



[Reading Room: Local Government](#)

The application of the Trust Model in the Local Government Sector

Scene Setting overview of the Trust Model

This paper was presented by Peter McKinlay, Executive Director of MDL, at a Society of Local Government Managers / Local Government New Zealand seminar on 16 August 2000

Introduction

My brief for this presentation is to provide an overview of the use and potential of trusts within the local government sector. The purpose is to set the scene for the more technical presentations during the course of this seminar.

I want to start by stating a personal position: I am an enthusiast for the use of trusts which I see as a particularly powerful instrument as local government moves more towards a community governance framework. However, my enthusiasm is tempered by caution. As with any powerful tool, the user needs to understand not only its potential but also its limitations and to ensure that when it is used, it is used for an appropriate purpose.

The attraction of Trusts

Trusts are only one of a number of different instruments which local authorities can use as a means of taking activity out of the mainstream of Council administration. Other instruments include stand alone business units, committee structures of various kinds including joint committees, companies and incorporated societies. Each has its own strengths and weaknesses and one or other of these different options will be chosen depending on the purpose which the local authority wishes to serve.

Trusts are appropriate when a local authority wishes to shift an activity from the council as the legally responsible party, to a separate legal entity (or to create a new activity within a separate legal entity in a way which reinforces a sense of public purpose). A trust is therefore different from (say) a committee or joint committee or a stand alone business unit, each of which is still wholly or partly within the ambit of the council as a legal entity and has no separate legal identity of its own.

What do I see as the principal attractions of trusts? Briefly:

- Trusts provide extreme flexibility of design. Either an incorporated society or a company structure brings with it a set of statutory rules regarding governance and structure which are quite difficult to vary. For example, an incorporated society is governed by a committee, the whole of which comes up for election once every twelve months. There is no scope for rotating appointments or for providing for a different means of selecting the committee. A company may have a greater element of flexibility, for example, in appointment of directors but it has a strong statutory framework regarding the role and discretion of directors, something which a number of local authorities have found quite frustrating in dealing with LATES (a frustration which, on occasion, has reflected more a lack of understanding by local authorities of the LATE structure than it has of the inherent difficulties the structure creates)
- The "body language" of a trust structure is a very positive one for an entity which has a public or quasi-public purpose. It is taken for granted that trusts exist for the public benefit. In contrast, the body language of companies, no matter how they may be structured in practice, typically gives a signal of for profit activity and of pursuing private rather than public benefit (It is interesting to speculate what the public, and in particular the medical profession's reaction to the National Governments' restructuring of hospitals would have been had that government selected trusts rather than companies as the preferred vehicle). At the same time, it is widely accepted that trusts can quite properly undertake business activity, sometimes of a quite significant nature - as with the Sanitarium Health Food Company. Incorporated societies, for reasons which at times I find a little difficult to understand, are typically seen as entities which cannot undertake large scale business activity
- Trusts do not raise the same problems of ownership as arise when transferring an activity to a company - you can achieve the benefits of independence from the council without what may be seen as the problems of private claims through ownership to the benefits of the activity (ie, trusts can avoid the political difficulties of privatisation).

In what Situations are Trusts Appropriate?

Looking at experience, the answer seems to be a bewildering variety. Local authorities have used trusts to take over the operation of libraries, museum, art galleries and a range of other leisure and recreational activity. They have been the preferred vehicle for the establishment of economic development agencies. They can be a very suitable vehicle for owning public housing or other property held for public purposes. Outside local government itself, but still as an important part of community governance, we have the community trusts, which originated from the corporatisation and ultimately privatisation of Trust Bank, the energy trusts which came out of the restructuring of electricity distribution, licensing trusts and some one off special purpose examples, not strictly trusts but described as such, including the former Auckland Regional Services Trust.

Although the range of trusts created by or in association with local authorities is wide, they have one thing in common. They are established to serve purposes of public benefit rather than to provide benefits to individuals as such (in the wider public arena the one exception to this general principle is a number of the energy trusts amongst whose purposes are distributing some or all of their income to consumers). Consistent with this, local authorities have typically sought to ensure that trusts which they establish, or with which they are associated, are incorporated under the Charitable Trusts Act and, ideally, recognised by the Inland Revenue Department as charitable for the purposes of the Revenue Acts (the two processes are separate; successful registration as an incorporated charitable trust does not of itself mean acceptance by the Inland Revenue Department that the trust is charitable).

Important consequences follow from incorporation. First, the trust becomes a separate legal entity able to hold property and enter into contracts in its own name rather than in the names of individual trustees. Secondly, trustees enjoy the benefit of limited liability (but are still liable as trustees for breaches of trust).

Some common themes can be picked up from the variety of instances in which local authorities have used trusts. They include:

- A sense of a public purpose
- A wish to bring into the governance of the activity people who are not currently councillors
- Accessing sources of public and or financial support which might not be available directly to the council.

A Sense of Public Purpose

To the best of my knowledge, when choosing amongst different types of structure for activities which they have decided to shift outside core council, local authorities have chosen to use trusts only when there is a clear and ongoing element of public benefit. For activities which more nearly represent conventional business activities - for example works and services, professional services, treasury functions etc - local authorities have used the company form. In my view, this reflects more a judgement (perhaps implicit) about the body language of the structure than it does the legal position. Somehow, it obviously seems to feel more natural that a business activity should be owned by a company structure, even if the ultimate owner is a local authority, and a public interest activity by a trust. It is possible that, as local authorities become more familiar with trust structures and the opportunities they offer, activities that they might previously have placed in a company structure will be placed with a trust instead, especially if public ownership as such is seen as a significant positive factor.

Bringing in non-councillors

This can represent one of the real benefits of using a trust structure, particularly in activities of clear public benefit and where there is strong support in the community as using a trust structure can open

up access to very real expertise. In most communities there are very capable individuals prepared to make a real contribution to the operation of a particular council function - say a library, a museum, an art gallery or an economic development agency - but who do not want either to go through the trauma of facing election or to take on the full responsibility of a councillor. Instead, they would prefer to make their contribution in a relatively focused way to a single activity. The ability to appoint such people as trustees provides a real opportunity of tapping that kind of community resource (councils can set up committees with only one council member or sub-committees with none but this means of bringing in outside expertise seems not to be attractive in cases where a measure of independence from the council, or permanent existence is desired).

Accessing resources which might not be available to the council

There are sources of financial or other support which are very appropriate for activities undertaken by a council, but which may be hard to access so long as the activity is council owned and operated. As a simple example, there are a number of grant-making bodies who exclude councils from their eligible grantees but would quite happily include a trust for what was previously a council activity.

In other instances, especially with museums and art galleries, the creation of a trust may make it much easier to obtain donations or gifts of artefacts from private individuals. Several years ago I undertook a major study for the Museum Directors' Federation on the governance and funding of museums. I was struck by the number of times I was told that one real advantage of using trusts for museums and art galleries was that individuals who were not prepared to donate money or artefacts to a council would quite happily do so to a trust. It seems that one reason was a concern that donations to a council would somehow disappear into its general funds, either directly or as a result of the council reducing its museum or art gallery funding by an equivalent amount. Although this could still take place with a stand-alone museum or art gallery trust, receiving funding from a council, the greater transparency of that process seems to be regarded as a protection.

A further opportunity for accessing additional resources is the ability of a standalone trust to trade. This is a combination of legal powers and of having a governing body dedicated to the interests of the entity itself, rather than of the wider council. I believe, for example, that there is a very good case for councils transferring their libraries to trust structures and quite specifically mandating their libraries to develop the commercial side of their information activities with the proceeds returned, ultimately, for the expansion of its public benefit role. Theoretically it might be possible for a library to do this as part of core council but without appropriate and skilled governance, and a separate legal identity, this is extremely difficult to achieve.

Some more advantages

I am particularly attracted to the potential which trusts offer for designing governance and accountability arrangements to suit their specific circumstances. Start with the positions of trustees. Trusts

cannot exist without trustees but the law says virtually nothing about how they should be appointed (although it does contain provisions in respect of their removal). This provides quite a bewildering range of choice. Trustees can be elected, with the electoral franchise itself designed to suit. They can be appointed, directly by council (but be aware of the tax implications of council controlled trusts). They can be appointed by some form of indirect process. They can be self appointing. The point I wish to stress is that there is no particular rule and the possibilities are almost infinite.

The same situation exists in respect of accountability. The Charitable Trusts Act does not even require a trust to publish accounts, let alone audit them. The principal remedies open to anyone concerned that there may be maladministration is to seek the intervention of the attorney general or to apply to the high court.

The absence of rules can be a weakness (something which I have argued is the case with energy trusts). Equally, however, it can be a strength. You can specify whatever accountability you think appropriate. You might, with a museum or art gallery trust, require trustees to report annually to a separate body such as a "Friends" society. Your trust deed could make provision for an annual meeting at which the public could attend and pass resolutions, binding or non-binding. A trust deed could make provision for classes of membership and give those members rights up to and including requiring the trustees to hold meetings at which members could pass binding resolutions or even dismiss the trust. Again, the range of possibilities is virtually infinite.

Getting Activity into a Trust

The Local Government Act is virtually silent on how a local authority may transfer an activity into a trust, or promote its establishment within a newly created trust. The only specific references in the Act are to particular classes of trusts designed for what are effectively one off situations. These include the community trusts which can be established with the proceeds of the sale of port company shares (see section 222D) and a similar provision which was part of the statutory framework for the former Auckland Regional Services Trust.

For trusts generally, the closest the legislation comes to any specific reference is Part XXXVI, which provides quite wide powers for local authorities to make grants or loans or provide guarantees for a variety of community and recreational purposes. (The reference is to "any organisation or group or body of persons (whether incorporated or not)")

Aside from these special circumstances, the practical reality is that the relationship between a local authority and a trust is based on the same set of legal principles as applies to the relationship between the local authority and any other separate entity with which it has dealings. Today, even when a local authority may be able to fund a trust by making a grant or providing other assistance under Part XXXVI of the Act, it is increasingly likely to treat the relationship as one of the purchase of services in the same way as it would services provided by a private firm.

What this means is that if you have legal authority to contract out a

service, then that service can be undertaken by a trust so long as the trust itself has adequate powers (and typically trust deeds will have been drawn to ensure that this is the case).

The use of the purchase agreement approach is more than just a convenient legal device. It is a very appropriate means of separating out the council's service objectives from the overriding purposes of the trust and, for that matter, avoiding confusion between the council's service objectives and the service objectives which other parties dealing with the trust might have. I have seen trusts promoted by councils which have included in their deeds provisions intended to regulate the provision of services by the trust. In my view that is quite inappropriate - in the jargon sometimes used in the state sector, this is to confuse the purchase and ownership interests. In the case of trusts, it can risk the council intruding into the responsibilities of trustees in a quite unhelpful fashion.

On the positive side, what I do want to highlight here is the very wide range of areas of activity which could, potentially, be undertaken in a trust format. So long as the council has the power to contract out a service, rather than undertake it itself, that service could be performed by a trust. It is interesting to speculate what could happen as councils come to recognise the full implications of this. Might we, for example, see much of the work of Environmental Business Units contracted out to some form of environmental management trust?

Some Do's and Don'ts for Establishing and Operating Trusts

I start with a very large don't. It is don't rush in. The very fact that trusts provide such a degree of flexibility makes it much more important to know why you have decided to set up a trust and that you have thought through how to structure it, what it should do, and how it should be held accountable.

What are some of the things to think about? First decide what you want the trust to be able to do. You can give a trust very narrow powers or very wide powers. You should assume that if you give it wide powers, it is likely they will be used. Equally, you should assume that if you give a trust narrow powers, sooner or later they will prove a very real obstacle (something of a parallel, here, with the more prescriptive provisions of the Local Government Act).

If, as is likely, the trust you are establishing will be a charitable trust, you should know and understand the difference between charitable purposes and trustees powers. In my experience, this is one of the greatest areas of confusion and can really get people into trouble.

The thing which makes a trust charitable is the purpose to which it applies its income and capital. Application is not the use of income or capital in the normal course of business. It is the use of that for the benefit of a third party or parties without receiving any equivalent consideration - in simple terms, the charitable purpose is the purpose for which you actually distribute your surplus income or capital. At law, there are four classes of purposes, the relief of poverty, the advancement of religion, education and other public purposes (the acceptance of which, by the Inland Revenue department, normally

requires that you can point to a court decision in a similar situation).

Powers are very different. Powers are concerned with what a trust does with its assets while it still owns them. With a full set of powers, a trust can carry on business with virtually as much freedom as company. The standout example in New Zealand is the Sanitarium Health Food Company which is in fact owned by a charitable trust for the advancement of religion; it is a main source of funding for the Seventh Day Adventist Church.

Next, consider carefully the nature of the activity or activities you want the trust to undertake and where the division of responsibility between the council and the trust should lie. A number of councils, in establishing trusts for purposes such as the operation of a museum or art gallery have decided that they should retain overall control of the main assets (usually buildings, occasionally the collection) and that the role of the trust should be to act as long term manager. Wellington City's Museums Trust is a good example.

This decision will turn on questions such as the council's concern about long term ownership and control of the asset; who is best placed to retain responsibility for the maintenance and integrity of the asset and so on.

Manage the process carefully and do not expect the transfer to a trust to be some kind of magic bullet for any problems you may currently have with that activity. A while ago I came across a situation in which a council had established a trust to take responsibility for a major recreational asset which had a quite considerable problem of deferred maintenance. The council thought that passing responsibility to a trust would solve the problem; somehow the trust would find monies, over and above its revenue from the operating contract with the council, which would solve the problem. Regrettably, it overlooked explaining this to the trustees before they were appointed. The result; a long and somewhat bitter argument between trustees and the council over who should pay - and a rather pointless argument as it was perfectly clear that the trust could not.

The lesson? Setting up a trust to take over a major activity should be treated in much the same way as the private sector would treat a business disposal / acquisition. Make sure that due diligence is done and that both parties know and understand exactly what is passing over, including the risks and liabilities associated with it, and that measures are in place for managing these.

Appointment of Trustees

Selection and appointment of trustees can be one of the more contentious issues. One question of particular difficulty is whether councillors should be appointed. In favour of appointing councillors it is often argued that they can act as a channel of communication between the trust and the council, brief their fellow trustees on what the council seeks from them, and represent the wider public interest in making decisions as trustees. In my view, none of these are good reasons. There are alternative ways of ensuring effective communication. They include requirements for reporting such information as the council requires in terms and at the times that suit its purposes, meetings between trustees and the council or an

appropriate committee, and ensuring that there are good working relationships between trust management and council management.

My own view is that councillors as trustees are inevitably in a position of conflict. Typically, a trust associated with the council will receive most of its operational funding from the council itself. This puts the councillor on both sides of the fence, a particular complication when his or her duty as a trustee is to make decisions in the interests of the trust beneficiaries, and not in the interests of the council funder. It also confuse accountability as a councillor/trustee sits on both sides of the relationship.

Another issue, particularly when trustees are remunerated, is the risk that appointing councillors will create something of an A team / B team scenario with some councillors seen as suitable for appointment and the additional income which goes with that and others rejected. Probably all of us at this seminar can think of cases where this has been quite a divisive factor in individual councils.

I am, though, something of a realist. Whilst some councils will want to take a pure view, and separate the roles, others will want to appoint at least some councillor trustees. I need also to acknowledge that there are well known instances of trusts which appear to have performed admirably with councillors amongst their trustees.

What I would argue is that trustee appointment needs to be taken seriously in much the same way as appointment to any other governance position. As a desirable minimum;

- There should be a clear job specification and person requirement developed for the position of trustee (if the trust already exists, this should be done in consultation with the chair)
- The opportunity to be appointed as trustee should be openly advertised
- The initial screening and selection of a shortlist for appointment should be undertaken through as independent a process as possible. Ideally, someone with appropriate expertise and independent of the council should undertake this role. Where the cost may be seen as a barrier, an option is for this to be done by council management - perhaps a monitoring unit within corporate office - but this carries with it the potential for some embarrassment if the candidates include councillors
- Final selection of trustees should be made by the council itself from a shortlist established on the basis that all of the persons on it are appropriately qualified for appointment
- The same process should apply both to councillor and non-councillor applicants.

Accountability

The first thing to recognise is that the typical council backed trust faces two kinds of accountability. One will be accountability to the council under its funding or purchase agreement for the services which

the council wants it to undertake. In practice, this should be no different in principle than the accountability arrangements the council has with any significant service provider. The second form of accountability is by the trust to its community. There will be an overlap between these two forms of accountability. As an example, the council as funder will almost certainly have some performance measures about the quality of experience which people (say) visiting a museum or art gallery might have. So will those people.

However note that the council's interest is actually as agent on behalf of its community rather than as principal. This may suggest that the primary accountability should be direct to the community.

In practice it is probably more efficient for the council to exercise this form of accountability as well but depending on scale and significance of the activity of the trust. As already noted, for a museum or art gallery it may be appropriate to share the accountability role with a friends organisation. For an economic development agency, the business community or community groups concerned with employment may have a role to play. If the activity is high profile, then an annual accountability meeting open to the public may be appropriate.

To conclude on the list of does, my overriding point is that due does matter. Although there is sense in each trust being designed to meet the particular needs of the circumstances in which it will operate, I have a strong personal view that this is an area where a template or good practice guide makes a great deal of sense. An awful lot of time can be wasted trying to reinvent the wheel.

One area of particular importance is managing the relationship between the council and the trust. From the trustees' perspective, their ability to undertake their tasks effectively and in a timely fashion will be very much dependent on the council itself knowing what is required of it when, and ensuring that it performs. This covers such matters as negotiating the purchase agreement, reviewing the previous years performance, the timetable for appointment/reappointment of trustees, integrating the trust's own planning cycle with that for the council to the extent that trust information is required for the council's own reporting purposes and a range of other matters which may require joint decision or where one party's decision depends on that of the other. This may seem an undue concern with detail. If you think it is, I can assure you I have seen situations where major difficulties have arisen precisely because matters of this kind have not been dealt with in a timely and effective fashion.

Finally I have one other word of caution, which I hope will have the support of my fellow presenters. This is that you draw a very sharp distinction between the public policy concerns involved in establishing a trust and the legal issues. In my experience, there are some lawyers who have a very good feel for the policy issues which lie behind or should inform local authority decisions. Equally, however, there are some who are expert in the law but lack a good feel for the policy side. My view in an area as important as this is that the primary role of the legal advisor is to assist the client find the optimal means of implementing the policy decisions the client has taken, rather than to impose a particular policy construct on the client in the guise of legal

advice. I apply to same caveat to policy advisors. It is appropriate, indeed necessary, for them to have a good understanding of what the legal issues might be but it is not appropriate that they seek to impose their views as though they were experts in the law.

Community Governance

A final few words on the relationship between the use of trusts and community governance. We are moving increasingly into an environment in which the role of local authorities is seen as that of enabling the governance of their communities, working with them to determine their preferred economic and social outcomes and then seek to achieve those. Equally, we are increasingly in a world of partnership: Partnerships between central and local government as signalled by the recent Central Government / Local Government Forum, partnerships between central and or local government and other sectors (voluntary, community, business) in pursuit of common goals.

The extreme flexibility which the trust structure offers makes them a very useful tool in this context. As an example, I see trusts as a much superior alternative to joint committees where local authorities wish to work together for a public benefit purpose. I see the same thing happening in areas where central/local government partnerships are preferred (housing seems likely to be one example of this; it is possible that the primary care organisations expected to play a significant role in the future of health services may be another). In at least two situations of which I am aware, it is possible that the Governments' recently announced Regional Partnerships Programme for economic development will result in the creation of quite influential trust structures which will play an important role in settling on the strategic direction for the regions involved and bringing together stakeholders in implementing the resultant decisions in ways which would be quite difficult for a local authority or authorities acting on their own.

In conclusion, I welcome the increased interest in trusts as a significant step forward in the evolving role of local government in New Zealand.

Conclusions

I want to compliment SOLGM and Local Government New Zealand on their decision to hold this seminar. Trusts are an extremely powerful tool when properly used and can do a great deal to enhance council related activities and the achievement of important economic and social outcomes for their communities. At the same time, as we can see all too clearly in other areas, for example with some energy trusts, there is a very clear need for trustees and people involved with trusts to understand what they are seeking to do and to ensure that the arrangements they have in place for regulating the relationship between trustees and other key stakeholders are appropriate and well understood. This applies particularly in areas such as the selection and appointment of trustees and their accountability to the public purpose or the beneficiaries on whose behalf they act.

Local Government is well placed to lead by example in this area and I

look forward to seeing it do so.

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