

THE LAW AND DIRECTORS' RESPONSIBILITIES

Who is a director?

A person can be a director without bearing the title. Thus, a shadow director is defined as 'a person in accordance with whose directions or instructions the directors of the company are accustomed to act'. In the case of many companies limited by guarantee, the directors may be known as 'council members' or 'governors'.

The Companies Act makes no distinction between executive and non-executive directors. Non-executive directors are directors for all purposes of the legislation, and bear all the relevant responsibilities.

Private companies need only one director, but in practice most have at least two. Companies must maintain a register of directors and notify the Registrar of Companies of any changes within 14 days. The relevant forms are:

- Form 288a - appointment
- Form 288b - resignation
- Form 288c - change of particulars

Common law duties

Since the Companies Act does not provide a comprehensive statement of directors' general duties and responsibilities, these have developed by way of comparison with other legal relationships, as follows:

Fiduciary duty

Each director must act in accordance with what he or she believes to be the best interests of the company. Directors must not place themselves in a position in which there is a conflict between their duties to the company and their personal interests. For example, in a take-over bid, the fact that the directors as individuals might hold between them a majority of the voting shares does not mean they can follow their own individual wishes.

Care and skill

The standard of care expected is, 'such care as an ordinary man might be expected to take on his own behalf'. The degree of skill expected is 'such a degree of skill as may reasonably be expected from a person with (the particular director's) knowledge and experience'.

Ratification

In certain circumstances, it is possible for the shareholders to ratify a transaction that would otherwise be in breach of duty.

Statutory duties

There are numerous statutory duties that apply to directors, many linked to defaults by the company. If a private company offers shares to the public, the company 'and any officer of the company in default' are guilty.

However there are some duties, whose breach is a criminal offence, that apply only to directors. One of the most important is the duty not to deal in securities when in possession of unpublished price sensitive information ('insider dealing').

Some legislative provisions impose civil liability upon a director. For example, a director who signs a cheque that does not have the company's 'name mentioned in legible characters' is personally liable on the cheque.

Accounts and dealing

Directors' duties in respect of accounts are stringent and comprehensive. Directors are responsible for preparing a profit and loss account and a balance sheet, ensuring that proper accounting records are kept, and taking all possible steps to ensure that the accounts show a true and fair view. This is now reflected in the 'Statement of Directors' Responsibilities', which has to be attached to the statutory financial statements.

Directors are also under a statutory duty to supply auditors with necessary information and explanations. This is the reason for requesting 'letters of representation'. Criminal liability can follow if directors 'knowingly or recklessly' make a 'misleading, false or deceptive statement' to the auditors.

Duties to whom?

The duties of directors under the general law are owed to the company and not to its shareholders, so it is the company, or its liquidator, that can sue. Creditors can, in the case of a company in liquidation, apply to the court for an order compelling the directors to repay such sum as the court considers just in respect of the directors' 'misfeasance or breach of trust.'

A director who is knowingly a party to fraudulent trading may also be personally liable to creditors.

However, although directors have a statutory duty to have regard to the interests of employees, it is doubtful whether employees could sue the directors personally, because the director's duty is to the company.

Wrongful trading

Wrongful trading may be broadly defined as a failure by a director or shadow director of a company to take every step that he or she should have taken to minimise loss to creditors once he or she knew or ought to have known that the company was unlikely to avoid insolvent liquidation. The possible penalties for wrongful trading are:

- Liability to make a contribution to the assets of the company in a sum to be decided by the court
- Disqualification from being concerned in the management of a company

When a company goes into insolvent liquidation, it is necessary to make a judgement:

- Whether the directors took such steps to monitor their company's affairs as would be taken by a reasonably prudent businessperson
- If they failed to do so, whether they would have realised the company's insolvency earlier if they had taken such steps

It is therefore essential that the board of directors ensure that appropriate steps are taken to monitor the company's financial position on a regular basis.

Tests of insolvency

There are a number of ways to test for insolvency. You should consider the following:

- Is the company paying its liabilities as they fall due or shortly thereafter, and will it continue to do so in the foreseeable future?
- Do the aggregate liabilities, including contingent or prospective liabilities, exceed the total value of the company's assets?
- If the company were put into liquidation now, would the realisations from the disposal of the assets be sufficient to pay all liabilities and the costs of the liquidation in full?

Fraudulent trading

Honest directors should not find themselves guilty of fraudulent trading. Nevertheless, if a company has already incurred liabilities that it failed to pay when they fell due or shortly thereafter, the board should consider the position carefully and place on record the factors that led them to conclude that any further liabilities incurred *would* be paid at the proper time before allowing the company to obtain any additional credit.

Disqualification

Grounds

A disqualification order may be made against a director on the grounds of:

- Responsibility for wrongful or fraudulent trading
- Unfitness to be concerned in the management of a company

A disqualification order may also be made if someone is found guilty of an indictable offence in relation to a company, or is in persistent default of filing requirements under the Companies Act 1985. The Companies Act includes some sixty-nine indictable offences, and there are about fifty separate duties placed on directors with regard to filing, so there is great scope for a director to be guilty of either an indictable offence or persistent default.

Duration and effect

A disqualification order will run for a minimum of two and a maximum of fifteen years.

A person who is subject to a disqualification order may not:

- Be a director of a company without leave of the court
- Be concerned or take part in any way in the promotion, formation, or management of a company without leave of the court

Recommendations

We recommend that, as a matter of good practice, every board of directors:

- Minute carefully the particular responsibility of each board member
- Ensure that appropriate management information is provided to it at regular intervals, and that action is taken where necessary
- Record at least in outline the information presented to it, any action it resolved to take as a result, and the director or directors responsible for implementing the action
- Seek proper professional advice on all material matters not within the general knowledge, skill, and experience of the company's own directors and senior staff

Those who are not directors of a company but nevertheless have a close business connection with it should satisfy themselves that their relations with the company do not make them shadow directors.

Life is becoming tough for directors. It is difficult enough for them to discharge all their duties satisfactorily when the requirements are clear, but unfortunately they rarely are.

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