

Responsibility for Non-Executive Directors by Judith Riordan



Non-executive directors must show they supervised and controlled the affairs of the company in order to avoid restriction. The High Court recently restricted all four directors of Tralee Beef & Lamb Ltd. (in liquidation) on the basis that they had acted honestly but not responsibly in relation to the conduct of the affairs of the company.

A restriction order means that a person cannot act as a director or secretary, or be concerned or take part in, the promotion or formation of any company, for a period of five years, unless it has a paid up share capital of €317,434.52 in the case of a plc, or €63,486.90 in the case of a private company. Every liquidator of an insolvent company must make an application for a restriction order unless he has been relieved of this obligation by the Director of Corporate Enforcement.

Tralee Beef & Lamb Ltd. (in liquidation)

This company, which was involved in the meat processing business, went into liquidation in 2001 with liabilities of €3.5million. There was one executive director of the company and three non-executive directors.

Despite the fact that one of the non-executive directors of the company was appointed to the position by a fund management company involved in business expansion schemes, the court held that he had failed to establish, to the court's satisfaction, that he acted responsibly in his capacity as a non-executive director of Tralee Beef & Lamb Ltd.

It was submitted to the court that consideration must be given for the fact that he was a non-executive director appointed pursuant to a B.E.S. scheme. The court accepted this submission but found no provision in the relevant legislation that prevented, or restricted him from discharging the normal duties and obligations of a non-executive director.

From the decision, it is clear that the difficulty this individual faced was that the court found that he failed, for a period of approximately twenty-one months, to make contact with his co-directors. The court found that he had been completely absent from the company during that period and thereby failed to inform himself about the affairs of the company and to join with his co-directors in supervising and controlling those affairs.

The court stated that he was under an obligation to participate with fellow directors in collectively supervising and controlling the affairs of the company, or at the very least, to place himself in a position to guide and monitor the management of the company and the court found that he had failed to do this.

This decision is presently under appeal to the Supreme Court.

In the meantime, it would appear prudent for non-executive directors to review their level of involvement in companies to which they are appointed.

What does a director need to prove to avoid an order for restriction?

A director can only avoid a restriction order by proving that he acted honestly and responsibly in relation to the conduct of the affairs of the company and that there is no other reason why it would be just and equitable that he should be restricted.

Generally, the court has no difficulty in determining the honesty of a director. However, the issue of responsibility is less straightforward.

How does a director satisfy the court he acted responsibly?

Case law has formulated some general criteria, which assist in this determination. The court will specifically look at the following:-

- the extent to which the director has or has not complied with any obligations imposed by the Companies Acts
- the obligations imposed by common law, including the fiduciary duties to the company and the duties to use due skill and care
- the extent to which the director's conduct could be regarded as so incompetent as to amount to irresponsibility
- the extent of the director's responsibility for the insolvency of the company
- the extent of the director's responsibility for the net deficiency in the assets of the company disclosed at the date of the winding up or thereafter, and
- the extent to which the director, in his conduct of the affairs of the company, has displayed a lack of commercial probity or want of proper standards.

The first consideration outlined above highlights a difficulty for both non-executive directors and for the court in that the legislation does not acknowledge the distinction between an executive director and non-executive director, and therefore, the obligations under the Companies Acts are identical for all directors.

Depending on the background of a director, the court could also consider what skills or influence the director in question brought, or should have brought, to the company. However, each director could also be judged by an objective standard, which must include the minimum common law duty to exercise due skill and care with regard to the affairs of the company.

The court should consider the director's conduct during his entire tenure as a director of the company but should not take into consideration his conduct in relation to any other companies of which he is a director.

Repercussions of this decision - the obligation to "supervise and control"

It is clear from this judgment that the court focused on the level of knowledge of each director regarding the affairs of the company.



Moreover, the judge held that merely seeking financial information is insufficient. Executive directors must bring to the board meetings sufficient information in relation to the affairs of the company so that the non-executive directors can inform themselves and thereby supervise the affairs of the company. However, non-executive directors must not follow such information blindly.

The court had no difficulty with directors delegating particular functions and trusting the competence and integrity of those individuals to whom they have delegated such functions, however only to a reasonable extent. Delegation does not absolve a director from the duty to supervise the discharge of those delegated functions.

In the decision, the court accepts that non-executive directors are a part of commercial life. However, from the decision it is clear that a non-executive director who does not actively supervise and control the affairs of the company may fail to establish that they acted responsibly in their role as a director of the company.

So what should a non-executive director do now?

Certainly, once the company is in liquidation it is too late to remedy the situation. However, it would also appear that it may not be enough to step in once the company has fallen into financial difficulty. There should be continuity in the non-executive director's supervision of the company's affairs, and the non-executive director should ensure, on an on-going basis, that he is being kept informed of what is going on in the company.

The following are some suggestions for non-executive directors who wish to ensure they would be able to show they adequately supervised and controlled the affairs of the company:-

- Attend all board meetings and ensure that attendance and any contribution to the meeting is duly noted
- Ensure board packs are received in advance of the meetings
- If board meetings are not being held on a regular basis, write to the executive directors seeking explanations and if unsatisfactory responses are received pursue the matter in writing until it is resolved. Any reasons offered for lack of board meetings should be considered carefully
- Maintain and document all contact with both executive and non-executive fellow directors on an ongoing basis
- Ensure up-to-date and accurate financial information is being received on a regular basis
- Ensure there is adequate supervision of those individuals to whom functions of the board have been delegated
- If on the board to give the benefit of a certain skill or expertise ensure that any contributions in this regard are duly noted in minutes of relevant meetings
- Upon resignation, ensure it is duly noted in the company records and in the Companies Registration Office as soon as possible

This decision may be very pertinent to members of the ACCA, who as accountants, may sit upon several boards of directors. Whilst only having an advisory role rather than being involved in the day to day running of the business, following this ruling it may be relevant for members in such a position to review their level of engagement with the company and their fellow directors to ensure that they, as a director, may be seen to have adequately supervised and controlled the affairs of the company.

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