

Waterway Societies:
Constitutions, Charitable Status,
Legal Structures and Governance

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INTRODUCTION

1. Waterway societies are part of what is commonly known as the 'voluntary and community sector' (VCS), in that their activities are carried out for public benefit rather than for private profit. All VCS organisations need to be properly constituted in order to secure the maximum privileges to which they may be entitled, and they need to adopt an appropriate governance structure. Governance is concerned with such matters as where decisions are made within the organisation, and how decision-makers are accountable to the people who are affected by their decisions (e.g. volunteers, the local community).
2. Many VCS organisations are registered charities, though not all. The Inland Waterways Association is itself a registered charity, and it is likely that many local waterway societies will wish to follow suit. Charitable status brings certain privileges and advantages, but it also imposes certain restrictions, so the pros and cons need to be weighed up in each case.
3. This chapter will later consider the issue of charitable status, and then look at the different forms of legal status available to waterway societies, whether they decide to pursue charitable status or not.

TYPES OF ORGANISATION

4. There is a finite range of forms of organisational types available to waterway societies. The ones we may most commonly encounter are–
 - Unincorporated association
 - Charitable trust
 - Limited company
 - Charitable company
 - Charitable incorporated organisation (since January 2013)
 - Community interest company
 - Community benefit society
5. Each of these has its own distinctive features conferred by statute or by case law. When designing an appropriate legal structure for an organisation, one task is to decide which of these forms of legal status is likely to be the most appropriate. Often two or more options will in fact be feasible.

KEY CONCEPTS

6. In order to discuss the topic of legal structures it is necessary to clarify a few key concepts and terms.

Governing document

7. A formal organisation must have a written set of rules which regulate certain matters that are of critical significance in the voluntary and community sector, in particular–
 - expression of social purposes
 - criteria for membership

- restrictions on the application of income and assets
 - voting rights and governance
 - disposal of assets on dissolution
8. Exactly what name is given to the governing document will depend on the legal form of the organisation–
- Constitution (a generic term but specific for unincorporated associations and charitable incorporated organisations)
 - Articles of Association (companies; though companies registered before 2009 may have ‘old style’ governing documents divided between the Memorandum and the Articles of Association)
 - Trust Deed (charitable trusts)

Governing body

9. Every organisation must have a governing body, i.e. an identifiable group of individuals who have legal responsibility for managing the organisation and its assets, ensuring compliance with the law and other such important governance functions. Again the precise title of this governing body will depend on the legal form of the organisation–
- Board of Directors (the language of company law)
 - Board of Trustees (the language of charity law)
 - The Committee or Management Committee (unincorporated associations, community benefit societies)

Membership

10. Membership is a fundamental governance issue. Essentially the members own the organisation; and the governing body is always accountable to the membership. The members of an organisation therefore retain fundamental constitutional privileges–
- to appoint and (generally) to remove members of the governing body
 - to amend the governing document
 - to wind up the organisation.
11. In a conventional, for-profit company the members are the shareholders. Their right to these constitutional privileges stems from their having invested in the business.
12. In VCS organisations, investment is not the core criterion for membership, as rewarding investment is not a primary aim of the organisation. The privileges of ownership will instead be conferred on some other stakeholder group who have a legitimate interest in the welfare of the organisation. Stakeholder groups who may be considered as candidates for membership of a waterway society might include–
- Volunteers
 - Waterway users
 - Members of the local community generally
 - Other local VCS organisations
13. Some VCS organisations do not consider it appropriate or practical to be accountable to a large membership comprising stakeholders, and instead restrict voting membership to the people who are on the governing body (directors, trustees, management

committee or what have you). These individuals are only then accountable to each other, not to any wider stakeholder group, and the implications of this should be considered before adopting this model.

Restrictions on the application of income and assets

14. The primary goal of a conventional private business is to return profits to members, as dividends or capital gains. All the business's income and assets are therefore available to the members one way or another.
15. The primary goal of a waterway society is not to maximise private gains to investors. They will instead be what is usually referred to as 'not-for-profit' (or 'non-profit-distributing'), where no surpluses at all can be distributed amongst members or others. Consequently a not-for-profit organisation cannot secure conventional investment and must rely on grants, donations, loans or income generation to meet its capital needs.
16. A second element of 'not-for-profit' status is the disposal of residual assets on dissolution: in other words, if the organisation is wound up while it is still solvent, what happens to any money, property and equipment left over? The convention is that any such residual assets must be transferred to another not-for-profit organisation with compatible objectives. Thus a not-for-profit waterway society which is winding up will donate its residual assets to another not-for-profit organisation, perhaps the IWA.

Asset lock

17. The term 'asset locked' is generally applied to an organisation which–
 - (a) cannot distribute profits amongst members, or only subject to a rigid ceiling on how much they may receive;
 - (b) must transfer any residual assets to another asset-locked body on dissolution;
 - (c) is subject to some form of external regulation to police this provisions.
18. In practice, references to an 'asset-locked body' in the UK are taken to mean–
 - (a) a registered charity, or
 - (b) a community interest company (CIC), or
 - (c) a community benefit society which has applied to the Financial Conduct Authority for such an asset lock.

These structures are discussed later in this paper.

Incorporation

19. Incorporation means the creation of a legal identity for an organisation which is separate from that of its members: a 'corporate body'. In an unincorporated association, the law does not recognise any distinction between the association and the people (or organisations) who make up its membership. Consequently anything that happens to (or is required of) the association is in fact happening to (or is required of) its members. A corporate body, however, is considered as a person in its own right.

Advantages of incorporation

Limited liability

20. Members of the governing body of an unincorporated organisation have unlimited liability and usually that liability is joint and several. What that means is that should the organisation fail to meet its debts, those individuals may be required to meet them: and that burden may well fall on those most able to pay rather than on all members equally. All members of a corporate body, by contrast, are protected by limited liability. When they agree to join the company they commit themselves to paying a fixed sum in the event of the organisation being wound up with outstanding debts. This sum is usually a nominal £1.00 in a not-for-profit organisation; sometimes it is nil.

Ownership of property and entering into contracts

21. Because an unincorporated body does not technically exist in law as a separate entity, it stands to reason that it cannot own property or enter into contracts. Thus one or more members of the governing body will usually have to own or contract on behalf of the association. This may be done deliberately – for example, by appointing certain people as holding or custodian trustees to own particular bits of property on behalf of the association – or it may happen by default in that the association acquires something without any clear specification of actual ownership. A corporate body can own property and sign contracts in its own name.

Social enterprise

22. The term ‘social enterprise’ has been increasingly used in recent years to describe an organisation that has primarily social purposes – like all VCS organisations – but runs itself in a rather more businesslike fashion. There is no legal definition of ‘social enterprise’ and not everyone uses it to mean the same thing. The most commonly-quoted definition of social enterprise is–

“businesses with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners”.

23. There has been some effort to promote a ‘Social Enterprise Mark’, along the lines of the Fairtrade Mark, to establish some minimum standards and raise public awareness of the ‘brand’. To qualify for the Social Enterprise Mark, it is necessary to meet six tests–
- (a) The company has social and/or environmental aims.
 - (b) The company has its own constitution and governing body.
 - (c) At least 50% of the company profits are spent on socially beneficial purposes.
 - (d) The company earns at least 50% of its income from trading.
 - (e) The company can demonstrate that social/environmental aims are being achieved.
 - (f) If the company were to cease trading, remaining assets must be distributed for social/environmental purposes.
24. It is possible that a waterway society that can earn significant income might choose to explore the social enterprise option. Note that it is not obligatory for an organisation that

consider itself to be a social enterprise to apply for the Social Enterprise Mark, and most do not. It is essentially a convenient label to indicate the general nature of the organisation.

CHARITABLE STATUS

25. A charity is a particular type of not-for-profit organisation that the Government has decided should enjoy certain fiscal privileges because its activities benefit the public or some section of it. Charities enjoy substantial financial advantages that are unavailable to non-charities: in particular tax relief, rate relief, and enhanced fundraising capabilities. In return, they are bound by certain restrictions on what they may and may not do.

Charitable purposes

26. A charity must only be concerned with pursuing those activities that the law recognises as charitable. Until very recently, these charitable purposes were derived from the archaic Charity Uses Act 1601, but a few years ago Parliament finally bit the bullet and approved an updated list of charitable purposes in the Charities Act 2006. These include such traditional charitable aims as relief of poverty and the advancement of education, but providing facilities for public use can also be charitable.
27. A charity must adopt an 'objects clause' which reflects legally charitable purposes and commits it to public benefit. For example the registered charity Buckingham Canal Society has as its objects—
- (a) *to promote the restoration of the old Stratford and Buckingham arms of the Grand Union Canal (hereinafter together called "the waterway") to good and navigable order and to promote the maintenance and improvement of the waterway for the benefit of the public.*
 - (b) *to promote the fullest use of the waterway by all forms of waterborne traffic and all forms of water-related commercial, local amenity, tourist and recreational activity for the public benefit.*
 - (c) *to promote the education of the public in the history and use of canals and waterways and the waterway in particular.*

Volunteer trustees

28. A key feature of a charity is that it must be run by a board of volunteer trustees (at least three people).

FORMS OF LEGAL STATUS

29. There follows a summary of the characteristics of the types of organisation listed in paragraph 4, above.

Unincorporated association

30. Characteristics of an unincorporated association—

- The most informal type of structure, sometimes no more than a loose clustering people around a shared idea and a simple set of rules ('constitution').
 - There is no significant body of law governing associations, only some scattered pieces of case law.
 - This structure is only available for not-for-profit activity. If any profits are distributed, it ceases to be an association and becomes a private business.
 - The minimum number of members is two. Governance structures are usually two-tier, with a management committee accountable to a wider membership.
 - As an unincorporated entity, members of the governing body have unlimited personal liability for any debts or liabilities, though it may be possible to insure against these.
 - Many unincorporated associations are registered as charities in which case the rules relating to charities will apply; but an association is not required to register as a charity.
31. Many waterway societies will start out life as unincorporated associations as it is the simplest and cheapest structure to adopt. Some may find the structure suits them in the longer term; others will convert to corporate bodies once they reach a certain scale of operation, and thus increase potential financial risks.

Charitable trust

32. Characteristics of a charitable trust–
- This is a form of public trust, registered as a charity (there are also private trusts – which are non-charitable – but they are irrelevant to waterway societies).
 - It is governed by trust law generally, its own trust deed and by Charity Commission rules.
 - It has no members other than the trustees (governing body), so they are not constitutionally accountable to anyone. The minimum number of trustees is generally three.
 - As a public trust, there are stringent limits on any benefits available to trustees or others.
 - As an unincorporated entity, trustees have unlimited personal liability for any debts or liabilities, though it may be possible to insure against these.

Limited company

33. Characteristics of a limited company–
- A corporate body registered under the Companies Act 2006.
 - Governed by the huge corpus of company law and its own constitution (Articles of Association – or often Memorandum & Articles of Association for companies registered prior to 2009).

- Regulated by the Registrar of Companies ('Companies House').
 - There are three types of limited company–
 - (a) Private company, limited by shares
 - (b) Private company, limited by guarantee
 - (c) Public limited company (PLC - limited by shares)
 - The minimum requirement for a private company is one person, who may be the only member and its only director. Equally a company may have many members, electing a smaller board of directors who are accountable to the members.
 - Articles may be amended by a 75% vote of the members, though certain provisions can be 'entrenched' and require a higher majority for alteration (e.g. 100%).
34. The company limited by guarantee (CLG) has been the mainstay of legal structures for the social enterprise and VCS sectors for many years. It is by far the most common legal form encountered, and a CLG may take on the additional identity of a community interest company or a registered charity, though many CLGs are neither of these.
35. The company limited by shares (CLS) is almost unknown in the VCS sector as it is essentially a mechanism for rewarding investment and is associated almost exclusively with private sector, for-profit businesses. With the introduction of the community interest company in 2005 (see below), some social enterprises were registered as share companies with the additional CIC mantle, as it was thought that the asset lock applying to CICs would lead to a more favourable view of share structures by funders and others. There is little evidence that this is the case, however, and the CLS is still avoided by most in the sector.

Community interest company

36. The community interest company (or CIC) was introduced as something of a halfway house between being regulated as a registered charity, and not being regulated at all. It was particularly intended for social enterprises rather than conventional VCS organisations. In particular, a CIC can trade freely and pay its directors, whereas a charity or a conventional VCS organisation cannot generally pay its directors (or committee, or trustees) and will usually be reliant primarily on donations, grants, and voluntary effort.
37. Characteristics of a community interest company (CIC): as above limited company, except–
- Governed by the Companies (Audit, Investigations and Community Enterprise) Act 2004 and the Community Interest Company Regulations 2005, in addition to the Companies Act 2006.
 - Regulated by the CIC Regulator in addition to Companies House.

- A CIC must pass a 'community interest test' but this is nowhere near as prescriptive as the test for charitable purposes and any waterway society is likely to pass without quibble.
- There are certain prescribed provisions which must appear in the Articles of a CIC and which cannot be removed or altered.
- In particular a CIC is subject to an 'asset lock': its property and wealth must be retained within the company unless it is
 - (a) transferred (sold) for full market value; or
 - (b) transferred for less than value to another asset-locked entity (a charity or a CIC) approved by the CIC Regulator; or
 - (c) used in the normal course of business.
- The recommended model rules for a CIC include the statement: *"The Company is not established or conducted for private gain: any surplus or assets are used principally for the benefit of the community."*
- On a winding up, any residual assets do not go to members or directors but to another CIC or to charity.
- CICs must produce annual reports that include a 'community benefit' assessment and details of all remuneration of directors and other relevant financial transactions, and these reports are readily available to the public.
- A CIC cannot de-register as such. A CIC may be converted to a charity (which is more heavily regulated) but it cannot default to a less well-regulated condition.

Charitable company

38. Characteristics of a charitable company–

- Although registered under the Companies Act, a charitable company is quite different from any other so it needs to be considered as a separate type of entity.
- Only a private company *limited by guarantee* may become a registered charity.
- Governed by the Charities Act 2011 in addition to the Companies Act; also by trust law generally .
- Regulated by the Charity Commission as well as Companies House.
- Directors of the company are also charity trustees.
- Payments to trustees are subject to restrictions and employees cannot generally serve as trustees.
- There are limits on the extent to which a charitable company may engage in trading activity.

- As a charity, it may only engage in activities that further its registered objects, and those objects in turn must be restricted to those things that are charitable in law.
 - All income, however derived, is considered to have been ‘donated’ and must be used according to the donors’ wishes so long as these fall within the charity’s objects.
 - A charity can never be de-registered as such. All assets that flow into the charitable sphere are locked in permanently, or until they have been used up in providing charitable services.
39. A charitable company has a significant advantage when it comes to raising money and donations from grant-giving trusts, sponsorship and the private sector. Charities enjoy statutory tax reliefs and a minimum 80% discount on business rates where property is occupied. These privileges can of course have a positive impact on viability if the accompanying limitations can be taken on board.
40. Another attraction of a charity is robust and permanent protection against asset-stripping or diversion of assets.

Charitable incorporated organisation

41. This is an alternative to the company limited by guarantee which has historically been the most common structure for incorporated charities. The CIO was introduced in January 2013.
42. Characteristics of a charitable incorporated organisation (CIO)–
- Enjoys full corporate status and limited liability, as a charitable company.
 - A single regulator: reporting only to the Charity Commission, not to Companies House.
 - Payments to trustees are subject to restrictions and employees cannot generally serve as trustees.
 - In common with all charities, there are limits on the extent to which a CIO may engage in trading activity.
43. There are a few specific characteristics that distinguish a CIO from a charitable company–
- *Security for borrowing.* Lenders often take a ‘fixed and floating charge’ over the assets of companies to which they lend. These charges are filed with Companies House, and are available to the public, so that the borrower can’t use the same assets to secure another loan from a different lender. There is no such register of charges for CIOs and some lenders have already indicated that this will be an issue for them.
 - *Speed of registration.* Registering a charitable company is a two-stage process. First the company is registered at Companies House, which need only take a few days; then the company is registered with the Charity Commission, which takes longer.

The organisation acquires its legal existence when registered by Companies House, so it can start acquiring property, signing contracts, employing staff etc from this date. The CIO won't exist at all until it is registered by the Charity Commission and, as registering as a charity commonly involves a degree of correspondence and negotiation, this may drag on for months.

Community benefit society

44. Though considerably less well-known than limited companies, this legal form has a long and respectable history. Until August 2014, community benefit societies were part of a larger family known as 'Industrial and Provident Societies' and it is likely that this terminology will endure for some time to come.

45. Characteristics—

- Governed by the Co-operative and Community Benefit Societies Act 2014 and by its own registered rules (constitution).
- Regulated by the Mutuels Team within the Financial Conduct Authority.
- A corporate body conferring limited liability on its members and directors.
- A community benefit society that meets normal criteria may qualify for charitable status.
- A community benefit society may apply an asset lock comparable to that of community interest company.
- Minimum membership is three persons.
- Members always hold shares, though Society shares are unlike company shares. They are usually (not always) withdrawable on demand, more like a deposit than a conventional share.
- Shares can be offered to the public or a community of interest without the normal prospectus requirements that would apply to a PLC – this makes the structure especially suitable for community share issues, which may be of interest to some waterway societies.¹ A society that issues shares is unlikely to qualify for charitable status, however.
- The return on share capital (if any) is limited, usually by a formula contained in the registered rules.
- Societies are inherently democratic: one member, one vote, regardless of shareholding or any other consideration.
- Amendments to the registered rules must be approved by the Registrar who may refuse to register amendments considered to breach the spirit of the legislation.

¹ See for example *Community Investment using Industrial & Provident Society legislation* by Jim Brown (Co-operatives UK, 2008); and for more technical information, *Community Shares – practitioner's guide to governance and offer documents* (Development Trusts Association and Co-operatives UK, 2010), both available online.