

Directors' Duties and Liability Seminar



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Seminar Overview



⌘ Companies Act 2006

- Background
- Implementation Timetable
- Key changes in relation to Directors Duties
- Other changes
- Conclusions/Practical steps

⌘ Refreshments

⌘ Directors Liabilities

⌘ Derivative actions – the new regime

⌘ Application of common law principles/duties

⌘ Corporate Manslaughter and Corporate Homicide Act 2007

Programme – Part 1



1. Background
2. Timetable
3. Key Changes
4. Preparing for Change

Background



- o Simplify, modernise and consolidate existing company law
- o March 1998 – Company Law review
 - *'Clear, concise and unambiguous language which can be easily understood by those involved in business enterprise'*

Background



- o Over 1300 sections
- o 800 pages
- o 1,000,000 companies

The Act has four main themes



- o A think small first approach
- o Making it easier to set up and run a company
- o Enhancing shareholder engagement and a long term investment culture
- o Flexibility for the future

Timetable



- o 8 November 2006- Royal Assent
- o 1 Oct 2007 to 2009- Majority of provisions

Key Changes - Directors



- o Minimum Age
- o Corporate Directors
- o Service Address
- o Service Contracts
- o Codification of Duties

Directors' 7 Duties



- (i) Duty to act in accordance with the company's constitution and only exercise powers for the purposes of which they are conferred;
- (ii) * Duty to promote the success of the company for the benefit of its members;
- (iii) To exercise independent judgment;
- (iv) To exercise reasonable care, skill and diligence;
- (v) To avoid conflicts of interest;
- (vi) Not to accept benefits from third parties;
- (vii) To declare interests in proposed transactions or arrangements with the companies.

Enlightened Shareholder Value



Directors must consider:

- o the likely consequences of any decision in the long term;
- o the interests of the company's employees;
- o the need to foster the company's business relationships, customers and others;
- o the impact of the company's operations on the community and the environment;
- o the desirability of the company maintaining a reputation for high standards of business conduct; and
- o the need to act fairly between members of the company.

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Directors' Duties



- o Consequences of breach
- o Derivative actions
- o Removal of directors

Other Key Changes



- o Company Secretary
- o Written Resolutions
- o Annual General Meetings
- o Loans to Directors
- o Company Communications

Preparing for change



- o Briefing
- o Training
- o Review company documentation

Directors Liabilities



⌘ It is unlawful for a company to exempt a director from or indemnify him against liability for negligence, breach of duty or breach of trust (s232CA06)

EXCEPTIONS

- Company may purchase insurance against such liability (s232)
- Company may indemnify directors in respect of Third Party proceedings (other than criminal or regulatory proceedings) in relation to any judgment and legal costs (s234)
- Similar new provisions in relation to pension scheme trustees (s235)

- ⌘ Disclose in Director's report (s236)
- ⌘ Copies of all indemnities to be kept at Reg office and retained for a year after expiry (s237)
- ⌘ Shareholders right of inspection (s238)
- ⌘ Ratification
 - Shareholders can ratify a directors breach of duty by simple majority BUT the votes of the director or any connected person must be disregarded (s239)
 - May lead to more derivative actions
 - Increased importance of indemnity insurance

Derivative Action – What is it?




Under the common law

- a shareholder could not bring an action for a wrong caused to the company
- the court will not intervene in the internal management of the company – the principle of majority rule applies

Exceptions

- where the company was controlled by the wrongdoers and majority rule would lead to a fraud on the minority
- where the act of the company was illegal and therefore incapable of ratification
- where an act of the company could only be authorised by special or extraordinary resolution

The New Derivative Action (s260-264 CA06)



- ⌘ A new statutory definition
- ⌘ Substantially wider causes of action:-
 - negligence
 - default
 - breach of duty
 - breach of trust
- ⌘ No longer need to establish that a director has personally benefited
- ⌘ Includes liability for acts before shares were acquired
- ⌘ An activist's charter?

Procedural *Safeguards*



- ⌘ After proceedings have been issued the shareholder must apply to court for permission to continue the claim.
- ⌘ The court must dismiss the claim unless the evidence filed discloses a prime facie case. The court must consider
 - whether the shareholder is acting in good faith
 - the importance a person acting to promote the success of the company would attach to continuing the claim
 - whether the act is likely to be ratified
 - whether the company has decided not to pursue the claim (and why)
 - whether there is another remedy available to the shareholder
 - the views of the other shareholders who have no personal interest
- ⌘ The court, if it does not dismiss the claim, give directions for evidence to be produced by the company.

Application of Common Law Principles/Duties

Why does it matter?



- ⌘ s170(3) Statutory Statement has effect in place of "*certain*" common law and equitable principles as they apply to directors BUT
 - ⌘ S170(4) Duties in the Statutory Statement are to be "*interpreted and applied in the same way as common law or equitable principles and regard shall be had to the corresponding common law principles and equitable principles in interpreting and applying the general duties*".
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Duties and Principles



Common Law

Apply to all Employees (inc directors)

Contractual in nature (express or implied)

Duty of good faith and fidelity

- competition during employment
- preparing for competition
- copying/memorizing confidential information
- recruiting/inciting employees
- diverting business opportunities
- answering questions truthfully

Damages/injunction

Equitable

Directors/de facto directors (as well as trustees, agents and professional advisors)

Fiduciary in nature

“duty of single-minded or exclusive loyalty”

- duty not to make a secret profit
- duty to avoid a conflict of interest
- duty to disclose misconduct

Damages/injunction/Account of profit/tracing

Preparing for Future Competition

Recent Developments



⌘ Helmet Integrated Systems v Tunnard

⌘ Shepherd Investments v Walters

⌘ Crowson Fabrics v Rider, Stimson and Concept
Textiles

Helmet Integrated Systems v Tunnard : the facts



- ⌘ Tunnard was senior salesman for Helmet which marketed the F600 fire helmet, primarily for LFB
- ⌘ 2001 – T decided to develop a new helmet for European market
- ⌘ Nov 2001 – applied for DTI funding, identifying a rival as preferred manufacturing partner
- ⌘ Dec 2001 – instructed product designers
- ⌘ Feb 2002 – T handed in his notice to expire on 28 Feb
- ⌘ During notice period sent drawings to competitors under NDA
- ⌘ April 2002 – incorporated newco which competitor then acquired.

Helmet : the factors



- ⌘ No misuse of confidential information
- ⌘ No breach of any restrictive covenant
- ⌘ No other Helmet employee involved
- ⌘ Own time – own resources
- ⌘ No commercial arrangement or actual competition before departure
- ⌘ T was not director or senior employee

Helmet : the decision



- ⌘ T did owe duties as an employee which included the duty to disclose competitive activity
- ⌘ T's contract did not restrict his freedom to prepare for future competition
- ⌘ Accordingly there was no breach

Shepherd Investment v Walters : the facts



- ⌘ Shepherds were investors in life policies
- ⌘ Walters – finance director
- ⌘ Hindle – investment director
- ⌘ Simmons – sales manager
- ⌘ Early 2003 Shepherds considered branching out into whole life policy investment
- ⌘ May 2003 W, H & S discussed a new investment fund for themselves
- ⌘ July 2003 draft business plan, with detailed financial predictions
- ⌘ Aug 2003 contacted Caymen Island Attorneys/Auditors approached

Shepherd Investment v Walters : the facts



- ⌘ Oct 2003 S & H resign. Newco incorporated
- ⌘ Nov 2003 Business agreements executed
- ⌘ Jan 2004 Promotional literature ordered and received
- ⌘ Feb 2004 Supply agreements in place
- ⌘ May 2004 W resigns
- ⌘ June 2004 First policy published

Shepherd Investment v Walters : the decision



- ⌘ Simmons owed fiduciary duties as de facto director
- ⌘ There was a breach of fiduciary duties from August 2003 when attorneys were instructed
- ⌘ Had the Defendants formed an irrevocable intention to launch the new business?
- ⌘ From then on there was a direct conflict of interest
- ⌘ They were also in breach of their duty to disclose from August 2003
- ⌘ S & H were liable to account for the profits from having diverted a maturing business opportunity.

Crowson Fabrics v Rider, Stimson & Concept Textiles : the facts

- ⌘ Crowson - leading producer of home furnishings and wall coverings
- ⌘ Rider - Operations Director (not a statutory director) – dealing mainly with suppliers
- ⌘ Stimson - UK and Export Sales Manager
- ⌘ Feb 07 - R and S decided to set up a rival business, supplying identical fabrics at less margin
- ⌘ Feb 07 - R and S identified mills to set up meetings
- ⌘ Feb 07 - Powerpoint presentations for potential investors prepared
- ⌘ Mar 07 - R resigns, lying about his future intentions
- ⌘ Mar-April 07 - R and S meet suppliers, customers and European agents of Crowson to see if they will deal with Concept
- ⌘ April 07 - R and S negotiated funding from investors
 - R creates a cashflow forecast using a database of Crowsons top 500 customers
 - Retail stands orders

Crowson Fabrics : the facts



- ⌘ May 07
 - Premises located/Concept incorporated
 - Confidential information incl Crowsons worldwide database of 7000 customers removed
 - S resigns
 - R and S visit Italian supplier of Crowsons top selling fabric and negotiate the supply of virtually identical product
 - S diverts his Outlook address book to his home computer
- ⌘ June 07
 - R and S employment ends
- ⌘ July 07
 - Concept commences trading
- ⌘ Aug 07
 - R downloads the entire Crowson database onto Concept's computer
- ⌘ Sept 07
 - Proceedings threatened
- ⌘ 2 Nov 07
 - Injunction application
- ⌘ 7 Nov 07
 - 3 day trial begins

Crowson Fabrics : the decision



- ⌘ R was in a fiduciary position due to his seniority. S was not.
- ⌘ All of the steps carried out by R & S from Feb 07 crossed the line between legitimate steps for the future and breach of their duties of fidelity
- ⌘ Additionally R had breached his fiduciary duty by failing to disclose his own misconduct and that of S

Crowson Fabrics : the decision



- ⌘ The information taken and used by R and S was not confidential as most was in the public domain or known to R and S but
- ⌘ In any event they had breached Crowson's database right under the Copyright and Rights in Database Regs 1997
- ⌘ Crowson may have been entitled to a Springbroad Injunction; damages; damages in lieu of an injunction or an account of profits.

Practical Suggestions



- ⌘ Service Agreements for Directors and Senior Employees including
 - restrictive covenants
 - confidential information clauses
 - ⌘ Specify in computer use policy
 - ownership of database
 - ownership of email address book
 - ⌘ Include a co-operation clause in contracts of employment
 - ⌘ Retain a back-up system esp for emails
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CORPORATE MANSLAUGHTER AND CORPORATE HOMICIDE ACT 2007

CORPORATE MANSLAUGHTER AND CORPORATE HOMICIDE ACT 2007



- ⌘ into force 6 April 2008
- ⌘ creates new criminal offence of corporate manslaughter
- ⌘ replaces common law offence of gross negligence manslaughter for companies

WHY THE CHANGE?



- ⌘ Addresses “key defect” in existing common law manslaughter
 - ⌘ Previously companies could only be convicted if a “directing mind” (in reality a director) was personally liable
 - ⌘ Now, wider management and systems failings can give rise to the offence, even if one identifiable individual is not culpable
 - ⌘ New offence complements not replaces existing H&S legislation
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Who does the new offence apply to?



- ⌘ Companies
 - ⌘ Other corporations including
 - statutory bodies such as local authorities, NHS agencies
 - LLPs
 - ⌘ Partnerships
 - ⌘ Government Departments
 - ⌘ Trade Unions
 - ⌘ Police forces
- NB Does not apply to individuals and they will continue to be liable under common law manslaughter

THE NEW OFFENCE (S1(i) MCH Act 2007)



An organisation will be guilty of the offence if:-

- ⌘ The way in which its activities are managed or organised
- ⌘ Causes a person's death AND
- ⌘ Amounts to a *gross breach* of a *relevant duty of care* owed to that person

Management Failings



- ⌘ Organisation cannot be convicted unless a substantial element of the breach lies in the way it's *senior management* managed or organised its activities (s1(3)).
 - ⌘ Senior Management = those who play a significant role in the management of the whole or a substantial part of the organisations activities (s1(4)).
 - ⌘ Includes strategic roles as well as those in senior operational management roles eg finance director/transport manager
 - ⌘ Delegating responsibility is no longer a defence!
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Gross Breach



⌘ Gross breach means conduct which falls *far* below what can reasonably be expected of the organisation in the circumstances (s1(4)(b))

⌘ Factors for the jury:-

- was there a breach of H&S legislation?
- how serious was the management failure?
- how obvious was the risk of death?

Relevant duty of care (s2)



- ⌘ Defined as those duties owed under the law of negligence
 - to employees and other workers inc sub-contractors
 - as occupier of the premises
 - as supplier of goods and services
 - connected with commercial activities
 - construction and maintenance work
 - using/keeping plant or vehicles
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Penalties



- Triable in Crown Court only – reserved for most serious cases
- Unlimited fine
- Remedial Order
- Publicity Order

Practical Considerations/Consequences



- ⌘ Very significant change/more prosecutions likely
- ⌘ No longer a reason not to put one director in charge of H&S
- ⌘ Review and audit your systems
- ⌘ Risk assessments and training
- ⌘ Beware the Derivative Action!
- ⌘ Consider indemnities/insurance