GREEN BOOK OF DIRECTORS' DUTIES

WALKER MORRIS

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Like the small print in any good contract, this guide to directors' duties is important. It's packed full of useful information on your legal obligations as a director of an English incorporated limited company. Of course, our book can never be a substitute for professional legal advice, but it's a little piece of Walker Morris at your fingertips.

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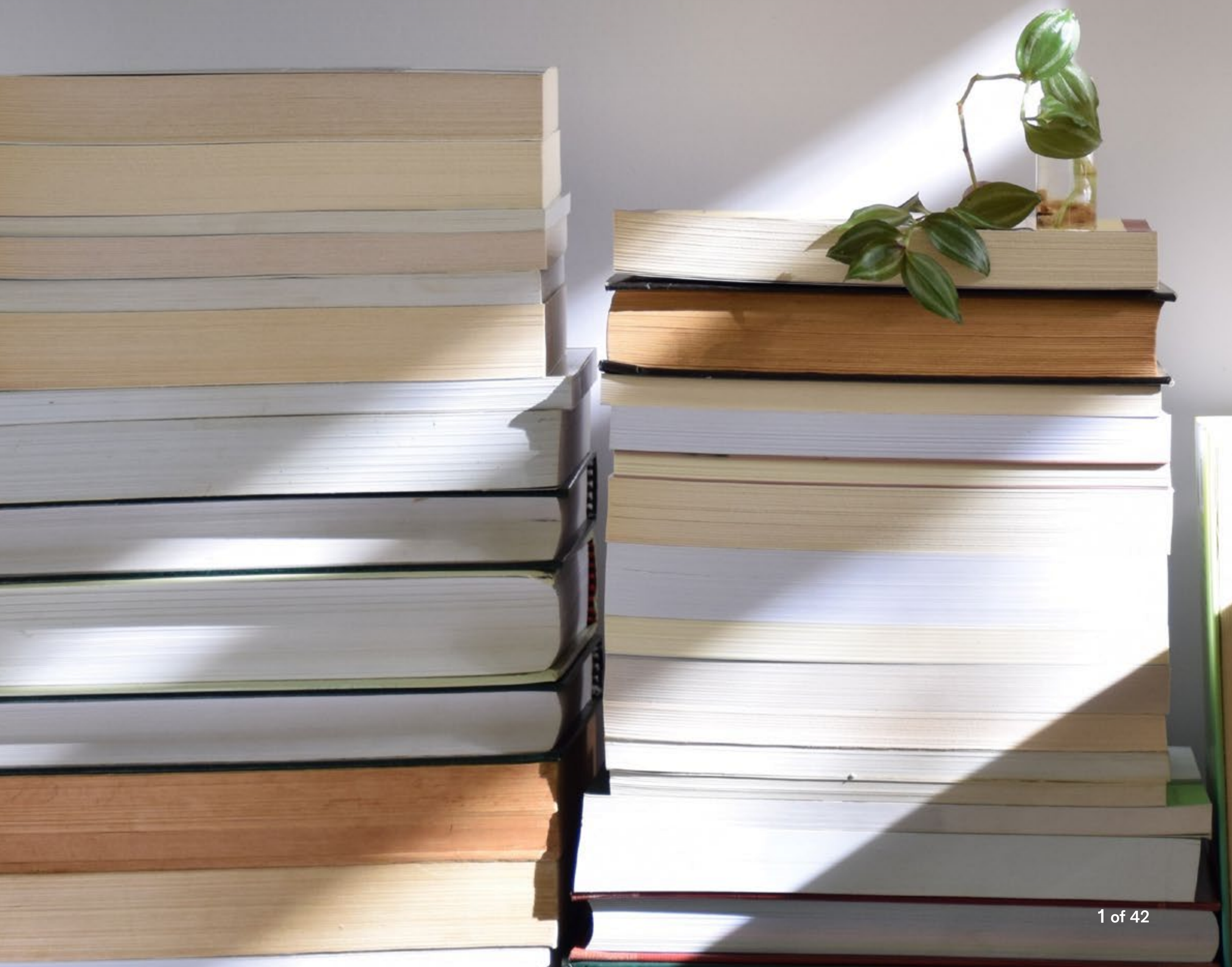


CHAPTER 1
AN EVER-CHANGING LANDSCAPE

A company is a legal entity which is distinct from its owners; it can own property, contract with others and sue and be sued in its own name. In other words, a company is a legal person: nevertheless, it is an abstraction, and its actions and thoughts can only be those of the individuals concerned with it. Whilst a company's owners (its shareholders) have rights in the company, responsibilities to the company are generally owed by those entrusted with its management, namely its directors. In fulfilling those responsibilities directors must act in compliance with the duties conferred and within the limitations placed upon them by the common law and statute.

Directors must also observe and procure the observance of the company's articles of association, the company's constitution which forms a legally binding contract between the company and its shareholders and between the shareholders themselves, and any resolutions and agreements affecting the company's constitution.

As agents of the company, directors may also be personally liable for the company's wrongdoings and defaults. They will also need to bear in mind specific obligations to third parties not immediately connected with their company which are imposed by law and by regulatory bodies.

In recent times, issues of corporate governance and directors' duties have been very much in the spotlight. Scandals involving, among others, Enron, Volkswagen and Kobe Steel, and more recently Carillion, have served to raise public awareness and prompted authorities worldwide to review their current means of monitoring corporate bodies.

The law is stated as 1 September 2024.

Key points/tips

- The UK corporate governance environment is constantly evolving. There is an increasing expectation on the part of investors and the public that directors will comply with applicable governance standards.

- Directors of all companies need to be aware of their responsibilities. Directors of Listed Companies and AIM companies face significantly enhanced responsibilities. Directors of public and private companies within the same group should be aware that different, stricter rules may apply to public companies than apply to private companies.

CHAPTER 2
WHAT KIND OF DIRECTOR ARE YOU?

Statute does not, on the whole, recognise any distinction between the different descriptions of directors which are used in practice to distinguish various roles and internal responsibilities which directors may assume. The common law and statutory duties of directors are binding upon any person who acts as a director of a company regardless of how their position is described.

Executive and non–executive directors
An executive director is a director who's also an employee of the company. As an employee, they'll have a contract of employment (which may or may not be in writing) and their activities will be controlled by the company.

As a director, they're an officer of the company, having responsibilities to the company to ensure that its business is properly carried on. The roles of the executive as both director and employee may be quite independent but, depending on the precise terms of the executive director's service contract, termination of the executive's directorship will normally terminate their employment.

The articles of association of public companies will often state that the appointment of any director to an office such as chair, deputy chair or managing director automatically ends if they cease to be a director, without affecting any claim for damages for breach of any contract of service between them and the company. In the absence of such a provision in the articles, the appointment of a director to any other executive office will only automatically end on their ceasing to be a director if the contract or resolution under which they hold office expressly provides for this.

Non–executive directors aren't employees of the company. Their primary purpose is to ensure independence in board decisions such as management performance, company strategy, business goals and objectives, and appointment and remuneration of executive directors. The obvious counterweight to this independence is that non–executive directors aren't generally expected to have the same degree of detailed knowledge about the company's day-to-day affairs.

The UK Corporate Governance Code provides that except for 'smaller' companies (which for these purposes means Listed Companies outside the FTSE 350) at least half the board of a Listed Company, excluding the chair, should comprise independent non–executive directors. 'Smaller' companies should have at least 2 independent non–executive directors.

It's a Main Principle of the Code that non–executive directors should constructively challenge and help develop proposals on strategy. This involves the scrutiny of management performance in meeting agreed goals and objectives and monitoring the reporting of performance. Non–executives are required to satisfy themselves of the integrity of financial information and that financial controls and systems of risk management are robust and defensible.

Non-executive directors are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing and, where necessary, removing executive directors and in succession planning. The Code contains more detail on how this is to be achieved and sets out how the board should determine whether or not a non–executive director is independent.

Alternate directors
A company's articles of association may allow a director to appoint an "alternate director" to act in their place. The circumstances in which alternate directors may be appointed and the precise duties which may be delegated to them will be governed by the articles, with most articles allowing alternates to be appointed to attend board meetings when the director is unable to attend personally. In performing their functions as such, the alternate director is required to fulfil the same responsibilities and has the same duties as the director appointing them.

It should be noted that the Model Articles for private companies do not provide for the appointment of alternate directors. The Model Articles for private companies came into effect on 1 October 2009 and are the default articles for private companies incorporated on or after that date. There will therefore need to be an express provision in the articles of private companies incorporated on or after 1 October 2009 if the directors are to have the power to appoint an alternate.

Nominee directors
A nominee director is the term often used to describe a director, more often than not a non–executive director, who's appointed to the board by a particular shareholder or group of shareholders, for example by a private equity investor or by a parent company in respect of its wholly owned subsidiary or by participating shareholders in a joint venture company. Nominee directors can find themselves in a delicate position. They're often held out as having a commission to represent and safeguard the interests of their appointing shareholder, however, like all other directors, a nominee director is in fact responsible for acting in the interests of all shareholders in the company and may be personally liable if they do not. The Court of Appeal has ruled that the fact of nomination by a shareholder doesn't, of itself, impose any duty on

the nominee to that shareholder, although such a duty could arise out of a separate agreement. However, any such duty wouldn't detract from the overriding duty of the nominee to the company of which they were a director.

The role of the nominee director is therefore less potentially awkward, both for them personally and also for other members of the board, if their appointment is seen to bring to the company concerned some particular expertise or knowledge associated with their appointor, rather than to provide the appointor with an advocate on the board.

Shadow directors

The term 'shadow director' is used in some statutes which regulate the responsibilities of directors. In the Companies Act 2006, a shadow director is defined as being a person in accordance with whose directions or instructions the directors of the company are accustomed to act. It wouldn't, however, include a person by reason only that the directors act on advice given by them in a professional capacity, nor a parent company in respect of its subsidiary unless there are special features in that relationship.

The Companies Act 2006, as amended by the Small Business, Enterprise and Employment Act 2015, provides that the statutory duties of directors set out in the Companies Act 2006 apply to shadow directors where and to the extent that they're capable of applying. For example, a shadow director, like a director, must disclose the nature and extent of their interests in existing transactions with the company by notice in writing. The courts have confirmed that a shadow director will owe a duty of good faith to the company to act in its best interests rather than their own separate interests. They may also have to contribute to the company's assets if there's wrongful trading, a subject which is examined later.

De facto director

A de facto director is a person who acts as a director without having been validly appointed. Therefore, someone who participates in making decisions may be treated as a de facto director even if there's no board minute formally appointing them and no forms have ever been filed at Companies House recording the appointment.

The High Court has reiterated that the overall question to be answered when determining whether an individual is a de facto director is whether the individual was part of the corporate governing structure of the company and whether they assumed a role in the company which imposed on them the fiduciary duties of a director. This is a question of fact to be assessed objectively. Merely being involved in the management of the company or exercising a degree of influence over its decision making is not in itself enough.

A director of a company that itself is a corporate director of a second company may, depending on the particular circumstances, be a de facto director of that second company, the crucial issue is whether or not the person alleged to be a de facto director has undertaken functions in relation to the second company that could properly be discharged only by a director. There's no need for the individual to be "held out" as a director (although this may be significant evidentially) and it's not what the person is called that matters but what they do.

A de facto director owes the same duties to the company as a formally and properly appointed director, i.e. they're subject both to statutory duties and prohibitions. Accordingly, they may be personally liable for breach of duty.

The courts have emphasised that the assessment of whether or not a person is a de facto or shadow director is highly fact specific. The courts have also said that, while distinct, the 2 concepts may overlap. It's possible for an individual to be simultaneously a de facto director and a shadow director of a company and the capacity in which they act in relation to the company will depend on the nature of the act.

Distinction with role as an employee

An executive director will usually have a service or employment contract and be an employee of the company. So, they'll have the protection of employment legislation should the company seek to terminate their employment. This will be quite separate however from their position as director and termination of a director's employment will not necessarily end their position as a director, or vice versa.

Most financial consequences resulting from a director's position with a company being terminated will flow from the termination of their employment rather that their removal as a director.

There are particular statutory provisions relevant to a director's service contract, notably that copies of the service contract must be kept at the registered office and can be inspected by the members and terms of 2 years or more require shareholder approval.

Key points/tips

- Although non-executive directors aren't involved in day-to-day decision-making, they still owe duties to the company (see under 'General duties and responsibilities').
- It's possible to owe duties as a director even though you have not been formally appointed.

CHAPTER 3
GENERAL DUTIES & RESPONSIBILITIES

An overview

The directors are responsible for carrying on the business of a company and exercising its powers; in other words, the powers of the company as a legal person are delegated to its directors.

The articles of association will commonly provide for the management of the business and affairs of the company by the directors, who are given the right to exercise all the powers of the company other than those which are required by statute or the articles to be exercised by the company in general meeting. In fulfilling such responsibilities, each director has a duty to act in the way they consider, in good faith, would be most likely to promote the success of the company as a whole. The company for such purposes means all its shareholders; majority and minority, present and future. A limited duty is also owed to creditors, present and future, although once a company is insolvent, or is bordering on insolvency, their interests will become paramount.

In recent years, companies have been coming under increasing pressure to take account of their 'corporate social responsibility', by taking into consideration so-called ESG matters; environmental, social and governance issues. This move is consistent with the requirement to have regard to wider 'stakeholder' factors contained in the Companies Act 2006.

Furthermore, in their custodianship of a company, especially a public limited company, and particularly in relation to the raising of money by the company and in the field of takeovers and mergers, directors must accept personal obligations to the investing public at large. These situations are covered in more detail below.

Codification of directors' duties

Until the coming into force of the Companies Act 2006 there had never been a coherent code of directors' duties. Until then, directors' duties were a mixture of principles derived from case law (common law) and statutes such as the Financial Services and Markets Act 2000 and the Insolvency Act 1986 and rules and regulations like the UK Listing Rules applicable to Listed Companies.

The Companies Act 2006 recast the position concerning directors' duties by setting out in statute — for the first time – statements of principle governing the duties of a director. The rationale behind the codification of directors' duties was to make the law more accessible and easier to understand, particularly for new directors or overseas directors assuming a UK directorship.

The statutory statement of duties contained in the Companies Act 2006 doesn't cover all the duties that a director may owe the company. Some duties are incorporated elsewhere in the Companies Act 2006, such as the duty to deliver accounts, while others remain uncodified, such as the duty to consider the interests of creditors when facing insolvency. Companies can provide for more onerous duties in their articles of association, but it's not possible to dilute the statutory duties.

The statutory principles are expressed to replace the common law duties of directors but the Companies Act 2006 also says that the common law will continue to be relevant to interpreting directors' duties. Accordingly, existing case law will continue to apply.

The common law duties have traditionally divided into 2: first, duties of care and skill or, to put it another way, competence, and the "fiduciary" duties which are expected of a director because of his particular position as a steward of the company's affairs. The duties of care and skill are positive duties, in that a director must demonstrate those in carrying out the job and the fiduciary duties are mostly negative, in that a director must avoid breaching them.

To whom are the duties owed?

The Companies Act 2006 explicitly retains the common law position that the duties are owed to the company rather than to individual shareholders (although members will be able to enforce duties owed to the company in accordance with the statutory derivative action procedure). A director must act in a way they consider, in good faith, would be most likely to promote the success of the company for the benefit of the members as a whole. This includes the interests of future shareholders; thus, the director must regard the company as a continuing organism and balance the long-term interests of the future shareholders against the short-term interests of the present shareholders.

The statutory duties

The 7 statutory duties are:

1. The duty to act within powers.
2. The duty to promote the success of the company.
3. The duty to exercise independent judgment.
4. The duty to exercise reasonable care, skill and diligence.
5. The duty to avoid conflicts of interest.
6. The duty not to accept benefits from third parties.
7. The duty to declare an interest in a proposed transaction or arrangement with the company.

DUTY TO ACT WITHIN POWERS

Directors must act in accordance with the company's constitution and only exercise powers for the purpose for which they were conferred. It is no answer to an alleged breach of this duty for the directors responsible for the relevant decision to say they were acting in the best interests of the company.

Acting in accordance with the company's constitution

A company's constitution comprises its articles of association and any resolutions and agreements affecting the constitution, such as a shareholders' agreement. Directors should familiarise themselves with the company's constitutional documents, in particular to establish what, if any, restrictions there are on their powers; for example, those relating to borrowing limits, the treatment of directors' interests and the power to delegate.

Since 1 October 2009, it's not been necessary for companies to have an objects clause — setting out the purpose of the company and its powers — and therefore companies incorporated after that date are deemed to have unrestricted objects. However, unless a company incorporated before 1 October 2009 has passed a resolution to dispense with its objects clause, its objects will continue to apply and will continue to act as a restriction on what the company may do.

The Companies Act 2006 provides that the validity of an act done by a company shall not be called into question on the ground of a lack of capacity by reason of anything in the company's constitution; so, for example, if a company's activities were restricted by an objects clause and the company acted for a purpose outside those objects, that transaction would nevertheless still be valid. (Note that there are separate rules for charitable companies).

The position of third parties

As far as third parties acting in good faith are concerned, the powers of the directors to bind the company are deemed to be free of any limitation under the company's constitution. This means that even if the directors have exceeded their powers, the company will still be bound by the contractual obligations entered into by the directors on the company's behalf.

The third party is not bound to enquire either as to the capacity of the company to enter into the transaction nor as to any limitation on the powers of the directors, and there's a presumption of good faith unless the contrary is proved. The current state of the law on good faith is that the hurdle for a third party not to be found to have acted in good faith is a high one — there must be effectively a dishonest or irrational belief; notice of irregularities or concerns that might have prompted a reasonable man to ask questions will not suffice, without more, to constitute a lack of good faith.

Where the transaction in question is with a director of the company or its holding company or with a connected person of such director, the transaction will be voidable at the instance of the company. The transaction ceases to be voidable: if it is ratified by the members; if restitution of the assets or money forming the subject matter of the transaction is no longer possible; if the company is indemnified for any loss arising out of the transaction; or if the rights of a bona fide purchaser for value without actual notice of the directors' exceeding their powers by a person who's not a party to the transaction would be affected. The members of the company may bring proceedings to restrain the doing of an action that's beyond the powers of the directors.

If a third party enters into a contract with directors who have no authority to bind the company, the directors will be liable to indemnify the company for any loss resulting from the transaction. This is the case even if the directors genuinely believed they had authority to bind the company.

Powers to be exercised for proper purpose only

The second limb of this statutory duty is that directors must exercise their powers solely for the purposes for which they were conferred. By way of example, it's been held that the issuance of shares by directors who were already majority shareholders, for the purposes of maintaining their control of the company, amounted to a breach of this duty. In another case, the directors sold the company's premises so that the company could raise funds to purchase shares from the directors and make ex gratia payments to them. The court held that the directors were not exercising their powers for a proper purpose.

DUTY TO PROMOTE THE SUCCESS OF THE COMPANY

The nature of the duty

The precise wording of this statutory duty is: "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 its members as a whole". In doing so they must "have regard" to a number of 'stakeholder' factors, considered below.

Note that the duty is not to promote the success of the company. It is to act in a way that the director considers, in good faith, would be most likely to promote the success of the company. Success of the company means for the benefit of the company's members as a whole — not, for instance, 1 class of shareholders, not the directors, nor the creditors. The courts have made clear that this is a subjective test and depends upon whether the director honestly believed their act or omission to be in the company's best interests. This is not the same thing as whether the act (or omission) turned out, with the benefit of hindsight, to be ill-advised. However, where a very material interest of the company, such as a large creditor of a company of doubtful solvency, is overlooked then the test becomes an objective one: would an intelligent and honest person in the director's position reasonably have believed the act or omission was for the benefit of the company?

The court will be prepared to doubt the director's honesty and professed support for the company's best interests where substantial detriment has resulted from the act or omission. The fact that the actions had caused detriment, and may objectively be seen as unreasonable, might support the conclusion that their alleged belief that they were acting to promote the interests of the company was not honestly held at the time.

So long as the company is solvent, the directors should consider the interests of the shareholders when assessing the company's best interests. Where the company is insolvent or bordering on insolvency, however, the interests of the creditors (as a whole) become paramount.

The party claiming the breach of duty carries the legal burden of establishing that breach, and it's not for the director to defend their position. However, where a director's decision is not one that any reasonable director would have considered to be in the best interests of the company, reliance upon their own alleged contrary belief will not avoid a finding of breach.

The stakeholder factors

The "stakeholder" factors to which directors are required to have regard are:

- The likely consequences of any decision in the long term.
- The interests of the company's employees.
- The need to foster the company's business relationships with suppliers, customers and others.
- The impact of the company's operations on the community and the environment.
- The desirability of the company maintaining a reputation for high standards of business conduct.
- The need to act fairly as between the members of the company.

This is not intended to be an exhaustive list. The overarching duty is to promote the success of the company and the consideration of "stakeholder" factors shouldn't be allowed to impede that duty. A decision that will increase shareholder value but may involve making some employees redundant or terminating a longstanding supply contract shouldn't be shelved for those reasons, though the directors should consider whether the same result could be arrived by a different route so as not to impact so adversely on the stakeholders. Similarly, there's no 'hierarchy' between the stakeholder factors, and indeed they may conflict: the directors must weigh them against each other and decide which course of action will be most likely to promote the success of the company for the benefit of the members as a whole.

The association of general counsel and company secretaries of the FTSE 100 (the GC100) has said that the requirements to consider stakeholder factors shouldn't oblige directors to evidence their thought processes. However, the GC100 recommends that for significant board decisions, papers should be prepared that address the stakeholder factors and that directors be properly briefed on their duty to consider these factors.

Confidentiality

The duty to act in good faith implies a duty of confidentiality on the part of the director to the company of which they are a director. The duty is such that, even where the director is appointed by a shareholder, they mustn't, without the authority of the company, disclose to that shareholder any confidential information relating to the company which has been gained by them as a director of that company. The management of this type of situation, should it be likely to arise, should be addressed in the company's articles of association.

Group companies

Particular care needs to be taken with respect to this duty in the group company context. The directors must act in the interests of the particular company in question, not its parent company or subsidiaries, or sister companies. Of course, an act that benefits those companies may also benefit their own company.

A good illustration is in the context of the group's banking arrangements and the giving of cross-guarantees. Each director must ask themself whether giving the cross-guarantee can be justified. The directors of the subsidiary might argue that supporting the parent company is justified because of the support services it receives from the parent while, in turn, the directors of the parent might argue that supporting the subsidiary is justified by the expectation of a dividend.

DUTY TO EXERCISE INDEPENDENT JUDGMENT

A director must exercise independent judgment. This overlaps with the duty to exercise reasonable care, skill and diligence discussed below. This duty is not infringed by a director acting in accordance with an agreement entered into by the company that restricts the future exercise of the directors' discretion or in a manner authorised by the company's constitution.

The courts have explained that while it's permissible for there to be a division and delegation of directors' responsibilities, each director retains a personal responsibility, including to inform themself of the company's affairs. As was explained during the prosecution in 2009 of Bernard Madoff who admitted to operating a massive Ponzi scheme, it would be a breach of duty for a director to allow themself to be "dominated, bamboozled or manipulated" by a dominant co-director, if this were to result in an abrogation of that responsibility.

It is, however, not a breach of the duty to exercise independent judgment to rely upon the judgment, information or advice of a co-director, where there's no reason to doubt that director's integrity, skill and competence. This issue is considered in more detail under 'Delegation'.

DUTY TO EXERCISE REASONABLE CARE, SKILL AND DILIGENCE

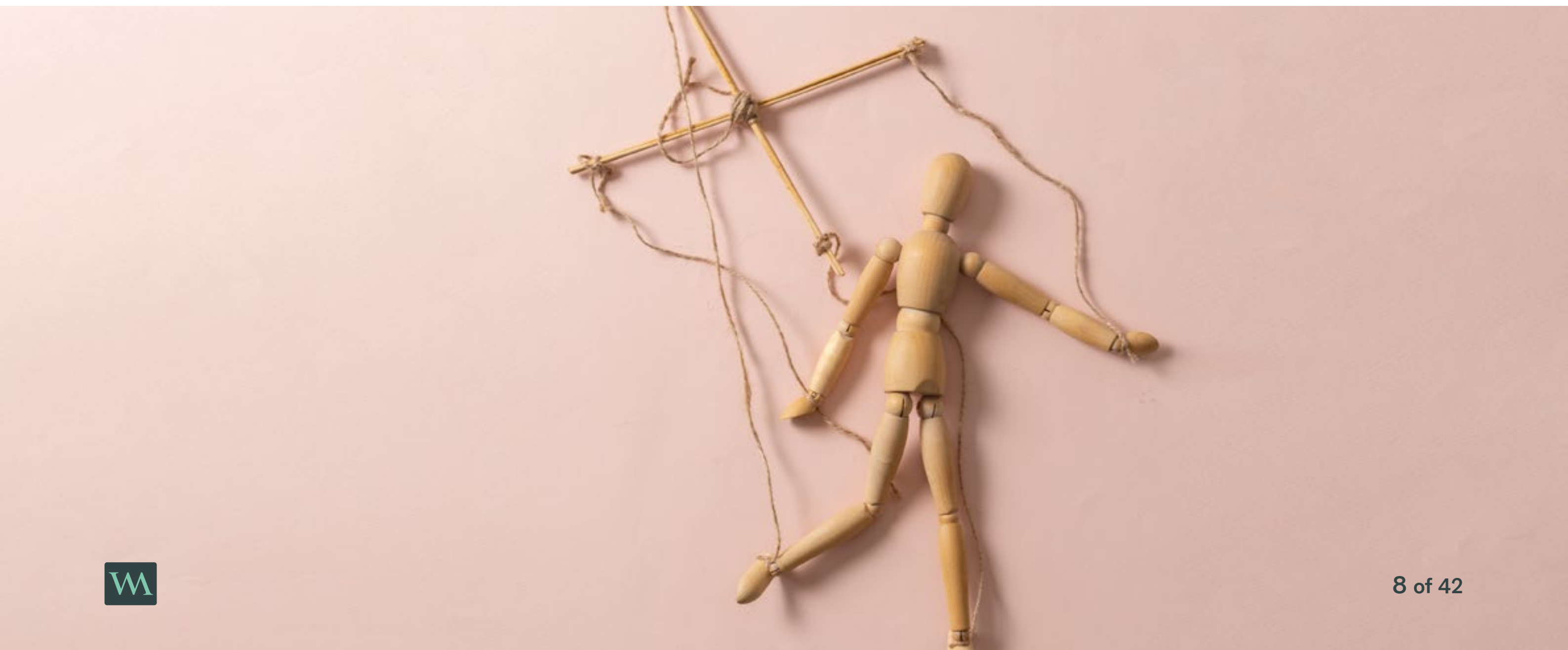
A director owes a duty to exercise reasonable care, skill and diligence. The standard required is to exercise the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that can reasonably be expected of a person carrying out the functions carried out by the director in relation to the particular company; and the general knowledge, skill and experience that the particular director has. This test builds on the existing case law.

In the leading case in which these duties were considered, it was stated that a director must act honestly and exercise a degree of skill and diligence as would amount to the reasonable care which an ordinary man might be expected to take, in the circumstances, on their own behalf. In addition, it was said that a director need not exhibit in the performance of their duties a greater degree of skill than may reasonably be expected from a person of their knowledge and experience. By way of example, it was said that a director of a life insurance company doesn't guarantee that they have the skill of an actuary. The director is not bound to bring any special qualifications to the office, although if the director does have special skills it will be the higher standard of a person with those skills which will be applied. Even if a director is skilled in relation to the subject matter before the board, they will not be liable for mere errors of judgment made in good faith.

There's an obvious overlap with the duty just considered, to exercise independent judgment. The law will not excuse a director who blindly or uncritically trusts others, since in acting in this way the director has acted unreasonably and failed in their duty to be diligent.

A non–executive director, in particular, necessarily relies on information supplied by officers and employees of the company. They must, however, be careful in depending on others and shouldn't accept unquestioningly the information and explanations supplied to them. The role of the non–executive director is in practice being defined with increasing precision and that role is being reflected in higher public expectations. For example, it's been held that a non–executive director who failed to appreciate their responsibilities in relation to understanding their company's financial affairs had displayed serious incompetence and neglect of their duties and was unfit to be a director (resulting in disqualification as a director). Ultimately each director must exercise their own judgment, mindful of their various duties and in each instance having regard to the circumstances before them.

The standards of skill and care expected of directors under the Insolvency Act 1986 (examined later in this guidance) are higher than those expected under the classic statement of the common law standards, although the courts have increasingly been applying these more stringent tests generally. The test set out in the Companies Act 2006 reflects that development.



DUTY TO AVOID CONFLICTS OF INTEREST

A director must avoid situations in which they have or can have a direct or indirect interest that conflicts with or may conflict with the company's interests.

Note that a director doesn't need to have any influence over the decision for there to be a conflict and that the duty is widely drafted and can catch situations which "possibly may" result in a conflict.

This reflects the common law position that a director must not put themself in a position where their duties to the company and their personal interests conflict. A director occupies a position of trust, a "fiduciary duty", which must not be abused. Many of the cases concerning breach of fiduciary duty have arisen as a result of directors making secret profits (i.e. profits which they have not disclosed to the company) for themselves. The director must not misuse their powers or the opportunities of their position to benefit themselves at the expense of the company, except with its knowledge or informed consent. A director is therefore liable to pay to the company any undisclosed profit they may make as a result of their office.

Another aspect of this is that a director may not misapply the company's assets. The common law position is that the director is a 'watching trustee' of the property of the company and it's their duty to ensure that the property is not misappropriated or misapplied. Case law has shown that if it's proved that a company's assets have been applied by the directors for purposes for which the company cannot approve, the directors are liable for their reinstatement even if they have not acted dishonestly.

The statutory duty to avoid a conflict of interest may be described as a duty to avoid "situational" conflicts – to distinguish it from the duty to declare an interest in a transaction or arrangement ("a transactional conflict") discussed under "Duty to declare interest in proposed transactions or arrangements with the company". The courts have indicated that the "no conflicts" rule is to be strictly adhered to.

Great care should be taken when directors are engaged in separate business which might give rise to situational or transactional conflicts with the interests of the company. Directors should ensure that they manage such conflicts properly, and in accordance with any requirements in the company's articles and the statute. It is important that directors not only consider and manage potential conflicts, but also that they fully document that process so that such considerations are clearly evidenced and documented in case of future challenge.

Examples of "situational conflicts" are:

- A director being associated with a competitor of the company.
- A director being a major shareholder in the company.
- A director being a director of other companies in the same group as the company.
- A director being a potential or actual customer or supplier of the company.
- A director wanting to take advantage of an opportunity previously declined by the company.

The above is not an exhaustive list and other scenarios of a "situational conflict" may arise. This duty is expressly stated to apply in particular to the exploitation of property, information or an opportunity — whether or not the company could itself take advantage of that property, information or opportunity. The company's articles may provide more onerous duties but may not dilute the statutory duty.

EXCEPTIONS

There are exceptions to the duty:

- The duty does not apply to transactions or arrangements with the company (see "Duty to declare interest in proposed transactions or arrangements with the company" below).
- The duty is not infringed if the situation "cannot reasonably be regarded as likely to give rise to a conflict of interest".
- The duty is not infringed if the matter has been authorised by the directors.

How can companies authorise a 'situational conflict'?

The position is different for private and public companies.

Private companies

The conflict may be authorised by the independent directors on the board (the conflicted director cannot form part of the quorum or vote on the authorisation of the conflict which concerns them):

- For private companies incorporated on or after 1 October 2008 the board is automatically empowered to authorise a conflict, provided there's no provision in the articles prohibiting this (which will not usually be the case).
- Private companies incorporated before 1 October 2008 must pass a shareholder resolution empowering the board to authorise a conflict.
- The independent directors need to resolve at a board meeting to authorise the conflict but this shouldn't simply follow as a matter of course – the directors must consider their other statutory duties to the company before deciding whether to authorise the conflict.
- Where all the directors are conflicted, the only practical course will be a shareholder resolution.

Public companies

The conflict may be authorised by:

- The independent directors on the board (the conflicted director cannot form part of the quorum or vote on the authorisation of the conflict which concerns them). In this case, there must be a specific provision in the company's articles specifically enabling the directors to authorise the conflict situation.
- Shareholder resolution. This will be the only practical

course where all the directors are conflicted.

The articles of a Listed Company and an AIM Company will generally contain detailed provisions relating to the treatment of directors' interests, usually to the effect that no director will be disqualified from contracting with the company, subject to the provisions of the Companies Act 2006 and requirements as to disclosure which are in the articles. These commonly provide that a director who's interested in a contract is not liable to account to the company or the shareholders for any benefit realised by the contract; that a director shall not vote on or be counted in the quorum in relation to any board resolution concerning their own appointment as the holder of an office or position with the company where they may profit; and that a director may generally not vote or be counted in the quorum in relation to any board resolution in respect of a contract in which they are (to their knowledge) materially interested, although there may well be exceptions to this prohibition. In the case of substantial non–cash transactions between a director (or their connected persons) and the company, prior approval by the shareholders in general meeting must always be obtained. This is described further below in the section headed "Substantial property transactions".

If all the directors are conflicted — which is far from a rare occurrence — the impasse can be resolved by passing a shareholder resolution to approve the conflict. For example, 50:50 joint venture arrangements typically require at least 1 director appointed by each shareholder to be present in order for a board meeting to be quorate. This may mean that a director's conflict between the interests of the joint venture company and the appointing shareholder cannot be authorised by directors. Authorisation at shareholder level is, therefore, likely to be more appropriate in this context.

DUTY NOT TO ACCEPT BENEFITS FROM THIRD PARTIES

Directors must not accept any benefit from a third party which is conferred because of their being a director or their doing (or not doing) anything as a director. This duty has assumed resonance following the introduction of the Bribery Act 2010. There's an exemption for benefits conferred by the company itself, its holding company or subsidiaries and for benefits conferred through the director's service agreement.

In contrast to the rules for conflicts of interest, a benefit cannot be authorised by the board; it can only be authorised by the shareholders.

"Benefit" has a wide meaning and could cover not just financial benefits but also an appointment to the board of another company or even the acceptance of corporate hospitality. However, a benefit may be accepted where it cannot reasonably be regarded as likely to give rise to a conflict of interest. In practice, the existence or not of a conflict is likely to be the key issue. There is no de minimis as what can reasonably be regarded as giving rise to a conflict of interest and it will vary depending on the size of the company and the circumstances of the director concerned.

DUTY TO DECLARE INTEREST IN PROPOSED TRANSACTIONS OR ARRANGEMENTS WITH THE COMPANY

Directors must declare to the other directors the nature and extent of any interest, direct or indirect, that they have in a proposed transaction or arrangement with the company. There's no need for the director to be a party to the transaction or arrangement for the obligation to apply and the obligation also arises in the case of persons "connected" with the director. The declaration must be made before the company enters into the transaction or arrangement. The declaration must be made at a meeting of the directors or by making a general notification of interest at a prior directors' meeting. The duty requires the director to disclose matters of which they should be aware and to update a declaration which proves to be or becomes inaccurate or incomplete before the company enters into the transaction. There's no requirement to make a declaration if the director's interest cannot reasonably be regarded as likely to give rise to a conflict of interest (although this is likely to be a grey area), or if the other directors are already aware of the interest or should have been aware of it, or if it concerns the terms of the director's service contract which have been or are to be considered by the board.

A director of a single–director company will not need to comply with this duty (as the duty centres on the obligation of disclosure to other directors).

There is a separate statutory duty requiring directors to declare the nature and extent of their interest in an existing transaction. Typically, this will be where a new director joins the board. Failure to comply with this requirement is a criminal offence. See under "Declaration of interests in existing transactions or arrangements".

The articles of association of a company will usually contain provisions regarding the disclosure of a director's interests in a transaction.

If a company's articles are based on the Model Articles, without appropriate modification, then any director who's interested in a transaction or arrangement with the company cannot vote or count in the quorum for board resolutions in respect of that transaction or arrangement. This restriction may, however, be waived by ordinary resolution of the shareholders, and the restriction doesn't apply to certain types of transaction (what the Model Articles call 'permitted causes', such as a guarantee given, or to be given, by or to a director in respect of an obligation incurred by or on behalf of the company or any of its subsidiaries).

THE RELATIONSHIP BETWEEN THE DUTIES

The general duties will frequently overlap. Taking a bribe from a third party would, for example, clearly fall within the duty not to accept benefits from third parties but could also, depending on the facts, be characterised as a failure to promote the success of the company for the benefit of its members or as an aspect of failing to exercise independent judgment.

The cumulative effect of the duties means that where more than 1 duty applies, the director must comply with each applicable duty, and the duties must be read in this context. So, for example, the duty to promote the success of the company will not authorise the director to breach the duty to act within their powers, even if the director considers that it would be most likely to promote the success of the company if the director were to act outside of their powers.

As well as complying with all the duties, the directors must continue to comply with all other applicable laws. The duties do not require or authorise a director to breach any other prohibition or requirement imposed on them by law. Also, section 180(5) of the Companies Act 2006 provides that the general duties have effect notwithstanding any enactment or rule of law except where there's an express or implied exception to this rule.

DIRECTORS' DUTIES IN A GROUP CONTEXT

Taking into account the interests of other group companies

Where the company is a member of a group of companies, a director may also take the interests of other group companies into account when making decisions, provided always that in doing so the director considers, in good faith, that they're acting in a way most likely to promote the success of the company for the benefit of the members as a whole. However, if the interests of the company and the other members of the group do not coincide, the director's first duty is to the company of which they're a director.

One old case is instructive. The directors of a partly owned subsidiary acquiesced in a policy of its parent company to deprive the subsidiary of business contracts, which were diverted to the parent company. The directors of the subsidiary, who were nominees (and also directors) of the parent company, were held to be in breach of their duties to the subsidiary by their inaction in failing to protect the company from the loss of business.

Another example is of a bank lending to the group. Where a company borrows money from a lender and gives security for that loan, the company is clearly deriving a benefit from the arrangement. However, where the lender requires security not only from the borrower, but also from its parent, subsidiary, or other companies in the group, it might not be clear what benefit such companies receive in return.

As noted, the directors have a duty to act in what they consider to be the best interests of the company which they direct and must ask whether they can justify the company securing another company's obligations. The test is: "whether an intelligent and honest man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transaction was for the benefit of the company". The risk of giving third party security must be balanced against the actual or potential rewards.

In the example of security offered for a loan, directors of a subsidiary might argue that supporting the parent company is justified because of the support services it receives from the parent, while, in turn, the directors of the parent might argue that supporting the subsidiary is justified by the expectation of a dividend. The assessment is fact specific and will be dependent on factors such as what's being asked of a company within the group and the structure of the group. It's very important therefore, particularly in the group context, that board minutes reflect what the particular corporate benefit is perceived as being to that particular company.

If the directors of a subsidiary company simply do as instructed by the parent company, they'll be in breach of their duty to exercise independent judgement. The parent company (and possibly 1 or more of its directors) may in some cases be at risk of being treated by the courts as shadow directors of the subsidiary.

Being a director of more than 1 group company

Particular problems can arise where a director is also a director of other members of the corporate group. What's a director to do when they're on the boards of 2 companies within the same group and finds themself with potentially conflicting duties to both companies? If, for example, the director participates in a decision by the parent company regarding the future strategy of a subsidiary, of which they're also a director, there's a risk that they'll owe a duty to disclose the information to the subsidiary which in turn conflicts with the duty of confidentiality they owe to the parent. This is why it's important to deal with these issues in the articles of association — it's very easy to change the articles of association of a wholly owned subsidiary, for instance, and the benefit of doing so to accommodate multiple group directorships easily outweighs the inconvenience of signing 2 sets of board minutes and a written resolution and the filing at Companies House.

The courts have tackled the issue of the duties owed by a director appointed by a parent company to a subsidiary and the current position is that a nominee doesn't owe a duty to the appointing company simply by virtue of the fact of nomination but that such a duty could arise out of a separate agreement; however, any such duty doesn't detract from the overriding duty to the company to whom they have been appointed. The director may take the interests of their nominating company into account, provided that their decisions as a director are taken in what they genuinely consider to be the best interests of the company to which they have been appointed.

Generally speaking, this is not usually much of an issue when the companies are financially healthy but if 1 or other company gets into financial difficulties the problems can become quite acute.

LIABILITY FOR BREACH OF DUTY

Liability generally

Breach of any of the statutory duties will give rise to the possibility of an action by the company against the director concerned. If the director acts improperly, they may be liable to repay any secret profit which has accrued to them and to reimburse the company for any loss caused by their misbehaviour. Liability doesn't depend on dishonesty. In addition, the fact that a director has made a mistake in deciding whether or not a course of action is a sensible one for the company to take will not of itself result in liability. It will only do so if the director was negligent in arriving at that conclusion or did so in breach of their duty of honesty and good faith.

Derivative actions and proceedings by members

The common law position is that, subject to some limited exceptions such as a fraud on the minority, a member cannot bring an action on behalf of the company for a wrong done to the company as the injured party is the company, and so the cause of action vests in the company. As the company will often be controlled by the person or persons who perpetrated the alleged wrong, that doesn't leave the aggrieved shareholder with much room for manoeuvre. Moreover, the courts will not intervene in the internal management of a company acting within its powers, and the ratification by the company of an act or omission that gives rise to a derivative claim will act as a bar to the making of such a claim.

The Companies Act 2006 extended the scope of circumstances in which an action on behalf of the company (called a derivative action) may be brought. In particular, it's now possible for minority shareholders to bring a derivative action for breach of directors' duties (even when the director concerned has not benefited personally from the breach). Furthermore, it's not necessary for the shareholder to show that those directors who perpetrated the wrongdoing were controlling shareholders.

The change to the law prompted protests from the business community that it would expose directors to more litigation, particularly from activist shareholders. Accordingly, Government introduced into the Companies Act 2006 new barriers to bringing derivative claims — by including a requirement to show a prima facie case at the outset, by requiring permission from the court to continue a claim. The court also has the power to make a costs order against the applicant shareholder.

In a derivative action brought in 2023 by the shareholder ClientEarth against Shell plc, ClientEarth alleged breach of directors' duties because of a failure to adopt and implement an energy transition strategy aligned with the Paris Agreement. The claim was dismissed by the court with the judge observing that English law respected the directors' autonomy and judgment when making commercial decisions as to the best way of achieving results which were in the best interests of Shell's members. Furthermore, there's a well-established principle that it's for the directors themselves to determine (acting in good faith) how best to promote the success of a company for the benefit of its members. In dismissing ClientEarth's application, the judge observed that it's for the directors to determine the weight to be given to the various factors to which they're required to have regard in the discharge of their general duty to promote the success of the company. The impact of Shell's operations on the community and the environment is just 1 of several matters which the directors are required to weigh in the balance.

Excusing a director's breach of duty

The majority shareholders of a company may excuse a director for acting in a way which might otherwise constitute a breach of statutory or fiduciary duty. This is of particular relevance within the context of a group of companies, where, for example, it may be in the group's wider interests that a subsidiary transfer an important asset to another company within the group at less than the asset's full value. Such a transaction cannot be in the transferring subsidiary's interests, but the directors may be exonerated from potential liability to shareholders (although perhaps not to creditors) where they're acting on the parent company's directions.

This is subject to the requirement that the votes in favour of the resolution cast by the director (if also a shareholder) or any person connected with the director and the votes of any member connected with them are to be disregarded in determining whether the resolution is passed. Ratification is not possible in every case, in particular where the act in question is unlawful, such as the payment of an unlawful dividend.

In addition, a court has a discretion, pursuant to the Companies Act 2006, to relieve a director from liability for negligence, default, breach of duty or breach of trust if it considers that they acted honestly and reasonably and that, having regard to all the circumstances, they ought fairly to be excused. A director who anticipates proceedings on any of these grounds can apply to the court for relief in advance of the claim against them. Articles of association commonly provide that a director who's relieved from liability by the court in this way will be indemnified against the costs of their defence out of the assets of the company.

INSURANCE AND INDEMNITY

It's clear that directors have much to consider in the conduct of their day-to-day activities. With duties owed under common law and statutory provisions alike, the prudent director would be wise to seek to limit their personal liability wherever possible. In the past, few claims were made in the UK against directors and officers in their personal capacity.

There are a number of reasons why the possibility of claims being brought against directors may be greater now than was the case in recent past:

- A rise in the number of class actions.
- The relaxation of the rules of derivative actions.
- The ability of administrators and liquidators to assign claims against directors, e.g. for wrongful trading, to third parties.
- The relatively new power of the court to order a director who has been disqualified for misconduct to compensate creditors who have suffered loss by reason of that misconduct.
- The likelihood of regulatory action arising from the greater powers of the regulators, e.g. the powers of the Competition & Markets Authority considerably outstrip those of its predecessor, the Office of Fair Trading. The Economic Crime and Corporate Transparency Act 2023 has also provided more scope for cross-sharing of information by regulators than was formerly the case.

It's also relevant that the cap on the fine that can be imposed by a Magistrates' Court for a criminal offence has been removed. This could include, for example, health and safety or environmental offences under the Companies Act 2006.

Indemnity from the company

Companies are entitled to indemnify directors for proceedings brought by third parties (covering both legal costs and the financial costs of an adverse judgment), except for the legal costs of unsuccessfully defending criminal proceedings or fines imposed in criminal courts or by a regulator, such as the Financial Conduct Authority (FCA). Companies can pay the defence costs as and when they're incurred, even where the company itself is the claimant, though the director would be required to repay the defence costs if their defence to the company's claim was unsuccessful.

A company's articles typically provide for the grant of indemnities to be permitted (the company may indemnify) rather than obligatory (the company shall indemnify). Directors do not always appreciate that the relevant provision in the company's articles, even if drafted as an obligation, is, on its own, insufficient. This is because the articles are deemed to be a binding commitment between a company and its members; a director is not a party to this commitment unless the director is also a member, and, even then, they'll only be able to enforce those provisions in the articles which confer rights on them in their capacity as a member. It is for this reason that the indemnity itself needs to be in a separate contract between the director and the company, often in a separate deed of indemnity.

Any such indemnities will need to be disclosed in the directors' report and a copy must be made available for inspection at the company's registered office for a year after it's made.

D&O insurance

A company can take out insurance cover for its directors against most of their liabilities. Directors' and officers' (D&O) insurance is designed to protect directors and officers of a company from loss resulting from claims made against them in relation to the discharge of their duties as directors or officers respectively. Companies may take out such insurance on behalf of their directors, and to pay the premiums, although the FCA prohibits regulated companies from entering into insurance contracts that would pay a financial penalty imposed by the FCA.

A standard D&O policy usually provides coverage for companies for amounts which the company pays in indemnifying its directors and officers. It also provides coverage directly to individual directors and officers for losses which they incur as a result of claims made against them for conduct in their capacities as directors or officers of the company, and in respect of which the company does not indemnify them.

The UK Corporate Governance Code contains a provision that the company should arrange appropriate insurance cover in respect of legal action against its directors.

Issues to consider include:

- Policies will usually cover the main board and directors of subsidiaries. Cover will not necessarily extend to the directors of joint venture companies or to companies in which the company has a minority shareholding or to officers (a company secretary, employed solicitors and other senior managers).
- Whether there is a run-off cover so that a director remains covered for a sufficient length of time (normally at least 6 years) after they leave the company in respect of actions which took place while they were a director.
- Does the level of cover factor in the possibility of claims being brought against all the directors of the company and each director needing corporate advice? Directors could be left exposed if the sum insured is exhausted by 1 or more large claims.
- Does the cover extend to subsidiaries acquired after the date of inception of the policy?

DELEGATION

Committees and managing or executive directors

The board may delegate authority to individual directors, e.g. a managing director or finance director. Where the board expressly authorises a director to do something this is called "actual authority". Where a director is appointed to a particular office, that director has "implied authority" to do anything that ordinarily falls within the functions of that office, e.g. a sales director has implied authority to negotiate and conclude a sales contract. If the company allows a director to perform a particular role, without formally appointing them to do so, the director is said to have "apparent authority" and a third party is entitled to assume that the director has the authority that someone in that position would have. See the section headed "The position of third parties" for the position where directors exceed the scope of their actual authority.

In addition to the powers given to individual directors to appoint alternates, a company's articles of association will commonly allow a board of directors to delegate its powers to committees (the purpose of committees is to enable board members to go into areas of particular sensitivity or difficulty in greater detail than would be possible were the matter to be kept at full board level). Both the Model Articles for private and public companies and Table A confer such a power of delegation. Any such delegation is subject to the overriding principle that, since the articles can only be altered by special resolution of the shareholders, the board cannot irrevocably delegate its powers. Articles usually permit the directors to delegate any of their powers or discretions to committees consisting of 1 or more directors and (if thought fit) 1 or more other co-opted persons. All committees must conform to regulations imposed by the directors when exercising the delegated powers.

The UK Corporate Governance Code provides that certain matters should be delegated to board committees comprising principally or exclusively non-executive directors. The main board committees are the audit, nomination and remuneration committees.

At common law, in respect of those duties that may properly be left to some other person, a director is, in the absence of grounds for suspicion or obvious deficiencies in the proposed delegate, justified in trusting that person to perform those duties honestly. This has meant in some cases that directors have been exonerated when they properly entrusted experts or managers with duties relating to the company's finances who then deliberately misstated the company's financial situation on the basis of which the directors recommended the payment of dividends out of capital. Similarly, the board may properly rely on committees of directors performing delegated functions. However, in so doing, it is important that the board should set out clearly the powers and responsibilities of any committee to which it delegates functions.

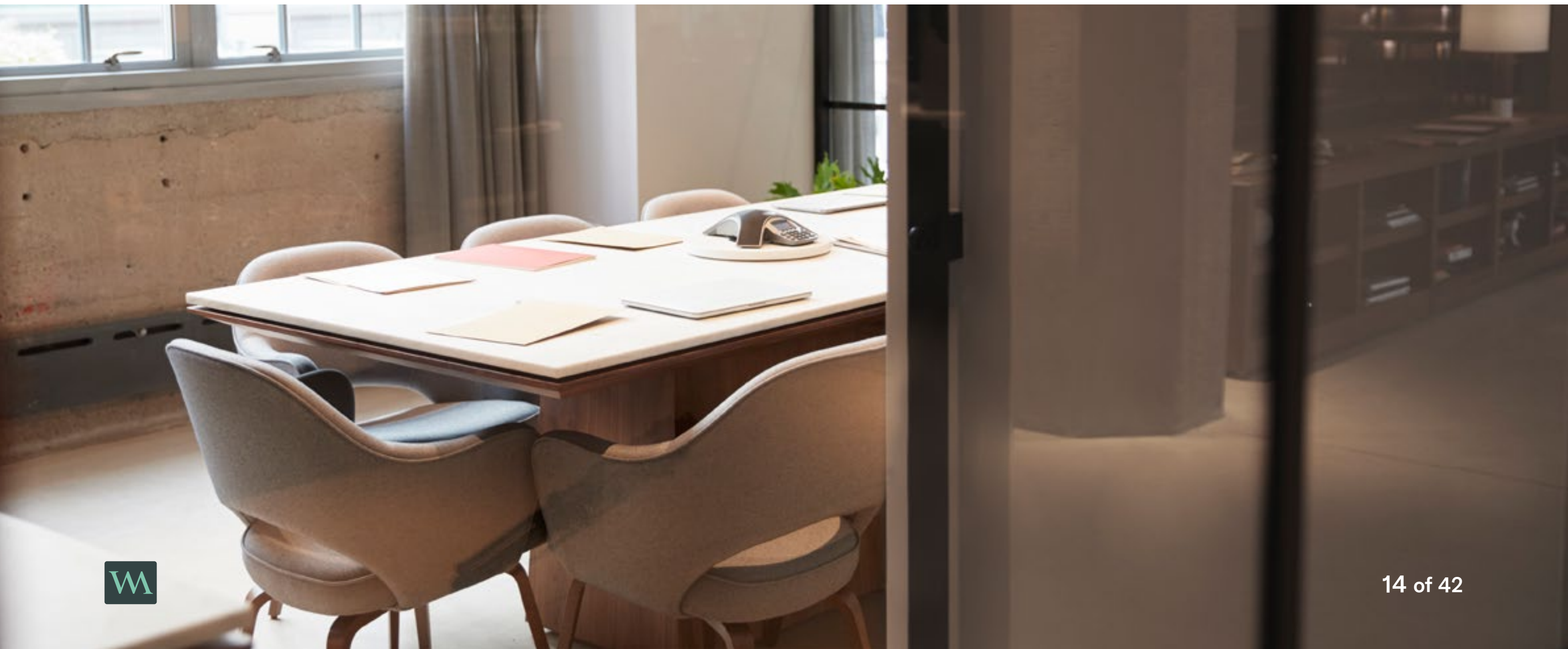
In the case of **Guinness plc v Saunders**, a committee of the board of directors of Guinness plc made a payment of £5.2m to 1 of its directors in connection with a takeover bid being made by the company. The House of Lords (now the Supreme Court) ruled that special remuneration could be awarded to a director serving on a committee only by the board of directors themselves and not by a committee. In such circumstances, a board of directors should make absolutely clear, in advance, those powers to be delegated and those to be reserved to the full board.

In the case of Re D'Jan of London Ltd, an insurance broker completed an insurance proposal form with an incorrect answer. The director nonetheless signed the form. The company premises subsequently burnt down. The insurers discovered the incorrect answer and refused to pay out. The court found the director to be in breach of their duty of skill and care. The director in question was not able to say that they had relied on the insurance broker to fill in the form correctly.

The FRC Guide to Board Effectiveness (July 2018) contains a recommendation that the annual report should include a statement of how the board operates, including a high level statement detailing which types of decision are to be taken by the board and which are to be delegated to management.

In the context of a takeover bid

Notwithstanding the extent to which directors' duties may be delegated as a matter of law, the City Code restricts the extent to which the conduct of takeovers of public companies may be delegated by the board of any company involved. The City Code requirements are designed to ensure that each director is aware of all principal developments arising during a takeover. Further details are set out under "Takeovers".



LIMITATIONS AND OBLIGATIONS IMPOSED BY STATUTE, THE DTRS, UK MAR AND THE LONDON STOCK EXCHANGE

Part 10 of the Companies Act 2006 contains provisions relating to the enforcement of fair dealing by directors.

Substantial property transactions

Companies are not, in most circumstances, permitted to enter into arrangements under which a director, or a director of its holding company, or a connected person, acquires or agrees unconditionally to acquire a non—cash asset of the "requisite value" from the company or the company acquires or is to acquire such an asset from such person unless the arrangement is first approved by the company in general meeting. "Requisite value" means that the asset must be worth £100,000 or 10% of the company's net assets, whichever is the less, but subject to a minimum of £5,000. It is possible for the agreement to be made conditional upon obtaining shareholder approval. If this provision is breached the director who was party to the arrangement and any director who authorised it are liable to account for any gain made as a result of the arrangement and to indemnify the company for any resulting loss.

In addition to the requirements imposed by statute, the UK Listing Rules require that a Listed Company (or any subsidiary undertaking) which enters into an arrangement to acquire assets from or dispose of assets to a director or a person connected with the director (known as a related party transaction) notifies an Regulatory Information Service (RIS) as soon as possible, including giving details of the nature and extent of the related party's interest in the transaction and obtains a "fair and reasonable" opinion from a sponsor. There are no disclosure requirements for smaller related party transactions.

The AIM Rules for Companies also include a provision dealing with related party transactions which requires the disclosure of relevant information to the London Stock Exchange, including a statement that the directors consider, having consulted with the company's nominated adviser, that the terms of the transaction are fair and reasonable insofar as the company's shareholders are concerned.

Interests in shares and debentures

The Companies Act 2006 removed the requirement for directors to notify the company of their interest in shares or debentures in the company (or any of its subsidiaries), and for the disclosure of acquisitions or disposals of interests in shares. For companies whose shares are neither admitted to the Official List nor AIM, there is no longer any requirement for the disclosure of significant interests or directors' interests in their shares.

However, the Disclosure Guidance and Transparency Rules (DTRs) oblige a shareholder of a Listed Company (which, in this context, means companies on the Official List, AIM or AQSE) to notify the company of the proportion of voting rights that they hold if they acquire or dispose of shares in the company to which voting rights are attached and, as a result of such acquisition or disposal, the proportion of the voting rights that they hold reaches, exceeds or falls below 3%, with the obligation to notify at each higher whole percentage point.

Notification must be made to the company as soon as possible and in any event not later than 4 trading days (in the case of notifications to a non-UK issuer) and 2 trading days (in all other cases) after the event. The notification must also be sent to the FCA. Listed Companies must notify the market as soon as possible, and not later than the end of the trading day following notification to it. AIM Companies incorporated in the EEA must make the notification "without delay", and not later than the end of the third trading day following notification to it.

Disclosure obligations and restrictions under UK MAR

The provisions of UK MAR apply to Listed Companies and AIM Companies. Article 19 of UK MAR requires "persons discharging managerial responsibilities" (PDMRs) (and persons closely associated with them (PCAs)) to notify the company and the FCA of all transactions (subject to the threshold below) conducted by the PDMR (or their PCA) on their own account relating to the company's shares or other financial instruments. Only transactions at or above EUR5,000 per calendar year need to be notified under UK MAR (but companies' own rules often require notification at any level). The FCA has recently issued its first significant fine in relation to breach of Article 19.

The notifications must include the prescribed content and must be made using a mandatory template. The PDMR (or PCA) must make the notification within 3 working days of the transaction and the company must in turn notify the market within 2 working days of being notified of the transaction.

UK MAR also provides that a PDMR within a company shall not conduct any transactions on his own account or for the account of a third party, directly or indirectly, relating to the shares or debt instruments of the company during a closed period. A closed period means the period of thirty calendar days before the announcement of an interim financial report or a year-end report, which the company is obliged to make public according to the UK Listing Rules or AIM Rules.

Note that the restriction on dealing applies only to PDMRs. PCAs are free to deal in a closed period although many companies extend dealing restrictions during closed periods to PCAs as well.

Declaration of interests in existing transactions or arrangements

Section 182 of the Companies Act 2006 requires directors to declare the extent and nature of their interests in existing transactions or arrangements as soon as possible. If the interest changes after a declaration has been made, or if the director realises that his interests weren't as originally declared, the director must make another declaration correcting or updating the earlier one. The declaration must be made either at a meeting of the directors, by written notice or by general notice. Disclosure is not required if the interest cannot reasonably be regarded as likely to give rise to a conflict; if the other directors are already aware of it (or ought to be aware of it) or if, or to the extent that, it concerns terms of the director's service contract that have been or are to be considered by the board (or committee of the board). Directors that fail to disclose an interest in an existing transaction or arrangement commit a criminal offence.

Loans

There are statutory restrictions on companies granting loans or quasi-loans to directors or entering into guarantees or providing security in connection with loans made to directors. The general rule is that loans and similar transactions, such as entering into credit transactions for directors or their connected persons, are prohibited unless the loan is first approved by the company in general meeting. The restrictions against loans or quasi-loans to directors are more stringent for public companies and their subsidiaries than for private companies.

The 2 most important exceptions to the general prohibition concern loans of less than £10,000 in aggregate and funding to cover expenses incurred by a director for the company's purposes. In the latter case, the amount mustn't total more than £50,000.

Connected persons

The restrictions on "substantial property transactions" and company loans apply not just to directors but to their "connected persons". This includes the director's spouse (or civil partner), any person with whom the director lives in an "enduring family relationship", children (or stepchildren) and parents. Directors can be "connected" with companies as well, where they (and persons "connected" with them) hold 20% of the shares or voting rights in that company.

Political donations

Directors have a duty to consult with shareholders in relation to the making of donations to political parties. Directors who fail to obtain shareholder approval may face liability for the unauthorised donation or expenditure plus damages and interest. Political "donation" is couched in sufficiently wide terms as to include gifts, non-commercial loans and the use of property and services on non-commercial terms (although the Companies Act 2006 does contain a useful exemption in respect of trade unions).

Health and safety

Developments in the area of health and safety make it essential for directors to revisit regularly their health and safety responsibilities.

Directors have a general common law duty to provide a safe and healthy place of work for the company's employees and to ensure that others who may be affected by its activities aren't exposed to unnecessary risks. In certain circumstances, depending on the nature of the parent/subsidiary relationship, a parent company may owe a common law duty of care to employees of the subsidiary to ensure a safe and healthy place of work.

Over recent years, the Health and Safety Executive (HSE) has issued guidance and enforcement policies. In response to mounting public pressure, Government is also demanding that companies and individuals be held to account in the criminal courts for their health and safety record following death or injury in the workplace. In the current climate of increased scrutiny and accountability, directors need to be aware of their personal liability for health and safety offences.

Under the Health and Safety at Work etc Act 1974, an individual director, company secretary or manager of a company can be held criminally responsible for health and safety offences where:

- The company itself is found guilty of a health and safety offence.
- The offence was committed with the consent or connivance of, or was attributable to any neglect on the part of, the director or manager.

In essence, where a director has knowledge and awareness of the circumstances and the risks which caused the health and safety failure and fails to do anything about it, they can be held criminally liable. Under sentencing guidelines, individual directors found guilty of "consent, connivance or neglect" in relation to the health and safety offence, face potentially unlimited fines and up to 2 years in prison. Whilst D&O insurance can be purchased to protect directors, protection can only be obtained for the cost of civil damages and for the legal costs in defending proceedings, and not for criminal fines or penalties (see 'Insurance and indemnity'). In addition, a director held to be liable can further be disqualified from being a director for up to 2 years.

Although difficult to secure, the number of prosecutions of company directors for manslaughter has been increasing. For example, in 1 case 2 directors of a haulage company were convicted of manslaughter after 1 of their drivers fell asleep at the wheel and caused the deaths of 2 other motorists in a motorway accident. The directors were convicted on the basis that they had failed to regulate the driver's hours. Both directors received 18 months' suspended prison sentences.

In 2018, guidelines were issued to judges to increase prison sentences for people convicted of gross negligence manslaughter in a workplace setting. The new guidelines were published by the Sentencing Council and mark the first time that comprehensive directions have been drawn up for the most serious and difficult cases of manslaughter. Under the guidelines, anyone convicted of manslaughter by gross negligence could face a prison sentence of up to 18 years.

In October 2015 the HSE published an enforcement policy statement (which is still in force), 1 of its purposes being to ensure that directors who fail in their responsibilities are held to account. One of the “principles of enforcement” in the statement is the prosecution of the directors themselves. HSE inspectors have been asked to consider, in particular, the management chain and the role played by individual directors and managers. Where appropriate, enforcing authorities are directed by the HSE to seek disqualification of directors under the Company Directors Disqualification Act 1986 (CDDA).

The UK Corporate Governance Code requires the board of directors of all Listed Companies to conduct a review of the effectiveness of the company’s system of internal controls at least annually, and to report to shareholders on this review in the annual report. In practical terms, this requires directors to maintain a system of internal controls which covers areas including health and safety. The guidance provided by the FRC’s report entitled Risk Guidance (Risk management, internal control and related financial and business reporting) places responsibility for internal controls firmly on the directors (both executive and non-executive). By making the board responsible for review of internal audits, the FRC Risk Guidance forces all directors to become aware of, and accountable for, all areas of risk, not just those pertaining to their particular area of responsibility.

The environment

There is a growing body of legislation in the UK designed to protect the environment (e.g. to prevent the pollution of air, water and land, the conservation of flora and fauna and protection of human health). Directors may face criminal liability, in some cases, for a breach of environmental law if, as a result of their acts or omissions, they create circumstances that give rise to the committing of the offence or where they consented to the offence (or turned a blind eye to it), or where the offence was attributable to their act or neglect.

It should also be borne in mind that directors, when complying with their duty to promote the success of the company, must have regard to the impact of the company’s operations on the environment and that companies must include in their annual report information on environmental matters. Demand is growing from investors, regulators and other stakeholders that companies should consider the effects of climate change on their business. The Task Force on Climate-related Financial Disclosures (TCFD) has developed a widely accepted voluntary framework for standardised and comparable reporting of climate-related information. In addition, the Companies (Strategic Report and Directors’ Report) (Amendment) Regulations 2023 amend the Companies Act 2006 to introduce further reporting requirements for companies with 750 or more employees and an annual turnover of £750 million or more. The regulations will largely come into force on 1 January 2025.

Competition

The Enterprise Act 2015 contains provisions imposing personal liability on individual directors for breaches of competition law by the companies they run. It created a “cartel offence” which established criminal liability for directors who engage in “hardcore” cartel behaviour. This covers behaviour such as agreements to fix prices, share markets, limit production or supply or rig bids. As such, it was introduced with the aim of increasing the effectiveness of the detection and elimination of illicit anti-competitive activity in the UK. This criminal offence runs in parallel with the civil regime in the Competition Act 1998. The maximum penalties for the cartel offence are up to 5 years’ imprisonment and an unlimited fine.

The Enterprise Act also introduced amendments to the CDDA, granting the Competition and Markets Authority (CMA) the power to apply to court for a competition disqualification order to be made against directors (including shadow directors and de facto directors) who are found to have infringed competition law. A competition disqualification order can be sought for any type of competition law breach (for example, the abuse of a dominant market position or vertical restrictions) and not just cartel activity. As a result, directors of a company who weren’t so directly involved in the cartel activity as to be liable for prosecution under the criminal cartel offence may still be subject to a competition disqualification order provided that their company is found to have infringed either EU or UK competition law. The CMA will take enforcement action against directors who had reasonable grounds to suspect the breach of competition law but took no steps to prevent it and directors who did not know of the breach but ought to have known about it.

The maximum period of a competition disqualification order is 15 years. During the period of the order it’s a criminal offence for the individual to be a director of a company, act as a receiver of a company’s property, in any way, whether directly or indirectly, be concerned or take part in the promotion, formation or management of a company or act as an insolvency practitioner. In addition, a person who acts in contravention of a competition disqualification order is personally liable for all of the relevant debts of the company.

As an alternative to seeking a court order, the CMA has the power to obtain a competition undertaking from a director. The undertaking will require that for a specified period of time (up to a maximum of 15 years), the individual will not (without leave of the court) be a director of a company, act as a receiver of a company’s property, in any way, whether directly or indirectly, be concerned or take part in the promotion, formation or management of a company or act as an insolvency practitioner. Breach of an undertaking will be a criminal offence in the same way as breach of an order.

CHAPTER 4
APPOINTMENT, REMOVAL, RESIGNATION & RETIREMENT

Appointment

The Companies Act 2006 requires that public companies must have at least 2 directors. Private companies only need to have 1 director. The articles of a company may impose a higher minimum and may impose a maximum. A corporate body can be a director of another company (although Government is implementing legislation that will mean that in the future all directors must be "natural persons", subject to certain exceptions) but all companies must have at least 1 director who's a natural person. The Companies Act 2006 introduced a minimum age requirement of 16. A register of the directors is kept by the company at its registered office (or its single alternative inspection location, if applicable) and is open for inspection by the members. Statute specifies the particulars which must be recorded in the register in relation to each director. Companies will also need to keep a separate register of the usual residential address of directors who are individuals. This register is not open to public inspection. Whenever there is a change of directors or a change in the particulars contained in the register, the company must notify the Registrar of Companies within 14 days of the change by sending a notification in the prescribed form.

The method of appointment of a director will be stated in the company's articles. The first directors of the company will be named in the application form to register a company (form IN01). The shareholders in general meeting will normally have the power to fill vacancies on the board and to appoint additional directors. Part of the normal business transacted at each AGM will often be the election of directors. In addition, articles (including the Model Articles and Table A) commonly give the board the power to appoint directors to fill vacancies or as additional directors. Such appointments customarily terminate at the next AGM, allowing the shareholders to decide whether or not to reappoint the director.

There are restrictions on certain persons becoming directors of a company. The CDDA provides, for example, that an undischarged bankrupt who acts as a director of a company without the leave of the court is liable to imprisonment or a fine, or both.

A main principle of the UK Corporate Governance Code provides that there should be a formal, rigorous, and transparent procedure for the appointment of new directors to the board. A nomination committee, a majority of whose members should be independent non-executive directors (and which should be chaired by either the chair or an independent non-executive director), should lead the process for board appointments and make recommendations to the board. The chair of the board shouldn't chair the committee when it's dealing with the appointment of their successor.

The QCA guidance (relevant to AIM Companies) states that the nomination committee should work with the board and chair to identify the skills and experience needed in the board's and company's development; concern itself with succession planning and be prepared to co–operate in the removal of under-performing directors.

The Chartered Governance Institute has published a guidance note proposing model terms of reference for a nomination committee to support the summary of principal duties in the UK Corporate Governance Code.

In practice, not all companies have nomination committees (most unquoted companies do not).

As part of its role in succession planning, the nomination committee should review the chair's position and should take account of the advantage of continuity set against the desirability of a freshness of approach. The UK Corporate Governance Code states that the chair shouldn't remain in post beyond 9 years from the date of their first appointment to the board. This period can be extended for a limited time but a clear explanation should be provided as to why.

For their part, the chair should be sensitive to the need to make way for a successor when it's in the interests of the company to do so.

Removal

Statute enables a simple majority of shareholders to remove a director if they so resolve, even if such removal is contrary to the company's articles or the provisions of any agreement between the company and the director. Some articles provide for the director, whose removal is called for, to have increased voting rights in respect of the resolution to remove them from office, although this would be unusual in the context of a Listed Company. Special notice of 28 days must be given of such a resolution and, when the company receives notice of the proposed resolution, it's obliged to send a copy to the director. The director has the right to make representations to the members in connection with the impending resolution. Written resolutions may not be used to remove a director.

In addition to the statutory right given to shareholders to remove a director, a director's tenure may be limited by the articles. There are several grounds on which articles typically provide that the office of director is to be vacated, such as mental incapacity, conviction for an indictable offence, personal bankruptcy and lengthy unauthorised and voluntary absence from board meetings. Any provision in the articles requiring directors to vacate office on attaining a specified age, e.g. 70, should, however, be removed, as this could amount to unlawful age discrimination.

The removal of an executive director from office is likely to have the effect of terminating their service contract and (assuming that the director is not themself in breach of that contract) entitling them to compensation for such termination.

Resignation

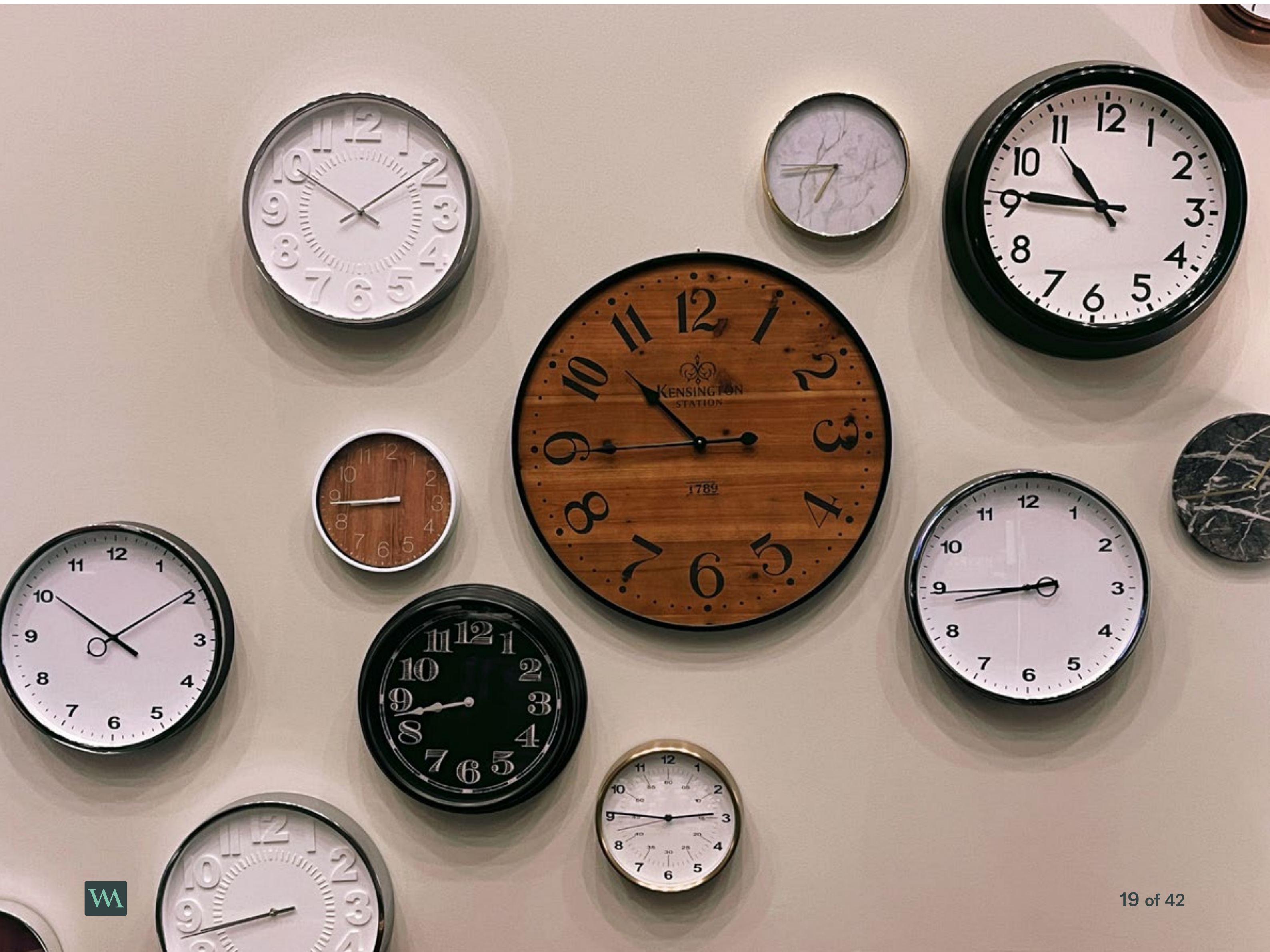
The articles will usually provide for the resignation of directors to be effected by delivery of the director's notice to the company secretary. Directors may resign at any time, even where the articles do not so provide, unless the articles include limitations or conditions on resignation which must be followed.

A common provision in articles states that the office of a director shall be vacated if they resign in writing and deliver their resignation to the registered office or if they offer in writing to resign and the other directors resolve to accept such resignation.

Retirement

Usually, the articles will provide for a certain proportion of the directors of a Listed Company to retire by rotation at each AGM and to be eligible for re-election. Articles will usually provide that a director who retires by rotation is deemed to be re-elected if their place is not filled and where such a provision is present, failure to fill the place will result in their automatic re-election.

Whilst all directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance, the UK Corporate Governance Code states that all directors should be required to retire from office and submit themselves for re-election at each AGM. Directors should be subject to election by shareholders at the first AGM after their appointment and to re-election subsequently every year. (The Model Articles for public companies currently provide for re-election every 3 years but this is out of step with the Code). In the case of non-executive directors, it's recommended that the chair should confirm to shareholders that, following formal performance evaluation, the non-executive director's performance continues to be effective, and they demonstrate commitment to the role. Previous provisions which highlighted that any term beyond 6 years for a non-executive director should be subject to particularly rigorous review were not retained in the 2018 UK Corporate Governance Code. There are no restrictions on how long non-executive directors may serve (subject to annual re-election) but serving more than 9 years will be relevant to the determination of a non-executive director's independence.



BOARD BALANCE AND INDEPENDENCE

The UK Corporate Governance Code provides as a main Principle that:

> *"The board and its committees should have a combination of skills, experience and knowledge. Consideration should be given to the length of service of the board as a whole and membership regularly refreshed."*

Other Principles provide that the board should include an appropriate combination of executive and non–executive directors (and, in particular, independent non–executives) such that no individual or small group of individuals can dominate the board's decision making. The board should be subject to annual evaluation which considers its composition, diversity and how effectively members work together to achieve objectives.

The UK Corporate Governance Code also states that at least half the board, excluding the chair, should comprise non–executive directors determined by the board to be independent. The chair should be independent on appointment and the roles of chair and chief executive shouldn't be exercised by the same individual.

Provision 10 of the UK Corporate Governance Code includes a test for independence. The board should identify in its annual report the non–executive directors it considers to be independent. The board should state its reasons if a director is considered independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:

- Has been an employee of the company or group within the last 5 years.
- Has, or has had within the last 3 years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company.
- Has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance–related pay scheme, or is a member of the company's pension scheme.
- Has close family ties with any of the company's advisers, directors or senior employees.
- Holds cross–directorships or has significant links with other directors through involvement in other companies or bodies.
- Represents a significant shareholder.
- Has served on the board for more than 9 years from the date of first election.

The QCA guidelines, last updated in April 2018, state that a company should have at least 2 independent non–executive directors, 1 of whom may be the chair. The QCA guidelines contain provisions on directors' independence which emphasise remuneration in shares and representation of major shareholders as issues that might affect a director's judgment.

The Pensions and Lifetime Savings Association (PLSA) guidelines state that AIM Companies should have at least 2 independent directors, excluding the chair. Smaller boards should have at least 2 independent non–executive directors to comprise not less than one third; 1 of these may be the chair.

GENDER AND ETHNIC DIVERSITY

The UK Corporate Governance Code requires Listed Companies to include in their report a description of the board's policy on diversity and inclusion, the gender balance of those in senior management, and any measurable objectives that the board has set for implementing the policy and progress in achieving the objectives.

The 2011 Davies Report, Women on Boards, set a series of objectives for Listed Companies to increase the proportion of women on boards. The Davies Review in October 2015 followed by the Hampton-Alexander Review in 2016 showed that the proportion of women on boards had continued to rise and published recommendations that women should make up 33% of the board of all FTSE 350 companies by the year 2020, this was subsequently increased to 40% by 2025. The annual Hampton-Alexander Reports since 2016 have shown that gender balance continues to improve, with the 2022 report from the FTSE Women Leaders Review highlighting that FTSE 350 companies have met the 40% target for women on the boards of FTSE 350 companies 3 years ahead of the December 2025 target. The Davies Report also recommended that one third of all new board appointments should be women. The Government's review of corporate governance in 2017 did not stipulate a change to the UK Corporate Governance Code to make these gender balance targets mandatory and so they remain a recommendation.

More recently, the Parker Review, led by Sir John Parker in 2017, made a series of recommendations in relation to improving ethnic diversity in the boardroom. The review committee recommended that each FTSE 100 board should have at least 1 director of colour by 2021 and each FTSE 250 board should have at least 1 director of colour by 2024. In 2022, new targets were launched which asked each FTSE 350 company to set a percentage target for senior management positions to be occupied by ethnic minority executives by December 2027.

DIRECTORS' RELATIONSHIPS WITH EACH OTHER

Directors act collectively as a board and the issue of their relations with each other doesn't generally arise until there is a disagreement between them.

Where disagreement occurs, the primary rule is that the disagreement is resolved by the directors voting on the issue and a majority vote decides the matter (in circumstances where there is an equality of votes, the chair may, under the articles, have the casting vote). Where a disagreement arises or may arise, the following should be borne in mind:

Responsibilities

In casting their votes, each director must act independently and in the way in which they consider, in good faith, would be most likely to promote the success of the company for the benefit of the members as a whole. In particular, directors must be aware of having their voting decisions swayed by a dominant chair or managing director, since they'll be in breach of duty if they so do. In the case of First Re-Investment Trust Limited and Other Companies the entire board of a Listed Company was held liable for acting in breach of duty after "rubber stamping" the investment decisions of a dominant chair. It's clear therefore that directors must apply their own judgment to company matters.

Remedies

The courts have held that a director who's outvoted on a matter is entitled to defer to the majority, even though they're not personally persuaded of the course of action approved by the board. There is no requirement for a minority director to resign or to refuse to be a party to implementing a decision they do not agree with where they're outvoted on a matter at a board meeting. However, in circumstances where a director finds themself in disagreement with the policies of their colleagues, various courses of action may be available to them including:

Action in board meeting — the most obvious way of expressing disagreement is for the director to raise the matter in a board meeting. If no meeting is in prospect, the director should requisition a meeting of the directors (assuming the company's articles allow the director to do so).

At the meeting, the director should raise their concerns and ensure that they're noted in the minutes. In circumstances where the director is outvoted on the matter, they should consider whether to accept the board's decision or to take further action (this being largely dependent upon the degree of importance they attach to the matter). In the case of the latter, the director may insist that the company's legal advisers are consulted to provide advice.

Action in general meeting — where a director's opposition has been unsuccessful at board level, they may consider raising the matter during a general meeting of the company. However, in considering this, the matter would need to be very serious.

The most obvious way the matter could be raised would be to give notice of a resolution to be held at the meeting, for example that the meeting has no confidence in the policy implemented by the board. In the case of public companies, the resolution could be proposed at the next AGM or, (for private and public companies) if the matter was urgent and the director had the support of 5% of the paid-up shareholders having the right to vote, a general meeting could be requisitioned under the provisions of the Companies Act 2006.

Resignation — where a director has tried to oppose a matter or course of action taken by the company and all means of opposition have been followed, it may be that the only option open to the director is to resign. This is an extreme option and before making the decision, the director should carefully consider what's likely to promote the success of the company.

In the event of the director deciding to resign, in fairness to the shareholders, the director should publish a statement setting out the reasons for their resignation.

In circumstances where a director finds themself under strong pressure from their fellow directors to resign (owing to taking an opposing line from the majority) again, in making their decision, they should consider what's in the best interests of the company. In any event, the director shouldn't resign for purely personal reasons.

Inspections by the Department for Business and Trade (DBT) — where a director considers that the actions of their colleagues involve serious irregularities, their best course of action may be to involve the DBT (formerly BEIS — the Department for Business, Energy and Industrial Strategy) to carry out an investigation into the company's affairs.

In making such an application, the director should ensure compliance with the provisions of the Companies Act 2006 and ensure that sufficient evidence supporting the reasons for the investigation are supplied.

Ultimately, after investigating the company's affairs, the DBT can publish an inspector's report, apply for an order to disqualify the directors and/or compel the directors to produce documents and answer questions.

Owing to the powers of the DBT in investigating the company's affairs, this may be viewed as a powerful deterrent to prevent malpractice from occurring.

Application to the court — the general principle is that the courts do not interfere in the internal affairs of a company but leave disputes to be settled by the shareholders according to the wishes of the majority.

However, there are exceptions to this principle and where they apply the director may apply to the courts for intervention. The exceptions include where:

- The act amounts to a "fraud on the minority".
- The wrongdoers prevent the company from taking action.
- The act complained of is illegal.
- The act requires something more than the consent of a simple majority of the shareholders, e.g. a special resolution (requiring 75% of the shareholders votes).
- A director is being wrongfully excluded from the

board by their colleagues.
- The director's personal rights as a shareholder are being denied, for example, where other directors are refusing to record their vote at a general meeting.

In addition, a director may be able to bring a "derivative action" on behalf of the company against their fellow directors.

REMUNERATION

Remuneration as directors

The articles of association of a Listed Company will usually provide that the ordinary remuneration of the directors shall be such amount as the directors may determine, not exceeding a stated aggregate amount per year or such other figure as the shareholders determine from time to time by ordinary resolution. This will usually apply only to remuneration receivable by the director in respect of their office as a director and not in any other capacity, for example as an employee, consultant or professional adviser. This provision is therefore only of real relevance to non-executive directors. Commonly there will be a further provision in the articles that extra remuneration by way of salary, commission or otherwise may be paid to directors who hold executive office or serve on a committee of the directors or provide special services.

The UK Corporate Governance Code provides:

When determining executive director remuneration policy and practices, the remuneration committee should address the following:

- **Clarity —** remuneration arrangements should be transparent and promote effective engagement with shareholders and the workforce.
- **Simplicity —** remuneration structures should avoid complexity and their rationale and operation should be easy to understand.
- **Risk —** remuneration arrangements should ensure reputational and other risks from excessive rewards, and behavioural risks that can arise from target-based incentive plans, are identified and mitigated.
- **Predictability —** the range of possible values of rewards to individual directors and any other limits or discretions should be identified and explained at the time of approving the policy.
- **Proportionality —** the link between individual awards, the delivery of strategy and the long-term performance of the company should be clear. Outcomes shouldn't reward poor performance.
- **Alignment to culture —** incentive schemes should drive behaviours consistent with company purpose, values and strategy.

The UK Corporate Governance Code further provides:

> *"Remuneration policies and practices should be designed to support strategy and promote long-term sustainable success. Executive remuneration should be aligned to company purpose and values, and be clearly linked to the successful delivery of the company's long-term strategy."*

Through the supporting provisions, the UK Corporate Governance Code assigns the task of monitoring and reviewing directors' remuneration packages to the remuneration committee. It's their responsibility to recommend annual pay awards and to ensure that such awards are consistent with industry and sector averages, particularly with regard to performance-related benefits.

The performance-related elements should be relevant, stretching and designed to promote the long—term success of the company.

The UK Corporate Governance Code provisions apply a further level of detail for example regarding the composition of the remuneration committee. It states that the committee should be made up of at least 3 (or in the case of small companies, 2) independent, non-executive directors. The company chair may also be a member of the committee but cannot be its chair. Before appointment as chair of the remuneration committee, the appointee should have served on a remuneration committee for at least twelve months.

The UK Corporate Governance Code also sets out guidelines relating to share-based remuneration. It provides that non-executive directors shouldn't be remunerated via share options or other performance-related elements and further states:

> *"Remuneration schemes should promote long-term shareholdings by executive directors that support alignment with long-term shareholder interests. Share awards granted for this purpose should be released for sale on a phased basis and be subject to a total vesting and holding period of 5 years or more. The remuneration committee should develop a formal policy for post-employment shareholding requirements encompassing both unvested and vested shares."*

The remuneration report

The UK Corporate Governance Code doesn't include requirements relating to the disclosure of directors' remuneration in the annual report. Instead, the Companies Act 2006 provides that every company must send a copy of its annual accounts and reports (which in the case of a Listed Company includes the remuneration report) to every shareholder, debenture holder and person entitled to receive notice of a general meeting. The remuneration report must include a directors remuneration policy, which is subject to a binding vote every 3 years, and an annual report on remuneration in the financial year being reported on, and how the current policy will be implemented in the next financial year.

If the shareholders fail to approve the report the possibility for a detrimental impact on market standing is clear. There has been an increase in recent years in the number of instances of shareholders voting down a remuneration report. In response the UK Corporate Governance Code has been revised to include a provision setting out the steps to be taken by a company when it faces significant opposition to its directors' remuneration report. When 20% or more of votes have been cast against the board recommendation for a resolution, the company should explain, when announcing results, what actions it intends to take to consult shareholders to understand the reasons behind the result. Related to this, the Investment Association (IA) has established and maintains a public register of all those companies which encounter a significant shareholder vote against a resolution, including their executive pay policy, together with a record of what the relevant companies have said they'll do in response.

The Large and Medium–Sized Companies and Groups (Accounts and Reports) Regulations 2008 (as amended in 2013) set out specific information regarding remuneration that Listed Companies must include in their annual report. The remuneration report must further detail the role and composition of the board's remuneration committee. The Regulations apply to all companies formed and registered under the UK Companies Acts, and whose shares are listed on the Official List, the New York Stock Exchange, NASDAQ and certain EU exchanges.

The annual remuneration report must disclose details of the remuneration package of each individual director, including total package and details of the individual elements, including salary and fees; pension entitlements; benefits in kind; annual bonuses and long–term incentive schemes, including share options. By disclosing the details of remuneration in respect of each individual director rather than an aggregation of the emoluments of all directors, the Regulations apply a high level of scrutiny.

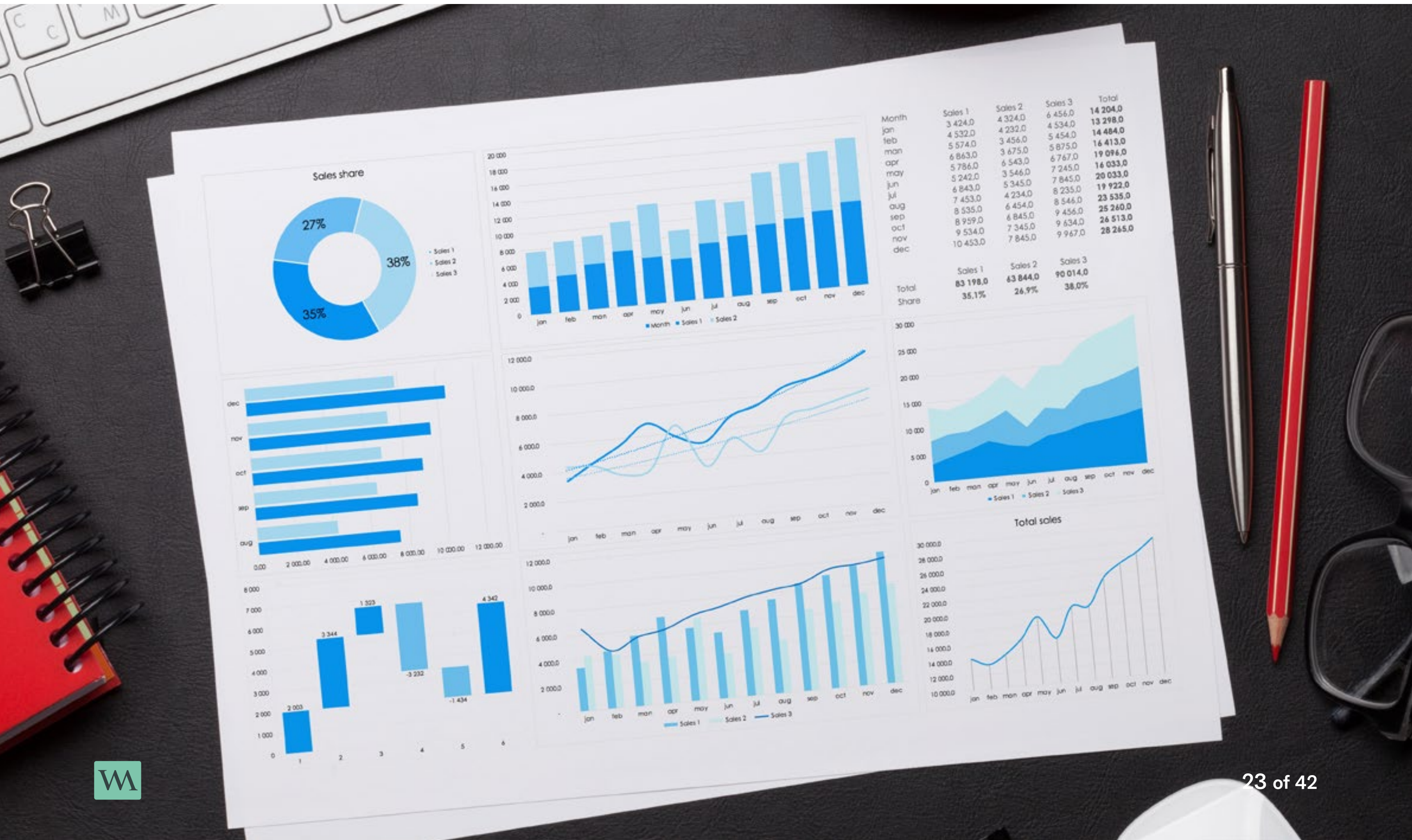
The annual remuneration report must also say how the directors intend to implement the approved directors' remuneration policy in the next financial year. That statement must include, if applicable, performance measures and targets.

The report must be made available on the company's website together with details of particulars of any remuneration payment made or to be made to any person ceasing to be a director and details of any payment made for loss of office made or to be made to a departing director.

The remuneration report must also include the ratio of CEO pay to the average pay of the company's UK workforce, plus a narrative explaining changes to the ratio from year to year and how the ratio relates to pay and conditions across the wider workforce.

The ratio is calculated by reference to UK employees only and will be based on the CEO's total annual remuneration (i.e. the "Single Figure" required to be set out in the directors' remuneration report). This CEO pay reporting requirement will sit alongside the existing requirement – in place since 2013 – for the directors' remuneration report of UK Listed Companies to have to disclose the annual increase in CEO pay over the previous year when compared to the annual increase in the average pay of the entire workforce.

The Companies (Miscellaneous Reporting) Regulations 2018 introduced a requirement that Listed Companies provide a clearer explanation in their remuneration policies of the range of potential outcomes from share–based incentive schemes that the company may have adopted as part of the remuneration package for senior executives.



Guides to the remuneration report

The QCA has published a Remuneration Committee Guide for Small and Mid-size Quoted Companies, aimed at assisting remuneration committees to develop a bespoke approach to remuneration, which supports the implementation of company strategy and effective risk management. The QCA Guide was last updated in December 2020.

There are also several institutional investor guidelines pertaining to directors' remuneration. The GC100 and Investor Group, for instance, published revised guidance on directors' remuneration reports in July 2019 and will do so again after the 2023 reporting season. The guidance includes the suggestion that companies may wish to consider viewing votes withheld (or in combination with votes against) of 20% or more as indicating a low level of support from investors that they'd wish to address, although this will depend on the company concerned. The IA Principles of Remuneration, last updated in November 2021, contain detailed provisions regarding remuneration and the role of the remuneration committee. The IA Principles focus in particular on the structuring of long–term incentive schemes and set out the principles that institutional shareholders expect companies to follow in their policies and practices on executive pay and long-term incentives.

Compensation payments

Compensation for loss of office is controlled by statute. Particulars of any proposed payment to a director (or a person connected to a director) by way of compensation for loss of office as a director or any other office or employment relating to managing the affairs of the company whilst director, or as consideration for or in connection with his retirement from office, must be disclosed to shareholders and the proposal must be approved by the company, subject to a minimum exception of £200.

Compensation is stated to include non-cash benefits. Any compensation payable by the company to a person who holds office as a director as damages for termination of their contract of service is not a payment for loss of office as a director. Thus, the statutory stipulation for the disclosure and approval of payments by way of compensation for loss of office wouldn't, for example, regulate a payment on termination of a managing director's service contract.

However, the UK Corporate Governance Code requires remuneration committees to consider what compensation commitments (including pension contributions) the directors' service contracts would entail in the event of early termination, stating, in particular, that the aim should be to avoid rewarding poor performance and to reduce notice periods to 1 year or less. Furthermore, the Listing Rules require Listed Companies to disclose to shareholders in the company's annual report any service contracts which provide for, or imply, notice periods more than 1 year (or any provisions for pre-determined compensation on termination which exceeds 1 year's salary and benefits) and an explanation of the reasons for the longer notice periods. Listed Companies must also disclose the unexpired term of any directors' service contract of a director proposed for election or re–election at the forthcoming AGM. Compensation payments must be in accordance with the company's approved remuneration policy, and there is also applicable investor guidance on the subject (in particular, from the IA).

Executive directors

Executive directors may, in addition to receiving salaries as employees, participate in staff pension, profit sharing and option schemes and enjoy privileges under the employment protection legislation. Copies of their service contracts (or written memoranda setting out their terms, if the contracts aren't in writing, and variations to the contract) must be kept by the company at the registered office and must be open to inspection by any shareholder during business hours. Members are entitled, upon request and payment of a fee, to be provided with a copy of any such contract (or memorandum) within 7 days. Copies of service contracts, memoranda of terms and variations must be retained and open for 1 year after expiry.

The only statutory restriction on directors' service agreements is the provision that any such agreement for a period of longer than 2 years requires prior shareholder approval by ordinary resolution. The provision cannot be avoided by a director of a holding company entering into a service contract with a subsidiary as the shareholders of the holding company must approve the term. Failure to obtain shareholder approval negates the relevant clause and a "reasonable" period of notice will be substituted.

For Listed Companies, there is, as stated above, increasing institutional shareholder pressure for notice periods in directors' contracts to be shortened and the UK Corporate Governance Code sets the objective that directors' service contracts should contain notice periods of 1 year or less. Further, the Corporate Governance Code provides that where it's necessary to offer longer notice periods to new directors recruited from outside, such periods should reduce after an initial period.

CHAPTER 5 SPECIFIC OFFENCES

INSIDER DEALING

Statutory restrictions on insider dealing have existed since 1980. Prior to 1980, the limited remedies in respect of the improper use of price sensitive information derived from the fiduciary duties imposed on directors. They are now to be found in the Criminal Justices Act 1993 (CJA). The aim of this statute is to prevent persons such as directors, who as a matter of course will have privileged access to inside information, abusing their position by dealing in their company's securities before the information becomes public knowledge. The philosophy of the legislation is to promote investor confidence in the integrity of the securities market. The offences are, therefore, generally confined to dealings on a recognised stock exchange. The relevant statutory provisions are outlined below.

The offences

It's a criminal offence, punishable by up to 7 years' imprisonment or a fine, or both, to:

- Deal in securities when in possession of inside information.
- Encourage another person to do so, when in possession of inside information.
- Disclose inside information otherwise than in the proper performance of one's employment, office or profession.

In all 3 cases, the offence can only be committed by an individual and the information must be held as an "insider".

"Inside information"

Inside information is specific information which relates to particular securities or to a particular issuer or issuers, which has not been made public and which, if it were made public, would have a significant effect on the price of any securities.

The CJA also provides that information shall be treated as relating to an issuer of securities if it's information which may affect that company's business prospects, even if the information doesn't actually relate to that company. For example, a director of a pharmaceutical company which had discovered a cure for the common cold would not be able to deal in the securities of any competitor companies whose shares would be affected by the news of the discovery. Similarly, a director of a company which has just won a large order at the expense of a rival company could not deal in the shares of that rival company before the news of the contract became public.

Obviously, in both of these examples the director would also be prohibited from dealing in the shares of the director's own company while the relevant news had not been made public.

Once information has been made public, it can no longer be inside information. Information can be made public by it being published in accordance with the rules of the FCA or the AIM Rules, such as through a RIS or RNS, or if it's contained in records open to public inspection, such as the records at Companies House or the Intellectual Property Office. Information is also made public if it's readily available to those likely to deal in the relevant securities or if it's derived from public information.

Held as an "insider"

It's necessary for the inside information to be held as an insider before an offence can be committed.

Information is held as an insider only if the individual in question knows it's inside information and it was acquired knowingly from an inside source. Information is obtained from an inside source if it's obtained because the individual in question was a director, shareholder or employee of a company – it doesn't have to be the company to which the information relates – or if the individual had access to it by virtue of their employment or profession.

All the directors and employees of a company who hold any unpublished sensitive information about the company (or, indeed about any other company if obtained in the course of their employment) will therefore hold that information as an insider.

Defences

The CJA contains a number of defences and, in each case, it's for a defendant to prove that the defence applies. In other words, once the prosecution has proved that the individual held inside information as an insider and dealt in securities, it's for a defendant to prove it was done in a non–culpable way.

They can do this by showing that they did not expect to make a profit or avoid a loss by the use of the information.

A further defence will be if an individual can show that they believed that the inside information was disclosed widely enough for none of those taking part in the transaction to be prejudiced. This defence aims to ensure that the legislation doesn't impinge on properly conducted corporate finance transactions such as underwriting offers of listed securities where the company and the underwriting bank are in contact with each other, and they both possess information that cannot yet be made public.

The third defence is that the individual would have done what they did even if they had not had the information.

MISLEADING STATEMENTS AND MISLEADING IMPRESSIONS

Section 89 of the Financial Services Act 2012 (FSA) creates a criminal offence relating to the making of a statement (such as in a prospectus) which the person making it knows to be false or misleading in a material respect or is reckless as to whether it's false or misleading, or the dishonest concealment of any material fact. A person commits an offence if the person makes the statement or conceals the facts with the intention of inducing, or is reckless as to whether they'll induce, another person to engage in, or refrain from engaging in, market activity in relation to a relevant agreement or relevant investment.

Section 90 of the FSA creates an additional offence of knowingly or recklessly creating a false impression for the purpose of (or with the knowledge that it's likely to lead to) personal gain, or the purpose of causing (or with the knowledge that it's likely to lead to) a loss to another person (or exposing that person to risk of loss).

There is a further offence under section 91 of the FSA of making misleading statements etc in relation to benchmarks.

A person guilty of an offence under sections 89, 90 or 91 is liable to imprisonment for up to 7 years or to a fine or both.

MARKET ABUSE

The civil offence of market abuse is regulated by the UK Market Abuse Regulation (which is the retained version of the EU Regulation 596/2014) (UK MAR). The market abuse regime applies to Listed Companies and AIM Companies. Market abuse encompasses unlawful behaviour in the financial markets and consists of insider dealing, unlawful disclosure of inside information and market manipulation.

The offence of market abuse can potentially be committed by anybody; company or individual, professional or lay person. Given the types of information commonly available to company directors, however, it is they who are potentially most at risk of falling foul of the UK MAR.

The market abuse regime prohibits the following types of behaviour:

- Dealing, or attempting to deal, on the basis of inside information.
- Disclosing inside information other than in the proper course of a person's employment, profession or duties.
- "Market manipulation", which comprises:
  - entering into a transaction, placing an order to trade or any other behaviour which:
  - gives or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument: or
  - secures, or is likely to secure, the price of 1 or several financial instruments at an abnormal or artificial level, unless the person entering into a transaction, placing an order to trade or engaging in any other behaviour establishes that such transaction, order or behaviour has been carried out for legitimate reasons and conform with accepted market practice;
  - entering into a transaction, placing an order to trade or any other activity or behaviour which affects or is likely to affect the price of 1 or several financial instruments, which employs a fictitious device or any other forms of deception or contrivance;
  - disseminating information through the media, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of a financial instrument or secures, or is likely to secure, the price of 1 or several financial instruments at an abnormal or artificial level, including the dissemination of rumours, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading; or
  - transmitting false or misleading information or providing false or misleading inputs in relation to a benchmark where the person who made the transmission or provided the input knew, or ought to have known, that it was false or misleading, or any other behaviour which manipulates the calculation of a benchmark.

Market abuse also includes recommending or inducing another to undertake these types of behaviour.

Market abuse is not a criminal offence and therefore is not punishable with imprisonment. However, the FCA may impose financial penalties, publicly censure a person and make an order to compensate or disgorge profits to affected persons. Injunctions to prevent market abuse (and to freeze assets) may also be available. If the abusive behaviour falls within the scope of the insider dealing provisions of the Criminal Justices Act 1993, it will be a criminal offence and will be punishable with imprisonment. A change to the legislation in June 2023, means that the scope of the insider dealing provisions within the CJA has been widened and is now more aligned with UK MAR.

FRAUD

The Fraud Act 2006 contains an offence of fraud, punishable by up to 10 years' imprisonment, which can be committed in 3 ways. The common link is the requirement to prove dishonesty and that the defendant intended to make either a gain or cause a loss or the risk of loss. The 3 types of offence are:

- **False representation —** this covers any representation made knowingly or with awareness that it may be false or misleading.
- **Failure to disclose —** this applies where there is a legal duty to disclose.
- **Abuse of position —** this is committed if a person who occupies a position in which they're expected to safeguard or not act against the financial interest of another person abuses that position with the necessary dishonesty and intent.

BRIBERY

The Bribery Act 2010:

- Sets out the specific offences of bribing another person, being bribed and bribery of a foreign public official.
- Includes a strict liability corporate offence of failing to prevent bribery. A company will only have a defence to this offence if it can show it had "adequate procedures" in place to prevent bribery.

For the first 2 types of offence described above (bribing another person and being bribed), either the person offering the bribe or the recipient of the bribe must have a "close connection" with the UK — so a British citizen or corporation or even an individual ordinarily resident in the UK would be caught — or the act or omission forming part of the offence must have taken place in the UK. The global reach of the Bribery Act is even greater in respect of the corporate offence referred to, which catches not just companies incorporated in the UK but also those with business interests in the UK.

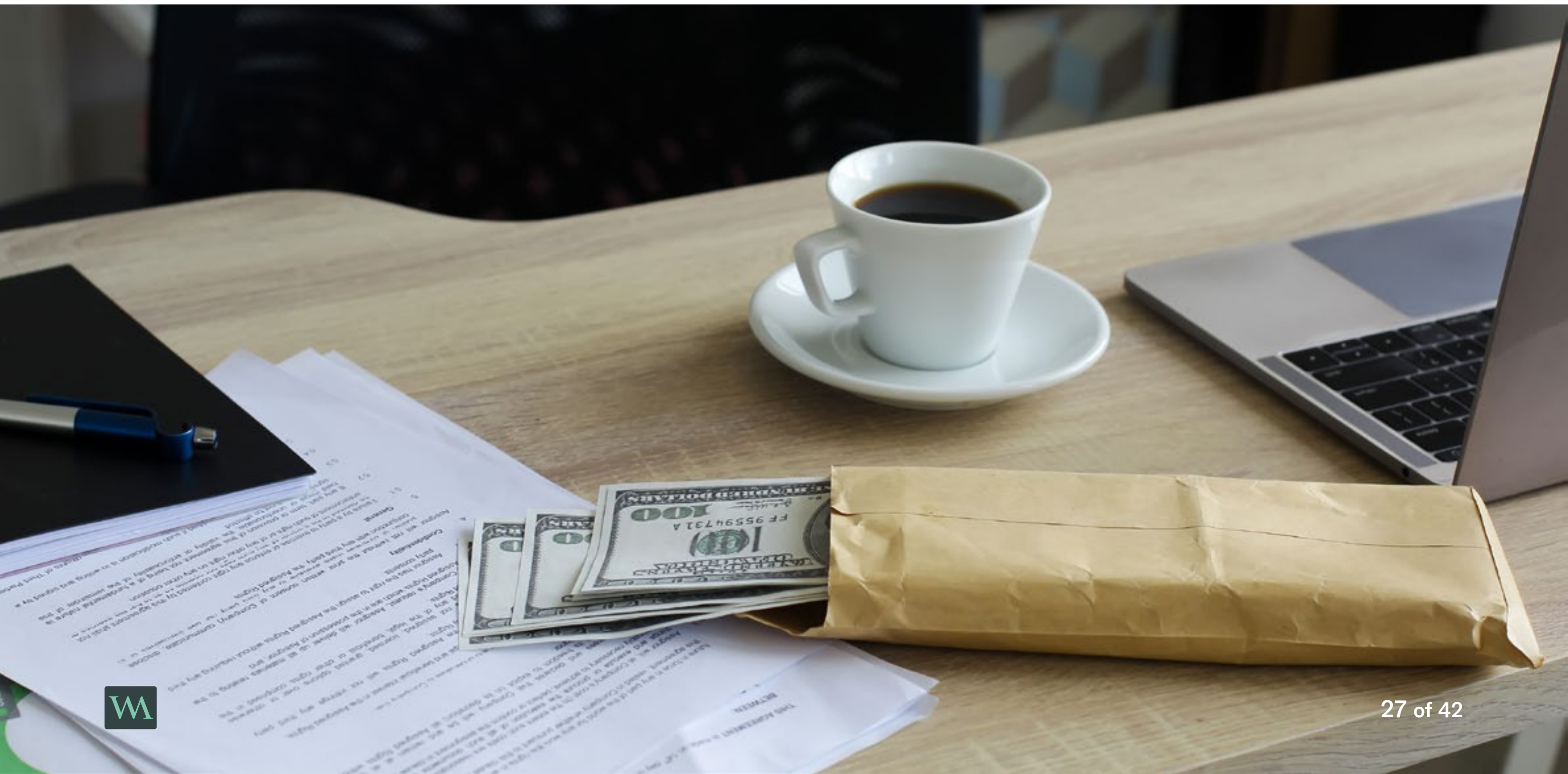
The offence of bribing a foreign public official is committed if a person offers, promises or gives a financial or other advantage to a foreign public official with the intention to influence the official in his capacity as a foreign public official. The person making the payment must intend to obtain or retain business or a business advantage. There is no need for the payment to be improper. Therefore, particular care should be taken when dealing with foreign public officials including employees of state–owned entities to ensure that all payments made are required by law and hospitality given is modest and recorded in a transparent fashion.

For example, in October 2023 2 former mining company executives and their alleged fixer entered not guilty pleas to criminal charges in a London magistrates court over allegations that they paid bribes to win contracts for their British mining business in Sierra Leone. The Serious Fraud Office has accused the 3 of bribing government officials in Sierra Leone in return for preferential treatment of the company's iron ore mining operations in the West African country. The trial is expected to be held in January 2025.

The offences contained in the Bribery Act carry severe criminal penalties for individuals and organisations. Individuals can be jailed for up to 10 years and/or receive a fine and companies can receive unlimited fines.

Where the company has been prosecuted for any of the first 3 offences — bribing, receiving a bribe, bribing a foreign public official — the company's senior officers may also be prosecuted where they have consented to or connived at (e.g. by turning a "blind eye") to the offence.

Directors should ask as a matter of course what their overseas (and home-based) agents and employees are doing when they seek to obtain or retain business.



COLLECTIVE REDUNDANCY

The Government has been prepared to institute prosecutions against individual directors for breach of the collective redundancy consultation requirements contained in the Trade Union and Labour Relations (Consolidation) Act 1992. This was illustrated in the high-profile cases of 3 former directors of CityLink and the chief executive of Sports Direct (in relation to the demise of USC) who were prosecuted for failing to notify the Secretary of State of the proposed redundancies using the 'HR1' procedure. The timing of the HR1 form is crucial – it must be sent before the dismissals take effect and in line with the minimum statutory consultation period.

Failure to notify the Secretary of State is an offence punishable by an unlimited fine. A prosecution against a director will only be brought if the offence is "committed with the consent or connivance of, or to be attributable to the neglect of" any director, manager, secretary or "other similar officer" of the employer.

EXPORT CONTROLS AND INTERNATIONAL SANCTIONS

The UK's export control legislation applies to military goods and so-called "dual use" items. Breach of the legislation may result in prosecution. So too may breach of international sanctions regimes and there may well be extradition to the United States to face charges there, as happened in the case of Christopher Tappin, who was eventually sentenced to 33 months' imprisonment for selling weapons' parts to Iran. This legislation may sound a long way removed from the normal business life of most companies but the nature of the "dual use" regime and the ever-changing nature of sanctions regimes, as illustrated following the Russian invasion of Ukraine, means that it shouldn't be ignored.

TAXATION

Section 121C of the Social Security Act 1992 empowers HMRC to issue "Personal Liability Notices" (PLNs) against directors in respect of unpaid PAYE and National Insurance Contributions (NICs). HMRC must be satisfied that the non-payment of PAYE/NICs is the result of fraud or neglect on the part of the director concerned. The PLN can cover the whole of the company's unpaid debt, penalties, and interest. In a 2014 case, a Tribunal upheld a PLN issued against a director for around £40,000 ruling that it was immaterial to a finding of "neglect" that the director might have withheld the deductions in question upon professional advice. HMRC has been starting to use its power to issue PLNs more widely particularly in insolvency wrongful trading cases.

Subject to the above, and the recent development described below, directors are generally not personally liable in respect of the tax liabilities of the company. However, HMRC has the power to transfer unpaid PAYE debts of the company to a particular director or to seek recovery from them in relation to any payments they received knowing that the company had "wilfully failed to deduct tax". This power is most likely to be used in the case of smaller owner-managed companies where the director controls the company's finances.

The Finance Act 2020 which came into effect on 22 July 2020 introduces provisions which make directors personally liable for the tax of a company (or in the case of an LLP, its members) in certain circumstances, namely (i) tax evasion; (ii) tax avoidance; and (iii) repeated insolvency and non-payment. Such a liability arises upon an authorised officer of HMRC issuing a notice to the director under the Finance Act 2020, known as a joint liability notice (JLN). The officer can give a JLN to an individual if it appears to the officer that certain conditions set out in the act are met.

FAILURE TO PREVENT THE FACILITATION OF TAX EVASION

The Criminal Finances Act 2017 (CFA) created a corporate offence of failing to prevent the facilitation of UK and foreign tax evasion.

The corporate offence of failure to prevent criminal facilitation of tax evasion applies to companies, partnerships, and LLPs. It doesn't apply to individuals.

An offence will be committed if:

- There is criminal tax evasion under either UK law or foreign law.
- It is enabled by the business' employee, agent or those performing services to the business.
- The business fails to prevent that person from enabling the crime.

If convicted a business will face an unlimited fine.

Similar to the existing failure to prevent offence under the Bribery Act 2010, it will be a defence for the company or organisation to prove that when the offence was committed they had in place prevention procedures. Prevention procedures are those designed to prevent persons associated with the company from committing tax evasion facilitation offences.

FAILURE TO PREVENT FRAUD

The Economic Crime and Corporate Transparency Act 2023 created a corporate offence of failing to prevent fraud. Under the new offence, a company will be liable where a specified fraud offence is committed by an employee or agent, for the company's benefit, and the company didn't have reasonable fraud prevention procedures in place. It doesn't need to be demonstrated that company directors ordered or knew about the fraud.

Importantly, the offence has a defence of "reasonable procedures" to prevent fraud. This means it effectively requires companies to review and enhance their anti-fraud systems and controls to cover fraud committed for their benefit by employees, subsidiaries, or third-party agents.

CHAPTER 6 CONTINUING OBLIGATIONS

REPORTING OBLIGATIONS

Directors' report

All companies (save for those entitled to prepare annual accounts in accordance with the small companies regime) must prepare a directors' report accompanying the accounts. The detailed requirements of what must be included in the report depend on the company's size and whether or not it's Listed, but all reports must state the amount (if any) that the directors recommend should be paid as a dividend. For Listed Companies, information required to be included by the UK Corporate Governance Code is usually included in this report (and the directors' remuneration report — see 'Remuneration').

Unless the company is exempt from audit and the directors take advantage of that exemption, the directors' report must contain a statement that, in the case of each director:

- So far as the director is aware, there is no information, which would be needed by the company's auditors in connection with preparing their audit report, of which the auditors aren't aware.
- The director has taken all the steps that they ought to have taken as a director to make themself aware of any such information and to establish that the auditors are aware of it.

A director will be regarded as having taken all the steps that they ought to have taken as a director if they have made such enquiries of their fellow directors and of the auditors, and taken such other steps, as required by their duty as a director to exercise reasonable care, skill and diligence.

Strategic report

The strategic report must contain a fair review of the company's business, and a description of the principal risks and uncertainties facing the company. The review must be a balanced and comprehensive analysis of both the development and performance of the company's business during the financial year, and the position of the company's business at the end of that year, consistent with the size and complexity of the business.

Since 1 January 2019, all large companies (including large subsidiary companies) have also had to include a separate statement in their strategic report that explains how its directors have had regard to wider stakeholder needs when performing their duty under s172 of the Companies Act 2006. Boards must demonstrate how, whilst acting in the way most likely to promote the success of the company for the benefit of members, the directors have had regard to the likely consequences of any decision in the long term; the interests of the company's employees; relationships with suppliers, customers and others; the impact of the company's operations on the community and the environment; the company's reputation; and the requirement to act fairly between members of the company. In particular, they have to report on how they have engaged with employees, which is a key focus of both the UK Corporate Governance Code 2018 and the Wates Corporate Governance Principles for Large Private Companies 2018. A board should also be able to demonstrate how a company has undertaken effective engagement with material stakeholders.

Enhanced reporting requirements apply in the case of Listed Companies. For these companies, the report must include:

- The main trends and factors likely to affect the future development, performance, and position of the company's business.
- Information about environmental matters (including the impact of the company's business on the environment); the company's employees; and social, community and human rights, and including information about any policies of the company in relation to those matters and the effectiveness of those policies.

If the report doesn't contain information on environmental matters, the company's employees and social, community and human rights issues, it must state which of those kinds of information it doesn't contain, a description of the company's strategy, its business model and a breakdown showing at the end of the financial year, the number of persons of each sex who were directors, senior managers, and employees. (For a group strategic report, the number of persons of each sex who were directors of the parent company must be disclosed and in relation to the disclosure of the number of persons of each sex who were senior managers of the company, there must be included the number of persons of each sex who were directors of the undertakings included in the consolidation).

Liability for reports

A director is liable to compensate the company for any loss it suffers as a result of any untrue or misleading statement in, or omission from the directors' report, including the strategic report, or the directors' remuneration report only if the director knew or was reckless as to whether the statement was untrue or misleading or knew the omission to be a dishonest concealment of a material fact.

The director's liability is limited to the company only (and not to shareholders or third parties), although a director may still incur liability for market abuse or criminal liability under sections 89 or 90 of the Financial Services Act 2012 (see 'Specific Offences').

In addition, under section 90A of the FSMA, a Listed or AIM Company will be liable to compensate any person who acquires, continues to hold or disposes of shares in reliance on information published by the company via a RIS where that loss arises as a result of any untrue or misleading statement in that published information, or the omission from that published information of any matter required to be included in it. The company will be liable if a person discharging managerial responsibilities for the publication knew that the statement was wrong or misleading, was reckless as to whether it was, or knew any omission was a dishonest concealment of fact. Directors may be liable to the company in respect of the loss suffered by the company (but not to the investors).

The company may also incur liability under section 90A where it acts dishonestly in delaying the publication of information and a person acquires, continues to hold or disposes of securities as a result of the delay in publishing the information. To succeed in their claim the investor will need to demonstrate that they actively relied on the statement in making their investment decision. Section 90A applies to all information published via a RIS, not simply financial reports. It applies to AIM Companies as well as Listed Companies.

DISCLOSURE OF INSIDE INFORMATION

"Inside information" for the purposes of the UK MAR is information that's of a precise nature which has not been made public, that relates directly or indirectly to the issuer or to its financial instruments and would, if it were made public, be likely to have a significant effect on the price of the company's financial instruments or related derivative financial instruments.

Information is precise if it indicates circumstances that exist or may reasonably be expected to come into existence or an event that's occurred or may reasonably be expected to occur and is specific enough to enable a conclusion to be drawn as to the possible effect of those circumstances or that event on the price of the company's financial instruments or related derivative financial instruments.

In deciding this a company must ask whether the information is "of a kind which a reasonable investor would use as part of the basis for his investment decisions".

The UK MAR requires a company to notify an RIS as soon as possible of any "inside information" which directly concerns it. A company can delay the public disclosure of inside information so as not to prejudice its "legitimate interests" but this is at the company's own risk and any such delay mustn't be likely to "mislead the public" and the company must be able to ensure the confidentiality of that information.

Listed Companies must make a detailed record of any decision to delay the disclosure of inside information and the FCA can demand a full explanation of the reasons for the delay. Whilst AIM Companies aren't obliged to keep a written record of any decision to delay, it's recommended that they do so that any decision can be justified to the FCA.

If there is a delayed disclosure the company must prepare a holding announcement in case there is a breach of confidentiality. Selective disclosure will only be allowed where a delay is allowed, and only if the person receiving the information owes the company a duty of confidentiality and the company can ensure that the information is kept confidential. If rumours are circulating about a company that are "largely accurate", if the information underlying the rumour is inside information, it's likely that the company can no longer delay disclosure.

The UK MAR also contains strict regulations regarding the conduct of "market soundings". A market sounding comprises the communications of information by or on behalf of the company, before the announcement of a transaction, to 1 or more potential investors in order to gauge their interest in a possible transaction and the conditions relating to it, such as potential size or pricing. The rules are detailed and directors must ensure they're familiar with them before conducting a market sounding.

INSIDER LISTS

The UK MAR requires Listed Companies and AIM Companies to compile and regularly update "insider lists". This a list of all persons who have access to inside information and who are working for the Company under a contract of employment, or otherwise performing tasks through which they have access to inside information (such as advisers, accountants, or credit rating agencies). The insider list must be in the prescribed form and kept updated.

In addition, any advisers or agents of the Company or other persons performing tasks through which they have access to inside information must keep their own lists of all individuals working for them with access to inside information about the Company. Such third parties are obliged to provide such lists to the Company as soon as possible on request and take the necessary measures to ensure everyone on the insider list acknowledges the legal and regulatory duties entailed and is aware of the sanctions attaching to misuse or improper circulation of inside information about the Company.

All insider lists must be kept for not less than 5 years from when drawn up or last updated (whichever is the later).

DISCLOSURE OF DEALINGS BY PERSON DISCHARGING MANAGERIAL RESPONSIBILITY

As well as directors, persons "discharging managerial responsibilities" (and the persons closely associated with them) must notify the company and the FCA within

3 working days of all transactions conducted on their account in the shares (or financial instruments relating to shares) of the company. The company must also notify an RIS of this information within 2 working days of being notified of the dealing. A person discharging managerial responsibilities is a senior executive with access to the information and with power to make managerial decisions affecting the future development and business prospects of the company.

The UK MAR also restricts the circumstances in which directors and persons discharging managerial responsibilities can deal in the company's financial instruments. There are 2 mandatory "closed" periods during which dealing is prohibited (subject to limited exceptions). These are:

- A period of 30 calendar days before the announcement of the company's interim financial report or year-end report.
- Where the company announces preliminary results ahead of the final year-end results and such preliminary results contain all inside information expected to be included in the year-end report, 30 calendar days before the announcement of the company's preliminary results.

AIM Companies must, and in practice Listed Companies also will, adopt a code of dealings regulating the circumstances in which directors and persons discharging managerial responsibilities can deal in the company's financial instruments. This may be more restrictive than under the UK MAR, to reduce the risk of insider dealing.

It will be apparent from the above that compliance with the requirements of the UK MAR regarding the control of inside information is an onerous burden. All Listed and AIM Companies need to create an inside information policy and related templates, e.g. an insider list template and a template for recording the conduct of market soundings. In practice, consider delegating responsibility for the control of inside information to a disclosure committee.

CONTINUING OBLIGATIONS UNDER THE AIM RULES

An AIM Company must notify an RIS without delay of any new developments that aren't public knowledge concerning a change in its financial condition, its sphere of activity or the performance of its business or its expectations, which if made public, would lead to a substantial movement in the share price. This obligation runs in parallel to the disclosure obligation under the UK MAR.

WEBSITES

There is an obligation to maintain a website which makes available a breadth of information concerning the company, including details of board members and their responsibilities; the company's constitutional documents; and details of major shareholdings. The company must also maintain on its website details of inside information for 5 years from the date of its disclosure. There are rules regarding the preservation of such information on the website with which all Listed and AIM Companies must comply.

OTHER REPORTING REQUIREMENTS

Modern Slavery

The Modern Slavery Act 2015 obliges UK companies and overseas companies carrying on business in the UK and which have a turnover of £36 million to publish an annual statement on their website documenting the steps they have taken to combat slavery and trafficking in their supply chain. Slavery for these purposes includes forced labour.

Failure to issue an annual statement may be enforced by an injunction but the greater cost for non-compliance is likely to be the reputational damage that may flow from a perceived unwillingness to embrace minimum ethical standards. Unlike with the Bribery Act, there is no personal liability that may be incurred by directors that fail to comply with the Act's requirements.

Amendments have been proposed to the Modern Slavery Act 2015 via a Modern Slavery Bill which proposes to mandate the contents of modern slavery and human trafficking statements, require them to be published on a public register and also include civil penalties for non-compliance.

Strategic report

Companies with over 250 employees must publish a gender pay report on their website, giving details of their "gender pay gap". The gender pay gap is the difference between the average earnings of men and women, expressed relative to men's earnings. Companies which qualify by size, will need to publish on their website the following information:

- Mean gender pay gap in hourly pay.
- Median gender pay gap in hourly pay.
- Mean bonus gender pay gap.
- Median bonus gender pay gap.
- Proportion of males and females receiving a bonus payment.
- Proportion of males and females in each pay quartile.

Payment practices

The Small Business, Enterprise and Employment Act 2015 obliges large companies to publish a report on payment practices, policies and performance. A "large" company for these purposes is one that satisfies 2 of the following criteria:

- An annual turnover over £36 million.
- A balance sheet total over £18 million.
- On average, more than 250 employees.

Information will need to be published which includes the average number of days taken to make payments, the percentage of payments which weren't paid within the agreed payment terms and the standard contractual length of time for payment of invoices.

CHAPTER 7 SPECIFIC CIRCUMSTANCES

ISSUE OF A PROSPECTUS/ADMISSION DOCUMENT

If securities are to be admitted to the Official List then:

- Application must be made to the FCA for the securities to be admitted to the Official List.
- Application must be made to the London Stock Exchange for the securities to be admitted to trading on its main market.

In relation to admission to the Official List, the relevant procedure is detailed in the Listing Rules, as enforced by the FCA under the authority of the FSMA.

At the heart of the required documentation is the prospectus. The FCA derives its authority to insist upon the issue and publication of a prospectus from section 85(1) of the FSMA. In short, no "new" securities may be admitted to the Official List unless a prospectus has been submitted to, and approved by, the FCA and published. "New" securities are defined as being those which are to be offered to the public in the UK for the first time.

A prospectus must contain certain kinds of information (prescribed by the Prospectus Regulation Rules) and, in addition to its approval by the FCA, must carry the responsibility statement referred to below. At the time of writing, the rules surrounding the publication of a prospectus are undergoing change and so care should be taken in this area. In addition, the FCA has a general power to make different provisions in different cases and to dispense with or modify the application of the Prospectus Regulation Rules and UK Listing Rules in particular cases or by reference to specific circumstances.

Companies seeking admission to AIM must produce an admission document. In order to ensure consistency with other EU markets, the London Stock Exchange based its rules on those applicable to a prospectus. However, in order to preserve AIM's lighter touch regulatory regime, not all of the requirements of the prospectus regime were adopted. Unless admission also involves an offer of shares to the public, in which case a full Prospectus Regulation Rules compliant prospectus will be required, the admission document must include most, though not all, of the information required to be set out in a prospectus. Importantly, an admission document doesn't require the approval of the FCA prior to its publication.

A prospectus is also required where transferable securities are offered to the public in the UK. "Offer to the public" is defined widely. Companies may need to issue a prospectus, therefore, even if the shares aren't to be admitted to trading on a regulated market (as, for example, with AIM Companies), provided there is an "offer to the public". There are a number of exceptions to the general requirement that an offer of shares to the public must be accompanied by a prospectus.

Contents of a prospectus

Prospectus Regulation Rule 2 duly sets out the specific information required to be included in a prospectus. It requires a prospectus to contain detailed financial, legal and other information to which it's thought potential subscribers ought to have access, including descriptions of the issuer's, or the group's business, finances, management, recent development and prospects.

In drafting the prospectus it's not sufficient merely to have regard to the contents requirements of the Prospectus Regulation Rules. Under section 80 of the FSMA, there is an overriding requirement that any prospectus must contain all information that investors and their professional advisers would reasonably require, and reasonably expect to find there, for the purpose of making an "informed assessment" of the assets and liabilities, financial position, profits and losses and prospects of the issuer, and the rights attaching to the securities being issued. If, after the publication of any prospectus and before listing becomes effective, any significant change to the information in the prospectus occurs, details must be disclosed by way of a supplementary prospectus.

This general duty of disclosure extends only to information which is within the knowledge of those responsible for the prospectus, or which it would be reasonable for them to obtain by making enquiries. Those persons responsible for the contents of the prospectus are not confined to the company itself as the issuer of securities. The legislation further confers a responsibility on the directors, as at the time the prospectus is submitted to the FCA, and also on each person who has authorised himself or herself to be named, and is named, in the prospectus as a director or as having agreed to become a director either immediately or in the future. Prospectus Regulation Rule 5.5 and Appendix 3 to the Prospectus Regulation Rules require the directors to make a responsibility statement, confirming that the information contained in the prospectus is correct to the best of their knowledge and belief. The issue of legal liability for any errors and omissions in the prospectus is discussed below.

The FCA is empowered to authorise the omission from a prospectus of information on certain grounds, for example that its disclosure would be seriously detrimental to the issuer of the securities and such omission is not likely to mislead investors (an appropriate case would be trade secrets).

In addition, the FCA has a general power to make different provisions in different cases and to dispense with or modify the application of the Prospectus Regulation Rules and Listing Rules in particular cases or by reference to specific circumstances.

Schedule 2 of the AIM Rules for Companies specifies what a company must disclose in its admission document. The London Stock Exchange has power to authorise the omission from an admission document of information on certain grounds, for example that its disclosure would be seriously detrimental to the company and wouldn't mislead investors.

Approval of a prospectus
The Prospectus Regulation Rules prohibit the publication of certain advertisements or other similar information in circumstances where a prospectus is to be published unless either, its contents have been submitted to and approved by the FCA, or the FCA has authorised the issue of the advertisement or information without such approval.

Before a prospectus can be published, it must be submitted to and obtain the approval of the FCA. The FCA will only grant formal approval of the prospectus once it's satisfied that all required documents accord with the Prospectus Regulation Rules, and any previously suggested amendments have been made.
Applicants to AIM need not submit their admission document to the London Stock Exchange for approval.

The responsibility statement
As previously mentioned, under Prospectus Regulation Rule 5.5 and Appendix 3 to the Prospectus Regulation Rules, the directors and the company's advisers must be identified in the prospectus.

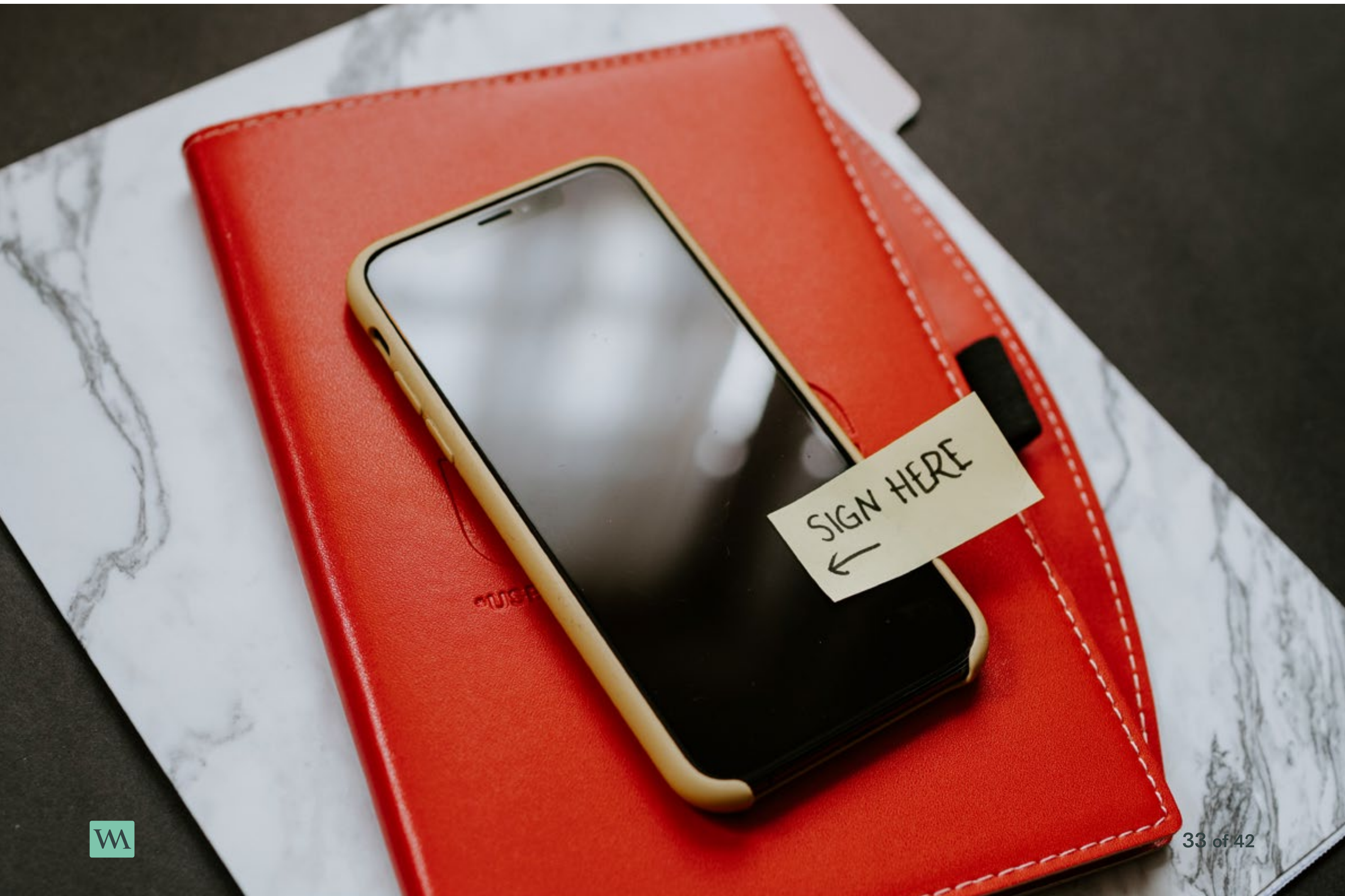
The directors will be required to make a responsibility statement as follows:

> *"The directors of the company… accept responsibility for the information contained in this document. To the best of the knowledge and belief of the directors (who have taken all reasonable care to ensure that such is the case) the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information".*

This express acknowledgement of the directors' personal responsibility for the accuracy of the prospectus has legal consequences, not only under the FSMA, but also as a matter of general law.

The AIM Rules for Companies require that an admission document includes a declaration by the directors that, to the best of their knowledge, the information contained in the admission document is in accordance with the facts and that the admission document makes no omission likely to affect the import of such information.

The company, as a person responsible for the prospectus or admission document, will also need to complete a responsibility statement.



Civil liability

Section 90 of the FSMA provides that anyone responsible for a prospectus is liable to compensate any person who acquires any of the securities and suffers loss in respect of it "as a result of any untrue or misleading statement in the [prospectus] or the omission from [it] of any matter required to be included" under the general disclosure obligation.

Certain defences are, however, available to a responsible person facing a claim for compensation, as specified in schedule 10 to the FSMA.

A "responsible person" will escape liability if they can show that the aggrieved investor acquired the securities in the knowledge that the prospectus was false or misleading or omitted the relevant matter. Additionally, a defence can be established where the "responsible person" reasonably believed that the statement in question was true and not misleading or that the matter the omission of which caused the loss was properly omitted. A further ground of defence arises where a statement in the prospectus is made by or on the authority of an "expert" and the responsible person believed (on reasonable grounds) that the expert was competent and had consented to the inclusion of the statement. Similarly, they wouldn't incur the statutory liability in respect of a statement made by an official person or contained in a public official document, provided the statement was accurately and fairly reproduced in the prospectus. A final defence is available where the responsible person protects themself by taking all reasonable steps to correct any untrue or misleading statement or a relevant omission.

The availability of remedies for breach of statutory duty imposed by the FSMA would, of course, be in addition to any other remedies available at law, for example for breach of contract or negligence.

An action for breach of contract will be available only to the parties to the contract; the original investor and the issuing company or (where an issuing house sells as principal) the issuing house or sponsor. Liability for negligent misstatement may rest not only with the directors but also with a wider category of persons on whom members of the investing public may reasonably rely in subscribing or purchasing securities.
By explicitly accepting responsibility for the accuracy of a prospectus, directors are obviously amongst those most likely to be found liable if it can be shown that they have failed to exercise proper care in ensuring the accuracy of a prospectus.

If a company is seeking to have its shares traded on AIM, then it will be subject to similar requirements for a company issuing a prospectus although there are some differences.

TAKEOVERS

Meanings of takeover and merger

A true merger, in the sense of fusing 2 separate entities to form a third, is very uncommon under English law. The term "merger" is however often used to describe the acquisition by 1 company of all the assets of another or a "friendly" takeover where the board of the acquired company has recommended the takeover to its shareholders. A takeover is normally understood to be the acquisition by 1 public company of all or a majority of the shares in another, while the term acquisition is normally used where the acquired company is a private company or a subsidiary of a public company. None of these expressions is, however, a term of art.

Schemes of arrangement

A scheme of arrangement given effect by the court pursuant to the Companies Act 2006 may be used to implement any of the transactions referred to above. Such schemes require a lengthy period of time to bring to fruition and require the consent of all parties concerned. In the case of shareholders of the company which is proposing the scheme, their consent is obtained at a special meeting convened by the court at which a majority in number holding 75% in nominal value of all the shares voted at the meeting concerned must approve the scheme.

During the Covid-19 pandemic when meetings were impossible, the courts were asked whether a virtual scheme meeting would satisfy the requirement that a special meeting of shareholders be convened to approve the scheme. The key issue was whether the Companies Act 2006 requirement for a 'meeting' of shareholders necessitated that all shareholders be able to attend a physical meeting in the same place. The court concluded that it was possible for a meeting to be held by telephonic means accompanied by a webinar. What was important was that there was a 'coming together' with the ability to consult. This could be achieved by telephone where participants could hear and ask questions in circumstances in which everybody else present was able to hear and ask questions.

Subject to shareholder approval and the court's sanctioning the scheme it will become binding on all shareholders. The need for a 75% majority contrasts with the position in relation to takeover offers where success is usually ensured by a stake of 50%, the offer or having the right to buy out minority shareholders once acceptances have reached a level of 90% of the shares to which the offer relates.

However, the dual test that a scheme must be approved both by a majority in number of the shareholders voting in person or by proxy at the court meeting and by shareholders holding 75% of the nominal value of the shares voted at the meeting is that, in contrast to an offer where positive action is required by shareholders to accept the offer (by returning a form of acceptance), a scheme can benefit from shareholder apathy in that only the views of those persons who attend the meetings or send in a proxy form are taken into account. However, on the other hand, where there is a group of minority shareholders opposed to the scheme they can, if they represent half or more of the persons attending the court meeting, block the scheme even if they hold a minimal number of shares between them.

The City Code

Takeovers are regulated by the City Code, which was created in the 1960s and is administered by the Panel. The City Code applies to all takeovers of public companies (not just Listed and AIM Companies) and certain takeovers of private companies within the United Kingdom.

Status of the City Code

The City Code has statutory effect, and the Panel can enforce its decisions through the UK courts, and can also involve the UK's main financial regulator, the FCA in enforcement actions. The City Code concerns every director of a company involved in a takeover, whether as acquirer or target and responsibility cannot be wholly delegated by them to other directors or professional advisers.

Structure of the City Code

The City Code is made up of 6 general principles and 38 specific rules. The 6 general principles can be further reduced into 4 cardinal principles which, whilst they do not cover every issue dealt with by the City Code, encapsulate its essence:

- Similarity of treatment and opportunity (for example, special deals shouldn't be made with particular shareholders).
- Adequacy of information and advice.
- Prohibition on frustrating action.
- Maintenance of an orderly market.

Obligations prior to announcement

It is imperative, not only for commercial reasons, to maintain absolute secrecy before a takeover is announced. Rule 2 of the City Code requires all persons privy to confidential information concerning an offer or contemplated offer to treat that information as secret and only to pass it to another person if it's necessary to do so and in circumstances where the person is made aware of the need for secrecy and security.

The City Code also contains a prohibition on dealing in certain securities prior to the announcement, which operates in addition to that contained in the CJA and MAR. Under the rules contained in the City Code, no dealings of any kind in the target company's securities can be made by anyone (other than the acquirer) who's privy to price sensitive information concerning an offer or contemplated offer.

The offer document

The offer document is required by the City Code to be prepared to the same standards of accuracy as a prospectus. Directors are required to accept personal responsibility for the accuracy of any document issued to shareholders in connection with an offer, which must include a statement that the directors of the acquirer or target, as the case may be, are the persons responsible for the information contained in the document and that

> *"to the best of their knowledge and belief (having taken all reasonable care to ensure that such is the case), the information contained in the document is in accordance with the facts and does not omit anything likely to affect the import of the information".*

If any director is to be excluded from such a statement, the Panel's consent is required. Where the responsibility for the preparation of a document is delegated the directors or the remaining directors must reasonably believe that the person to whom preparation is delegated is competent. This responsibility is in addition to the responsibility imposed by the Prospectus Regulation Rules, the AIM Rules and the FSMA in respect of any prospectus for shares being issued for the purposes of the offer.

The City Code contains detailed requirements for the contents of offer documents, and particular importance is attached to any profit forecast made during an offer. Generally, any form of words which puts a floor under or a ceiling on the likely profits for a particular period or contains the necessary data to calculate an approximate figure for future profits will be treated as a profit forecast; where there is any doubt in this area, the Panel should be consulted. Profit forecasts, if used at all, have to be compiled with scrupulous care by the directors whose responsibility they are, and must be reported on by advisers. The assumptions on which any profit forecast is based must be stated.

Advertisements

Advertising in connection with a potential offer is prohibited unless it falls within 1 of the specified exempt categories, such as product or corporate image advertisements, information which is not controversial, such as reminders of closing times, and advertisements of preliminary or interim results. In all other categories, the wording will have to be cleared with the Panel in advance. Normally the responsibility statement will have to be included.

Statements during a bid

An overriding consideration is that any statement of any sort which is made in the course of a takeover must not be misleading. In particular, no statement should be made which implies that an offer may be improved without actually committing the acquirer to do so.

Extreme care must be taken by directors in talking to the press and radio and TV interviews shouldn't be given, or at any rate shouldn't contain any new information. There are similar restrictions on telephone campaigns.

The conduct of the target

The City Code regulates the behaviour of the target as well as the acquirer during the offer period.

One of the City Code provisions states that at no time after a bona fide offer has been communicated to the board of the target, or after the board of the target has reason to believe that a bona fide offer might be imminent, may any action be taken by the board in relation to the affairs of the company which could effectively result in the offer being frustrated (e.g. by means of the issue of shares, grant of options, selling of assets or making of unusual contracts) or in the shareholders being denied an opportunity to decide on its merits, without the approval of the shareholders in general meeting.

The target is obliged to register transfers promptly to ensure that all current shareholders can exercise their voting rights. Any information given to a preferred acquirer must, on request, also be made available to any other less welcome bona fide acquirer or potential acquirer. A company should always be prepared for a bid and the grounds upon which any bid would be defended should be decided in advance.

Dealings in shares during a bid

Complicated rules govern the extent to which parties to a takeover (including those connected with the principals) may deal in the shares of either company. No such dealings should be undertaken during the period when an offer is in contemplation or during the offer period except on the basis of expert advice. In addition, most dealings during an offer period will have to be announced on a daily basis.

The duties of directors generally during a bid

A director should always remember that, whilst their advice on the merits or otherwise of an offer will be directed towards a company's existing shareholders, it's their statutory duty to promote the success of the company for the benefit of the members as a whole.

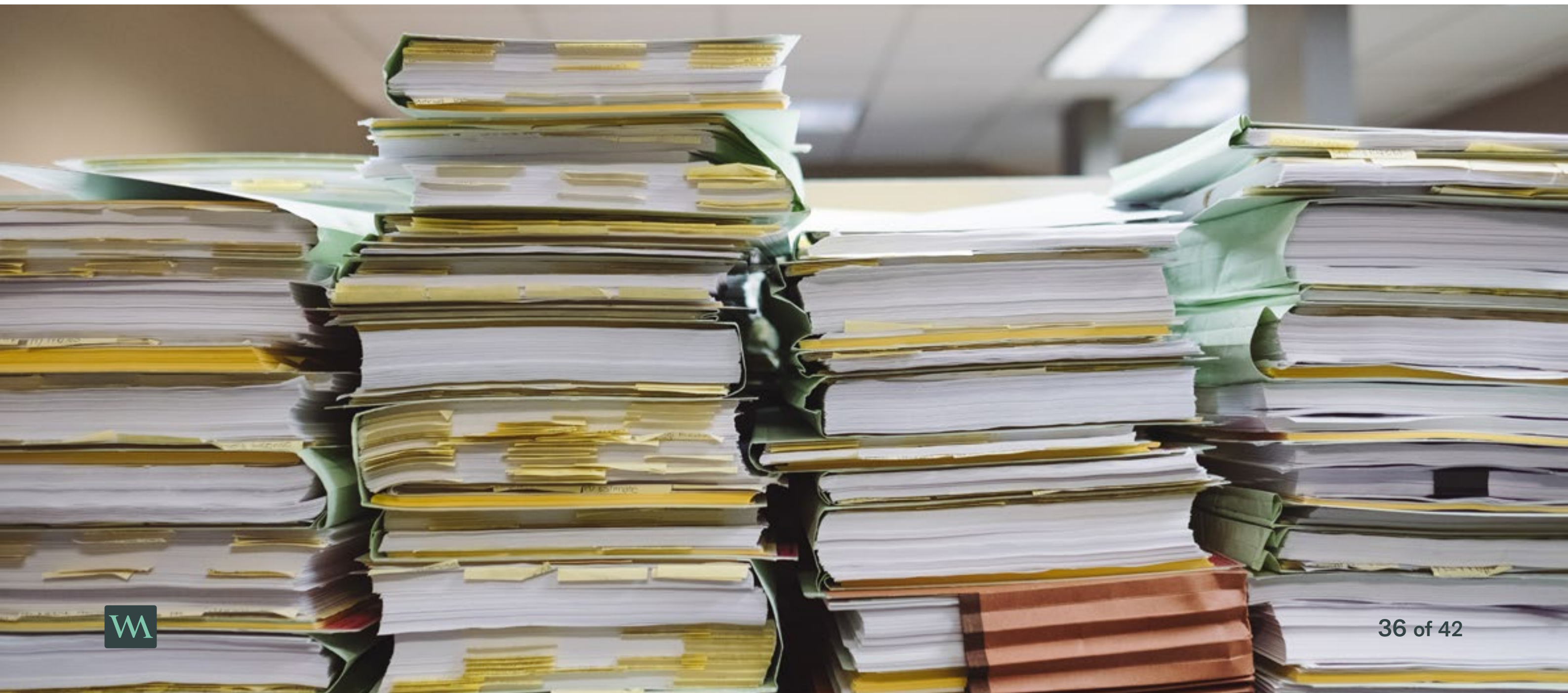
In this context, it's relevant to note the "poison pill" tactics which have been used, particularly in the United States, as a defence and protection against unwanted takeover bids. The adoption of such tactics should always be weighed against the directors' general duties to the company.

In any event, statute prevents directors from entrenching themselves in office. The Companies Act 2006 provides that the shareholders in general meeting may at any time dismiss any director by ordinary resolution and this is a right of shareholders which cannot be ousted.

Also, at common law, directors must not use their powers for an "improper purpose". In a recent case the articles of association of a company enabled its directors to impose restrictions on the shares held by a shareholder who did not comply with a notice requiring information about their interests in shares (effectively disenfranchising them). The directors suspected that the shareholder concerned was a potential unwelcome predator and the court held that the directors had used their powers for an improper purpose, i.e. to thwart a potentially hostile bid.

Appendix 3 to the City Code outlines the responsibilities of directors in relation to an offer. It states that while a board may delegate the day-to-day conduct of an offer to individual directors or a committee, the whole board must ensure that proper arrangements exist which will enable it to monitor that conduct so that each director can fulfil his responsibilities under the City Code.

The board must be provided promptly with copies of documents and announcements issued by or on behalf of the company relevant to the offer, details of all dealings in relevant securities by the company or its associates and details of any obligations incurred by or on behalf of the company in relation to the offer which do not concern routine administrative matters. Those directors to whom responsibility has been delegated must be able to justify all their actions to the board and, where appropriate, the opinions of advisers must be available to the board. Generally, all directors need to be kept up to date.



INSOLVENCY

Fraudulent trading and wrongful trading

Statute recognises that there are circumstances in which directors should be liable to contribute to any deficiency suffered by creditors of the company. The most important statutory provisions in this regard are those concerned with fraudulent trading and wrongful trading.

Fraudulent trading

Section 993 of the Companies Act 2006 imposes criminal liability for fraudulent trading. Any person found guilty is liable, in the case of conviction on indictment, to imprisonment for up to 10 years or a fine or both or, on summary conviction, to imprisonment for up to 12 months or a fine or both. The Insolvency Act, section 213, deals with civil liability for fraudulent trading.

The Companies Act 2006 liability applies (whether or not the company has been, or is in the course of being, wound up) to any person who's knowingly a party to the carrying on of the business of a company

> *"with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose". Similarly, the Insolvency Act liability exists if "in the course of a 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 creditors of any other person, or for any fraudulent purpose".*

The latter, however, can only be invoked during a winding up of a company by a liquidator. Any person so liable is obliged to make such contributions (if any) to the company's assets as the court thinks proper.

Need for knowledge of fraud

A defendant must knowingly be a party to the fraudulent activities; this will involve positive steps of some nature on his part, although the power of management or control over the carrying on of a business is by no means essential. While a company in financial difficulties continues to carry on business its directors must take care to avoid incurring credit when there is no reason for thinking that funds will be available to pay the debt when it becomes due or shortly thereafter.

The strict standards of pleading and proof which are applied in criminal proceedings make it difficult to establish the requisite dishonesty for the successful prosecution of the offence of fraudulent trading.

Wrongful trading

Wrongful trading applies if a company has gone into insolvent liquidation or insolvent administration and, at some time before the commencement of the winding up of the company or insolvent administration, a director knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation or insolvent administration. It can be contrasted with fraudulent trading which can apply to third parties provided that they're knowingly party to it and where the burden of proof in proving fraud is far stricter.

In such circumstances, on the application of the liquidator or administrator, a court may declare that the director is liable to make such contribution to the company's assets as the court thinks proper. For these purposes, "director" includes a shadow director.

Liquidators and administrators also have the power to assign wrongful (and fraudulent) trading claims to third parties.

Insolvency

A company is said to go into "insolvent liquidation" if it goes into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding up. A company goes into insolvent administration if it goes into administration at a time when its assets are insufficient for the payment of its debts and other liabilities of the administration. The essential test for insolvency in the context of wrongful trading is the absence of a reasonable prospect that the company will avoid going into insolvent liquidation or insolvent administration. This is a much narrower test than, for example, the test applicable when deciding whether a petition may be presented to wind up a company; a company may be insolvent for the purposes of this test but still have a reasonable prospect of avoiding insolvent liquidation or insolvent administration (for example, by entering into a voluntary arrangement with its creditors).

Directors' duties

Directors should ask themselves a number of questions when they're considering whether to carry on trading may be "wrongful". They must assess whether it's possible that the company will go into liquidation in the foreseeable future and, if it does, whether it will have sufficient assets at that time to meet its liabilities and the costs of a winding up. They must also ask themselves whether their conclusion that the company will avoid an insolvent liquidation is a reasonable conclusion to reach.

It's difficult to say on what criteria a "prospect" will be judged reasonable since the test will only be applied by a court where the company is in insolvent liquidation, which means the court will be judging whether a "prospect", which has not been borne out by events, was reasonable at the time.

In addition, the standards of skill and judgment expected of a director in assessing the reasonableness of a prospect are those of a reasonably diligent person having both the general knowledge, skill and experience which that director has and that which might reasonably be expected of a person carrying out the same functions. A court would therefore impute to a director their actual knowledge, skill and experience, supplemented (where that was lacking) by that which would be expected of a notional person occupying their position.

Defence available to directors

The court cannot make a declaration if it's satisfied that after the person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation or insolvent administration, the person "took every step with a view to minimising the potential loss to the company's creditors as (assuming that director to have known there was no reasonable prospect that the company would avoid going into insolvent liquidation or insolvent administration) they ought to have taken". In contrast to the requirements of fraudulent trading, there is no requirement to show intent in order to prove wrongful trading. Wrongful trading relates more to what the director knew or should have known and what they did or should have done.

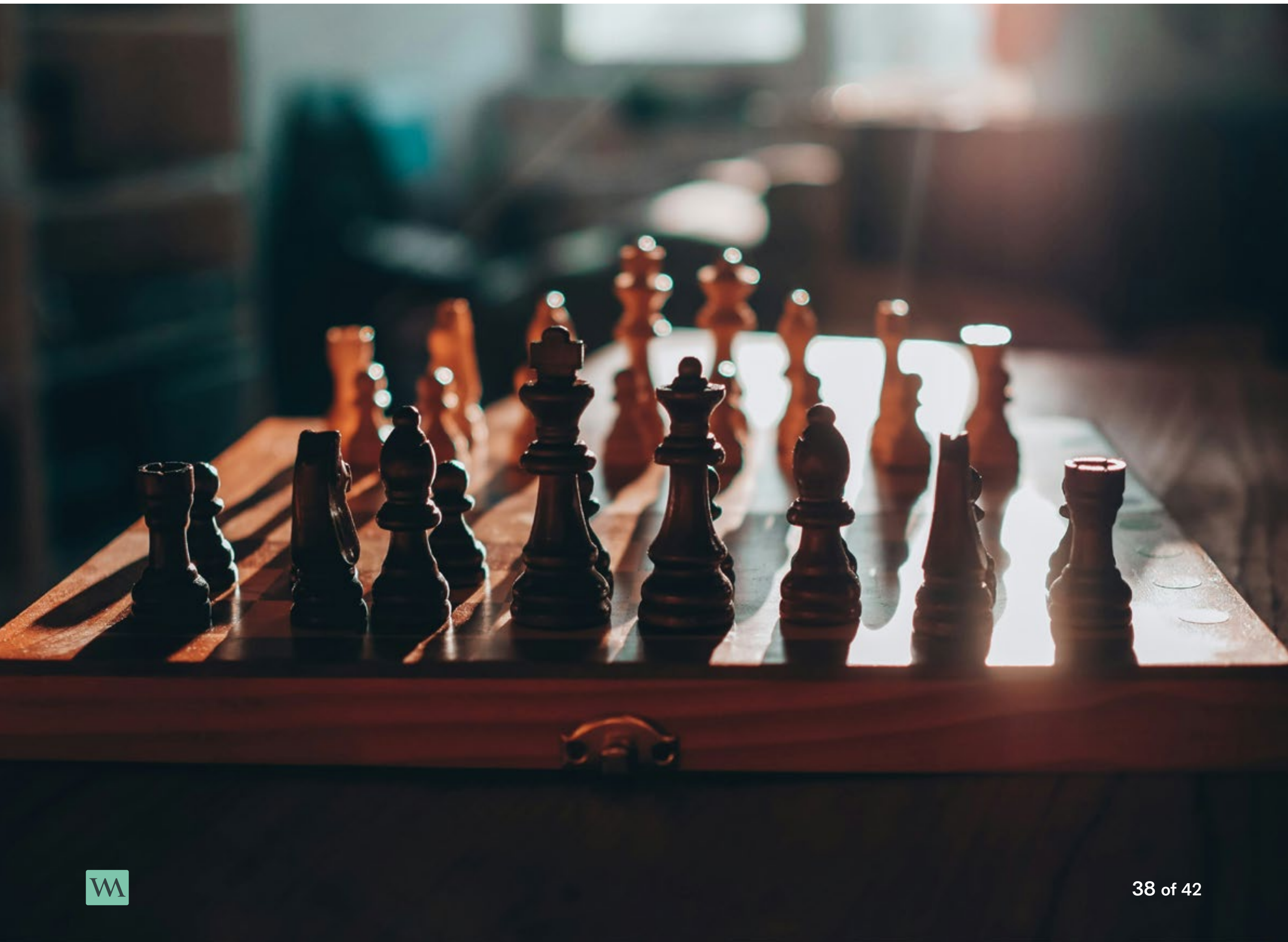
It should be noted that it will not always be the case that the directors can limit their liability by immediately ceasing to trade. If or when the directors conclude (or should conclude) that there is no reasonable prospect of avoiding insolvent liquidation, then the point will have been reached where to continue trading would be wrongful unless it can be shown that every step was taken to minimise the potential loss to creditors. The Insolvency Act 1986 therefore provides every incentive for directors to ensure that they have full and adequate information relating to their company's cash flow, budget forecasts and other management accounts; ignorance will not be a defence.

Misfeasance

A liquidator can bring an action against directors of the company after liquidation if misfeasance (i.e. breach of any fiduciary duty) has occurred. If misfeasance is established then, under section 212(3) of the Insolvency Act, directors can be ordered by the court to repay any money or personally contribute to the assets of the company to compensate for their misfeasance.

Personal guarantees

If a director has given any personal guarantee on company loans and the company defaults under the terms of that loan, the lender may choose to enforce the guarantees against the personal assets of the director. In extreme cases, such action may result in a bankruptcy order being made against individual directors.



CHAPTER 8
CONTINUING OBLIGATIONS

Disqualification

The personal, financial, and practical consequences of disqualification under the CDDA can be substantial. Disqualification will mean not only that the person disqualified cannot be a director of a company for the relevant period but also that they cannot be involved in the promotion, formation, or management of a company, which is clearly much more far reaching.

A disqualification order is mandatory where the court is satisfied that the person concerned:

- Is or has been a director of a company which has at any time become insolvent (while that person was a director or subsequently).
- That their conduct as a director of the company (taken either alone or together with their conduct as a director of other companies) makes them unfit to be concerned in the management of a company.

In the case of a company which becomes insolvent after an individual ceased to be a director, unless their conduct actually contributed to the subsequent insolvency, it's not very likely in practice that proceedings would be instituted against them.

Compensation may be ordered against a director where creditors have suffered identifiable loss from the director's misconduct.

The minimum period of disqualification is 2 years and the maximum period is 15 years.

Liquidators and administrators are obliged by statute to report on all directors in relation to matters which may assist the Secretary of State in deciding whether it's in the public interest to apply for the making of a disqualification order, within 3 months of the insolvency date. In addition, the Secretary of State and the official receiver have power to require the liquidator, administrator, or administrative receiver of a company or former holders of those offices to provide information with respect to a person's conduct as a director and produce relevant books, papers, and other records.

Criteria for determining unfitness

There is no definition of unfitness, although the statute's catalogue of relevant errors and omissions encompasses a wide variety of acts which can lead to disqualification. When determining whether a person's conduct makes them unfit, the court will have regard to a wide range of factors including:

- Breach of any applicable legislation (including applying outside the UK.
- Responsibility for a company's, or an overseas company's, insolvency.
- The materiality and frequency of the director's conduct.
- The loss or potential harm caused to the company by that conduct.

The courts are required to take into account any overseas misconduct when deciding whether or not to disqualify a director in the UK.

Failure to prepare annual accounts is also an offence by reference to which "unfitness" can be said to exist.

The court also has a discretionary power to disqualify directors:

- Who have been convicted of an indictable offence in connection with the promotion, formation, management, liquidation, or receivership of a company.
- Who have been persistently in default in relation to any return, account or other document required to be filed with the Registrar of Companies (persistent default being 3 or more defaults in the last 5 years).
- Who have been declared liable to make a contribution to a company's assets as a result of participating in fraudulent or wrongful trading.

The CMA can apply to court for a disqualification order on the basis that a director's conduct (in the content of their company's breach of competition law) makes them unfit to be concerned in the management of a company.

The Rating (Coronavirus) and Directors Disqualification (Dissolved Companies) Act 2021, which received Royal Assent on 15 December 2021, implements changes to the CDDA. Most importantly, it allows the Insolvency Service to investigate the conduct of directors of dissolved companies.

Penalty for contravention

If a person acts in contravention of a disqualification order, they'll be liable to imprisonment or a fine or both. Thus, although the insolvency legislation is administered by the civil courts, criminal punishment is metered out to directors who act in contravention of disqualification orders.

A director who acts while disqualified will also be personally responsible for all debts incurred by the company whilst they were involved in its management. A person will also be personally liable for these debts if they act or is willing to act on the instructions of a person known to them to be the subject to a disqualification order. Liability for such debts is joint and several with the company and any other person who may be so liable.

CHAPTER 9
USEFUL WEBSITES

AIM – London Stock Exchange's market for small and medium size growth companies
The Companies House Website
The Department for Business and Trade
The Financial Conduct Authority website
The Financial Reporting Council website
The Institute of Directors website
The London Stock Exchange website
The Walker Morris website

CHAPTER 10
FINAL WORDS

This green book has considered the general duties of directors from the company law perspective. However, there are other contexts in which directors owe duties and/or statutory obligations.

Employment considerations
If a person acts in contravention of a disqualification order, they'll be liable to imprisonment or a fine or both. Thus, although the insolvency legislation is administered by the civil courts, criminal punishment is metered out to directors who act in contravention of disqualification orders.

Regulatory & Compliance considerations

All UK business sectors are subject to some measure of regulation and some regulations apply across the board, such as those in respect of health and safety, data protection or competition compliance. Directors can face personal liability, sometimes even criminal liability, for breaching relevant legislation. Our Regulatory & Compliance team advise directors on all aspects of the regulatory landscape.

Tax considerations

Directors need to ensure their companies comply with the legislation regulating the management of a company's tax affairs. Our dedicated Tax team can assist with this as well as advising directors how to make their companies become more tax efficient.

Financial services considerations

Our Financial Services specialists can help to ensure that a company's activities are compliant with the often complex provisions of the Financial Services and Markets Act 2000 and related legislation.

Banking, Restructuring and Insolvency considerations

Directors are very likely at some point to need advice on lending and security documentation and possibly advice on a subsequent restructuring. Hopefully, they won't need insolvency advice. Our Banking, Restructuring and Insolvency team can offer advice and assistance whichever is needed.

Real Estate

Any company that thrives is likely to need premises from which to grow. Our Real Estate specialists have an enviable breadth and depth of advising on commercial leases and more complex property transactions.

Dispute Resolution

It's an unfortunate fact of corporate life that disputes arise. When this happens our Dispute Resolution specialists are available to help you resolve the dispute as satisfactorily as possible — and to ensure that any litigation is conducted in accordance with the rules governing the conduct of litigation in the UK and abroad.

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GLOSSARY

AGM annual general meeting

AIM the AIM market of the London Stock Exchange

AIM Companies companies whose shares are traded on AIM

CDDA the Company Directors Disqualification Act 1986

City Code the City Code on Takeovers and Mergers which is issued by the Panel

CJA the Criminal Justice Act 1993

CMA the Competition & Market Authority

DTRs the Disclosure Guidance and Transparency Rules published by the FCA under the authority of the FSMA

Enterprise Act the Enterprise Act 2002

FCA the Financial Conduct Authority

FRC the Financial Reporting Council

FSMA the Financial Services and Markets Act 2000

Insolvency Act the Insolvency Act 1986

Listed Companies companies whose shares are listed on the Official List

Listing Rules the rules published by the FCA under the authority of the FSMA

London Stock Exchange the London Stock Exchange plc

Model Articles the model articles contained in the Companies (Model Articles) Regulations 2008

Official List the Official List of the FCA

Panel the Panel on Takeovers and Mergers

Prospectus Regulation Rules the rules published by the FCA under the authority of the FSMA

RIS Regulatory Information Service

RNS Regulatory News Service

QCA the Quoted Companies Alliance

Table A Table A contained in the Companies (Tables A to F) Regulations 1985

UK MAR the Market Abuse Regulation as retained in UK law

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