an offence committed when directors carry on business with intent to defraud the creditors of a CIC.
- *Possible consequences: a fine, order to make payment to CIC or to creditors, and/or imprisonment*

## Personal guarantees

- If a director gives a guarantee in his personal capacity and without the authorisation of the CIC, they will be personally liable to the other party if the obligations promised are not fulfilled.
- *Possible consequences: compensation to the CIC and/or to the third party for any losses caused*

## Criminal sanctions

- Certain legal requirements carry personal criminal liabilities for directors if not complied with, such as Health and Safety law.
- *Possible consequences: fine or imprisonment*

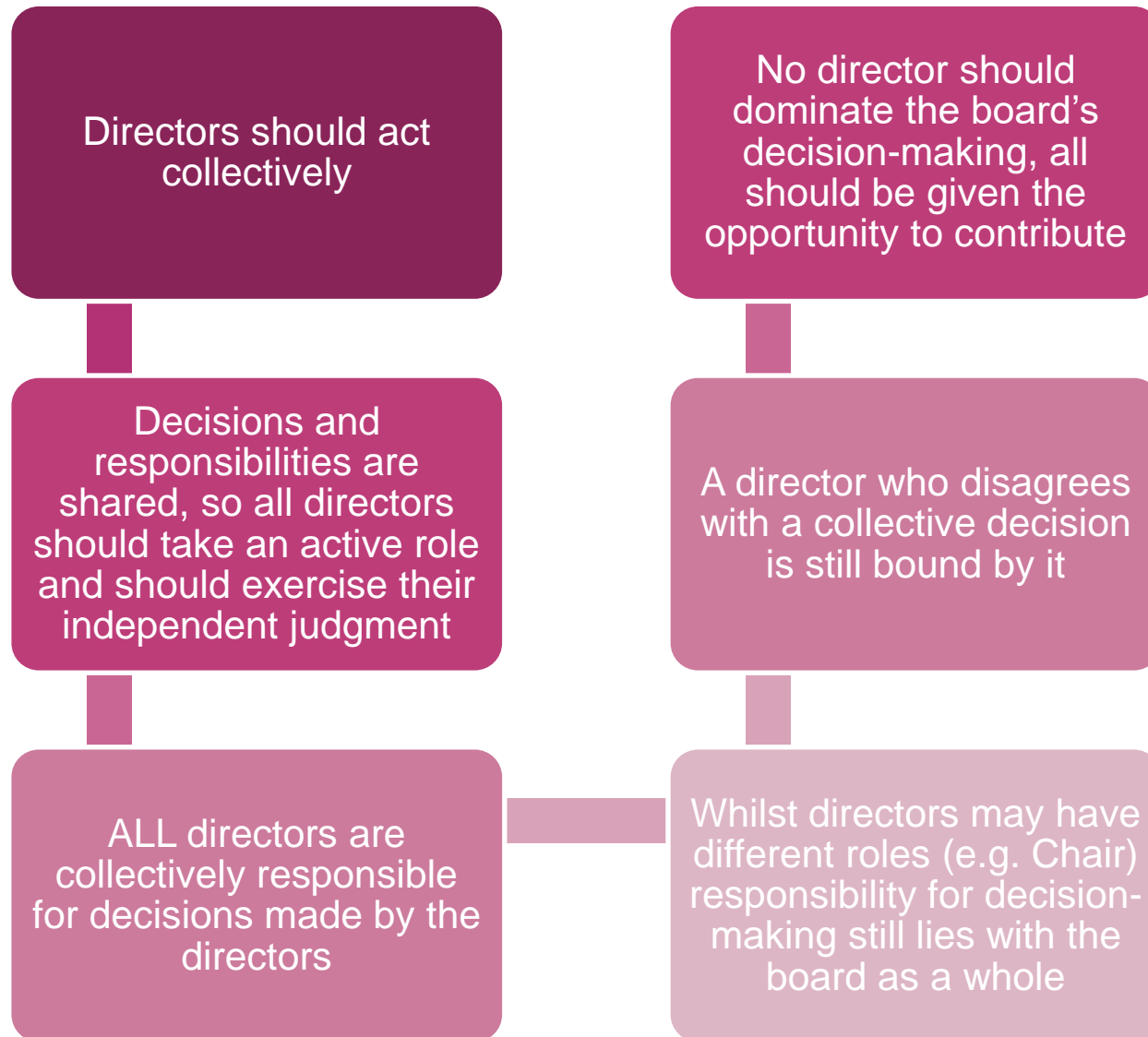
## Breach of fiduciary duty

- Directors can be personally liable to the CIC or to creditors for failing to exercise their duties as set out in this toolkit.
- For example, if the CIC loses money due to a director's lack of care, skill and diligence then the director may be liable to repay the money to the CIC.
- *Possible consequences: order to make payments, including compensation for losses, to CIC and/or creditors*

# Minimising risks or personal liability

- Act reasonably
- Act honestly
- Appropriate oversight
- Formal risk assessment
- Contractual limitation
- Indemnity insurance
- Don't give personal guarantees!

# Responsibility to make decisions effectively



# Directors must accept responsibility for everything the CIC does...

Directors are responsible for the vision, mission and overall management of the charity. They are accountable if things go wrong

However, directors are able to and should delegate in certain circumstances



Directors must comply with ground rules when delegating power:

**Power to delegate** as set out in Articles – which powers are the directors permitted to delegate and to what extent?

**Terms of Reference** for Delegated Committees

**Budget** – specific approval by the board for expenditure over a certain amount?

**Meeting requirements** of committees with the board

**Reporting requirements** by committees to the board

# Good Governance



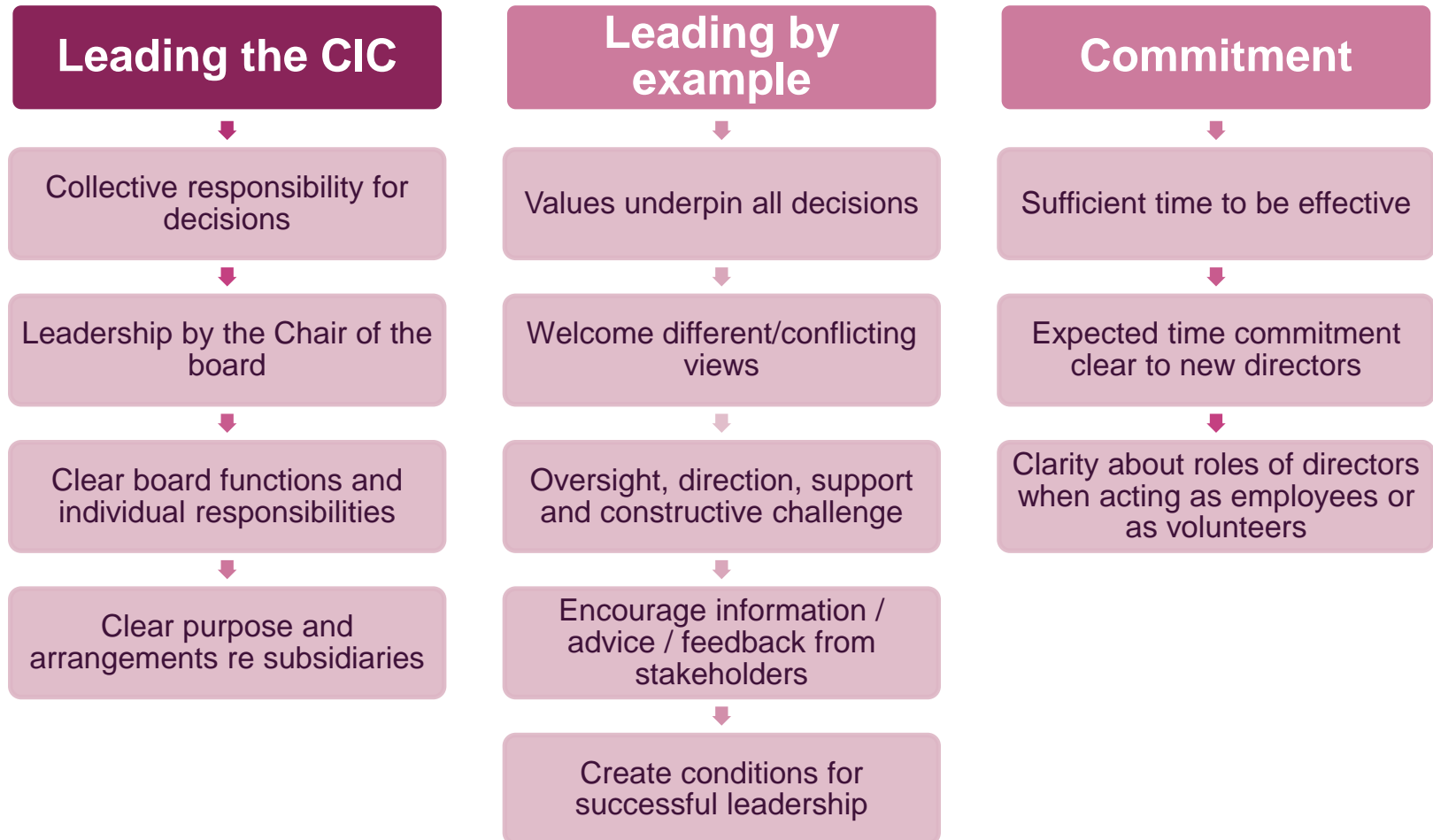
# Good Governance – general principles



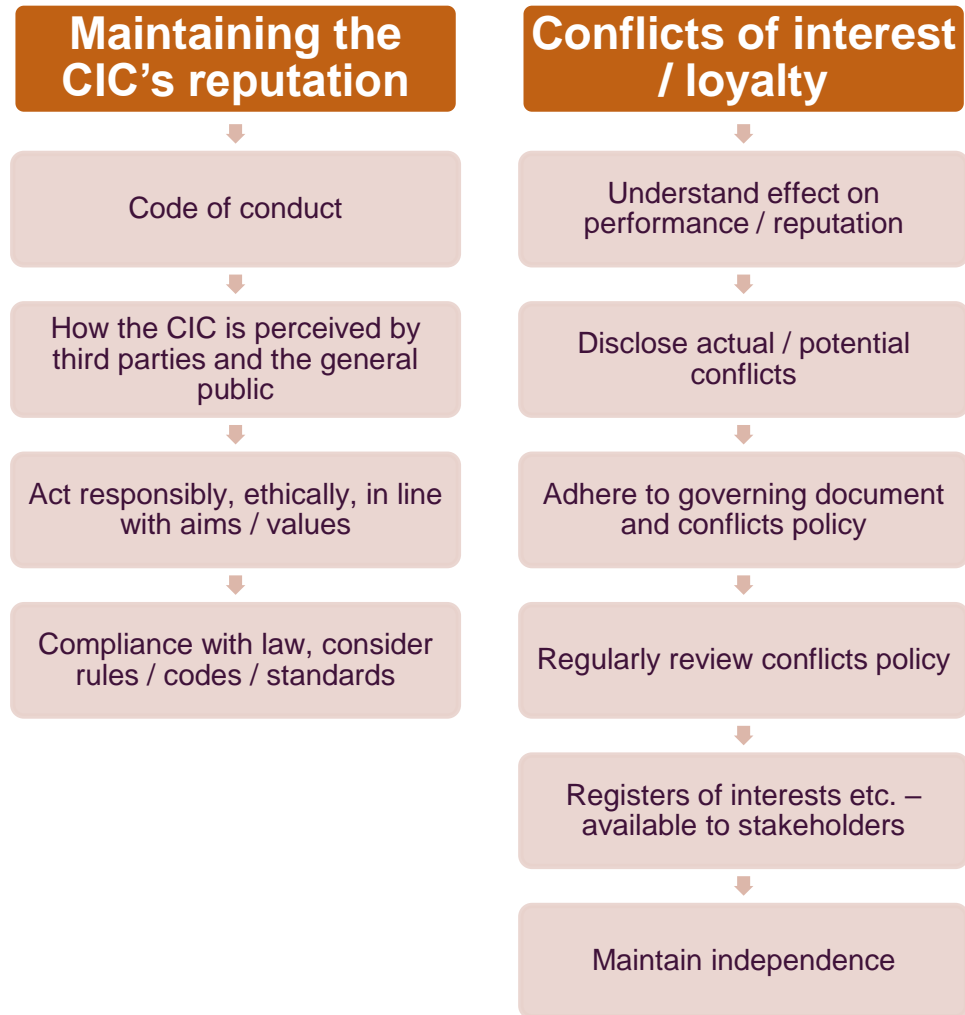
# Principle 1: Organisational Purpose



# Principle 2: Leadership



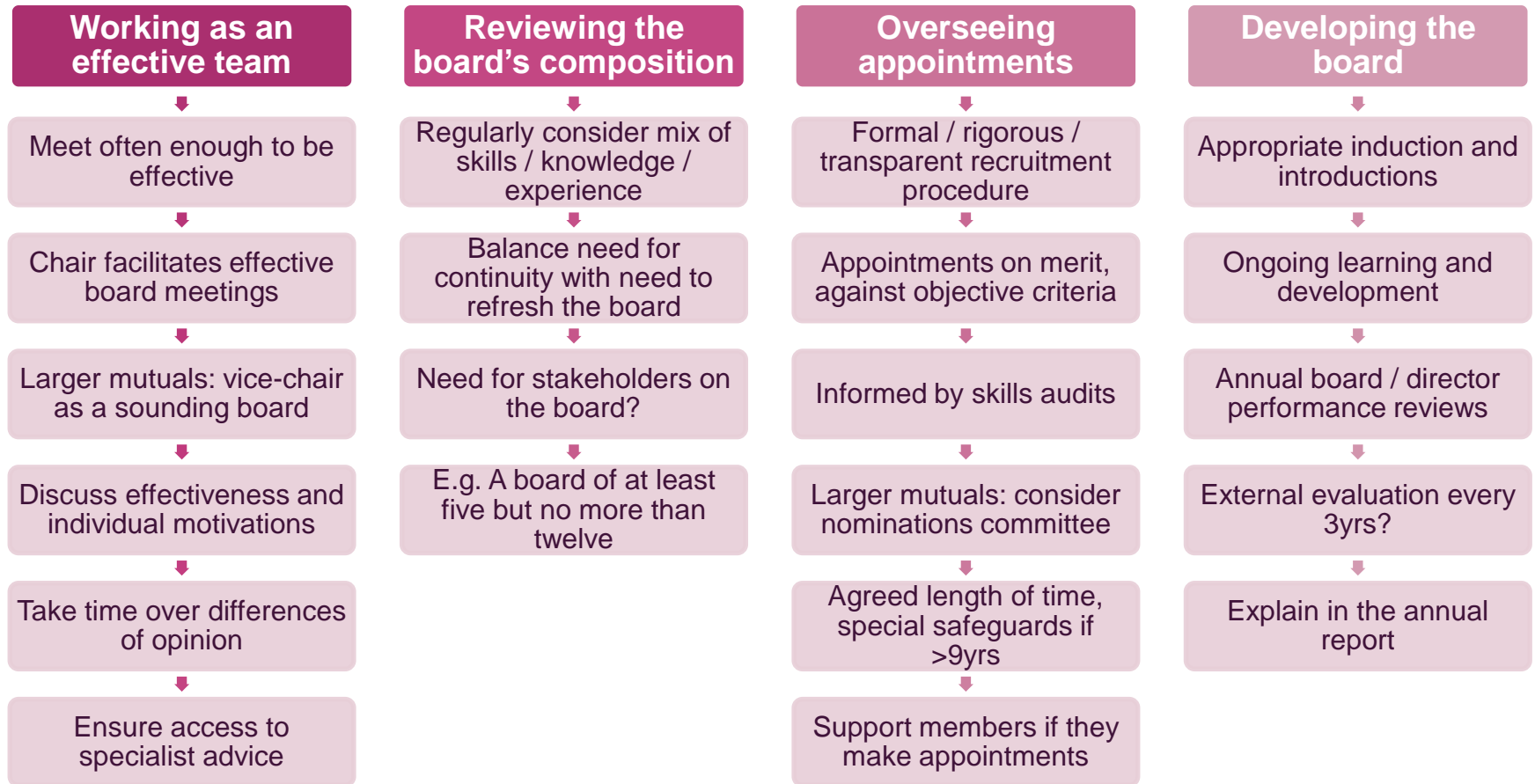
# Principle 3: Integrity



# Principle 4: Decision making, risk and control



# Principle 5: Board effectiveness



# Regulatory regime

CICs are subject to the following regulatory regimes:

- CIC Regulations 2005
- Companies Act 2006
- The Company, Limited Liability Partnership and Business (Names and Trading Disclosures) Regulations 2015 (SI 2015/17)
- The guidance of the CIC Regulator

The CIC Regulator's own guidance acknowledges that the regulatory regime for a CIC is light touch, and relies on self-reporting or others bringing any matters of concern to the CIC Regulator's attention.

# Records and Reporting

Part of good governance is good administration of the CIC as required under the regulatory regime. This includes:

- Keeping records of board and committee meetings
- Keeping register of members up to date
- Annual filings to Companies House:
  - annual audited accounts
  - community interest company report
  - confirmation statement
- Ad-hoc filings with Companies House, such as appointments or terminations on the board or change of address
- Maintain financial and statutory records





# Meetings

- The CIC's Articles of Association will usually contain the procedure by which directors' meetings are called and held. Although there is no absolute legal requirement on how often the board should meet, directors simply need to meet often enough to ensure that they are carrying out their responsibilities properly.
- It may be possible under the Articles of Association for some decisions to be taken outside of a meeting, for example by email.
- It is important to take minutes of meetings and keep written records of decisions made.
- The members will meet annually at the Annual General Meeting if the Articles require the CIC to hold one. They may also need to meet at other times to take particular decisions. It is important to comply with the requirements in the CIC's Articles of Association and in the Companies Act 2006 for giving notice of the meeting and providing copies of relevant documents.

# Delegation

- While directors have ultimate responsibility for the Mutual, they may wish to delegate to others. There are no restrictions on delegating the implementation of decisions, nor on seeking recommendations from others in areas where the directors make the ultimate decisions.
- The power to delegate should be expressed in the CIC's Articles of Association, and the CIC Regulator's guidance states that clearly established lines of delegation are essential to good governance.
- The Articles, or a separate rule/byelaw or policy, should cover what powers are being delegated, to whom is power delegated (e.g. staff or a committee), how any committees will be constituted and details about the timing and nature of reporting back to the full board of directors.
- The board should always set out the terms of the delegation in writing (e.g. by Terms of Reference for committees, or job descriptions for individuals to whom certain decisions are delegated) and keep the delegation under regular review. These terms ought to include sensible limits on delegation.

# Policies

- Policies in key areas help directors and anyone to whom decision making is delegated to manage the CIC effectively and consistently. Some policies are required by law.
- Policies should be ‘living’ aspects of a CIC’s management. They should be followed by directors and staff, reviewed regularly and kept up to date. The board needs to strike a balance between having appropriate policies in place and spending time on the real business of managing the CIC.
- Where relevant, details of certain policies should be recorded in the CIC’s annual report. These may include the CIC’s investment policy, or any other policy which relates to the community benefit test or asset lock.
- Some policies we would expect a well governed CIC to have in place would be:
  - Conflict of Interest policy
  - Staff handbook (including disciplinary policy, anti-bullying policy etc.)
  - Safeguarding and welfare policy
  - Data protection policy
  - Expenses policy

# Glossary

- Annual General Meeting: the annual meeting of members of a company, where key decisions are usually made and members are updated on the progress and activities of a company.
- Articles of Association: the governing document (constitution) of a company, which sets out its purposes, its powers, the rules for its members and directors, and other key provisions relating to its governance.
- Asset lock: explained on slide 6 – this is the principle of community benefit which usually prevents a CIC from transferring any of its assets for less than market value.
- Board of Directors or Board: the term used to refer to the group of directors who run a company (see slides 15 to 31).
- Companies Act 2006: at the time of publication, the main Act of Parliament governing companies in England and Wales.
- CIC Regulations 2005: CICs are subject to these regulations in addition to the provisions of the Companies Act 2006.
- CIC Regulator's Guidance: the guidance issued by the CIC Regulator to aid CICs in complying with their duties under the regulations.
- Community interest test: explained on slide 20 – this test must be satisfied to establish a company, and allow it to operate, as a CIC.
- Company Law: the general term used to refer to the regulations and legislation governing companies, e.g. the Companies Act 2006.
- Confirmation statement: this statement must be provided by companies to Companies House every year to confirm that key information about the company is up to date.
- Insolvency: a company is 'insolvent' when it can no longer meet its financial obligations in accordance with certain rules.
- Liability: legal responsibility.
- Natural person: as a company is included in the legal definition of 'person', we use this term to distinguish an individual person from a company.
- Special resolution: a decision passed by the members of a company by a 'special majority' i.e. 75% or more voting in favour.
- Written resolution: a decision passed by the members of a company in writing, outside of a meeting.

# Signpost to other Resources

- CIC Regulator:

<https://www.gov.uk/government/organisations/office-of-the-regulator-of-community-interest-companies>

- CIC guidance:

<https://www.gov.uk/government/publications/community-interest-companies-how-to-form-a-cic>

Chapter of guidance covering corporate governance:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/605421/13-712-community-interest-companies-guidance-chapter-9-corporate-governance.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/605421/13-712-community-interest-companies-guidance-chapter-9-corporate-governance.pdf)

- Get Legal (model legal documents and policies):

<https://getlegal.bwbllp.com/>



# Thank you.



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