The Changing Landscape of Directors' Duties in Ireland

The long-awaited Companies Act 2014 which consolidates and reforms – in some cases quite radically – Irish company law, entered into force on 1 June 2015. Such reform is welcome, particularly in the areas where the previous law lagged behind that which applies in the United Kingdom, our closest trading partner. It has long been recognised that it is not very satisfactory if the company law in this country is less favourable to Irish businesses than the law that applies to their counterparts operating in Northern Ireland, or across the short stretch of the Irish Sea. Consequently, one of the objectives of the Companies Act is to modernise Irish company law, reduce the burden of "red tape" imposed on directors by the current law, and help to increase the competitiveness of Irish companies.

However, reflective of the increasing emphasis on individual personal responsibility for the governance of their companies, the Act also imposes additional duties and requirements on directors, especially those of larger companies, and imposes new and enhanced penalties and liabilities on directors for non-compliance.

This article looks at the extent to which the Act changes the current landscape of directors' duties in Ireland, and highlights some actions directors should consider taking.

Codification of fiduciary duties

The law in relation to directors' fiduciary duties has been developed by the courts in the UK and Ireland in an ad hoc fashion over many years. The UK Companies Act of 2006 codified the law in this area in the United Kingdom, but until now, there has been no corresponding codification in Ireland. As a result, prior to 1 June, there was no prescribed list of such duties which could be readily consulted here- instead, such duties had to be gleaned from the decisions of the courts.

However, when the Companies Act came into force, it introduced, for the first time in Irish law, a concise statement of the principal fiduciary duties of the directors of an Irish company, whether public or private. Among the key fiduciary duties codified in the Act are the following:

- the duty to act in good faith in what the director considers to be the interests of the company (although it is to be recognised that a director may also have regard to the interests of a particular shareholder of the company, where the director has been nominated by that shareholder in accordance with the company's constitution or a shareholders agreement);
- the duty to act honestly and responsibly in relation to the conduct of the affairs of the company;
- the duty not to use the company's property, information or opportunities for his or her own or anyone else's benefit, unless expressly permitted by the company's constitution or with the approval of the shareholders;
- the duty to avoid any conflict between the directors' duties to the company and the directors' other (including personal) interests, unless the director is released from his or her duty to the company;
- the duty to exercise the care, skill and diligence which would be exercised in the same circumstances by a reasonable person having both (i) the knowledge and experience that may reasonably be expected of a person in the same position as the director and (ii) the knowledge and experience which the director has.

These duties are owed to the company and the company alone and are similar to, but not the same as, the list of codified directors' duties in the UK. Such duties are owed not just by directors, but also by "shadow" directors and "de facto" directors (essentially, directors who have not been formally appointed).

Where directors act in breach of their fiduciary duties (other than the duty to act honestly and responsibly) the Act confirms that, as was previously the position under common law, they will be liable to account to the company for any gain made, and/or indemnify the company for any loss or damage resulting from the breach.

Practical consequences of codification

Locating the fiduciary duties of directors in one place in the Companies Act acts as a useful concise signpost for anyone who is, or is contemplating becoming, a director of an Irish company.

Codification may also help to create a greater sense of awareness of, and focus the minds of existing and potential directors on, these duties. In addition, putting the fiduciary duties of directors on a statutory basis may bring about an increase in corporate compliance activity, with companies seeking to demonstrate that their directors are compliant with those duties. For example, the boards of companies wishing to adhere- and to be seen to adhere- to good corporate governance standards, and to be fully compliant with the new legislation, may be advised in some cases to put appropriate documentation in place (for example, detailed board minutes, or memoranda of advice from their legal advisers), so as to demonstrate how the directors have considered and discharged their duties in compliance with these new statutory requirements. In addition, third parties, such as lenders, may seek additional written assurances that directors have complied with all relevant fiduciary duties as a pre-condition to entering into particular transactions with the company.

This is an opportune time for company directors to seek a refresher session on their duties, and what they mean in practice. However, only time will tell if codification will actually result in greater levels of corporate compliance by directors.

The new "compliance statement" regime – consequences of compliance

A more significant change to the current landscape of directors' duties is the increased emphasis in the Act on the personal responsibility of directors for compliance, with the introduction of a requirement for directors of certain companies to include an annual compliance statement in their directors' report accompanying the company's financial statements. This provision applies in respect of financial years commencing on or after 1 June 2015.

Compliance statements will be required from directors of private limited companies and guarantee companies which have a balance sheet of over €12.5m and a turnover in excess of €25m in the year to which the directors' report relates. They will also be required from directors of all public limited companies, (other than those that are investment PLCs), regardless of balance sheet or turnover figures.

Under the new regime, the directors of the affected companies will have to acknowledge in the directors' report their responsibility for securing compliance by the company with tax law, and also certain company law provisions imposing serious penalties for non-compliance. These include the need to keep adequate accounting records and to ensure that the company does not give any unlawful financial assistance in relation to the acquisition of shares in the company.

The directors of affected companies must also confirm (1) that they have drawn up a "compliance policy statement" setting out the company's policies regarding compliance by the company with such provisions, (2) that arrangements or structures are in place that are, in the director's opinion, designed to secure material compliance with such provisions, and (3) that they have reviewed, during the financial year, the arrangements or structures which have been put in place to secure such material compliance. If these statements, confirmations and reviews have not been made or carried out, the directors must, in the directors' report, specify the reasons why not. The Act states that such arrangements or structures will be regarded as being designed to ensure material compliance if they provide a "reasonable assurance of compliance in all material respects" with those obligations.

Helpfully, directors will be able to rely on the advice of one or more persons employed by the company or retained under a contract for services, who appear to the directors to have the requisite knowledge and experience to advise the company on compliance with its relevant obligations.

This new compliance regime is less onerous than that which was proposed some years ago but never brought into effect, due to concerns about its onerous nature. The regime proposed by Section 205 E of the Companies Act 1990, inserted by the Companies (Auditing and Accounting) Act 2003, provoked significant concerns on a number of grounds, including its likely impact on competitiveness, and was never commenced into law. The compliance regime in the Companies Act is a compromise.

However, while the new provisions are less onerous than what was originally proposed, they will require the companies affected to put in place formal arrangements to ensure that their directors can give the required confirmations, to the extent that these arrangements are not already in place. There will undoubtedly be a financial cost for many of the affected companies in producing these compliance statements on an annual basis. For example, advice will in many cases have to be obtained from professional advisers, such as company lawyers and tax advisers, as to the nature of, and how to ensure compliance with, the relevant laws. It will also become increasingly important that legal advice is obtained throughout the year before effecting transactions or taking other action, so as to ensure compliance. Management time will also have to be committed to ensuring that the directors can be comfortable about making the required statements.

There will also be many Irish private companies which will exceed these relatively low balance sheet and turnover thresholds, and so will fall within the "compliance statement net". In addition, depending on the nature and scale of their business operations, the burden of compliance may in some cases be greater, relatively speaking, for companies which only exceed the relevant thresholds by a relatively small amount, as opposed to companies which have balance sheets and turnovers that are significantly in excess of the thresholds.

It should also be borne in mind that UK companies do not have to produce equivalent compliance statements under English law, and it therefore remains to be seen what, if any impact the new requirements will have on the competitiveness of Irish companies vis-a-vis their UK counterparts in particular.

New duties regarding secretaries

The Act imposes a new duty on directors of all private companies to ensure that the company secretary has the skills or resources necessary to discharge his or her statutory and other duties, and also that the secretary has the skills necessary to maintain (or procure the maintenance of) the company's statutory non-financial records. Directors of public limited companies were already obliged to ensure that the secretary of their company satisfied specific requirements prescribed in the (now largely repealed) Companies Act 1990. However, the Act also imposes a similar duty on directors of PLCs to ensure that the secretary has the skills necessary to maintain the company's non-financial records.

The Act does not, however, indicate how directors can be sure that they will have complied with these new duties. Some directors may seek to comply by requiring the company secretary to hold an appropriate secretarial qualification, and attend regular training courses. In other cases, it may be deemed more appropriate to outsource the function to a professional secretary. Again, the costs of compliance with this new requirement will need to be considered.

Audit committees required for "large" companies

The Act introduces a new requirement for the boards of directors of "large" private companies (balance sheet total in excess of €25 million and turnover in excess of €50 million, or a company and its subsidiaries which together meet these thresholds, in the most recent financial year and the one preceding it) and also unlisted PLCs (other than those which are investment PLCs), regardless of financial thresholds, to establish audit committees, or else explain in the directors' report why such committees have not been established. The Act also lays down specific requirements as to the composition of the committee, and its functions.

While some "large" companies may already have an audit committee in place, they will need to review its composition and terms of reference in order to ensure that the committee will be compliant with the new regime. There may also be overlapping regulatory requirements for some companies which are already subject to specific audit committee requirements, such as banks and insurance companies.

This provision also applies in respect of financial years commencing on or after 1 June 2015.

New statutory audit confirmations from directors

The Act introduces a new statutory obligation on all directors of a company to include a statement in their directors' report that (1) so far as each director is aware, there is no relevant audit information of which the company's auditors are unaware, and (2) he or she has taken all the steps that he or she ought to have taken as a director to make himself or herself aware of any relevant audit information, and to establish that the company's auditors are aware of that information. This new obligation is based on a similar obligation contained in the UK Companies Act 2006.

There is already an existing practice whereby some or all of the directors of a company are required by their auditors to sign what is known as a "management representation letter" in connection with the preparation of the annual audit. These letters aim to provide similar comfort directly to the auditors. However, the new statutory obligation goes further than this, because it effectively requires each director to make enquiries, not just of his or her co-directors, but also of the company's auditors, to make himself or herself aware of any relevant audit information, and to establish that the auditors are aware of it too. It will be a criminal offence if the required statement in the directors' report is false, and if the director concerned knew it was false or was reckless as to whether it was false and then failed to take reasonable steps to prevent that report from being approved.

As with the new provisions requiring audit committees to be established, and compliance statements to be included in directors' reports etc, this new audit confirmation provision also applies for financial years commencing on or after 1 June 2015.

Loans and quasi-loans by companies to directors and vice versa

The Act has introduced some new evidential requirements with regard to loans made by companies to directors, and vice versa.

If a loan or quasi-loan made to a director or director of its holding company or connected person by a company is not in writing, or is in writing or partially in writing but is ambiguous, there will be a rebuttable presumption in legal proceedings that it is repayable on demand, and that, until it is repaid, it is subject to interest at 5% p.a.

Additionally, if a loan or quasi-loan made by a director or a connected person to the company or its holding company is not in writing, or is in writing or partially in writing, but is ambiguous, there will be a rebuttable presumption in legal proceedings that there was no loan or quasi-loan. Further, if it is proved that such a loan or quasi-loan was made to the company or its holding company, there will be another rebuttable presumption that, if the terms are ambiguous as to whether it is interest-bearing, or whether it is secured, or what priority it has over other indebtedness of the company, then the loan or quasi-loan will be interest-free, or will be unsecured, or will be subordinated to other indebtedness (as the case may be).

New penalties and liabilities for directors

One important aspect of the Companies Act, which so far has attracted very little comment, is the fact that it significantly increases the current penalties and liabilities for non- compliance with company law by directors. There is a new "streamlined" offences regime, whereby all offences under the Act are grouped under one of four categories, with "category 1" offences carrying the highest penalties (for conviction on indictment, imprisonment for up to 10 years and/or a €500,000 fine), and "category 4" offences carrying the lowest penalty of a "Class A fine" (being a fine of up to €5,000).

However, of greater significance is the fact that penalties for breaches of various provisions of the Act have been increased, in some cases very significantly, and in other cases, new and significant liabilities have been introduced.

A couple of examples will serve to illustrate this. First, in relation to the new "summary approval procedure" (SAP) for the sanctioning of certain transactions (similar to the existing financial assistance "whitewash" procedure under section 60 of the now repealed Companies Act 1963), which is aimed at making it easier for companies to effect those transactions, a court is able to declare a director personally liable, without any limitation of liability, for all the debts and liabilities of the company, where a solvency declaration is made by the director (as required under the SAP) without having reasonable grounds for his or her opinion on the solvency of the company.

Secondly, a director risks imprisonment for up to 10 years and/or a €500,000 fine if found guilty of a "category 1" offence relating to the keeping of adequate accounting records, which previously carried a much lower penalty under the Companies Act 1990.

Conclusions

The Companies Act has introduced a wide range of beneficial, and long overdue, reforms to our company law. However, the Act is not all about consolidating and streamlining the law, and reducing "red tape"- it also creates new obligations on directors of Irish companies, and in some respects significantly alters the corporate governance landscape. In addition, the Act imposes new and enhanced liabilities and penalties for non-compliance. Directors should therefore familiarise themselves with the new regime now that the legislation has entered into force.

Complying with the new Companies Act

Now that the bulk of the Act is in force, Directors should:

- consider seeking a refresher session on their fiduciary duties, and the new offences and penalties regime which the Act has introduced;
- ascertain whether they will be required to include an annual compliance statement in their directors' report, or explain why not and, if giving a compliance statement, lay down the foundations necessary so that they can adhere to their obligations;
- review the skills of the company secretary, and consider whether there is need for outsourcing or further training;
- ascertain whether they will be required to establish an audit committee or to explain why not and, if establishing one, get advice as to its required composition and functions. If the company already has an audit committee, its composition and terms of reference should be reviewed;
- familiarise themselves with the audit confirmations which will need to be given in the directors' report accompanying the company's financial statements, and consider what changes may need to be made in the practices and procedures of the company to enable them to give the required confirmations.

For further information, please contact Eithne FitzGerald, (Partner, Corporate Department), Jack O'Farrell, (Consultant, Corporate Department), a member of our Knowledge Team, or one of your usual Partner contacts at A&L Goodbody.

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Note: The above information is a summary for information purposes only of some changes which were introduced into Irish company law by the Companies Act 2014. The bulk of the Act entered into force on 1 June 2015. Specific advice should always be sought before taking any action.

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