

Commercial
Case Law Update
Rosling King LLP



Background

Keeping Kids Company (“**Kids Company**”) was founded in 1996 by Ms Camila Batmanghelidjh, originally as a drop-in centre. It was incorporated as a company limited by guarantee in September 1997 and was registered as a charity in February 1998. Kids Company provided support to disadvantaged and vulnerable young people at a number of centres in London, and latterly Bristol and Liverpool, as well as schools in London and Bristol. The trustees were the directors of Kids Company and were both “charity trustees”, bound by the Charities Act 2011, and company directors, subject to duties under the Companies Act 2006 (“**CA 2006**”).

Kids Company relied on a combination of private donations and central and local government funding. It grew substantially between 2012 and 2014, both through replication of its London operations, particularly in Bristol, and in response to increasing need. During this time the level of government grant income was largely stable, and they continued to receive substantial private donations.

Although Kids Company continued to grow it experienced significant cash flow problems, with increased staff costs (staff employed to provide support to vulnerable young people) the biggest expense. Further expenditure was incurred by sending money directly to ‘clients’ (vulnerable children and their families), as well as running costs.

Kids Company recognised that it could not continue to increase in scale to meet demand without changing its funding model. In 2013, there were discussions with senior members of the government, and latterly philanthropists, about Kids Company’s future funding model, and the shape and size of the charity. Serious difficulties became apparent from late November 2014. In response to the difficulties a detailed contingency plan was developed, discussions with the government were pursued and additional controls on expenditure were imposed.

Although a restructuring plan and further funding was agreed, Kids Company was forced to close in July 2015 following sexual assault allegations. On 11 August 2015, the board determined that an application should be made to the Court for Kids Company’s winding up, on the basis that it was unable to pay its debts. A directors’ petition was presented the following day, and on 20 August 2015 the Court ordered a winding up.

On 17 August 2017, the Official Receiver, Anthony Hannon (the “**Receiver**”), issued a Part 8 claim for a disqualification order against the trustees under s6 Company Directors Disqualification Act 1986 (“**CDDA 1986**”).

In order for s6 of the CDDA 1986 to apply the Court would need to satisfy itself that the conduct of the trustees of Kids Company (the “**Trustees**”) were “unfit to be concerned in the management of a company”. There are two stages to prove this allegation – first an allegation or allegations about a defendant’s conduct must be proved; secondly, the Court must be satisfied that the conduct justifies a finding of unfitness. Any finding could result in the Court making disqualification orders against the Trustees banning them from acting as directors of any company for a minimum of two years up to a potential maximum of 15 years.

In relation to Ms Batmanghelidjh, there was an additional question because she was not appointed as a director of Kids Company. In order to make a disqualification order against Ms Batmanghelidjh the Court would also need to satisfy itself that she was a “de facto” director. Only if Ms Batmanghelidjh was a de facto director would it be necessary to decide whether she was “unfit”.

The allegation against the Trustees was framed as a single allegation of having “*caused and/or allowed Kids Company to operate an unsustainable business model*”. The allegation was that the business model was unsustainable without material change from no later than 27 September 2013, that by no later than 30 November 2014 failure was “*inevitable without immediate material change*”, and furthermore that the Trustees knew or ought to have known about the unsustainability of the model.

The Decision

The Court ruled in favour of both the Trustees and Ms Batmanghelidjh. Although aspects of Kids Company’s operating model were high risk, it was not unsustainable in principle nor uncommon for charities.

Mrs Justice Falk noted that the primary purpose of s6 CDDA 1986 is to protect the public. Although, in parts, the conduct of the Trustees was criticised, the Judge asserted that the public did not need protection from the Trustees and commented, “*this is a group [the Trustees] of highly impressive and dedicated individuals who selflessly gave enormous amounts of their time to what was clearly a highly challenging trusteeship...*The decisions they made were matters of honest judgment, made in difficult circumstances in what they thought were the best interests of the charity”. The Judge was very critical of the Receiver and the way he constructed the application to the Court. In particular, the Receiver failed to consider the context of the company in its charitable setting and the reasonableness of the reliance on government support and Ms Batmanghelidjh’s proven fund-raising abilities. Furthermore, auditors had reported consistently on the accounts and continued to sign-off the company on a going concern basis prior to the insolvency position. The Receiver had not demonstrated that the decisions that the Trustees took, or failed to take, were outside a range of ‘reasonable decision-making’ and, as such, their conduct did not amount to incompetence of a high degree.

Further, there was no breach of duty under the CA 2006, in particular s172 CA 2006, where directors have a duty to promote the success of the company. It should be noted that there was discussion on whether Kids Company, as a charitable company, would be bound by certain aspects of the CA 2006. Ordinarily directors must have regard to the interests of creditors when directors know or should know that the company is or is likely to become insolvent. The Judge noted it was a developing area of the law, however, Kids Company’s focus would ordinarily be on its charitable objectives rather than the interest of its members (or potentially creditors). In any case, the Trustees had properly considered questions of solvency and their decisions were in a reasonable range of decision-making, falling short of finding unfitness based on incompetence.

In respect of Ms Batmanghelidjh, the Judge ruled that she was not a de facto director. While Ms Batmanghelidjh had significance influence at Kids Company, she was ultimately not part of

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the decision-making structure and was not on an equal footing with the Trustees, not having the same, or equivalent, status or functions. Although Ms Batmanghelidjh was not considered to be a de facto director, the Judge stated that a disqualification order would not have been made against her even if she was deemed to be a director. While some of her conduct was criticised, in particular her over-optimism and her failure to accept the seriousness of the deteriorating financial situation, the Judge said her previous work in successfully building Kids Company from its foundation to a highly regarded and successful operation by 2013 should be considered.

Commentary

The case shows that there is a high bar for the 'unfitness' stage to be reached by directors or trustees of charities. While some of the Trustees decisions were criticised, the Judge ruled that these were ultimately made for the benefit of vulnerable children and in the best interests of the charity.

The Judge impressed the point that disqualification of directors was to protect the public at large and these individuals did not pose a threat to the public or to charitable organisations. The Judge commented that able and experienced individuals, with a range of skills, are required by charities and that the failures at Charity should not deter such individuals from becoming charity trustees in the future.

However, it does demonstrate that, whilst Courts will be sympathetic to the charitable sector, trustees on a practical level need to be careful with placing over-optimistic expectations on funder support which is a common issue leading up to insolvencies of charitable entities.

For further information, please contact [Alexander Pelopidas](#) or the Partner with whom you usually deal.