

# Kids Company: who rules?

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## Cases cited

Keeping Kids Co, Re [2021] EWHC 175 (Ch); [2021] 2 WLUK 190 (Ch D)

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*\*P.C.B. 175 Keeping Kids Company, the charity founded by Camila Batmanghelidjh, which went into a high-profile liquidation in 2015, has been the subject of a Charity Commission report into the charity's administration and management.<sup>1</sup> The conclusions of the report, published earlier this year, differ significantly from the conclusions drawn by the High Court after the culmination of a 10-week hearing in late 2020.<sup>2</sup> This article considers the report and its key findings and compares them with the conclusions drawn by the High Court. In this article and its footnotes, in the interests of brevity, the Charity Commission report will be called the "CC Report" or "the Report" and the High Court judgment "Re KKC".*

## Background

The history of the charity has been rehearsed and repeated on numerous occasions in articles and commentary charting the rise and fall of the charity and the subsequent legal proceedings. In order to contextualise this article, a brief summary of the background is set out below.

The charity was put into voluntary insolvent liquidation in August 2015. In the same month, the Charity Commission opened a statutory inquiry under s.46 of the Charities Act 2011. The scope of the inquiry was to examine:

- 1) The administration, governance and financial management of the charity including concerns around allegations of inappropriate spending, breaches of financial controls and the conduct of the trustees and the CEO amid concerns about the future viability of the charity;
- 2) Any regulatory concerns arising from the investigation carried out by the Official Receiver as part of the liquidation process;
- 3) Whether or not the trustees had complied with and fulfilled their duties and responsibilities as trustees under charity law.

In the same year the Official Receiver, pursuant to his statutory duties and following his appointment as liquidator of the charity, began his investigation into the charity. Both the Charity Commission and Official Receiver conducted interviews with each of

the trustees and the CEO, Ms Batmanghelidjh. Certain *\*P.C.B. 176* other senior employees were also interviewed. The Official Receiver had access to the books and records of the charity, which it reviewed, in part at least, in the course of his investigation.

The next key event was the announcement, in August 2017, that the Official Receiver had launched formal disqualification proceedings under s.6 of the Company Directors Disqualification Act (CDDA) 1986 against the trustees in office at the time of the charity's closure, one trustee who had resigned a few months beforehand, and the CEO. It was later confirmed that this inquiry had been placed on hold pending the outcome of the Official Receiver's attempt to disqualify the trustees and CEO.<sup>3</sup>

The sole allegation made by the Official Receiver was that the trustees and CEO had allowed the charity to operate an "unsustainable" business model.<sup>4</sup> It is important to note that there were no allegations made of inappropriate spending of charity funds, dishonesty or bad faith. The claim was eventually heard, mid-pandemic, between October and December 2020. The lengthy and detailed trial, presided over by Falk J, was forensic in its assessment of the facts: it spanned the course of 10 weeks, heard evidence from 13 witnesses and the documents placed in front of the court totalled almost 20,000 pages.

Falk J's judgment was handed down in February 2021, just under two months after completion of the trial. Spanning 914 paragraphs and 218 pages, the judgment is comprehensive and enormously detailed. In summary Falk J was "wholly satisfied that a disqualification order is not warranted" against any of the defendants.<sup>5</sup> On the contrary, Falk J expressed a "great deal of respect for the care and commitment [the directors] showed in highly challenging circumstances".<sup>6</sup>

Following the conclusion of the disqualification proceedings, the Charity Commission's delayed inquiry report was eventually published a year later on 10 February 2022. The key conclusion of the Charity Commission's investigation mirrors that of the High Court: the Charity Commission determined *not* to take any regulatory action against the trustees or CEO. However, the Charity Commission's findings differ from those of Falk J in two main respects, the charity's financial management and its reserves policy.

In general, the disparity is arguably surprising. It is acknowledged that the High Court and the Charity Commission were applying different tests. Specifically, the Official Receiver's claim under s.6 of the CDDA required it to satisfy the high bar for a director to be disqualified: that based on their conduct, the director was "unfit to be concerned in the management of a company".<sup>7</sup> The rationale being that any disqualification should be for the protection of the public. The Charity Commission examined whether there had been "misconduct and/or mismanagement" in the administration of the charity.<sup>8</sup> These are not terms that are defined in statute and, as such, are open to interpretation by the Commission. They are likely to constitute a lower threshold.

However, at heart, both tests require a judgment to be made of how the trustees and CEO managed the charity. The Charity Commission and the High Court were considering the same conduct. Critically, the High Court, having looked in detail at the same fact pattern as the Commission, went much further in favour of the trustees than simply stating that the high threshold for disqualification was not met.<sup>9</sup> It in fact praised the trustees for their management of the charity.

The two key areas of disparity and how they are dealt with in the High Court decision are discussed in more detail below. *\*P.C.B. 177*

### ***Financial management***

The Charity Commission concluded that the charity operated a "high-risk" business model and made a formal finding of "mismanagement in the administration of the Charity".<sup>10</sup>

The High Court proceedings gave significant attention to the issue of financial management and in particular payments to key creditors (HMRC, staff and self-employed contractors), which was the area the Commission chose to criticise in the CC Report. The Official Receiver's counsel cross-examined witnesses on this subject in detail. The core of this questioning, and the basis of the Commission's finding of mismanagement, was the timing of payments to HMRC. Until June 2014 the charity had broadly made payments to HMRC in line with HMRC's expectations. However, from July 2014 onwards the discussions between the charity and HMRC became more urgent as the debt increased and a payment plan was not met. The charity made regular payment to HMRC but, in some months, this was below the expected amount. The summer had historically always been a low

period for fundraising for the charity, whilst major donors were on holiday and there were no significant fundraising events. The run up to Christmas was historically a high point for the charity in terms of donations.

November 2014 represented a turning point for the management of the charity. It was at this moment that the trustees, for the first time, became concerned that the charity may not raise the required income to meet all outgoings for 2014. It was also around this time that the charity was one day late in paying payroll for staff. From the end of November 2014 onwards, the trustees were on a war footing—looking for ways to stabilise the charity (either through raising further funds or cutting costs) and secure its long-term future. Managing HMRC during this more parlous period became a key concern, with the trustees receiving regular updates. By this time the charity's scheduled payments to HMRC were approximately £350,000 per month but the charity increasingly struggled to pay this amount. The charity continued in the deficit position, albeit in constant communication with HMRC, managing the debt, until closure in August 2015 (except in April 2015 when a substantial payment was made, following receipt of a grant from central government).

The CC Report describes a "pattern of failure to pay monies owing to HMRC on time" from July 2014, based on "Records" that it had seen. However, the CC Report does not go into significant detail, dedicating just three paragraphs to addressing the issue of "Financial Management". The Report cites the failure to pay HMRC on time as "evidence of mismanagement in the administration of the charity" and suggests that it "illustrates the financial difficulties that the Charity was in and the failure to manage these effectively".<sup>11</sup> No analysis of why payments to HMRC might have been delayed is included in the Report. Nor did the Report discuss in any detail the patience with which HMRC dealt with the charity and the willingness HMRC showed to wait for payment and allow the charity to "trade" out of its difficulties. Instead, the Report cites the fact that the charity made late payments to HMRC as *prima facie* evidence of financial mismanagement.

The High Court judgment dedicates 19 paragraphs to a chronological analysis of the charity's correspondence and relationship with HMRC. Falk J rejected the Official Receiver's suggestion that the relationship with HMRC and failures to pay were mismanagement or a cause for strong criticism of the trustees stating:

"My own assessment is that HMRC were indeed patient, but this would not have been based on simple altruism. Final demands were either met, or where they were not I infer that HMRC took the view that the debt was more likely to be paid by allowing the charity to continue to operate, as indeed *\*P.C.B. 178* proved to be the case in respect of all amounts other than the sum left unpaid at the point of liquidation."<sup>12</sup>

...

"In summary, despite a number of difficulties HMRC allowed the company to continue to operate, never presenting a winding up petition. It is also not the case that Kids Company was continually overdue in its payments to HMRC. There were particular difficulties in 2013 but the charity made the required payments throughout most of 2014, and in 2015 substantially caught up following the government's grant payment."<sup>13</sup>

Falk J's approach and conclusion on the issue of HMRC (and therefore the charity's financial management generally) is much more nuanced than that of the Charity Commission. When compared to the findings of the CC Report (that payments were late, ergo there was financial mismanagement), Falk J's conclusion is notably more holistic, and takes into account evidence of the charity's ongoing relationship and correspondence with HMRC. This evidence demonstrates that whilst HMRC *was* at times paid late, the charity maintained open and transparent lines of communication with HMRC and actively managed this relationship in light of the charity's cashflow difficulties. The position was therefore very closely managed, rather than mismanaged.

### **Reserves**

As noted above, the second issue that was the focus of criticism in the CC Report, albeit not a criticism that in the Commission's view amounted to mismanagement, is the charity's level of reserves. The charity operated a demand-led model and experienced an increase in demand for its services on a year-by-year basis. Due to this policy, together with the fact that many donations were restricted (i.e., they specified what expenditure the donation was to cover), the charity struggled to build up substantial cash reserves over the course of its existence.

The Report is critical of the charity for maintaining a low level of cash reserves and for prioritising "the immediate and urgent needs of its beneficiaries at the expense of its longer-term sustainability".<sup>14</sup> It explains the Charity Commission's view that

"it would have been prudent for the Charity to seek to build up reserves to provide it with a financial cushion in the event of unexpected expenses or an unexpected fall in income".<sup>15</sup>

The Report goes on to suggest that

"... [i]f the Charity had had a higher level of reserves, it may have been able to utilise these to weather this storm and thereby avoid insolvency and/or wind up in a more orderly fashion or merge with another organisation and therefore ensure ongoing care and support for its beneficiaries. The trustees' decision to operate with a low level of reserves meant they could not do so."<sup>16</sup>

The "storm" referred to relates to a criminal investigation launched in July 2015 into allegations of sexual and physical abuse at the charity. Ultimately the allegations were unfounded. The police found no *\*P.C.B. 179* evidence of criminality, nor did they identify any failings by the charity in respect of their duty to safeguard children and vulnerable adults.

Whilst Falk J found that reserves in the form of liquid resources would have been "desirable", she recognised that creating them was more easily said than done in the context of the level of need the charity sought to address, given the demand-led model that it had adopted, and donors' desire for their money to be used actively rather than held in reserves.<sup>17</sup> Further to this, Falk J recognised that

"to the extent that [a build up of liquid reserves] could have been achieved it would have diverted resources from meeting the needs of the Charity's clients, which were increasing year-on-year ..."<sup>18</sup>

Ultimately Falk J found that the trustees' decision to prioritise spending on charitable objects rather than to build reserves was reasonable and fell within a number of decisions that the trustees could have justifiably made in the exercise of their discretion.<sup>19</sup>

Significantly, Falk J also disagreed with the suggestion (later adopted by the Charity Commission in the Report) that the charity could have survived the July 2015 criminal allegations if it had built up appropriate reserves, stating that this was "not demonstrated by the evidence".<sup>20</sup> Even if the charity had managed to accumulate three months' worth of reserves (as was its aspiration), the detailed police investigation took until January 2016 and Falk J found no reason to doubt that it would have taken at least six months to regain donor confidence.<sup>21</sup> No clear explanation is provided by the Charity Commission for its decision to disagree with this finding.

### **Recommendations made**

It remains difficult to align certain of the findings of the CC Report with the High Court judgment. We highlight above two key areas of difference. It has been reported that Ms Batmanghelidjh intends to seek judicial review of the Commission's decision as contained in the Report.<sup>22</sup> Further clarity may be forthcoming if the judicial review proceeds, and the reasoning behind the Commission's decision is considered by a court. Notwithstanding this, there are some helpful recommendations made by the Report that should be noted by the charity sector.

### ***Record keeping***

The CC Report highlighted that certain of the charity's records were destroyed at the time of its collapse and some decisions that were made were not properly documented. Such destruction of records was done without the trustees' knowledge or consent and the Report and the judgment both recognise that any destruction was against the trustees' instructions.<sup>23</sup> Nevertheless, the fact that it was known documents were destroyed inevitably raised questions about the completeness of the records available to review following the charity's closure. All charities should ensure that they have comprehensive policies dealing with the preservation of records and the circumstances in which it is acceptable for any record to be destroyed. *\*P.C.B. 180*

### ***Rotation of the trustee board***

The CC Report highlights that the charity's chair had been in post since 2003, and the CEO since 1996. The Report suggests that

"... [r]otation of the trustee board including the chair is usually in the interests of a charity as it allows for an injection of new ideas and approaches and for challenges to the way in which a charity operates"

and recommends that

"Trustees should think about how long they have been in post, the requirements of their Governing Document and their current mode of activities and whether the current composition of the Board is operating in their charity's best interests." <sup>24</sup>

In the case of the charity, as noted in the High Court judgment and the CC Report, the trustees had planned to restructure the board, which would have included the appointment of new trustees with financial and clinical experience. <sup>25</sup> The trustees were in the process of seeking new trustees before its collapse. Ensuring there is a good balance of expertise and a rotation of members of a trustee board is sensible to ensure that the trustees can ensure they fully understand and assess the performance of their charity and challenge any entrenched behaviours. Care should be taken by charities with regular trustee rotation prescribed by the charity's governing documents as the strict requirements can be inadvertently missed. The terms of office and dates of retirement should be carefully recorded and diarised so that the process is properly managed in practice.

#### Final remarks

Despite the criticisms levelled at the charity's trustees and Ms Batmanghelidjh by the CC Report, the most significant aspect is that the Charity Commission decided that it would take no further action against any of the trustees or Ms Batmanghelidjh.

As noted above, any suggestion that the publication of the Report marks the end of this saga may be premature. It appears that Ms Batmanghelidjh intends to challenge the decision as set out in the Report in the form of a judicial review. She has been quoted as saying that she has "been left with no option but to consider [her] legal position and seek a judicial review of the Charity Commission's report". <sup>26</sup> In short, watch this space.

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#### Footnotes

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- 10 Charity Commission, "Charity Inquiry: Keeping Kids Company" (10 February 2022), gov.uk, <https://www.gov.uk/government/publications/charity-inquiry-keeping-kids-company/charity-inquiry-keeping-kids-company> [Accessed 13 June 2022], "Operating Model".
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- 17 *Re KKC [2021] EWHC 175 (Ch)* at [530]–[532].
- 18 *Re KKC [2021] EWHC 175 (Ch)* at [540].
- 19 *Re KKC [2021] EWHC 175 (Ch)* at [540] and [878].
- 20 *Re KKC [2021] EWHC 175 (Ch)* at [822].
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