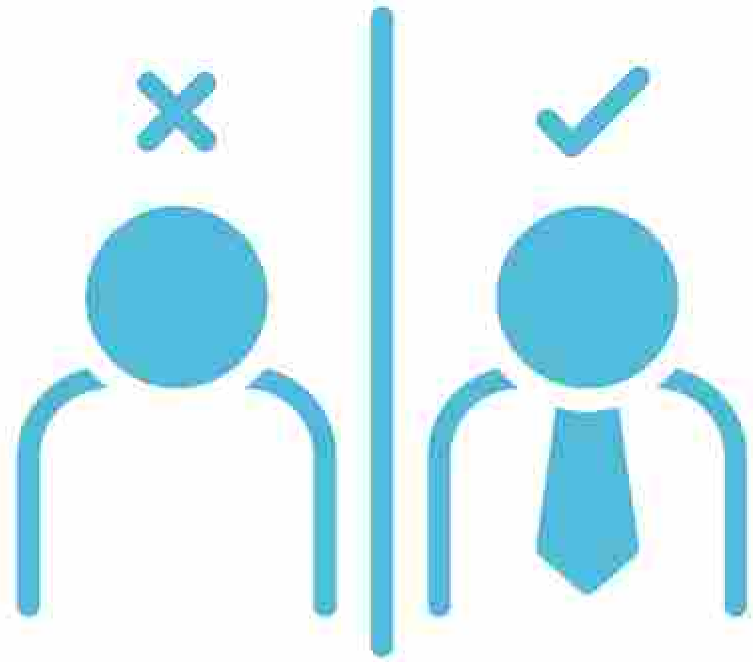
PayePass

PayePass eGuide

DIRECTORS

OTHER CONSIDERATIONS& CONSEQUENCES OF BREACHING THE SEVEN DUTIES OWED BY DIRECTORS

The seven duties are owed to the company, so it is only the company, acting via its board of directors, that can enforce them. An action for a breach of duty brought by the company would fall within the general management of the company. It is the board's decision whether or not to act against a particular director.



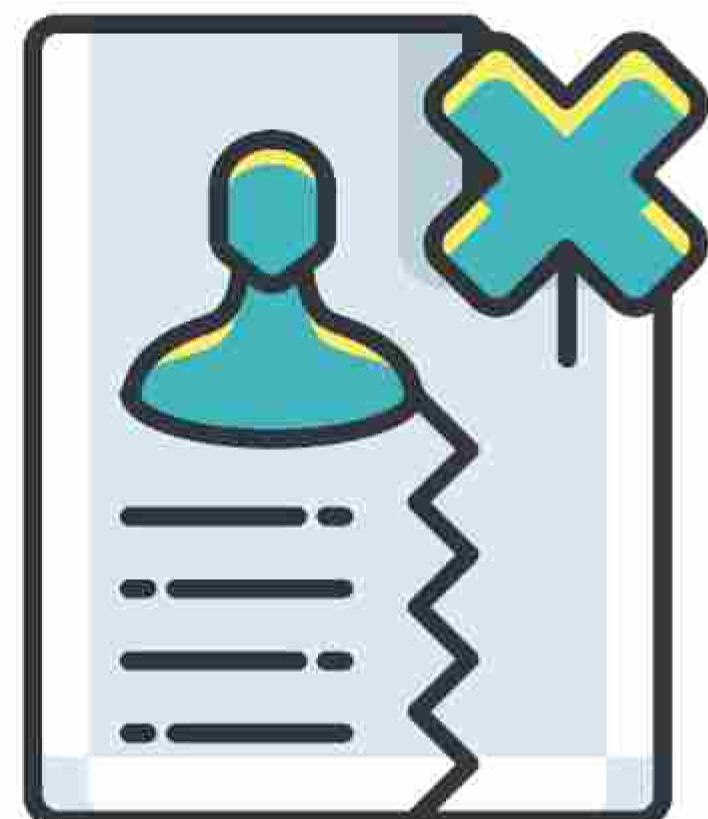
In some circumstances, the shareholders can step in and bring an action in the name of the company to recover loss on behalf of the company. Such claims are usually considered if the board of directors choose not to proceed against the director in breach. However these claims can be difficult to bring as there is a two-stage process of court approval that must be satisfied.

A claim for breach of duty can also be initiated by a liquidator or administrator of the company on insolvency. In these situations the insolvency practitioner takes control of the company and so may bring a claim for any historic breach of duty by a director.

Breach of duty may also give a company grounds to dismiss a director as an employee and the director could face disqualification proceedings, preventing them from acting as a director, or being involved in the management of another company.

The general remedies available for a breach of the statutory general duties include:

- damages - to compensate the company for any loss suffered as a result of the breach
- setting aside the transaction - this would mean rescinding any contract entered into by the company as a result of the director's breach and placing the parties back in the position they were in before it was entered into
- accounting for profits - here the director would have to pay back any profit made as a result of the breach of duty
- restoration of company property - the director may be required to return any property held by them which rightfully belongs to the company.



Protections for directors

There are some ways that a director can be protected against liabilities arising from a breach of duty.

Court Relief

If proceedings are brought against a director for a breach of duty, the court may relieve the director, fully or partially, of any liability if they acted honestly and reasonably and, considering all the circumstances of the case, they ought fairly to be excused. However, the courts are generally reluctant to grant relief in this way and it should be seen as a last resort by a director to hope to rely on it.

Ratification

In certain circumstances, a company can choose to 'forgive' a director's breach of duty by passing a resolution to ratify the act or omission giving rise to the breach. However, a company cannot ratify all acts of a director, particularly where the director was dishonest or where the relevant act was unlawful.

The ratifying resolution must be passed by a simple majority of the shareholders unless otherwise specified in the articles.

Any shareholder who is connected to the director would not be eligible to vote on the ratifying resolution. 'Connected' for this purpose includes that director's family members, any trusts of which the director is a beneficiary/trustee, any company in which the director holds at least 20% of the shares and any person who is a partner at a firm where the director is also a partner.

Indemnity

Although the general rule is that a company cannot indemnify a director against liabilities arising out of their directorship, an indemnity can be given in certain circumstances. To be lawful, the indemnity must qualify as a 'third party indemnity provision', indemnifying a director against liability incurred to a person other than the company or an associated company.

The indemnity cannot indemnify the director against a fine imposed in criminal proceedings, a penalty payable to a regulatory authority or any liability incurred where judgment is given against the director.

Permission to grant such an indemnity is usually found in the company's Articles of Association, although a director may prefer this to be included in the service agreement or in a separate deed in order to be certain that the indemnity can be directly enforced by the director.

Insurance

Companies will often obtain directors' and officers' (D&O) insurance to insure their directors against any liability arising out of the discharge of their duties as directors, including claims for negligence, breach of duty or other default. The policies offer protection for a variety of claims such as official investigations, claims by shareholders and claims arising on the company's insolvency. However, they usually exclude any action that is considered fraudulent, dishonest or criminal in nature.

Other duties and responsibilities include:

Statutory Registers

Every company is required to keep certain statutory registers and to provide access to them. These must be kept at the company's registered office or at some other place notified to Companies House. There are various registers that must be maintained, in particular:

- register of members
- register of directors
- register of directors' residential addresses (not open to public inspection); register of secretaries;
- register of persons with significant control (PSC register);
- copies of all charges and mortgages; and
- copies of directors' service contracts.

Accounting Records

Directors must keep adequate and accurate company accounting records.

The records must show and explain transactions and disclose the company's financial position with reasonable accuracy. As a minimum, accounting records must contain day to day entries of all sums of money received and expended by the company as well as a record of the assets and liabilities of the company

Data Protection

Under data protection legislation in the UK, a company will be classed as a 'data controller' and must ensure personal data is processed lawfully, fairly and in a transparent manner. The legislation sets out how personal data must be handled and relates to the collection, recording, use, storage, disclosure and destruction of personal data held by the company. Companies must be able to provide evidence that the legislation has been complied with.

All UK-registered companies are required to comply with the legislation and company directors will be responsible for ensuring compliance. Key requirements under the legislation include having appropriate data protection policies and procedures in place and, if the company meets certain criteria, a designated data protection officer must be appointed.

Failing to comply with the stringent requirements can lead to significant fines and any data protection breach is likely to impact on the company's reputation.

In addition to company specific sanctions and fines, directors could potentially face personal liability of a criminal nature should anybody within the company commit a breach of the legislation.

Directors should ensure that adequate training is provided to all employees so that the rights of data subjects are preserved. The company should also have procedures in place to allow it to respond to any requests from data subjects relating to their personal data.

Health and Safety

Directors owe duties to their employees and to persons not in their employment but who may be affected by their actions (such as contractors and visitors to their site, etc). These duties stem from the Health and Safety at Work Act and related legislation.

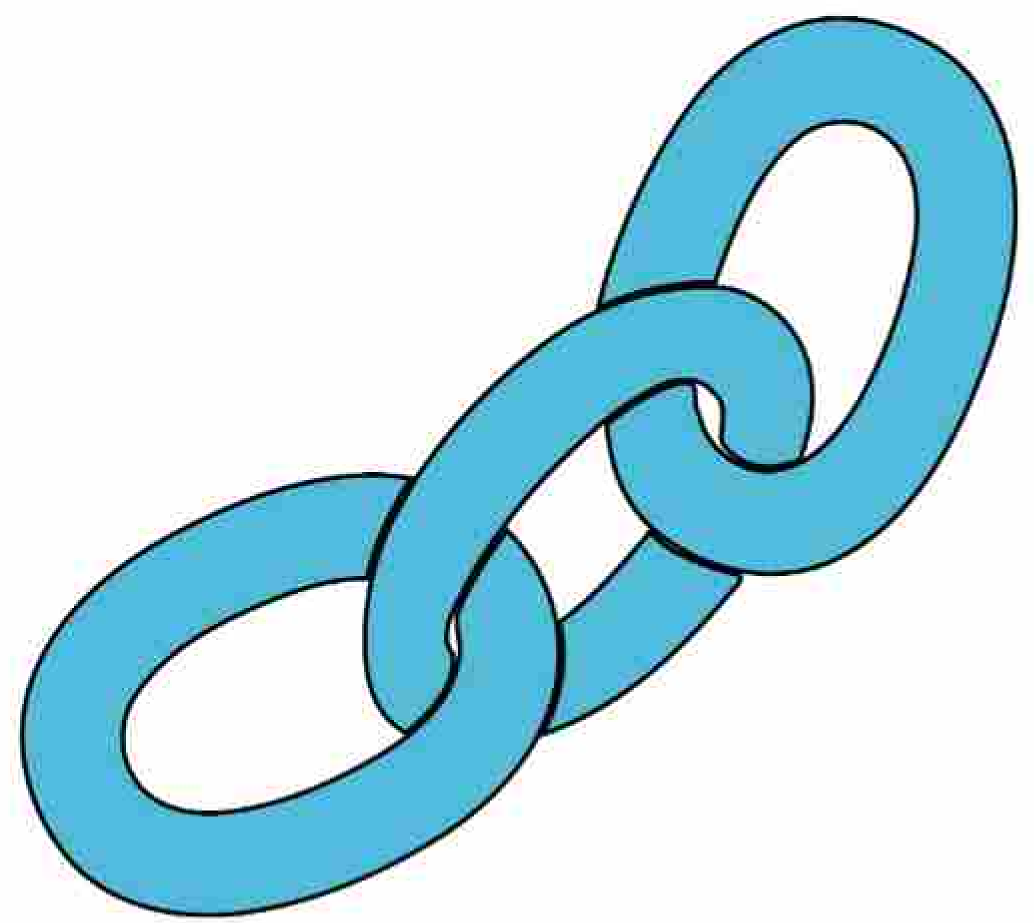
Where an offence under any health and safety legislation is committed by a company and it is considered by the Health and Safety Executive to have been committed with the consent or involvement of, or to have been attributable to the neglect of any director or other officer of the company, that person, as well as the company, will face proceedings for breach of the relevant health and safety legislation.
In these circumstances, ignorance of the law is not a defence. Directors are expected to understand and act in accordance with their obligations.

If convicted, penalties range from a fine to imprisonment for up to two years and disqualification from acting in the capacity of a director for up to 15 years.

In the event of a fatal work-related incident, companies may also face corporate manslaughter charges and a director could face a charge of gross negligence manslaughter which carries a maximum term of life imprisonment.

Having appropriate systems to manage, monitor, audit and review health and safety within an organisation is imperative in order for a director to comply with the legal obligations and to avoid the risk of prosecution.

All directors should familiarise themselves with the joint guidance available from the Health and Safety Executive and the Institute of Directors.



Modern slavery statement

The Modern Slavery Act is aimed at increasing transparency in supply chains. Large organisations with a turnover of over £36 million a year are required to disclose the steps taken to ensure their business and supply chains are free from modern slavery and human trafficking.

Organisations caught by the Act must publish a modern slavery statement every financial year on the company's website which must be approved by the board and signed by a director.

The statement should include information relating to company policies and any due diligence undertaken as well as highlighting areas of the business which are most at risk from human trafficking along with the steps taken to manage that risk.

There is no direct penalty for failing to publish a modern slavery statement. However, failure to comply is likely to lead to criticism and negative publicity and could result in a court order forcing compliance.

Prevention of facilitation of tax evasion

All directors need to be aware that there are corporate offences relating to the facilitation of tax evasion both in the UK and overseas. A company will be liable if it fails to prevent any of its associated persons from facilitating tax evasion if it cannot demonstrate that reasonable prevention procedures are in place.

There are three stages to the offences:

- firstly, there must be criminal evasion of a UK or foreign tax by an individual or an entity
- secondly, there must be facilitation of that criminal tax evasion by a person associated with the company
- thirdly, the company must have failed to have reasonable procedures in place to prevent that facilitation of tax evasion

In very limited circumstances, a company may be able to argue that it was not reasonable to expect it to have any prevention procedures in place at all. To rely on the "reasonable procedures" defence, a company would be expected to carry out a risk assessment to establish which procedures are proportionate to the risk of tax evasion within its organisation and businesses (or whether any procedures are required at all).

HMRC has issued guidance about the procedures that companies can put in place and this lists the same guiding principles as set out below for the bribery offences.

As with the bribery offences, the principles are not strictly mandatory and failing to satisfy all of the suggested methods of prevention will not necessarily mean that the statutory defence is unavailable.

Perhaps most importantly for directors, although companies are required to have appropriate procedures in place to prevent both bribery and the facilitation of tax evasion, they should avoid the temptation to simply apply the same procedures to both offences. The risks of tax evasion are much wider than those for bribery and different factors will need to be considered.

It is worth noting that the legislation and guidance do not require a company to prevent every act of facilitating tax evasion from being committed, but merely require it to adopt an approach that is proportionate to the areas of identified risk.

Prevention of bribery

The Bribery Act imposes various obligations on a company and its directors. The Act covers the conduct of a business both in the UK and abroad.

There are four main offences in the Bribery Act:

- offering, promising or giving a bribe
- requesting, agreeing to receive or accepting a bribe; bribing a foreign public official
- for commercial organisations, failing to prevent bribery by those acting on their behalf
- A company will commit an offence if a person associated with it bribes another person for the benefit of that company or its group. This means that actions of the company's agents, employees, subsidiaries and suppliers could make the company liable for this offence. There is no need for the involvement of the company to be established.

A company will commit an offence if a person associated with it bribes another person for the benefit of that company or its group. This means that actions of the company's agents, employees, subsidiaries and suppliers could make the company liable for this offence. There is no need for the involvement of the company to be established.

The directors' role here is in ensuring that 'adequate procedures' are in place to prevent the bribery offences which is a defence to those offences.

Adequate procedures include:

- proportionate procedures
- top level commitment
- risk assessment
- due diligence
- Communication
- Monitoring and review

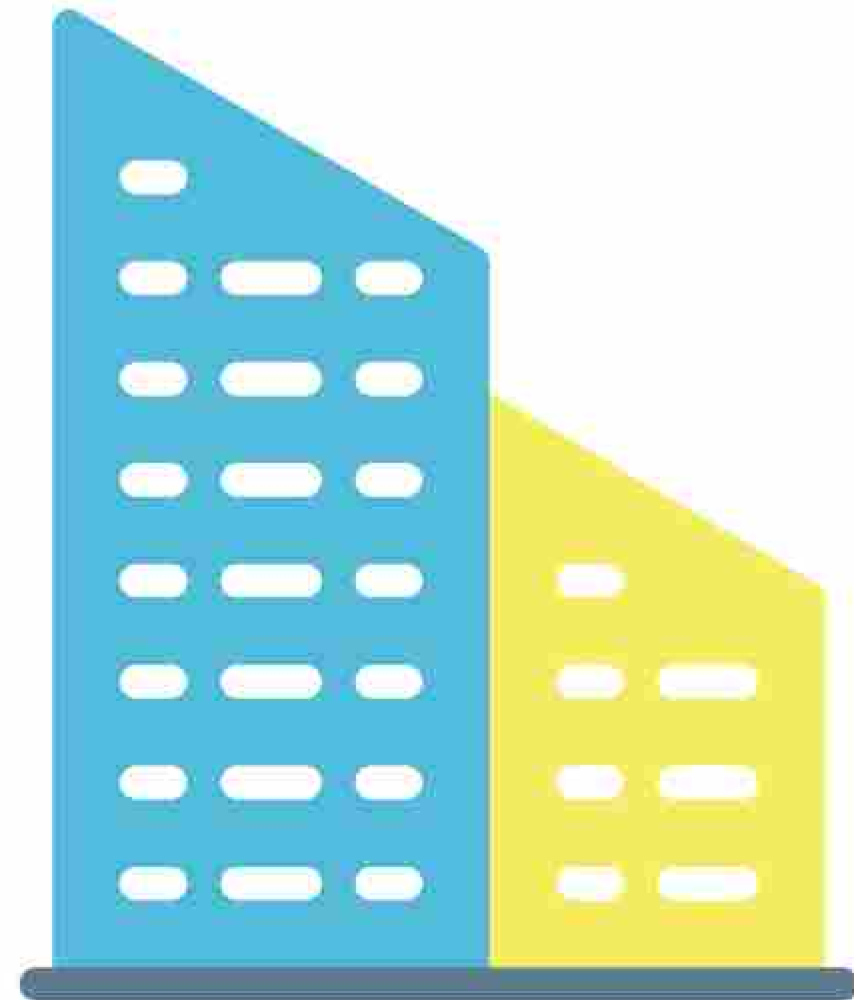
Companies and individuals could face an unlimited fine, with directors risking a maximum prison sentence of 10 years. To negate such risks, directors should conduct regular risk assessments and ensure that adequate procedures are in place to prevent bribery.

Directors of publicly listed companies face additional duties depending on the market on which the company is listed.

The London Stock Exchange imposes rules through the Listing Rules and the AIM Market imposes additional obligations through the AIM Rules for Companies. Both markets are also subject to the market abuse regime which is designed to provide a level playing field for those seeking to invest in listed companies.

A director must take positive action to mitigate the potential loss to creditors – a claim that they have done nothing to cause loss themselves is not sufficient. This action must be taken at the right time, so the director must neither act too late nor put the company into liquidation too early.

A director cannot avoid liability by resigning when they realise that the company is facing financial difficulty. Such a resignation is unlikely to minimise the loss to creditors.



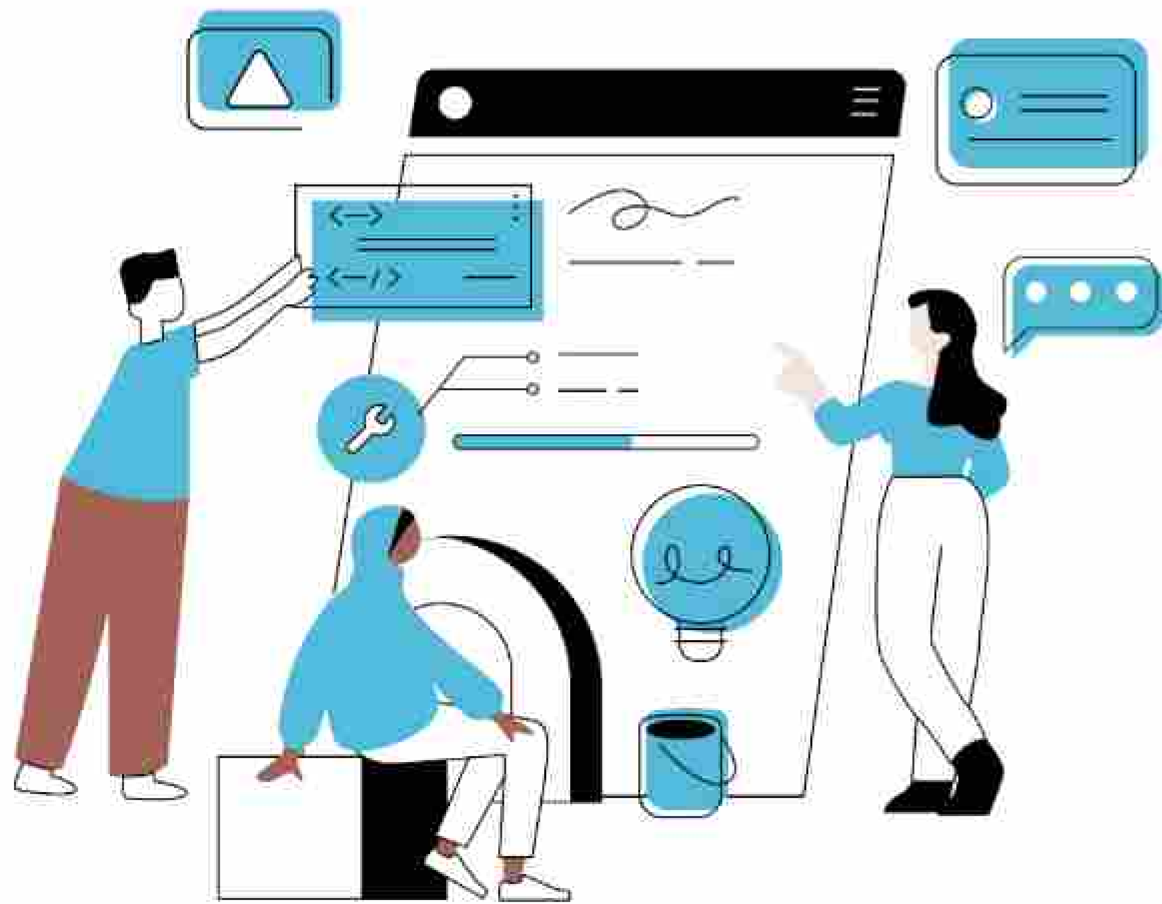
The director should remain on the board of the company to ensure that their warnings are recorded, for their own protection and so that at least one voice will be heard representing the interests of creditors, if other directors should refuse to act.

Obligations to file companies information at Companies house

All companies have an obligation to file documents and updates with Companies House at certain intervals.

These are usually annual filings or a filing that is required as a result of a particular event or change to the company. It is the responsibility of the company's directors to know when these filings are required and to ensure that these filings occur on time.

Directors will also owe specific contractual duties and obligations under their service agreement and their position as an employee could give rise to a number of implied duties, such as a duty of confidentiality.



Duties when facing insolvency

When a company is facing financial difficulties, there is a shift in the focus of a director's duties.

The main change stems from the duty to promote the success of the company. In times of threatened insolvency, the duty to act for the benefit of the company's members switches to a requirement to act in the best interests of the company's creditors. If a director breaches this duty, they may be required to contribute to the company's assets on insolvency.

There are also some specific insolvency-related offences of which a director should be aware:

- wrongful trading – a director may be ordered to contribute to the general pool of assets available to the creditors where they knew or ought to have known that there was no reasonable prospect of the company avoiding insolvent liquidation and they continue to allow the company to trade and do not take every step to minimise the potential cost to creditors.
- fraudulent trading – this is another way in which a director can be ordered to contribute towards the company's pool of assets. If the business of the company was carried on with the intent to defraud creditors, then a criminal offence is committed. An example of such trading would be where a director continues to incur credit on the company's behalf without any reasonable expectation of funds being available to repay the debt when it becomes due

Both of these claims can only be brought by a liquidator. In order to succeed in a claim for fraudulent trading, actual dishonesty must be proved on the part of the director. It follows that a claim for wrongful trading is easier to satisfy.

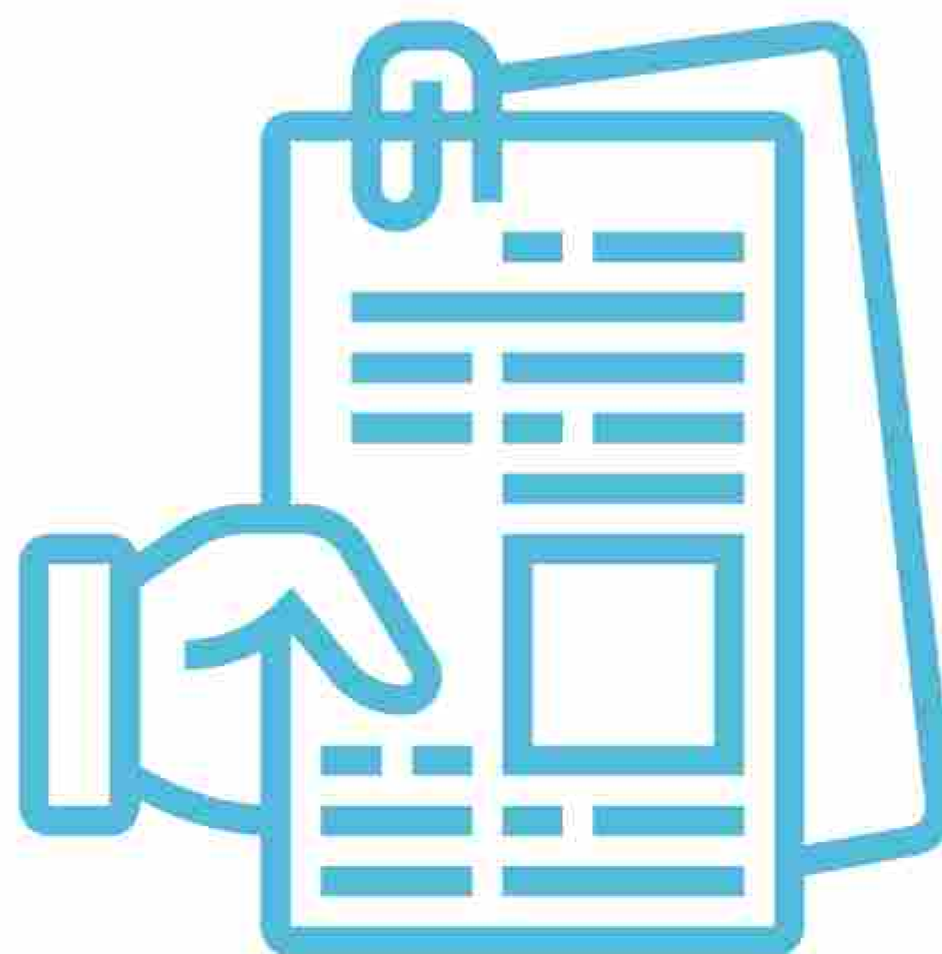
To avoid any liability under these offences, it is advisable for directors to obtain independent advice as soon as they become aware that the company is in financial difficulties.

Other individuals can be hired to manage these tasks, such as an accountant, but a director is still legally responsible for accounts, records and performance. A director can be fined, prosecuted or disqualified if they do not meet their responsibilities.

Company records that may not be relevant in a financial sense, but are still important to the running of the company include:

- details of shareholders, directors and company secretaries;
- the results of any shareholder votes and resolutions;
- details of any promises to pay back loans at a specific date;
- details of any indemnities;
- information regarding share transfers; and
- details of loans or mortgages secured against the company's property.

It is also important that Companies House are made aware if records are being kept at a location other than the company's registered office.



Changes to report to companies house

If any significant changes occur within a company, the directors must ensure that these are notified to Companies House.

Changes that may occur during the life cycle of a company can be divided into two categories: event driven filings, which usually relate to a change in the company; and annual filings, which are annual requirements outlined by Companies House.

Event driven filings:

- a change of registered office address
- the appointment of a company director or secretary
- a change of personal details of a company director or secretary
- the termination of the appointment of a company director or secretary
- a change of the address where the company records are made available for inspection; an allotment of new shares
- a change to the company's total share capital

- a change to the company's accounting reference date; a change to the company's name
- the creation of a charge over any of the company's assets
- a special resolution or certain other types of resolution being passed by the company's members; re-registration of the company, from a public to private company, or vice versa
- any change to the people who have significant control over the company (the company's 'PSCs')

There are substantially more event driven filing requirements when compared with annual requirements. Note also that a significant change to a company may not be effective unless the relevant form is filed with Companies House. With many of these event driven filings, the change will only take effect once the form is submitted.

It is therefore essential that the company directors complete the right form and submit it in the specified time period. Detailed guidance on filings can be found on the Companies House website.

If annual filings are not made, then Companies House may assume that the company is no longer carrying on business or is no longer in operation. This may result in steps being taken to strike the company off the register. The effect of this is that the company is deemed to no longer exist and all assets become property of the Crown.

In conclusion

The extent of a director's duties, responsibilities and potential liabilities should not be underestimated as to do so could result in not only the failure of the company, but also some life changes personal consequences.

Even so, what might appear to be daunting is actually all easily manageable and achievable with some simple procedures in place and common sense professional conduct for directors to avoid sleepless nights and avoidable stress.

Get in touch...
0151 440 2993
askus@payepass.com
www.payepass.com

PayePass