PART III – THE DIRECTOR AS AN INDIVIDUAL

ELIGIBILITY

294. There are remarkably few restrictions under the general law about who can be a director.

295. The auditor of a company may not also be its director. No person may be appointed a director unless he or she has attained 18 years.

296. Most importantly, persons who are currently disqualified may not be appointed as directors (see paras 308 to 317 below).

297. In addition, a company's Articles may restrict eligibility further than provided for by the general law, and most companies will therefore exclude for instance persons of unsound mind who are technically eligible to be directors. Some Articles stipulate that each director must hold a certain number of shares in the company.

APPOINTMENT, REMOVAL, DISQUALIFICATION

APPOINTMENT

298. The Companies Ordinance requires every company to appoint at least two directors for non-profit companies; and one director for private companies (see however paras 87 and 89 regarding Listed Companies). A corporate body cannot be the director of a company unless the company is a private company and is not a member of a group of companies of which a listed company is a member.

299. The method of appointment of a director is laid down in the company's Articles. Normally the first directors are named in the Articles. Thereafter, the company in general meeting has a common law power to fill vacancies. Normally the Articles will also give the directors power to fill vacancies or to appoint extra directors provided the maximum number permitted by the Articles is not exceeded, and the Articles will usually give the company power to make and confirm appointment at its general meetings.

300. The CG Code requires non-executive directors to be appointed for a specific term, subject to re-election, and that all directors should be subject to retirement by rotation at least once every three years. The establishment of nomination committees is also recommended.

EMPLOYMENT

301. We have seen that a director can be just that and no more, as are many non-executive directors. He or she can also, however, combine the office with that of a company employee. The question of whether or not a director is also an employee is one of fact, but its resolution is important for many reasons. If a director is also an employee, the removal of a director at a company meeting may not necessarily end his or her employment. Moreover, as an employee, he or she acquires rights under common law and under redundancy and employment protection legislation. Also, certain benefits, e.g. the right to participate in a company's pension scheme, may be available only to employees. In a winding up, employees are entitled to be paid certain amounts in respect of wages or salary in priority to other creditors (Section 265 of the WUMPO) and receive further benefits under the Protection of Wages on Insolvency Ordinance. To be an employee, he or she would need to have a contract of service and to work under the control, and subject to the instructions of, some other employee or officer of the company.

302. All employees have contracts of service, otherwise they could not be employees. Where there is nothing in writing the contract is implied and the terms are to be inferred from the conduct of the parties, assisted by the relevant statutory conditions. A director will be an employee, therefore, when he or she has a contract of service apart from the directorship. The case of Parsons v. Albert J. Parsons & Sons (1979) decided that a full time working director is not necessarily to be regarded as working under an implied contract of service. The absence of such a contract was inferred there because:

    (i) There was no express contract, either oral or written;

    (ii) In the accounts, the remuneration of the directors was shown separately under the heading "directors' fee" – not as wages or salaries; and

    (iii) Because the directors were treated as self-employed in the purchase of National Insurance stamps.

    The Parsons case related to a close family company run by the family and, in the absence of other evidence, a shareholder who is a working director in such a company is less likely to be regarded as an employee than a similar director of a larger concern. Thus, in one case, a managing director who held over 90% of the company's shares was held not to be an employee on the facts. By contrast, the managing director of a wholly owned subsidiary of a foreign company has been held to be an employee. In each case it is necessary to consider all aspects of the relationship and weigh each fact according to the evidence.

303. The moral is clear. Every director carrying out a function over and above his or her board duties should have a written contract of employment. The limitations and disclosure obligations now imposed in relation to such contracts have been dealt with. On the simple proposition that certainty is always preferable, an executive director's contract should deal with such matters as pay, duties and responsibility, working hours, sickness, holidays, pensions, insurance, indemnity, termination and dismissal.

304. Note that under the amended Listing Rules, directors' service contracts may be subject to independent shareholders' approval if they are longer than three years' duration or require payment of the equivalent of one year's emoluments or more in the case of termination.

REMOVAL FROM OFFICE

305. A director may be removed under any relevant provision in the company's Articles. In addition, under Section 462 of the Companies Ordinance, which cannot be excluded by the Articles, a director can be removed by an ordinary resolution of members in general meeting. Twenty-eight days' notice of intention to move such a resolution must be given to the company and the company must immediately send to the director concerned a copy of the notice. He or she is entitled to require that his or her written views be communicated to the members, provided that they are not defamatory, either by inclusion with the notice of meeting sent out to members or by having them read out at the meeting, and he or she is also entitled to speak at the meeting. Removing a director under provisions of Section 462 does not affect any right he or she may have to compensation or damages due to his or her removal from office.

RETIREMENT

306. It is normal for the Articles to provide for directors to retire by rotation, and to be eligible for re-election.

307. Beyond this provision, a directors' tenure will be governed by the Articles which provide for removal on the grounds of age, mental illness, prolonged unauthorised absence from meetings, criminal conviction and so on.

DISQUALIFICATION

308. Once eligible to act and properly appointed, a director may be disqualified, either by virtue of the company's Articles, or by one or more provisions of the Companies Ordinance.

Articles

309. A company's Articles may require that a director must resign in certain circumstances, for example if he or she becomes of unsound mind, becomes bankrupt, regularly fails to attend board meetings without reason or even if he or she is requested to resign by all the co-directors.

Companies Ordinance

310. In addition to the possibility of there being a provision in the company's Articles preventing a bankrupt person being a director, Section 480 of the Companies Ordinance makes it an offence, punishable with a fine and imprisonment, for an undischarged bankrupt to act as a director of a company, except by leave of the court by which he or she was adjudged bankrupt.

311. A person may also be disqualified from acting as a director of a company, or being in any way concerned in its management, under Sections 168C to 168S of the WUMPO.

312. Sections 168C to 168S of the WUMPO provide that the court may, or must in some circumstances, make a disqualification order preventing a person, for a specified period ranging from 1 to 15 years, from:

- Being a director, liquidator, receiver or manager of a company or its property; or
- Being in any way directly or indirectly concerned in the promotion, formation or management of a company.

313. A number of people may apply for such an order, depending on the grounds upon which disqualification is sought. The Registrar of Companies, the Financial Secretary, the Official Receiver, a liquidator, together with any past or present member or creditor of a company affected by an offence or default of a director, may apply under the provisions. The court itself may make an order of its own volition in certain circumstances.

314. Briefly, the grounds upon which a person may be disqualified under the new provisions include:

- Where a person is convicted of an indictable offence in connection with the promotion, formation, management or liquidation of a company (maximum disqualification period 5-15 years);

- Where it appears that a person has been persistently in default of the requirements of the Companies Ordinance relating to the filing of notices, accounts, annual returns or other documents (maximum disqualification period 5 years);

- Where it appears to the court that, in the course of the winding up of a company, a person has been guilty, whether convicted or not, of an offence under Section 275 of the WUMPO or has otherwise been guilty of any fraud or breach of duty in relation to the company (maximum disqualification period 15 years);

- Where a declaration has been made under Section 275 of the WUMPO to the effect that a person is liable for the debts of a company as a result of fraudulent trading in the course of a winding up (maximum disqualification period 15 years);

- Where a company becomes insolvent and the court is satisfied that a person's conduct as director or shadow director, or former director or shadow director, of that company makes him or her unfit to be concerned in the management of a company. If the court is so satisfied, it must disqualify a person for a minimum of 1 year (maximum disqualification period 15 years);

- If, after investigation of the company by inspectors, the Financial Secretary thinks it expedient, in the public interest, he or she may apply for a disqualification order against a director or shadow director or former such directors of the company (maximum disqualification period 15 years).

Penalties: Sections 168M to 168N of the WUMPO

315. It is an offence, punishable by imprisonment and a fine, for an individual not to comply with a disqualification order against him or her.

316. In addition, a company itself or officer of the company or someone purporting to act in that capacity, or possibly even the members of a company if they manage its affairs, may be found guilty of acting in contravention of a disqualification order. This may be so if, due to their consent, connivance or negligence, a disqualified person is allowed to be a director of the company.

Personal Financial Liability

317. Under Section 168O of the WUMPO a person involved in the management of a company in contravention of a disqualification order, or a person who is willing to act on the instructions of a person he or she knows to be declared bankrupt or subject to a disqualification order, may be made personally liable for all debts incurred by the company during the relevant time. The relevant time is the period he or she is managing the company while disqualified or taking instructions from someone disqualified.

REMUNERATION AND COMPENSATION

ENTITLEMENT TO REMUNERATION AND EXPENSES

318. At common law, directors have no automatic entitlement to remuneration for their services or reimbursement of expenses. They therefore have no automatic right to claim directors' fees for performing their duties. Such remuneration as they can receive must be provided for in the Articles of Association of the company. Sometimes the Articles provide for specific fees. Often they provide for fees to be fixed by the board. It is all a matter of what is considered best for the particular company involved and, if circumstances alter, the Articles can be changed by appropriate resolution. In the absence of an express provision in the Articles, a director is not entitled to reimbursement of expenses incurred in attending board and general meetings.

319. Directors as such are similarly not automatically entitled to a company pension. A company may, however, include a power to pay directors and their dependents a pension in the Articles of Association. Even if the board of directors is expressly so authorised to pay a pension, payment may still be unlawful if the directors act in breach of their fiduciary duties towards the company. They must act bona fide in what they consider to be the interests of the company. The same applies to any ex gratia payment. In addition, Sections 516, 523 and 529 of the Companies Ordinance state that before making any payment by way of pension to any director who has received a payment for loss of office, a company must disclose to the members the proposed pension (including the amount thereof) and the proposal must be approved by the company.

320. In any event, it is normally not desirable for non-executive directors of a company to be reliant for their future financial security on pension arrangements provided by that company; such dependence is hard to reconcile with the independence of judgement which non-executive directors are expected to bring to bear on the company's affairs.

321. In practice, the proper exercise of the duties referred to in the previous paragraphs means that pension arrangements which have been made prospectively or during the director's tenure of office and can be demonstrated to be deferred remuneration or to have some form of incentive effect will normally be lawful, so long as the company is generally authorised to make them. It will normally be more difficult to show that arrangements made retrospectively on or after a director's resignation, retirement or death are made under a proper exercise of those duties. Similar considerations apply to lump-sum ex gratia payments to retiring directors. See further paras 70 and 71 on Remuneration Committees.

COMPENSATION FOR LOSS OF OFFICE AND EX GRATIA PAYMENTS

322. Payment by a company to a director for compensation for loss of office (except a bona fide payment in settlement of a claim for breach of contract and payments by way of pension or superannuation gratuity in respect of past services) requires the prior approval of the company in general meeting.

PROFIT SHARING AND OTHER INCENTIVE ARRANGEMENTS

323. It is important to tailor remuneration arrangements, whether for directors or employees, to achieve the maximum motivational benefit in the particular circumstances of the individual and company concerned. Tax efficiency cannot be ignored but should be a secondary consideration.

324. For example, an empirical study by Bell and Hanson, Profit Sharing and Profitability (1987), found evidence of a link between profit sharing and improved company performance only where the amount of profits distributed (whatever the form of the distribution – cash or shares) was genuinely related to the recent profit performance.