

New Legal Forms for Charities in the United Kingdom

Introduction

The Charities and Trustee Investment (Scotland) Act 2005¹ and the Charities Act 2006² introduced wide ranging changes to the regulation of charities in Scotland, England and Wales. The most prominent changes related to the introduction of a new public benefit test³ for charities and a revision of the lists of charitable purposes⁴ open to charities. Rather less public attention has been afforded to the creation of two new dedicated incorporated legal forms for charities: the Scottish Charitable Incorporated Organisation⁵ for charities registered in Scotland and the Charitable Incorporated Organisation⁶ for charities registered in England and Wales. The legal regimes resulting from the creation of the bodies combine regulation of form and status in a unique manner. This article considers the history and background to the development and introduction of the new bodies and reviews the major characteristics of the SCIO and CIO as outlined in the 2005 and 2006 Acts. The relationship between the regimes established in respect of the new forms and existing company law is considered and an assessment made as to how successfully the initial policy objectives for the new bodies have been achieved by the creation of the SCIO and CIO and how well the new regimes provide for the effective operation of the new bodies.

History and Policy Objectives

History

There has been discussion about the possible introduction of a new corporate body to be used by and designed particularly for charities since the early 1990's⁷. Substantive work was undertaken at the University of Liverpool in the mid-1990's as to what issues might be involved in developing a new corporate form and what structure such a body might take⁸ and the recommendations from the Liverpool working party were well received in the Deakin Report⁹ in 1996. The notion of a new incorporated body

¹ Henceforth referred to as the '2005 Act'.

² Henceforth referred to as the '2006 Act'.

³ In relation to Scottish registered charities the public benefit element of the revised charity test is to be found in s.7 (1) (b) of the 2005 Act. For English registered charities the public benefit test is in s.3 of the 2006 Act.

⁴ See s.7 (2) of the 2005 Act and s.2 of the 2006 Act.

⁵ Henceforth referred to as the 'SCIO'.

⁶ Henceforth referred to as the 'CIO'.

⁷ An early example of the type of alternative corporate structure that might be used by charities is described by Professor Jean Warburton in "Charity corporations: the framework for the future?" [1990] *Conv* 95.

⁸ The work was undertaken by a working party involving members of staff from the Department of Law at the University of Liverpool, the Charity Law Association and the National Council for Voluntary Organisations. The working party report, *A New Legal Structure for Charities* was published in 1996 and it recommended the creation of a new body to be known as the charitable incorporated institution or CII. For details of further work undertaken by a subsequent working group of the Charity Law Association see the commentary by Francesca Quint in "A New Charitable Incorporated Vehicle" (2000) 6 *Charity Law and Practice Review* 199.

⁹ See page 84, paragraphs 3.41-3.4.3 of *Meeting the Challenge of Change: Voluntary Action in the 21st Century*, Report of the Commission on the Future of the Voluntary Sector (NVCO, 1996), chaired by Nicholas Deakin.

was also welcomed in Scotland as part of the recommendations of the Kemp Report which recommended that “A new legal identity for use by charities on an optional basis should be created.”¹⁰ The possibility of a new corporate form for charities being introduced increased in probability as a result of the deliberations of the then Department of Trade and Industry as part of the Company Law Review process. In 2000 the Company Law Review Steering Group issued a consultation document¹¹ which “...saw the advantage in having a separate vehicle for charitable companies”¹². Consultation responses to this proposal were positive and in the next stage of the company law review process¹³ the Company Law Review Steering Group noted the broad welcome for the earlier proposal and, in particular, it noted that the Charity Commission had established its own advisory group on the proposals with anticipation that this group would “...produce initial recommendations on the essential content at least of any primary legislation in time for these to be reflected in the Review’s final report next May.”¹⁴ In Spring 2001 The Advisory Group to the Charity Commission produced a report¹⁵ setting out the main characteristics of what was now being referred to as the Charitable Incorporated Organisation. In July 2001 the Final Report¹⁶ of the Company Law Review Steering Group was issued and the Charitable Incorporated Organisation was recommended as a corporate form for specifically for charities¹⁷. The work of the Company Law Review Steering Group was in this area timely for the Scottish Charity Law Review Commission¹⁸ and it recommended that the Company Law Review Steering Group’s recommendation be accepted in full and “that a new form of incorporation called Charitable Incorporated Organisation (referred to as the “CIO”) should be made available to Scottish Charities.”¹⁹ So by the end of 2001 there was a clear position in both Scotland and England which recommended the introduction of a new body to be known as the Charitable Incorporated Organisation. The next stage in the process was the 2002 publication of *Private Action, Public Benefit – A Review of Charities and the Wider Not for Profit Sector*²⁰. *Private Action, Public Benefit* was accompanied by a separate background and discussion paper dedicated to the charitable incorporated organisation²¹ and it recommended that “...a new legal form designed specifically for

¹⁰ See recommendation 7.16.2 of *Head and Heart* Report of the Commission on the Future of the Voluntary Sector in Scotland (SCV0, 1997) chaired by Arnold Kemp.

¹¹ *Modern Company Law for A Competitive Economy: Developing the Framework*, (March 2000) DTI URN 00/656 (henceforth “*Developing the Framework*”).

¹² See paragraph 9.19 of *Developing the Framework*.

¹³ *Modern Company Law for a Competitive Economy-Completing the Structure*, (November 2000) DTI URN 00/1335 (henceforth “*Completing the Structure*”).

¹⁴ See paragraph 9.2 of *Completing the Structure*.

¹⁵ The reference for this report at the time of reporting was <http://www.charity-commission.gov.uk/common/incorporg.asp>

¹⁶ *Modern Company Law for a Competitive Economy: Final Report* DTI URN 01/942 (henceforth referred to as “*the Final Report*”).

¹⁷ See paragraphs 4.63 to 4.67 of the Final Report.

¹⁸ Often referred to as “the McFadden Commission” after the Commission’s chair, Ms. Jean McFadden

¹⁹ See recommendation 11 of *Charity Scotland* the Report of the Scottish Charity Law Review Commission, Scottish Executive, 2001.

²⁰ Henceforth, “*Private Action, Public Benefit*”. The review was undertaken by the then Strategy Unit of the Cabinet Office. The review can now be found at

<http://www.cabinetoffice.gov.uk/upload/assets/www.cabinetoffice.gov.uk/strategy/strat-data.pdf> on the website for the Office of the Third Sector, which remains within the Cabinet Office.

²¹ *Private Action, Public Benefit: Charitable Incorporated Organisation* was published at the same time as time as *Private Action, Public Benefit* in September 2002. The discussion paper is not now available on the website for the Office of the Third Sector.

charities, the Charitable Incorporated Organisation (CIO), be introduced, which will only be available for charitable organisations.”²² Given the now very clear support at the highest level for introduction of a new and dedicated incorporated legal form for charities the contents of the Government’s response to *Private Action, Public Benefit* in relation to the proposed CIO were to be predicted. In July 2003 in *Charities and Not-for-Profits: A Modern Legal Framework*, The Government’s response to *Private Action, Public Benefit*²³, the Government accepted the recommendations in *Private Action, Public Benefit* and confirmed that the CIO would be included in the proposed Charities Bill for England and Wales which was by that stage under discussion. So by mid 2003 there was a clear position in relation to England and Wales which anticipated introduction of the CIO as part of the broad process of reform of charity law. In Scotland, the Scottish Executive also announced in May 2003, some two years after the McFadden Commission, that it was unequivocally committed to reforming legislation²⁴ which would also include a new form of charitable incorporated organisation. The close linkage in timings of the positions taken by the respective governments in England and Scotland was, at least initially, also reflected in the parliamentary processes undertaken in both jurisdictions in relation to charity reform. In England a Charities Bill was issued as a consultation draft in May 2004²⁵ and introduced in the House of Lords in December 2004 while in Scotland the Charities and Trustee Investment (Scotland) Bill was issued in draft in June 2004 as a consultation document²⁶ and then introduced into the Scottish Parliament in November 2004. In 2005 the parliamentary processes began to diverge but by this stage it was clear that the Scottish Executive had benefited from the ideas developed for England and Wales and the proposals in the Scottish bill in relation to a new incorporated legal form for charities were very similar to those in the English bill. The English Charities Bill was temporarily abandoned because of the general election of 2005 while the Scottish bill was passed at Holyrood on 9th June 2005 as the Charities and Trustee Investment (Scotland) Act 2005. Chapter 7 of Part 1 of that Act deals with the SCIO, which was created by section 49 of the 2005 Act. In England and Wales the Charities Bill was reintroduced into the House of Lords on 18th May 2005 and completed its parliamentary progress on 8th November 2006. Section 34 and Schedule 7 of the 2006 Act deal with the CIO. The provisions in the 2005 Act and 2006 Act relating to the SCIO and CIO have still to come into force. In relation to Northern Ireland the Charities (Northern Ireland) Order which was published in 2007²⁷ made provision in Part XI (articles 107-123) for the creation of a charitable incorporated organisation for Northern Ireland. With the Northern Ireland Assembly

²² See page 6 of *Private Action, Public Benefit: Charitable Incorporated Organisation*.

²³ Available at

http://www.cabinetoffice.gov.uk/upload/assets/www.cabinetoffice.gov.uk/third_sector/charitiesnotforprofit_eng.pdf on the website of the Office of the Third Sector.

²⁴ See statement of the Minister for Communities, Official Report of the Scottish Parliament, Plenary Session, September 24, May28, 2003, cols 133-136 and further statement in Official Report, Plenary session, September 24, 2003, cols, 1955-1958. It remains unclear whether the Scottish Executive would have taken forward the McFadden Commission proposals at this stage had it not been for the occurrence and reporting of two high profile cases involving malfeasance in charities which reached the Court of Session and highlighted concerns over the efficacy of then applicable monitoring and compliance regime for charities in Scotland. The Scottish Executive’s timing also allowed it to take into account the deliberations and outcomes associated with *Private Action, Public Benefit*.

²⁵ Cm 6199.

²⁶ See Draft Charities and Trustee Investment (Scotland) Bill: Consultation Paper (Scottish Executive, 2004).

²⁷ See <http://www.opsi.gov.uk/SI/si2007/draft/20070067.htm>

now having assumed legislative competence it is anticipated that there will be a charities act in Northern Ireland in 2008 which will in large part implement the proposals contained in the 2007 order²⁸.

Policy Objectives

Central to the reasoning behind the introduction of the new corporate form for charities are two key tenets. The first is that there are benefits to charities to be achieved through incorporation and the second is that current corporate forms are to a greater or lesser extent inappropriate.²⁹ This two fold deficiency in the apparent appropriateness of existing legal forms as vehicles for the constitution of charities had been at the heart of the earliest calls for the introduction a new legal form.³⁰ In relation to existing legal structures the trust is seen to lack legal personality distinct from its trustees and as a consequence leaves trustees exposed to potentially unlimited liability as individuals³¹. The trust is also not conducive to being structured easily to accommodate the needs or requirements of membership structures. The unincorporated association can be structured to far more readily and appropriately accommodate the needs and requirements of membership or associative organisations but it again lacks separate legal personality and carries similar risks of unlimited liability for asset holding trustees, officers and potentially even members. The later contributions to the discussion on legal form also recognised the impact that changes in activity in the charitable sector were having on the perspective brought to bear by trustees in relation to their own positions and that of their charities and it was noted in *Private Action, Public Benefit: Charitable Incorporated Organisation* that “..efforts to increase revenue and sustainability through primary purpose trading in the charity sector, and the trend towards contracting, rather than grant funding, mean that charity trustees are increasingly likely to seek the comfort that incorporation and limited liability bring. As an individual charity grows in size and perhaps takes on a lease or paid employees, incorporation will be seen as an increasingly attractive option for many small and medium sized charities.”³²

The most commonly used corporate form, the company limited by guarantee deals well with the issue of liability limitation; it enjoys separate legal personality and facilitates a membership structure. There are, however, a series of apparent problems and difficulties associated with the use of guarantee companies by charities. Many of the difficulties argued to arise from use of the guarantee company structure highlight the tension between issues of status and structure.³³ Structurally the guarantee

²⁸ The Minutes of the Social Development Committee of the Northern Assembly for 31st May 2007 (<http://www.niassembly.gov.uk/social/2007mandate/minutes/070531.htm>) and 27th September 2007 (<http://www.niassembly.gov.uk/social/2007mandate/minutes/070927.htm>) give an indication of the present intent and status of the proposed changes in Northern Ireland.

²⁹ *Private Action, Public Benefit: Charitable Incorporated Organisation* gives a clear and concise summary of the propositions in relation to each of these issues. Quint, in “A New Charitable Incorporated Vehicle”, n.8 above pp1 and 2, also discusses the background to the earliest proposals.

³⁰ See J Warburton, Charity corporations: the framework for the future” n.7 above; J Warburton “Charities, members, accountability and control” [1997] *Conv* 106

³¹ Warburton comments that “It is probably no longer realistic to expect charity officers to accept potential open-ended liability.” See “Charity corporations: the framework for the future”, n.7 above at p.100

³² See *Private Action, Public Benefit: Charitable Incorporated Organisation* p.4

³³ See P Luxton, *Charities*, (Oxford, OUP, 2001) (henceforth Luxton *Charities*) at para 1.45 for a more general discussion on the tensions which can arise between matters of status and matters of structure.

company is regulated primarily by companies legislation³⁴ which takes no particular cognisance of the activities undertaken by the company or the fact that it has charitable status. This bifurcated approach to status and structure means that charities which are also companies limited by guarantee will have been subject to registration with Companies House, the Charity Commission or OSCR³⁵ or potentially all three³⁶. The burden of dual regulation also extends to the preparation and submission of accounts and annual returns³⁷. More broadly in relation to company law it has been argued that there is uncertainty as to how the fiduciary duties applicable to company directors by virtue of company law relate to and potentially overlap with the duties which bind charity trustees and concern as to which prevails in the event of uncertainty³⁸. The application of charity law and company law also gives rise to the possibility of confusion on the part of trustees as to the potential extent of personal liability arising from issues such as wrongful trading. More broadly there are ongoing concerns as to the present or future applicability of EU company law directives to charitable companies³⁹. The creation of a new legal form which addresses these and other issues is what lies behind the proposals for the CIO and SCIO.

The assumption that there is a need for a new and dedicated incorporated form for charities has been widely accepted and there has been no substantive disagreement with or indeed even comment on the validity or otherwise of the policy arguments supporting the introduction of a new form. The extent of Parliamentary scrutiny and discussion in respect of both the CIO and SCIO are indicative of the acceptance of the underlying arguments in favour of their introduction and reflective of that wide scale acceptance⁴⁰. In relation to many of the arguments adduced in favour of the new form this is undoubtedly a reflection of the substantial validity of the arguments. The extent of discussion, reflection and consultation over the introduction of the new form for charities can be contrasted favourably with the processes pursued in relation to the Limited Liability Partnership⁴¹ (the “LLP”), the first new legal form to be created in

³⁴ The principal regulation is now to be found in a combination of the Companies Act 1985 and the Companies Act 2006 as that act increasingly comes into effect.

³⁵ The Office of the Scottish Charity Regulator. See Ss 1(1) and 1(3) of the 2005 Act.

³⁶ The combined effect of sections 13 and 14 of the 2005 Act is to require charities established outside Scotland to register with OSCR if, broadly, they intend to represent themselves as charities in Scotland. In the case of charities already registered with the Charities Commission the additional registration requirement will not apply where the only representation made makes it clear that they are a charity registered in England and Wales with the Charity Commission.

³⁷ Presently dealt with in relation to private companies by Part VII (in particular, chapters I, II and III) and Chapter III of Part XI respectively of the Companies Act 1985.

³⁸ For more detailed comments see *Private Action, Public Benefit* at p.5.

³⁹ *Private Action, Public Benefit* at p.5 footnote 4 discusses the application of Article 58 of the EC Treaty. Article 58 defines companies as meaning “...companies or firms constituted under civil or commercial law, including co-operative societies, and other legal persons governed by public or private law, save for those which are non-profit making.” (underlining added). The uncertainty arises from concerns over the use of an incorporation regime which is also applicable to for-profit organisations, particularly when not-for-profit guarantee companies are not subjected to any statutory lock on reconstitution as a commercial body.

⁴⁰ The First Report of the House of Lords and House of Commons Joint Committee on the Draft Charities Bill (HL 167-I/HC 660-I) noted that “There was general welcome for the CIO as a useful means of incorporation and of easing the burden of dual regulation.” (See paragraph 245, of Volume 1 (Report, formal minutes and evidence) of the Report to be found at <http://www.parliament.the-stationery-office.co.uk/pa/jt200304/jtselect/jtchar/167/16702.htm>). The extent of the discussion of the CIO by the Joint Committee is reflected in the brevity of treatment in the Report.

⁴¹ See the Limited Liability Partnerships Act 2000.

the United Kingdom in nearly a century⁴². In that instance the process which led to the creation of the LLP involved little or no engagement with the Company Law Review process⁴³ and there was strong criticism of the LLP proposals as they passed through Parliament⁴⁴. The result was the introduction of a corporate form which appeared designed to serve the needs of a particular constituency⁴⁵ but which did not resonate as having been particularly well designed nor to have a level of utility which would extend beyond that limited constituency. As can be seen from the historical development of the CIO and SCIO there is less foundation for criticism as to the depth of reasoning behind their introduction, but there are areas where the policy objectives and underlying tenets have been less well examined and scrutinised than might have been anticipated and this is reflected in the structures as they appear in the 2005 and 2006 Acts. The fundamental attractiveness and availability of limited liability is a cornerstone of the new form yet there is no meaningful discussion in any of the deliberations on the new form as to the applicability or otherwise of creditor or member protection regimes⁴⁶ which would be expected to be features of a regime built on limitation of liability principles. The burden of dual regulation under both company law and charity law is argued to be a key reason for the introduction of the CIO and SCIO but there has been little or no discussion as to how that burden may have shifted as a result of the substantial number of deregulatory measures introduced in relation to companies by the Companies Act 2006. One specific area of change arising from the Companies Act 2006 relates to directors duties. Directors' duties have been recast in the Companies Act 2006⁴⁷ and s.172 (1) of that Act now requires company directors to have regard to a range of groups, interests and activities in promoting the success of the company. One such interest is "the impact of the company's operations on the community and the environment",⁴⁸ This is an example of a more manifestly broad ranging approach to directors' duties as a result of the company law reform process and it stands in contrast to the more conventionally worded statements of trustees duties and responsibilities in England and Wales and Scotland⁴⁹. As a contributory factor in the governance of charities trustees' duties have a position of considerable prominence and any apparent differences in substance or presentation from those now prevailing in respect of companies is an issue which may have an impact on those involved in the decision making process as to whether or not CIO or SCIO form is or is not appropriate for a particular charity. Each of these issues and others arising from the substantive form of the CIO and SCIO as outlined

⁴² For critical comment on the LLP see J Freedman and V Finch, "Limited Liability Partnerships: Have Accountants Sewn up the 'Deep Pockets' Debate?", [1997] *J.B.L* 387, J Freedman and V Finch, "The Limited Liability Partnership: Pick and Mix or Mix-Up?" [2002] *J.B.L* 475 and S R Cross "Limited Liability partnerships Act 2000: Problems Ahead?" [2003] *J.B.L* 268.

⁴³ See Freedman and Finch, "The Limited Liability Partnership: Pick and Mix or Mix-Up?" n.42 above at p.476.

⁴⁴ See Freedman and Finch, "The Limited Liability Partnership: Pick and Mix or Mix-Up?" n.42 above at p.476.

⁴⁵ See Freedman and Finch, "The Limited Liability Partnership: Pick and Mix or Mix-Up?" n.42 above at p.476.

⁴⁶ See the discussion at paragraphs 246 and 247 of the First Report of the Joint Committee on the Draft Charities Bill referred to at n.40 above.

⁴⁷ See generally Part 10 and, in particular sections 170-181 of Chapter 2 of Part 10 of the Companies Act 2006.

⁴⁸ See s.172 (1) (d) of the Companies Act 2006.

⁴⁹ See s.66 of the 2005 Act in relation to trustees' duties in Scotland. There is no single statutory location for or statement of trustees' duties in relation to English registered charities. For a broad description of such duties see Luxton, *Charities*, Chapter 9.

in the 2005 and 2006 Acts are considered below in the context of the major characteristics of the new bodies and their interaction with the companies legislation and their actual corporate status.

Characteristics of the CIO and SCIO

While the SCIO reached the statute book first, the deliberations in Scotland⁵⁰ on the progress of what was to become the 2005 Act drew on what was the then Charities Bill in England and Wales⁵¹ and this is reflected in the similarities between the CIO and the SCIO. The legislative approach to the CIO is rather different in the 2006 Act from that adopted in the 2005 Act towards the SCIO⁵² but the substantive intent of both legislatures towards the new legal forms is largely the same. For the purposes of this review of the characteristics of the new form reference will be made primarily to the SCIO and where substantive differences in approach between the SCIO and CIO are identified these will be highlighted. Both approaches to the new form set out the basic framework for the organisation and secondary legislation⁵³ will be required in respect of both to deal with a range of matters including, somewhat curiously, such important matters as insolvency⁵⁴. This approach reflects the approach taken by the Charity Commission in its work on the structure of the proposed new form⁵⁵ and follows the recommendations in paragraph 4.63 of the Final Report of the Company Law Review Committee.⁵⁶

Nature and Constitution

(a) Basic Form

The new form is optional⁵⁷ and has a number of basic features which characterise its structure and availability. It is a body corporate⁵⁸, having a constitution⁵⁹, a principal

⁵⁰ Part of the deliberations on the SCIO involved a sub-group of the Bill Reference Group which aided the Scottish Executive's Charity Law Team during the preparation of and progress of the 2005 Act. The writer was a member of the sub-group which considered the SCIO.

⁵¹ See n.25 above.

⁵² The 2006 Act devotes one section (S.34) to the CIO which simply specifies that Schedule 7 to the Act makes provision about charitable incorporated organisations. All of the substance is, therefore, to be found in Schedule 7 which largely comprises of a series of insertions into the Charities Act 1993 (hereafter referred to as 'the 1993 Act'). The 2005 Act devotes fifteen sections to the SCIO (sections 49-64) and has no accompanying schedule.

⁵³ For more specific comment see Notes 65 and 74 of the Explanatory Notes to the 2005 Act at <http://www.opsi.gov.uk/legislation/scotland/en2005/2005en10.htm> and note 134 on the 2006 Act at <http://www.opsi.gov.uk/acts/en2006/2006en50.htm>

⁵⁴ This approach to the treatment of matters of some significance was one of the very few areas where criticism was voiced by those who commented on the proposed introduction of the CIO and SCIO. Particular comment was made by some who submitted evidence to the Joint Committee on the Draft Charities Bill to the effect that "...the lack of detail about the CIO made it difficult to judge its ultimate benefit." See paragraph 246 of the First Report of the Joint Committee on the Charities Bill, referred to at n.40 above.

⁵⁵ See n.15 above.

⁵⁶ See references at n.16 and n.17 above.

⁵⁷ The language used in the 2005 Act is more overt in specifying the optional nature of the SCIO by referring in s.49 (1) to the fact that "A charity **may** (emphasis added) be constituted as a Scottish charitable incorporated organisation..."

⁵⁸ S.49 (2) of the 2005 Act and s.69A (2) of the 1993 Act.

⁵⁹ S.49 (2) (a) of the 2005 Act and s.69A (3) of the 1993 Act.

office located in the country of registration⁶⁰ and a membership requirement⁶¹. At a fundamental level the new form is only available to organisations which are charities at the time of registration⁶² and there is either no liability on members in the event of winding up⁶³ or that liability is limited to a maximum amount in respect of each member⁶⁴. The availability of the form to charities only is understandable as an implementation of the basic policy objectives for the form and is consistent with the availability of other and, arguably, more appropriate forms for social enterprises which do not have charitable status. For example, the Community Interest Company⁶⁵, which is also a product of *Private Action, Public Benefit*, is now available for use by organisations conducting not for profit activities but which are not, either as a matter of choice or law, charities. However, while the decision to make the CIO and SCIO available as a matter of choice and not compulsion is understandable at a pragmatic level it does raise a series of issues. In the Final Report, the Company Law Review Group followed the approach taken by the Charity Commission's Advisory Group⁶⁶ and did not recommend that transfer to CIO status should be made compulsory, "...or that other routes for the incorporation of charities should be closed off."⁶⁷ This approach recognises the difficulties and costs which would arise for many charities if compelled to change legal form and takes account of the practical difficulties which would have been experienced by both the Charity Commission and OSCR in administering the immediate conversion of large numbers of existing charities. What this approach does not do is recognise the inherent benefit of reconciling issues of status and structure for all incorporated charities (and, indeed, possibly for all charities) which would flow from a requirement that all such bodies must use the CIO or SCIO form⁶⁸. Such an approach would have removed any possible tensions or issues arising from the application of dual regimes in relation to such matters as trustees' and directors' duties and would have reconciled form/substance and status/structure arguments. The Home Office has accepted that there should be a review of the position five years after the introduction of the new form⁶⁹ but in the interim the new forms will be available alongside existing corporate forms. This also raises issues as to comparability and choice for those either contemplating creation of a charity with corporate form or those considering a change in status of an existing charity. The CIO and SCIO become options to be considered by charities from a range of incorporated legal form which will continue to include less commonly adopted mechanisms such as the industrial and provident society and the currently common guarantee company. While it may be possible to argue that the new form is objectively more attractive than pre-existing forms the evaluative process

⁶⁰ S.49 (2) (b) of the 2005 Act and s.69A (4) of the 1993 Act.

⁶¹ S.49 (2) (c) of the 2005 Act and s.69A (5) of the 1993 Act.

⁶² S.49 (1) of the 2005 Act and s.69E (3) of the 1993 Act.

⁶³ In Scotland this is the only position specified as ensuing in the event of a winding up. See s. 49(4) of the 2005 Act. In England and Wales the complete absence of is one of two positions which can ensue in a winding up. See s.69A (6) (a) of the 1993 Act.

⁶⁴ S.69A (6) (b) of the 1993 Act.

⁶⁵ See Part 2 (sections 26-56) of the Companies (Audit, Investigations and Community Enterprise) Act 2004. For broader discussion of the reasons for creation of the community interest company see pages 50-55 of *Private Action, Public Benefit*.

⁶⁶ See the paragraph on 'General Principles' in the report of the Charity Commission's Advisory Group, referred to at n.15 above.

⁶⁷ See paragraph 4.65 of the Final Report.

⁶⁸ Also discussed in P Ford, "Supervising Charities: A Scottish Civilian Alternative [2006] 10 *Edinburgh Law Review* 352 at 364.

⁶⁹ See *Charities and Not-for-Profits: A Modern Legal Framework*, n.17 above, at para.4.15.

and identification of the issues to be included within that process may demand a level of sophistication which is not available to many charitable organisations. In a slightly perverse manner, therefore, the availability of the CIO and SCIO as options may complicate matters for those charities which have a decision to make as to form. These issues of choice and comparability become more complex when recent changes in company law are taken into account and are discussed in more detail below in relation to the corporate status and inter-relationship of the new form with company law.

(b) Membership

The requirement that the new form has a membership reflects the early recommendations of the Charity Commission's Advisory Group⁷⁰ and in *Private Action, Public Benefit: Charitable Incorporated Organisation*⁷¹ the proposed characteristics of the CIO are described as incorporating "Foundation and membership formats – which means that the CIO will be appropriate for charities with and without a membership structure." This means, in essence, that the CIO and SCIO are hybrid organisations. As Ford comments, this results in the form having to take account of the "...difference between membership organisations, which need supervisory arrangements capable of accommodating the involvement of a possibly large number of members, and non-member, asset managing organisations such as grant-making trusts, where the focus must be on official supervision of a small body of administrators whose stewardship will not be subject to the scrutiny of a membership."⁷² This approach is reflected in the requirements for both the CIO and SCIO to have members⁷³, which may or may not include some or all or indeed may comprise entirely of the body's members⁷⁴. Structurally, this is also reflective of the way companies limited by guarantee are presently used by charities and it does nothing to address the criticisms levelled against the guarantee company by those who argued in favour of the introduction of a new incorporated form. A typifying example in relation to both governance and procedural matters may involve individuals acting in their capacity as charity trustees resolving to pursue a course of action, the same individuals acting as members of the guarantee company then resolving in their capacity as members that the recommended action is implemented and finally remitting the matter back to themselves as charity trustees to proceed with the approved course of action. This circular approach to governance and procedure has at least been tempered in some respects in relation to guarantee (and other) companies by deregulatory measures in relation to company law which permit a streamlined approach to the passing of resolutions by both officers and members of guarantee

⁷⁰ See p.2 of the report which comments that "charities largely follow one of two general forms, a foundation or a membership organisation and the new legal entity needs to recognise this..."

⁷¹ See n.20 above, at para.5

⁷² See Ford, "Supervising Charities: A Scottish Civilian Alternative n.68 above at p.362.

⁷³ There is a curious difference in approach in the relevant provisions of the 2005 and 2006 Acts in relation to numbers of members. The English requirement in relation to the CIO is that the CIO shall have "...one or more members" (see s.69A (5) of the 1993 Act, while the Scottish requirement in relation to the SCIO requires "2 or more members" (see s.49 (2) (c) of the 2005 Act). There is no apparent explanation for the difference in approach and the Scottish provision does not reflect the approach in relation to companies which has been to permit single member companies since 1992 (see Companies (Single Member Private Limited Companies) Regulations 1992 (SI 1992/1699). There may be governance arguments which argue in favour of a higher number of members for charitable organisations but these were not enunciated in the legislative process which led to the 2005 Act.

⁷⁴ See s.49 (3) of the 2005 Act.

companies⁷⁵. In the absence of a supporting body of law equivalent in nature and content to company law, CIO's and SCIO's will require to rely on their constitutions or whatever supporting principles and mechanisms may be provided by secondary legislation to achieve the flexibility of approach which can be adopted by guarantee companies. This is one example of the positive utility of company law in relation to guarantee companies when utilised by charitable bodies. When that form is used it also opens up alternative remedies and mechanisms to potentially aggrieved or disgruntled members of the company which are not present by virtue of the 2005 and/or 2006 Acts. The general range of remedies open to members of a company such as the unfair prejudice or derivative action exist in relation to companies limited by guarantee by nature of the legal form of the organisation and arise from company law⁷⁶. In the absence of draft secondary legislation in respect of either the CIO or SCIO it is not clear what is anticipated in respect of members' rights relating specifically to the organisational form, but as matters stand a member or members will only have the rights arising from the organisation's constitution, those which are contained in the otherwise applicable legislation regulating charities or, more generally, implied as a matter of general law or contract. Both the 2005 and 2006 Acts are silent as to general members' rights of the type afforded in the companies legislation and members would therefore have to rely on their general rights in relation to the charity. Arguably, behaviour towards a member of a charity which is in form a company limited by guarantee and which could give rise to a potential claim in the form of an unfair prejudice action⁷⁷ might only be actionable in relation to a CIO or SCIO as an issue of misconduct or breach of a trustee's duties in terms of the legislative regime regulating the charity's activities. That remedy would also be open to the member of the guarantee company who is, therefore, placed in a position of enjoying remedies under status and structure regimes whereas the member of the CIO or SCIO is limited to those remedies available under the conflated status and structure regime which exists in relation to the CIO and SCIO. This returns the argument to the tension between status and structure. It also highlights another area where the interface between company law and charity law becomes one of significance in relation to the CIO and SCIO and why issues of choice in relation to legal form may be significant in the optional arrangements which have been provided.

(c) Constitutions

Both the CIO and SCIO are required to have a constitution⁷⁸ which must contain key information such as the organisation's name and purposes⁷⁹, provision as to eligibility for membership and how a person becomes a member⁸⁰, details as to the appointment

⁷⁵ With effect from 1st October 2007 Part 13 of the Companies Act 2006 replaces most of sections 266-383 of the Companies Act 1985. This will have the effect of substantially relaxing the rules on private company meetings and assuming that most companies will take decisions by written resolutions, reducing the majority for most resolutions to a simple majority and making the previous elective regime for private companies the default regime.

⁷⁶ With effect from 1st October 2007 Part 11 of the Companies Act 2006 introduces a statutory derivative claim mechanism for shareholders.

⁷⁷ Until 30th September dealt with by s.459 of the Companies Act 1985. From 1st October 2007 the matter is dealt with in Part 29 of the Companies Act 2006.

⁷⁸ See s.49 (2) (a) of the 2005 Act and s.69A (3) of the of the 1993 Act.

⁷⁹ See s.50 (1) of the 2005 Act and Ss.69B (1) (a) and (b) of the 1993 Act.

⁸⁰ See s.50 (2) (a) of the 2005 Act and s.69B (2) (a) of the 1993 Act.

of charity trustees (including eligibility conditions)⁸¹, and the application and disposal of property⁸². The Report from the Charity Commission’s Advisory Group on the CIO recommended that “the constitution should be required to be in one of two prescribed forms, or as near to the relevant form as circumstances permit.”⁸³ The specified forms were to cover “(a) the CIO which has members who are not charity trustees, and (b) the CIO whose members are the charity trustees.”⁸⁴ The Final Report of the Company Law Review Committee followed this recommendation and agreed that “CIOs will be more effective structures if they are required to have full written constitutions...forms of which will be prescribed.”⁸⁵ During the progress of the 2005 Act two specimen forms of constitution were prepared for the sub-group of the Bill Reference Team which was considering specific issues relating to the SCIO⁸⁶. These two model forms were designed as being for one tier and two-tier organisations and they largely reflected the recommendations outlined in the Charity Commission’s Advisory Group’s report. However, both the 2005 Act and the 2006 Act have in contemplation that constitutions will be regulated in terms of content by reference to secondary legislation and they provide, for example, that constitutions will either be “...in the form specified in regulations.. or as near to that as the circumstances admit.”⁸⁷ or that a constitution must comply with such requirements, as are specified in regulations...⁸⁸ During the original consultation process on the Charities Bill as introduced in 2004 a set of ‘dummy’ regulations was prepared⁸⁹ in relation to the CIO and these adopted a rather different approach from that which appeared to be in contemplation in Scotland. The CIO Regulations did not form part of the further deliberations on the bill when it was re-introduced in 2005. The CIO Regulations do not provide specimen forms of constitution but set out in considerable detail a range of issues which it was expected that the constitution of a CIO would contain on a mandatory basis⁹⁰. Important matters which were unsurprisingly specified as requiring treatment in the constitution included the types of and procedures for calling and conducting meetings for both members and trustees⁹¹, retirement from membership⁹² and the retirement or removal of charity trustees⁹³. What is particularly noteworthy in respect of the proposals relating to constitutions for both the CIO and SCIO is that in both the 2005 and 2006 Acts and in the draft constitutions and

⁸¹ See s.50 (2) (b) of the 2005 Act and s.69B (2) (b) of the 1993 Act. There is an interesting baseline difference in this requirement between Scotland and England. The Scottish requirement is for a minimum of three or more charity trustees while the English requirement only specifies that one need be appointed.

⁸² See s.50 (4) of the 2005 Act and s.69 (2) (c) of the 2006 Act.

⁸³ See paragraph 3 of the section on ‘Proposals for the Content of Primary Legislation’ in the report of the Charity Commission’s Advisory Group, referred to at n.15 above.

⁸⁴ See paragraphs 3(a) and (b) of the section on ‘Proposals for the Content of Primary Legislation’ in the report of the Charity Commission’s Advisory Group, referred to at n.15 above.

⁸⁵ See para 4.64 of the Final Report.

⁸⁶ The Model Forms may be found at <http://www.scotland.gov.uk/Topics/People/15300/charities/22383>

⁸⁷ See 69B(5) of the 1993 Act

⁸⁸ See s.50(3) of the 2005 Act

⁸⁹ The Charitable Incorporated Organisation Regulations 2005 (henceforth referred to as the “CIO Regulations”). These were published in January 2005, and can be found at

http://www.cabinetoffice.gov.uk/upload/assets/www.cabinetoffice.gov.uk/third_sector/charities_dummy_reg.pdf.

⁹⁰ Clause 3(3) of the CIO Regulations specified that the constitution of a CIO “shall” contain provisions relating to-

⁹¹ See clauses 3(3) (c) and 3(3) (i) of the CIO Regulations.

⁹² See clause 3(3) (b) of the CIO Regulations.

⁹³ See clause 3(3) (o) of the CIO Regulations.

regulations which have been prepared thus far the legal mechanisms and framework provided to support key constitutional, procedural and governance issues is limited or does not exist. Draft secondary legislation has as yet to be promulgated in respect of either the CIO or SCIO and it may be that draft regulations will deal with such issues but this is not suggested by the early drafting examples. The position may be contrasted with that prevailing in respect of other newly introduced legal forms and in relation to other existing corporate forms which might be adopted by charities. The simple example of removal of a charity trustee highlights the issue. In relation to a director of a company limited by guarantee which is also a charity removal of a director from that position is a matter which may be regulated in very specific terms by the company's articles of association if they have been specifically drafted to take account of an anticipated form and procedure for removal. In the absence of specific constitutional treatment of the issue in the articles, removal falls to be dealt with by reference to the default content of the company's articles of association, any provisions contained in a contract of service and/or employment between the director and the company and, as an over-riding provision, section 303 of the Companies Act 1985⁹⁴ which provides a mechanism for removal of a director which cannot be over-ridden by any agreement to the contrary. Similarly, a director the subject of removal proceedings is entitled on a statutory basis to protest against removal⁹⁵. This body of law would also be applicable in relation to a director of a community interest company as that organisation is in form another species of company. In relation to the LLP the position is more complex as primacy is given to the agreement between members in the LLP but even in that situation default rules apply which are drawn from parts of the Partnership Act 1890⁹⁶ and which address expulsion. While regulations may require the constitution of a CIO or SCIO to contain provision relating to the removal of a trustee the depth of treatment of such an occurrence is limited entirely to the content of the constitution of the body in question. There are no common principles for the legal form. As already discussed above in relation to membership it would remain open for action to be taken against an arguably malfeasing charity trustee on the basis of non-compliance with other provisions of the applicable charities regime but there is no evidence that this is or should be the only intended remedy in relation to a putative removal where the constitution may be inadequately drafted. This is but one example of how the CIO and SCIO sit in isolation from a developed body of law in relation to the form. The translation of the form to sit within a legal regime which is primarily focussed on regulation of status achieves a key policy objective in obviating elements of dual regulation. However, what it also highlights is a potential deficiency in the nature and extent of the legal framework and scaffolding required to adequately support the form within a conflated status and structure arrangement. This is discussed in more detail in the treatment below of the relationship between the new forms and company law.

Creation and Registration

(a) Creation

⁹⁴ To be replaced by s.168 of the Companies Act 2006.

⁹⁵ Presently in s.304 of the Companies Act 1985 and to be restated in s.169 of the Companies Act 2006.

⁹⁶ For a fuller discussion of the approach taken to the default application of partnership and company law principles to the LLP see G Morse, PDavies, I F Fletcher, D Milman, R Morris, *Palmer's Limited Liability Partnership Law* (London, Sweet & Maxwell, 2002) (henceforth referred to as Morse, *Palmer's Limited Liability Partnership Law*) at p 147.

Central to each of the regimes created for the CIO and SCIO is the fundamental level of control over the new forms which is passed to the Charity Commission and OSCR. While the Charity Commission, Scottish Charities Office and then OSCR had historically enjoyed a role in respect of certain aspects of form relating to charities⁹⁷ the CIO and SCIO may only come into existence by means of the registration process which is controlled and administered by OSCR and the Charity Commission in respect of the SCIO and CIO respectively.⁹⁸ This transference of the function of creation satisfies one of the key policy objectives relating to charitable form by removing dual regulation in relation to the process of creation of a charitable organisation.

The process for creation involves an application process which requires the submission⁹⁹ of basic information in relation to the proposed new body¹⁰⁰ and, effectively, compliance with two main conditions. The first condition relates to charitable status, the second brings the proposed new body within a names regime. In relation to charitable status the statutory language may differ in relation to the SCIO and CIO but the net effect is the same. OSCR and the Charity Commission will only grant an application if the application demonstrates that the proposed new body will meet the relevant requirements to be a charity at the time of registration¹⁰¹. This is a non-controversial requirement for applications relating to new bodies but it introduces an interesting issue for existing bodies contemplating conversion to the new form. In that instance the same condition exists and that effectively requires an existing charity to demonstrate that at the time of conversion it satisfies the relevant requirements for charitable status at the time of conversion¹⁰². The conversion and amalgamation process is considered more fully below but the point of substance to note is that the application of this condition to both new applications and conversion applications potentially brings a charitable body to a stage of reflection and assessment as to compliance with the new public benefit requirements at an earlier stage than might otherwise have been arisen and may be a significant factor in the minds of many bodies in assessing as a matter of choice whether conversion to one of the new forms is an issue to be undertaken at an early juncture. The second main pre-condition for registration is compliance with requirements as to names¹⁰³ and general compliance of the proposed constitution and application with the requirements of the relevant

⁹⁷ This was particularly the case in relation to proposed changes to a charity's constitution.

⁹⁸ See generally Ss.54 and 55 of the 2005 Act and Ss.69E and 69F in relation to the registration requirements for the SCIO and CIO.

⁹⁹ The process must be undertaken by two or more individuals in Scotland (see s.54 (1) of the 2005 Act whereas in England and Wales the requirement is only one (see s.69 (E) (1) of the 2006 Act. This simply reflects the nature of the two bodies whereby in Scotland the SCIO requires a minimum of two members whereas the CIO can be created with only one member. See n.71 above.

¹⁰⁰ See s.54 of the 2005 Act in relation to the SCIO and S.69E of the 1993 Act in relation to the CIO. The information is centred on the proposed body's constitution (see s.54 ((2) (a) of the 2005 Act and s.69 (E) (2) (a) of the 1993 Act and such other information and documents as may be required by OSCR or the Commission or in pursuance of as yet to be made regulations (see s.54 (2) (d) of the 2005 Act and s.69 (E) (3) of the 1993 Act.

¹⁰¹ See s.54 (3) in relation to the SCIO and s.69 (E) (3) of the 1993 Act in relation to the CIO.

¹⁰² See s.57 (2) of the 2005 Act in relation to the SCIO and s.69 (H) (2) in relation to the CIO. For a fuller discussion in relation to the SCIO see the note on section 57 in S Cross and P Ford, *Greens Annotated Acts: The Charities and Trustee Investment Act 2005* (Edinburgh, Green, 2006).

¹⁰³ See s.54(4) of the 2005 Act in relation to the SCIO and Ss.69E(3) and (4) of the 2006 Act in relation to the CIO

legislation and applicable regulations. For the SCIO this involves compliance with the new regime in relation to names created by the 2005 Act¹⁰⁴.

(b) Consequences of Registration

(i) Purposes, powers and third parties

Once the conditions have been satisfied the new body is created as a body corporate¹⁰⁵. The significance of this status is approached by both the 2005 and 2006 Acts in a typically understated fashion and the fundamental attributes of the new bodies corporate are dealt with in relatively short order in the sections in the respective acts dealing expressly with creation while other issues such as powers, capacity and vires, which arguably go to the heart of the true nature of the new bodies corporate, are dealt with in a somewhat haphazard approach across the legislation. This approach to the fundamental characteristics of the new bodies makes it rather less than straightforward than might have been expected to characterise the new bodies by comparison with other forms such as the guarantee company,. The most immediate consequences of registration are that the new body has as its constitution, members and name, those set out and contained in the original application¹⁰⁶ and a vesting mechanism which reflects the establishment of legal personality in the new body and vests property held in trust on behalf of the new body¹⁰⁷. The purposes of the organisation must be outlined in the constitution¹⁰⁸ and both organisations are given broad ranging powers which permit them to undertake anything which will further the purposes of, or is conducive or incidental to doing so¹⁰⁹. The approach to powers¹¹⁰ in relation to the new bodies is more restrictive than that in relation to companies generally but it appears intended to reflect the overall approach taken in relation to charitable companies (albeit by exception to the general principles set out in the Companies Act 2006). This therefore means that there is a direct linkage between the drafting of a constitution and the valid exercise of powers on behalf of one of the new bodies in relation to third parties. Those dealing with one of the new bodies and who do so in good faith and for value¹¹¹ need have no concern on a vires basis as to any restrictions in the body's constitution or otherwise in relation to the body's trustees which would prevent the body in acting in the way it has with the third party¹¹². The crucial issue from a drafting perspective and from the perspective of trustees acting on behalf of a CIO or SCIO is that while third parties may emerge unscathed from a transaction which is ultra vires this does not elide any potential

¹⁰⁴ See sections 10-12 of the 2005 Act.

¹⁰⁵ See s.55 (3) in relation to the SCIO and s.69F (2) of the 1993 Act.

¹⁰⁶ See s.55 generally in relation to the SCIO and s.69 (F) of the 1993 Act.

¹⁰⁷ See s.55 (3) of the 2005 Act in relation to the SCIO and s.69F (3) of the 1993 Act.

¹⁰⁸ See s.50 (1) of the 2005 Act in relation to the SCIO and s.69B (1) (b) of the 1993 Act.

¹⁰⁹ See s.50 (1) of the 2005 Act in relation to the SCIO and paragraph (1) (1) of Schedule 5B of the 1993 Act.

¹¹⁰ In relation to powers see generally s.62 of the 2005 Act in relation to the SCIO and paragraph (5) of Schedule 5B of the 1993 Act.

¹¹¹ This language in relation to Scotland (s.62(1) of the 2005 Act) is reflected by language inserted into the 1993 Act which refers to "full consideration in money or money's worth"-see paragraph 5(4) of Schedule 5B of the 1993 Act. The Scottish requirement that this must also have taken place in circumstances of good faith is also inserted but the English requirement contains a stated presumption that the third party has acted in good faith see paragraph 5(4) of Schedule 5B of the 1993 Act. This assumption does not appear in the Scottish provisions and there is no provision as to where the burden of proof would lie in any such situation.

¹¹² See s.62 (1) of the 2005 Act and paragraphs 5(2) and (3) Schedule 5B of the 1993 Act.

injunctive action based on ultra vires at the instance of any other party.¹¹³ The thread towards any such action therefore starts with the statement of purposes in the constitution which can, in the drafting, introduce limits on the extent of the body's powers which in turn may form the basis of a challenge as to the vires of an action taken by or on behalf of the body. In terms of intended outcomes this appears to be the same as that which was intended in relation to charitable companies but with one subtle but potentially significant distinction. The default provision in respect of private companies is that such a company's objects are unlimited¹¹⁴ unless specifically limited by the company's articles of association. To satisfy the requirements of the Charity Commission or OSCR as to charitable status further specification of a company's objects is required beyond this statutory default and a memorandum of association will contain drafting in relation to objects which is there solely to satisfy OSCR or the Charity Commission. In drafting terms this therefore has the effect of delivering further specification to the regulatory body as to the specific objects the intended charitable company intends to pursue, but provided there is no parallel statement of the charitable purposes in the company's articles of association there is no consequential boundary effect on the extent of the company's objects simply by having specified them in detail for the purposes of satisfying the Charity Commission or OSCR. In relation to the SCIO and CIO there is no unlimited statutory default position as to purposes. These must be positively stated and asserted in the constitution submitted to OSCR or the Charity Commission at the outset. The drafting will take exactly the same approach in respect of the peculiarly charitable purposes and activities which form the basis for seeking confirmation from the relevant regulator that the body is charitable, but the default position is, from the outset, weaker. If left unheeded in the drafting this thread would arguably flow through to the issues of powers and thus to the potential issue of an ultra vires challenge. This is another instance of potential conflict between the positions of a charitable company as constituted under companies legislation and the new bodies. In isolation one instance of difference between the two forms may not prove to be a key determinant in choosing which form to adopt but if the body of distinctions and differences becomes sufficiently meaningful as to influence choice as to adoption or otherwise then that is significant when an assessment falls to be made as to the success or otherwise of the relevant legislation in achieving the identified policy objectives through the new form. Two final consequences arising from registration of one of the new bodies highlight further differences between them and a charitable company. The issues arise in relation to members' and trustees' duties.

(ii) Members' and Trustees' Duties

The company limited by guarantee and the unincorporated association are the other main forms of organisational structure used by charitable bodies with membership structures. In a step which arguably places members of the SCIO and CIO in a position which tangibly differs from other membership forms, the members of the new bodies owe a series of statutory duties in relation to the SCIO or CIO of which they are a member¹¹⁵. The reasons for the introduction of a member's duty are unclear but the development does dovetail with research published by the Charity

¹¹³ See s.62 (2) of the 2005 Act and paragraph 5(7) of Schedule 5B of the 1993 Act.

¹¹⁴ S.31(1) of the Companies Act 2006

¹¹⁵ See s.51 of the 2005 Act in relation to the SCIO and paragraph 9 of Schedule 5B of the 1993 Act in relation to the CIO.

Commission in 2004 in relation to membership charities¹¹⁶. This in turn had been prompted by a number of high profile instances of difficulties in charities relating primarily to membership and related governance issues¹¹⁷. The legislative approach to the member's duty differs in respect of the SCIO and CIO. In Scotland the approach used in section 51 of the 2005 Act is to deem the application to members of certain of the duties otherwise set out in the act as applicable to charity trustees in circumstances when the members are not trustees. This is a scenario where the organisation is truly two tier in nature. The English approach differs slightly in terms of technique by setting out the duties in full in relation to members and trustees in two adjacent subsections of the 2006 Act¹¹⁸. The net overall effect is the same in terms of outcome, in that a range of duties which would otherwise only be applicable in relation to charity trustees now also apply to members who are not also trustees in their charity. While the strategic outcome is the same for both bodies the actual wording of the duties differs slightly. This is a direct reflection of the difference between the wording of the duties to be observed by charity trustees. At the core of the duty is an obligation on members to act in good faith in a manner which is consistent with¹¹⁹ or which is most likely to further the purposes of the CIO¹²⁰. In respect of both duties it is unclear to whom the duty is owed and at whose instance the duty is enforceable but there must be a strong presumption that the duties are owed to the SCIO or CIO. The initial difference in approach suggests a slightly more onerous standard in relation to the CIO with the emphasis being on furtherance while the Scottish approach is benchmarked against consistency. For most purposes this difference may only be of marginal importance but it is another instance of difference between the Scottish and English bodies where there is no evidence from that the differences arise from a strategic intention to achieve that as an outcome. However, what is more relevant is the overall difference between the new bodies which now embody a statutory framework for member's duties and the absence of any parallel approach for other members based charitable bodies. In relation to unincorporated organisations it appears that there is no authority in case law to the effect that there is any form of good faith or integrity based duty on non-trustee or committee members and that the courts are unlikely to impose any such duty unless there are very particular circumstances which clearly imply or require that such a duty be imposed¹²¹. In relation to a charitable organisation which has the form of a company limited by guarantee it is again the case that members of a company owe no general level, fiduciary based duties to the company¹²². This means that in structural terms there is a clear distinction to be drawn in relation to the new forms and other membership forms

¹¹⁶ Membership Charities (2004), Report RS7.

(<http://www.charitycommission.gov.uk/publications/rs7.asp>)

¹¹⁷ See, for example, the internal dispute within the RSPCA in relation to its policy on hunting which was the subject of judicial comment by Lightman J. in *Royal Society for the Prevention of Cruelty to Animals v Attorney General* [2001] All E.R 530 at 551.

¹¹⁸ Paragraphs 9 and 10 of Schedule 5B of the 1993 Act.

¹¹⁹ This is the standard expected of members in Scotland in relation to the SCIO (see s.66 (1) (a) of the 2005 Act).

¹²⁰ This is the standard expected of members of a CIO (see paragraph 9 of Schedule 5B of the 1993 Act).

¹²¹ For a detailed discussion of the duties owed to a charity by members see J.Warburton, "Charity members: Duties and Responsibilities". See in particular p.332 for a discussion of the duties owed by members of an unincorporated association.

¹²² See, for example, the comments of Megarry V.C in *Estmanco (Kilner House) Limited v Greater London Council* [1982] 1 All E.R 437 at 444. For a fuller discussion see Warburton, "Charity Members: Duties and Responsibilities" at p.341.

when the use is for a clearly two tier organisation and when a distinction can be drawn between trustees who are also members and those members who are only involved with the charity in the capacity of a member. The inclusion of SCIO and CIO members within the broad ambit of fiduciary based governance mechanisms may prove to be an effective mechanism in addressing some of the governance tensions that have been encountered in membership organisations but if that was the intention of the mechanism why should it be applied in a differential manner which leaves the currently predominant forms with differently focussed regimes? The approach may have attractive features for charity trustees, funders and regulators but it is less clear that the new duties will act as an inducement to putative members. The approach to the treatment of members in relation to the new forms introduces a further element requiring judgement into the process of evaluating which form to adopt. It also marks a rather curious emphasis in terms of the balance of treatment of members within the new form. There is a statutory foundation for members' duties but no equivalently strong treatment of members' rights. In constructing a regime for form that seems a curious omission.

The treatment of trustees' duties in relation to the SCIO and CIO also gives rise to what appears to be a further difference in approach between the English and Scottish organisations and, in turn, between the new forms and companies limited by guarantee. In Scotland the requirement that a SCIO's constitution must make provision for the appointment of three or more persons as charity trustees with general control of the administration of the SCIO¹²³ means that these individuals, as charity trustees, must observe the duties on charities set out in the 2005 Act generally and in section 66 in particular. Sections 69 P 9 and 10 of the 1993 Act impose specific duties on the trustees of a CIO. These are identical to those applied to non-trustee members of the body. The difference in approach and degree already identified in relation to members in the basic formulation of the duty (i.e. the distinction between furtherance and compliance) is therefore repeated in relation to trustees. A further complication arises in situations where trustees are also members of an incorporated charity. When this situation arises in a charity which is a company limited by guarantee the directors are subject to the general duty in s.172(1) of the Companies Act 2006 to act in good faith to promote the success of the company for the benefit of the members as a whole. In their capacity as members of the company they have no clear duties to the company other than those set out in the memorandum and articles of association. Dual capacity trustees and members of a CIO or SCIO are obliged in both capacities to act in good to further or act consistently with the body's purposes. A further and more complex distinction arises in relation to the duty of care which can be expected from charity trustees. In respect of the SCIO the duty is expressed to require a charity trustee to "act with the care and diligence that it is reasonable to expect of a person who is managing the affairs of another person"¹²⁴. This standard of care has been set slightly higher than that which prevails at common law for trustees in the common law of trusts in Scotland¹²⁵. This in turn contrasts with the standard expressed for trustees of the CIO which has three elements involved. The trustee must (1) exercise such care and skill as is reasonable in the circumstances¹²⁶, having regard

¹²³ S 50(2) (b) of the 2005 Act.

¹²⁴ S.66 (1) (b) of the 2005 Act.

¹²⁵ For discussion of the standard of care see the note on section 66(1) (b) of the 2005 Act in S Cross and P Ford, *Greens Annotated Acts: The Charities and Trustee Investment Act 2005* (

¹²⁶ Paragraph 10(1) of Schedule 5B of the 1993 Act.

to (2) any special knowledge or experience that the trustee has or holds himself out to have¹²⁷ and (3) if acting as a charity trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession¹²⁸. It may be arguable that the more broadly expressed standard of care in relation to the SCIO may be interpreted as encompassing elements of the test expressed in relation to the CIO but as the test for the SCIO appears to have been drawn from principles of trust law in Scotland it may be that the courts in Scotland may choose to construe the test on the basis of trust law and not to draw on the case law on duty of care in relation to companies. However, while the test for trustees of the CIO is substantially closer to the test in s.174 of the Companies Act 2006 as applicable to companies limited by guarantee, even those differ. The test in relation to the CIO combines the ‘objective’ / ‘subjective’ approach which is familiar in company law and remains in s.174 of the Companies Act. What is new, for what may come to be referred to as ‘business trustees’ (i.e. charity trustees acting as such in the course of a business or profession), is specific reference to an additional level of care and skill defined by reference to special knowledge or experience that may be reasonably expected of a trustee acting in the course of that kind of business or profession¹²⁹. The net result in relation to trustees duties is a pattern of differing treatment and, again, the potential for confusion and uncertainty as to the appropriateness of a particular vehicle if the issue of trustee responsibility is a significant factor in the evaluative process for those deciding which form to adopt. The position in relation to charity trustees’ duties for directors of guarantee companies becomes even more distinctive when the impact of the restated duties on company directors is taken into account¹³⁰.

Conversion, Amalgamation and Transfer

Both the 2005 and 2006 Acts follow the recommendations in the Final report of the Company Law Review Committee in relation to conversion¹³¹ and provide a mechanism for existing incorporated charities to change to the new form¹³². The conversion facility is restricted to companies and industrial and provident societies although the 2006 Act does permit the making of regulations to provide for the conversion of a community interest company into a CIO¹³³. There is no equivalent provision in relation to the SCIO although it would presumably be possible to include provision in regulations made in furtherance of the general power on regulations contained in section 64(f) of the 2005 Act. The process for conversion is relatively straightforward and it appears unlikely that any significant issues will arise in relation to conversion. One feature of the process is noteworthy and reflects a trend towards greater co-operation between regulators. The Commission and OSCR are obliged to consult the appropriate registrar and such other persons as it thinks fit before it determines an application for conversion¹³⁴. This mechanism provides a means for the

¹²⁷ Paragraph 10(1) (a) of Schedule 5B of the 1993 Act.

¹²⁸ Paragraph 10(1) (b) of Schedule 5B of the 1993 Act.

¹²⁹ Paragraph 10(1) (b) of Schedule 5B of the 1993 Act.

¹³⁰ See generally Part 10 of the Companies Act 2006 and the fuller discussion in this article on the interrelationship between the new forms and company law.

¹³¹ See paragraph 4.65 of the Final Report.

¹³² See ss.56-58 of the 2005 Act in relation to the SCIO and ss.69G, H and I of the 1993 Act in relation to the CIO.

¹³³ See s.69J of the 2006 Act.

¹³⁴ See ss.57 (1) (a) and (b) of the 2005 Act in relation to the SCIO and ss.69G (4) (a) and (b) of the 2006 Act in relation to the CIO.

relevant registrar for the conversion applicant to express concerns over the suitability of the applicant for conversion to the new form. In practice this will relate almost exclusively to the Registrar of Companies and will permit the Registrar to communicate concerns to OSCR or the Charity Commission on a statutory basis in relation to issues which might be relevant in determining an application for conversion. Non-compliance with companies act and filing obligations would be a clear example. The mechanism also permits consultation with ‘other persons’. This again provides statutory authority for discussions with other regulators who may have regulatory competence in terms of the functions carried out by an existing incorporated body and other bodies such as HM Revenue and Customs. Both the 2005 and 2006 Acts also provide relatively straightforward mechanisms for amalgamations¹³⁵ between the new bodies and the transfer of one body’s undertaking to another¹³⁶. There is no express provision for intra UK cross-border treatment in relation to conversion, amalgamation or transfer but in the case of conversion there is no reason in principle why, for example, an existing charity incorporated in England should not convert to SCIO form provided it complies with the requirements of the 2005 Act. The provisions in relation to amalgamation and transfer are more clearly delineated and do not appear susceptible to use for cross-border mergers or transfers.

Corporate Status and Relationship with Company Law

As bodies corporate both the CIO and SCIO can be clearly distinguished from the other new legal forms which have been introduced since 2000. While the community interest company is a new form of company it is still a company and, in broad terms, it sits within the overall regime for the regulation and control of companies. The limited liability partnership is a new and distinct legal form but the majority of the statutory rules regulating both the form and substance of the LLP have been drawn from company law and it has been suggested that in assessing the nature of an LLP “A better approach would be to regard the LLP as a modified form of company....”¹³⁷. The SCIO and CIO stand apart from the other new legal forms in appearing to demonstrate a much stronger independent identity. There is no direct reference as to the applicability of company law in the primary legislation creating the SCIO and CIO and there is clear evidence as to the intent to create separate and independent legal forms. This approach is entirely consonant with the earliest policy discussions about the new forms. Nonetheless, the manner and extent of the interaction between the regimes for the new bodies and company law is an issue of significance for a variety of reasons. Firstly, the company limited by guarantee remains as an option for charities seeking to incorporate and this means that issues of comparability will arise in relation to other available forms. Secondly, in assessing the completeness of the legal frameworks established for the new bodies any identifiable gaps in those regimes will draw comparison with the treatment of those areas by company law and assessments will inevitably be made as to whether company law might provide effective examples as to how those gaps might be filled. Finally, there have already been indications that existing company law principles and rules may be deemed to apply to the new bodies when they become available and the complete

¹³⁵ See ss.59-61 of the 2005 Act in relation to the SCIO and ss.69K and L of the 1993 in relation to the CIO.

¹³⁶ See s.61 of the 2005 Act in relation to the SCIO and s.69M of the 1993 Act in relation to the CIO.

¹³⁷ See para A1-02 (page 4) of Morse, *Palmer’s Limited Liability Partnership Law*.

legislative schemes for both the SCIO and CIO are in place. If this does prove to be the case that may require a further appraisal of the true distinction between the new forms and the existing corporate forms.

Comparison with Charitable Companies

By offering the SCIO and CIO as optional forms it becomes inevitable that some form of evaluative process has to be undertaken by those contemplating either the creation of a new corporate form or the conversion of an existing charity. A range of areas have already been identified where potentially difficult and technically complex assessments may fall to be made in assessing whether to adopt one of the new forms, with the treatment of members' rights and duties and trustees' duties having already been discussed. The new forms clearly deliver on one of the stated policy objectives by removing dual regulatory control at the level of form and this alone is likely to prove attractive to many organisations, particularly new charities. But to focus solely on the convenience of registration takes no account of the substantial changes which have been made to the overall burden on and approach of company law in the United Kingdom in relation to private companies since the first calls for a new legal form in the early 1990's¹³⁸. Similarly, the new approach to 'regulated alterations' to memorandum and articles of association outlined in the 2006 Act¹³⁹ is but one example of a situation where dual regulatory engagement will no longer be required. The broad restatement of directors' duties in the Companies Act 2006 has only just come into effect and while there may, for instance, be a new duty to promote the success of the company¹⁴⁰ there is no clear argument to the effect that this is likely to be more burdensome on directors of charitable companies than the formulation of trustees' duties which will prevail in relation to the SCIO and CIO. The expanded statement of this particular duty makes it clear that the duty is a good faith based obligation to promote the benefit of the members as a whole and in relation to charities and community interest companies this has been confirmed as meaning the attainment of the objectives for which the company was formed. At least in respect of this particular issue and despite what may be concerns to the contrary, there is likely to be little by way of further burden on charitable companies. Overall, the attractiveness of a single regulator in relation to both form and status is likely to be a strong determining influence when charities seek to incorporate. For existing charities this feature may also prove decisive in an evaluation of whether or not to convert to one of the new forms. However, for those charities there are many more elements which need to be balanced and assessed in reaching a balanced conclusion as to the respective merits of guarantee company status or SCIO or CIO form. Company law is far less burdensome than hitherto and in a number of areas the balance between appropriateness and burden in relation to the regulatory regimes cannot be assumed to automatically favour the SCIO and CIO.

Completeness of the Legal Framework and Application of Company Law

In establishing a legal framework for both the CIO and SCIO the 2005 and 2006 Acts deal satisfactorily with basic practical matters such as the processes for creation, registration, conversion and amalgamation. There are other areas such as members'

¹³⁸ See n.75 above for references to provisions in the Companies Act 2006 in relation to the conduct of meeting etc. by private companies.

¹³⁹ See s.136 of the 2006 Act.

¹⁴⁰ See s.172 of the Companies Act 2006.

rights where the legislation is silent. A further omission is any provision for creditor protection. The 2005 Act and 2006 Act both contain provision for the making of regulations in relation to the winding up, insolvency and dissolution of SCIOs¹⁴¹ and CIOs¹⁴² but there is no indication as to how, if at all, and as part of a coherent regime, creditors of the new forms are to be treated. When the CIO Regulations were published in 2005 some insight was given as to how it was anticipated that this matter might be approached. The CIO Regulations proposed that in general terms the insolvency regime for companies set out in the Companies Act 1985 and the Insolvency Act 1986 should broadly be deemed to apply to CIOs¹⁴³. Included within this deemed application were sections 213 (fraudulent trading) and 214 (wrongful trading) of the Insolvency Act 1986. In broad terms this appeared to be the approach to creditor protection which was to accompany the benefit of limited liability as a structured package for the CIO. It remains to be seen whether the secondary legislation to be promulgated for the SCIO and CIO will reflect this early approach but what is striking is the manner in which such a fundamental issue is approached. There is no sense that in constructing a legal regime for the new forms which is based on a combined approach to form and status that all facets of the form have been considered. The provision of limited liability was seen as an essential priority for members but a rounded treatment of how the provision of that benefit might impact upon creditors, particularly involuntary creditors, is absent. The requirement that the new forms be flexible enough to accommodate membership type organisations has been built into the new forms but the absence of mechanisms to deal with membership disputes and grievances is another example of how the legislation fails to deal fully with the requirements of the new form. Before the publication of the CIO Regulations Lord Hodgson of Astley Abbots had proposed an amendment to the then Charities Bill which was to the effect that “() A CIO will not be subject to provisions of company law.” Commenting on that amendment after the publication of the CIO Regulations, Lord Hodgson remarked that “The concept of a CIO gave us an opportunity to think *de novo* about how best to structure it for its specific charitable purposes. If one accepts that view then falling back on a company law framework represents an opportunity missed”¹⁴⁴. Lord Hodgson clearly saw the exclusion of company law as an opportunity to require the construction of a legal framework for the CIO which was in all respects complete and which was constructed to reflect the needs of those who would use and engage with the form within an exclusively charitable environment. This is not the approach which has been taken in respect of either the SCIO or the CIO. The actual approach has been pragmatic and utilitarian. The SCIO and CIO will be relatively straightforward to administer from the perspectives of OSCR and the Charity Commission in terms of creation and registration but a range of issues of substance for members, trustees and third parties have been left untouched.

Secondary legislation may be used to fill some of the gaps which appear to exist in the overall frameworks for both the SCIO and CIO. However, that approach, particularly if it places over reliance on existing company law mechanisms, carries with it the risk that the SCIO and CIO will develop as organisational forms which increasingly

¹⁴¹ S.64 of the 2005 Act.

¹⁴² S.69N of the 2006 Act.

¹⁴³ See Clause 4 of the CIO Regulations.

¹⁴⁴ Hansard, H.L, March 16, 2005, col.507, Grand Committee on the Charities Bill (HL), Official Report.

resemble the existing company form and do not develop as the distinctive forms which it was intended that they should be.

Conclusions

The SCIO and CIO both appear to successfully address a number of the basic policy objectives outlined in the earliest possible discussions on a new legal form for charities. They provide an incorporated form with limited liability which is administered by a single regulator. For those reasons alone it is probable that when the new forms become available they will prove attractive, particularly in relation to newly created charities. The position may be less clear in relation to existing charities. The optional nature of the new forms means that existing charities will have to draw comparisons between existing incorporated forms and the new bodies. It is at this juncture that the distinctions between new and old may be seen to be less clear and the conversion decision rather more complex. By combining regulation of status and form through the creation of the SCIO and CIO an opportunity was presented to create a new and well grounded legal regime for each of the new bodies. Lord Hodgson's remarks about the opportunity to think *de novo* about the structures go to the heart of the opportunity which was provided. That opportunity has not been taken in the regimes as presently established. The treatment of members' rights and duties is weak and incomplete, the relationship between the new bodies and existing company law is not always clear, the treatment of insolvency and creditors' rights has yet to be dealt with. The SCIO and CIO sit within legal frameworks which are partial in their state of completion. Secondary legislation may complete elements of the legal scaffolding and framework needed to fully support the operation of the new bodies but if, in crucial areas such as insolvency, that approach simply relies on the application of existing company law rules and principles Lord Hodgson's concerns will have been vindicated.