

## Appendix A

**Councillors appointed as Directors of Limited Liability Companies****Legal Status**

1. Upon incorporation a company becomes a separate legal entity, which can hold property in its own right, enter into contracts and sue and be sued in its own name. In the case of a limited liability company the liability of members of the company is limited to the amount they paid or agreed to pay when they joined the company. This can be as little as £ 1.
2. Companies limited by shares are those which have a share capital e.g., 1,000 shares of £ 1 each. Each member holds shares and receives a share in the profits made by the company according to the value of the shares held. Shares can be sold. Liability in the event of a winding-up is limited to the amount unpaid on the shares held.
3. Companies limited by guarantee do not have shares. Instead, each member agrees that in the event of the company being wound up they will agree to pay an agreed amount eg £ 1. This is most common in the public and voluntary sector, particularly where charitable status is sought.

**Directors' Duties**

4. The role of a councillor who has been appointed as a director will depend upon the company's Memorandum and Articles of Association (its constitution). A company's constitution will vest most of its powers in the board of directors and the board will exercise these either directly or through managers appointed by the board. Directors must understand the requirements of the Memorandum and Articles of Association in order to fulfil their responsibilities properly.
5. Directors will need to be aware of the requirements of the "Combined Code on Corporate Governance" to the extent that this has been adopted by the company, including general management of the company, rules on directors' remuneration, internal financial and operational controls and risk management.
6. Directors, as agents of the company, must:
  - act in good faith in what they believe to be in the best interests of the company as a whole (not the Council).
  - act with reasonable care, diligence and skill;
  - exercise their powers reasonably and for the purpose for which they are given;
  - keep an open mind when making decisions on company business; in particular a councillor director must exercise independent judgment and not simply follow Council policy when voting on company matters;

- avoid placing themselves in a position where their private interests or their position as a councillor conflict with their duties to the company;
  - be aware of the company's financial position through attendance at board meetings and reading the accounts, agendas and minutes; it is not sufficient to assume that the other directors are doing a good job.
7. Some directors may be given special responsibilities under the company's constitution, for instance a managing director or finance director. Those with special roles will be expected to have the personal and technical skills to perform the duties associated with that role, which may be onerous.
8. The above duties apply to non-executive directors as well as executive directors.
9. There are other statutory requirements which may be relevant depending on the company's business. Directors will need to be familiar with these. For example, if the company is an investment vehicle which engages in fundraising activity, financial services legislation will apply.

### **Observer status**

10. The position of observer has no specific legal status in company or local authority law. Any person appointed as an observer should ensure that their role is clearly defined and avoid involvement in the management of the Company. If an observer acts beyond their remit and exercises real influence over the company's affairs and decision making the observer may be deemed to be a shadow director, with all the duties of an ordinary director.
11. Observers and others, such as professional advisors, may attend board meetings. Generally the minutes of the meetings will note the names of observers and the fact that they are "in attendance". Persons "in attendance" have no specific legal status and in itself the phrase does not indicate any particular level of participation in the company's affairs. The extent of the participation of a councillor described in board minutes as "in attendance" is a question of fact. They should, however, take care to avoid involvement in the management of the company so as to avoid being treated as a shadow director.
12. A director (or shadow director) may incur personal liability if they are in breach of the above duties. This may arise where:
- the company is found, in the course of winding up, to have been trading for fraudulent purposes. If a director has acted dishonestly this is also a criminal offence;
  - following liquidation, a director is found liable for wrongful trading, i.e. allowing the Company to continue to trade at a time when the director knew or ought reasonably to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation;
  - the company commits a breach of the criminal law, for example, health and safety legislation;

- a director acts negligently or in breach of their duty to the company (including the duty to maintain confidential any confidential information relating to the company that comes into their possession).
- a director knowingly causes the company to act beyond the activities authorised by its Memorandum of Association;
- there is a breach of trust, such as the misappropriation of company funds or property;
- a director uses their powers improperly or makes a personal profit from their position as director.
- there is a failure to comply with the requirements of companies legislation, such as the making of returns to the Registrar of Companies.

**Insurance**

13. Councillors appointed as directors should find out if the company maintains appropriate insurance cover against directors' liability. If this is not in place this should be requested, but this is a matter entirely for the board and the Council cannot insist upon this. It will be necessary to ensure that the company has the resources to maintain payment of the insurance premiums.
14. Further guidance on the responsibilities of company directors is available on the websites of the Institute of Directors and Companies House:

<https://www.iod.com/Home>  
<http://www.companieshouse.gov.uk>