



# NON-EXECUTIVE DIRECTORS: A REMINDER OF YOUR DUTIES

Amit Gupta  
Enterprise Chambers

# Remit

- ▶ This talk is focussed at non-executive directors (NEDs)
- ▶ Surge in the last two decades of NEDs being appointed to the board of larger private companies (not just PLCs). Often particularly useful in *owner-manager* companies.
- ▶ A quick run through of directors' duties by statute and at common law
- ▶ A look at 3 court cases and FA 2020, Schedule 13

## NEDs

- ▶ "...the duties of a director whether executive or not are the same": see ***Dorchester Finance v Stebbing*** [1989] B.C.L.C. 498 Ch D
- ▶ No distinction in liquidation either – s.212 Insolvency Act 1986 gateway applicable
- ▶ Know your role
- ▶ UK Corporate Governance Code - useful guide for the courts

# The duties

- ▶ s.171, act within powers
- ▶ s.172, promote the success of the company
  - Additional duty when director knows, or should have known, that Co is or is likely to become insolvent
- ▶ S.173 exercise independent judgment
- ▶ S.174 exercise reasonable care, skill and diligence
  - “One of the duties of non-executive directors is to monitor the performance of the executive directors. But I do not think that those responsibilities can go so far as to require the non-executive directors to overrule the specialist directors, like the finance director. The duty is not to ensure that the company gets everything right.” : see **Re Continental Assurance** [2001] B.P.I.R. 733
- ▶ S.175 avoid conflicts
- ▶ S.176 do not accept benefits from third parties
- ▶ S.177 declare interest in a proposed transaction

- ▶ A total abrogation of responsibilities is impermissible.
- ▶ Continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business
- ▶ Directors must not allow themselves to be dominated, dazzled, manipulated or deceived by a co-director
- ▶ A director cannot escape liability for loss caused by the improper acts of a co-director by alleging that they had a confined area of responsibility / trusted their co-director
- ▶ Where a director knows of an improper practice being perpetrated by those managing a company's affairs, and does nothing about it, he may properly be treated as having permitted

# Re Lexi Holdings [2009] EWCA Civ 117

- ▶ Shaid was a fraudster (both to the civil and criminal standard).
- ▶ He created a fictitious DLA. Misappropriated c.£60M.
- ▶ The CofA was concerned with the role of his two sisters, who were totally inactive directors.
- ▶ When becoming directors, they both knew he had prior convictions, they should have looked at the accounts and questioned Shaid. Had they done so, they would have concluded that the DLA was fictitious.
- ▶ One of the DLA's with money owed was in the name of one of his sisters before she became a director.
- ▶ This should have alerted the incoming directors to the large-scale fraud.
- ▶ Once alerted, cannot do nothing.
- ▶ Should at least have informed the auditors.
- ▶ Gave three weeks to discover the fraud.
- ▶ Judgment against sisters for £37M and £41m each.

# Raithita v Baig [2017] EWHC 2059 (Ch)

## Facts:

- ▶ Co was incorporated in 2005 as a community project to ensure that meat was Halal
- ▶ Co was accruing debts therefore 4 new Dirs were appointed in 2008, including DH
- ▶ Co always had accountants, who prepared accounts 3 sets of accounts before DH joined
- ▶ Accountants were heavily involved in the Co's operations
- ▶ DH had asked accountants if Co was compliant with all financial obligations and had been assured
- ▶ 2011 HMRC made inquiries about if should be VAT registered
- ▶ Eventually registered for VAT (met threshold since 2005, therefore backdated)
- ▶ HMRC said loss caused in respect of VAT because it was not accounted for quarterly for a decade
- ▶ Defence was that exercised reasonable care, skill and knowledge

## Judgment:

- ▶ Found DH to be honest and bright
- ▶ Duty of the director to acquire and maintain sufficient knowledge and understanding of the Company's business to enable him to discharge duties as director.
- ▶ An incoming, inexperienced director should acquire the necessary knowledge and understanding of the Company's operations, and ensure that it is compliant with issues as wide ranging as trading standards, health and safety and taxation.
- ▶ It is not sufficient to simply delegate tasks in a small/medium sized enterprise.
- ▶ Not sufficient to claim inexperience or lack of knowledge.
- ▶ Overall findings:
  - ▶ Took appointments as a direct result of the financial mismanagement of the previous directors;
  - ▶ Had assumed that (a) all matters concerning taxation were or had been dealt with by the previous management, and (b) there was nothing to do in respect of accounts or taxation other than leave the situation as it existed;
  - ▶ Did not ask the accountants whether VAT was payable on supplies;
  - ▶ Had assumed the accountants would advise the board of directors on any issue relating to financial management including taxation; and
  - ▶ Incorrectly assumed the Company had an exemption from VAT.
- ▶ Held liable



# Re IT Protect [2020] EWHC 2473 (Ch)

## Facts:

- ▶ R1 was a bricklayer and R2 worked in catering
- ▶ R2's brother, Steven, who was “*very persuasive*”, convinced R1 that he had a good idea for business. Co set up and R1 became a director because Steven had “*bad credit history*”
- ▶ Co began to trade as a telephone sales business
- ▶ R1 had no role but R2 worked for the Co.



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## Judgment:

- ▶ Steven set up the Co on his own
- ▶ R1, who was largely removed from the Co, should have been aware of various payments out of the Co's account, ought to have known the Co was the subject of a penalty that Steven dealt with and should have appealed the decision (albeit he did not know about any of this) and if he had known about the penalty he would have realised the Co was in financial strife...
- ▶ Should thereafter have undertaken a cashflow review with weekly checks
- ▶ If he had done this, would have discovered misappropriations and stemmed further losses
- ▶ R2, who claimed that she "*ran*" the Co (and admitted perjury x 2), but denied she was a de facto director: claim dismissed
- ▶ No claim even brought against Steven

# FA 2020, Schedule 13

- ▶ Joint and several liability for an individual, to HMRC, involving insolvency or potential insolvency, for amounts payable by a Co. Three ways:
  - ▶ (1) Tax avoidance/evasion (s.2)
    - ▶ Condition A: Arises from tax-avoidance arrangements or tax-evasive conduct.
    - ▶ Condition B: in insolvency procedure or serious possibility
    - ▶ Condition C: individual was responsible for Condition A or benefitted
    - ▶ Condition D: Likely to be a tax liability
    - ▶ Condition E: serious possibility that some or all of tax not be paid
  - ▶ (2) Penalties arising from tax avoidance/evasion issued to Co (s.5)
  - ▶ (3) Repeated insolvencies and non-payment cases (s.3)

# Take home messages

- ▶ Meetings: if you fail to plan, you plan to fail
- ▶ Check your documents - know your responsibilities / clarify them if need be
- ▶ Be diligent / do not turn a blind eye / do not assume someone else's responsibility
- ▶ You are entitled to seek advice (depends on your letter of appointment / contract / articles / policies if Co will pay for it)
- ▶ You can always resign
- ▶ *“Wrong for the court to substitute its opinion for that of the management, or indeed to question the correctness of the management’s decision, on such a question, if bona fide arrived at” : see Howard Smith v. Ampol Petroleum [1974] AC 821*
- ▶ Directors may be deemed to have acted reasonably by relying on the advice of accountants: see *Pro4Sport v Adams [2016] 1 BCLC 257*



# Contact us

## LONDON

9 Old Square, Lincoln's Inn, London, WC2A 3SR,  
DX: 301 London/Chancery Lane  
T: 020 7405 9471  
E: london@enterprisechambers.com

## LEEDS

43 Park Square, Leeds, LS1 2NP,  
DX: 26448 Leeds / Park Square  
T: 0113 246 0391  
E: leeds@enterprisechambers.com

## BRISTOL

4-5 College Green, Bristol, BS1 5TF,  
DX: 7863 Bristol  
T: 0117 450 7920  
E: bristol@enterprisechambers.com

## NEWCASTLE

65 Quayside, Newcastle upon Tyne, NE1 3DE,  
DX: 61134 Newcastle upon Tyne  
T: 0191 222 3344  
E: newcastle@enterprisechambers.com

[www.enterprisechambers.com](http://www.enterprisechambers.com)

