

REPORT TO THE TRUSTEES OF THE BARLOW INSTITUTE ON INCORPORATION

Further to our meeting with Christine Waring and Peter Russell on 7 May 2019, please find below our advice on the constitutional issues.

A Current position

As you know the Barlow Institute (**Organisation**) is unincorporated. This means it is not a legal entity in its own right. Whilst continuing on that basis has certain attractions in terms of involving relatively less administrative burden and avoiding the costs involved in setting up a new corporate vehicle and transferring the unincorporated Organisation's assets and undertaking to it, it also has a number of significant disadvantages as follows:

- 1 The Organisation, being an unincorporated charity is not a legal entity in its own right and can therefore only act through its trustees as individuals. The trustees have joint and several personal liability for the debts and liabilities of the Organisation. Any contracts relating to the Organisation must be entered into in their own names and may be sued in their own names on matters relating to the Organisation.

Joint and several liability arises when two or more persons (here the trustees) jointly agree in the same contract to do the same thing, but also separately promise to do the same thing. For example, if the trustees promise jointly and severally to pay £10,000 to a builder engaged to carry out work to the building, then not only are they jointly under an obligation to pay the £10,000 but they are also individually under an obligation to pay that sum. In such a case, the builder is entitled to £10,000 in total and it can enforce the obligation in full against all of the trustees or one or more only of them. If the builder sues one trustee and not the others and obtains judgment, the one who has been sued will have to pay the full amount of the judgment. If he does so it is open to him to claim a contribution from the others but the value of that right is dependent on the ability of the others to pay their contribution. By way of an example, if there are two trustees and one pays the builder in full and finds the other trustee has gone bankrupt, the right to claim a contribution is likely to be of little or no comfort.

Whilst the charity trustees are entitled to be indemnified from the assets of the Organisation for any costs and expenses properly incurred by them in the performance of their duties, this right is only as good as the ability of the Organisation to meet those costs and expenses. In other words, if the Organisation's assets are insufficient to meet those liabilities, the trustees are likely to find themselves personally liable for the shortfall. This potential liability is unlimited. A creditor of the Organisation can, as already noted, obtain judgment against the trustees and enforce any such judgment against the personal assets of the trustees including homes, cars etc. If a trustee cannot meet this liability, he may find himself made bankrupt.

The extent to which personal liability of trustees is a concern does, of course, depend on the activities undertaken by the Organisation. For example, if the Organisation is purely

making grants, there may be little risk in practice. If, however, the Organisation, for example:

- provides services;
- employs staff;
- owns and/ or operates substantial property, such as land and buildings;
- enters into commercial contracts (for example, to hire a venue for an event, or engage commercial or professional services e.g. in connection with renovation of buildings);
- has borrowed, or intends to borrow, money

the risks to which the trustees are exposed are potentially very substantial. The existence of these risks may well deter individuals from agreeing to act as trustees.

Our view is that the Organisation falls or potentially falls into most if not all of the categories listed above, Whilst it is, obviously, for the trustees and potential future trustees to make a judgment as to whether the resulting risks are acceptable, our advice is to very seriously consider adopting a limited liability vehicle both for the peace of mind of the current trustees and also with a view to increasing the pool of individuals who may be willing to act as trustees in the future.

- 2 As already noted, the Organisation cannot execute documents, own land, sue or enter into contracts and other obligations in its own name. Rather this can only be done in the individual names of the trustees. As well as the risks outlined above, this may be administratively inconvenient as trustees change relatively frequently. I appreciate that in the case of the land and buildings, the use of North Turton Parish Council as custodian trustee should alleviate this inconvenience, the concern remains very much live in relation to contracts. For example, if you are to borrow significant sums of money for works to be carried out over a significant period, it may be that not all of trustees who enter into the loan agreement and agreements with builders, architects etc. will still be trustees as the project progresses.
- 3 It remains to be seen how willing potential lenders are to lend to the Organisation whilst it remains unincorporated. You would need to test the water in this regard but I can imagine some lenders may be uncomfortable.

B Other options

One possibility which, on the face of it appears to fit your circumstances well is a community interest company (**CIC**). This is a limited liability company and therefore would achieve limited liability status. The difficulty is that you have charitable status and an organisation cannot be both a charity and a CIC so it is not a runner if you wish to maintain charitable status. However, and for completeness, there is an established procedure for a charitable company to convert to a CIC with the consent of the Charity Commission. You are, of course, not a company at present and there is no established procedure for converting an unincorporated charity into a CIC so I suspect this would involve a two stage process i.e. convert to a charitable company first and to a CIC thereafter. Also, although a charity cannot itself be a CIC, it can set up a CIC as a subsidiary company if that is considered desirable.

Assuming a CIC is not regarded as appropriate for the reasons set out above, the options available for the Organisation to achieve limited liability status are as follows:

- Limited liability company (**LLC**); or

- Charitable incorporated organisation (CIO).

Both LLCs and CIOs are legal entities in their own right. This means they can hold land in their own name (there is no need for the land to be held by a custodian trustee) and can enter into contracts in their own name. They can also sue and be sued in their own name. So, for example, if a contract is entered into with a builder in connection with works to be carried out to the building and it is necessary to bring court proceedings against that builder in connection with defects in the work, those proceedings can be brought by the LLC or CIO (rather than by the trustees personally). Similarly if the builder wants to bring court proceedings, say in relation to a dispute as to payment, and his contract is with the LLC or CIO (as the case may be), he must bring those proceedings against the LLC or CIO and (subject to our comments below regarding personal guarantees) has no recourse against the trustees personally if the LLC or CIO cannot or does not pay any amounts it owes.

Both LLCs and CIOs offer the trustees the benefit of limited liability status subject to a couple exceptions.

The first is that some persons or organisations dealing with the LLC or CIO may ask for personal guarantees from trustees. To the extent a trustee agrees to give a personal guarantee for the liabilities of the LLC or CIO, the benefit of limited liability status. However, such a request is only likely in the case of contracts of significant value e.g. a lender may require loan repayments to be guaranteed and it may well be that the numbers involved are such as to ensure that no trustee will agree to sign the guarantee. The point, however, is that any personal guarantee would need to be in writing and signed so with an LLC or CIO there is no risk of a trustee assuming this liability without realising (as might be the case with an unincorporated organisation if the trustee in question is unaware of the rules as to liability).

The second is that there are specific circumstances in which trustees can incur personal liability both under charity law and company law. It is beyond the scope of this advice to set these out in detail as, broadly speaking, they require some sort of wrongdoing on the part of the trustees involved. So for a well and prudently run organisation, they should not be an issue.

In the case of a charitable company, liability is limited to the amount specified in the articles of association. This amount is usually nominal e.g. £1.

In the case of a CIO, the members are either liable to contribute up to a specified amount to the assets of the CIO if it is wound up, or are not liable to make any contribution at all.

C LLC versus CIO

The CIO is a relatively new concept having been introduced in 2013. As the name suggests its availability is restricted to charities. It is intended to be straightforward and cheap to set up. Its constitution must be in a form specified by regulations made by the Charity Commission or “as near to that form as the circumstances permit”. There are two model forms of constitution for a CIO, namely a foundation model (where the only persons voting are the trustees) or an association model (where there is a voting membership beyond the trustees).

In contrast to an LLC it is registered only with the Charity Commission (an LLC must be registered with both the Charity Commission and Companies House) which reduces the administrative burden. Also the Charity Commission does not currently charge for filing information whereas Companies House does charge for certain filings. However, I don't think for most well run organisations, the additional administrative requirements in dealing with Companies House create any significant issue – essentially

this involves filing accounts and a confirmation statement (the equivalent of the old annual return) annually and various event driven filings.

However, there is no searchable register of charges over the property of CIOs and, to the best of our knowledge, no plans to introduce one. The only public register of charges over CIO property is therefore that maintained by the Land Registry which covers only those charges that have to be registered with it and even that is arranged by property rather than by owner. This lack of a register of charges such as applies to LLCs may mean that a CIO is a less attractive option for organisations which seek to raise funds through issuing debentures seek to borrow money against the security of their property. Given your need to raise funding in the near future, I suspect you might find you have significantly greater flexibility in terms of funding taking the LLC route rather than the CIO route. On a more basic level still, lenders will be far more familiar with LLCs than they are with CIOs (which, as noted, are relatively new and restricted to charities) and it may be that lenders are therefore more comfortable dealing with LLCs. You need to weigh up all the points made in this advice but, given the significant funding requirement, I tend to think the LLC is likely to be your best route to limited liability status.

D Summary of options

The points made above can be summarised in the following table:

Structure	Advantages	Disadvantages
Current Structure	<ul style="list-style-type: none"> - Simplicity. The lightest administrative burden - No set up costs save to the extent you wish to amend the current constitution 	<ul style="list-style-type: none"> - Unlimited personal liability for the trustees - Not a separate legal entity so cannot contract (including borrowing money), hold property or sue and be sued in own name - Unincorporated organisations not likely to be particularly well understood by those dealing with them
CIO	<ul style="list-style-type: none"> - Limited liability status - A separate legal entity so can contract (including borrowing money), hold property or sue and be sued in own name - No administrative burden in terms of Companies House 	<ul style="list-style-type: none"> - One off set up costs - Additional administrative burden in terms of Charity Commission when compared to current structure - No equivalent of the register of charges at Companies House which is likely to be a disadvantage in the context of (and may even preclude) secured borrowing - CIOs are a relatively new concept and relatively rare so likely to be less well understood by those dealing with them
LLC	<ul style="list-style-type: none"> - Limited liability status - A separate legal entity so can contract (including borrowing money), hold property or sue and be sued in own name - Register of charges at Companies House which is likely to be of 	<ul style="list-style-type: none"> - One off set up costs - Additional administrative burden in terms of Charity Commission when compared to current structure - Additional administrative burden in terms of Companies House

	benefit in the context of secured borrowing - Limited liability companies are an established vehicle which are well understood by those dealing with them	
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E **Converting to LLC status**

I have assumed for the purpose of this section that a conversion would be to an LLC rather than a CIO (I tend to think the funding considerations may outweigh other considerations). However, most of what is set out here would be equally applicable if you decided CIO status was preferable.

The first consideration is what is required by the existing rules to enable this change to LLC status (known as the process of **incorporation**) to take place. The existing constitution does not appear to contain either express power to merge with, or transfer assets to, another charity or express power to dissolve or wind up the charity. We will therefore need to rely on one of the following routes (we will need to look at these in more detail if you decide to proceed):

- Section 268 of the Charities Act 2011 confers a power to transfer all the property of a small unincorporated charity to another charity. However, this the availability of this is subject to various conditions which include a requirement that the charity does not have any designated land i.e. land held on trusts which stipulate that it is to be used for the purposes, or any particular purposes, of the charity. I suspect this requirement may rule this option out in your case. If not, the requirement that the charity's gross income in its last financial year must not exceed £10,000 (unless the transfer is to a CIO in which case there is no financial limit) is likely to be problematic in the case of a transfer to an LLC.
- Use powers conferred by the Trustee Act 2000 or, in relation to land, the general power in section 6 of the Trusts of Land and Appointment of Trustees Act 1996.
- Amend the constitution to include a specific power.
- If none of the above options are available the trustees can apply to the Commission for a scheme to make the amendment (I suspect this is how the changes made in 2000 were approached).

So, one way or another, it should be possible to get the necessary authority to pursue the incorporation and it will be a case of deciding which of the above bases is best suited to the particular circumstances.

It will be necessary to form the LLC which is a two stage process. First a company limited by guarantee will need to be registered at Companies House. Secondly we would need to apply to register the company as a charity with the Charity Commission (this process would involve confirming that the new charity is intended to replace the existing unincorporated one). The Companies House part of the process is pretty quick but the Charity Commission part is likely to take several months.

The LLC will require appropriate articles of association to be prepared which act as its governing document. These need to be in a form acceptable to the Charity Commission. The Charity Commission have a model form of articles which can be used but it is not necessary to do so if these are not felt to be appropriate. A company limited by guarantee has members and directors. The directors are responsible for the day to day management of the company and will, effectively, be the current trustees. The members will be those with an interest in the LLC's work who apply to become members. There need be no cost to becoming a member and it would be the members who would appoint the directors. This would in effect replace the current situation where those turning up at AGMs get a vote which I think would be difficult to entirely replicate in the context of either an LLC or CIO. However, I think a more formal system for determining who is entitled to vote makes sense (I'm not sure with the current system how easy it is to police whether a person attending is entitled to vote – for example, would you necessarily know if a person attending was under 18 or from outside the area of benefit). In effect we would be replacing a system where those who are qualified can turn up and vote with one where those qualified can become members and thereafter attend and vote. It is also possible to provide for members to be removed (obviously this would be in exceptional circumstances but it is not impossible to envisage circumstances where it might be useful). Clearly having a more formal membership would involve additional administrative work but we think this disadvantage may be outweighed by the greater certainty such a system would create.

If you do wish to proceed with incorporation it will be necessary to draw up a timetable with required steps. It will be necessary to consider the existing Operation in more detail and how to deal with the various aspects of it e.g. transfer of the land and buildings, assignment of any contracts, transfer of any employees etc. This can be looked at in more detail if you wish to go ahead.

Please do not hesitate to let us know if you have any questions or require any further clarification arising out of the above.

WHN Solicitors Limited

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