

# The Essential Society Director

In-depth guide





# The Essential Society Director

Every society registered under the Co-operative and Community Benefit Societies Act 2014 (the Act) must have a governing body. The governing body may be referred to as the Board or Committee. However, regardless of the name given to the governing body, if a person holds themselves out as director or committee member of a society then it is likely that the law will view them as such. Therefore, it is important that all directors understand their duties and responsibilities to enable them to carry out their role.

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## What qualifications does a society director need?

Directors of societies are not required to hold any specific qualifications. However, they must be able to carry out the role to the best of their ability and not be disqualified from acting as a director. Often, the rules of a society will set out the qualifications required to be appointed as a director. Most commonly these include a requirement for the person to have reached a certain age (the Act states that the minimum age is 16) and that they must be a member of the society.

## How are society directors appointed?

The Act states that the rules of all societies must provide for the appointment and removal of a committee. However, it does not stipulate the minimum number of directors a society must have, or the procedure for appointing them. Therefore, it is important that these details are included in the rules of each society. In some cases, it may be sensible to require directors to sign a Code of Conduct which sets out what is expected of a director.

Typically, the rules of a society will set out the minimum and maximum number of directors; how they are elected or appointed; the term of office; and retirement procedure. Directors' details must be kept in the register of members and included in the society's annual return to the Financial Conduct Authority (FCA).

## How are directors removed from office?

The governing document should set out the process for the removal of a director. Typically, examples include: resignation; conclusion of his/her term of office; removal by resolution of the company's members; or where he/she ceases to be eligible to carry out the role such as disqualification under the Society Directors' Disqualification Act 1986.

## What are the liabilities of directors?

Directors of societies are protected by limited liability. This means that when the society goes into liquidation or is wound up with outstanding debts, they will not have to contribute to the assets of the society above the amount of the value of the shares they hold (usually a nominal sum). This protection may be lost in certain situations as follows:

### Wrongful trading

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The court can order the director of a society that has gone into insolvent liquidation to make a contribution to the assets of the society if it appears that he/she knew, or ought to have known, that the society was going into insolvent liquidation, but took no steps to try and avoid it. The court may make such an order even if the director did not know the society was going insolvent. The crucial test is whether he/she ought to have known.

### Fraudulent trading

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If it can be proved that directors have carried on trading with the intent to defraud creditors, the court has the power to order a director to contribute to the assets of the society. Unlike limited companies, criminal proceedings for fraudulent trading under s993 of the Companies Act 2006 are not available to societies.

### Personal Guarantees

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If a society approaches a bank or other financial institution for a loan it is common practice for them to ask that the directors give personal guarantees, particularly if the society of which they are a director does not have many assets. Giving a personal guarantee is the equivalent of taking out a personal mortgage and the director will not be protected by limited liability.

### Liabilities to third parties

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A director of a society can be personally liable to a third party in these situations:

- If he/she signs a cheque which does not contain the full and proper name of the society
- If he/she does not make it clear he/she is signing as an agent of the society
- If the third party has the impression that the contract is being made personally with the director and not with the society
- If he/she makes fraudulent or negligent statements to the third party which that person subsequently relies on
- If he/she acts outside his/her area of responsibility without the authority of the board of directors (a concept known as 'breach of warranty')

**In each of the above situations any debt which follows and which remains unpaid will be considered to be the debt of the director and he/she may be sued for payment.**

### What powers do society directors have?

The Act states that the rules of all societies must set out the powers the directors have to manage and conduct the business. These powers are usually wide-ranging, but the rules may also set out specific powers that a society has. For example, it may state that a society has the power to borrow or to take on leases. Directors have overall management responsibility for the society and it is essential that they are familiar with their provisions of the rules and abide by them, so that they can carry out their duties in the correct manner.

### What duties do society directors have?

Directors should discharge their legal duties and responsibilities in a way which seeks to ensure that the society remains committed to operating as a successful co-operative business in accordance with the values and principles that are set out in the International Co-operative Alliance Statement of Co-operative Identity, which is the basis of all co-operative enterprises, and serve the interests and protect the assets of the society's members by exercising independent and objective judgement.

Broadly there are three categories of legal duty:

- The duty of good faith
- The duty to take care
- The duty to obey the law

#### Duty of good faith

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A director is in a position similar to that of a trustee – namely being responsible for somebody else's (the society's and the members') property. As a result the law imposes a duty of good faith on directors, which can broadly be summarised as follows:

- Truthfulness and honesty – acting with complete integrity in any dealings with or on behalf of the society
- Treating the society's affairs as confidential - individual directors have no legal authority to disclose anything outside of governing body meetings except what is already in the public domain, or what they are expressly authorised by the governing body to disclose
- Acting at all times in the best interests of the society – this means ensuring that the society's interests always come first, and that a director never uses their position to obtain a benefit or advantage for themselves, for other people or other organisations

- Respecting the collective decision making process – directors should accept decisions made by the governing body in accordance with the law and the society's rules, even if he or she disagrees with it, and voted against it if a vote was taken. This includes a commitment to support any decision of the governing body outside of its meetings
- Avoiding conflicts of interest – directors should avoid putting themselves in a position where their duties and responsibilities as a director conflicts with other personal interests. Where a conflict arises, they must comply with the society's rules and processes.

### Duty to take care

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In carrying out their responsibilities and decision-making, directors must take proper care. They are expected to show:

- Such skill and care in carrying out their responsibilities as a person having their background and experience would reasonably be expected to show (the subjective test)
- The levels of skill and care that a person carrying out that role would reasonably be expected to show (the objective test)

In other words, the directors are not expected to be experts, but they are expected to use such expertise as they have. Furthermore, directors must recognise that an objective standard is applied, which means that where they do not have the knowledge and expertise needed, they should either undergo training, or additional skills should be brought onto the governing body, possibly through the co-opting of professional external directors.

The duty to take proper care includes the following:

- Reading papers before governing body meetings and arriving properly prepared
- Asking questions, requesting clarification if further information or explanation is needed, and challenging the members of the management executive when not satisfied with the answers given
- Taking advice both from the management executive and from independent advisors, when appropriate, in the best interests of the society
- Disclosing any material interest to the governing body as provided for in the rules of the society. Directors should also do this in conjunction with any Conflict of Interest Policy that the society may adopt and the Code of Conduct for Directors as approved by the governing body

Directors should aim to carry out their role to the highest possible standards. It is not acceptable to leave things to other people, to fail to attend meetings without an unavoidable reason for doing so, or to treat other matters as more important than those of the society. A director who does not give an appropriate level of commitment to the society's affairs is failing in his or her duty.

Directors should ensure that they are properly equipped to carry out their responsibilities. It is not sufficient to rely on current knowledge and experience. In order to keep pace with changing needs and changing legal and financial obligations, directors need to undergo appropriate training and professional development on an ongoing basis.

#### Duty to obey the law

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Directors have a duty to conduct the affairs of the society under the Co-operative and Community Benefit Societies Act 2014 and common law. They must also follow the rules of the society.

### **Do company directors' duties apply to society directors?**

The Companies Act 2006 codified directors' duties for limited companies. Although this codification doesn't apply to societies, the general duties set out in company law are based on developed common law and equitable principles and although society directors are not obliged to follow them, it is best practice to do so.

#### Duty to obey the law and comply with society rules

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Directors must obey the law both to guard against the commission of offences under the Act and under other legislation, such as consumer protection and health and safety laws where offences by a society may also result in liability for governing body members or officers of the society. Directors must also comply with the rules adopted by the society.

#### Duty to use powers only for the purposes for which they were conferred

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Directors must use powers that they are given for the purpose for which they were given. The use of a power for some other ('collateral') purpose will be a breach of duty. For example, it is a misuse of a power to decide when to call a general meeting if a date is deliberately chosen to prevent certain members attending.

#### Duty to act in the society's best interests

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In reaching decisions and exercising their powers under the law and the rules of

the society, directors must act in good faith in what they consider to be the best interests of the society and not for any collateral purpose. The court looks to the directors to define what is in the interests of the society and will not substitute its own view. The interests of the society are the interests of the members as a whole, both present members and future members. If a society is insolvent or close to it, the interests of the society become the interests of its creditors and directors should be mainly concerned with the effects of their decisions on that group. The duty to act fairly between members arises where a decision that is considered to be in the interests of the society in good faith may have an adverse impact on particular members or groups of members. For example, in a society with different membership classes, when the governing body makes decisions in the interests of the society as a whole, it also needs to balance the interests of different member groups.

#### Duty to exercise independent judgement

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Directors must always consider any issue independently while honestly seeking to pursue the interests of the society. This means that when a director is elected by a particular constituency of members they owe their duty to the whole society membership and must not follow instructions without considering how each decision will be in the best interests of the society.

#### Duty of care, skill and diligence

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In carrying out their responsibilities, directors must take proper care when carrying out their responsibilities. They are expected to show:

***the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that the director has.***

Directors are not expected to be experts but they are expected to use what expertise they have to carry out their role appropriately.

#### To avoid conflicts of interest

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There must be no possibility of a conflict between the director's duty to the society and his or her personal interest or interest in some other body. Usually the rules would state that a director is required to declare his/her interest to the governing body and would not be allowed to vote on the issue. If the rules of the society make provision for this and the correct procedure is followed then the society cannot challenge the transaction, or claim the director's profits.

Conflicts can also be much wider. For example, where a director comes across information or an opportunity in which the society might be interested (eg to buy land adjacent to society land) by chance and unconnected with their role as a director and takes the opportunity without informing the society. That may put them in conflict with the society's interests even if the society has no interest in the



opportunity and no proprietary claim to it.

The procedure for dealing with a conflict of interest should be set out in the society's rules. Where the rules fail to provide a procedure for dealing with a conflict of interest, the director will have to provide full information about the conflict of interests or interest and duty to society members at the general meeting, which will decide whether or not to use its remedies against the director and whether to consent to the breach of the 'no conflict' duty.

#### Duty not to misuse the society's information or property or make secret profits

The assets of a society cannot be dealt with as if they belonged to a director or any other member. If property is not dealt with lawfully in the society's interests, the general law allows the society to sue for the return of misappropriated property or to seek compensation in the courts for losses caused by the misuse of the property by a director.

In addition to those general remedies, the Act provides a cheap and speedy procedure. Money or other property belonging to the society that has been misappropriated or misused by a director in breach of duty can be recovered by an order of the magistrates' court with or without a conviction for a criminal offence.

# Essential reading

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