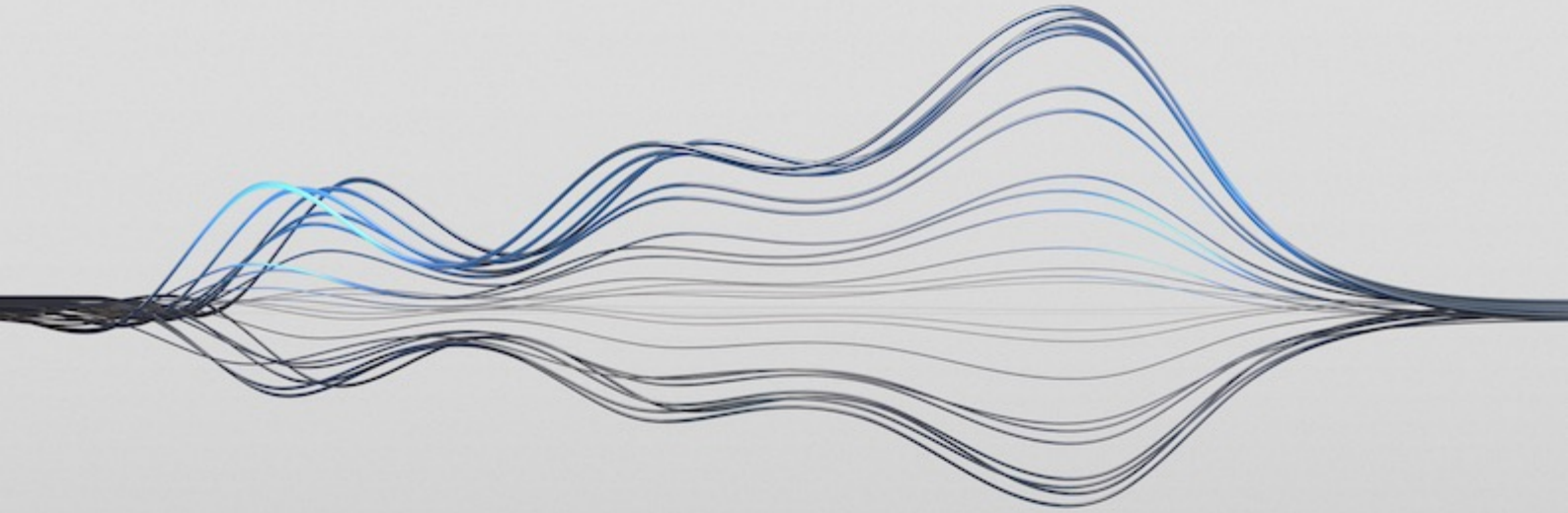
UNITED KINGDOM

Global Guide to Directors' Duties



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Corporate entities

What type of company is typically used in group structures?

In the UK, the most common type of company used in group structures is the private company limited by shares. This guide therefore focuses on the management of private limited companies.

Types of director

What is a "director"?

There is no complete definition of the term "director" in UK company law. Basically, the law regards someone who manages the affairs of a company on behalf of its shareholders as a director (whether they are called a director or not).

What are the different types of director?

Directors validly appointed as such are known as *de jure* directors and may be executive (usually employees, with an operational /executive role) or non-executive (usually not employees) - and may also be appointed to represent a particular shareholder (a nominee director). In addition, a de facto director is a person who acts as though they are a director but is not validly appointed as such and a "shadow director" is a person in accordance with whose directions or instructions the directors of a company are accustomed to act. In general, however, UK company law does not differentiate between different types of director – all directors are subject to the same duties.

Eligibility

Who can be a director?

A director must be at least 16 years old, but there are no nationality or residency restrictions. It is possible to have a corporate director, although at least one other director must be a natural person. There are proposals to implement a ban on corporate directors (which will be subject to certain limited exceptions), but no implementation date has yet been announced.

Minimum / maximum number of directors

A private company must have at least one director. There is no maximum. The company's constitution may, however, specify a greater minimum number and/or specify a maximum.

Appointment and removal

How are directors appointed?

Directors must consent to their appointment and can be appointed by the company's shareholders (via a shareholders' meeting or by written resolution) or, if the company's constitution allows, by the other directors. In private subsidiary companies, the constitution commonly allows the parent company to appoint directors by a simple written notice to the company.

Details of the appointment must be filed at the companies register within 14 days of the appointment taking place. A director's residential address and full date of birth are not included on the public record but must be supplied to the registrar of companies.

Under new laws to be introduced, new and existing directors will need to have their identity verified. Details of the verification process are not yet available, but it is expected to involve digital facial recognition using an approved form of ID such as a passport or driving licence. Alternative verification methods will be available for those who cannot access or use the digital service. It will be an offence for directors to act if their identity has not been verified.

How are directors removed?

Shareholders have a residual statutory power to remove directors by a majority resolution (subject to certain procedural requirements) which cannot be removed by the company's constitution. It is common for the constitution to confer additional powers of removal – for example, to enable the board to remove a director, or, in a subsidiary context, for the parent company to be able to remove a director by simple written notice to the company. A director may also resign at any time.

When a director leaves office, notice must be filed at the companies register within 14 days.

Board / management structure

Typical management structure

Boards of UK private companies are unitary structures made up of all the company's directors. Each director has the same obligations and accountability to the company. The directors are responsible (on a collective basis as a board) for the management and operations of the company and for ensuring that the company meets it statutory obligations.

How are decisions made by directors?

The manner in which directors can make decisions is set out in the company's constitution. In private companies, the constitution typically provides directors with flexibility to determine between themselves how decisions are made – whether by physical meeting, telephone meeting or a written resolution. Other than single director companies, the minimum quorum for board meetings is generally two directors (although notice must generally be given to all). Unless the constitution stipulates otherwise, voting at board meetings is on a simple majority basis. When decisions are made in writing, however, the unanimous agreement of all directors is usually required, although the constitution may specify otherwise.

Authority and powers

As far as third parties are concerned, directors are able to bind the company and enter into contracts on its behalf even if there are internal limits on their power to do so (eg in the company's constitution or in internal policies and protocols).

Normally, the company's constitution gives the directors wide powers to manage its business and affairs as they think fit (although the constitution may also provide that shareholders may give the board specific directions as to its conduct). Directors' powers are collective, meaning that directors should act together as a group on the company's behalf.

Delegation

If authorised by shareholders, or if permitted by the company's constitution, the board can delegate their powers to committees and others (eg executives). However, the board retains overall responsibility for the company's operations and management.

Duties and obligations of directors

What are the key general duties of directors?

The key duties of a director are set out in the Companies Act 2006 (the Act). These are duties to:

- **Promote the success of the company.** Directors must act in the way that they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, having regard (amongst other matters) to: (1) the long term consequences of decisions; (2) the interests of the company's employees; (3) the need to foster the company's business relationships with customers, suppliers and others; (4) the impact of the company's operations on the community and the environment; (5) the desire to maintain a reputation for high standards of business conduct; and (6) the need to act fairly between members.

  There is no hierarchy to these factors and, where they conflict, a director will need to use their business judgement in weighing them against one another.

  Companies which are "large" for accounting purposes are required to include a statement in their annual financial report describing how, during the relevant financial year, the directors have had regard to these factors when performing their duty to promote the success of the company.

- **Act with reasonable care, skill and diligence.** Directors must meet the minimum standard of skill and care expected of someone in their position and they must also bring to bear their particular skills and experience – therefore, the more qualified or experienced a director is, the greater the statutory standard required of them.

- **Exercise independent judgement.** However, a director may rely on other people (eg through proper delegation or by seeking advice) provided they judge that it is reasonable to do so. A director may not usually limit their discretion, however in certain circumstances they can do so by acting in accordance with an agreement entered into by the company or in a way authorised by the company's constitution.

- Act within the company's constitution and exercise their powers for the purposes for which they were given and not for any collateral purpose.

- **Avoid conflicts of interest.** Directors must not put themselves in a position where there is, or could be, a conflict between their personal interests or their duties to another person and the interests of the company (for example, where they are a director or employee of another company or where they may be in a position to take advantage of any property, information or opportunity they became aware of as a director). This duty is not breached if the situation cannot reasonably be regarded as giving rise to a conflict of interest or if the situation has been pre-authorised by the board (provided conflicted directors take no part in this decision), by shareholders or in the company's constitution.

- **Not accept benefits from third parties**, without prior shareholder approval. This duty is not breached if acceptance of such benefits cannot reasonably be regarded as giving rise to a conflict of interest. This allows for reasonable levels of corporate hospitality from third parties.

- **Declare interests in proposed transactions or arrangements with the company.** Directors must disclose the nature and extent of their personal interests in a proposed transaction or arrangement with the company before it is entered into. Directors must also declare the nature and extent of their interest in a transaction or arrangement that has already been entered into by the company as soon as reasonably practicable.

In addition, directors have duties under common law, for example not to misuse the company's property and to keep company information confidential and only use it for the benefit of the company.

What are directors' other key obligations?

The Act requires directors to prepare and file annual accounts and submit other information to the companies register, including information about significant shareholders. The accounts and other information must be submitted to the companies register within the prescribed time limits.

Directors are also responsible for ensuring that the company complies with its other statutory and legal obligations, for example under environmental and health and safety laws, employment laws, consumer protection laws, competition laws and bribery/anti-corruption laws.

Transactions with the company

The Act regulates the circumstances in which directors and their connected persons (broadly, family members and connected companies or trusts) can enter into transactions with the company. The transactions covered by these rules include long term service contracts, loans and the disposal or acquisition of substantial assets. Unless any exemptions apply, these transactions may only be entered into with prior shareholder approval.

Liabilities of directors

Breach of general duties

Directors owe their duties to the company itself and not directly to the parent or other group companies, individual shareholders or creditors. Therefore, only the company can bring an action for breach of duty against a director.

However, shareholders are able to bring an action for breach of duty on behalf of the company (a derivative action) in certain circumstances. Broadly, a shareholder must first obtain the court's permission to proceed with a derivative action and the court will take into account a number of factors when deciding whether to grant this permission – including whether the shareholder is acting in good faith, the views of independent shareholders and whether the company is likely to ratify or authorise the act or omission giving rise to the claim.

A company may seek a range of remedies against a director for breach of duty including damages, recovery of misapplied property (including the payment of unlawful dividends), accounting for profit made in breach of duty, an injunction to prevent breach and rescission of a contract.

Liabilities on insolvency

Additional personal liabilities may arise for directors if the company is insolvent or nearing insolvency. Directors who knowingly or negligently allow a company to carry on trading when it is insolvent may be held liable for fraudulent or wrongful trading. These expose the director to liability to contribute to the company's assets on a winding up and, in the case of fraudulent trading, to criminal penalties. Liability for wrongful trading can be avoided if the director can satisfy the court that they took every step they ought to have taken to minimise the loss to creditors. In practice, this may limit the director's ability to resign when the company is insolvent or nearing insolvency.

Other key risks

Personal liability for directors may, in certain circumstances, arise under UK legislation including that relating to environmental and health and safety, employment, consumer protection and bribery/anti-corruption. In certain cases, criminal liability may arise.

A director may also be disqualified by the court from acting as a director or from taking part in the promotion, formation or management of a company. A disqualification order can be made for a variety of reasons (e.g. conviction for criminal offences relating to the running of a company, persistent breaches of statutory obligations such as filing documents with the companies register, being found liable for fraudulent or wrongful trading and generally for conduct which makes a director unfit to manage a company).

Failure to comply with company-related obligations, such as the preparation and filing of accounts, can also lead to fines for individual directors.

Protection against liability

How can directors be protected from liability?

- **Ratification.** Shareholders can ratify conduct by a director which is negligent or in breach of duty by a majority resolution (excluding the votes of the director concerned or their connected persons). However, there are limits on what may be ratified (eg illegal acts cannot be ratified) and ratification by shareholders does not absolve a director from any liability to a third party in relation to the matter concerned (eg creditors in an insolvency/pre-insolvency situation).
- **Indemnity.** Although it is not possible for a company to exempt its directors from liability, a company is able to indemnify its directors against certain liabilities incurred to third parties. An indemnity can potentially cover both the award of damages against a director

and the costs involved in defending a claim but cannot cover regulatory fines or the unsuccessful defence of, or fines imposed in, criminal proceedings. The company may also pay a director's defence costs as they are incurred – however these costs become a loan which must be repaid by a director should the defence be unsuccessful and the costs are not covered by any permitted indemnity. The company may seek to obtain security for such loans if appropriate in order to protect the company's assets.

- **Insurance.** Directors' and officers' (D&O) insurance is common in the UK. It typically provides both cover for individual directors against claims made against them in in their capacity as director, including defence costs (which applies when indemnification by the company is not available), and company reimbursement when it has indemnified its directors (subject to an excess/retention). Policy exclusions typically include claims in respect of a director's fraud, dishonesty, wilful default or criminal behaviour.

What practical steps can directors take to avoid liability?

Directors should:

- Keep informed about the affairs of the company, particularly its financial position. Directors should have access to up to date financial information, prepare thoroughly for and regularly attend board meetings and familiarise themselves with key legislation affecting the business.
- Make full disclosures to the board and shareholders if they have outside positions or interests which may give rise to a conflict of interest and / or if they have a personal interest in any proposed or existing transaction or arrangement with the company.
- Keep records and take advice – directors should ensure that full written records of board proceedings are made reflecting the reasoning behind key decisions. This should include any alternative courses of action considered. Minutes should also record any disagreement amongst the board and the reasons for that. In addition, directors should ensure that returns and accounts are filed promptly and take professional advice for decisions based on areas outside their personal expertise, for example from legal professionals and accountants.
- Be aware of, and comply with, any group-wide governance policies. These may cover areas such as health and safety, ethics, bribery /anti-corruption, and human rights. Compliance with them is designed to help directors (and employees) fulfil their duties and obligations and minimise the risk of liability.
- Also in a group situation, keep in mind that directors must act in the best interest of their group company. Whilst group interests and that company's interests are usually aligned, this may not always be the case (eg when their group company's solvency is adversely impacted). It is important to keep communication and reporting lines as open and clear as possible between parent and subsidiary companies when issues may arise and seek appropriate advice.

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