Transactions with directors
Checklist

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Has your company entered into a transaction or arrangement with a director? Or is it about to do so? Are you unsure how to deal with the statutory requirements regarding conflicts of interest? This checklist is designed to help guide you through the potential pitfalls.

Please note: this checklist is for guidance only and is not a substitute for legal advice. If you are in any doubt about the applicability of any of the steps summarised below or the legal issues involved, please contact Paul Emmett or Richard Naish.

1 Pre-transaction considerations

1.1 Does the transaction require members’ approval? This will be the case if it is any of:

1.1.1 substantial property transaction (para 5);
1.1.2 loan, quasi-loan, credit transaction and related arrangement (para 6);
1.1.3 long-term service contract (para 7); or
1.1.4 payment for directors' loss of office (para 8).

1.2 Have the directors (i.e. both the director entering into the transaction and those approving the transaction) considered their statutory duties, in particular that of each director under section 172 of the Companies Act 2006 to act in the 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.

1.3 Check the company's articles of association for any prohibitions and restrictions on the company's ability to enter the transaction and the individual director's ability to be involved in approval of the transaction. Check whether, if the director has declared their interest, they can form part of the quorum and vote on the transaction.

2 Declarations of interest in a proposed transaction or arrangement

2.1 Consider whether any of the exemptions to the duty of disclosure applies. No declaration is required where:

2.1.1 the director is not aware of their interest or of the transaction or arrangement in question. Directors are treated as being aware of matters of which they ought reasonably to be aware;
2.1.2 if the interest cannot reasonably be regarded as likely to give rise to a conflict — it is generally not good practice to rely on this exception as what is or is not likely to give rise to a conflict may be a matter of interpretation;

2.1.3 the other directors are aware of the interest; or

2.1.4 the interest concerns the terms of the director's service contract which are to be considered at the board (or committee of the board) meeting.

2.2 If no exemption applies, the director must declare both the nature and extent of their interest in a proposed transaction or arrangement. Remember that a director need not be party to the transaction for the duty of disclosure to arise and the nature of the director's interest can be direct or indirect.

2.3 The declaration must be made before the company enters into the proposed transaction or arrangement.

2.4 Think about whether the director's "connected persons" may be caught and whether their interests need to be disclosed. A person is "connected" with a director if they are a member of the director's family (i.e. their spouse, civil partner, any person with whom the director lives as a partner in an enduring family relationship, a child or stepchild of the director, a child or step-child of a director's partner (if living with the director and under the age of 18), or the director's parents). A company is connected with a director if the director (and their connected persons) is interested in 20 per cent or more of the equity share capital of the company, or can exercise more than 20 per cent the voting power at a general meeting of the company. There are similar provisions which serve to connect persons to a director in relation to trusts set up for the benefit of the director, their family and in relation to partners of a director.

2.5 There is no statutory requirement as to the form of notice the declaration must take.

2.6 Where the declaration proves to be or becomes inaccurate or incomplete, a further declaration must be made so long as the company has not yet entered into the transaction or arrangement in question.

2.7 A director will not be in breach of duty if he or she complies with any provisions of the articles regarding conflicts. As the duty is owed to the company, it is the company, rather than an individual shareholder, that would enforce against any breach.

2.8 It is not a criminal offence to breach this duty.

3 Declarations of interest in an existing transaction or arrangement

3.1 The duty does not apply where the declaration referred to in paragraph 2 has been made.

3.2 Assuming no such declaration was made, consider next whether any exemption applies. These are:

3.2.1 the director is not aware of their interest or of the transaction or arrangement in question. Directors are treated as being aware of matters of which they ought reasonably to be aware;

3.2.2 if the interest cannot reasonably be regarded as likely to give rise to a conflict — it is generally not good practice to rely on this exception as what is or is not likely to give rise to a conflict may be a matter of interpretation;

3.2.3 the other directors are aware of the interest; or
3.2.4 the interest concerns the terms of the director's service contract which are to be considered at the board (or committee of the board) meeting.

3.3 A sole director of a company which is not required to have more than one director is exempt from the obligation to disclose. However, you must check the articles as if the company is required to have more than one director, the director's declaration must be recorded in writing.

3.4 Assuming no exemption applies the director must declare the nature and extent of their interest in an existing transaction or arrangement as soon as reasonably practicable (and the declaration must still be made even if not made as soon as reasonably practicable). As with interests in proposed transactions or arrangements, a director need not be a party to an existing transaction or arrangement for the duty of disclosure to arise and the nature of the director's interest can be direct or indirect.

3.5 Where the declaration proves to be or becomes inaccurate or incomplete, a further declaration must be made so long as the company has not yet entered into the transaction or arrangement in question.

3.6 The declaration must be made by one of the following:

   3.6.1 at a board meeting;
   3.6.2 by written notice
   3.6.3 by general notice.

   Declarations by way of written notice and general notice are subject to particular requirements as to form and delivery of the notice (set out in sections 184 and 185) which should be checked.

3.7 Breach of this duty to disclose is a criminal offence.

4 Situational conflicts

4.1 Be careful not to confuse "the duty to avoid conflicts of interest" (section 175 of the Companies Act 2006) with the duty to declare an interest in proposed or existing transactions or arrangements. The duty to avoid conflicts is expressly stated not to apply to transactions or arrangements with the company.

4.2 Different rules apply to managing situational conflicts.

5 Substantial property transactions

5.1 Members’ approval by an ordinary resolution is required if:

   5.1.1 a company acquires or is to acquire (directly or indirectly) a substantial non-cash asset from a director of that company or that company's holding company or a person connected with such a director; or
   5.1.2 a substantial non-cash asset is acquired or to be acquired (directly or indirectly) from a company by a director of that company or that company's holding company or a person connected with such a director.

5.2 An asset is 'substantial' if its value:

   5.2.1 exceeds £100,000; or
5.2.2 exceeds 10 per cent of the company’s asset value and is more than £5,000.

5.3 Take particular care with “connected” persons. The law in this area is notoriously difficult.

5.4 There is an exemption for transactions between a holding company and its wholly owned subsidiary or between two wholly owned subsidiaries of the same holding company.

6 Loans, quasi-loans, credit transactions and related arrangements

6.1 The following must be approved by ordinary resolution of the members:

6.1.1 loans to a director of the company or a director of its holding company (or their “connected persons”);

6.1.2 the giving or guarantee or security in connection with such a loan.

Where the loan is made to a director of the holding company (or their “connected person(s)”) the members of the holding company must also approve the loan.

6.2 In addition, public companies will require an ordinary resolution of the members before they:

6.2.1 make a “quasi-loan” (as defined in the Act) to a director of the company or its holding company or their connected persons;

6.2.2 give a guarantee or security in connection with any such quasi-loan;

6.2.3 enter into a “credit transaction” (as defined in the Act) as creditor for the benefit of a director of the company, the holding company or their connected persons;

6.2.4 provide a guarantee or security in connection with a credit transaction entered into by a third person for the benefit of such a director or their connected persons.

If the beneficiary is a director of the holding company (or their connected person), the members of the holding company will also have to approve the transaction.

A memorandum containing prescribed details of the transaction will need to be circulated to the members.

6.3 There are exemptions, in particular for intra-group transactions and for expenditure on company business of up to £50,000.

7 Long-term service contracts

7.1 If the service contract is for more than two years it must be approved by ordinary resolution of the members. Where the director is a director of the holding company as well as another group company, the members of the holding company must also pass an ordinary resolution.

8 Compensation for loss of office

8.1 A payment by a company to a director, or a director of its holding company, for loss of office must be approved by ordinary resolution of the members of the company and, if applicable, the holding company.
8.2 The rules also catch payments to directors' "connected persons".

8.3 There are additional requirements for payments for loss of office in connection with the transfer of an undertaking and in connection with a share transfer.

9 Additional considerations for Main Market companies

9.1 If the transaction is a "related party" transaction for the purposes of the Listing Rules, the company must:

   9.1.1 obtain the guidance of a sponsor to assess the application of the Listing Rules;
   9.1.2 send a circular to shareholders;
   9.1.3 obtain shareholder approval;
   9.1.4 make the various notifications required by the Listing Rules.

9.2 The following are "related party transactions":

   9.2.1 a transaction (other than a revenue transaction in the ordinary course of business) between the company and a related party (e.g. the acquisition of an asset from the director);
   9.2.2 any arrangement pursuant to which the company and related party each invests in, or provides finance to, another undertaking or asset;
   9.2.3 any similar transaction or arrangement the purpose and effect of which is to benefit a related party.

9.3 A "related party" includes any person who is a director of the Main Market company or of any company which is its subsidiary or parent undertaking or other subsidiary undertaking of its parent company.

9.4 As always, great care must be exercised with "connected persons" (the Listing Rules uses the term "associates").

10 Additional considerations for AIM companies

10.1 AIM companies are obliged to notify details of transactions with "related parties". The directors must also confirm that, having consulted with the company's Nominated Adviser, they are satisfied that the terms of the transaction are fair and reasonable from the perspective of the shareholders.

10.2 A "related party" includes any person who is a director of the AIM company or of any company which is its subsidiary or parent undertaking or other subsidiary undertaking of its parent company.

10.3 As always, great care must be exercised with "connected persons" (the AIM Rules uses the term "associates").
Contact Details

For further information please contact:

Paul Emmett:  +44 (0)113 2832580
paul.emmett@walkermorris.co.uk

Richard Naish:  +44 (0)113 283 4415
richard.naish@walkermorris.co.uk

Walker Morris LLP
Kings Court
12 King Street
Leeds
West Yorkshire
LS1 2HL
England

Tel: +44 (0)113 283 2500
Fax: +44 (0)113 245 9412
DX: 12051
E-mail: info@walkermorris.co.uk
Website: http://www.walkermorris.co.uk