*Keeping Kids Company* – are the rules for disqualifying those guilty of misconduct in running incorporated charities different?

By Abbas Mithani\* and Dr John Tribe\*\*

Much has been written and commented about the spectacular collapse of the high-profile charity known as *Kids Company* or *Keeping Kids Company* (“the Charity”). The Charity was incorporated as a company limited by guarantee and primarily operated to enhance the emotional health of young people through counselling, support and art therapy, and to help schools, and other educational institutions, address the emotional needs of young people. It stopped operating on 5 August 2015 and was wound up by the court on 20 August 2015.

The collapse of the Charity attracted widespread publicity. Several negative articles were written, and adverse comments made, in the media and elsewhere about its activities. The Charity was also subject to several public reports about those activities, most notably by the National Audit Office on 29 October 2015, Public Administration and Constitutional Affairs Committee on 21 January 2016, and, most recently, by the Charity Commission on 10 February 2022. The last report concluded, among other things, that “in [the Charity Commission’s] opinion … the Charity operated under a high-risk business model as illustrated by the combination of (i) heavy reliance on grants and donations, (ii) reliance on a key fundraiser (the CEO), (iii) a lack of reserves and (iv) a demand led-service. The trustees were aware of these risks and continued to operate the Charity under the same model for many years, only developing a restructuring plan in the last months of the charity’s operation”.

Brief Overview of the disqualification claim brought against the CEO and directors of the Charity

On 17 August 2017, the Official Receiver, acting on the directions of the Secretary of State for Business, Energy and Industrial Strategy issued a claim for a disqualification order under s 6 of the Company Directors Disqualification Act 1986 (“the CDDA 1986”) against the CEO of the Charity and against its directors who were in office at the time of its collapse. Before the trial of the claim, one of the defendant-directors entered into a disqualification undertaking in favour of the Secretary of State. The claim against the rest of the defendants was tried by Falk J over a period of some 10 weeks. The judge delivered a detailed judgment in the claim on 12 February 2021 in which she dismissed the claim against all those defendants: see [2021] EWHC 175 (Ch).

Section 6 of the CDDA 1986 requires the court to disqualify a director (whether *de facto* or *de jure*) or “shadow” director for a period of at least two years if it makes a finding that he is unfit to be concerned in the management of a company. If the court finds that the complaints alleged and proved against the defendant are sufficient to support a finding of unfitness, the making of a disqualification order for a minimum period of two years is mandatory. The maximum period for which a disqualification order may be made is 15 years. Under section 6(1) of the CDDA 1986, there is no judicial discretion to avoid the imposition of a period of disqualification. Accordingly, the question for the judge to determine was whether the CEO of the Charity, who was not formally appointed as its director, was nonetheless a director in fact (i.e., a *de facto* director) and, if she was, whether she and the other defendants (who were formally appointed as directors) were each unfit to be involved in the management of a company.

For the purpose of considering the question posed by this article, neither the facts of the case nor the detailed reasons given by the Judge to support her conclusions (including the Judge’s decision that the claim should be dismissed) require mention. The purpose of this article is to consider whether, as a result of certain of the observations made by the Judge in her judgment, which can only be said to be *obiter*, the rules relating to the liability of persons to be disqualified under the CDDA 1986 may or should be different for those who run corporate entities in the charities sector from those who run other corporate entities. However, three points about the decision should be noted: first, the charge brought against the defendants was that they had “caused and/or allowed [the Charity] to operate an unsustainable business model”, a charge never, to the authors’ knowledge, having been brought in a previous disqualification claim. The Official Receiver had sought to amend the charge before the trial but the Judge refused to accede to it: [2020] EWHC 2839 (Ch); second, once, the Judge had decided that the charge could not be proved on the facts, there could be no question of her deciding that the defendants were unfit. The claim had to be dismissed, though, it is difficult for the authors to reconcile the findings of the Judge with the views of the Charity Commission in its Report dated 10 February 2022; and third, the exoneration of the directors of the Charity was based on a generous application by the Judge of the law relating to the ability of directors to delegate particular functions, premised on the fact that the directors were “non-executive” directors and did not receive remuneration for the services they provided to the Charity: see [2021] EWHC 175 (Ch), at [856]-[859]. The analysis carried out by the Judge on this issue could allow *de jure* directors who do not receive remuneration, or adequate remuneration, for the services they provide to a company to pass blame for their inadequate supervision of a function delegated to those below them in the management chain. Indeed, in the case itself, it is difficult to understand where the buck would have stopped – and who would ultimately have had to bear responsibility for the demise of the Charity – if the charge made, or some other charge, had been established.

The Judge reiterated several matters about the fair and transparent pursuit of disqualification claims. Specifically, the Judge: (i) indicated that it was important for defendants have to be able to clearly ascertain the allegations and evidence against them; (ii) stated that particular emphasis had to be placed on the requirements of balance and fairness in assembling reports and evidence and making submissions, and the decision whether to bring disqualification claims had to be reached with care; (iii) stated that care had to be taken to minimise the risk that lengthy reports, and thus the presentation and conduct of the case, might amount to oppression; and (iv) reiterated that the resources involved in bringing disqualification claims, and the scale and nature of the case, had to be viewed in the overall context. These propositions are plainly correct and supported by a wealth of previous authority: see *Mithani: Directors’ Disqualification*, Division II, Division III Chapter 2, Division IV, Chapter 1, Division VIII, *passim*.

The Judge’s comments about disqualifying those guilty of misconduct in running incorporated charities

Falk J stated, applying cases such as [*Attorney General v City of Exeter*](https://uk.westlaw.com/Document/I3D174E90094311DEA5EFF13444E92BFC/View/FullText.html?originationContext=document&transitionType=DocumentItem&ppcid=da516a1eaadd4616a1a83cb2586e646b&contextData=(sc.Search))  (1826) 2 Russ 45 and [*Lehtimaki v Cooper* [2020] UKSC 33](https://uk.westlaw.com/Document/IC5AF2C40D19711EABFC1E47CD76B7CE5/View/FullText.html?originationContext=document&transitionType=DocumentItem&ppcid=da516a1eaadd4616a1a83cb2586e646b&contextData=(sc.Search)), that while the directors or trustees of charitable companies had the same duties, and were liable to disqualification in the same way, as other company directors, the courts might take a benevolent approach towards directors and trustees where there was no allegation of dishonesty or wilful misconduct on their part. It is difficult to see how this statement can be correct as a bare proposition of law. In the cases relied upon by Falk J, the courts were primarily having to consider (or were commenting on) the liability of charity trustees for breaches of duty and the like, a much narrower enquiry which the court needed to conduct than the enquiry which it needs to conduct where it has to decide whether a director should be disqualified under section 6 on the ground of “unfitness”.

“Unfitness” does not require that the director should be in breach of the fiduciary or other duties he owes, a point that the judge appears to have accepted: see, for example, *Secretary of State for Trade and Industry v Goldberg* [2003] EWHC 2843 (Ch). It simply requires whether, adopting a broad-brush approach, which has to have regard to all the circumstances of a particular case, the Secretary of State or Official Receiver has satisfied the court that the conduct of the director was serious enough to make him unfit to be concerned in the management of a company so as to warrant the making of a disqualification order against him: see *Re Westmid Packing Ltd (No 3), Secretary of State for Trade and Industry v Griffiths and others* [1998] 2 All ER 124. Falk J correctly observed, at [852], that in deciding unfitness, “what must be assessed is the individual's conduct, and that must be evaluated in its context. That context, or setting, must include the nature of the company and its activities, as well as (for example) the role played by the individual director. The fact that the company was a charitable company is a relevant part of the context”. However, it is a little more difficult to see how her subsequent observation – that “[i]t could mean, for example, that incompetent conduct which might merit a finding of unfitness in a director of a commercial company would not necessarily [the Judge’s emphasis] lead to the same conclusion in a different, charitable, context” – can be correct. Plainly, as the Judge observed, “in each case conduct must be assessed in its factual setting. It is one of all the circumstances to take into account. Its materiality or otherwise will depend on the facts of the case”. However, where the circumstances concerning the conduct of a director in a non-charitable corporate enterprise warrant the making of a finding of unfitness against that director, it is difficult to conceive of circumstances where the exact same conduct, without more, would be considered to be insufficient to constitute unfitness against a director in an incorporated charity. As His Honour Judge Behrens, sitting as a Judge of the High Court, observed in *Re Brampton Manor (Leisure) Ltd* [2009] EWHC 1796 (Ch): “where a director simply fails to undertake, whether through lack of knowledge, incompetence or whatever, those duties which he ought to undertake, he is as guilty as those who do positive wrong, and, if anything, probably even more dangerous”.

Nor is it clear to the authors why, as Falk J stated, at [911], directors or trustees of incorporated charities should be afforded special treatment based on the premise that the charity sector depends on capable individuals being prepared voluntarily to take trusteeship roles (particularly, as the Judge observed, if, as was the position in relation to all but one defendant in that case, the directors or trustees provided their services to the charity entirely gratuitously). The Judge qualified this statement by saying that such individuals might be dissuaded from doing so on the basis of the perceived risk of disqualification proceedings based on “wide-ranging but unclear allegations of incompetence”. While the allegation in that case might have been wide-ranging and unclear and, therefore, insufficient to warrant disqualification (though opinions on this will differ), if that statement were accepted by the court, directors (particularly non-executive directors) of companies in other sectors might also be able to argue that they should be treated differently (particularly if they were also not paid) because the availability of expertise in their sector was scarce. This argument might also be adopted by directors who were members of “unlimited” companies – i.e., a company where the liability of the members is unlimited – on the basis that because they decided to be liable for all the debts of the company, they should be afforded special treatment on the ground that they did not seek to abuse the privilege of limited liability. It is not surprising that arguments of this type have largely been rejected by the courts: see, for example, *Re Continental Assurance of London Co plc* [1997] 1 BCLC 48. Indeed, the application of the disqualification regime of the CDDA 1986 to an insolvent partnership, albeit by an express extension of the regime pursuant to delegated legislation (i.e., the Insolvent Partnerships Order 1994), is evidence of the fact that a person may, in certain circumstances prescribed by Parliament, be disqualified for running a company on the basis of his conduct in running an unincorporated organisation if it can be demonstrated that that conduct made him unfit to run a company. The question also arises whether, in such circumstances, individuals might decide to set up as charitable companies in order to avoid the full rigour of the insolvency and disqualification regimes.

Falk J also suggested, at [910], that the primary means of regulating the behaviour of directors or trustees of incorporated charities should be the Charity Commission, ”being the regulator that has the most appropriate expertise”, stating, at [909], that “she was struck by the lack of experience that the Official Receiver had had in relation to charities, in particular the failure to give full recognition to the fact that it is common for charities to be heavily dependent on donations, and the apparent difficulties that both the Official Receiver and deputy Official Receiver] had with the concept of wholly non-executive boards of directors”. The authors disagree with this suggestion for a number of reasons. They include the following:

The regulation of incorporated bodies, including an incorporated charity, has expressly been prescribed by Parliament to be undertaken through the disqualification regime under the CDDA 1986, which, for this purpose, has been described as “regulatory” in nature: see, for example, Re Westminster Property Management Ltd (No 1), Official Receiver v Stern [2000] 2 BCLC 396, CA.

The effect of a disqualification order or disqualification undertaking is “economy wide” so that if the conduct of the directors of a charitable company warrants the imposition of disqualification, they will be prohibited from running any company (whether charitable or not) for the period of the disqualification and (by way of the extension of the prohibitions which apply to disqualified persons) also barred from being charity trustees under section 178 of the Charities Act 2011. In contrast, disqualification as a charity trustee is limited to involvement in the charity sector, so if a person is disqualified as a charity trustee by the Charity Commission, he or she can run or continue to run an incorporated body which is not a charity with impunity;

The clear intention of Parliament was that the disqualification regime should regulate standards of corporate behaviour, regardless of the type of business which the corporate vehicle deployed for this purpose undertakes. The charity sector is no exception to this – a fact made clear from section 22(2) of the CDDA 1986, which defines the expression “company” in the widest possible terms, to include virtually every type of company. There is no suggestion in the CDDA 1986, Charities Act 2011, or any other legislation that alternative regulatory regimes would be more appropriate to bring those who run incorporated entities to account for their behaviour. Indeed, every indication is that the regime for disqualifying directors is the most appropriate regime to regulate the standards of corporate behaviour across all sectors, including the charity sector, a fact made clear by section 22F of the CDDA 1986 which applies the disqualification regime under the CDDA 1986 to a charitable incorporated organisation (“CIO”) even though a CIO does not fall within the meaning of the expression “company” in s 22(2). Even banks and (by virtue of section 22A of the CDDA 1986) building societies are susceptible to the disqualification regime under the CDDA 1986, despite the fact that the regulation of those institutions is primarily in the hands of the Financial Conduct Authority (“FCA”) and/or the Prudential Regulation Authority, neither of which bodies are given standing to bring disqualification claims (other than the FCA under section 9A for competition breaches).

The Charity Commission (and many other sectoral regulators) are, it is respectfully suggested, ill-equipped to conduct the type of detailed investigation which the Insolvency Service (on behalf of the Secretary of State or Official Receiver) is able to do. That is why (other than for competition breaches under section 9A of the CDDA 1986) none of them is given power to bring disqualification claims.

It is important also not to place too much emphasis on the apparent lack experience and expertise on the part of the Insolvency Service in dealing with particular sectors, such as charities. In the first place, the test for deciding whether a person should be disqualified (under sections 6 and 8, at any rate) is whether he has shown himself to be unfit in the running of a company: see, for example, *Re Clean & Colour Ltd, Secretary of State for Trade and Industry v Tuck* [2001] All ER (D) 200 (Apr), referring to *Re Westmid Packing Services Ltd (No 3), Secretary of State for Trade and Industry v Griffiths and others* [1998] 2 All ER 124: a “broad brush approach” is required. That does not require any substantial expertise or knowledge of the particular sector in which the company operates, though this type of expertise or knowledge will, in almost cases, be available to the Insolvency Service anyway, if not from officials from those sectors (with whom the Insolvency Service will always work closely) then from solicitors and counsel that it instructs. Second, taking to its logical conclusion, the same could be said of corporate entities in other sectors which fall to be “regulated” as companies under the disqualification regime, such as those which operate in the financial services sector. If the Judge’s observations were adopted, it would mean that only regulators for those sectors (rather than the Insolvency Service) should be responsible to bring those who run such entities to account for their misconduct.

There is no statutory equivalent of many of the measures which have been put in place under the CDDA 1986 to ensure that the regime for disqualifying directors operates efficiently at a practical level (for example, through the “undertakings” regime) and allows creditors to be compensated for directors’ misconduct (for example, through the payment of compensation under sections 15A and 15B of the CDDA 1986). On the latter point, the public would be seriously short-changed if regulation were undertaken through the Charity Commission. Although in such a case, the possibility exists that a disqualification claim could follow any action which the Charity Commission decided to take, there would be immense practical difficulties (not to mention the costs involved) in doing so.

Conclusion

It is unlikely that the general proposition that directors or trustees of an incorporated charity should be treated more benevolently (by reason only of their being a director of an incorporated charity) will be adopted by a higher court. To do so would drive a coach and horses through the disqualification regime, with those who run corporate enterprises in other sectors similarly claiming to be entitled to special treatment. As Jonathan Parker J (as he then was) observed in *Re Barings plc (No 5)* [1999] 1 BCLC 433 at 488b–d (affd [2000] 1 BCLC 523 at 535, CA), the degree of care required from a director may vary substantially with the size and type of business of the company, with greater care being required of a director of a larger company. The degree of care required may also vary depending upon a wide variety of other factors, such as the level of “reward” which the director received or was entitled to receive. In the context of a director or trustee of an incorporated charity, these are all matters which must be put in the mix in deciding whether a director is unfit. However, it is quite another matter to posit the proposition that a director or trustee of an incorporated charity may escape disqualification by reason of his running a charity in circumstances where a director running a non-charitable enterprise, in similar circumstances, would not. The Judge accepted, as must be correct, that directors of all companies (including charitable companies) owe the same duties. However, the observations of the Judge could be interpreted as supporting the premise that the duties owed by directors or trustees of incorporated charities are different from those owed by other directors. This would not only be wrong in principle but also not supported by authority.

Nor can the suggestion that the Charity Commission (not the Insolvency Service through the operation of the disqualification regime) should regulate the behaviour of directors or trustees of incorporated charities be correct. That suggestion could only be implemented by wholesale changes being made to the CDDA 1986 and other legislation. The CDDA 1986 has evolved over a number of years to provide the most effective form of protection to the public from the conduct of errant directors. Any such changes would substantially lessen that protection and would be a retrograde step for the Government to take.

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