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Author James Saunders

A director's right to resign

KEY POINTS

- Directors are *prima facie* entitled to resign as they see fit and even against the commercial interests of their company.
- However, directors are subject to duties to monitor and supervise their co-directors and other subsidiary officers. In discharging these duties they may be required to take positive steps which prevent or qualify their ability to resign.
- The case law divides between misappropriation cases and management decisions properly left to the board acting (generally) by majority. The pre-resignation requirements are more stringent in the former category of cases.

INTRODUCTION

Difficult cases will arise where patently inappropriate management decisions may engage the duties applicable to misappropriation cases and qualify a director's ability to resign. Taking up the role of a director as an executive or non-executive is a voluntary enterprise. Ceasing to be a director by resigning, however, is an altogether less straightforward affair. This article examines the general right to resign as a director and the mechanics of doing so as well as the duties which continue post-resignation and most centrally when the 'right' to resign may be more limited than first appears.

THE MECHANICS OF RESIGNATION

The current version of the model articles for companies limited by shares provides at clause 18:

> 18. Termination of director's appointment
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> 18.A person ceases to be a director as soon as –
>
> (f) notification is received by the company from the director that the director is resigning from office, and such resignation has taken effect in accordance with its terms.

The starting point therefore appears straightforward. Subject to variation of the model articles a director can resign their office by providing notice to the board. Notice cannot be refused by the company and cannot be withdrawn by the director save with the company's agreement. No minimum period of notice is required unless otherwise provided. Giving notice must therefore be considered carefully.

Section 154 of the Companies Act 2006 (CA 2006) places a numerical restriction on the above right by mandating that a public company must have at least two directors and a private company at least one.

The consequence of infringing the section is not necessarily that the resignation is invalid however, only that a direction may be given by the Secretary of State to remedy the breach, failing which an offence is committed both by the company and by every officer who is in default: s 156(6). This foreseeably covers the retiring director as an officer who *'authorises or permits, participates in, or fails to take all reasonable steps to prevent, the contravention'*: s 1121 CA 2006.

Provided notice is properly given the resignation then takes effect pursuant to its terms.

CONTINUING DUTIES

The general rule is that a director, including a *de facto* director, ceases to be subject to the general statutory duties when they cease to be a director of the company. It is this release from the burden of duty, and correspondingly the scope for liability, which draws many directors to resign and advisors to suggest the course in the face of difficult circumstances. However, a number of duties expressly do not cease on resignation. Section 170 CA 2006 provides that:

> (2) A person who ceases to be a director continues to be subject –
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> (a) to the duty in section 175 (duty to avoid conflicts of interest) as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director, and
>
> (b) to the duty in section 176 (duty not to accept benefits from third parties) as regards things done or omitted by him before he ceased to be a director.
>
> To that extent those duties apply to a former director as to a director, subject to any necessary adaptations.

Directors may also be straightforwardly liable after resigning for acts occurring prior to their resignation.

A LIMITED RIGHT TO RESIGN?

Aside from statutory limits on the number of directors and the continuation of certain duties by express provision, can a director otherwise freely exercise their right to resign as they see fit? Can and should a director do so where they disagree with the decision of the board and does the position change if there is a known breach of duty by a co-director?

Prima facie a director who no longer wishes to perform their duties, or who finds it impossible to do so, may properly resign: *Re Galeforce Pleating Co Ltd* [1999] 2 BCLC 704.

As was expressed in *Hunter Kane Ltd v Watkins* [2003] EWHC 186 (Ch):

> A director's power to resign from office is not a fiduciary power. He is entitled to resign even if his resignation might have a disastrous effect on the business or reputation of the company.

Not only is the right therefore not a fiduciary one to be exercised in good faith for the benefit of the company, it can be exercised

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in circumstances where it may be positively damaging to the company albeit it should not be exercised for that purpose.

However, this general expression is not unqualified. Directors owe a continuing duty to obtain sufficient knowledge of their company's affairs to properly discharge their functions, which include the monitoring and supervision of their co-officers. Directors may be held personally liable where they are aware of breaches of duty by their fellow directors and do not take sufficient steps to remedy, or attempt to remedy, the same before their departure.

The ability to resign and the scope of the right is necessarily informed and qualified by the scope of the supervisory duties imposed by the general law where a breach comes to a director's attention.

For example in *Lexi Holdings v Luqman* [2008] EWHC 1639 (Ch), a case concerned with misappropriations made by one of several directors, Briggs J held:

> … a director who wishes to retire may nonetheless be required to take steps to deal before departure with a pressing matter calling for attention, or to put her continuing colleagues on the board in possession of information known to her relevant to the matter in question, so as to enable them to deal with it. Exceptionally, a director may upon departure be obliged to put relevant information in the hands of the company's shareholders or other stakeholders, if not satisfied that continuing colleagues on the board have the inclination or the ability to deal with a matter of concern.

In the context of insolvency 'stakeholder' may well embrace creditors. Numerous cases have now considered how the monitoring duties ought to be discharged. In *Lexi* itself the directors ought to have notified the company's accountants and auditors of improper transactions and sought to remove the errant director.

In *Re IT Protect* [2020] EWHC 2473 (Ch) the court held that the director ought to have been aware of misappropriations, alerted the bank, changed the codes for online access to the company's bank account, arranged for the cancellation of any existing bank cards for the account, and arranged for the issue of a new bank card for his sole use.

In *Neville v Krikorian* [2006] EWCA Civ 943 a majority shareholder and one of two directors ought to have taken steps to call in loans improperly made by the company to their fellow director. The Court of Appeal went so far as to observe that Avo Krikorian controlled the company, rendering the shareholding position potentially relevant to the scope of the director's duties.

Finally in *Byers v Chen Ningning* [2021] UKPC 4 the Privy Council held that *'a director who knows that a fellow director is acting in breach of duty or that an employee is misapplying the assets of the company must take reasonable steps to prevent those activities from occurring'*.

It follows that simply resigning does not comply with this duty. The duty is to either restore or preserve company assets as the circumstances dictate: *Re TMG Brokers Ltd* [2021] EWHC 1006 (Ch) at [144] and can therefore embrace steps to recover assets lost as well as preventing further breaches.

Thus, where a director owes the duties noted above resigning will plainly not avoid liability. Indeed, quite the opposite with resignation itself being a breach of duty if it puts the means of remedying matters beyond the director's control.

Resignation is commonly linked with a desire to simply walk away from the company. If necessary information is not passed on by the departing director as observed in *Lexi* that too may found liability.

MANAGEMENT DECISIONS

The cases considered above all concern misappropriations or similar transactions such as impermissible loans. In such circumstances the breach of duty is likely to be clear once discovered, as is the remedial course of action open to the director. That resigning does not comply with a director's duties will be apparent.

Circumstances differ where the breach is not a misappropriation but a more nuanced breach arising in the course of management such as a decision to perform a particular action, enter a given transaction or direct the company's affairs to a particular end. Typically, such decisions are left to directors with a reluctance for courts to second-guess matters after the event. The test for s 172 decision-making is typically subjective good faith provided there is evidence of due consideration. What is a dissenting director to do where they not only disagree but also consider that the proposed course of action constitutes a breach of duty?

First, one must recall that board decisions are typically made by majority, subject to any amendments to a company's articles. A dissenting director may therefore find themselves entirely powerless to direct the company's course so far as votes are concerned. A minority of directors equally cannot wind up their company, all directors must so elect: s 124(1) Insolvency Act 1986 and *Re Instrumentation Electrical Services Ltd* (1988) 4 BCC 301.

Is silent resignation then open to the director? The authorities confirm that the answer is 'no'. There is a duty to *'at least to put before their doubting fellow directors the case for the action they wished to see taken'* (*Re Southern Counties* [2008] EWHC 2810 (Ch)) and *'to make his views known to the other directors'* (*Secretary of State for Trade v Taylor* [1997] 1 WLR 407). Chadwick J there considered that a director who knew their attendance at board meetings was purposeless as their co-directors took no account of their views yet remained as a director so as to draw their fees might well be so lacking in appreciation of their director's duties as to be unfit to be concerned in the management of a company and disqualified. This is a stern endorsement that more than silent passivity is required of even dissenting directors.

However, provided a director complies with their duties and does not remain passive then as observed in *Madoff Securities International v Raven* [2013] EWHC 3147 (Comm) by Mr Justice Popplewell:

> … corporate management often requires the exercise of judgement on which opinions may legitimately differ, and

Biog box
'Expedient, efficient, concise and reliable' (Legal 500, Insolvency: Tier 4 London Bar) James Saunders has fast developed a busy commercial chancery practice and is particularly at home with complex disputes engaging multiple overlapping areas of law. James has a strong insolvency specialism, regularly acting as sole counsel for insolvency practitioners, litigation funders, directors and third-parties alike in both corporate and personal insolvencies on and off-shore.
Email: James.Saunders@NewSquareChambers.co.uk

> requires some give and take. A board of directors may reach a decision as to the commercial wisdom of a particular transaction by a majority. A minority director is not thereby in breach of his duty, or obliged to resign and to refuse to be party to the implementation of the decision…
>
> A director is not in breach of his core duty to act in what he considers in good faith to be the interests of a company merely because if left to himself he would do things differently.

Thus, where the question is one of management a director is unlikely to act in breach of duty where they express their views on the issue, are outvoted and implement the majority decision. This will not be the case where the action implemented is plainly unauthorised as above and see *Ramskill v Edwards* (1885) 31 Ch D 100.

As for the views expressed in the misappropriation cases of how a director ought to act in the face of a co-director's breach, HHJ Russen QC observed as follows in *Stobart Group Ltd v Tinkler* [2019] EWHC 258 (Comm) where a dissenting director disapproved of a decision and took it upon himself to inform shareholders:

> 413. In my judgment, the authorities cited to me by each side support the unsurprising proposition that the duty to exercise independent judgment is one that operates upon each director in the context of him operating as a member of the board of directors. This obligation comes with the office of director and does not carry with it some kind of entitlement or licence for an individual director to go off and do his own thing, independently of the board, in relation to matters that fall within the sphere of management of the company's business… any discussion by him of those matters with shareholders should either be in the presence of the rest of the board or with the prior approval of the board.
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> 415… But where a dissenting director does feel sufficiently strongly about a proposed course of action to justify his resignation, having sought unsuccessfully to dissuade the majority from pursuing it, then by that action he will have relieved himself of both the obligation and any notion of entitlement which the duty to exercise an independent mind supports. For so long as a person occupies the office of director, I do not see how the duty to exercise an independent mind can carry with it any entitlement to speak or act as if he were not a member of the board without responsibilities to that collective decision-making body.

HHJ Russen QC went on to approve of the ability of a director to raise grievances with shareholders after first ventilating concerns to the board and then ensuring that the issues are communicated to *all* shareholders publicly rather than only some privately.

LINGERING ISSUES

The above analysis divides the case law into misappropriation cases and management decisions. Many real-world scenarios do not admit of such neat classification. What of a board which wishes to pay a major creditor when faced with probable insolvency? What if the decision proposed by the board is one that no reasonable board could take? Such cases may not always involve *'matters that fall within the sphere of management of the company's business'* where the decision is patently unreasonable or inappropriate.

Inevitably cases will turn on their facts and the degree to which it is obvious that a proposed course is a plain breach of duty by the majority. If the breach is obvious and would exceed the powers of a board acting properly, it may fairly be argued that implementing the decision is not to defer to majority management but to facilitate a dereliction of duty; management decisions shade into misappropriations.

The duties at the root of the above case law are s 174 and s 172 CA 2006. The former applies an objective standard of reasonable action and the latter a typically subjective good faith assessment. Where a board's actions may fall within the remit of a board acting appropriately there will be far less scope to charge a dissenting director with inaction or resignation but decisions will fall on a spectrum.

Whilst it may also be tempting to draw a distinction between resigning before rather than after a decision is implemented, the positive duty to remedy has equally been formulated as a duty to prevent (*Re TMG*) and it would be difficult to justify a difference in treatment between a director who resigns knowing a breach is likely versus after a breach has occurred.

The second lingering issue is one of causation. Where misappropriations occur a director's duties are heightened and so too is the scope of permitted or necessary action. In such cases a director is not subject to being a powerless minority board member susceptible to being outvoted but is entitled and required to act unilaterally as confirmed in *inter alia Lexi Holdings* and *Re TMG*. Accordingly, the scope for a director to say they were powerless to prevent the wrong diminishes.

Where the decision is truly a management decision for the board a director may be protected by arguing that had they voted against the decision they would have been outvoted. Cases which shade from management decision into misappropriation or plain breaches may not admit of a causation related defence. ■

Further reading

- Lexis PSL Restructuring & Insolvency; Insolvency Litigation; Claims by an insolvent estate or its insolvency office-holder; Directors' duties: companies in financial difficulties
- Lexis PSL Restructuring & Insolvency; Insolvency Litigation; Claims by an insolvent estate or its insolvency office-holder; Rare success in wrongful trading (*Safe Depot Ltd (In Liquidation)*)
- Have the courts gone too far with fiduciary accountability? (2020) 10 JIBFL 665