**Chapter 7**

**Classifications of Director**

Here, basic guidance to the end-of-chapter questions will be provided.

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| 1. **Define the following terms:**
* ***de jure* director;**
* ***de facto* director;**
* **shadow director;**
* **executive director;**
* **non-executive director;**
* **alternate director;**
* **nominee director.**
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| **Term** | **Definition** |
| *de jure* director | A person who has been validly appointed as a director |
| *de facto* director | A person who acts as a director, but has not been validly appointed as a director |
| shadow director | A person in accordance with whose direction or instructions the directors of a company are accustomed to act (CA 2006, s 251(1)) |
| executive director | A director, usually full-time and operating under a contract of service, who engages in the day-to-day management of a company |
| non-executive director | A director, usually part-time and operating under a letter of appointment, who provides independent objective guidance to the executives and holds them to account |
| alternate director | A person appointed to act as director in place of a director (e.g. where a director cannot attend a board meeting, or is incapacitated) |
| nominee director | A person appointed as director by, or to safeguard the interests of, a person (e.g. a major shareholder or creditor) |

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| 1. **State whether each of the following statements is true or false and, if false, explain why:**
* **a person who is not called a ‘director’ will not be a director;**
* **the chairman is the head of the company;**
* **a *de jure* director is a director who has been validly appointed;**
* **a person cannot be a *de facto* director and a shadow director;**
* **a NED who has close family ties with an executive director will not be regarded as independent;**
* **every company has the right to appoint one of its directors as CEO.**
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* **A person who is not called a ‘director’ will not be a director:** This statement is false. A person may be a director, even if they are not called a director.
* **The chairman is the head of the company:** This statement is false. The chairman is the head of the board. The CEO is the head of the company.
* **A *de jure* director is a director who has been validly appointed:** This statement is true.
* **A person cannot be a *de facto* director and a shadow director:** This statement is false. It is possible for a person to be both a *de facto* director and a shadow director.
* **A NED who has close family ties with an executive director will not be regarded as independent:** This statement is false. Such a NED may be independent, but if the NED has been identified as independent by the board, the annual report must explain why the board considers the NED to be independent.
* **Every company has the right to appoint one of its directors as CEO:** This statement is false. A company can only appoint a person as CEO if the articles provide for this.

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| 1. **‘The law relating to shadow directors is unclear, and the courts have not drawn a clear distinction between shadow directors and *de facto* directors.’ Discuss this quote.**
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**Introduction**

* Every essay should begin with a succinct introduction that demonstrates that you understand the essay question. Briefly explain what the essay is about and set out what the essay will discuss and how it will be structured.
* This essay requires you to discuss the law relating to shadow directors, and the extent to which a shadow director and a *de facto* director are clearly distinguished.

**The law relating to shadow directors**

* Egin by looking at what a shadow director is and discussing the definition found in s 251 of the CA 2006.
* Point out that whether a person is a shadow director is highly dependent on the facts of the case, meaning that applying precedent can be difficult. Give examples of the types of person who have been held to be capable of being shadow director.
* Discuss the key case law guidance (e.g. *Secretary of State for Trade and Industry v Deverell*; *Secretary of State for BIS v Chohan*).
* You may also want to mention the fact that, historically, the courts have struggled to set out what fiduciary duties a shadow director is subject to. This has, to a degree, been remedied by s 170(5) of the CA 2006, which provides that the general duties apply to a shadow director where and to the extent they are capable of so applying.

**Distinguishing between shadow directors and *de facto* directors**

* Historically, the courts held that a person could not be both a shadow director and a *de facto* director, with the key rationale for this being set out by Millet J in *Re Hydrodam (Corby) Ltd*.
* However, beginning with *Secretary of State for Trade and Industry v Deverell*, we started to see the courts blurring the line between a shadow director and a *de facto* director. Eventually, in *Revenue and Customs Commissioner v Holland*, the court admitted that the distinction between a shadow director and a de facto director was ‘impossible to maintain.’
* Since then, a number of cases have acknowledged that a person can be both a shadow director and a *de facto* director (e.g. *Secretary of State for BIS v Chohan*; *Smithton Ltd v Naggar*). You may want to discuss whether you think this is correct or whether the original distinction should have been retained.

**Conclusion**

* Every essay should end with a conclusion. Briefly summarise the main points/arguments and, if possible, come to a conclusion regarding the essay topic (i.e. which of the opposing views has the stronger arguments).

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| 1. **Dragon Ltd was first incorporated in 2005, and re-registered as public in 2008. In 2015, the company listed its shares on the Main Market of the London Stock Exchange. Its board consists of 5 executive directors (namely Jane (the CEO), Jude (the chair), Ruby, Ivan, and Anna) and five NEDs, (namely Angus, Greg, Sajid, Kate, and Nancy). Note the following:**
* **Angus, Greg and Sajid have been NEDs ever since Dragon re-registered as a public company).**
* **Kate has only been a NED for one year. Before this, she was a senior manager of Dragon.**
* **Nancy is married to Ivan.**

**The board regularly meets with representatives of Welsh Bank plc. Welsh Bank has lent Dragon a considerable amount of money and is keen to ensure that it is paid back. Accordingly, these representatives of Welsh Bank provide the board of Dragon with advice on how the business should be run and this advice is usually followed, although some of the NEDs are uncomfortable with the extent of the representatives’ role. One of these representatives advises Dragon to end its supply contract with TechCorp Ltd and instead to enter into a supply agreement with OmniTool Ltd on the ground that OmniTool will provide higher quality supplies. Dragon does this and the supplies are indeed of a higher quality. That the board of Dragon does not realise is that the representative is married to a director of OmniTool.****Discuss whether there has been any breaches of the law or any best practice recommendations.** |

* There are two key issues to discuss here, namely (i) whether the composition of Dragon’s board complies with corporate governance standards, and; (ii) whether there is an issue with the contract between Dragon and OmniTool.

**Board composition**

* The first issue to discuss is the composition of Dragon’s board, of which two topics are relevant.

*Boardroom diversity*

* Boardroom diversity has become an extremely prominent governance topic in recent years, so it is worth looking at the gender make-up of Dragon’s board.
* The question tells us that Dragon has ten directors, of which five are women (Jude is a name that could be male or female, but we can see from the diagram on p 11 that Jude is a man).
* It is worth noting that the Hampton-Alexander Report has recommended that FTSE 350 companies should aim for 33% board representation by the end of 2020. Although we do not know whether Dragon plc is FTSE 350 or not, it is good to see it is exceeding this recommendation.
* One current criticism of FTSE 350 companies is the lack of women in executive positions. Again, Dragon has a strong showing here with three of the five executive directors being women, including the CEO.

*Executive and non-executive directors*

* Principle G of the UK Corporate Governance Code provides that the board should include an appropriate combination of executive directors and NEDs. Provision 11 goes on to state that at least half of the board, excluding the chair, should be NEDs whom the board considers to be independent.
* Dragon has five executive directors and five NEDs. Excluding Jude (the chair), it has four executives and five NEDs. However, Provision 11 states that at least half the board should consist of NEDs whom the directors consider to be independent. Accordingly, we need to discuss the independence of Dragon’s NEDs.
* Provision 10 of the Code states that the board should identify in the annual report each NED that it considers to be independent. We do not know which NEDs (if any) have been identified as independent.
* Provision 10 goes on to specify a number of circumstances which are likely to impair, or could appear to impair, a NED’s independence, of which the relevant ones are:
1. The NED has served on the board for more than nine years from the date of their first appointment. Angus, Greg and Sajid have been NEDs since 2008
2. The NED is or has been an employee of the company or group within the last five years. Prior to being appointed as a Ned a year ago, Kate was a senior manager of Dragon.
3. The NED has close family ties with any of the company’s advisers, directors or senior employees. Nancy is married to Ivan, an executive director.
* Accordingly, all Dragon’s NEDs are involved in circumstances that fall within Provision 10. Therefore, if the annual report identifies any of the NEDs as being independent, then a clear explanation must be provided as to why that Ned is considered to be independent.

**The contract between Dragon and OmniTool**

* The issue here is whether the representative of Welsh Bank is a shadow director. We are told that the advice of Welsh Bank’s representatives is usually followed, indicating that the representative could be a show director.
* By reason only that the directors act on advice given by that person in a professional capacity. However, s 251(2) of the CA 2006 provides that a person will not be regarded as a shadow director. Despite this, the courts have held that, depending on the facts and the actions of the professional, that such a person is capable of being a shadow director.
* The significance of the representative potentially being a shadow director is that he would be subject to the general duties, notably the duties found in ss 177 and 182 of the CA 2006.
* Section 177 provides that if a director is interested in a proposed transaction or arrangement with the company, he must declare that interest to the other directors before the transaction is entered into. The representative of Welsh Bank is married to a director of OmniTool and this is an interest that would need to be disclosed. A failure to disclose the interest would render the transaction voidable at Dragon’s instance.
* As the transaction has been entered into, s 182 becomes relevant. Section 182 provides that if a director is interested in an existing transaction or arrangement, he must declare this to the other directors as soon as is reasonably practicable. A failure to make this declaration is a criminal offence.