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A Worldwide Review
Third Edition

Edited by
Alexander Loos



the global voice of
the legal profession®

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International Bar Association

The Global Voice of the Legal Profession



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The International Bar Association (IBA), established in 1947, is the world's leading organisation of international legal practitioners, bar associations and law societies. The IBA influences the development of international law reform and shapes the future of the legal profession throughout the world.

It has a membership of over 55,000 individual lawyers and 206 bar associations and law societies spanning all continents. It has considerable expertise in providing assistance to the global legal community as well as being a source of distinguished legal commentators for international news outlets.

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United Kingdom

Karla Dudek

The Companies Act 2006 (the 'Act') has been in full force and effect since 1 October 2009. The Act brought about a substantial reform and modification to company law in the United Kingdom (the 'UK'), including a codification of the law relating to directors' duties and substantive changes to the law relating to derivative actions. If a UK incorporated public company, or now, an overseas incorporated company, has a premium listing of equity securities on the main market of the London Stock Exchange, there are a number of additional corporate governance obligations that its directors must comply with. These obligations are set out in the UK Corporate Governance Code (the 'Corporate Governance Code'),¹ the most recent version of which is dated September 2014. This chapter also refers to the additional obligations of the directors of listed companies under the Corporate Governance Code.

I 'NATIONAL BASICS' AND NATIONAL LEGAL THEORIES OF DIRECTORS' LIABILITIES

[A] Two-Tiered or Unitary Company Structure

In the UK there are two types of companies, public and private. Both public and private companies have a single board of directors comprising all of the directors of the company. It is common for listed companies to have a mix of executive and non-executive directors. Although there is no statutory definition of those terms it is generally considered that an executive director is a person who acts as a director of the company and is on the board, but also holds a management position within the

1. The most recent version of the Corporate Governance Code was published by the Financial Reporting Council on 17 September 2014 and applies to financial years beginning on or after 1 October 2014.

company and is paid a salary. A non-executive director solely acts as a director of the company and is on the board but does not receive a salary, although may receive a director's fee.

[B] Chairman and CEO

There is no legal requirement for the roles of Chairman and CEO to be held by two separate people, but, for listed companies, the Corporate Governance Code requires the roles of Chairman and CEO to be held by two different people.² Although the Corporate Governance Code is not mandatory, Listing Rule 9.8.6R (which does have legal effect) says that every listed company must state in its annual report whether it has complied with the Corporate Governance Code, and if not, provide reasons for why it has not complied. From a corporate governance perspective, and to ensure that the company maintains a good relationship with its institutional shareholders, most listed companies try to comply fully with the Corporate Governance Code.

If exceptional circumstances exist and a listed company has to appoint one person to be both Chairman and CEO, the Corporate Governance Code says that the board should consult with its major shareholders in advance of combining the roles and the company should set out in the annual report why the roles have been combined.³

[C] Board Structures

The shareholders of a company authorize the board of directors to manage the company for the purposes, if any, for which it is established and in accordance with the contract between the company and its shareholders (this contract is known as the Articles of Association of the company (the 'Articles')).

Every private company must have at least one director⁴ and every public company must have at least two directors.⁵ Every company must have at least one director who is a natural person⁶ and every director that is a natural person must be at least 16 years of age.⁷

If a company is listed, at least half of its board of directors (excluding the Chairman) should be made up of independent non-executive directors in order for the company to comply with the Corporate Governance Code.⁸ It is up to the board of directors of the Company to determine whether each non-executive director is independent in character and judgment.

2. Code Provision A.2.1.

3. Code Provision A.3.1.

4. Section 154(1), Companies Act 2006.

5. Section 154(2), Companies Act 2006.

6. Section 155, Companies Act 2006.

7. Section 157, Companies Act 2006.

8. Code Provision B.1.2, although if the listed company is not in the FTSE 350 it only requires two independent non-executive directors.

[D] Directors' Elections/Staggering

The Articles set out how the directors are appointed. The Articles can provide that the directors can be appointed by an ordinary resolution of the shareholders, written notice by a majority shareholder, or by the existing directors. In the case of a public company,⁹ if the Articles allow the board to appoint a director, either as an additional director or to fill a vacancy, it is also usual for the Articles to provide that that director must retire at the next annual general meeting of the company, but that he or she can be put forward for reappointment by the shareholders. For FTSE 350 Companies, the Corporate Governance Code requires all directors to be subject to annual election by the shareholders.¹⁰ All other directors of a listed company should be subject to election by shareholders at the first annual general meeting after their appointment and to re-election after that at intervals of not more than three years.

The statutory default Articles for public companies, known as the Model Articles,¹¹ now provide that directors should retire once every three years rather than providing for a staggered one-third rotation every year.

A listed company should have a nominations committee made up of a majority of independent non-executive directors whose function is to recommend all new director appointments and make recommendations to the board.¹²

[E] Directors' Term of Appointment

The Corporate Governance Code says that any term beyond six years for a non-executive director should be subject to a particularly rigorous review. Non-executive directors of a listed company may serve for longer than nine years, subject to annual re-election by the shareholders.¹³

[F] Delegation

Typically, the Articles provide that the board is responsible for the management of the company's business and permit the board to delegate any of its powers to any committee or to an executive director of the company. This enables the day-to-day management of the company to be handled by the executive directors and ensures that decisions relating to the management and daily operation of the company can be made in a timely manner without the need to call a board meeting. The Act and the Listing

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9. A company registered as a public company under the Act, which, *inter alia*, must have an issued share capital of GBP 50,000, of which 25% must be paid up.
 10. The FTSE 350 Index is a stock market index incorporating the largest 350 companies by market capitalization which has their primary listing of equity securities on the London Stock Exchange.
 11. The Companies (Model Articles) Regulations 2008, Sch. 3, SI 2008 No. 3229.
 12. Code Provision B.2.1.
 13. Code Provision B.2.3.

Rules respectively require some matters, such as the approval of financial statements and the approval of major transactions, to be formally reserved for the board of the company.

Even though a matter has been delegated, the board has a continuing duty to supervise the matters that have been delegated¹⁴ and retains overall responsibility for the management of the company. The Corporate Governance Code requires every listed company to maintain sound risk management and internal control systems.¹⁵ The Corporate Governance Code also requires directors to confirm in the annual report that they have carried out a robust assessment of the principal risks affecting the company's business model, future performance, solvency or liquidity and to express how those principal risks are managed or mitigated.¹⁶

[G] Removal of Directors

The Articles set out how a director can be removed from office. It is common for the Articles to say that a director can be removed by the board if he or she fails to attend a certain number of board meetings within a set time period and for the directorship to immediately cease in certain situations, such as if the director is declared bankrupt. Under the Act, the shareholders of the company can remove a director from office if they pass an ordinary resolution at a meeting. The statutory removal right is available to shareholders irrespective of anything more restrictive set out in the Articles or in any employment contract between the company and the director.

II RECENT CASES DEALING WITH DIRECTORS' LIABILITY

Directors must comply with a number of duties when managing the company's business. The Act sets out seven general duties owed by a director of a company to the company: (1) a duty to act within powers; (2) a duty to promote the success of the company; (3) a duty to exercise reasonable judgment; (4) a duty to exercise reasonable skill, care and diligence; (5) a duty to avoid conflicts of interest; (6) a duty not to accept benefits from third parties; and (7) a duty to declare an interest in a proposed transaction or arrangement involving the company. These codified duties are based on the common law rules¹⁷ and equitable principles that were in force prior to the Act and are stated to have effect in place of those rules and principles as regards the duties owed by a director to the company.¹⁸ The codified duties are to be interpreted and applied in the same way as the previous common law and equitable principles and regard should be had to these when interpreting and applying the general duties.¹⁹ In addition to the codified duties, further duties are implied on a director under common law (such as the

14. *Re Barings plc (No. 6)* [1999] 1 BCLC 433.

15. Code Provision C.2.3.

16. Code Provisions C.2.1.

17. That is, rules that have been established by courts.

18. Section 170(3), Companies Act 2006.

19. Section 170(4), Companies Act 2006.

duty in certain limited situation to consider the interests of the shareholders (as distinguished to the company), and, arguably, the duty of a director to disclose his own wrong doing)²⁰ and it is also permissible for the Articles of a company, or the director's employment contract, to impose duties that are more onerous than those codified within the Act.

The case law to date supports the view that the Act has codified the already well-established common law obligations of company directors and has not introduced any radical new obligations.²¹ When considering the extent of their duties, the directors must look beyond the Act and consider the way in which the courts have interpreted and supplemented those duties. As such, the codified directors' duties should be seen as a statutory framework, which is to be supplemented by case law. However, it should also be noted that recent case law has stated that although the common law rules and equitable principles that applied prior to the enactment of the Act continue to apply, it would be unrealistic to ignore the terms in which the general statutory duties have been framed for cases after the Act because the codified duties extract and express the essence of the rules and principles which they have replaced.²² An example of recent case law includes a consideration of the duty in section 172 of the Act to act in the way that the director considers in good faith would be most likely to promote the success of the company, which the Court determined can only be breached if the director acts in bad faith, whereas, the test as to whether a director has breached his obligation under section 175 of the Act to avoid a conflict of interest is an objective one which does not offer the director a good faith defence.²³

There are a number of other statutory provisions under which the directors can be personally sued, including legislation and regulations relating to securities,²⁴ insolvency,²⁵ pensions,²⁶ health and safety,²⁷ the environment,²⁸ and antitrust issues.²⁹ Under some of the above legislation, directors can also have criminal actions brought against them in their personal capacity.

III JUDICIAL REVIEW

The judiciary has adopted the approach of continuing to apply existing common law rules and equitable principles in determining whether a director has breached the codified duties contained in the Act.

20. It was considered in *GHLM Trading Ltd v. Maroo & Others* [2012] EWHC 61 (Ch) that this duty may now be considered to be part of the general duty under s. 172 of the Act for a director to promote the success of the company.

21. For example, *West Coast Capital (Lios) Limited* [2008] CSOH 72; *Re Southern Countries Fresh Foods Ltd* [2008] EWHC 2810.

22. *Premier Waste Management Ltd v. Towers* [2011] EWCA Civ 923.

23. *Richmond Pharmacology Ltd v. Chester Overseas Ltd* [2014] EWCH 2692 (Ch).

24. Financial Services Act 2012.

25. Insolvency Act 1986.

26. Pensions Act 2004.

27. Health and Safety at Work, etc., Act 1974.

28. Environment Act 1995.

29. Enterprise Act 2002.

IV TYPICAL SCHEMES/BEHAVIOUR TO AVOID DIRECTORS' LIABILITY

One way in which recent company law reforms have sought to improve the enforceability of directors' duties is through statutory restrictions on who can be a director. For example, when the Act was first implemented it introduced a new requirement that a company's board of directors must always include at least one natural person.³⁰ It was hoped that this would reduce the possibility of company structures being abused by those intending to commit fraud, by making it more difficult for them to obscure the identity of individuals involved in the running of the company. This was further supplemented by a new provision which is expected to be implemented to take effect from October 2016, revoking section 155 of the Act and instead requiring, save for limited exceptions, every director to be a natural person, thereby prohibiting the appointment of corporate directors.³¹

V CORPORATE GOVERNANCE

In the United Kingdom, corporate governance is provided by a combination of: (i) common law rules; (ii) statute; (iii) the Articles of a company; (iv) the Prospectus Rules and Listing Rules that apply to all companies that are listed on the main market of the London Stock Exchange; (v) the Disclosure and Transparency Rules that apply to all companies that are admitted to the main market of the London Stock Exchange and also to some companies quote on AIM; (vi) the Corporate Governance Code; (vii) the City Code on Takeovers (which sets out the rules that the Takeover Panel applies in relation to takeovers and mergers of public companies); (viii) the Code of Market Conduct (which contains guidance from the Financial Conduct Authority (FCA) to determine whether behaviour amounts to market abuse); and (ix) non-binding guidelines issued by institutional investors such as pension funds and insurance associations.

A brief description of the primary corporate governance rules relating to board procedures and structures of oversight are set out below.

[A] Board Procedures

For private companies and non-listed public companies, some of the requirements for running formal board meetings, such as the required notice periods and quorum, may be laid down in the Articles. In addition, the Corporate Governance Code sets out best practice principles for the conduct of board meetings of a listed company. These include a requirement for meetings to be held sufficiently regularly to discharge the board's duties effectively and a requirement for there to be periodic board meetings without any executive directors present.³²

30. Section 155 of the Companies Act, 2006.

31. Section 156A Companies Act 2006, expected to take effect in October 2016.

32. Code Provisions A.1.1 and A.4.2.

[B] Structure of Oversight

Boards are accountable to the shareholders of the company at general meetings and their accounts are subject to annual audit. In larger public companies, the board is also often split between executive directors and non-executive directors and the non-executive directors will have a supervisory role (as further detailed below). It is also always possible for the shareholders to remove an underperforming director under section 168 of the Act.

It is necessary for all companies (other than companies that qualify as small companies under the companies accounting regime) to produce a strategic review that will help shareholders to assess how the directors have performed their duty to promote the success of the company.³³ Shareholders are likely to consider this strategic review carefully in reviewing the performance of the directors and they may potentially use the information as grounds for bringing a derivative action against the directors, or for removing an underperforming director or board.

For listed companies, the Corporate Governance Code emphasizes the role of non-executive directors as supervisors of the management of the company. Non-executive directors are also required to scrutinize the performance of management in meeting agreed goals and objectives and to satisfy themselves of the integrity of financial information and controls. It also falls to the non-executive directors to determine appropriate remuneration for the executive directors, and non-executive directors have a pivotal role in appointing and, if necessary, removing directors. The Corporate Governance Code ensures that these principles are applied in practice by requiring a listed company to set up a nominations committee (to recommend future director appointments), which must be made up of a majority of independent non-executive directors;³⁴ a remuneration committee (which recommends remuneration and rewards for senior executives), which must include two independent non-executive directors (three for FTSE 350 companies);³⁵ and an audit committee (which monitors the financial reporting of the company and the independence of its auditors), which must be made up of only independent non-executive directors, at least one of whom has recent and relevant financial experience.³⁶

VI LIABILITY ISSUES**[A] Who Can Sue?**

Directors owe their duties to the company and it is therefore the company that must bring an action against the director (though in limited cases a shareholder may instigate

33. Section 414A and 414C, Companies Act 2006.

34. Code Provision B.2.1.

35. Code Provision D.2.1.

36. Code Provision C.3.1.

a derivative action – see section VI[E]).³⁷ This rule does not prevent a third party bringing an action directly against a director if the director has assumed personal responsibility for the actions of the company.³⁸

A director may be personally liable to third parties for a breach of statute. For example, under section 90(1) of the Financial Services and Marketing Act 2000 (FSMA) a director will be responsible for any loss suffered by a person who has acquired securities where that loss has resulted from false or misleading statements made in the prospectus supporting an application for the listing of those securities.

Regulatory bodies can also bring actions against directors, including, in some instances, criminal prosecutions. Examples are companies in regulated sectors (banking, insurance, etc.), companies listed on regulated markets and the Registrar of Companies for breaches of the Act. The FCA (which is a regulatory body) also has the power to prosecute directors for the criminal offences of making false or misleading statements and creating false or misleading impressions under sections 89-91 of the Financial Services Act 2012 and for insider dealing under Part V of the Criminal Justice Act 1993.

[B] Who Can Be Sued?

Someone who is not formally appointed a director may accrue liabilities if the board of the company is accustomed to act in accordance with his or her instructions or directions (a ‘shadow director’). In these instances the shadow directors may be sued by a person bringing a claim against a director or the board of a company. In addition, any person who occupies the position of a director by whatever name called is also considered to be a director for the purposes of the Act (commonly referred to as a de facto director) and can be sued.³⁹

If the company has breached the law it will be the company, and not its shareholders or directors, that will be sued. Some legislation, including the Act, does, however, make officers criminally liable in addition to the company in instances where the company is in default of its statutory obligations.⁴⁰

[C] ‘De Facto’ Director

Someone who is not formally appointed a director may be deemed to be a director of a company if the board of the company is accustomed to acting in accordance with his

37. Section 170(1), Companies Act 2006 and, in relation to additional duties that are not codified, *Foss v. Harbottle* [1843] 2 Hare 461; 67 ER 189.

38. *Standard Chartered Bank v. Pakistan National Shipping Corp (No 2)* [2002] UKHL 43, [2002] All ER (Comm) 931, a director was liable for deceit arising from statements made in relation to falsely dated bills of lading.

39. Section 250, Companies Act 2006.

40. For example, under s. 30(2) of the Act, every officer is made liable with the company if the company has failed to file certain resolutions with Companies House within a prescribed time period.

or her instructions or directions.⁴¹ The codified duties contained in the Act also apply to such shadow directors, but only where and to the extent that they are capable of so applying.⁴² In addition, obligations and duties apply to de facto directors. Whether a person will be classified as a de facto director is an objective question of fact, with the key determinants including a consideration of the company's corporate governance system to see whether the relevant individual assumed the status and function of a director.⁴³

[D] Thresholds and Limitations/Caps of Liabilities

If an action is brought against a director for breaching his or her duties to the company there is no cap on the amount of damages that can be awarded against the director, but punitive damages will not be awarded. The company will only be awarded an amount equal to the loss that it has suffered as a result of the breach of duty, or for the amount of any undisclosed profit made by the director.⁴⁴

Where a statute provides that a director can be liable to a fine, the statutory maximum fines range between GBP 200 and GBP 5,000.⁴⁵

[E] Joint Liability/Solidarity

Whether liability is joint or individual depends on the kind of action envisaged. Generally, board responsibility will be joint and a non-executive director will bear the same responsibility as an executive director.

[F] Derivative Actions

Under section 260 of the Act it is now possible for a shareholder to bring a statutory action against any director for his or her alleged negligence or breach of duties to the company (including a breach of the codified duties), including in circumstances where the director has received no personal benefit.

The derivative action must be brought by a shareholder of the company, the cause of action must be vested in the company and the relief must be sought on behalf of the company (not the shareholder).⁴⁶ The Act requires a shareholder who brings a derivative action to obtain the permission of the court to continue the action. This permission involves two stages: first the court considers whether the shareholders' application and the supporting evidence establish sufficient grounds for bringing a derivative claim. If the court concludes that the elements of a claim have been established, a full application hearing will be held. The Act sets out detailed rules

41. Section 251, Companies Act 2006.

42. Section 170(5), Companies Act 2006.

43. *Smithton Ltd v. Naggar and others* [2014] EWCA Civ 939.

44. See, e.g., *Industrial Development Consultants Ltd v. Cooley* [1972] 2 All ER 162.

45. Criminal Justice Act 1982, s. 37(2).

46. Section 260, Companies Act 2006.

concerning the court's decision as to whether to grant permission at the second stage. In particular, the court must not permit a derivative claim to continue if: (1) a person acting to promote the success of the company would not continue the claim; and (2) the underlying act was authorized by the company. If the above requirements are not satisfied, the court has a discretionary power to grant permission to bring an action. In granting such permission, however, the court is obliged to take into account a number of factors, including whether the shareholder is acting in good faith and the importance that a person acting in accordance with the duty to promote the success of the company⁴⁷ would attach to continuing the action.

[G] Class Actions

English law does not have a developed concept of class actions so, while similar cases are sometimes joined in the courts for administrative convenience, the plaintiffs must be known individuals.⁴⁸ This is starting to change and recent legislation intended to encourage and facilitate private enforcement of competition law, in particular by consumers and small- and medium-sized businesses, has introducing US-style opt-out class actions to the UK for the first time.

[H] Relevance of Bankruptcy of the Corporation

Directors will not be liable for the debts of a company unless they have given a personal guarantee. However, if it appears to the court during the winding up of a company that any business of the company was carried on by the directors with the intent to defraud creditors, then the court can make an order requiring the director to make a contribution to the company's assets.⁴⁹ To be liable for fraudulent trading of this type, the directors must have acted dishonestly. They will not be liable simply because they continued to incur debts knowing that the company was insolvent.⁵⁰

Directors may also be required to make a contribution to the company's assets if the court finds that the directors continued trading at a time that they knew, or ought to have concluded, that there was no reasonable prospect that the company would avoid going into insolvent liquidation.⁵¹ No element of dishonesty is required, but the court will not make a wrongful trading order if the director took every step with a view to minimizing the potential loss to the company's creditors as he ought to have taken.⁵²

47. That is, the duty contained in s. 172 of the Companies Act 2006.

48. Consumer Rights Act 2015.

49. Section 213, Insolvency Act 1986.

50. *Re Patrick and Lyon Ltd* [1933] CH 786.

51. Section 214, Insolvency Act 1986.

52. Section 214(3), Insolvency Act 1986.

VII INDEMNIFICATION

Under the Act, a company is prohibited from exempting a director for liability that results from the director's negligence, default, breach of duty, or breach of trust in relation to the company.⁵³ However, a company may provide an indemnity against any such liability provided that it does not indemnify a director against any liability to the company; any fines imposed in criminal proceedings; any sums payable to a regulatory authority by way of penalty for non-compliance with any regulatory requirement; or for any liabilities incurred in defending any criminal proceedings in which the director is convicted or any civil proceedings brought by the company in which judgment is given against the director.⁵⁴

VIII DIRECTORS' AND OFFICERS' INSURANCE

A company can purchase directors' and officers' insurance to protect a director from liability in connection with any negligence, default, breach of duty or breach of trust by that director to the company.⁵⁵ Policies would not usually cover fines, penalties or punitive damages imposed by regulators or criminal courts.

IX OTHER METHODS OF PROTECTION

Section 239 of the Act provides a mechanism by which shareholders can absolve directors, including former directors and shadow directors, of conduct amounting to negligence, default, breach of duty or breach of trust in relation to the company. In order to ratify breaches by a director, section 239 requires the company's shareholders to pass either a written resolution or a resolution at a general meeting releasing the director from a claim by the company for breach of the relevant duty. This requirement applies regardless of any other, more lenient, alternatives contained in the company's Articles, or under general law. Section 239 provides that when passing a resolution neither the director in question, if he or she is a shareholder of the company, nor any shareholder connected to him or her, may vote on whether to ratify the director's breach.

Another way in which a director may avoid liability for a breach of duty is at the discretion of the courts. Section 1157 of the Act provides that where proceedings for negligence, default, breach of duty, or breach of trust are brought against a director, the court may relieve the director from liability, either wholly or in part, if it considers that he or she has acted both honestly and reasonably, and, considering all the circumstances of the case, he or she ought fairly to be excused.

53. Section 232(1), Companies Act 2006.

54. Section 234, Companies Act 2006.

55. Section 233, Companies Act 2006.

X LAWYER DIRECTORSHIP

If a lawyer accepts an appointment to act as a director of a company, he will be held to a higher duty of skill and care to the extent that legal matters have to be considered as part of that director's duties.⁵⁶ If the company's lawyer is a member of the board and gives legal advice at the board meeting, this may result in legal professional privilege being lost.

XI FORECAST ON FUTURE LEGISLATION DEVELOPMENT

The Financial Reporting Council has published a discussion paper on board succession planning with a focus on board succession for those companies to which the Corporate Governance Code applies. The aim of the paper is to look at the key issues for good succession planning, identify suggestions for good practice and examine how the nominations committee can play its role effectively. Following a review of the responses and further consideration it is likely that changes will be proposed to the Corporate Governance Code with respect to board succession planning.

56. Section 174(2), Companies Act 2006.