

Company Secretary's Review

Changes Ahead for Directors

The Small Business, Enterprise and Employment Bill will ensure the UK continues to be recognised globally as “a trusted and fair place to do business”, says the Government. In this article, Rachel Woodburn from Travers Smith LLP highlights key provisions in the Bill for directors.

Introduction

In April 2014, the Department for Business, Innovation and Skills (“BIS”) gave the go-ahead for a raft of proposals designed to improve corporate governance and transparency of company ownership. Those proposals are to be enacted in the Small Business, Enterprise and Employment Bill (“the Bill”), which had its first reading in the House of Commons in June 2014.

There has been a lot of publicity surrounding the proposed new public register of beneficial ownership [to be featured in the next issue of CSR], which is designed to prevent individuals using companies as a front for illegal activity. However, there are also a number of ancillary measures of which company directors, lenders and investors should take note.

Shadow directors

The Government’s original plan to require nominee directors to disclose their nominee status has been dropped. Instead, in order to hold to account those directors who act as a front for the illegal activities of their appointor, the Bill contains provisions to make shadow directors subject to the full set of Companies Act 2006 (“CA 2006”) directors’ duties (save to the extent that they are exempted by regulations yet to be published). BIS also plans to introduce measures to promote greater

understanding of directors’ duties, the consequences of breach and more effective enforcement of those duties, although there is nothing so far in the Bill on these measures.

The CA 2006 definition of “shadow director” (which also appears in the Insolvency Act 1986 (“IA 1986”) and in the Company Directors Disqualification Act 1986 (“CDDA 1986”)) is someone in accordance with whose instructions the board as a whole is accustomed to act.

As the law stands, the general CA 2006 directors’ duties have limited application to shadow directors. The most recent notable case on shadow directorships is *Vivendi SA and anor v Richards and anor* [2013] All ER (D) 112 (Oct), in which the High Court decided that “shadow directors commonly owe fiduciary duties to at least some degree” and could reasonably be expected to act in the company’s interests rather than their own. The *Vivendi* case turned on facts which pre-dated the CA 2006 statutory duties of directors, but there has been a strong argument since *Vivendi* that shadow directors at least owe the statutory equivalent of a good faith obligation, i.e. the obligation under CA 2006, s 172 to promote the company’s best interests.

Comment: The shadow director rules are especially significant for banks and private equity and other financial investors, most of whom are already

keenly aware of the implications of shadow directorship, particularly in distressed situations. The key issue for them is the likelihood of being held liable for a wrongful trading claim under IA 1986 so they must tread carefully in their dealings with companies in financial difficulties. Banks and investors typically avoid directing the board such that the directors are deprived of the discretion whether or not to comply, and directors nominated by investors to sit on the boards of their investee companies strive to maintain an arm’s length relationship with their appointors.

However, for investors in particular, the new rules requiring shadow directors to comply with the full range of directors’ duties imply the need for them either (i) to embrace the shadow directorship role and request additional operational and strategic information from investee companies, which would be cumbersome and fundamentally at odds with the traditional approach of delegating oversight to a nominee, or (ii) to step back entirely to avoid the shadow directorship label which will make governance difficult.

The shadow directorship proposals are likely to receive opposition from banks and investors on the basis that they interfere with legitimate commercial arrangements. Whilst it is not unreasonable to expect banks and investors to act responsibly when they step into a

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governance role as regards their portfolio companies, it is important to ensure that those good governance rules do not impede investment at a critical time in the economic cycle.

Corporate directors

The Bill will outlaw corporate directors, subject to a transitional period of 12 months (from the date the Bill is enacted) for existing companies to comply. The Government is concerned that corporate directors are used by individuals to disguise their involvement, and that it is currently very difficult to bring a claim for misfeasance against corporate directors (as illustrated in *Holland v The Commissioners for Her Majesty's Revenue and Customs: Re Paycheck Services 3 Ltd* [2011] 1 BCLC 141).

Comment: At present, CA 2006 requires that companies have at least one director who is a natural person, but many companies legitimately use corporate directors, particularly in group situations. Separate regulations, yet to be published, will set out limited exemptions to the prohibition, thought to include group companies, OEICs, charities and corporate pension trustees for whom the prohibition would be extremely inconvenient.

During the consultation process, the Government suggested that, for consistency, LLPs would be caught by the prohibition. For LLPs, there is no distinction between members and directors, so the prohibition would mean that only individuals could ever be members of an LLP. This suggestion has attracted strong opposition from the investor community since LLPs are the standard vehicle for UK asset managers due to their flexibility, tax transparency and limited liability, and for them, the prohibition would be extremely disruptive, requiring a huge amount of unravelling of existing structures, but it remains under discussion and the hope is that it will be dropped.

Larger companies are keenly awaiting the draft regulations to ensure standard group structures are exempted.

Directors' dates of birth

The Bill enacts the Government's proposal to suppress a director's full date of birth ("DOB") from the Companies House

register, to combat identity theft. Whilst the full DOB will be disclosed to Companies House upon appointment, only the month and year of birth will be visible on the public register.

Comment: Directors should note that full DOB information already on the public register will not be removed automatically and Companies House will be under no obligation to check filed documents for the absence of DOB information. Also, if a private company opts out of the requirement to keep registers of directors, secretaries and members and instead rely on the public records maintained by Companies House (provided for elsewhere in the Bill), the public register of directors will show the full DOB information. The Government has taken the view that if company information is solely available at Companies House, those wishing to inspect a particular register should continue to have access to the same information which would have been available on inspection of the company's own registers (except directors' residential address information where this is protected).

Director disputes

The Bill also enacts the Government's proposals for a new regime whereby companies must provide evidence of a director's consent to act in the event of a dispute, to reduce the number of complaints from individuals registered as directors without their permission. So, when a director is appointed, the company will have to make a "statement of truth" to confirm that the relevant individual has consented to act, whereupon Companies House will notify the individual that his appointment has been recorded. The new director will then be entitled to dispute the validity of the appointment on the grounds that he did not consent to it. If the company cannot then provide evidence of such consent, the details of the appointment will be removed from the public register. It will be an offence for the company to make a false "statement of truth", making it easier to prosecute companies which supply fraudulent information as regards directors' appointments.

Comment: This proposal is welcome as it removes the burden on companies to obtain a signature from the director on the

Companies House filing. A signed director's service contract will constitute suitable evidence of appointment and consent to act in the event of a dispute. The new regime will only apply to appointments made after the Bill is enacted.

Directors' disqualification

Finally, the Bill contains various new provisions which strengthen the company directors' disqualification regime, principally (i) to ensure that those who have been disqualified or convicted of relevant offences overseas cannot be directors of UK companies, and (ii) to broaden the factors which may be taken into account by the court in deciding whether to disqualify a director to include:

- ◆ material breaches of applicable domestic or overseas *sectoral* legislation or regulations;
- ◆ the extent to which the person was responsible for a company (or an overseas company) becoming *insolvent*; and
- ◆ the nature and extent of any *loss or harm* caused or which could have been caused by the person's conduct.

The Bill also increases the limitation period on disqualification proceedings in an insolvency situation to three years from the onset of insolvency (it is currently two years).

Comment: In practice, the courts regularly take into account factors beyond those currently listed in the Schedule to CDDA 1986, so in a sense, the law is merely catching up with practice. However, a broader list of factors in the legislation itself will provide welcome clarity as to the range of misconduct which could result in disqualification.

Timing

The Bill had its first reading in the Commons in June, is expected to reach the House of Lords towards the end of this year, and to become law before the next election in **May 2015**.

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Further information

The Small Business, Enterprise and Employment Bill can be viewed at www.lexisurl.com/CSR431.