

PARISH COUNCILS AND COMMUNITY COMPANIES

Summary

This note sets out ways in which a council can seek to avoid becoming liable for the debts of a community company.

This note refers to *boards* and *directors*, but in some cases the board may be referred to as a *committee*, and directors as *trustees*.

Background

1. Many parish councils are approached by community organisations asking that a Parish Councillor becomes a member of their board of directors to assist in liaison between the organisation and the council. There is often great merit in such a step and no **legal** reason to decline such a request. A nominated councillor must consent to becoming a director.
2. The legal status of such an organisation needs to be known, is it a limited company by either shares or guarantee, and/or a charity or just a members group (an unincorporated association)?
3. The usual legal position is that directors are not personally liable for a company's debts unless they have given specific guarantees, for example to the bank. In a company limited by guarantee, the members are only liable up to the amount of the guarantee, often just a nominal £1.
4. Directors may become liable for the company's debts if there has been *Wrongful Trading*. This is where companies continue to carry on their daily business but are trading insolvent, that is, unable to pay their debts as they fall due. It is usually a case of hoping that things will improve even though they continue to spiral downward. In wrongful trading there is no intent to defraud the company's creditors but merely a case of poor judgement or the failure of directors to carry out their responsibilities.

5. In such a case, once the company is put into receivership or administration, the liquidator can seek a court order requiring the directors at the relevant time(s) to contribute towards the company's debts. This is rare in practice.
6. When a Councillor is appointed to the board of a company, they have two potentially conflicting duties:
 - Their duty as a Councillor towards the council; for example, when in a council meeting, and
 - Their duty as a Director towards the company; for example, when at a board meeting

It is always good practice to remind fellow directors or councillors (as the case may be) of their other role.

7. The links below give more information on the duties on directors but an honest and well-founded belief that a dip in the company's fortunes is only temporary is unlikely to attract a claim on the directors. [It should be noted that persistent absence by a director from board meetings is not a way of avoiding liability, indeed such absences may increase the likelihood of a claim against an individual.]
8. On occasions, unscrupulous traders have sought to avoid this potential liability by having nominee as directors, usually people without assets and so not worth suing. In 1986 provisions were introduced to enable recovery from *Shadow Directors*, i.e. the people with real control of the company.
9. It is therefore important to ensure that the company is not seen as being under the actual control of the council. It is perfectly proper for a community company to **consult** the council before deciding on a course of action. Care must be taken to ensure that the company does not seek the **approval** of the council, unless there is a reason, such as a clause in a lease between the council and the company.
10. Care should be taken when drafting minutes of both council and board meetings to avoid giving the impression of control.

11. In conclusion, there is nothing new behind this note and the provisions are now over 30 years old. With prudent wording and a clear understanding of the different roles of *Councillor* and *Director*, the potential for shadow director claims will be minimised.
12. The need for compliance with the council's adopted code of conduct remains. Councils will need to consider whether to grant a dispensation to allow the councillor-directors to participate in council discussions which may affect the company.
13. The note does not deal with the position where the Council is a director as different issues arise.

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More Information

The Companies House Guidance on running a company

<https://www.gov.uk/topic/company-registration-filing/running-company>

and on the legal duties of a director

<https://www.gov.uk/guidance/being-a-company-director>

A December 2017 article by one of local govt.'s leading experts on local authority companies

http://localgovernmentlawyer.co.uk/index.php?option=com_content&view=article&id=33512%3Arunning-local-authority-trading-companies&catid=49%3Acomment-a-analysis-articles&Itemid=1

The national NALC have produced an LTN 31 on setting up a company – available on the members' part of their website