

## Conflicts and Loans

are one of the most important  
the company secretary (if there is  
duties in light of the Companies  
other important matters  
directors' remuneration, loans to  
insurance.

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the management of a company's  
of a company.

ere derived from several sources,  
ner statutes.

Directors' common law duties were set out in sections 171-177 of the Companies Act in this area not only codify directors' duties but develop

ors (and shadow directors). They  
be able to bring an action against  
ders can bring a derivative action

llows:

- with the company's constitution and they were conferred (section 171).

of association, resolutions and other agreements).

- to promote the success of the corporation, the director considers, in good faith, would be in the best interests of the corporation for the benefit of its members.

the performance of directors' duties  
the enlightened shareholder value  
and to" in the course of making their  
need to consider, including: the  
m; the interests of the company's  
business relationships with suppliers,  
operations on the community and

the environment; the desirability of maintaining high standards of business conduct (section 172). (The company.)

- **Exercise independent judgment** (section 173).

This would not prevent a director from acting in accordance with the company's constitution or an agreement entered into.

- **Exercise reasonable care, skill and diligence** (section 174).

The expected standard is not an objective and subjective standards. A director's actual understanding may not be enough if more could reasonably be expected of someone.

- **Avoid conflicts of interest** (section 175).

Directors must avoid situations where they have, or could have, a conflict of interest, or may conflict, with the company. This applies in particular to the exploitation of any property or opportunity regardless of whether or not the company could take advantage of it.

- **Not accept benefits from the company** (section 176). A duty to disclose position of director or accept benefits from the company (either do so by the company (either a resolution of the shareholders) (section 176).

- **Declare interests in proposed transactions or arrangements with the company.** A duty to disclose proposed transaction or arrangement of the company (section 177).

Any director, directly or indirectly, in a transaction or arrangement with the company must declare the interest to the other directors.

The statement of general duties is set out in the Companies Act 2006 and for how they account for the way directors are expected to act in the company.

## Duties owed to the Company & the Shareholders

These general duties are owed to the company and the individual shareholders. As described above, it is the company's duty to act in the best interests of the company. A breach of duty means the company can bring a claim against a director for breach of duty. A breach of duty means the director concerned and allows the company to claim damages or compensation from the director as well. Failure to disclose an interest in an existing transaction or arrangement with the company also carries the risk of criminal fine.

## Shareholder Litigation and Derivative Claims

However notwithstanding that the Companies Act 2006 allows shareholders a claim against a director in the company's name (known as a "derivative claim") in certain circumstances (i.e. a loss) arising from an

maintaining a reputation for high standards of business conduct (section 172). (The company.)

Exercise independent judgment (section 173).

accordance with the company's constitution or an agreement entered into.

duty to exercise reasonable care, skill and diligence (section 174).

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s of interest (section 175).

e, or could have an interest that conflicts with the company. This applies in particular to the exploitation of any property or opportunity regardless of whether or not the company could take advantage of it.

to make a personal profit from the company, except where authorised to do so by the company (either a resolution of the shareholders) (section 176).

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to the company, the Companies Act 2006 allows shareholders a claim against a director in the company's name (known as a "derivative claim") in certain circumstances (i.e. a loss) arising from an

actual or proposed act or omission in connection with the trust by a director of the company or a person who is a party (or both), including former directors or parties, before or after the person seeking the declaration becomes a shareholder of the company.

However, it is only the company, derivative claim. In addition, there must go through, including court case. It is not therefore a straight need to approach with caution. Those without any real merit.

## Ratification

If a director commits negligence, d can ratify the breach by passing a shareholder, any votes he or she c family or other 'connected person whether a simple majority has b unanimous.

### **Conflicts of Interest**

Company secretaries and compar about conflicts of interests. This is duties specified under the Compa follows:

- **Section 175** - A duty to consider the interests of the company in a proposed transaction with the company
- **Section 176** - A duty not to accept a bribe or other inducement
- **Section 177** - A duty to consider the interests of the company in a transaction or arrangement with the company

## Duty to avoid conflicts of interest

A **conflict of interest** occurs when a person has competing interests, one of which could possibly influence their judgement. A conflict of private interest arises when a person's private interests may be perceived as being capable of influencing their professional judgement.

For example, suppose the board of directors of a company owns property. One of the directors owns property adjacent to the company's property. An increase in value subsequent to the company's acquisition of the property of interest, as his judgement may be affected by the fact that neighbouring property rise in value.

Other potential conflict situations in the company (e.g. an accountant to the treasurer or a person who is or may be in a conflict of interest with the company).

fault, breach of duty or breach of  
de against the director or a third  
matter whether the loss occurred  
the derivative claim became a

o may obtain compensation in a  
n action and criteria that the claim  
lder is actually able to proceed to  
e that potential shareholders will  
directors from spurious claims or

breach of trust, the shareholders of the director in breach is also a director (as well as votes of his or her company) for the purposes of determining the votes of all the members are

be prepared to advise directors three out of the seven directors' conflicts of interest. They are as

(except where they arise out of a section 177 below).

third parties.

that a director has in a proposed  
the company's other directors.

organisation) is involved in multiple for an act in relation to the other. interest which *might* influence, or cement even unconsciously.

is discussing an investment in a property, which has the potential to company. That director has a conflict to see his own investment in his

ships, advisory positions with the sector as well) and being connected

## Prior authorisation by the board

A conflict situation can potentially arise if a director's duty is not infringed.

- the matter has been authorised by the board;
- the director is not counted as being present at the meeting at which the matter is considered; and
- the matter is agreed by the board.

*For companies incorporated since 1 October 2008:*

The company's articles must be consistent with the law and could invalidate an authorisation of a conflict of interest.

*For companies that were in existence before 1 October 2008:*

The shareholders should pass a resolution enabling board authorisation of conflicts, (See: [Shareholders' Ordinances of Interest](#)). This resolution then enables the board to authorise the Companies House – [File Resolution of Interest](#)).

The interested director must make a declaration of interest, to enable the board to consider the matter with a view to authorising or not an existing or proposed transaction.

- at a meeting of the directors, (See: [Declaration of Directors' Interests](#)); or
- by notice in writing, (See: [Declaration of Director's Interest in Proposed Transaction](#)); or
- by general notice, (See: [Letter to Companies House – Declaration of Director's Interests](#)).

Often a director will take advantage of the Companies Act 2006, which allows him to give a general notice of interest in relation to any or business, or of a specified transaction at a board meeting. Declarations of interest should always be recorded in the minutes.

Even once the board has authorised a transaction, the director concerned is still under a duty to act in a way that he or she considers, in good faith, will be most likely to promote the success of the company (section 172 duty).

Where a director is not aware of the transaction or arrangement in question, the director is treated as being aware of it if he or she ought reasonably to be aware.

## Considerations for the board when considering a conflict of interest

When the board considers whether to authorise a transaction, each authorising director must consider the duty to act in a way that he or she considers, in good faith, will be most likely to promote the company's success (section 172 duty).

The board may also want to impose a condition that the director in question may not be present at the meeting if the matter is discussed.

### Some situations where a declaration of interest is advisable

There are several situations where a director may be required to declare a conflict of interest.

For example:

- Where a director sits on more than one company's board of directorships authorised by the company's articles of association;
- Where a director holds shares in a company that is a potentially competing company;
- Where a director owns property that is the company's property, or the value of which may be affected by the company's actions;
- Where a director has an advisory role in a company that has an advisory relationship with the company, or an interest in a company – for example, accountants, lawyers, or a legal or consultancy firm.

### Situations where there is no need to declare a conflict of interest

A director need not declare an interest in the following circumstances:

- if it cannot reasonably be expected that the director's interest will give rise to a conflict of interest; or
- if the other directors are aware of the interest (and are treated as being aware); or
- if it concerns terms of his appointment or remuneration as determined by a meeting of the directors.

### Who are connected persons?

Connected persons include the following:

- Family members (spouse, partner, child, or other person with whom the director lives in a domestic relationship);
- Trustees of a trust of which the director is a trustee;
- Corporate bodies to which a director is connected;
- A director's business partner.

'Connected persons' interests are also covered by the provisions of the Companies Act 2006, and also fall under the remit of sections 175 and 176 of the Companies Act 2006.

For example, if a director's son or daughter is a director of a potentially competing business, a potential conflict of interest may arise. A declaration of his indirect interest in the business, and the board should give prior authorisation for the purchase, if or when the director concerned must make a purchase, and the board should consider it does not interfere with their duty as directors.

authorisation – for example, that the board should give prior authorisation where the relevant matter is discussed.

### Declaration of interest is advisable

There are several situations where a director may be required to declare a conflict of interest.

For example, if a director sits on more than one company's board of directorships authorised by the company's articles of association, he should have all of his interests declared. If a director holds shares in a company that is a potentially competing company, he should declare his interest in the company's property, or the value of which may be affected by the company's actions. If a director has an advisory role in a company that has an advisory relationship with the company, or an interest in a company – for example, accountants, lawyers, or a legal or consultancy firm, he should declare his interest.

### Situations where there is no need to declare a conflict of interest

A director need not declare an interest in the following circumstances:

if it cannot reasonably be expected that the director's interest will give rise to a conflict of interest; or if the other directors are aware of the interest (and are treated as being aware); or if it concerns terms of his appointment or remuneration as determined by a meeting of the directors.

Connected persons include the following: family members (spouse, partner, child, or other person with whom the director lives in a domestic relationship), parents), trustees of a trust of which the director is a trustee, corporate bodies to which a director is connected, and a director's business partner.

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For example, if a director's son or daughter is a director of a potentially competing business, a potential conflict of interest may arise. A declaration of his indirect interest in the business, and the board should give prior authorisation for the purchase, if or when the director concerned must make a purchase, and the board should consider it does not interfere with their duty as directors.

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ing by the company of substantial persons. There are restrictions in transferring substantial assets from or to with a director unless shareholder

tion), where the value of the asset

- reference to the last set of  
£5,000.

Have Substantial Property

is for loss of office are excluded  
sions, and approval is not required  
a company and a person in his

pany is being wound up (unless  
administration (note, however, that the  
in receivership or administrative

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al Articles (Companies Act 2006),  
ty vote in a meeting (i.e. a board  
allow slightly more flexibility than  
hen not all of them are physically  
other (for example, by telephone

a meeting of directors is any two  
by a decision of the directors. For  
of two is waived.

man, and if there is an equality of

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Both state that directors are entitled to compensation. Compensation is decided by the passing of a resolution. Model Articles permit the other

Under the Model Articles, a director is entitled to remuneration not only for his services as a director but for any other services he provides for the company. In both cases, remuneration is deemed to accrue from the company in the absence of any provision to the contrary.

Article 83 of Table A and article 20 of the Model Articles state that directors may be paid for out of pocket expenses incurred in the discharge of their duties.

Article 87 of Table A and article 19 of the Model Articles allow directors to receive gratuities and pensions. Table A states that a director who *no longer holds any executive office* in the company, whereas the Model Articles state that gratuities and pensions are included as part of a director's remuneration.

Note that if a director's service contract provides for a guaranteed term of more than two years, prior approval by way of a shareholder resolution is required.

### **Loans to Directors**

#### **Loans to directors and the provisions of the Companies Act 2006**

The Companies Act 2006 removed the requirement for loans to directors to be approved by shareholders, instead with a requirement for loans to directors to be approved by the board.

A private company may make a loan to a director, or give a guarantee or provide security in connection with a loan to a director, without the approval of the shareholders, provided that the transaction must first be approved by the board of directors. (See: [Shareholders' Ordinary Resolution for a Director](#)).

#### **Exception for loans under £10,000**

If the aggregate value of the loan to a director does not exceed £10,000, there is no need to obtain shareholder approval (note that the £10,000 is an aggregate value, meaning that if a director has more than one loan to a director combine to a value over £10,000, it would require shareholder approval).

#### ***Other exceptions to the requirement for shareholder approval***

There are other exceptions to the requirement for shareholder approval. For example, where the loan is for expenditure (of under £50,000) on the company business, or where the loan is for a director with funds to defend civil or criminal proceedings in connection with the company business.

#### **Note 'connected persons'**

Companies should watch out for transactions with a director requires shareholder approval. Where a transaction is *connected' with the director*, shareholder approval will also be required in respect of a transaction *between the company and a director*.

Thus a loan to a 'connected person' requires shareholder approval.

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- # A

more of the share capital, or can

connected with the director.

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Board Minutes – Consider Director's

- the director requesting a loan (note the 'interests' of the director, where the company is the subject of the loan) (see above).

- Shareholders' approval is not required and will need board approval. When performing all of their duties; the board should *will promote the success of the*

- ined that shareholder approval is  
the directors need to agree the  
the shareholders explaining the  
n must set out the following:

- if it is required, and  
transaction connected with the loan.

- shareholders' written resolution.

- able to shareholders by being sent to be held, being made available the general meeting and at the

- holders' approval. Then arrange the loan agreement should have

## L

unsecured, secured and secured  
Directors' Loan Agreements.



The secured loans grant the company a weaker form of security than a legal mortgage. We also provide guidance on the legal aspects of the company's equitable charge in the company's articles.

### **Consumer Credit Act**

The company should ensure that it complies with the Consumer Credit Act 1974, either by complying with the requirements of the Act or one of the exemptions. Information on the exemptions is available on the Office of Fair Trading website.

### **Loans from Directors' to a Company**

A director (or shareholder) can make a loan to a company if the organisation makes a loan to a director for the director's requirements, particularly if the company is a small company. A director may make the loan to the company on the same basis as any commercial loan. If the director is the sole director and sole shareholder of the company where there is no precedent, representations and warranties.

Whether the director will require interest on the loan is a commercial matter. However directors should consider their own personal tax position and may need to consult a tax advisor.

A loan from a director to a company must be on terms that will promote the success of the company (section 172 of the Companies Act). If the director of the borrower, that director must declare to the other directors the nature of his interest in the loan (section 177 of the Companies Act (again see above)). The director must not vote on the resolution concerning the loan.

Our loan and finance documents are available on the company's website.

### **Indemnity and Insurance**

Under the 2006 Act, a company must indemnify its directors for negligence, default, breach of duty or breach of trust.

However, this does not prevent a company from purchasing insurance for its directors against negligence, default, breach of duty or breach of trust. The purchase of such insurance must be authorised by a resolution of the shareholders (this is not the case if there is no equivalent provision in the company's articles).

over the director's home. This is a weaker form of security than a legal mortgage. Registry formalities are simpler. The company must ensure that need to be made to protect the company's interests.

complies with the Consumer Credit Act 1974, either by complying with the requirements of the Act or by bringing the loan terms within one of the exemptions, including licensing and exemptions, is available on the Office of Fair Trading website.

on the same basis as any commercial loan. If the director is the sole director and sole shareholder of the company where there is no precedent, representations and warranties.

or charge interest on the loan is a commercial matter. However directors should consider their own personal tax position and may need to consult a tax advisor and consult HMRC.

of interest issues. The company's directors must ensure that the loan is on terms that will promote the success of the company (section 172 of the Companies Act). If the lender is a director of the borrower, that director must declare to the other directors the nature of his interest in the loan (section 177 of the Companies Act). The director must not vote on the resolution concerning the loan.

director seeking to make a loan to the company must ensure that the loan is on terms that will promote the success of the company.

director from any liability for negligence, default, breach of duty or breach of trust. Any attempt to do is void.

ing insurance for its directors against negligence, default, breach of duty or breach of trust. The purchase of such insurance must be authorised either by the articles or by a resolution of the shareholders (this is not the case if there is no equivalent provision in the company's articles – note that section 53 of the Model Articles).