



Company Directors
Powers, Duties
and Responsibilities

PANNONE
THE COMPLETE LAW FIRM

Pannone Corporate

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COMPANY DIRECTORS - POWERS, DUTIES AND RESPONSIBILITIES

Introduction

A company is a separate legal entity that cannot act on its own and it is a company's directors who are generally responsible for the management of the company's business. This encompasses not only the day to day running of the company's operations but also the development and implementation of a long term strategy. A company's directors have authority to bind it and complete authority to exercise all of its powers. The veil of limited liability provides protection to directors in that they will not generally be liable for the debts of a company. This relative degree of freedom is balanced by the many obligations placed on a company's directors by company law which – if they are not complied with – could result in a director being prosecuted, fined or disqualified. As well as this, insolvency law sets out situations in which directors can face personal liability for the debts of an insolvent company. There are many more obligations and liabilities to be found in the general law including Health and Safety legislation, environmental legislation, the Corporate Manslaughter and Corporate Homicide Act, Bribery and Corruption laws and other areas as well as common law.

As Mr Justice Parker said in *Re Barings plc (No 5)* [1999] 1 BCLC 433 "Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors".

Qualification

There is no requirement that a company director must have a particular qualification although certain categories of people, including undischarged bankrupts and children under 16 may be disqualified. All new directors should be sure to familiarise themselves with the duties and liabilities that the office carries with it as ignorance of the law does not excuse a breach.

Appointment

- 3.1 A director can usually be appointed in one of three ways:-
- a. On incorporation of a company, under section 9 of the Companies Act 2006 (Act). A statement of a company's proposed officers must be delivered to the Registrar of Companies as part of the application for registration. Once the application for registration has been processed, the proposed officers are deemed to have been appointed by operation of section 16(6).
 - b. By ordinary resolution of a company's shareholders if permitted by the articles of association. See regulation 17 of the Model Articles for Private Companies Limited by Shares (Model Articles).
 - c. By a resolution of a company's existing directors. Most companies' articles allow for this but some may not. See regulation 17 of the Model Articles. An appointment in such manner by a public company must be approved by ordinary resolution of its shareholders at its subsequent AGM.

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- 3.2 All appointments are subject to any stipulated minimum or maximum number of directors, usually fixed by the articles. The default position under section 154 of the Act is that a private company must have 1 director and a public company 2.
 - 3.3 Under section 155 of the Act, all companies must have at least one director who is a 'natural person'. This means that it is illegal for a company to only have directors which are themselves corporate bodies.
 - 3.4 Under section 157, a person may not be appointed as a director of a company unless they have attained the age of 16.
 - 3.5 The auditor of a company may not also be a director of that company.

4 Definition of 'Director'

- 4.1 Section 250 of the Act defines a director as 'any person occupying the position of director, by whatever name called'.
- 4.2 This broad definition is deliberate so that anyone acting with the power and authority of a director - whether that person has been formally appointed or not – can be made subject to the duties and liabilities imposed on directors by the Act. Individuals holding themselves out as a director and acting as a director without having been formally appointed are known as 'de facto' directors and are subject to the same duties and responsibilities as a director who has been properly appointed.
- 4.3 Some companies may give titles to Senior Executives that include the word 'director' where those individuals are not actually directors of the company. This may be intended to enhance the individual's status but is misleading and should be avoided.

- 4.4 'Shadow director' is defined in section 251 as 'a person in accordance with whose directions or instructions the directors of the company are accustomed to act'. The difference between a shadow director and a de facto director is the element of deceit involved in attempting to avoid the duties and liabilities of directors by not being formally appointed as one. Shadow directors give rise to issues of transparency and accountability as anyone dealing with a company may not be aware of their existence and influence over the company's business. There can be consequences for individuals who are found to be a shadow director, particularly in an insolvency situation, where such individuals could be held personally liable for contributing towards settling the company's debts in the same way as any other director.

"If somebody in a company, who can be, for example, a Sales Manager as titles go, regularly gives advice to the directors of the company, who then customarily act in accordance with that advice, that Sales Manager becomes a shadow director in the eye of the law, and will bear the grunt of all directorial responsibilities and liabilities" Institute of Directors, November 2009

5 Removal of a Director

- 5.1 A company's articles will generally include provisions to specify the ways in which a director can be removed from office. Under regulation 18 of the Model Articles, there are six situations in which a person's appointment as a director will be terminated. These are:
 - a. the person ceases to be a director by virtue of any provision of the Act or is prohibited from being a director by law;
 - b. a bankruptcy order is made against the person;

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- c. a composition is made with the person's creditors generally in satisfaction of the person's debts;
 - d. a registered medical practitioner who is treating the person gives a written opinion to the company stating that the person has become physically or mentally incapable of acting as a director and may remain so for more than three months;
 - e. by reason of the person's mental health, a court makes an order which wholly or partly prevents the person from personally exercising any powers or rights which the person would otherwise have;
 - f. notification is received by the company from the director that the director is resigning from office, and such resignation has taken effect in accordance with its terms.
- 5.2 Any director may be removed from office at any time by an ordinary resolution of a company's shareholders under sections 168 – 169 of the Act. The Act provides a specific procedure that must be followed, and allows the director in question the right to protest against their removal. Removal in this way will not affect the director's right to compensation for loss of office, nor will it necessarily terminate their contract of employment.
- 5.3 A director may be disqualified from holding office as a director under the Company Directors Disqualification Act 1986 – see further below.
- 5.4 Unlike its predecessor, Table A, the Model Articles do not include provisions that require the directors of a private limited company to retire by rotation at the company's AGM. This is because there is no requirement in the Act for private companies to hold an AGM each year. For public companies, the requirement for directors to regularly retire and stand for re-appointment at the company's AGM remains an important opportunity for the shareholders to hold a company's directors to account.
- 5.5 The Model Articles do not allow a director to be removed by a decision of the company's other directors.
- 5.6 Terminating an individual's directorship does not automatically alter their position as an employee. It could however potentially lead to a claim of constructive dismissal by the employee if the removal of his directorship results in a loss of status.

6 Directors' Powers

- 6.1 Model Article 3 states that, subject to the articles, the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company. However this power of the directors may be constrained by other provisions of a company's articles and/or the individual's service agreement. In addition, under Model Article 4, a company's shareholders have a 'reserve power' to direct by special resolution that the directors take, or refrain from taking, specified action. The powers of an individual director may be determined or varied by resolutions of the board, and/or the individual's service agreement.

6.2 Companies are usually managed by a board of several directors although private companies may operate with just one director, and public companies with just two. The question of control of the board and the way in which decisions of the board are made should be dealt with in the articles. The articles will prescribe a quorum for board meetings – typically two directors – and for decisions at a board meeting to be determined by a majority of votes. The Model Articles also provide for unanimous directors’ decisions to be taken otherwise than at a formal meeting where ‘all eligible directors indicate to each other by any means that they share a common view on a matter’. This could allow for decisions to be taken by email or even by text message.

6.3 Under Model Articles 5 and 6, the directors of a company may delegate any of their powers to a particular individual or committee (none of whom need also to be directors) to whatever extent, with regard to whichever matters and on whatever terms they think fit. It should be noted that whilst powers may be delegated in this manner, duties and responsibilities may not and such delegation does not absolve the delegating director of responsibility. While directors may be entitled by a company’s articles to delegate functions to others, they must therefore still supervise the tasks that have been delegated. Ultimately, responsibility remains with the delegating director. It is advisable that the exact details

of any such delegation of authority is properly noted in the records of the board meeting at which the decision to delegate was approved.

6.4 The powers of directors and the principles of sound corporate governance are the subject of much guidance. The principles which apply to UK LSE listed companies (whether incorporated in the UK or elsewhere) are set out in the Financial Reporting Council’s “UK Corporate Governance Code” (June 2010) and those which apply to private and unlisted companies are set out in ecoDa’s “Corporate Governance Guidance and Principles for Unlisted Companies in Europe” (March 2010), each of which are freely available to download online.

7 Actual and Ostensible Authority of Directors

7.1 Whatever limits are placed on a director’s authority, outsiders dealing with the directors are protected against them exceeding their actual authority in two ways:

- a. The company will be bound by the act of a director within his ostensible authority – the authority which the company allows him to appear to have, or the authority a director would usually be expected to have.
- b. Under section 40 of the Act, in favour of a person dealing with a company in good faith, the directors’ power to bind the company, or to authorise others to do so, is deemed to be free of any

limitation under the company's constitution. A company may therefore be bound by a contract entered into by a person with actual or implied authority, even if that person's action exceeds a restriction in the company's articles.

The board should put in place adequate measures to ensure anyone who deals with contracts has proper authority or procedures to protect the company in such circumstances.

7.2 Whilst directors have the power to manage the company on a day to day basis they must act in accordance with the constitution of the company. The memorandum of association and articles of association which form the constitution of a company and these documents can only be amended with shareholder approval. Whilst this provides checks and balances in theory, it is difficult as a matter of practice for shareholders to curb the authority of directors.

7.3 It should be noted that a director is also personally liable for losses suffered by a third party if the director had acted in a deceitful manner. The case of *Lindsay v O'Loughlane* (2010) EWHC 529 (QB) found that a director's deceit in using client monies specifically agreed to be held on trust to satisfy other creditors was sufficient to create a personal liability on the director for the claimant's losses.

8 Directors Duties - the Companies Act 2006

8.1 Prior to the implementation of the Companies Act 2006, the duties of directors were derived from the common law, from the fiduciary nature of a director's relationship with the company and from the principles of agency. Many of these duties are now enshrined in statute in the new Act.

8.2 The duties of directors are stated in sections 171 to 177 of the Act as follows:

- a. Duty to act within the powers of the company;
- b. Duty to promote the success of the company;
- c. Duty to exercise independent judgment;
- d. Duty to exercise reasonable care, skill and diligence;
- e. Duty to avoid conflicts of interest;
- f. Duty not to accept benefits from third parties; and
- g. Duty to declare an interest in a proposed transaction or arrangement.

8.3 Duty to act within the powers of the company

Directors must not exceed the powers conferred on them by the company's constitution and use such powers only for their proper purpose. See 'Directors Powers' and 'Ostensible and Actual Authority' above.

8.4 Duty to promote the success of the company

A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of the members as a whole. In doing this however, the director must also have regard to:

- a. the likely consequences of any decision in the long term;
- b. the interests of the company's employees;
- c. the need to foster the company's business relationships with suppliers, customers and others;
- d. the impact of the company's operations on the community and the environment;
- e. the desirability of the company maintaining a reputation for high standards of business conduct; and

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- f. the need to act fairly as between the members of the company.

The matters to which the directors must have regard reflect the government's intention to place a statutory duty on directors to consider the interests of the company's stakeholders in all decisions that they make whilst also considering the long term and wider implications of such decisions. It should be remembered that this list is not exhaustive and that directors must have regard to any and all matters that are relevant to a particular decision. At the same time, it is important to recognise that whatever weight is placed on these issues in a particular transaction, the overriding duty is to promote the success of the company for the benefit of its members as a whole. The wording of this duty however can certainly provide directors with a possible argument to favour a long term view over shareholder pressure for short term gain.

8.5 **Duty to exercise independent judgement**

Directors must exercise independent judgement however this duty will not be infringed if the director is acting in accordance with an agreement entered into by the company that restricts the exercise of discretion by the directors, or if the director is acting in a way that is otherwise authorised by the company's constitution.

8.6 **Duty to exercise reasonable care, skill and diligence**

This is defined as the care, skill and diligence that would be exercised by a reasonably diligent person with:

- a. The general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
- b. The general knowledge skill and experience that the director has.

This definition is derived from the standard expected of a director as stated in the Insolvency Act 1986, and by its application directors are subject to both an objective and subjective test. The courts are not generally inclined to hold directors to account for errors of judgement provided that the director has acted in good faith. Successfully running a company for the benefit of its members must inevitably involve some element of risk. However ignorance and incompetence will not be a defence to a breach of this duty.

8.7 **Duty to avoid conflicts of interest**

Of the duties codified in the Act, this duty arguably has no precedent in common law and thereby represents a new duty with which directors must comply.

A director of a company must avoid a situation in which they have, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. Any director that has an actual or potential conflict of interest with the company will be in breach of this duty. This issue can be dealt with under the terms of section 175 of the Act, which gives the directors a power to authorise a particular director's conflict of interest as long as the company's articles do not prevent this. Once a situation has been authorised by the directors, there will be no infringement of the duty.

Private limited companies incorporated before 1st October 2008 should note that the directors' power to authorise conflicts cannot be invoked automatically and must first be approved by the company's members. Use of the power does not require approval on each occasion but just a single resolution to 'activate' the directors' power to authorise conflicts.

The directors of public limited companies may only authorise conflicts if permitted to do so by the company's articles. Of course, it should be borne in mind that any decision to authorise a director's conflict must be taken in accordance with the other director's duties enshrined in the Act.

8.8 Duty not to accept benefits from third parties

Directors must not accept a benefit from a third party that is conferred by reason of the person being a director, or in return for doing or not doing anything in their capacity as a director. By operation of this duty it is intended that directors should remain free from the influence of third parties and should prevent directors from getting into a position where they may have a conflict of interest. If the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest then the duty will not be infringed. Otherwise, such benefits can only be authorised by resolution of the company's shareholders.

8.9 Duty to declare interest in proposed transaction or arrangement

A director must declare the nature and extent of any direct or indirect interest that he has in any arrangement or transaction with the company. This is a separate duty from the duty to avoid conflicts of interest. This duty requires directors to declare their interests to the other directors, either by written notice or at a board meeting, and must be made before the company enters into the transaction or arrangement in question. If the director's notification of his interest becomes inaccurate or incomplete it must be updated. Most articles of association will include provisions to allow that an interested director, having declared his interest, will be entitled to vote and form part of the quorum at a meeting at which the

transaction is to be considered. Failure to make a necessary declaration is a criminal offence punishable by a fine.

8.10 Breach of the statutory duties

Section 178 of the Act states that the consequences for breach of any of the statutory duties are the same as would apply for breach of the corresponding common law rule from which they are derived. Any remedies may still therefore lie in areas of law not covered by the Companies Act including trust law, agency law and the principles of equity.

The duties imposed on directors by the Act are owed to the company. In general, if a director is in breach of any of his duties to the company, or has been negligent in the performance of his duties, the company may be able to recover damages to the extent of its consequent loss and the director at fault may be dismissed from office.

Once a company becomes insolvent the duties are owed to the company's creditors to ensure the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefit of the directors (see below).

9 *Derivative Claims*

If a company has suffered a detriment by an act or omission of its directors, then strictly it is the company that should bring a claim against the individuals at fault. Since the company is essentially controlled by the directors, the directors could prevent such a claim being brought.

A derivative action can only be brought by a shareholder of a company or by a person who is not a shareholder but to whom shares in the company have been transferred or transmitted by operation of law.

Before the implementation of the Act, the common law provided that the shareholders of a company could bring a claim on behalf of the company for an act or omission of the company's directors. Such claims were rare as the circumstances in which they could be brought were very limited. The 2006 Act has introduced a new procedure by which any shareholder may, on behalf of the company, bring a claim against a director for an actual or proposed act or omission involving negligence, breach of duty or breach of trust. The procedure is detailed and gives the courts discretion as to whether to allow a claim to be brought. Certain aspects of the procedure are intended to prevent frivolous or vexatious claims, and the ability of the court to exercise its discretion appears to be preventing claims being brought by activist shareholders. Overall however the new procedure may make such claims easier to pursue.

As was the position at common law, permission to bring a derivative claim must be refused where the court is satisfied that the act or omission was authorised by the company before it occurred or has been ratified by the company since it occurred. It should be noted however that on a vote on a resolution to ratify conduct by a director amounting to negligence, default, breach of duty or breach of trust, the votes of the director (if he is a member of the company) and of any member connected with him are disregarded (section 239).

10 *Unfair Prejudice*

Directors need to ensure that they consider the best interests of all shareholders when taking decisions on behalf of the company. If a minority shareholder feels that decisions taken by the board of directors cause him or her to be unfairly prejudiced, the minority shareholder can bring court proceedings against the majority shareholders and the company. The relief sought would usually be a buy out of shares owned by the minority at a "fair value". In small companies the directors are often the same individuals as the majority shareholders. Examples of unfairly prejudicial conduct are as follows:

- Exclusion from management/removal as director in circumstances where there is a legitimate expectation of participation. For example in a small company where there is an agreement or an understanding of involvement in management by a certain director it might be unfairly prejudicial for that director to be removed;

- Failure to consult the minority / provide information where required under the Companies Act 2006. For example a failure to provide annual accounts to a shareholder would usually amount to unfair prejudice;
- Misappropriation of corporate business / assets. For example if the majority shareholders develop a business opportunity themselves which belongs to the company this diversion would be unfairly prejudicial;
- Mismanagement of company's business. For example the diversion of commissions would amount to unfair prejudice;
- Payment of excessive remuneration or financial benefits to a director. For example paying a director considerably more than it would cost to replace that particular director is strong evidence of unfair prejudice;
- Failure to pay reasonable dividends. For example it is often unfairly prejudicial if dividends are not paid to shareholders because excessive remuneration is being paid to certain directors;
- Allotments of shares and rights issue unfairly diluting a minority shareholder's holding. For example if it can be shown that the motive of the board of directors was simply to dilute a certain person's shareholding this is likely to be unfairly prejudicial; and
- Failure to comply with the Companies Act 2006. For example not complying with the rules on calling meetings or approving annual accounts could be unfairly prejudicial.

11 Practical Matters to Consider Regarding the Statutory Duties

- 11.1 Directors should ensure that minutes of meetings at which decisions are taken include a proper record of how their decisions were reached, the matters taken into consideration and the relative weight attached to each. Where it is necessary or appropriate, directors should seek guidance (including legal advice) on how a proposed transaction or arrangement may affect the company's stakeholders.
- 11.2 All companies should consider including provisions in their articles to deal with the mechanics of authorising directors' conflicts. Records should be kept of all authorisations and the terms and conditions that may apply. Directors should regularly be reminded of their duty to avoid conflicts and a note of known conflicts should be circulated periodically to prompt any further disclosures.
- 11.3 As with 'situational conflicts' directors should be continuously reminded of the duty to disclose direct or indirect interests in any proposed transaction or arrangement with the company. As the duty requires the 'nature and extent' of any interests to be disclosed, such disclosures should be properly recorded in the board minutes of the meeting at which they are made. Companies should also check their articles to ensure that interested directors may still participate in discussions and decisions once the necessary declarations have been made. In addition, if any disclosures become inaccurate due to a change in a director's circumstances, they must be updated.

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- 11.4 Directors should review their directors and officers liability insurance policies to ensure that they provide cover with regard to defending derivative claims.
- 11.5 With regard to the duty to promote the success of the company, the DTI has expressly stated that proper consideration should be given to the factors listed above, and that giving only 'lip service' to them would not be sufficient to discharge the duty.
- 11.6 In terms of the duty to exercise reasonable skill, care and diligence, directors should be aware of the full extent of the burden upon them. For example, a CEO would be expected to exercise such level of care with reference to his actual skill and experience, whilst a CEO with an accountancy qualification may have a more onerous duty due to his personal knowledge and experience being greater due to this qualification. Consequently, more would be expected of such person under the duty. On the other hand, a director acting as an FD although with no financial qualifications would still be expected to have the knowledge and experience of an accountant despite the lack of qualification. Beware of extending this duty.

12 Other Obligations Under the Companies Act 2006

12.1 Apart from the directors duties outlined above, the Act places various specific obligations on directors in connection with a number of different matters.

12.2 Accounting Records

All companies are required to keep proper accounting records. The records must be adequate to show and explain the company's transactions, to disclose the financial position of the company and must comply with the requirements of the Act. The records must contain day to day entries of all receipts and payments and if the company's business involves dealing in goods, the accounting records must contain statements of stock held at the end of the financial year and all details of stocktakings from which such statements are prepared as well as statements of all goods sold and purchased together with details of the buyers and sellers in each case. Accounting records must be kept at the company's registered office or at such other place as the directors think fit and must at all times be open to inspection by the company's officers. Private companies must retain the records for three years and a public company for six years. Failure by a company to comply with the obligation to keep proper accounting records is an offence by every officer of the company in default which is punishable by imprisonment or a fine.

12.3 Annual Accounts

Directors must prepare accounts for the company for each of its financial years which comprise a balance sheet as at the last day of the financial year and a profit and loss account. The directors must be satisfied that the balance sheet and the profit and loss account give a true and fair view of the assets, liabilities, financial position and profit

and loss of the company. The accounts must be approved by the board and if required by the Act, they must be audited.

Public companies must lay their accounts before members in a general meeting. Once the accounts have been circulated to the company's members they must be filed at Companies House. The accounts must include a directors' report and business review, unless exempt under the Act. Failure to prepare a directors report when required by the Act is an offence punishable by fine. Listed companies must also prepare a directors' remuneration report.

Private companies must submit their accounts to Companies House within nine months of the year end and public companies within six months. Failure to do this is an offence on the part of every director of the company who was in office immediately before the end of the financial period to which the accounts relate and is punishable by a fine. There are also civil penalties that will be imposed on the company for late filing of accounts at Companies House. For private companies this can be up to £1,500 and for public companies can be up to £7,500. If the accounts are filed late two years in a row, the fines are doubled.

12.4 Statutory Registers and Records

A company's officers are responsible for maintaining certain registers which must be kept either at the company's registered office or at a single alternative inspection location. All companies must keep a register of directors, a register of secretaries, a register of members and a register of charges. Public companies must keep a register of interests in voting shares. The registers must be made available for inspection by members of the company and by members of the public on the terms set out in the Act and regulations made under

the Act. All companies must keep a register of directors' residential addresses. Minutes and/or records of directors' and members' decisions must also be kept.

12.5 Returns of Information to Companies House

Under the Act, as under previous Companies Acts, there are numerous occasions where returns of information have to be made to Companies House. Appointments and resignations of directors or secretaries, a change of the company's registered office or accounting reference date and allotments and buy-backs of shares all require notification to Companies House, among many others.

A company's officers are responsible for ensuring that these notifications are made and are liable to prosecution and a fine for failing to do so. It is important to continuously update the company's public record as any filings made which appear to conflict with the information held by Companies House can result in an 'inconsistency notice' being issued against the company and a note being placed on the company's record. This could happen, for example, if the company files a notice of resignation of an officer whose appointment was never notified in the first place. The filing requirements also apply to various shareholder resolutions such as a resolution to adopt new articles of association, to authorise the directors to issue shares, to suspend pre-emption rights, to approve the consolidation or subdivision of shares, and so on.

In addition to event-driven notifications, every company must also file at least one Annual Return in every 12 month period. Failure to file the Annual Return is an offence and failure to rectify the situation when requested to do so by Companies

House will also lead to the Registrar of Companies commencing an action to strike the company from the register. It should also be noted that under section 1112 of the Companies Act 2006, it is an offence for any person to knowingly or recklessly deliver a document to the Registrar or make any statement to the Registrar that is misleading, false or deceptive. Punishment on conviction is by way of imprisonment or fine, or both.

12.6 Trading Disclosures

All companies must make certain information about themselves available to the public. This includes displaying the company name at the company's registered office and each of its places of business, as well as displaying information on letterheads, order forms, cheques and other business stationary. If the company has a website, then the prescribed information must also be available somewhere on the site. Any person that a company deals with in the course of its business may make a written request to the company for information regarding the address of its registered office, the address of any inspection place at which it keeps its records, and the type of company records which are kept at that office or inspection place. The company must respond with the information within five working days of receiving the request. As ever, failure to comply with these requirements is an offence punishable by a fine.

12.7 Restrictions on Directors

Subject to certain exceptions, companies may not make loans to the company's directors (or guarantee a loan to a director) unless approved by the company's members. In order for the members to approve a loan, disclosure must be given in advance of the nature of the transaction, the amount of the loan and the purpose for which it is required, and the extent of the company's liability under any transaction connection with the loan. This also applies to 'quasi loans' in which a company reimburses a director's creditor – a director's credit card company, for example. Again subject to certain exceptions, property transactions between a director and the company (or a director's connected persons) must also be approved by the company's members. Generally, a company may not transfer to a director, and a director may not transfer to a company, a non-cash asset whose value exceeds the lesser of £100,000 or 10% of the company's net assets. Such 'substantial property transactions' which are not exempt or which have not received the approval of the company's members are voidable. As with other aspects of the law that applies to directors, the effects of this may be most keenly felt if a company becomes insolvent.

12.8 The above-mentioned obligations and restrictions under the Act are just a selection of some of the more common matters that directors need to be aware of. The potential offences under the Act are too numerous to describe in a single guidance note.

13 Duties and Liabilities of Directors on Insolvency

13.1 As a company approaches a situation where it may have to enter a formal insolvency process, the directors' duties are still owed to the company, but are also then owed to the company's creditors as well. Once a company has entered into formal insolvency proceedings, it is likely that the directors' conduct during the period leading up to the commencement of those proceedings will be scrutinised. This could lead to directors facing liability for any personal guarantees they have given or claims by the liquidator for fraudulent trading, wrongful trading and/or 'misfeasance'.

13.2 Personal Guarantees

As mentioned above, the doctrine of separate legal personality means that under normal circumstances, a director will not be liable for the company's debts - the debts of the company belong to the company alone. However, if a director has given a personal guarantee in respect of any such debts, the guarantee may be enforceable and the director may be liable under its terms.

13.3 Fraudulent Trading

Under section 213 of the Insolvency Act 1986, if in the course of the winding up of a company, it appears that any business of the company has been carried on with intent to defraud creditors of the company, or for any other fraudulent purpose then a court may order the individuals involved in the fraudulent activity to contribute to the company's assets in such amount as the court thinks proper. Fraudulent trading can be difficult to establish as it must be shown that the director (or directors) acted dishonestly in continuing to trade and run up debts to the company's creditors at a time when the company was facing financial difficulty. Any person held liable for

fraudulent trading can be disqualified under the Company Directors Disqualification Act 1986 (see below). Fraudulent trading is also a criminal offence under section 993 of the Companies Act 2006 which is punishable by imprisonment or fine, or both.

13.4 Wrongful Trading

Under section 214 of the Insolvency Act 1986, if the directors of a company continue to trade after such time as they knew or ought to have known that there was no reasonable prospect of avoiding insolvent liquidation, then they may be ordered by a court to contribute to the assets of the company in such amount as the court thinks proper. Wrongful trading does not involve the element of dishonesty that is required for fraudulent trading and is therefore easier to establish and more common. For example, a director could fall foul of this section by failing to regularly monitor financial performance or by failing to introduce financial controls.

In assessing what a director knew or ought to have known, the court considers the objective and subjective test which forms the basis of a director's duty of skill and care under the Act. For the purposes of wrongful trading, it is the higher of the two standards against which a director is judged ie. the general knowledge, skill and experience that may be expected of a person carrying out the same function as the director in question or the general knowledge, skill and experience that that particular director has. Given the potential problems that lie in continuing to trade, the decision as to when to cease trading is a difficult one. However, it should be borne in mind that in some circumstances, ceasing to trade too early may not be in the best interests of the company's creditors and directors should therefore take advice

before deciding to enter a formal insolvency process. In general, directors should always be alert to signs that the company may be approaching insolvency, and should have up to date information regarding the company's finances at all times. Once the directors are aware that an insolvent liquidation is becoming a possibility, the board should seek independent advice.

13.5 Misfeasance

Misfeasance refers broadly to any act or omission of a director by which they have misapplied or retained, or become accountable for any money or other property of the company, or have breached any fiduciary or other duty, such as the duty of care. If found guilty, the court may order the director to repay, restore, or account for money or property with interest or to contribute to the company's assets in such sum as the court thinks fit.

13.6 Other Offences

The Insolvency Act includes a host of other offences such as fraud in anticipation of a winding up, transactions in fraud of creditors (such as making a gift or transfer of any property of the company prior to a winding up), misconduct in the course of winding up (failure to co-operate with and to make full disclosure of all matters to the company's liquidator), falsification of the company's books, making a material omission in any statement relating to the company's affairs, and making false representations to creditors. The Act also makes provision to deal with situations where a company has, in the period leading up to an insolvency, disposed of any assets for less than their true value (transactions at an undervalue). In such cases the liquidator is empowered to 'claw back' any such assets or any proceeds from the sale of such assets following their transfer.

14 The Company Directors Disqualification Act 1986

14.1 Under this Act, an individual can be disqualified from acting as a director, liquidator, administrator, receiver or manager of a company without the consent of the court. Disqualification can be for a period of between 2 and 15 years. The disqualification can happen automatically on the occurrence of a defined event, or can be a result of an application to the court that a person is unfit to be a director. Contravention of a disqualification order is a criminal offence punishable by up to two years' imprisonment or an unlimited fine.

14.2 Automatic Disqualification

In the case of directors of an insolvent company, the court has a duty to disqualify any director whose conduct as a director of the company (either taken alone, or taken together with his conduct as a director of any other company or companies) makes him unfit to be a director. Unfitness can arise either as a result of a director's actions or as a result of a failure to act.

In the case of directors of a company that have committed a breach of competition law, the court must make a disqualification order against any person whose conduct, in the opinion of the court, makes them unfit to be involved in the management of a company. The Office of Fair Trading intend to increase the use of their powers to apply to the court for director disqualification orders - see paragraph 17 below.

14.3 Discretionary Disqualification

Under the Act the Court may make a Disqualification Order in any of the following circumstances:

- if a person has been convicted of an indictable offence in connection with the management, promotion, formation or liquidation of a company;

- for persistent failure to file accounts or annual returns or other documents required by Companies House, or has failed to keep statutory records;
- if a director has been found guilty of fraudulent trading or has committed some other offence or breach of duty where the director is required to make a contribution to the company's assets for insolvent trading;
- where disqualification is in the public interest.

15 Insider Dealing

For listed companies, directors are an important group of 'insiders' – that is they are holders of inside information which, if generally available, would be likely to affect the price of the company's securities. Insider dealing is a criminal offence under Part 5 of the Criminal Justice Act 1993. Under this Act, the offence is committed when a person knowingly deals in securities or encourages another person to deal in securities on the basis of inside information. It is also an offence for a person to disclose inside information otherwise than in the proper performance of their employment, office or profession. Individuals found guilty of the offence are liable to an unlimited fine and/or imprisonment.

As well as the insider dealing regime under the Criminal Justice Act, the Financial Services and Markets Act 2000 introduced a new civil offence of market abuse. Market abuse may consist of misuse of information that is not generally available to the market, creating a false or misleading impression as to the value of an investment and behaviour likely to give rise to market distortion. As a civil offence, market abuse carries a lower burden of proof which may make it easier for the FSA to secure a conviction. It should be noted however that given the heavier penalties attached to insider dealing, the FSA remain keen to pursue it so it may act as an effective deterrent to others.

16 Additional Liability under the Financial Services and Markets Act 2000

As well as the offence of market abuse, the FSMA 2000 created an offence relating to misleading statements and practices. A director will be guilty of an offence if he recklessly, dishonestly or otherwise makes a statement, promise or forecast which he knows to be misleading, false or deceptive in a material particular. The same applies to dishonestly, concealing any material facts in connection with the making of a statement, promise or forecast (or otherwise), or simply making a statement, promise or forecast which is misleading or deceptive in a material particular, whether made dishonestly or not. The penalties for the offence are imprisonment for a term not exceeding seven years and/or a fine.

17 Liabilities under Competition Law

Companies and undertakings may face civil sanctions for breaches of competition law under the Competition Act 1998. However as a further deterrent to anti-competitive behaviour, section 188 of the Enterprise Act 2002 introduced a new criminal offence for which directors may face personal liability. Known as the cartel offence, a person is guilty of an offence if he dishonestly agrees with one or more other persons to make or implement, or cause to be made or implemented, arrangements such as price-fixing, limiting production or supply, sharing customers or markets and bid rigging. Breach of section 188 can lead to imprisonment for a term not exceeding five years and/or a fine. In practice prosecuting cartels has been complicated, but the OFT remains committed to this strategy.

In addition, offences will also be committed in failing to co-operate in an investigation into a suspected cartel by the Office of Fair Trading (OFT); making false or misleading statements, destroying, falsifying or concealing documents that would be relevant to such an investigation; and intentionally obstructing a person in the

exercise of powers to conduct a search under a warrant.

Following the publication of studies which show that individual deterrence is the key to influencing corporate conduct, the Office of Fair Trading announced its intention to make directors personally accountable by increasing the use of its powers under the Enterprise Act to apply for Director Disqualification Orders. The individual can be disqualified for up to 15 years if his/her company breaches EU or UK competition law and the court considers that the person's conduct as a director makes him or her unfit to be concerned in the management of a company.

The disqualification does not just prohibit the person from being a director, but also prohibits any direct or indirect involvement in the promotion, formation and management of a company; breaching the order is a criminal offence and makes the director personally responsible for the debts of the company.

The OFT amended its guidance to directors as to when it may apply for such orders. The main change in the position of the OFT relates to the "ought to have known" standard. Previously active involvement in the competition breach was required but under the new guidance, a director can be disqualified if he or she had reasonable grounds to suspect a breach but did nothing about it, or was unaware but should have known. The OFT will consider the director's role and his position and responsibilities; his or her relationship to the perpetrators and the knowledge, skill and experience someone in that position should possess. It is therefore essential that all directors ensure that competition law compliance is given high priority. It is clear that the OFT will use its powers.

18 Liabilities Relating to Employment

18.1 Under the Immigration, Asylum and Nationality Act 2006, a director who consents or connives to the company knowingly employing a person subject to immigration control or who has not been granted leave to enter or remain in the UK (or whose leave is invalid, has been curtailed, revoked, cancelled or expired) or who is subject to a condition preventing him accepting employment, is guilty of a criminal offence. The penalty is up to a maximum of 2 years imprisonment, an unlimited fine, or both.

18.2 Under the National Minimum Wage Act 1998, a director who consents or connives to the company:

- refusing or wilfully neglecting to pay the NMW;
- failing to keep the required NMW records;
- keeping false records;
- providing false records or information;
- intentionally obstructing or delaying an enforcement order;
- refusing or neglecting to answer questions or provide information to an enforcement officer;

is guilty of an offence. This also applies if the above mentioned breaches are attributable to a director's neglect. The penalty is an unlimited fine.

18.3 Under the Working Time Regulations 1998, a director who consents or connives to the company committing certain breaches of the regulations (or those breaches are attributable to his neglect) is guilty of a criminal offence. Depending on the breach in question the penalty can be an unlimited fine (on indictment) or 'improvement' or 'prohibition' notices issued by the Health and Safety Executive or local authority inspectors, with potentially unlimited fines

and up to two years' imprisonment for directors on conviction on indictment if such a notice is not complied with.

18.4 Various provisions of the Data Protection Act provide for criminal sanctions in the event of breach. Directors can be prosecuted as well as their company if the company has committed an offence under the Data Protection Act 1998 with their consent or connivance or if the offence is attributable to their neglect.

18.5 In addition to the above, directors could also potentially face personal liability for acts of discrimination.

19 Health and Safety

19.1 Under section 37 of the Health and Safety at Work Act 1974, an individual director can be held criminally responsible where the company itself is found guilty of breaching health and safety law and the offence in question was committed with the consent or connivance of, or was attributable to any neglect on the part of, the director. Any director found guilty under section 37 can be disqualified from acting as a director for up to two years under section 2(1) of the Company Directors Disqualification Act 1986, as well as being subject to any fine imposed by a court.

19.2 In addition to the above, an individual director, as an employee of the company, can also be held criminally responsible for a health and safety offence under section 7 of the Act where he fails to:

- take reasonable care for the health and safety of himself and other persons who may be affected by his acts or omissions at work; and
- as regards any duty or requirement imposed on his employer or any other person by or under any of the relevant

statutory provisions, co-operate with him so far as is necessary to enable that duty or requirement to be performed or complied with.

19.3 An individual director can be criminally liable for manslaughter when he or she causes a death through recklessness or negligence. For this offence to be established, the following elements have to be satisfied:

- that the director owed a duty of care to the deceased;
- that the director breached this duty;
- that the breach was so bad that in all the circumstances it amounted to a crime.

Although prosecutions against individual directors for manslaughter are difficult to pursue, there has been an increasing number of such cases. This trend may continue particularly because the Corporate Manslaughter and Corporate Homicide Act 2007, while imposing liability on companies, does not apply to individual directors despite focussing on their "collective failures". A director found guilty of manslaughter by gross negligence can be disqualified as a director for up to 15 years as well as any sentence imposed by a court. It should of course be borne in mind that, while the Corporate Manslaughter and Corporate Homicide Act does not impose liability on individual directors, a conviction for corporate manslaughter could devastate a company's business as well as the reputation of those that are responsible for running it.

Essential Reading for all directors is the joint guidance issued by the IOD/HSC "Leading Health and Safety at Work"; www.hse.gov.uk/pubns/indg417.pdf.

20 *Liabilities in Environmental Law*

20.1 The Environment Agency has an increasing focus on individual responsibility for environmental damage, resulting in a steady increase in the number of personal prosecutions of directors. Sanctions against individuals convicted of environmental offences can include fines, imprisonment or disqualification as a company director.

20.2 **The Environment Protection Act 1990**

Under section 157 of the Environment Protection Act 1990, an individual director may be liable if:

- an offence under the provisions of the Environment Protection Act 1990 is committed by the body corporate; and
- the offence in question was committed with the consent or connivance of, or is attributable to neglect by, the director.

20.3 Water Resources Act 1991

Under section 217 of the Water Resources Act 1991, an individual director may be liable if:

- an offence under the provisions of the Water Resources Act 1991 is committed by the body corporate; and
- the offence in question was committed with the consent or connivance of, or is attributable to neglect by the director.

20.4 **Regulatory Enforcement and Sanctions Act 2008**

The Environment Agency can impose a range of civil sanctions, including fixed monetary penalties, enforcement undertakings and a Stop Notice where an offence is being, or is likely to be committed. These powers are in the hands of the Environment Agency rather than the courts.

20.5 **Proceeds of Crime Act 2002**

Environmental crime can also lead to an investigation by the Serious Organised Crime Agency with powers to confiscate the proceeds of crime and to freeze assets before or after a conviction.

20.6 **CRC Energy Efficiency Order 2010**

A director can even face criminal sanctions for energy efficiency issues and carbon reporting. If a director knowingly or recklessly makes false or misleading statement on material matters in the CRC scheme, he can be fined £50,000 in the Magistrates Court or face 3 months imprisonment, or be subject to an unlimited fine and 2 years imprisonment in the Crown Court.

21 *The Bribery Act 2010*

21.1 This Act brings UK bribery law up to date and into line with the OECD Bribery Convention which the UK ratified in 1998. Section 1 of this Act sets out the offence of bribing another person. This is defined as offering, promising or giving a financial advantage to another person either with the intention of bringing about the improper performance of a relevant function or where it is known or believed by the person offering the bribe that the acceptance of the financial advantage offered in itself constitutes the improper performance of a relevant function or activity. Under section 2, this Act sets out offences relating to being bribed, and section 6 establishes a separate offence of bribing foreign public officials. Under sections 7, 8 and 9 a commercial organisation can itself be held liable where a person associated with the organisation bribes another person, intending to obtain or retain business or a business advantage. It is a defence for the organisation to show that it had adequate procedures to prevent bribery in place.

21.2 An individual found guilty of the offence of bribery or of being bribed is liable on summary conviction to imprisonment for a maximum of twelve months or to a fine of up to £5,000. Anyone found guilty on indictment could be sentenced to imprisonment for a term of up to ten years or to a fine, or both. Companies found to be in contravention of section 7 will be subject to a fine.

21.3 It is important that directors should be aware of these offences and should ensure that they implement procedures and systems to prevent either the offering or taking of bribes. This might involve a broad based approach including training, internal controls, monitoring, establishing an ethics policy and reviewing whistleblowing procedures.

If directors have concerns about the practices and policies of their organisation then professional advice should be taken.

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