Chapter one

The nature of the beast

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How did we get here?

Until the 13th Century whoever was running a failed business had personal liability to its creditors (and could find themselves in a debtors prison if they failed to pay). The description of a 'company' (from the Italian 'compagnia' – '*gathering together to break bread*' used by family firms where each had joint liability to the value of their 'wordly goods') began to be used.

Then the concept of a Royal Charter – one literally signed by the monarch – was introduced (on a restricted basis) to grant protection from such personal liability. The first two Charters were granted to Oxford and Cambridge Universities although these were swiftly followed by towns and cities becoming incorporated – hence in a contract with a local authority the description 'the Mayor and Corporation of…' is often used.

For a further 300 years, owners' liability could only otherwise be protected by creating an organisation under a specific Act of Parliament – one of the first (around 1600) being the East India Company (with the authority of Elizabeth I and which lasted nearly 300 years, effectively ruled India and had an army of 260,000), whilst the Hudson Bay company – incorporated in 1670 – is still trading today. Prominent people participated in the ownership of commercial (usually unincorporated) entities – for example, Shakespeare is said to have owned an eighth share in the original Globe Theatre.

In the 1840s the rapid development and promotion of the railways in the UK meant that each year around 200 separate Acts of Parliament were needed to be passed to create such companies. In 1844 the Joint Stock Companies Act was passed and the Registrar of Companies office was set up.

There were massive changes to mid-19th century UK life following the introduction and development of the railways. However the profound effect on social, domestic and business life generally was to no small extent mirrored by the effect on the development of company law – and eventually the accountability of those running limited liability companies. After 1840, the number of railway companies swiftly proliferated. Many such companies had Members of Parliament as their owners and directors and some of them were landowners who, despite possible inconvenience, benefitted financially from the creation of the permanent way being built across their lands for the new 'iron horses'.

These directors could ensure the required Acts of Parliament to set up the companies went through swiftly.

Although there was a high failure rate amongst the railway companies, many survived and in some cases became very large and important parts of the national economy – the London and North Western railway company's capitalisation was over £29 million in 1851 and it was the largest joint stock company in the land at that time; whilst by 1885 the capitalisation of all the surviving railway companies – many smaller companies having by then either failed or merged – was £816 million, whereas the total capitalisation of all other UK companies was only £495 million. In 1894 there were still approaching 280 railway companies.

Inevitably with such an explosion of interest in an entirely novel method of travel opportunists abounded and some of the newly founded companies were little more than devices for *pyramid selling* (i.e. capital contributed by new shareholders being used to 'reward' earlier investors) and others were headed by fraudsters. One such was Lionel Redpath who worked for the Great Northern railway for several years but who was eventually unmasked and jailed. The devices by which Redpath created a fortune for himself out of the operation of the company were discovered by an accountant – William Deloitte. Similarly at the London and North Western railway company their audit was overseen by Edwin Waterhouse who also oversaw the financial affairs of the London Brighton and South Coast Railway – where he stopped the practice of the company paying dividends out of capital. The names Deloitte and Waterhouse are easily recognisable as being part of major accounting firms in the UK today.

The railway 'bubble' burst in 1847 creating a financial crisis akin (in relative terms) to that experienced recently in the UK. Following recovery from recession, in 1856 the first Companies Act was passed allowing companies to be set up under its auspices – i.e. not needing an individual Act. In the event of the failure of a company this provided limited liability for the owners – protecting their investment at the expense of the creditors. Public opinion was generally against this development and the Act was ridiculed as a '*rogue's charter*' and '*a means of devising the encouragement of speculation, overtrading and swindling*'. The public outcry was so great that Gilbert and Sullivan wrote one of

their operettas on the subject – '*Utopia Ltd*' – which featured a director sheltering behind – and protected by – limited liability!

The 1856 Act was followed by a second Companies Act in 1862 which again, ironically, was followed in 1866 by a further and massive financial crash linked to the railway industry (including the failure of one of the biggest banks operating in and for that industry) and another major recession!

These Acts (a worldwide first, the principles of which have been copied in many countries) created a '*legal persona*' – the limited liability company – with virtually the same rights as real or natural persons – indeed a company is sometimes referred to as an '*unnatural person'.* However, the shareholding owners of such a company had their liability limited to the total value of the shares that they had invested. Once they had paid that, unless they had acted fraudulently, they had no liability to creditors of their companies should they fail. The limited liability company was born.

As noted above, in the wake of these enactments there were very real concerns that some directors of such companies (who very often were the shareholders) could run the company into the ground knowing that they could walk away from a failed company with no liability to the unpaid creditors. These critics were of course proved right and in a number of instances this is exactly what happened.

In addition in some cases it was clear that although the properly appointed directors' names were known and registered with CH, in fact the companies were being '*directed*' (i.e. actually operated by) by persons whose presence was not acknowledged or disclosed. Thus the directors' actions were being manipulated by a kind of '*eminence gris*' or '*shadowy*' persona who had real control of the company.

Information about limited liability companies was made available via CH mainly to protect the creditors since they could inspect the (unaudited) financial results of the companies to which they were advancing credit.

Amongst other data, directors' details had to be lodged – but obviously the details of those pulling the strings of a board were not; thus details of the people who were actually running such companies were concealed. The numbers of companies were quite small – under 100,000

at 1900 (when for the first time shareholders had the right to receive audited accounts of the company they owned from the directors) and under 500,000 by 1985. An explosion of numbers of companies has occurred since 1985 so that the number is now approaching 4 million.

The continuing legislative movement

As is customary, once it is known there are legislative loopholes, subsequent legislation is introduced to attempt to plug the gaps. Since the mid-nineteenth century every 15/20 years new company legislation has performed this function as well as adding considerably to the regulatory requirements placed on limited liability companies – and their officers.

From time to time there have been major re-writes of company legislation consolidating previous primary and secondary legislation. CA85 was notable since not only did it consolidate all the legislation since CA48 but in addition for the first time defined the '*shadowy persons*' not acknowledged as directors at CH referred to above. Section 251 of CA06 states a '*shadow director*' means '***a person in accordance with whose directions or instructions the directors of the company are accustomed to act***'. Additional restrictions are being implemented regarding shadow directors.

The Insolvency Act 1986

Linking with CA85 and close on its heels, the Insolvency Act for the first time since 1856 placed potential liability on those actually running companies. The twin offences of '*wrongful*' and '*fraudulent*' trading were created.These require that directors (and others) who continue to run their companies when they knew or (the critical obligation) **should have known** that their companies were taking on credit which might not be paid on the due date – or within a reasonable time of that date – can be required to contribute personally to the creditors if their companies fail.

It must be said that there have not been that many prosecutions of culpable directors mainly since the attitude of what is now the DBEIS was that unless there was a very good chance of success it would not be appropriate to spend public money in such circumstances. (One is then tempted to wonder '*why bother to pass the legislation?*')

However the responsibility for initiating proceeding and gaining potential recovery from wealthy directors who have broken the law in this way has now been passed to Forensic Investigation and Recovery Services (FIRS) who may generate more cases.

Fraudulent trading is proscribed anew in CA06. S993 states that any person who carries on the business of a company with intent to defraud the creditors (or anyone else) is guilty of an offence for which the sanctions are potentially imprisonment for up to 10 years or a fine (or both) as well as personal liability for the debts.

Liability can be held to continue even when the company under which the liability was created has been sold to another. In the scandal concerning the insolvency of the BHS pension fund following its sale to someone best described as a 'man of straw', Sir Philip Green (whose family had enjoyed the benefit of substantial dividends from BHS whilst they controlled the company) was forced to contribute to the funds to (partly) reduce the company's pension fund deficit.

At virtually the same time as the Insolvency Act 1986 was enacted so too was the Company Director's Disqualification Act 1986 which gave Courts the power to disqualify those acting as directors (whether properly appointed or not) from continuing to do so.

Abuse=legislation

The Insolvency and the Company Directors Disqualification Acts were introduced as a direct result of the nefarious activities of the man running Pergamon Press which collapsed owing millions in unpaid invoices to the creditors. The Board of Trade report into the failure commented that the person concerned should never again be involved in running a UK company. However, there was no mechanism to implement this at the time. The man was Robert Maxwell – and the rest is history.

The Companies Act 2006

The above resumé brings us to the mid 1990s and the start of a 9 year consultation process which eventually resulted in a completely new Companies Act. After a three year implementation phase, CA06 was

brought into full operation in October 2009. Since then there have been well over 100 statutory instruments implementing the detail of the Act.

What is a company

A company is a legal (or *unnatural*) person – created by and operating under Company Law. It has an existence which is separate from its owners (shareholders, guarantors etc.) and separate from its officers (directors, company secretary and managers). Unlike the real persons who operate it, a company is immortal since regardless of who owns it or who directs it, it can (at least in theory) operate forever. In addition, it is brought into being via a process laid down under the CA – and it can be wound up, dissolved, struck off etc. under those Acts. This legal person can not only '*die*' but by decision of the Court can be brought back to life in order to face a liability claim.

Company Law does not permit shareholders to run companies – they are legally required to appoint directors to do that. In essence shareholders' rights are restricted to appointing directors and, if they do not like the way their company is being run, removing them. Recently in the UK there have been examples of shareholder power in determining who should be (or continue to be) directors. Other than determining who are to be the directors, a shareholder who interferes with the running of a company runs the risk of becoming a '*shadow director*' (see Chapter 2) with potential liability as such.

To try to prevent the ultimate control of a company being hidden, companies are now required to disclose (to CH) any **persons of significant control**, or, as and when changes take place in such persons, the nature of such change (s) (see Chapter 2).

A company as a legal person must comply with its legal obligations – not only company law, but all laws. If it breaks those laws, then the company itself can be made subject to the sanctions set out in those laws. However, in most cases the company acts via its agents – the officers – who can also be held personally liable for such actions. If the actions are very serious then imprisonment may be the sanction. A company cannot be imprisoned – but its officers can.

Companies can be limited by shares (the vast majority – either private or public) or by guarantee. There is a guide to types of companies in Appendix I.

Formation

A company can be formed under CA06 relatively easily and it is possible for anyone to do so – but this may be unwise for those without experience in drafting a company Constitution – the Articles – as mistakes could be created. Taking legal advice would be preferable. Conversely for a small fee (and within a matter of hours) CH can form a new company electronically although the standard set of Articles accompanying CA06 must be used. These are quite short (only 53 regulations) compared to the CA85 version (118 regulations) and will not suit every company. (See Appendix III for a guide to the omissions.)

If a new company is required urgently, the electronic formation process could be used. Then, once the company is in being, a General Meeting could be convened to pass a special resolution (see Chapter 12) adopting a revised set of Articles customised to fit the company's exact requirements. The new Articles would then need to be filed at CH.

Re-Registration

Most companies are formed as LTDs and remain so throughout their life. Some however re-register as PLCs. To do so an LTD must:

- change its name to end PLC
- have £50,000 or more issued share capital of which 25% has been paid up
- remove from its Articles the right of the directors to refuse to register a share transfer and

- be in receipt of a trading certificate from CH (it must not trade as a PLC until it has this certificate. If it does the directors can be held personally liable for its debts or liabilities).

A PLC can re-register as an LTD, and an unlimited company can re-register as an LTD.

Legal advice should be taken.

The Veil of Incorporation

A company is a legal person created or brought into being under company legislation with an existence entirely separate from its owners and its directors. It is also an entity totally separate from its own subsidiaries (even if it owns all the shares in those companies). The extension of this is that being separate entities, should a subsidiary (even if wholly-owned) of a parent company become insolvent, the parent (unless it has guaranteed the debts of the subsidiary) has no liability and can simply walk away and wash its hands of its subsidiary's plight. The parent's loss could ultimately be restricted to the (probably nominal) value of the shares in the subsidiary. This 'separateness' is created by what is known as the '*veil of incorporation*'.

However, if it can be shown that the parent or the parent board of directors exercised undue direct influence over the activities of the subsidiary, the parent can still be held responsible for the results of such activities – particularly liability. Thus there have been a few instances where the Courts have allowed this veil of separateness to be '*pierced*' meaning that a claimant against a subsidiary could bring a successful action directly against the parent.

Parent responsible for acts of subsidiary or not?

In *Chandler v Cape plc* the parent company was held to have a duty of care to the employees of its defunct subsidiary company. Mr Chandler worked with asbestos during his employment with a subsidiary of Cape plc, which, by the time his symptoms of mesothelioma had appeared, had ceased to exist.

The Court of Appeal held that since the parent company exercised control over its subsidiaries including dictating the overall health and safety policy of the group, although the subsidiary could exercise a degree of independence, the parent company did have a duty of care to Mr Chandler. The parent company should have been aware at the time that contracting a harmful disease from asbestos dust was a distinct possibility and thus they had a liability to the employee of the subsidiary.

However, in a similar case (*Thompson v The Renwick Group plc*), Renwick (the parent company) appointed a director with responsibility for health and safety to the board of a newly acquired subsidiary. Thompson (working for that subsidiary) handled asbestos and later contracted mesothelioma. His attempt to hold Renwick responsible failed since the parent could not be shown to have ***controlled*** the activities of the (now-defunct) subsidiary for which Thompson formerly worked – merely to have appointed a director to its board. (Renwick's course of action would then be to apply to the Court to have the defunct subsidiary resuscitated so he could claim against it and/or its insurers directly.)

NOTE: Under the 'Persons of Significant Control' requirements a parent company owning more than 25% of the shares needs to be disclosed in a register and at CH. In fact this information should already be in the public domain since details of all a parents' subsidiaries are required to be disclosed within the parent's annual accounts. (See Chapter 2.)

The director/company relationship

The 'separateness' of parent company and subsidiary referred to above is mirrored in the relationship between the company itself and those that operate it. As a legal person under Company Law the company has an existence separate from its owners (shareholders or guarantors) and its directors (whose contractual relationship will be examined in Chapter 3). Despite the company being a separate legal person, it can act only via its directors. Since many of their actions are taken in the name of the company it can be held responsible for such actions.

The company – a legal persona.

The owners – shareholders or guarantors (who can be legal entities as well as real persons).

The officers – mainly the directors. Directors can be legal entities* as well as real persons although there must be at least one real person on every board. In addition the Company Secretary, auditors and managers can also be regarded as company officers.

** A company can be a director of another company but only in:*

- *UK listed and quoted PLCs*
- *Large PLCs and LTDs in group structures, and*
- *Charitable companies and trustee companies of pension funds.*

However, the 'separateness' illustrated above will not always mean that full responsibility is passed to the separate legal person that is the company.

The separate *persona*

The fundamental principle that the company is a legal persona, entirely separate from those that own it as well as those that run it, was clarified by the Courts many years ago. In 1897, Salomon, a rather disreputable leather merchant, transferred his sole trader 'business' into a new company that he set up – 'Salomon and Co Ltd' – which promptly collapsed, insolvent. The company's creditors failed in their attempt to hold him personally liable for their unpaid invoices as the Court stated that his company was a separate legal entity, even though it could only act via its officers (i.e. Salomon himself).

Nowadays had Salomon not regarded the interests of the creditors as 'paramount' when his company was failing, (i.e. he allowed it to continue to trade ignoring the fact that the creditors could lose their money) he could have been required to contribute to their losses, as under the Insolvency Act 1986, this would almost certainly have been classified as 'wrongful' or even 'fraudulent' trading – see Chapter 4.

But directors cannot hide behind the company or blame it for their own acts, even if their actions were carried out in the company's name.

Passing the buck

In *Bilta (UK) Ltd (in liquidation) v Nazir & ors*, the four directors of Bilta were involved in a scheme with a third party to create transactions (in the company's name) enabling it to fraudulently overclaim VAT. The directors failed in their attempt to pass the liability for their fraudulent activities to the company itself. The liquidator acting on behalf of the failed company was therefore entitled to seek financial contributions from those involved in the fraud. In addition, by involving the company in such fraudulent activities the directors had damaged the company and thus were in breach of their fiduciary duty to the company (and presumably could have been liable to pay damages to it).

Conversely it is only through the directors that the company can carry out what is required of it.

Whose actions at fault?

In *Brumder (B) v Motornet Service & Repairs Ltd (M)*, B was sole shareholder and sole director of M. B suffered an injury at work and sought to hold the company responsible since he argued it had negated its obligations to him under Health and Safety legislation.

The Court held that a claimant could not assert that the company had not done all it could to comply with safety regulations when it was only through the claimant himself that the company could take action to comply with those regulations.

What is a 'Director'

Most people will understand or assume, that a Director '*directs*' in the same way that a manager '*manages*' and a supervisor '*supervises*', even though they might then be hard put to actually define the verbs used somewhat casually to '*define*' the nouns. It seems logical to require a definition of the word '*director*' and even more logical, since it is company law with which directors must comply, to refer to the latest Act to find a definition. Immediately, however, we strike a

problem since rarely within the law itself is the term '*Director*' used (the Act refers to '*officers*') – even though the numerous obligations and requirements placed upon such persons and the penalties for their non-observance are dealt with at length. Indeed it may come as some surprise, since most companies are controlled by '*Boards of Directors*', to realise that the legislation does not require companies to have a Board either – and neither does it stipulate that, if there is a Board, that it should meet (although how directors who do not meet would be able to demonstrate the exercise of their required '*duty of care'*, if challenged, is questionable). The situation is further confused by Section 161 of CA06 referring to '*the acts of a director*' being valid notwithstanding any defect in his appointment. By using the word '*manager*' with that of '*director*' the Act apparently equates the role of the direction of the company with that of managing it. (One assumes the inference is that the '*manager*' would be a '*general manager*' rather than a departmental manager.) Even more confusion may be caused by the legislation referring to a company's '*officers*' – the '*officers*' being '*the directors, the company secretary and managers*'.

NOTE: Employees have a duty of fidelity (i.e. they should not steal from their employer). Officers, however, not only have a duty of fidelity they also have the 'higher' fiduciary duty (i.e. of utmost good faith). They must always sublimate their own interests to the interests of the company of which they are an officer.

Disclosing own breach

In *Tesco Stores Ltd v Pook*, a senior manager fraudulently arranged for payments on false invoices and received a bribe from the '*supplier*'. Directors and senior managers not only owe their employers a fiduciary duty (in addition to their duty of fidelity as employees) they also have an obligation to disclose their breach to the employer and advise their employer of any secret profits. Pook was held to be in breach of this fiduciary duty, and was required to pass the bribe to Tesco. In addition, the fraudulent receipts had to be repaid. The Court regarded Pook, a manager, as an officer.

S 250 of the CA06 repeats an earlier legal 'definition' stating: "*'director' includes any person occupying the position of director, by whatever*

name called" which although it may be a warning to those acting as Directors without being properly appointed that they might become personally liable, is of little assistance in terms of a definition of what a director actually does. It may help if we suggest that a director is someone who:

- **takes complete (shared if there is more than one director) legal responsibility for all the actions and activities of a company and those working for it;**
- **determines the aims of the company and decides lawful and safe methods and procedures whereby such aims are attained; and**
- **plans the activities of and leads those working for the company to achieve such plans.**

This may not be an ideal definition (and of course it has no legal standing) but at least it may serve to underline several important issues, particularly to those taking on the duties for the first time.These duties include the items listed in the checklist below (which itself is illustrative – not exhaustive).

A Director's exposure

1. Complete range of legal obligations and responsibilities. It is after all not only company law obligations that Directors assume but also those arising from the laws on employment, commerce, competition, environment, health and safety and so forth (all of which are ever-increasing in breadth and depth);
2. Responsibility for the actions of those employed by the company and its agents. There is an obligation to ensure, as far as possible, that they all act within the law, which in turn entails an obligation to set down and police adequate procedures and controls;
3. Acting as a Board, to lead the team that works for them in order to achieve the aims they have set the company; and
4. To determine the aims of and for the company, and generate plans to achieve such aims. Failure to attain such aims (or at least to preserve the status quo) could lead Directors into direct conflict with the shareholders who appointed them as their '*stewards*' to operate their company.

NOTE: Refer also to the 7 explicit duties of directors required of them by Sections 171 to 177 CA06 (see Chapter 2).

Appointment – First principles

Any real person aged 16 or over can be a director although anyone who is (or becomes) bankrupt cannot be a director and neither (for the period of disqualification) can anyone convicted of offences under the Insolvency Act 1986 or CDDA86.

An appointment to the Board is a matter of achievement and praise but it is far, far more than that and those that feel that they have 'made it' when they hear those magic (and often long-awaited) words '*we'd like you to join the Board*' owe it to themselves and their dependents to consider fully all the implications in at least as much detail as the perks and rewards that are now their entitlement. Indeed, so onerous are the obligations now placed on Directors and so swiftly are the occasions being extended where the Director may find him or herself personally liable, that appointees might be forgiven for feeling that the elevation may more closely resemble a poisoned chalice than a well-deserved promotion.This is not to say that any such appointment should be rejected but simply to advise that before making the jump from manager to director, the full implications of this quantum leap should be researched, understood and appreciated (not least that the interests of their own department must now be sublimated to the interests of the Company as a whole).

There is an assumption that directors understand their companies and their parameters and the environment within which they operate. Like many assumptions this may be false. Companies should discover the range of knowledge of their directors – and supply means by which any gaps are filled.

Many forward thinking companies ensure that their recruits are made to feel at home by being introduced to new colleagues and surroundings, and given an outline of the administration applicable to their new position and grounding in what is required of them in their job. Although this undertaking is widely referred to as '*induction*' it may be better described as '*familiarisation*'.

'*Familiarisation*' should have three distinct sections. Some items may appear in more than one section, since repetition is a fundamental way of ensuring we retain information – particularly when there is so much that is new to be assimilated. The three sections could be termed as '*introduction*', '*induction*' and '*instruction*'.

- **Introduction** covers the application process, the interview(s), offer of employment and first day of work when many personal introductions will have to be made.
- **Induction** is the more formalised process of working through a checklist of items that a newcomer needs to know in order that they can start to contribute to the work of the organisation. Many of these will be fairly mundane (and thus tend to be taken for granted – and possibly overlooked – by '*old hands*') but are nevertheless important to a newcomer.
- **Instruction** is the process by which there is reinforcement of knowledge provided during the earlier sections, but detailed and specific coaching in performing the job and moving to a level of required competence in that job.

So how does this apply to directors?

To some extent this is a non-question. Why should there be any difference in terms of approach between the most senior persons in the organisation – and the most junior? Even the most senior persons will require basic information about the organisation particularly if it is new to them, and the procedures etc. Operating at a senior level may well enable the routine aspects of the process to be speeded up but the organisation still needs to be able to satisfy itself that the requirements of the director are themselves satisfied. If there is a detailed familiarisation process for (say) a senior management appointment, that could be used as a base however there are additional items that directors need to be made aware of.

Directors have a potential and personal legal liability for the activities of their companies, not shared with most other employees. '*The buck*

stops in the boardroom' and thus those in the boardroom need to know for what they have responsibility. If the answers to the following are '*no*' – coaching and/or reading may be necessary. Almost certainly this will be on-going since many aspects are constantly changing – it might be helpful for a brief précis of legislative and other changes to be presented at each Board meeting.

Directors training/knowledge

Legal obligations

Does the director understand the legislative environment under which the company operates e.g.

- the basis and outline of company law?
- the latest commercial legislation including competition law?
- outline requirements of employment law?
- general requirements of other legislation affecting the company?
- the internal operating rules of the company (e.g. the Articles of Association)?
- has the Chairman checked the scope of such knowledge?
- and that the Board are responsible for the information required to be regularly filed at CH?

Finance

Does the director understand:

- the management and published accounts and ancillary data?
- that he has personal responsibility for the figures?
- the method by which queries should be raised?
- that since he must always be confident of the future solvency of the company he should not allow credit to be taken on when it might not be paid on the due date or within a reasonable time thereof?
- that commitment to expenditure on behalf of the company should only be in accordance with the regularly reviewed authority / risk chart?

Board work

Does the director realise:

- that for the company's success, its aims and the means to attain those aims must be delineated (and updated regularly)
- that he has an obligation to attend Board meetings – and to contribute to the discussion (which infers that he is satisfactorily briefed on all matters)?
- that he should always declare an interest in any third party with which the company is dealing?
- that he should always exercise his decision-making process independently of other directors (even if this means he is in a minority of one)?
- that minutes should be read and agreed (or objected to and corrected) and not passed without consideration?
- his role is proactive not reactive – he must make things happen?
- that the performance of every board member should be regularly and formally assessed?
- that he should insist that at least two working days are allowed between the receipt of items (other than routine matters) and a decision time?
- that he should insist decisions are properly minuted and that any required dissent notes are included?
- that if there are matters of which he is unaware (both in and outside the Board room) that this should be made clear and he must take steps to obtain the information?

Morality

Has the director:

- been given a copy of the Codes of Ethics, Gifts, Corporate Governance and/or any other similar requirements?
- shown that he is content that his knowledge of such items is adequate?
- been told that bribes, inducements etc must not be offered, made or requested by any person on behalf of the company?

- been made aware of the Company's obligations under the Bribery, Modern Slavery and Taxation Acts and ensured that, if he becomes aware of wrongdoing, he should take immediate steps to ensure it ceases and the errors are rectified?

Accountability

Does the director realise:

- that he is answerable to the shareholders for the activities of the company and its results
- that he is expected to authorise the company to take risks but only after a proper assessment of those risks and their potential outcome
- that contingency and disaster recovery plans should be prepared and updated covering all major eventualities
- that he is answerable to the various regulatory authorities for the activities of the company and its employees

Employees

Does the director appreciate:

- that the true value and worth of employees can only be gained if they are properly and continuously trained and/or coached in their work and any changes?
- that the Board should regularly audit personnel practice and interfacing – to generate real communication between the parties?

NOTE: This is illustrative only and not intended to be exhaustive. It draws attention to some of the main areas that need to be addressed. It needs to be customised to fit individual companies. Working through the headings will almost certainly generate other areas needing attention. With relatively little re-arranging the checklist could be used as a performance review basis since ideally directors should be assessed and their attention drawn to areas capable of improvement.

Joining the throng

In the United Kingdom there are approaching 4 million companies registered at three CHs (Cardiff for England and Wales, Edinburgh for Scotland and Belfast for Northern Ireland). Every company must have a Director – and many have more than one. Many holders of the office have several directorships, and there are over 6 million directors names registered at Cardiff alone. This is roughly 9% of the whole population, which is a sizable proportion of the total, bearing in mind that more than a few of these will be wealthy and powerful individuals able to wield a disproportionate amount of influence. Because such influence and power can be exercised for bad as well as good the parameters under which Directors are required to operate are increasingly defined – and constrained. Nowadays, society is becoming aware that power is moving away from politicians (who, whatever their faults are, at least in theory, subject to the electorate's choice) and towards corporations. As a result of amalgamations and takeovers, evident particularly since the globalisation of capital markets, the move is towards internationally based corporations becoming ever larger and more powerful. Until the recent financial crises had the effect of shrinking some of the largest companies, over 50% of the 100 largest entities in the world (that is including countries) were (and no doubt in due course will be again) corporations. General Motors sales are '*bigger*' than Denmark or Thailand, Ford Motor Co sales were '*bigger*' than Turkey and Wal-Mart (the largest retailer in the world) sales (even before they took over ASDA) were '*bigger*' than Greece (The McDonalds chain of restaurants employs more people worldwide than the NHS – the UK's largest employer). In addition, some of the new Internet-based corporations completely dwarf some of the largest companies – and are apparently able to avoid with impunity laws and obligations which apply to the latter. These companies and corporations were controlled in theory by their shareholders but in practice by their Directors. To some people this is a subject of some concern which has been evidenced in recent years by pressure to enact ever tighter controls to try to ensure compliance and responsible corporate governance. There is no doubt that this move will continue and that every Director will be required to comply with a larger range of laws, practices and requirements backed by increasingly severe fines and penalties, and an extension of their personal liability.

As we shall see later, directors can be disqualified from office, fined and even imprisoned. They must also disclose any interests in third parties which might conflict with their obligations as directors. In addition, no-one can be a director of a UK company if they are disqualified (either in the UK or in an overseas jurisdiction). It might be prudent to ask all new appointees to complete a form such as the following:

To [Board of company – name]

Name [of director] _____Date _____

I confirm that:

- I am willing to act as a director of [name of company]
- I am not disqualified from acting as a director under either UK law or the legislative process of another jurisdiction.
- Neither I nor any connected person has any interest with third parties with which the company may do business*
- I (and/or a connected person) have the following interests in third parties with which the company does or may do business [give details]*

* *Delete as applicable*

Signed _____

'*Connected persons*' are defined in CA06 S252-4 as spouse, civil partner, and any person with whom the director lives as partner in an enduring family relationship, child or stepchild (to age 18), parents and any company or body corporate in which the director has a voting interest of 20% or more.

NOTES:

1. Obviously circumstances change and it may be prudent to ask for such disclosure on occurrence (when it could be entered in a Register of Directors Interests) and by completion of an updated form, annually (say at the first board meeting each new financial year).
2. Some organisations (as a result of the implications of the Bribery Act) also require a statement of all instances of providing entertaining and being entertained in a declaration such as (see over):

To [Board of company – name]

Directors name _____Date _____

During the last [period under review] I have been involved in the following instances of entertaining

a) Provided to suppliers, clients, customers, agents, other (specify);

_____ (date, occasion, guest (status and organisation) amount

_____

_____

b) Enjoyed as guest of suppliers, clients, agents, customers, other (specify)

_____ (date, occasion, guest (status and organisation) amount

_____

NOTE: It may be helpful to provide guidance as to '*amounts normally able to be spent*' to those involved in providing entertaining. It would also seem sensible to allow the exclusion of small sums – the difficulty may be in trying to quantify a '*small*' sum. The £40 cost of a lunch may be deemed '*small*' but if such lunches (with the same third party) are repetitive (e.g. every week) in total it becomes anything but small – and may be unacceptable. Practical guidance should be provided. (See Chapter 10).

Constitution – Aims and purpose

Traditionally companies were required to have two constitutional documents:

- a Memorandum of Association which stated the date of incorporation, name and number, registered office, share capital, initial subscribers, and the objects or aims of the company
- a set of Articles of Association which set out the internal rules by which the company would be operated by the directors.

(If a company did not adopt Articles then the pro forma set in Table A of the CA under which the company was incorporated applied. Most companies adopted much of Table A with deletions and additions to customise it to suit their particular needs.)

The company's objects clause (which tend to be very lengthy attempting to allow all the things a Board would want their company to do) was formerly both guide and limitation for the directors. If they allowed the company to do something not covered by its objects clause then they were stated to be acting '*ultra vires*' – that is, beyond its, and their powers and they could be held personally liable.

'*Ultra vires*' was effectively abolished by CA89 as far as the company and third parties were concerned – that is the company would be bound by the contract whether it was allowed by the objects clause or not. The danger for the directors was that in allowing the company to trade outside its objects clause the shareholders could hold them liable. The shareholder(s) could subsequently ratify the matter (thereby effectively changing the objects clause – a change which needed to be filed at CH).

In addition the directors were best advised to obtain from the shareholders confirmation that they would not be held liable for any loss occasioned by entering into a contract outside that allowed by the objects clause.

CA89 permitted companies to adopt very brief objects clauses (simply '*the company will be a general commercial company*') in place of very lengthy and fully comprehensive versions often running to several pages. This dilution of the restrictiveness of the objects clause was not taken up in many cases since banks asked to advance money to the company disliked such unrestrictive clauses (as they would have little control over the purposes for which their loans might be used).

CA06 effectively abolished the main content of the Memorandum (the objects clause which sets out what new companies exist to do) and overcomes opposition by removing all the '*restrictions*' of the objects clause (other than for companies that are charities). This may pose a problem for directors seeking to borrow money on behalf of the company since banks may well ask directors to personally guarantee the loans they advance, or possibly to give an undertaking for what purpose the money will be used (with personal liability if the funds are used for other purposes).

In addition, the detailed objects clauses in Memorandums of companies formed pre CA06, are now deemed to be part of the Articles of those companies. For new companies the Memorandums simply deal with the date and country of incorporation, company number, and the names of the initial subscribers.

The objects clause is effectively abolished in that a company's objects are unrestricted unless the Articles restrict them (s31). If the company alters the position regarding the objects under the Articles then this must be advised to CH and the change will not be effective until CH registers the change. CH can require a company to file an updated set of Articles incorporating its objects clause (if applicable).

In fact even the detailed objects clauses usually give only the most general description of the aims of the company and one of the prime considerations of every Board should be to determine its operational aims, not just for its own use as a guide in planning for and directing the company, but also as a criteria for motivating and managing those who work for it. Increasingly companies are adopting aims, visions or corporate missions in order to identify objectives and to act as criteria for action.

Internal obligations

The Articles are the internal rules of the company with which the officers are expected to comply both by the owners and the outside world (since their contents are subject to public scrutiny by being lodged at CH). Should a director fail to act in accordance with the requirements of the Articles, they are said to be acting *ultra vires* and can be made personally liable for any loss arising from their actions and suffered by the company. The requirement to act in accordance with the Articles is particularly pertinent should there be owners not on the board. For pre-CA06 companies, the objects clause(s) in their Memorandums are deemed transferred into the Articles, which are now regarded as the company's **Constitution** (CA06 s 17). However, in some companies there can be additionally a shareholders agreement (SA). This is a document whereby the owners of a company agree certain matters between themselves in a quasi-secret way (since an SA is not required to be lodged at CH – and thus its contents are not made available to the world at large). Where an SA exists its contents should not be in conflict with the Articles as, if so, there can be a dispute as which has precedence.

This potential conflict can be taken to the next level where an SA is clearly stated to **override** the Articles. Ignoring the question of whether this is strictly valid (the Articles are required to be filed so that everyone knows the rules under which the directors are required to operate etc.) such effective control would presumably require **disclosure** under the newly required **Persons with Significant Control** registers (see Chapter 2).

Rolling the message out

In his book '*Making it happen*', former Chief Executive of ICI (then the largest UK company) and star of the first BBC TV series '*Troubleshooter*', Sir John Harvey Jones stated '*with the best will in the world and the best Board in the world, and the best strategic direction in the world, nothing will happen unless everyone down the line understands what they are trying to achieve and gives of their best*'. Unless the Company knows where it is going it can have no firm purpose. Aims are for Directors to develop (ideally with the active involvement of their employees – see Chapter 11) and codify,

but they need to be regularly updated – and of course to be promulgated and achieved by a process of detailed planning, revision and execution of the acts entailed. Perhaps this epitomises the main role of a Director which we can summarise as:

> *'knowing where he wants to take whatever it is that he has control of, and ensuring that the company is constantly moved towards those goals'.*

Lacking codified and promulgated aims and the plans that support them there is a danger that the company may drift into activities rather than be directed to purposeful ends – which may not be in the interests of the shareholders who appoint the Directors as their stewards. The aims also provide the shareholders with a criterion against which the performance of the Directors can be measured.