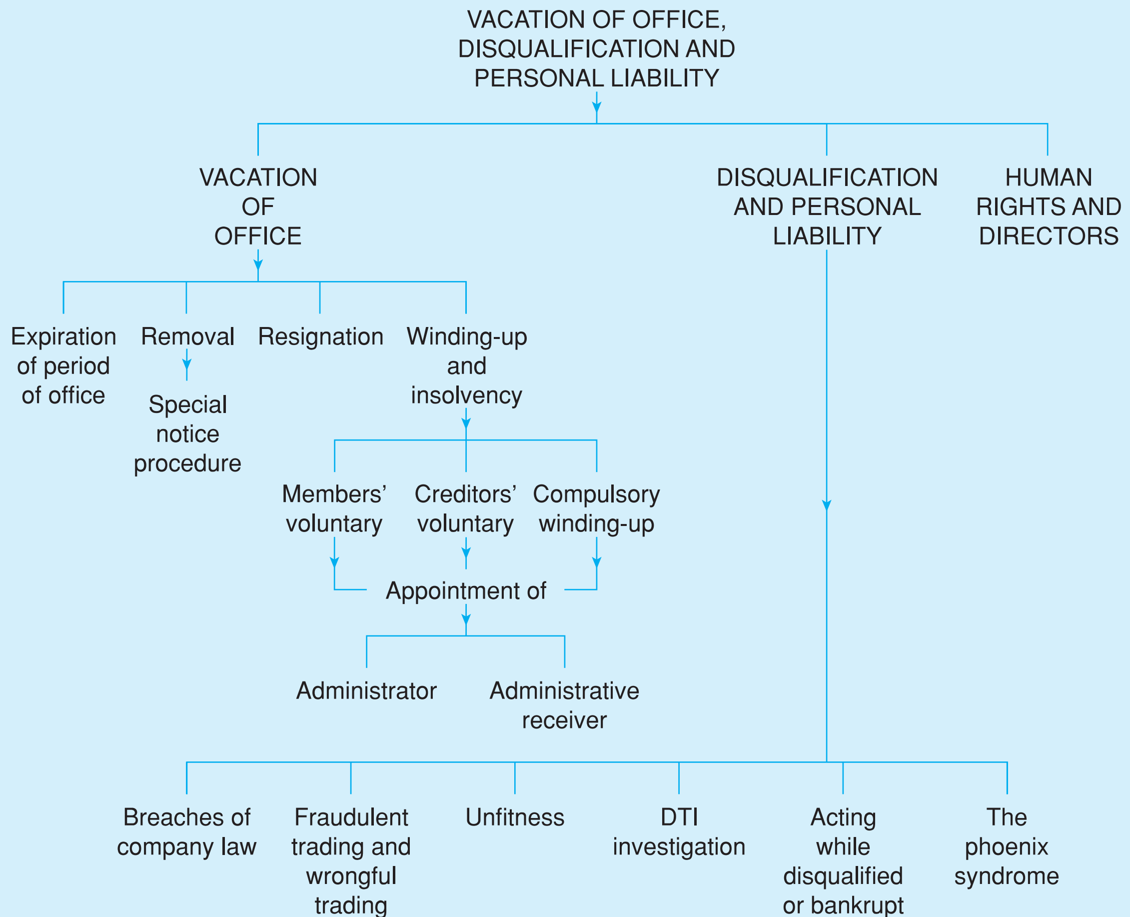
20 Vacation of office, disqualification and personal liability



A director may vacate office for a variety of reasons.

Expiration of the period of office

The articles usually provide what the period of office shall be. *Table A* provides that at the first annual general meeting all the directors shall retire from office, and at the annual general meeting in every subsequent year one-third shall retire, or if their number is not three or a multiple of three, then the number nearest to one-third shall retire from office. If the company has only two directors one of them will retire every year if *Table A* applies because one is the nearest to two-thirds of the directors who are subject to the retirement by rotation rules. A sole director must retire every year (***Re David Moseley & Sons Ltd*** [1939] 2 All ER 791) (but see below). The directors retiring will be those longest in office since their last election. Difficulties may arise in the early years of the company's life if all the directors were appointed at the same time. If this is the case, those retiring must, by reason of *Table A*, be ascertained by agreement between the board and on agreement failing, by drawing lots. It should be noted that the model articles for private companies no longer demand retirement by rotation. Directors of public companies are still subject to this in the module articles.

Table A provides that a retiring director shall be eligible for re-election, and further provides that if the office vacated by a director *on retirement by rotation* is not filled, the retiring director shall, if he still offers himself for re-election, be deemed re-elected, unless the meeting expressly resolves not to fill the vacancy or unless the resolution for the re-election of such director has been put to the meeting and lost.

The board may fill casual vacancies and appoint additional directors up to the maximum in the articles. These persons must stand for re-election at the next AGM and do not count in the one-third retiring, but are additional to that number. If not re-elected, they vacate office under *Table A* at the end of the AGM. There is no deemed re-election as is the case with directors retiring by rotation. Furthermore, the managing director and directors holding any other executive office, e.g. finance director, do not retire by rotation. They are subject to the terms of their contracts but cannot be either managing director or executive director unless also directors. Therefore, they cannot continue in post if they are removed as directors by the members under s 168, CA 2006 or under a provision in the articles. They would normally have a claim for breach of contract.

Since the current *Table A* and previous ones make the AGM the lynchpin of director retirement and re-election, private companies now existing under *Table A* may no longer have retiring directors because CA 2006 no longer require a private company to hold an AGM. They will stay in post unless they voluntarily resign or a member calls for a meeting to be held, which is his right, at which to discuss the removal of a director, or a removal procedure in the articles is used (s 303(3)).

Alternatively, companies wishing to dispense with the AGM requirement but still wanting retirement by rotation would have to insert an article under which retirement by rotation was triggered in some other way, e.g. by a date, such as, say, one-third to retire on 31 March each year.

The Model Articles for Private Companies Limited by Shares did not make changes to the way in which private companies may appoint directors either by ordinary resolution of the

shareholders or by decision of the directors. However, these Model Articles now cover the position where a sole director who is also the sole shareholder dies. Finally, there is no time limit for a director to retain office however they serve only until the next AGM on appointment by the board, as was the case under Article 79 of *Table A*.

In the Model Articles for Public Companies, public companies may appoint directors by ordinary resolution or by decision of the directors. In relation to the requirement for retirement of the directors by rotation, re-election takes place every three years to ensure consistency with the Combined Code.

In neither the draft Model Articles for Private Companies Limited by Shares nor the draft Model Articles for Public Companies is there a provision for the termination of a director's appointment for failure to attend meetings. Nor is there a more general provision under which the appointment will terminate when all the other directors decide that the particular director should be removed from office.

Removal – under statute

A company may by *ordinary resolution* in general meeting remove a director before the expiration of his period of office regardless of the way in which he was appointed and notwithstanding anything in its articles or in any agreement with him (CA 2006, ss 168 and 169), though weighted voting rights may render the section ineffective. The written resolution procedure is not available for this purpose because the director has a right to put his case against removal to the meeting (see below).

Bushell* v *Faith [1969] 1 All ER 1002

Mrs Bushell, Mr Faith and their sister, Dr Bayne, each owned 100 shares in a family company which had an issued share capital of 300 fully paid shares of £1 each. The company had adopted *Table A* for its articles of association but a special Art 9 provided that, in the event of a resolution being proposed at a general meeting for the removal of a director, any shares held by that director should carry three votes per share.

Mr Faith's conduct as a director displeased his sisters and they requisitioned a general meeting at which an ordinary resolution was passed on a show of hands to remove him. Mr Faith demanded a poll, contending that, in accordance with Art 9, his 100 shares carried 300 votes and that therefore the resolution had been defeated by 300 votes to 200.

Mrs Bushell then claimed a declaration by the court that the resolution had been validly passed and an injunction restraining her brother from acting as a director. Ungoed-Thomas J, at first instance, granted the injunction *holding* that Art 9 was invalid because it infringed what is now CA 2006, s 168 and that therefore the resolution removing Mr Faith had been duly passed. The Court of Appeal did not agree with the decision at first instance and allowed Mr Faith's appeal. In particular, Russell LJ stated that a provision as to voting rights in the articles which has the effect of making a special resolution to alter the articles incapable of being passed if a particular shareholder or group of shareholders exercise his or their voting rights against it is not a provision depriving the company of the power to alter its articles or any of them by special resolution, and so does not contravene what is now s 9 and is valid. However, an article providing that no alteration shall be made in the articles without the consent of a particular person would be contrary to s 9 and so would be invalid.

Mrs Bushell's appeal to the House of Lords ([1970] 1 All ER 53) was also dismissed, their Lordships *holding* that the provisions of what is now CA 2006, s 168 did not prevent companies from attaching special voting rights to certain shares for certain occasions, e.g. to directors' shares on a resolution at a general meeting for the removal of a director.

Comment

In the House of Lords, Lord Reid pointed to what is now Reg 2 of *Table A* as justifying the weighted voting provisions. *Table A*, Reg 2 provides 'any share may be issued with such rights or restrictions as the company may by ordinary resolution determine'. This to Lord Reid indicated that there was no reason why shares should not have weighted voting rights if the company wished that to be the position.

Special notice of 28 days to the company is required of the intention to move the resolution. If the company calls a meeting for a date, say, 26 days after receipt of the special notice to foil the attempt to remove, the notice is nevertheless regarded as valid under CA 2006, s 312(4). Under s 312(4), the meeting at which the resolution to remove is to be considered must be called with at least 21 days' notice. It is not necessary that the person who served the special notice should propose the resolution. This could be done, for example, by another member.

Removal under the articles

This power is in addition to any other means of removal that may be provided in the articles, e.g. a power under which certain of the directors may remove others (***Bersel Manufacturing Co Ltd*** **v** ***Berry***, 1968, see below). Thus, shareholders who wish to remove a director have a choice: either they can proceed under CA 2006, s 168 or under a provision, if any, in the articles, and if the articles make removal more difficult, as where they require a special resolution, then s 168 will be used. On the other hand, where the articles allow the directors themselves to carry out the removal, as in ***Bersel Manufacturing Co Ltd*** **v** ***Berry***, 1968 (see below), then, of course, it would be easier to do it through the power vested in the board, first because the articles do not require a members' resolution to effect the removal but perhaps just a letter signed by the company's chairman and secretary and, second, because the article is unlikely to give the director being removed rights of representation as s 168 does.

A quite common use of a clause in the articles setting out a means of removal of directors is to be found in the articles of subsidiary companies where a removal clause allows the holding company to remove the directors of the subsidiary, something which cannot be achieved under s 168 where removal must be by the members of the company of which the person removed is a director.

Bersel Manufacturing Co Ltd* v *Berry [1968] 2 All ER 552

Berry and his wife were the first directors of a private company and were appointed permanent life directors by Art 11 of the company's articles of association. In addition, Art 16(H) provided that 'The permanent life directors shall have power to terminate forthwith the directorship of any of the ordinary directors by notice in writing.' Mr Berry's wife died in 1962. The question before the court in this case was whether or not the power given in Art 16(H) could only be exercised during the joint lives of Mr Berry and his wife and ceased to be exercisable when she died.

Held – by the House of Lords – that the power was not vested in the permanent life directors as recipients of a joint confidence but for the securing of their joint interests, and the principle that a bare power could not be exercised by the survivor of joint holders did not apply. Furthermore, the principle that a power annexed to an office passed to successive holders of the office was not conclusive since the office in question died with the death of the survivor of the two occupants of the power. Therefore, on a true construction of the articles the power conferred by Art 16(H) remained exercisable by Mr Berry after the death of his wife. In these circumstances it was possible for Mr Berry to terminate the directorship of any of the ordinary directors by a notice in writing.

Comment

The power to remove a director in the articles is effective even if the directors who exercise the power have acted with ulterior motives as in ***Lee* v *Chou Wen Hsian*** [1984] 1 WLR 1202 where a director who was asking for information about the company's dealings and not receiving all the information he wanted asked the secretary to convene a board meeting but was removed by the other directors two days before the meeting under a power in the articles. A removal under s 168 would seem to be effective in a similar situation.

Statutory removal – restrictions

If the s 168 procedure is followed the director concerned is allowed to put his case to the members by the circulation of his representations with the notice of the meeting, or if his representations are received too late for this, they are to be read out at the meeting. The company is required under s 169 to send a copy of the special notice to the director concerned forthwith.

The vacancy so created may be filled at the meeting, or if not so filled, may be filled as a casual vacancy and any person appointed in the place of a director removed under s 168 shall be deemed to hold office for as long as the director removed would have held it, and to retire when he would have retired.

Nothing in s 168 is to deprive a director so removed of any action he may have for dismissal, as where he has a contract outside the articles appointing him for a specified period which has not expired.

At first sight, s 168 appears to give any member of a company who is not satisfied with the way in which a director is carrying out his duties the right to ask the members as a whole to consider passing an ordinary resolution in general meeting to remove him.

Let us suppose, as would be usual, that X, a member of the company, chooses the annual general meeting for this purpose. Let us further suppose that he serves special notice on the company secretary in the proper manner of his intention to propose a resolution to remove the director or directors concerned. Are the directors obliged to place that resolution on the agenda and take it at the annual general meeting? According to the decision of Slade J in ***Pedley* v *Inland Waterways Association Ltd*** [1977] 1 All ER 209, the answer is no, unless, that is, X or persons joining with him satisfy the requirements of CA 2006, ss 314 *et al*.

This section provides that members representing not less than one-twentieth of the total voting rights of all members or 100 or more members holding shares in the company on which there has been paid up an average of not less than £100 per member can, by making a written requisition to the company, compel the company in effect to put a particular item of business up at the annual general meeting.

Therefore, if a particular member or members cannot satisfy, e.g. the one-twentieth voting rights provision, then the directors are not obliged to raise the question of the removal of one or more of their number at the annual general meeting. Thus, it would seem that the rights given by s 168, and indeed CA 2006, s 510 (power to remove auditors), are much more restricted than might hitherto have been thought. It is impossible to use these sections unless the member or members concerned can satisfy the requirements of CA 2006, s 338 (at least so far as the annual general meeting is concerned).

Although the ***Pedley*** case dealt only with matters regarding the removal of a director at the annual general meeting it would seem that an individual member is in a similar position if he wishes to remove a director between annual general meetings. Unless the board is willing to call an extraordinary general meeting, he or members joining with him will have to do so. This can be done under CA 2006, s 303, but only by members holding not less than one-tenth of such of the company's paid-up capital as carries voting rights at the general meetings of the company.

Resignation

A resignation need not be in writing; thus an oral resignation at a board meeting is effective. Once resignation has been made it cannot be withdrawn except with the consent of those persons who are entitled to appoint new directors.

Winding-up

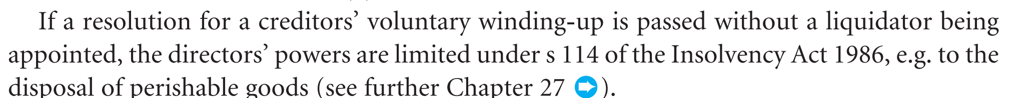
The position is as follows:

(a) In a members' voluntary winding-up

Here the company is necessarily solvent and the directors' powers cease only on the appointment of a liquidator, not when the resolution to wind up is passed. However, the members or the liquidator may sanction the continuance of the directors' powers (Insolvency Act 1986, s 91). The directors may decide to resign, but if they do not their powers remain in suspense until they would have retired by rotation and obviously they cannot be re-elected (***Re Zinotty Properties Ltd*** [1984] 3 All ER 754). Executive directors may claim redundancy or unfair dismissal as the case may be under the usual employment law rules. There could also be a claim for wrongful dismissal at common law.

(b) In a creditors' voluntary winding-up

Here the company is necessarily insolvent. The directors' powers cease on the appointment of a liquidator. They may resign but if not they vacate office as in (a) above. The position of executive directors is also as in (a) above.



If a resolution for a creditors' voluntary winding-up is passed without a liquidator being appointed, the directors' powers are limited under s 114 of the Insolvency Act 1986, e.g. to the disposal of perishable goods (see further Chapter 27).

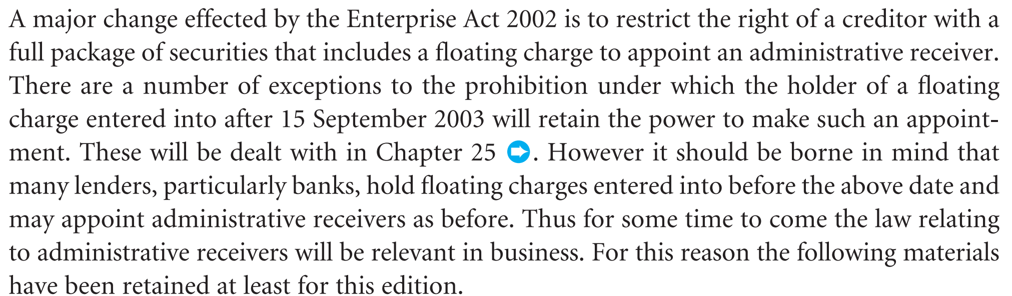
See p. 593

Although the directors' powers cease on the appointment of a liquidator, the liquidation committee or, if none, the creditors can approve the continuance of the directors' powers in whole or in part (s 103 of the 1986 Act). To do so would be rare.

(c) In a compulsory winding-up

The directors' powers cease on the making of a winding-up order or on the earlier appointment of a provisional liquidator. There is no mechanism whereby the directors' powers can be continued. The position of executive directors is as in (a) above.

Appointment of an administrator/administrative receiver



A major change effected by the Enterprise Act 2002 is to restrict the right of a creditor with a full package of securities that includes a floating charge to appoint an administrative receiver. There are a number of exceptions to the prohibition under which the holder of a floating charge entered into after 15 September 2003 will retain the power to make such an appointment. These will be dealt with in Chapter 25. However it should be borne in mind that many lenders, particularly banks, hold floating charges entered into before the above date and may appoint administrative receivers as before. Thus for some time to come the law relating to administrative receivers will be relevant in business. For this reason the following materials have been retained at least for this edition.

See p. 554

On the appointment of an administrative receiver the powers of the directors effectively cease. They are not dismissed, however, though the administrative receiver is entitled to continue the company's business and realise its property without interference by the board (***Gomba Holdings UK Ltd*** v ***Homan*** [1986] 3 All ER 94). There may be rather special situations in which the court will allow the directors to exercise their powers, as the following case shows.

Newhart Developments Ltd v *Co-operative Commercial Bank Ltd* [1978] 2 All ER 896

A scheme for a housing development in North Wales was to be carried out by a company formed specially for the purpose and jointly owned by Newhart Developments Ltd (Newhart) and the Co-operative Commercial Bank Ltd (the bank), finance being provided by the bank. The scheme got into difficulties and the bank appointed a receiver of Newhart under the provisions of a debenture in common form. In particular, clause 2(c) provided that the company should not deal with its books or other debts or securities for money otherwise than by getting in and realising the same in the ordinary course of business. Clause 5 provided that the receiver should have power to take possession and collect and get in the property charged by the debenture and for that purpose to take any proceedings in the name of the company or otherwise. Newhart took the view that they might have a claim against the bank for breach of contract arising from the development scheme. They issued a writ (claim form) and the bank applied to the court to have it set aside because it had been issued by the directors of Newhart without the receiver's consent. The bank's application was successful in the High Court but Newhart appealed to the Court of Appeal which allowed the appeal thus enabling Newhart's claim to proceed to trial.

Shaw LJ said that the function of a receiver was to protect the interests of debenture holders; he was not like a liquidator whose function was to wind the company up. During a liquidation

directors were divested of their powers but not so in a receivership. The fact that a receiver had been appointed did not prevent the directors of the company concerned from exercising their powers as the governing body of the company provided that their acts did not threaten the assets which were subject to the debenture holders' charge. In this case the receiver was put into a curious and unenviable position because the action by Newhart was against the bank which had appointed him. Nevertheless, where a receiver had in his discretion chosen to ignore an asset, such as a right of action, there was nothing in law to prevent the directors pursuing it in the company's name. A company might have creditors other than the debenture holders and those creditors were entitled to expect the directors to bring an action which, if successful, might provide a fund out of which to pay them. If the claim succeeded, the receiver would have an interest in the disposition of any money received, but if he decided not to pursue a claim of this kind, the directors could do so provided that nothing in the course of proceedings would influence the security of the debenture holders.

Under the Insolvency Act 1986 the directors have an obligation to co-operate with an administrative receiver, under the penalty of prosecution and a fine if they do not. Continued refusal can result in a fine on a daily basis.

Directors' powers are suspended during an administration. They must give way to the administrator and in addition the administrator may remove them from office and appoint new directors. However, they are not dismissed merely by the appointment of an administrator and retain some residual powers on the lines of the ***Newhart*** case. They retain their Companies Acts duties in regard to the keeping of records. An administrator has no statutory obligations in this regard.

Disqualification – generally

A director may become disqualified, and if so he automatically vacates office. The following are the reasons for disqualification:

(a) Under a provision in the articles

Table A provides that the office of director shall be vacated if the director:

(i) ceases to be a director by virtue of any provision of the Act, e.g. removal under CA 2006, s 168; or becomes prohibited by law from being a director, e.g. is disqualified by the court; *or*

(ii) becomes bankrupt or makes any arrangement or compositions with his creditors generally; *or*

(iii) becomes of unsound mind; *or*

(iv) resigns his office by notice to the company; *or*

(v) has for more than six months been absent without permission of the directors from meetings of the directors held during that period *and* the directors resolve that his office shall be vacated. Under *Table A* one counts from the last meeting he attended and not the first meeting that he missed. It should be noted also that this provision covers involuntary absence, as where the director is ill.

The articles may be altered to provide additional reasons for disqualification (***Shuttleworth* v *Cox Bros***, 1927, see Chapter 5), though an express contract is not affected by alterations

See p. 115

in the articles and the director may bring an action for wrongful dismissal (***Southern Foundries*** v ***Shirlaw***, 1940, see Chapter 5 ➲).

➲ See p. 115

A more current example would be where the company is involved in financial services and a director loses a licence or permission to act from a regulatory body such as the Financial Services Authority.

(b) Share qualifications

The office of director is vacated if the director does not within two months from the date of his appointment, or within such shorter time as may be fixed by the articles, obtain his qualification shares, or if after the expiration of that time he ceases at any time to hold his qualification where a qualification is required.

(c) Minimum age requirement

A director may become disqualified if his or her age is below the minimum age of 16 years. This matter has already been dealt with previously (CA 2006, s 159).

(d) Bankruptcy

Where a director is disqualified because of bankruptcy he does not automatically vacate office unless the articles provide as does *Table A*. Article 17 of the Model Articles for Private Companies Limited by Shares provides an undischarged bankrupt is disqualified (unless they have been given permission by the court to act for a particular company).

Disqualification by the court and personal liability

This section is based mainly on the provisions of the Company Directors Disqualification Act 1986 and section references are to that Act unless otherwise indicated.

Disqualification only

The following headings and their supporting paragraphs deal with areas where directors may be disqualified but personal liability for the company's debts is not involved.

Disqualification on conviction of an indictable offence (s 2)

The offence must be in connection with the promotion, formation, or management or liquidation of a company or with the receivership or management of a company's property. Disqualification is possible even though the indictable offence was tried summarily before magistrates rather than by a jury in the Crown Court.

The court which convicts the offender can make the disqualification order. There is no minimum period of disqualification. The maximum is five years in a magistrates' court and 15 years in a Crown or other court. There are no provisions relating to personal liability.

An example is ***R*** v ***Corbin*** [1984] Crim LR 302. C set up in business selling yachts through three companies. He obtained money and property by fraud, e.g. he obtained money from

two finance companies to buy yachts by falsely representing that a deposit had been paid on them and took a part-payment for a yacht from a customer but the yacht never materialised. He was sentenced to two and a half years' imprisonment and disqualified from acting as a director for five years.

It should also be noted that there have been disqualifications in more recent times where a director has been tried and convicted of an indictable offence under the Health and Safety at Work Act 1974, for an infringement of health or safety requirements, which is a management offence within s 2.

Disqualification for persistent breach of company law (ss 3 and 5)

A person may be disqualified following persistent default under company legislation, e.g. in filing returns, accounts and other documents with the Registrar.

Persistent default is conclusively proved by three convictions (whether or not on the same occasion) within a period of five years.

There is no minimum period, but the maximum, whether in a magistrates' or other court, is five years. There are no provisions relating to personal liability.

Disqualification following the crime of fraudulent trading (s 4)

The court may make a disqualification order following an offence under CA 2006, s 993, (crime of fraudulent trading). There is no minimum period but the maximum is 15 years. There are no provisions for personal liability.

Disqualification for unfitness (ss 6, 7, 9 and Sch 1)

The court *must* disqualify a director (including a shadow director) on the application of the Department of Business, Innovation and Skills (BIS) through the medium of the Trade Secretary or the Official Receiver if the company concerned has become insolvent while the person concerned was a director (or subsequently) *and* his conduct makes him unfit to be concerned in the management of a company. Insolvency arises under the Act from insolvent liquidation or the making of an administration order or the appointment of an administrative receiver.

Liquidators, administrators and administrative receivers must report alleged unfitness to the BIS.

The minimum period of disqualification is two years and the maximum is 15 years. There is a time limit of two years from the date on which the company became insolvent, e.g. the date when the company went into insolvent liquidation, during which an application must be made, although the court can allow a later application.

The first check on the suitability of disqualification proceedings under these sections is the BIS. The BIS may, not must, apply for disqualification. The second check is with the court which must be satisfied as to unfitness. Schedule 1 sets out matters to be taken into account when determining unfitness.

The Schedule, which is long, reflects the experience of the government's insolvency service and the comments and experience of practitioners. It is concerned with the way in which the directors have managed the company. It includes matters usually found when a company has been badly managed by incompetent directors, e.g. failure to keep accounting records and failure to send the annual return and to keep necessary registers.

Schedule 1 is split into: Part I, matters applicable in all cases; and Part II, matters applicable where the company has become insolvent. This is to take care of disqualification after inspection (see below) where the company need not be insolvent.

There are no provisions relating to personal liability for the debts of the company.

The case law indicates that unfitness has become divided into three main areas, i.e. (1) commercial immorality; (2) recklessness in management; and (3) gross incompetence.

Disqualification following Secretary of State investigation (s 8)

If it appears to the Secretary of State: (a) from a report made by inspectors under s 437 of the Companies Act 1985 (provision for inspectors to make interim and final reports) or (b) from information or documents obtained under s 447 (power to require production of documents) or s 448 (regarding entry and search of premises) of the 1985 Act that (c) it is in the public interest that a disqualification order should be made against a person who is or has been a director or shadow director of any company, then (d) the Secretary of State may apply to the court for such an order. *The company need not be insolvent.* The court must be satisfied that the particular director's conduct makes him unfit to manage a company and Sch 1 applies.

There is no minimum period of disqualification. The maximum is 15 years. There are no provisions in s 8 relating to personal liability of directors.

Disqualification: some illustrative case law

The following cases in which the courts have interpreted the various sections of the Company Directors Disqualification Act 1986 are included in order to enable the student to give examples of the application of the Act in the business context.

Nationality, residence and domicile

The High Court decided in ***Re Seagull Manufacturing Co (No 2)*** [1994] 2 All ER 767 that a disqualification order may be made against a director regardless of his or her nationality and current residence and domicile. Furthermore, the conduct leading to the disqualification need not have occurred within the jurisdiction. In other words, you can run an English company badly from abroad. The director concerned was a British subject but at all material times he was resident and domiciled in the Channel Islands. Nevertheless, he could be disqualified under s 6 for unfitness. The relevant legislation contained no express jurisdiction requirement or territorial distinction.

Director/secretaries

The High Court also decided in ***Re Pamstock Ltd*** [1994] 1 BCLC 716 that a director who was also the secretary of the company could be disqualified as much for failure to perform his duties as secretary as those of a director. The company had two directors and one was also the company secretary. It traded beyond the point at which it should have ceased to do so and went into insolvent liquidation. The judge said that as the company secretary one of the directors had failed to ensure that accounts and returns were filed on time and that an adequate system of management was put in place. These were serious defaults which must be taken into account when dealing with the period of disqualification. This implies that it was the director's failure to carry out his duties as a secretary that was at the root of his disqualification for two years. There is, of course, no power to disqualify a company secretary from acting as such.