Directors' Duties

Company &
Commercial
Services

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A basic guide for Company Directors

All limited companies must have directors. The Companies Act 1985 *"the Act"* stipulates that a private limited company must have at least one director and a public limited company *"(plc)"* must have at least two directors. The directors of a company are responsible for its day to day management and they must conduct the company's business and its internal affairs in accordance with the law and the company's memorandum and articles of association.

This guide highlights some of the key areas of responsibility facing company directors. However, if you require further or more detailed information, please contact us.

Can you become a company director?

The company's articles of association will set out the provisions for appointing directors to any particular company. The articles may provide that directors can be appointed either by the existing board or by the shareholders. Regardless of the provisions contained in the articles, the Act allows the shareholders of the company to appoint a director to the board following a vote at a general meeting. The shareholders also have the power to remove a director from the board in the same fashion.

You may not become a company director if:

- you have been disqualified by a Court from acting as a company director;
- you are an undischarged bankrupt; or
- you are over the age of 70 and are a director of a plc or its subsidiaries.

Different types of company director

There are a number of different types of company director. Set out below is a brief description of each:

Executive director
This is a director who is also an employee of the company. An executive director will usually have a written contract of employment, known as a service contract, and will work full-time for the company, usually with extensive management responsibilities.

Non-executive director
This is a director who is not an employee of the company. Non-executive directors are usually part-time and may only visit the company when attending board meetings. They may have particular responsibilities for certain situations where an objective view is required, such as setting executive directors' salaries or conducting an audit of the company. A non-executive director will often act as chairman of the company. Despite their limited role, however, they have the same obligations and responsibilities as any other director.

Shadow director
This is a person in accordance with whose directions or instructions the directors of a company are accustomed to act, even though the person is not registered officially as a director of the company. A shadow director may, for example, be a shareholder with a controlling stake in the company. In the eyes of the law, a shadow director has the same obligations as any other director.

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Alternate director
A person who temporarily takes the place of a particular director who is unable to attend a particular board meeting. The articles of association of most companies will allow this and often an alternate director will be one of the other directors *(who will then have two votes at the board meeting)* or somebody else approved by the remaining directors. Once again, an alternate director will be subject to the same obligations and responsibilities as any other director.

A de facto director
This is a person who acts as a director without having been appointed validly, or at all. Many companies will give certain individuals a job title such as "associate director" despite the fact that this person is not actually a director of the company. Companies should be careful when doing this, however, as giving anyone who is not a director a title including the word "director" may allow a customer or supplier to claim that they believed they were dealing with a director of the company.

Directors' responsibilities

The common law imposes fiduciary duties and a duty of care and skill on company directors. Statutes and regulations also create additional offences and many of them impose strict liability, which means that ignorance of the law is no excuse.

Fiduciary duties
The word "fiduciary" is a legal term and one for which there is no simple definition. A fiduciary is best described as a person who holds a position of trust in relation to another and, accordingly, must act for their benefit.

The common law fiduciary duty requires company directors to act honestly and in good faith and in the company's interests. This is the most fundamental of all directors' duties. If you are a director, you must bear in mind the best interests of the company at all times and must not act on your own account.

Duty of skill and care
Directors must exercise due skill and care in fulfilling their duties. The required level of skill is what is reasonably expected of a director both from an objective point of view and a subjective point of view. If you have knowledge and experience in a particular area, then you will be expected to exercise a higher standard of skill. You cannot necessarily avoid liability by relying on somebody else's advice, even if that advice is given to you by a qualified professional.

You should not therefore take on a directorship unless you are sufficiently qualified or experienced to be able to fulfil the functions that you might reasonably be expected to carry out and, if you are particularly highly qualified or experienced you must exercise that high level of skill and care in your directorship.

Duty not to allow personal interests to conflict with the company's interests or make any personal profit at the expense of the company
The law provides that a director must account to the company for any personal profit which he makes as a result of his directorship unless such profit was authorised by a shareholder resolution. So, if you discover information about a new business opportunity as a result of being a director, you must not divert the opportunity from the company or make any personal profit from it. This duty extends to an obligation not to misapply any of the company's property for personal profit. Furthermore, you must disclose to your fellow board members any personal interest that you may have in a contract into which the company proposes to enter.

Duty to act within the powers conferred by the company's memorandum and articles of association and to exercise those powers for proper purposes
You must not cause the company to undertake activities which are not permitted by its constitutional documents. You are also prohibited from exercising your powers for any "improper purpose". For example, to prejudice a particular shareholder or class of shareholders.

Duty not to fetter your discretion
You must not enter into an agreement with a third party which would prevent you from exercising an independent judgment.

Duty to avoid conflicting interests and conflicting duties
You should not place yourself in a position where there is a conflict between the duties which you owe to the company and your own personal interests or other duties which you may owe to a third party, for example employees of the company or creditors.

Duty to prepare and publish annual accounts
Although the company's auditors or accountants may draw up the accounts, the directors are responsible for ensuring that they give a true and fair view of the company's affairs. Each director will also be responsible for ensuring that copies of the accounts are distributed to the shareholders and filed at Companies House within the time limits set out in the Act.

As a director, you are responsible for filing the company's annual return. The annual return *(Form 363)* provides important basic information about a company such as:

- the current directors and secretary;
- registered office address;
- shareholders; and
- share capital.

If annual returns or accounts are filed late, or not at all, the company and its directors can be prosecuted. Furthermore, the company may also be struck off the register.

As a director, you will also be responsible for ensuring that Companies House is given up to date information with regard to any of the following changes:

- extending or shortening the accounting reference date;
- moving to a new registered office;
- changing directors, the secretary, or any of their personal details;
- allotting any new shares in the company;
- any special or extraordinary resolutions and certain types of ordinary resolutions passed by the shareholders; and
- details of any mortgage or charge created by the company.

Penalties

If you are a director and you have failed to deliver accounts or annual returns, you could be prosecuted. On conviction, you may end up with a criminal record and a fine of up to £5,000 for each offence.

Alternatively, if the Registrar believes that your company is no longer trading, he could strike it off the register and dissolve it. If this happens, all the assets of the company, including its bank account and property, could become the property of the Crown.

The company can only be restored to the register by seeking a Court Order.

Can this happen in practice?

Yes. It can and it does. Statistics from Companies House indicate that more than 1,000 directors are prosecuted each year for failing to deliver financial statements and returns to the Registrar on time. Persistent failure to deliver statutory documents on time may also lead to your disqualification from taking part in the management of a company for a specified period of time.

Insolvency Law

Wrongful trading
If a company has gone into insolvent liquidation, a director may become personally liable to make a contribution to the company's assets if he knew, or ought to have known, that there was no reasonable prospect of the company avoiding liquidation.

A Court will impose its own judgment as to whether or not a director in this situation should have concluded that the company could not avoid going into insolvent liquidation. Therefore, a director could be guilty of wrongful trading even if he thought that the company would struggle through and that his actions were honest.

There is a defence available: a director must demonstrate that he took every step available in order to minimise the loss to creditors. If in doubt it is important that directors seek specialist advice from a qualified professional such as a lawyer or an insolvency practitioner.

Fraudulent trading
There is a more serious offence designed primarily to protect creditors against fraud. Proceedings can be brought by a liquidator.

Disqualification

Mandatory disqualification
If you are a director involved in running a company which becomes insolvent *(either during or after your directorship)*, and the Court considers you to have been unfit to have been involved in the management of that company, then it will disqualify you from holding office as a company director.

When determining unfitness, the law directs that the Court should consider some of the following matters:

- any wrongdoing or breach of any fiduciary duty;
- misapplication or retention of any money or other company property;
- failure to comply with the Act in connection with accounting records, registers of directors or secretaries, filing of annual returns or failure to register any charges;
- the extent of your responsibility for the insolvency;
- any failure to supply goods or services paid for in advance; and
- giving preferential treatment to one creditor over another or entering into transactions at an undervalue.

Discretionary power
In circumstances other than an insolvency, the Court retains discretion with regard to disqualification of directors. Some examples of grounds for disqualification are:

- conviction for an indictable offence;
- persistent breaches of the Act or other legislation relating to companies; or
- fraud in a winding up.

Furthermore, you can be disqualified if found liable for wrongful trading as detailed above.

Unless you have specific permission from the court, a disqualification order will prohibit you from:

- being a director of a company;
- being a liquidator or administrator of a company;
- being a receiver of manager of a company's property; or
- being concerned or taking part in the promotion, formation, or management of a company in any way.

Criminal law penalties

The Act, and other legislation relating to directors, imposes criminal sanctions for many breaches. The penalties will vary depending on whether the offence is triable by the Magistrates Court or on indictment to the Crown Court. The Magistrates Court can impose a maximum prison sentence of six months and/or a fine of up to £5,000. Fines in the Crown Court are unlimited and the Crown Court has sentencing powers beyond that of the Magistrates. A sample list of offences can be found at the end of this note.

Greater Regulation for Directors of PLCs

Directors of plcs should be aware that they are subject to the regimes designed to protect investors on public markets. There are rules relating to directors contained in the listing rules of the UK Listing Authority which governs trading on the London Stock Exchange and the Financial Services and Markets Act 2000 which governs and regulates all aspects of the provision of financial services in the UK.

How Can You Protect Yourself

Ratification

The shareholders of the company can vote in a general meeting to approve or ratify unlawful acts or acts that are beyond the power of the company. However, a director in breach of any duty may not seek ratification by using his own shares to vote at that general meeting if to do so would amount to a fraud on a minority shareholder. Furthermore, shareholders can only ratify an honest mistake and, accordingly, ratification is only available for breaches of duties of care and skill.

Directors and officers insurance

A company may take out an insurance policy to cover the liability of its directors. If you are considering a directorship, you should request that the company covers you under an insurance policy of this type.

Indemnity from the company

The company's articles of association will often contain a provision indemnifying directors against losses or liabilities which they may sustain as a result of conducting their duties. Such an article is useful in protecting directors. However, you cannot completely rely on this provision as its scope is limited by the Act which allows the company only to indemnify you against any liability incurred by you in defending civil or criminal proceedings where a judgment is given in your favour or you are acquitted.

Relief from the court

The Court has the power to grant relief to directors in certain cases where in proceedings against a director for negligence, default, breach of duty or trust, the Court deems the director to have acted honestly and reasonably and considers that he ought fairly to be excused.

This booklet highlights some of the main aspects of a director's duties and some potential liabilities. It does not amount to a comprehensive note of all duties and liabilities and is designed only to give a basic outline. If you require any detailed or further specific advice, please contact us.

Examples of Offences Under The Companies Act 1985

	Section of Act creating offence	*General nature of offence*
1	88*(5)*	Officer of company failing to deliver return of allotments etc. to Registrar
2	95*(6)*	Knowingly or recklessly authorising or permitting misleading, false or deceptive material in statement by directors under Section 95*(5)*
3	221*(5)* or 222*(4)*	Company failing to keep accounting records *(liability of officers)*
4	240*(6)*	Failure to comply with requirements in connection with publication of accounts
5	317*(7)*	Director failing to disclose interest in contract
6	458	Being a part to carrying on company's business with intent to defraud creditors, or for any fraudulent purpose

The above is a summary of some points of the topic covered. It should not be regarded as legal advice in its own right. For that advice please contact us direct.

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