

NOTES FOR GUIDANCE - 12

DIRECTORS' INTERESTS

The whole issue of “Directors’ Interests” should be simple but in fact is rather complex and confusing. Unlike many other aspects of the Act it is not easily amended to make life simple for small companies.

Some people seem to think that directors have to disclose the sort of personal and financial information that MPs, Councillors and the like are required to do under “Standards in Public Life” legislation. This is not the case and there are only two types of Directors’ Interest that need to be recorded. These are details of the shareholding that the director has in the company itself, and any interest he or she has in any contract entered into by the company of which he/she is a director

In a private company keeping track of a directors shareholding is fairly simple and should be recorded in the Combined Register. However the legal requirements relating to directors’ interests in contracts is commonly misunderstood and often simply ignored. The penalty for non-compliance is a fine of £1,000 or more, but other more serious consequences can follow as explained below.

WHAT IS “AN INTEREST IN A CONTRACT”

In law, “contract” means “agreement”. Thus a director of a trading company who agrees to buy from or sell to that company is making contracts with the company. If by doing so he or she secures some financial advantage, the consequences explained below must be considered.

Apart from the obvious case, where the director enters directly into a contract with the company, we must consider “indirect” interests. For example a person may be a director of and/or shareholder in two companies. If these companies then enter into a contract that person will be *indirectly* interested from both sides. He or she will certainly have to declare this interest at board meetings of *both* companies, but if the articles of either (or both) companies had not been drafted to allow the person to have these “interests” then any contract may be held to be unenforceable and the director may even have to pay over to either (or both) companies any gain or profit made by either one of the companies!

THE LAW GENERALLY

A director occupies a position of trust. The position in common law is that if, when acting for the company, he or she makes a personal profit (whether at the company’s expense or at the expense of someone else) he or she must pay over the profit to the company. Moreover, if the director stands to make a profit from a contract with the company, the director cannot enforce the contract against the company. However, a company can, by its articles, permit a director to contract with it and even to retain any resulting profit. Alternatively so long as a director declares his or her interest in a contract (see below) then he or she may retain any resulting profit.

Articles usually provide that a director shall not vote at a board meeting and shall not be counted in a quorum on contracts where he is interested. With a small company this could make it quite impossible to get a quorum of “disinterested” directors, so normally articles are drafted to allow “interested” directors to vote on such matters and be counted as part of a quorum.

NON-STATUTORY REGISTER OF INTERESTS

Although not required by law, some companies, mainly PLCs, require directors to record their own and their families investments and other interests much as MPs and councillors. It is questionable whether they can insist on this and certainly such information should not be disclosed outside the boardroom. Directors unhappy about being asked for this information should take legal advice.

DECLARING AN INTEREST

Section 317 (1) of the Act requires that a director who has any interest in a contract made with a company must “declare his interest” at a board meeting. *The Articles cannot waive this duty.*

Section 317 (2) sets out the rules as to the time when the declaration should be made but can be summed up by saying: “As early as possible”. Sections 330 and 346 extend this so that in the case of loans and similar transactions the director must declare an interest if a “connected person” (e.g. a spouse, child or partner) has an interest in a contract.

Section 317 (3), however, permits a director to give general notice in advance that he is interested in all contracts that may be made in future with named companies or partnerships of which he is a member. It *appears* that specific disclosure is required on every occasion if his interest is that of a director or creditor.

Obviously to provide evidence to protect the director who makes such a disclosure, it should be recorded in the minutes of the meeting. It is advisable at the first board meeting of the company for directors to present a list of companies in which they are shareholders and therefore interested. It is recommended that a “Register of Directors’ Interests” is kept (as part of the Combined Register) and we suggest that this is referred to at the start of any subsequent board meetings along the lines of “the Secretary drew attention to the Register of Directors’ Interests”. In this manner the minutes show that the directors and secretary were aware of any interest that may have a bearing on decisions taken at the meeting.

If a director omits to declare an interest, either by accident or otherwise, then although the company is entitled to the profit made all may not be lost as the matter can be rectified by approval of the members. What would happen is that an Extraordinary General Meeting would be called and the facts presented to the shareholders who would vote to ratify the interest or not. It could also be done by unanimous written resolution of the shareholders.

In simple terms if a director declares an interest at a board meeting then there is no problem as the other directors take the decision in the knowledge of that interest. If the director does not declare an interest before the contract is approved then only the members can decide whether or not the director may profit from the contract.

In a small company it is possible that the shareholders and directors are frequently identical. If this is the case, at any board meeting where the directors feel unable or unwilling to proceed, because of fears of contravening the Companies Act, then the board can simply convene a shareholders’ meeting to be held immediately. If all shareholders are present or if they can be called to the meeting there and then, formal notice is not required. Although an interested *director* cannot vote, there are no restrictions on an interested *shareholder*, though the interest should still be noted to the company secretary. Having done this, the shareholders’ meeting is closed and the board meeting resumed. This can be done for any other reason if the directors feel it necessary, for example, if they discuss some change that needs shareholder approval, such as to the Articles of Association. *However, all shareholders or their representatives must be present or this meeting would be improperly convened.*

It is important to note that even if the directors and shareholders are the same persons any director interest still must be declared and minuted. On one occasion the writer of this note was instructed by an auditor to convene an EGM to ratify as shareholders a decision taken by himself and his wife (the sole shareholders) as directors! So it is easy to get it wrong.

<p>These notes are based on our understanding of the law at this date and are general rather than specific. We cannot accept any responsibility for errors or omissions, and we must emphasise that the final responsibility for compliance with the requirements of the Companies Act rests with the Directors and Secretary who should seek appropriate legal advice if in doubt about over any particular aspect of company administration.</p>
