Chartered Governance Institute UK & Ireland

COMPANY SECRETARY'S HANDBOOK

12TH EDITION

DOUGLAS ARMOUR

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Contents

Foreword

The myriad of governance requirements coming from legislation, regulation, codes of practice and various other forms of guidance can be daunting to even the most seasoned of governance professionals. The role undertaken by company secretaries, and their team, can be wide-ranging and varied. On any given day, the company secretary might be working on board logistics and support, writing board papers, advising other members of the management team, writing policies, project managing the production of annual reports and organising general meetings. There may also be other professional disciplines reporting into them.

In practice, the company secretary is generally juggling any number of crucial tasks, for a number of stakeholders, usually with critical time pressures that also need to be met.

To fulfil the role to the full potential, there are a vast amount of governance requirements, for the organisation, most notably coming out of the Companies Acts, that need to be considered and complied with.

As anyone who has worked in a secretariat team will know, navigating the range of requirements can take time. The requirements are also nuanced according to the type of organisation you are dealing with, which Douglas Armour has usefully summarised in his Introduction, and how they are regulated, if at all.

For those who are not a company secretary, by profession, the range of requirements can be even more daunting. So whether you are a company secretary, director, solicitor or an accountant, the information within the *Company Secretary's Handbook* will soon prove itself to be invaluable in ensuring compliance.

Lyn Colloff, MBA, FCG, ACII
Chartered Secretary/Governance Professional

alteration (ss. 633 and 634). A copy of the court order must be filed with the Registrar within 15 days of it being made.

Companies creating new classes of shares or members, or varying the rights of existing classes of shares or members, are required to notify the Registrar of the particulars of the rights created or affected within one month of the date of variation (ss. 636–640).

Protection from unfair prejudice

Directors have a **fiduciary** duty under **common law** and under s. 172(1) to act in the interests of the members as a whole, and can be held liable in the event that they act for the benefit of a subgroup of members or for their own benefit rather than the members as a whole or even at all.

Any member of a company may apply to the Court on the basis that either the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least themself), or that an actual or proposed act or omission of the company is or would be prejudicial (s. 994).

It is important to note that the claimant must be able to demonstrate that the conduct complained of is both unfair and prejudicial to the interest or rights of the members or some part of the members of the company.

Conduct may be unfair even in circumstances where there has been no bad faith or no intention to be unfair or prejudicial. The test is objective and there is no need to show that anybody acted in bad faith or with the intention of causing prejudice. The courts will regard the conduct as unfair if a hypothetical reasonable bystander (the so-called man on the Clapham omnibus) would believe it to be unfair.

The conduct must be prejudicial to the complainant's interests in their capacity as a member of the company. The court does, however, take a broad view of what constitutes members' rights.

If the court find in favour of a complainant and agree that unfair prejudice has occurred, the Act sets out several remedies available to the court (s. 996(2)) in addition to a general provision to make any order it deems appropriate (s. 996(1)):

- regulate the conduct of the company's affairs in the future;
- require the company to refrain from doing or continuing an act complained of, or to do an act which it has omitted to do;
- authorise civil proceedings to be brought in the name and on behalf of the company by such person/s and on such terms as the court may direct;
- require the company not to make any, or any specified, alterations in its articles without the leave of the court; and
- provide for the purchase of the shares of any members of the company by other members or by the company itself and, in the case of the purchase by the company itself, the reduction of the company's capital accordingly.

The power to authorise civil proceedings subject to terms directed by the court can be a particularly useful remedy for the complainant as it not only enables an action to be pursued by the company, but also means the costs of the action will be borne by the company.

The most common remedy is to order that the shares held by the members whose interests have been prejudiced be purchased by those who caused the unfair prejudice.

Ordering that shares of a private company be purchased can cause considerable problems since the shares, not being traded, have no established market value and there are many conflicting methods of valuation. Although the court will not necessarily stipulate the valuation method to be used, they will often oblige the valuer to value the company at the date the prejudice initially took place and on the basis that the prejudicial conduct had not taken place.

Derivative action claims

The Companies Act introduced a derivative action procedure, making it easier for members to sue directors or others for a broader range of acts or omissions than was previously possible under common law (ss. 260–269). Due to the different legal systems in England, Wales, Northern Ireland and Scotland, the legislation is split, with ss. 260–264 applicable to proceedings brought in England, Wales or Northern Ireland, and ss. 265–269 applicable to proceedings brought in Scotland. The provisions themselves are intended to have the same effect in all territories.

Grounds for bringing a derivative action

A derivative action claim may only be brought under the provisions of the Companies Act or under a court order, and may be brought in respect of an actual or proposed act or omission involving negligence, default, breach of duty (including the codified duties described on pages 74–76) or breach of trust. The claim may be brought by a member whether the cause of action arose before or after they first became a member (ss. 260 and 265).

Application for permission to continue derivative claim

A member who has brought proceedings must apply to court for permission to continue the claim.

If a company has brought a claim and that claim could be continued as a derivative action claim, a member may apply to the court to continue the claim as a derivative action claim on the grounds that:

- the manner in which the company brought or is continuing the claim is an abuse of a process of the court; or
- the company has failed to prosecute the claim diligently; or
- it is appropriate for the member to continue the claim.

The court must dismiss the claim if the evidence filed by the member does not disclose a ***prima facie*** case for giving permission. In dismissing a claim, the court may make any consequential order it considers appropriate, including a costs order.

If the evidence does disclose a *prima facie* case, then the court may give directions as to the evidence to be provided by the company and may adjourn the proceedings to allow that evidence to be obtained (ss. 261, 262, 266 and 267).

Grounds for permission to continue

On hearing the permission application, the court must refuse permission to continue the claim if a person seeking to promote the success of the company for the benefit of its members would not continue the claim or if the conduct complained of has been authorised or ratified by the company (i.e. the members). On any resolution to ratify a director's negligence, default, breach of duty or breach of trust, the votes of those members personally interested in the ratification must be disregarded.

In exercising its discretion to allow an action to be continued, the court must consider:

- whether the member is acting in good faith;
- the importance a director promoting the success of the company would attach to continuing the claim;
- whether the conduct would be likely to be authorised or ratified by the company;
- whether the company has decided not to pursue the claim; and
- whether the applicant should pursue a remedy in their own right instead of on the company's behalf.

The court must have particular regard to the evidence of independent members in deciding whether to grant permission (ss. 263 and 268).

Application to continue action brought by another member

Where a member has commenced a derivative action against the director's claim, another member may apply to the court to continue the claim on the grounds that:

- the manner in which the first member brought or is continuing the claim is an abuse of a process of the court; or
- the first member has failed to prosecute the claim diligently; or
- it is appropriate for the second member to continue the claim.

The court must dismiss the claim if the evidence filed by the member does not disclose a *prima facie* case for giving permission. In dismissing a claim, the court may make any consequential order it considers appropriate, including a costs order.

If the evidence does disclose a *prima facie* case, then the court may give directions as to the evidence to be provided by the company and may adjourn the proceedings to allow that evidence to be obtained (ss. 264 and 269).

6 – Directors

Introduction

The definition of a director contained in s. 250 is very general. It states that a director is any person who occupies the position of director, by whatever name called. This is clearly illustrated in companies where the senior executive director will often have the job title Chief Executive Officer (CEO) whereas a 'client services director' in most instances will not be a board director at all.

A **shadow director** is a person who is effectively directing the affairs of the company but who is not called 'director' (s. 251).

The definition refers to any person rather than any individual and thus will include corporate bodies having a legal persona. In this way, it is possible for one company to be appointed a director of another company. SBEE2015 was intended to introduce a general prohibition on the appointment of corporate directors however at the time of writing those provisions had not been brought into effect.

This chapter looks in detail at types of directors, how they are appointed, resign or are removed, and at their powers, duties, liabilities and disclosure requirements.

Appointment

Eligibility

There are only two eligibility criteria in the Companies Act to satisfy when appointing directors:

1 There must be at least one natural person appointed as a director at all times (s. 155).
2 On appointment, the person being appointed must be at least 16 years old (s. 157).

A company's articles of association may, however, contain additional eligibility criteria. For example, directors might be required to hold a minimum number of shares or a particular professional qualification relevant to the business. A company carrying on business as a registered auditor may require that all directors are capable of being appointed as auditors in their own right. It is very common for

the directors of a residents' management company to be required to be property owners or tenants of the particular development.

Provided the two Companies Act eligibility criteria, together with any criteria in the company's articles, are met, anyone may be appointed to the office of director, provided they are not specifically prohibited. These prohibited persons are as follows:

- A bankrupt person may not be appointed as a director. If a director becomes bankrupt after appointment, they must immediately resign, unless leave to continue is given by the courts (CDDA1986, s. 11).
- A person who has had a disqualification order made against them may not act as a company director, unless leave has been given by the courts (CDDA1986, ss. 2 and 5).
- The auditor of a company cannot also be a director or company secretary of that company (s. 1214).
- The director of an insolvent company cannot, without the leave of the court, be appointed as a director of a company with a 'prohibited' name (IA1986, s. 216).

In addition, the Act and articles of association may provide further instances where appointment may not be made or may cease – for example:

1 If the person is suffering from a mental disorder and is admitted to hospital under the Mental Health Act 1983, a court order is made on the grounds of mental disorder or a register medical practitioner gives a written opinion that the person has become physically or mentally incapable of acting as a director for a period of at least three months (Private Model Articles reg. 18(d)(e)). From 28 April 2013, a change to the model articles has been brought about by provisions in the Mental Health (Discrimination) Act 2013 insofar as it removes model article 18(e) from the model articles for private companies to tackle discrimination in this area of law. Additionally, model articles for public companies have also been amended to remove any such discrimination (article 22(e) of the model articles).
2 If a receiving order has been made against the director or proposed director, or if they compound with their creditors generally (Private Model Articles reg. 18(c)).
3 If the maximum number of directors permitted by the articles has been reached.
4 The articles of a company incorporated before January 2007 may require directors to retire annually upon reaching the age of 70. This reproduced the effect of CA1985 s. 293, which has now been repealed, and companies should consider removing such a clause which may be unenforceable under age discrimination legislation.

Procedure for appointment

The first directors of a company are those whose names are entered on Form IN01 on the incorporation of a company. Subsequent appointments as directors are governed by the provisions of the company's articles of association. These usually provide that the board itself may or the members in general meeting may fill any casual vacancies or appoint additional directors up to the maximum number permitted by the articles.

For public companies and any private company that chooses to hold annual general meetings, elections or re-elections of directors following **retirement by rotation** must be approved in general meeting (Public Company Model Articles reg. 21). Also, at the company's first annual general meeting, all the directors retire from office and have to be re-elected by the members at the meeting (model articles of a public company reg. 21(1)).

A casual vacancy is one arising from the death or resignation of a director. Once it has been established that the proposed replacement is willing to be appointed (consent is formally required by signature of the consent-to-act section of Form AP01 or AP02), the procedure for appointing a director to fill a casual vacancy is as follows:

1 The board resolves to appoint the new director (see precedent 14).
2 The company secretary confirms to the newly appointed director their appointment by the board and deals with the following:
   (a) requesting personal particulars, including date of birth, which are required to complete Form AP01 or AP02 (there are different forms to be completed by natural persons and corporate entities) and to make the necessary entry in the register of directors (s. 162). The date of birth is required for all directors (s. 163(f)). Although the full date of birth must be provided to Companies House, only the month and year of birth are placed on the public record;
   (b) Form AP01 or AP02 is no longer required to be signed by the appointee signifying their consent to act, but instead is signed on behalf of the company confirming that the appointee has consented to act. Alternatively, details of the new appointment may be made online either using an appropriate software package or via the Companies House website. Pre-registration is required for both these services;
   (c) as Forms AP01 and AP02 no longer contain a consent to act declaration, formal consent to be appointed as a director should be obtained from new directors. Without this consent, it may be difficult to prove that the person has consented to be appointed and if there is a dispute, application can be made to the Registrar of Companies for the appointment to be struck out (see page 71);
   (d) if the director will be signing cheques on the company's behalf, requesting a specimen signature to be sent to the company's bank;

(e) informing the director of any share or other qualifications that must be acquired under the articles and the time allowed in which to do this;
(f) inviting the director to give a general or specific notice of their interests in contracts with the company (ss. 182 and 185);
(g) providing dates of forthcoming board meetings;
(h) enquiring how the director wishes their remuneration to be paid, e.g. sent to their home address or paid direct into their bank account, including information regarding their PAYE coding and National Insurance contributions (if they are already paying the maximum contributions in connection with another employment, they should obtain and submit to the company a certificate of exemption from contributions);
(i) providing general information about the business of the company if the newly appointed director is not already involved in the company. Copies of the articles of association, reports and accounts for recent years and interim reports and circulars should be made available, if required; and
(j) (*Listed, AIM and NEX companies only*) providing a copy of the company's rules for securities transactions, if any, and asking the director to acknowledge receipt.

3 (*Listed, AIM and NEX companies only*) A regulatory information service should be notified of the appointment by the end of the business day following the decision to appoint the director (*LR 9.6.11, AIM Rule 17, NEX Rule 70*). Details of the director's other business activities must be disclosed to a regulatory information service within 14 days. Details of any interests in shares of the company must also be disclosed within five days of their appointment. A NEX company should announce this information as soon as possible.

4 If appropriate, a press announcement should be sent to newspapers or through the company's press agents.

5 On receipt of the relevant information from the director, the necessary entries in the register of directors and the register of directors' residential addresses. The completed Form AP01 or AP02, whether on paper or electronic, must be sent to the Registrar of Companies within 14 days of the date of appointment. There may also be other matters to attend to, depending on the circumstances.

6 Where a director is not required to have a share qualification, it is usual for the articles to provide that the director may receive notice of, and attend and speak at, general meetings of the company. As a non-shareholder, they would not otherwise have such power except if acting as chairman of the meeting.

7 If the company has an insurance policy covering directors and officers of the company against liabilities incurred in carrying out their duties, the insurance company should be notified of the appointment of the new director, either at the time of appointment or at renewal, depending upon the wording of the policy.

Directors' addresses

Directors are required to give details of a service address for the receipt of official notices. The service address can be their usual residential address, but if it is not, details of their usual residential address must be provided on Form AP01, on appointment, or any subsequent change in their usual residential address on Form CH01. Companies House verifies the address details supplied against the Post Office database and will reject any that appear to be an office address. Accommodation addresses and PO Box numbers cannot be used, as clearly these are not residential addresses. Companies House does not place the residential address information on the public file unless it has reason to believe that mail addressed to the service address is being returned, not being actioned or not being forwarded to the individual concerned.

Although the residential address is not placed on the public file at Companies House, if the Company takes advantage of the option to use the central registry as their statutory books (see Chapter 7), this will result in the residential address information and full date of birth information being available to anyone who searches the public records.

Alternate directors

There is no provision in the Act authorising a director to appoint an alternate to act on their behalf in their absence, so alternates may be appointed only if the articles specifically provide for this.

Article 25 of the model articles for a public company make provision for a director to appoint another director to be their alternate, or they may appoint any other person as their alternate subject to that person being approved by the board of directors (see precedent 16). The model articles for private companies and companies limited by guarantee do not provide for the appointment of alternate directors.

Alternate directors are included in the definition of 'director' in s. 250 and their particulars should be entered in the register of directors and secretaries, and filed with the Registrar of Companies on Form AP01. This form does not differentiate between the appointment of a person as a director or as an alternate director; however, it is possible to enter 'alternate director' in the occupation field if preferred.

Accordingly, a search of the records at Companies House will reveal alternate directors' appointments as well as those of directors, without any distinction. They are subject to the same rules as directors with regard to disclosure of interests in shares of traded companies and related party transactions with the company. Their names must also be shown on letterheads if it is company practice to show the names of directors on such stationery. An alternate director may act only in the *absence* of the appointing director: it is not a complete assignment of office by the director.

Shadow directors

A person not being formally appointed as a company director but who nevertheless either controls the management of the company or on whose instructions the directors act is a 'shadow director' of the company and is deemed to be a director of the company for all purposes (s. 251). The appointment of a shadow director should be notified on Form AP01; however, the requirement for the company to confirm that the appointee has consented to act might prove difficult, as by their very nature, shadow directors are unlikely to consent formally. In such circumstances it is recommended that the form be submitted to Companies House with a covering note explaining the circumstances of the 'appointment'.

Although directors will often act on the recommendations of their professional advisers, this would not normally imply that those advisers were shadow directors, provided that their advice is limited to a particular part of the business such as accounts or commercial property transactions. A professional adviser giving wide-ranging assistance on areas outside the scope of their engagement runs the risk of being a shadow director.

Minimum number of directors

A public company must have at least two directors and a private company must have at least one director (s. 154). All companies must have at least one director who is a natural person (s. 155).

The articles may stipulate that there must be a higher minimum number of directors. If, for any reason, the number of directors falls below this number, the remaining directors have the power to fill a casual vacancy or to convene a general meeting only for the purpose of allowing the shareholders to appoint an additional director(s). If, for any reason, it is not discovered that the number of directors has fallen below the minimum number, once the number has been restored it is recommended that the board ratify the decisions made while there were insufficient directors. Provided the acts being ratified were within the board's authority, they can be ratified by the board. In such circumstances, many companies will also seek ratification by the shareholders to ensure that the decisions are not queried in the future.

Defective appointment of directors

If the appointment of a director is found to be defective in any way, s. 161 provides that, for the protection of third parties, any earlier acts made by the person acting as a director remain valid. Section 239 provides that the members of the company may ratify prior acts of directors either individually or collectively for acts of negligence, default or breaches of duty or trust.

Disputed appointments

SBEE2015 introduced a new process which came into force in April 2016 under which a director can dispute their appointment or amend details filed in respect of their appointment and make application to Companies House for the appointment to be struck out (s. 1095(4A)).

Application is made using Form RP06. The Registrar will enquire of the company to ascertain whether consent was given or not; where consent cannot be proved, the appointee's details will be removed from the record. The process can only be used in respect of appointment from Form AP01 or AP02 received by Companies House on or after 6 April 2016.

Managing directors and other executive directors

The appointment of directors as managing or executive directors is governed by provisions contained in the company's articles, giving the directors power to appoint such directors, to determine the terms of their appointment and remuneration, and to delegate to them such powers of the board as may be desired (Private Model Articles reg. 19, Public Model Articles reg. 23). Since the office of managing director is normally a full-time executive appointment, it is good practice for this appointment to be governed by a formal service agreement, rather than just a note of the principal terms, so that the remuneration and other benefits associated with the appointment may be made clear. The agreement should also contain any provisions relating to confidentiality and some control over the director's activity, in the event of their leaving the service of the company. The contracts of directors who also hold salaried executive positions with the company should specify whether the remuneration stated in the contract is exclusive or inclusive of directors' fees. For a smaller company, the terms of appointment could be set out in the minutes of the board appointing the director and a letter sent to the director containing a copy of the minutes and asking them to confirm acceptance of the proposed appointment in writing.

The articles normally give the board of directors power to revoke any appointment of a managing director, subject to the terms of any service agreement with the company. The appointment would also cease if the director ceased to be an employee of the company for any reason.

Non-executive directors

A non-executive director (NED) is a member of the board of directors without executive responsibilities in the company. The role of non-executives is to contribute skills and experience to board decision making that might not otherwise be available, and to provide a suitable balance of power in the boardroom. Most smaller companies will have no need to appoint non-executive directors, but the role of NEDs is seen as increasingly important for larger, Listed companies, and the issue of

the balance between executive and non-executive directors on boards has become a key tenet of good corporate governance practice (see Chapter 17). Where appointed, NEDs have the same powers, duties and liabilities as executive directors.

Special types of director

Some companies' articles provide for the board to appoint persons to offices with the word 'director' as part of their title, e.g. divisional director, associate director. Such a person is not a director within the meaning of s. 250 and is not entitled to attend board meetings. Such a person is not subject to the statutory responsibilities and liabilities of a director, provided that they do not represent themselves as being a director, in terms of the Companies Act, in dealings with third parties. It can be misleading to appoint officials with the word 'director' in their job titles when they are not subject to the legal duties of a director. However, the practice is sometimes followed in order to give an added measure of status to senior executives to facilitate their dealings with customers and suppliers, especially if the company has substantial dealings in overseas territories.

Local boards are also sometimes formed by companies under provisions contained in their articles. These persons are not full directors for the purposes of the Companies Act 2006.

Contracts of employment

A director's employment contract (often referred to as a service contract) that cannot be terminated other than for breach of contract within a period of two years must be approved by the shareholders in general meeting (s. 188) (see precedent 17).

Shareholders' approval may be given by an ordinary resolution passed at a general meeting, provided that a written memorandum setting out the terms of the proposed agreement or a copy of the service contract is available for inspection by members of the company at the registered office for a period of not less than 15 days prior to the date of the meeting. Companies are required at all times to keep copies of directors' service contracts available for inspection by members, at an address specified for that purpose by the company (s. 228).

In accordance with the UK Corporate Governance Code, Listed, AIM and NEX companies are encouraged to have service agreements with their directors with a notice period of not more than one year (code provision D1.5) (see Chapter 16).

Powers of directors

The directors of a company are authorised by the articles of association to manage the business of the company and to exercise the company's powers (Private and Public Model Articles article 3). This seemingly unlimited authority is usually balanced by the fact that this authority is subject to the provisions of the Companies Acts, the company's articles of association, by resolution of the members, internal policies and the directors' service contracts.

The power of the directors is given to the board collectively and not individually. Directors are usually also given power to delegate any or all of their power to one or more persons or one or more committees consisting of one or more directors (Private and Public Model Articles, regulation 5, see precedent 24).

Matters reserved for the board

For many companies there is no practical difference between the composition of the senior executive management team and the board of directors. However, in larger companies and especially listed companies executive directors will very much be a minority on the board of directors and there will be an executive committee below the board of directors which undertakes the day-to-day management of the business and implementation of the strategy agreed by the board of directors.

In exactly the same way that delegation of board authority to its committees must be fully documented the same is true of separation of the roles and responsibilities of the board and executive management. With this division of responsibilities, it is essential that there is a clear demarcation of matters that are the responsibility of the board and those matters delegated to the executive management team.

The directors should identify categories of matters as well as specific items which require the prior approval of the board of directors. The schedule is most often referred to as the 'matters reserved for the board'. The directors should also lay down procedures to be followed in the rare circumstances where a decision is required before the next directors' meeting.

As a basic principle, all material contracts, and especially those not in the ordinary course of business, should be referred to the board of directors for decision prior to the commitment of the company.

The directors should approve definitions of the terms 'material' and 'not in the ordinary course of business'.

Where there is any uncertainty regarding the materiality or nature of a contract, it is best practice for that contract to be brought before the board of directors for consideration.

Duties

A director's prime duty, which they hold together with their fellow directors, is to manage the company for the benefit of its members. The directors may delegate some or all of their powers to particular directors (perhaps constituting a

committee of the board) and/or other senior officers in the company, but they cannot delegate their duties.

Although the Companies Act is clear that directors' prime duty is to the company members the Act notes that they must also have regard to the interests of employees, customers, suppliers, the community and the environment. The evolution of corporate governance places greater emphasis on the interests of these non-member stakeholders and while not overruling the Companies Act provisions places greater obligations on directors of larger companies to explain how they have exercised their powers and fulfilled their duties. Introduced for financial years beginning on or after 1 January 2019, s. 414(CZA) requires directors of large companies to describe how they have exercised their duty under s. 172.

The Companies Act 2006 introduced seven duties of directors. These duties codified, with some amendments, existing case law.

1. To act within their powers (s. 171)

Directors must act in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred. The company's articles of association should be consulted to ascertain the extent of a director's powers and any limitations placed upon them.

2. To promote the success of the company (s. 172)

A director must act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (among other matters) to:

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

3. To exercise independent judgement (s. 173)

4. To exercise reasonable care, skill and diligence (s. 174)

The duties imposed by ss. 173 and 174 require that a director owes a duty to exercise the same standard of care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of the person carrying out the same functions as a director in relation to that company (an objective test); and the general knowledge, skill and experience that the director actually has (a subjective test).

For example, a finance director would be expected to have a greater knowledge of finance issues than, say, the HR director (the objective test); but if the HR director is also a qualified accountant, then they would be expected to have a greater knowledge than would normally be expected of a HR director, although not necessarily the same knowledge as the finance director (the subjective test).

5. To avoid conflicts of interest (s. 175)

Directors must avoid situations in which they have or might have a direct or indirect interest that conflicts or might conflict with the interests of the company. Of particular importance are conflicts relating to property, information or opportunity, regardless of whether the company could take advantage of such opportunities (s. 175(2)).

The duty does not apply to conflicts arising out of transactions or arrangement between the company and the director.

Where the company is a private company, authorisation may be given by resolution of the directors, provided there is nothing in the company's articles of association that invalidated the authorisation (see precedent 18).

Where the company is a public company, authorisation may be given by resolution of the directors, provided there is specific authority in the company's articles of association that permits directors to authorise such transactions (see precedent 18).

Such authorisation, whether for a private or public company, is only valid if the necessary quorum for a meeting of the directors is present excluding the director with the conflict of interest and without that director voting (s. 175(6)).

6. Not to accept benefits from third parties (s. 176)

Directors must not accept a benefit from a third party being given by virtue of their being a director or due to any action or inaction by the director.

Benefits received by a director from a person by whom their services are provided are not to be regarded as paid by a third party.

The duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.

7. To declare interests in any proposed transaction or arrangement (s. 177)

A director must declare the full nature and extent of any direct or indirect interest in any proposed transaction or arrangement before that transaction or arrangement is entered into. The declaration may be given at a meeting of the directors or by notice in accordance with ss. 184 or 185.

Where a previous notification or interest becomes inaccurate or incomplete, additional notification(s) must be made.

Notification is not required where the director is not aware of the interest or is not aware of the transaction or arrangement.

Notification is not required where the nature of the interest is such that it cannot reasonably be regarded as likely to give rise to a conflict of interest, to the extent that the other directors are already aware of the interest without requiring specific notification or where the transaction relates to the director's service contract.

Directors of companies whose shares are publicly traded also have additional non-Companies Act duties and responsibilities, and these are considered in Chapter 16.

Liabilities

Directors properly exercising the powers of the company and acting as agents for the company will not incur personal liability in the event of a breach of contract. However, directors may incur personal liability if they have given personal guarantees or if they have not made it clear that they are acting as agent of the company and not in a personal capacity.

There are also a number of circumstances under which a director may be personally liable to the company or third parties from a breach of duty or statutory offence, including:

- acting as a director while disqualified (CDDA1986 s. 15);
- a director of an insolvent company carrying on a business with a company with a prohibited name (IA1986 ss. 216, 217);
- employing illegal immigrants (AIA1996 s. 8);
- evasion of VAT (FA1986 ss. 13 and 14);
- failure to show company name on correspondence, cheques, etc. (ss. 83 and 84);
- fraudulent preference (IA1986 ss. 238–240);
- fraudulent trading (s. 993);
- irregular share allotment (ss. 563 and 579);
- making false statement in a prospectus (FSMA2000 s. 90);
- non-observance of pre-emption rights on allotment (ss. 563 and 572);
- public company trading prior to issue of trading certificate (s. 767);
- trading with intent to defraud (IA1986 s. 213);
- wrongful trading (IA1986 s. 214); and
- health and safety offences (HSWA1974 s. 37).

Member action

As considered in Chapter 5, members may take legal action against the directors under an action for unfair prejudice or as a derivative action claim.

Unfair prejudice

Any member of a company may apply to the court on the basis that either the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members (including at least themself), or that an actual or proposed act or omission of the company is or would be prejudicial (s. 994).

It is important to note that the claimant must be able to demonstrate that the conduct complained of is both unfair and prejudicial to the interest or rights of the members or some part of the members of the company.

Derivative action claims

Sections 260–269 introduce a derivative action procedure, making it easier for shareholders to sue directors or others for a broader range of acts or omissions than was possible under common law.

Due to the different legal systems in England, Wales, Northern Ireland and Scotland, the legislation is split, with ss. 260–264 applicable to proceedings brought in England, Wales or Northern Ireland, and ss. 265–269 applicable to proceedings brought in Scotland. The provisions themselves are intended to have the same effect in all territories.

A derivative action claim may only be brought under the provisions of the Companies Act or under a court order, and may be brought in respect of an actual or proposed act or omission involving negligence, default, breach of duty (including the codified duties described above) or breach of trust. It may be brought by a member whether the cause of action arose before or after they first became a member (ss. 260 and 265).

Vacation of office

The office of director is vacated on the death of the office holder or under a provision in the articles of association of the company. Such a provision might be that the directors are appointed for a fixed term and, on expiry of that term, their appointment automatically ceases.

Vacation of office may also arise under statute, as follows:

1. If the director becomes bankrupt, unless the court permits the appointment to continue (CDDA1986 s. 11).
2. If the director is disqualified from being a director by court order (CDDA1986, ss. 1–6, as amended). A register of such disqualification orders is maintained by the Secretary of State for inspection by the public (CDDA1986 s. 18).
3. The appointment of a person as a director who has not attained the age of 16 is void (s. 159).

Under the articles, further methods of vacating office may be specified as follows:

- Where the articles stipulate any qualifying criteria and that criteria has not been met, the office of director would be vacated at the conclusion of the qualifying period.
- In the case of a company where the director reaches the relevant age limit set out in its articles, the office of director would be vacated at the conclusion of the next following annual general meeting.
- *Resignation*. This will usually take effect from the date on which the letter of resignation is received by the company, unless this states some subsequent date on which the resignation is to become effective. To be effective, the resignation does not need to be accepted by the board, unless the articles provide otherwise.
- *Absence*. If the director is absent from board meetings for some specified period (often six months) without leave of absence. In order to monitor the operation of any such article, therefore, the secretary should arrange for the board to grant leave of absence where it is known that a director is likely to be absent for a period exceeding six months, e.g. because of overseas travel on the company's business or because of long illness.
- If a receiving order is made against a director or the director compounds with their creditors generally.
- If an order is made by the court on grounds of mental disorder.
- If the director is removed from office, e.g. by a notice signed by all co-directors or by any holding company.

Retirement by rotation (public companies only)

The model articles for public companies provide for the retirement of one-third of the total number of directors by rotation every year (Public Model Articles, reg. 21). There is no general requirement in the Act for directors to retire by rotation at annual general meetings. It is usual for the articles to provide that a person appointed as a director by the board to fill a casual vacancy, or as an additional director, must be re-elected at the next following annual general meeting of the company. Such retirements and elections are not taken into account in determining the directors who are to retire by rotation at that meeting (Public Model Articles, reg. 21(b)).

For a Listed company, the UK Corporate Governance Code recommends that all directors should offer themselves for re-election every year (see Chapter 16). The procedure to be followed for the retirement of directors by rotation depends on the wording of the articles, but typically will be as follows:

1 At the first annual general meeting of the company, all the directors must retire and be elected by the members (see precedent 19).

2 At subsequent annual general meetings, one-third of the directors or, where the number is not an exact multiple of three, the number nearest to one-third retire from office. Directors who are retiring because they have been appointed since the last annual general meeting and directors who are excluded from the retirement by rotation provision (e.g. managing directors) are not taken into account for this purpose. Some companies' articles provide that the number of directors to retire by rotation shall be one-third of the directors or, if their number is not three or a multiple of three, then the number nearest to but not exceeding one-third shall retire. For example, in the case of a board of directors consisting of eight directors, under such provisions, three directors would retire; under these alternative articles, only two directors would retire.
3 The directors to retire at any annual general meeting are those who have been in office longest since their last election. If two or more persons became directors on the same day, those to retire (unless they otherwise agree among themselves) shall be determined by lot.
4 Directors retiring by rotation are eligible for re-election, but the company in general meeting may elect some other person to take that director's place.
5 In public companies, the resolutions at a general meeting for the appointment or reappointment of directors must be voted on individually unless those at the meeting first agree unanimously that the appointments or reappointments may be made by a single resolution (s. 160).

Removal of directors

The members may remove a director at any time by ordinary resolution (see precedent 20), regardless of anything to the contrary in the articles or any agreement with the director (s. 168). Removal, however, does not deprive the director of any rights they may have to compensation or damages payable in respect of the termination of their appointment as a director.

Special notice must be given to the company of the intention to propose such a resolution (see precedent 21). A copy of the notice must be sent to the director concerned, to give them the opportunity to make representations in writing to the company and to request that these be circulated to the members.

Where such special notice is received by the company, care must be taken to ensure that the requirements of s. 169 are strictly complied with. It may be advisable to obtain legal advice as to the precise procedure. In the case of a public company, a resolution could be proposed at the next annual general meeting. In all other cases, the removal will be dealt with at a general meeting and special notice must be given to the company of the intention to propose a resolution to remove a director not less than 28 days prior to the meeting, as specified in s. 168(2).

Articles of association may not exclude the provisions of ss. 168 or 169, but may make additional provisions for removal of directors, such as by unanimous resolution of the other directors or by written notice of the holding company.