

The Kids' Company Case - Moving a Line in the Sand

As she wrote her 220 page judgement in the Kids Company case* was the Judge remembering another lawyer, namely Lieutenant Colonel William Barrett "Buck" Travis?

Travis, then aged 26, is remembered for drawing a line in the sand in 1835 at the Alamo. The Judge appears, in this case, to have drawn another line. This time it was about the sustainability of charity business models. It contains some important comfort for non-executive board members.

Background

The Official Receiver sought to disqualify the board members and the chief executive of the Kids Company, Ms Batmanghelidjh, from acting as directors or being involved in the management of a company. The allegation against the defendants was of having "caused and/or allowed Kids Company to operate an unsustainable business model". The allegation of operating an unsustainable business model was elaborated on by a number of matters relied on by the Official Receiver.

These included criticisms of Kids Company's "demand led" model, inadequate governance or control (in particular financial control), failing to build up reserves, and failing to plan for increasing risk as the business and client base grew. There was also a particular focus on the cash flow difficulties that the charity had faced, in particular its reliance on loans and on what were said to be over optimistic expectations about income, and delays in payments to creditors.

Outcome

After a 10 week hearing, the court concluded, on this issue, that whilst aspects of Kids Company's operating model were high risk, its operating model was not "unsustainable" in principle.

Many commentators were opened mouthed about the contrasting views of the Public Administration and Constitutional Affairs Select Committee (PACAC) and the Judge on the board members.

The PACAC concluded:

"the Chief Executive and Trustees relied upon wishful thinking and false optimism and became inured to the precariousness of the charity's financial situation."

By way of contrast, in her judgement, the Judge wrote:

"The decisions they made were matters of honest judgement, made in difficult circumstances in what they thought were the best interests of the charity. The Official Receiver has not demonstrated that decisions the Trustees took, or failed to take, in the factual context were outside a range of reasonable decision-making..."

She added:

"The public need no protection from these Trustees. On the contrary, this is a group of highly-impressive and dedicated individuals who selflessly gave enormous amounts of their time to what was clearly a highly challenging trusteeship."

While the judgment is very fact specific it is interesting to consider its implications for charities reserves and for those charities with a dominant chief executive.

The PACAC noted:

“The Charity Commission’s guidance warns that Trustees must avoid exposing the charity’s assets, beneficiaries or reputation to undue risk and take care not to over-commit the charity. Kids Company relied on a hand-to-mouth existence and by refusing to prioritise the building of any significant reserves, the Trustees failed to exercise this duty of care towards the charity’s clients, employees and donors.”

In evidence to PACAC, William Shawcross, Chair of the Charity Commission, stated that a responsible approach to reserves “is a problem for all charities.” He is quoted as saying:

“We advise charities that they should spend their money, and at the same time they must have adequate reserves, so it is quite a hard act for them to follow.”

The questioning of the Kids Companies auditors illustrated just how hard an act it is to follow. The PACAC report noted that the auditor had:

“suggested that six months spending (about £12 million) would have been an appropriate level of reserves for Kids Company’s size and demand-led model. However, Kids Company sustained free reserves at a fraction of this level throughout its existence;”

The Judge agreed this was desirable, but thought that reserves at the expense of the charitable objects was properly a matter for the judgement of the Trustees.

What this judgement means for RPs

Let’s imagine a board of an RP or a charity providing housing for severely handicapped find they have to undertake urgent repairs to the properties, which will use up all of their reserves and necessitate extensive restructuring of the organisation.

The judgment indicates that if a charity’s board reasonably believes that additional funding could be obtained from the government, a local authority or donor, it could continue to run down its reserves.

What is to stop the ambitious chief executive of our handicapped charity using the judgment to try and persuade the board that as the charity has a “demand led” operating model? As a result, the “line in the sand” drawn

by the Charity Commission guidelines on reserves (CC19) has just been moved, by the judgement – so the charity’s funds could be spent as they are received. So much for building up 6 month’s reserves!

Taking the matter a step further, why shouldn’t the RP’s director of development argue that as an RP has a reasonable prospect of obtaining grant, the trustees should approve an ambitious innovative development, to house the homeless – another demand led project - which will put the RP on the front page of the housing press.

However, many charity and RP boards may be wary of ignoring the existing Commission guidelines even though they may be a “hard act”. The PACAC made it clear that it expected the Charity Commission to go away and produce new guidance on reserves.

The Charity Commission were “hot out of the blocks”, publishing their revised guidance on the 29th January 2016 two days before the PACAC. Its own summary says:

“There is no single level or even a range of reserves that is right for all charities. Any target set by the Trustees for the level of reserves to be held, or decision that there is no need for reserves, should reflect the particular circumstances of the individual charity and be explained in the policy”.

It will also be interesting to see how the Charity Commission intends to use its powers to disqualify trustees under its powers in Charities (Protection and Social Investment) Act 2016. Let’s see what emerges in the light of this case.

PACAC also observed:

“The Charity Commission’s guidance to trustees warns that trustees should not allow their judgement to be swayed by dominant personalities, but this is what occurred in Kids Company”.

Takeaways for board members

As in the case of any Community Benefit Society, an RP can only operate through its board. Management of a business consists of making decisions and implementing them; and while some may be seen as sound and others less so, the Judgment reiterates that the Courts do not judge with the benefit of hindsight, whether the board members took the best commercial view. Their concern is the manner in which the board members took their decision and whether it was within a spectrum of reasonable and prudent outcomes focussed on delivering the objects of the RP. This may at times be at odds to the

view of the Regulator of Social Housing, but the RSH does not itself have the power to bring an action for financial recompense from board members (although it does have the power to remove them).

Steps RP board members should take

Practically what this means for RP board members is that they should satisfy themselves before committing the RP to an agreement or arrangement, including to group arrangements, they have a clear view of where their entity's best interests lie; and that they believe the arrangement be in the RP's best interests, and if relevant, as well as those of the group and advance their objects.

As a result, board members should always be methodical in the way they make decisions and ask a series of questions including; what are my duties, whose interests do I need to consider (and whose should I not)? In addition, board members should record the reasons why a decision was made at the time it was taken.

All board members (including ones who represent any special interest group) are expected to:

- Inform themselves about the business of the RP.
- Understand the key implications of information provided to the board.
- Be satisfied that they have a governance structure to ensure that the major decisions go to the entire board.
- Read the board papers and actively participate in board discussions
- Take appropriate advice
- Take collective decisions on behalf of the RP and have collective responsibility for them.

When making decisions, it should be noted that technically a non-executive director legally bears the same responsibilities as an executive director who is a board member.

Reputational risk

Another main reminder from the case is the importance of reputation and handling a potential crisis. Here charity compliance and the regulatory position of the Regulator of Social Housing are very similar. Board members need to be aware of their organisation's reputation and the importance of its maintenance on the success of their business.

In the case of Kids Company, the whistleblow resulted in a chain of events which led to the demise of the charity, even though it was shown that the allegations were unfounded.

Conclusion

The Kids Company judgment is good news for RP board members who are justifiably concerned about whether the results of their decisions could result in personal liability for them. But the lessons of Kids Company are nonetheless a good reminder for RP boards to ensure they fulfil their responsibilities.

We have produced helpful videos providing a [summary of trustee duties as well as practical guidance for Board Members](#).

We have also prepared a note of issues for prospective trustees to consider including key questions to ask. Please contact Andrew Cowan, Andrew Crawford, Keith Jenkins or your usual contact at Devonshires to request a copy.



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**Kids Company: Official Receiver v Batmanghelidjh & Others [2021] EWHC 175 (Ch)*

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