

Guidance for Councillors and Officers on being company directors.

1. Introduction

- 1.1. For Portsmouth City Council ("PCC") to be able to "trade" (i.e. "*to do something for a commercial purpose*") the Council must do so through a company (i.e. as a separate legal entity to PCC).
- 1.2. The responsibility for supervising PCC owned companies is through PCC's Shareholder Committee, a committee of the political cabinet which meets regularly in public and which ensures that PCC owned companies are meeting their business objectives in accordance with company Business Case and are held to account for performance.
- 1.3. PCC may from time to time appoint its own Officers or Councillors to be directors of PCC owned companies in accordance with relevant company constitution. This guidance is intended to provide an overview to Officers and Councillors who are asked by PCC to become directors of PCC companies so that they can ensure that they are prepared for the obligations and responsibilities of being a company director.
- 1.4. More detailed training and guidance can be requested by contacting the Legal Corporate, Commercial and Regeneration Team.

Overview of Director responsibilities

2. What is a Company Director

- 2.1. Directors will be appointed by either the company itself or by its shareholder/s (PCC). Directors are legally responsible for running the company.
- 2.2. Under the Companies Act 2006 (referred to from here as "**the Companies Act**") directors owe a number of General Duties to their appointing company as well as other duties under both the Companies Act and a wide variety of other laws and regulations (such as insolvency and health and safety legislation). Executive Directors (see section 3.4.1) may also be subject to employee duties.
- 2.3. The General Duties of a director (explained in more detail in sections 4) under the Companies Act are;
 - 2.3.1. To act within their powers
 - 2.3.2. To promote the success of the company
 - 2.3.3. To exercise independent judgement
 - 2.3.4. To exercise reasonable care, skill and diligence
 - 2.3.5. To avoid conflicts of interest
 - 2.3.6. To not accept benefits from third parties
 - 2.3.7. To declare interest in proposed or existing transactions or arrangements with the company.

- 2.4. The consequences of breach of General Duties are that the company may seek an injunction, damages or compensation from its directors. Failure to disclose an interest in an existing transaction or arrangement with the company carries the risk of a criminal fine
- 2.5. If a director has acted in a way which breaches the general duty then;
 - 2.5.1. It maybe possible for the breach to be ratified by a resolution of the companies' shareholders;
 - 2.5.2. It maybe possible for the court to grant relief if the director acted honestly and reasonably;
 - 2.5.3. The company may have arranged insurance for the benefit of its directors which would cover some or all of the liability of the director.
 - 2.5.4. The company may indemnify the director against costs incurred in successfully defending a claim for breach of duties owed to the company.

3. **Types of Company Director**

- 3.1. A director is not defined in the Companies Act, it is simply provided that a director "*includes any person occupying the position of director, by whatever name called*" (s250).
- 3.2. Directors can either be;
 - 3.2.1. A *De jure director* - this is someone validly appointed as a director; or
 - 3.2.2. A *de facto director* - this is someone who assumes to act as a director, although never actually or validly appointed. There is no single definitive test for such a director and as such the question is whether they were part of the corporate governance system of the company and whether they assumed the status and function of a director so as to make themselves responsible as if they were a director.
 - 3.2.3. A *Shadow Director* - a person in accordance with whose directors or instructions the directors of a company are accustomed to act. Such a person is not to be regarded as a shadow director by reason only that the directors act on advice given by them in a professional capacity, in accordance with instructions a direction, guidance or advice given in the exercise of a function conferred by or under an enactment;
- 3.3. PCC would expect there to only be *de jure directors* of its own companies. *De factor and shadow directors* may owe similar or identical fiduciary duties to the company as *de jure directors*. It is important therefore that PCC Officers and Councillor's are aware of the distinction as it is possible for them to be lawfully considered directors irrespective of a formal appointment process. In cases where the reality appears unclear to a PCC Officer or Councillor, PCC legal services should be contacted.

- 3.4. In addition to the above, PCC companies will also likely have a mixture of *Executive Directors* and *non-executive Directors* as prescribed by the relevant company constitution;
- 3.4.1. *Executive Directors* - general used to refer to a *de jure* director who carried out executive functions in the company and is usually a full-time employee of the company.
- 3.4.2. *Non-executive Directors* - is used to refer to a *de jure* director who is not an employee of the company or holder of an executive office. Such a director would usually devote part of their time to the affairs of the company as an independent adviser or supervisor.
- 3.5. PCC Officers or Members will most often be appointed as *de jure non-executive Directors* of PCC owned companies.

4. The General Duties of a Director

- 4.1. There are seven general duties under the Companies Act owed by the company's directors. The duties are owed to the company and only the company will be able to enforce them. Directors do not, by virtue of the office of director, owe fiduciary duties to the company's shareholders or creditors (i.e. PCC) although in certain circumstances shareholders may be able to bring a derivative action on the company's behalf. The General Duties are as follows;

Duty to act within powers (s171)

- 4.2. The Director of a company must;
- 4.2.1. Act in accordance with the company's constitution¹; and
- 4.2.2. Only exercise powers for the purposes for which they are conferred.

Duty to promote the success of the company (s172)

- 4.3. A Director must act in the way they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In doing so, the Directors must have regard (among other matters) to:
- 4.3.1. The likely consequences of any decision in the long term.
- 4.3.2. The interests of the company's employees.
- 4.3.3. The need to foster the company's business relationships with suppliers, customers and others.
- 4.3.4. The impact of the company's operations on the community and the environment.
- 4.3.5. The desirability of the company maintaining a reputation for high standards of business conduct.

¹ The constitution will include the company's articles of association, decisions taken in accordance with the articles and any resolution and agreement affecting a company's constitution such as shareholder agreement.

4.3.6. The need to act fairly as between the members of the company.

- 4.4. In having regard to the listed factors, the duty to exercise reasonable care, skill and diligence will apply.

Duty to exercise independent judgment (s173)

- 4.5. A Director must exercise independent judgment. In relation to a PCC company, this particularly means that the Director could not agree to vote with a third person (such as the appointing shareholder - i.e. PCC) to vote at board meetings in any particular way, even if voting in that way would not otherwise have breach the Directors duties to the company.
- 4.6. The duty will not be infringed by a Director acting in accordance with an agreement entered into by the company that restricts the future exercise of the directors' discretion (such as a shareholder agreement) or in a way authorised by the company's constitution (such as a provision permitting a nominee director to follow the instructions of the person who appointed him or her). Any powers of delegation should therefore be set out in the articles.
- 4.7. The duty does not prevent directors relying on advice, as long as the directors exercise their own judgment in deciding whether or not to follow the advice.

Duty to exercise reasonable care, skill and diligence (s174)

- 4.8. A Director must exercise the care, skill and diligence which would be exercised by a reasonably diligent person with both;
- 4.8.1. The general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (*the objective test*).
- 4.8.2. The general knowledge, skill and experience that the director actually has (*the subjective test*).
- 4.9. As a minimum therefore, a director must display the knowledge, skill and experience set out in the objective test but where a director has specialist knowledge, the higher subjective standard must be met.
- 4.10. A Director will be required to exercise their duties diligently, keeping themselves informed about the company's affairs and join with their co-directors in supervising and controlling them.

Duty to avoid conflicts of interest (s175)

- 4.11. A Director must avoid situations in which they have or can have a direct or indirect interest that conflicts with, or may conflict with, the company's interests. That applies, in particular, to the exploitation of property, information or opportunity, and whether or not the company could take advantage of the property, information or opportunity. The test of whether there is a breach of the duty is objective, and does not depend on whether the director is aware that what they are doing is a breach of their duty.
- 4.12. The duty will not be infringed;

- 4.12.1. If the situation cannot reasonably be regarded as likely to give rise to a conflict of interest;
- 4.12.2. If authorisation has been given by directors who are genuinely independent (in that they have no director or indirect interest in the transaction)
- 4.13. The relevant company's articles may also set out how a director is to deal with conflict of interest noting the reality that PCC officers and councillors will have existing pre-existing conflicts due to the existing office post held.

Duty to not accept benefits from third parties (s176)

- 4.14. Directors must not accept any benefit (including a bribe) from a third party which is conferred because of his or her being a director or doing or not doing anything as a director. "Benefit" is not defined but the government has stated that it intended to mean "*favourable or helpful factor, circumstance, advantage or profit*".

Duty to declare interest in proposed transaction or arrangement with the company (s177)

- 4.15. Directors must declare to the other directors the nature and extent of any interest, direct or indirect, in a proposed transaction or arrangement with the company. The director need not be a party to the transaction for the duty to apply. An interest of another person in a contract with the company may require the director to make a disclosure under this duty, if the other person's interest amounts to a direct or indirect interest on the part of the director. It would therefore be prudent for directors to do some due diligence into the interests of their connected persons.

5. Consequences of a breach of the General Duties

- 5.1. The General Duties are owed to the company and only the company will be able to enforce them, although in certain circumstances shareholders may be able to bring a derivative action on the company's behalf.
- 5.2. The remedy for a breach of the duty of care, skill and diligence is usually damages
- 5.3. Remedies for breaches of the other fiduciary duties include;
 - 5.3.1. An injunction.
 - 5.3.2. Setting aside of the transaction, restitution and account of profits.
 - 5.3.3. Restoration of company property held by the director.
 - 5.3.4. Damages.
- 5.4. It may also lead to the termination of an executive directors' service contract or disqualification as a director including future appointments.

6. Indemnity and insurance from the company

- 6.1. The company will not be able to exempt a director from any liability for negligence, default, breach of duty or breach of trust in relation to the

company.

- 6.2. The company may however indemnify the director against defence costs, or costs incurred in an application for relief provided that the director repays the costs if he or she is unsuccessful.
- 6.3. The company may also purchase insurance for its directors, and those of an associated company, against any liability attaching to them in connection with any negligence, default, breach of duty or breach of trust by them in relation to the company of which they are a director. For example, a director may incur liability:
 - 6.3.1. To the company for breach of the director's general duties under the Companies Act or for wrongful trading under the Insolvency Act 1986;
 - 6.3.2. To third parties, such as an investor for misrepresentation;
 - 6.3.3. To employees for discrimination under the Equality Act 2010;
 - 6.3.4. Under legislation imposing personal liability on directors, such as health and safety legislation, environmental legislation, the Financial Services and Markets Act 2000, the Corporate Manslaughter and Corporate Homicide Act 2007 and the Bribery Act 2010; and
 - 6.3.5. For costs incurred in defending civil, criminal or regulatory proceedings.

Before you come a Director

7. Due diligence on the company

- 7.1. As a director of a PCC owned company you must ensure that you are comfortable with what you are being asked to do and that you understand the consequences of being a director.
- 7.2. You should first undertake some due diligence of the company itself. You should understand what the company does and what its aims and objectives are. Please engage with PCC legal Services to discuss any queries.
- 7.3. You should ask to see copies of the constitutional documents of the company so that you understand how it is run. This will include;
 - 7.3.1. The Articles of Association (also publicly available on companies house);
 - 7.3.2. The shareholder agreement (which the company should be able to provide you with);
 - 7.3.3. Your (proposed) letter of engagement;
 - 7.3.4. Business Case/ Annual Business Plan;
 - 7.3.5. Insurance policies;
- 7.4. You should ask the directors what insurance the company has in place for being a director. Ask to see the insurance policies so you can understand

what you would be covered for and what you wouldn't.

- 7.5. You should ask to speak with the current company directors and ask them any questions you have. Some of those questions could include;

- 7.5.1. Why do you want to appoint me?
- 7.5.2. What skills do you think I'll bring?
- 7.5.3. What support will you make available to help me discharge my duty as a director - e.g. will there be accountants and lawyers available for me to speak to, and who are they?
- 7.5.4. Will you provide regular training to me as a director?
- 7.5.5. How often will I need to attend meetings?
- 7.5.6. Will I be responsible for anything in particular at the company?

8. Your role at PCC

As an Officer

- 8.1. As an employee of PCC, you must ensure that you comply with your employment contract and the Employee Code of Conduct. You particularly will have duties in relation to the confidentiality of PCC information such as business or commercial information.
- 8.2. Acting as a director of a company, your duties to the company may at times conflict with your duties as a PCC Employee and visa versa.
- 8.3. You will be required to have evidence of permission for your appointment from the relevant Head of Service to ensure that they are supportive of you acting as a company director. You should discuss any areas of your PCC work that may conflict with your areas of work as a company director and ensure that you and your line manager/Head of Service are comfortable with the arrangements and how you may need to act if there is a conflict.
- 8.4. You should, having spoken to other directors of the company, have an idea of what sort of time commitment you will need to make. You should ensure that your line manager/Head of service permits you to make time during your PCC working day to carry out your company director duties and role. You may wish to keep a written record of that discussion.
- 8.5. The Employee Code of Conduct requires there to be consent from the relevant Head of Service if you wish to engage in any business, take up additional employment or work outside the authority. Being a director of a PCC company would be considered under this requirement. You must therefore ensure you have Head of Service (or where you are a director, the Chief Executive) consent in writing (to be retained with a copy of your signed code of conduct) to the appointment before you agree to become a company director. You may wish to keep a record of this approval in your own personal records.
- 8.6. The consent referred to in paragraph 8.5 must be reviewed annually during

the Performance and Development Reviews to ensure that the declaration remains the same and that there is either nothing further to declare or anything to stop declaring.

- 8.7. The Council provides a very specific indemnity² for Officers who are appointed as a director of a PCC company. For more information about this indemnity contact legal services.

As a Councillor

- 8.8. As Councillor of PCC, you must ensure that you comply with the Councillor Code of Conduct. You particularly will have duties in relation to the confidentiality of PCC information such as business or commercial information.
- 8.9. Acting as a director of a company, your duties to the company may at times conflict with your duties as a Councillor and visa versa. If you have any concerns about this then you should seek advice from the City Solicitor.
- 8.10. Being a director of a company, even one owned by PCC, will be a Personal Interest and also likely a Prejudicial Interest under the Councillor Code of Conduct. If you are appointed as a company director, you must ensure that it is registered with the Council's Monitoring Officer in accordance with the code of conduct. The Council provides a very specific indemnity³ for Councillors who are appointed as a director. For more information about this indemnity contact legal services.
- 8.11. Councillors should include their appointment as a PCC company director in their register of interests, and advise the Monitoring Officer of any change to those interests within 28 days. Councillors will have a **Personal Interest** in any business of PCC that relates to or is likely to affect the company.
- 8.12. This means that if a Councillor is present at a meeting where an item of business arises which relates to or affects a company to which that Councillor has been appointed, that Councillor must declare that personal interest and the nature of that personal interest before the matter is discussed or as soon as it becomes apparent to that Councillor.
- 8.13. Where a Councillor has a **Personal Interest** then they will also have a **Prejudicial Interest** in PCC business when the interest is one which a member of the public with knowledge of the relevant facts would reasonably regards as so signification that it is likely to prejudice that Councillors judgement of the public interest.
- 8.14. If the Councillor has a prejudicial interest in a matter under discussion then they must declare it. They must then leave the meeting room, unless members of the public are allowed to make representations, answer questions or give evidence about the matter. If that is the case, the Councillor can make their representations etc., but must leave the room

² As approved by a meeting of the Full Council 4th April 2006

³ Ibid.

immediately after doing so. The Code of Conduct supports Councillor's role as a community advocate and enables Councillors, even with a prejudicial interest, to represent their community and speak on issues that are important to them and to the Councillor.

Bias and Predetermination

- 8.15. If a Councillor believes that they have no prejudicial interest, then that Councillor's duties as a director may well be regarded, on an objective appraisal, as giving rise to a legitimate fear of lack of impartiality, especially having regard to the desirability of maintaining public confidence. Participation in the decision making at a PCC committee meeting by a Councillor who is biased or has predetermined the decision potentially invalidates the decision.

- 8.16. Councillors who are directors of companies to which they have been nominated by PCC are under the following obligations⁴:-

- 8.16.1. That the remuneration they receive from the company should not exceed that received from the local authority, and should be declared.
- 8.16.2. To give information to other councillors about their activities as required by the local authority (save for confidential information).
- 8.16.3. To cease to be a director immediately upon disqualification as a councillor

9. Becoming a director

- 9.1. By this stage you should understand the legal duties expected of you as a director. You should have done some due diligence on the company itself so that you understand how it functions and you will have the written approval of your head of service to becoming a director. You now need to decide whether you wish to accept the offer.
- 9.2. You should not take on a directorship unless you are sufficiently qualified or experienced to be able to fulfil the functions that you might reasonably be expected to carry out.
- 9.3. Being a director of company comes with a lot of responsibility, it is difficult and time consuming. The appointment as a director will be personal to you and it is your responsibility to ensure that you can discharge the duties of a director.
- 9.4. You should not feel pressurised to be a director. If you are uncomfortable with the role, for example you don't feel that you have time to do it, you don't understand what it involves or simply don't want to do it, then you must ensure that you make the decision that is right for you.
- 9.5. If you feel that you need training before you accept the role, then you should

⁴ Local Authorities (Companies) Order 1995 (SI 1995/849).

ask those proposing to nominate you for such training.

- 9.6. Acting as a director is different to being an Officer or a Councillor of PCC. Although PCC will have nominated you to the role, this does not mean that you are PCC's representative on the board. PCC cannot tell you how to vote or act (unless there is a shareholder agreement or other constitutional document which limits your power to do so) and if an Officer or Member tell you how to vote then you must ensure that you comply with the law and demonstrate independent judgment in how you decide to act, not just follow what you are told.
- 9.7. Once you are satisfied that you wish to be appointed as a director, you should ensure that the company issues you with a letter of appointment as a director. You should keep a record of that letter of appointment in your own private records.

Being a director

10. Directorship

- 10.1. Once you have been appointed as a director, you will have all of the rights of a director to information about the company. You must ensure that you act in accordance with the General Duties of a Director and other legislative requirements.
- 10.2. If you need support with your role as a director, then that is the responsibility of the company itself. The role is independent of PCC and PCC will not be responsible for providing you with advice on your discharge of that role (i.e. legal, finance, HR etc) unless there is a contract in place between the company and PCC for PCC to deliver those services.

11. Conflict

- 11.1. Conflict issues may arise with your role as PCC officer or councillor (1) as Company Director, and (2) as an employee / councillor of PCC. There is an obligation on you as an individual to observe the legal duty under company law (s175 Companies Act) **to avoid conflicts of interests by avoiding a situation in which you have (or can have) a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.**
- 11.2. The fact that you as a Company Director are appointed by and may also be an officer or councillor of PCC is likely to place you in a position of potential conflict between loyalty to PCC and duties to the company.
- 11.3. Conflicts of interest can be actual, potential or perceived;
 - 11.3.1. Actual - there is a real conflict between duties and interests
 - 11.3.2. Potential - there could be conflict between duties and interests
 - 11.3.3. Perceived - a third party could form the view that there is a conflict between duties and interests
- 11.4. It is impossible to define all instances of a conflict of interest, so in many

cases a reasonable degree of openness and judgment is required to assess the nature and extend of conflict of interest. This should be addressed at the outset and discussed with the City Solicitor to access whether your appointment as Director may be affected by any such conflict.

- 11.5. The company articles will have been drafted to automatically require the need to address any conflicts of interest arising purely by virtue of a director being a councillor and/ or officer of PCC, and for you to be able to participate in discussions on the matter in question and to vote on decisions concerning the matter. Other conflicts that arise, for example, a personal interest in a site to be developed, would need to be managed in the normal way with declarations and exclusion from related discussions / votes unless authorised by non-conflicted directors.
- 11.6. The company will have a register of interests which will require self-declaration and management with the relevant company secretary. Please liaise with PCC legal services to discuss such conflict and relevant declarations.
- 11.7. All conflicts of interest must be disclosed to the board of Directors (excluding the director affected). If you are unsure whether you have a conflict of interest it is always better to disclose it to your board and consider seeking independent legal advice.
- 11.8. A failure to acknowledge and manage a conflict of interest could cause a significant reputational risk, may result in disqualification and have financial consequences for the Director. Moreover, some conflicts can also have criminal implications. Remember, if you think you might have a conflict of interest, always disclose it and consider seeking independent legal advice.
- 11.9. The duty to avoid conflicts of interest will continue to apply after a person ceases to be a director as regards the exploitation of any property, information or opportunity of which he became aware when he was a director.

Appendix 1 - Checklist for being a director

(Non-exhaustive list)

Before you become a director	
Ensure that you understand why you are being asked to be a company director - what skill in particular are they asking you to bring to the table.	
Ensure you have a copy of your letter of appointment so that you understand the conditions of your engagement as a company director.	
Ask for copies of the Constitutional Documents of the Company - the key documents are; <ul style="list-style-type: none"> • The Articles of Association (also available publicly on Companies House); • The Shareholder Agreement (the document between the company and PCC which sets out how the company is to act and the role of PCC in its governance) 	
Ensure that you understand the purpose of the company - what is it there to do and how will it do it?	
Speak to the company directors (particularly if they are PCC officers/Councillors too) to get their insight on the role	
Do you understand the commitment required of you such as the frequency of meetings, when you will be asked to make decisions, other time commitments etc?	
Ensure you are familiar with the legal obligations placed on you as a company director. Ensure that you understand the General Duties of a Director (part 4 above). If you feel you need to know more then; <ul style="list-style-type: none"> • Undertake additional research • Seek guidance/training from PCC Legal Services. 	
Ensure that you understand the insurance position in relation to your role as a director - what insurance does the company have and what will it cover you for?	
Ensure you understand how your role as a company director will affect your role as a PCC Officer or Councillor. Consider any issues which may cause you difficulty when discharging one role or the other and any potential conflicts that may arise.	
Officers only - Discuss your potential appointment with your line manager. Particularly issues such as; <ul style="list-style-type: none"> • How the role as a director may affect the time you have to do your ordinary PCC role and how you and will manage this; • Whether you will have time out from your ordinary PCC working day to undertake 'company work' (or whether it will need to fit in on top of those obligations) • Discuss any issue of conflict that you may have anticipated and discuss how such issues can be mitigated. 	
Becoming a director	
Officers - Obtain written approval from your line manager (or the Chief Executive if you are a PCC Director) to be included with your signed code of conduct.	

Update your declaration annually as part of your Performance and Development Reviews	
Councillors - declare the interest with the Council's Monitoring Officer in accordance with the Councillor Code of Conduct.	
Sign and return your formal letter of appointment. Ensure you keep a record yourself.	