

35. Trustee liability and trustee indemnity insurance

Contents:

What is trustee liability?	1
How does such personal liability arise?	1
What is trustee indemnity insurance?	4
Useful Organisations	7



What is trustee liability?

Charity trustees have powers, duties and responsibilities that derive from the charity's constitution or trust deed or from statute and common law, and from the contracts they enter into. Failure to comply with such duties and responsibilities or to fulfill contractual undertakings can result in the charity trustees being personally liable.

How does such personal liability arise?

Personal liability of charity trustees arises because, as they are the persons having control of the administration and assets of a charity, they are the ones who the law recognises as having ultimate responsibility for any loss that accrues.

Personal liability can arise in contract, tort, breach of trust and breach of statutory duty (e.g. failure to comply with the Health and Safety at Work etc Act 1974). Most of such liability can be covered by public liability insurance and, where staff are employed, by employers' liability insurance. No insurance is available to cover a charity trustee against criminal liability (e.g. payment of a fine for breaching the Health and Safety at Work etc Act 1974) because this would be against public policy.

I do not understand what is meant by 'liability arising in contract, tort, breach of trust and breach of statutory duty'

Let us look at each situation in turn.

Contract

When a charitable unincorporated association enters into a contract, it is not entering into it in its own name (this would be invalid); instead it 'borrows' the legal identity of some or all of its management committee members to enter into that contract on behalf of the charity. If the charity is in breach of the contract, it is the members of the management committee who are liable. Breaches of contract arise most commonly where a charity:

- in the case of a contract of purchase of goods or services, cannot or does not pay the amount due
- fails to provide a service it has agreed to provide, e.g. the charity shuts down a day care centre it has contracted with a local authority to provide
- fails to provide services to the required standards
- breaches the terms of a lease for property, e.g. fails to repair or re-decorate

Tort

Tort is the term that covers a range of actions or inaction by which a person suffers loss, injury or damage as a result of someone else's negligence, recklessness or nuisance. An example, in the context of a community building or village hall, might be failure by the management committee to maintain the building floor and a visitor breaks their leg as a result. In these circumstances, public liability insurance should cover any liability.

Breach of trust

A charity trustee commits a breach of trust where he or she acts in a way that is not authorised by the constitution or neglects to fulfil his or her duties as a trustee. They therefore cover a wide variety of misconduct and include actions, which can be regarded as purely technical breaches such as investing charity assets in an unauthorised manner. A grave breach of trust will arise if a charity trustee, instead of only acting in the best interests of the charity, deals with charity assets in such a way as to derive some personal benefit.

The most common failures in trustees' duty of trust are-

- spending money on activities that are not charitable or outside the charity constitutional objects
- making unauthorised payments to trustees
- failure to declare a conflict of interest
- spending money on unlawful political activities

Breach of statutory duty

This is breach of any requirement of statute that affects charity trustees, e.g. failure to comply with the Charities Act requirements on accounts or breach of the Data Protection Act 1998.

OK, but what happens if a trustee, acting honestly and reasonably, is nevertheless sued for breach of contract, tort or for breach of trust or of statutory duty?

You have to ask yourself, honestly, whether any of the circumstances described above will happen in the normal, day-to-day business of your charity, if you and your colleagues act reasonably, honestly and in the best interests of the charity. Let us look at some possibilities.

Contract

If an unincorporated charity undertakes a large contract, e.g. a contract to build or alter a community building, it is the individual members of the management committee who enter into such contract and assume responsibility. Hopefully, such contract will run smoothly and all amounts due to the building contractor paid on time. Unfortunately, these contracts rarely run smoothly and there can be cost overruns. If the charity has insufficient reserves or cannot fundraise in time, the contractor may decide to sue the management committee for monies outstanding. In view of this possibility the Charity Commission explain that charity trustees should try to have inserted into the contract a suitable limitation of liability clause. Unfortunately, it is often the case that the contractor refuses to accept any such limitation.

If the contractor in these circumstances successfully sues the management committee, the charity trustees may have the right to an indemnity out of the charity's funds: it is normal for charity constitutions to include such right. If there are insufficient charity assets available, the Charity Commission may sanction the use of permanent endowment, i.e. the community building.

In the event of neither charity assets nor the realisation of permanent endowment being sufficient to satisfy the demand, the charity trustees may petition the court for relief from the court under s.61 of the Trustee Act 1925. Provided the charity trustees have acted reasonably and honestly, the court will grant such relief.

Note that trustee indemnity insurance does not cover breach of contract.

Tort

Most liability in tort will be covered by public liability insurance. Of course, liability in tort can arise in any number of situations, even in circumstances when public liability insurance cover is not available. For example, if a charity trustee of a village hall gave negligent legal advice to a third party, he or she would be liable in tort. Such liability can be insured against by the appropriate professional liability insurance. But this does beg the question, what is a charity trustee of a village hall doing giving legal advice?

If liability in tort does arise the position described above for breach of contract should apply provided they have acted reasonably and honestly and in the best interests of the charity, i.e. the charity trustees will almost certainly have the right to an indemnity out of the charity's funds.

Breach of trust

It is difficult to provide comfort in the case of breach of trust. All charity trustees should make themselves aware of the terms of their trust and act accordingly. It could be said that charity trustees should accept liability for breach of trust without complaint, but there is always the possibility of a technical breach in circumstances where a charity trustee acted reasonably and honestly.

As explained further on, trustee indemnity insurance will cover a breach of trust. However, if a charity trustee acts in breach of trust attributable to any act or omission which he or she knew to be a breach of trust or which was committed in reckless disregard of whether it was a breach of trust or not, they will not have the benefit of any insurance cover, including indemnity insurance, because this would be a standard exclusion from insurance cover.

Breach of statutory duty

The comments above on breach of trust apply.

What about breaches of criminal law?

Many of the statutory responsibilities placed on trustees involve criminal sanction in the event of breaking the law. For example, failure to provide a safe working employment for staff is a criminal offence. Most offences are punishable by fine but, in serious cases, imprisonment may result.

There is no insurance cover available for breaches of criminal law.

How do we limit the risk of personal liability?

The best way of protecting trustees from personal liability is to make sure such liabilities are not incurred. That can be achieved by ensuring that the charity is well managed and the good practice is followed at all times. The Charity Commission, ACRE, RCC village hall advisers issue good practice guidelines, and Community matters. Trustees who need professional advice are allowed to pay for such advice out of charity funds.

Another method is to incorporate as a company limited by guarantee. Members of such a company assume liability that is limited to a set amount, usually £1. The directors of such a company will not incur personal liability provide they act reasonably and honestly and only in the best interests of the company and do not act fraudulently or engage in wrongful trading. This method should not, however, be seen as an opportunity to limit liability without having to ensure that the charity is well managed and good practice is followed.

We are not reassured by the idea of 'good practice', especially as society is becoming increasingly litigious?

The risk of personal liability can be minimised by including in the charity's constitution or trust deed a provision to the effect that the charity will indemnify (compensate) the trustees from the charity's assets should they suffer a personal loss as a result of the charity's activities despite acting with proper authority and due care.

If there are insufficient charity assets available, the Charity Commission may sanction the use of permanent endowment, i.e. the community building. In the event of neither the charity assets nor the realisation of permanent endowment being sufficient to satisfy the demand, the charity trustees may petition the court for relief from the court under s.61 of the Trustee Act 1925. Provided the charity trustees have acted reasonably and honestly, the court will grant such relief.

Insurance cover is available for many types of liability as explained above.

What is trustee indemnity insurance?

The Charity Commission describes this (in its leaflet CC 49) as personal insurance for trustees (which is sometimes known as “liability insurance”) which protects (or indemnifies) trustees against the risk of personal liability arising from their breach of trust. The protection it offers is limited as the Charity Commission will not give permission for charity assets to be spent on such insurance that protects trustees against liability for acts that the trustees knew were in breach of trust or duty, or which were committed in reckless disregard of whether they were in breach of trust or duty.

Typical indemnity insurance policies tend to follow the pattern of directors and officers insurance and cover the payment of damages, plus most costs and expenses flowing from, an actual or alleged breach of duty, breach of trust, neglect, error, omission, misstatement, libel, slander and any other act committed by a trustee solely in the course of the activities of the charity. The reach may extend to include everyone working for the charity, even employees and voluntary helpers, although the policy exclusions may impact on this. Cover is never offered in respect of intentional wrongdoing or the making of improper profits and even when liabilities are negligence-based, many kinds of damage will be excluded. Great care should be taken in assessing and negotiating the exact type and extent of cover, and such policies should always be reviewed whenever there are significant organisational changes.

Trustee indemnity insurance will not cover-

- acts, criminal or not, which the charity trustees know to be wrong
- liability to third parties, e.g. for breach of contract or lease
- redundancy payments to employees
- penalties for breaches of statutory duties or fines
- injury to members of the public whilst on the charity’s property (this is covered by public liability insurance)
- fraud or dishonesty of employees
- faulty, inaccurate or wrongful advice given either under fee or contract (this will require specific indemnity cover (e.g. legal advice indemnity insurance))
- losses from failure to insure the charity’s assets, where the failure to insure would be regarded as a breach of trust, or
- liabilities arising from wrongful trading, i.e. where the trustees allow the charity to continue trading when they knew or ought reasonably to have known that the charity was insolvent.

Most trustee indemnity insurance will cover the costs of successfully defending legal action brought against a trustee for breach of trust or breach of duty. However, the Charity Commission will not allow trustees to be indemnified for the costs of an unsuccessful defence.

Note that fraud and dishonesty may be covered under fidelity guarantee insurance. Other insurance may be available to cover specific concerns, e.g. legal expenses.

In what way is this different from public liability insurance?

Public liability or third party insurance covers charity trustees against liability for injury to persons or damage to property caused during the course of the charity’s activities. Thus, if a third party is injured whilst attending an event in a community centre or a village hall, their claim for damages will be against the charity trustees who will be protected by the charity’s public liability insurance. Such insurance would also cover the situation where a member of the management committee suffers an injury and seeks compensation from the other charity trustees.

The problem for charity trustees is that these types of insurance do not protect them against a claim for pecuniary (i.e. monetary) loss otherwise than by reason of personal injury or damage to property.

Public liability insurance does not cover liability for breach of contract. It is possible to insure against intervening events which result in a charity becoming unable to complete its contractual commitments, e.g. the holding of a fete prevented by bad weather, but otherwise charity trustees are personally liable. However, trustees who have acted reasonably and properly in carrying out the objects of their charity will normally be entitled to reimbursement from the charity's funds. However, if these funds are insufficient, the trustees may be liable to make up any shortfall. In this case, the charity trustees may petition the court for relief from the court under s.61 of the Trustee Act 1925.

Trustee indemnity insurance is designed to cover only those circumstances where a third party sues individual charity trustees for pecuniary loss resulting from breach of duty, breach of trust, neglect, error, omission, misstatement, libel, slander and any other act committed by a trustee solely in the course of the activities of the charity.

What happens if charity or holding trustees are sued by a landlord for breach of the lease?

A lease is a contract. There is no insurance cover available for breach of a lease - certainly indemnity insurance will not cover it. The trustees in these circumstances will have to rely on their right to indemnity out of charity assets. You should ensure that the lease contains a clause which (a) limits liability under the lease to the net realisable value of the charity's assets and (b) excludes all personal liability of the trustees. Additionally, the trustees could petition the court for relief under s.61 of the Trustee Act 1925.

But, if we do not take out trustee indemnity insurance, could a charity trustee be personally liable and lose his or her assets include their home?

The truthful answer is 'possibly but very unlikely'. Over the last 10 years or so, particularly since the passing of the Charities Acts 1992 and 1993, managing trustees in the voluntary and community sector are increasingly concerned about the apparently increasing regulation and control of voluntary activity and the growing need for legal compliance by charity trustees. In fact, the duties of charity trustees have not increased significantly, it is only a perception. What has increased is the amount of law covering areas of work traditionally undertaken by community organisations and village halls. Health and safety, employment rights, the national minimum wage, working time regulations - all have contributed to the general feeling among many charity trustees that they are putting their assets and livelihood in jeopardy or that 'volunteering is no fun any more'.

The problem is that trustee indemnity insurance does not, on the whole, provide the protection that many people believe it to have.

In situations where personal liability arises and no insurance cover is available, the circumstances of such liability must be taken into account. As mentioned above, provided a charity trustee has acted reasonably and honestly in the best interests of the charity, he or she should be entitled to an indemnity out of the charity's assets. Where such assets are insufficient to cover the liability, the charity trustees may petition the court for relief under s.61 of the Trustee Act 1925.

So how do we decide whether we should take out trustee indemnity insurance?

Do an audit of your organisation's activities and how your management committee operates and makes decisions. Follow good practice in terms of inducting new trustees: ensure that all charity trustees know the constitution and understands the duties and responsibilities of charity trustees.

In the case of a community association or village hall the simple hiring out of community facilities to local people and groups is unlikely to result in any personal liability that will not be covered by public liability or employers' insurance. If your charity does undertake activities that might not be covered by insurance you must consider whether it should be undertaking such activities.

OK, we have done the audit and decided that we want trustee indemnity insurance. What do we do next?

It used to be the case that, unless your constitution included the power to pay for trustee indemnity insurance, you would have to ask the Charity Commission for consent to include such power in your constitution. Such consent would only have been given if you could present a good case to the Charity Commission that such insurance cover was necessary.

Earlier this year (2003), the Charity Commission changed its approach to approving the purchase of trustee indemnity insurance by moving away from the thorough investigation, and possible denial, of a charity's wish to purchase trustee indemnity insurance towards a self-certification process. The Charity Commission has decided that, as matter of policy, charities will decide for themselves whether the purchase of trustee indemnity insurance is in the interests of the charity, and that the Commission will accept a structured but minimal level of justification for concluding that the purchase of trustee indemnity insurance is in the interests of the charity and consequently ought to be authorised.

The procedure that you should follow depends on whether or not your charity's constitution or governing document contains an express prohibition against trustees benefiting personally from the charity. If it does, you will have to ask the Commission for a Scheme. If there is no such prohibition, you will have to seek from the Commission an Order under s.26 (in the case of an unincorporated charity) or s.64 (in the case of a corporate charity) of the Charities Act 1993. When you contact the Charity Commission, the Commission will send you an information sheet (OG 100 C4) and two self-certification forms: form CHY 1279A (to be used if your charity's governing document has no express power to purchase trustee indemnity insurance, but does not specifically forbid trustee benefits; and form CHY 1279B (to be used if your charity's governing document has no express power to purchase trustee indemnity insurance and it specifically forbids trustee benefit. The information sheet will explain which form to use but, if in doubt, complete both forms.

Once the completed form is received, an Order under sections 26 or 64 of the Charities Act 1993 can be completed and returned to the you. The Order will sanction the purchase of the insurance directly, rather than authorise a power of amendment.

Note that where your charity has a membership, your management committee will have to certify that the members have given their approval to the application. This will require in most cases the calling of a general meeting of members. This is unlikely to apply to the majority of village halls.

The above procedures only need to be followed if charity funds are to be used to pay the insurance premium. There is nothing to stop you from using your personal funds to pay for such insurance.

Useful Organisations

Charity Commission
Harmsworth House
13-15 Bouverie Street
London
EC4Y 8DP
Telephone: 0870 333 0123
Website: www.charity-commission.gov.uk

Aon Limited
Somerset House
47-49 London Road
Redhill
RH1 1LU
Telephone: 01737 783600

Law Monitoring Group
C/o Community Matters
12-20 Baron Street
London
N1 9LL
Telephone: 020 7837 7887
Website: www.communitymatters.org.uk

Village Hall Advisers can be located at Rural Community Councils.

For details contact:
Action with Communities in Rural England (ACRE) as detailed on the back page of this
Information Sheet.