EMPLOYMENT

Director exits– *Are you prepared?*

In an ideal world, all companies will have a perfect and mutually beneficial relationship with their directors. Circumstances may develop however over time, which lead to a company seeking to remove a director from office. From the outset of the relationship, it is key that a company is aware of the ways in which it may lawfully terminate a director's appointment.

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Termination of appointment

There are a number of circumstances under which a director's appointment may be terminated:

1) Resignation

Subject to the company's Articles of Association, a director may resign at any time by providing adequate notice to the company. In many cases, the resignation may require board approval.

2) Under Articles of Association

The Articles of Association of a company should ordinarily stipulate when a director may be vacated from office. In such cases, the director will automatically be removed on the occurrence of a particular event or act. No resolution will be required to authorise this.

The model articles for private companies provide the following examples of when a person will cease to be a director:

- By virtue of any provision of the Companies Act 2006
- By law, e.g. a bankruptcy order
- Following a written opinion from a registered medical practitioner that deems the person physically or mentally incapable of acting as a director
- Notice of resignation

A company may choose to include other provisions within their articles such as failure to attend a specified number of board meetings, termination of a director's service agreement, or criminal conviction.

3) Removal under section 168 of the Companies Act

Prior to the expiration of the term of office, a company may remove a director by special notice of the passing of an ordinary resolution. This right overrides anything to the contrary within the company's articles or the director's service contract. A director has the right to protest against their removal under Section 169 of the Companies Act which allows them to make representations regarding their removal.

However, removing a director by this method will not remove their right to compensation or damages in respect of their termination and may potentially lead to an unfair prejudice petition if the director is also a minority shareholder.

4) Directors' service agreement

A directors' service agreement is defined by Section 227 of the Companies Act 2006 as:

> *"a contract under which a director of the company undertakes personally to perform services for the company".*

That fairly stark description ignores the fact that it will almost certainly also constitute a contract of employment, which in turn means that it must also comply with the statutory basis operated in Northern Ireland. This is often where two worlds collide, as employment law compliance can often jar with corporate obligations, such as the need for the shareholder approval where a service agreement is fixed for a period of two years or more.

It is important to note that termination of a service agreement, particularly for an executive director, may lead to contractual or statutory claims for unfair dismissal if the appointment has been terminated in breach of obligations such as providing adequate notice.

Potential implications

Removing a director can have potential implications on the company if the appropriate protections are not in place.

Employment issues

Chief among the employment issues engaged is the inter relationship between statutory employment provisions and blending those with the existing corporate rules established in the Memorandum / Articles of Association. Frequently, these are not aligned and care should be taken at the outset to ensure both are compatible and actually, when properly addressed, good drafting can create a suite of complimentary documents, which afford comprehensive protection for the business and its interests.

When relationships do break down, it is often important to remember that the director wears three 'hats' – as employee, director and shareholder. Each category brings with it complications but also opportunity – for example restrictive covenants can be limited within the pure employment context but much more creative when approached from the shareholders agreement perspective.

Also, bear in mind the 'new age' directorships and regulatory oversight – best illustrated in the form of NED's (Non-Executive Directors) and the new protocols introduced to certain employers in the form of the SMCR (Senior Managers and Certification Regime) – both elements which have transferred the employment aspects of director appointment, tenure and termination.

Protecting company interests

A director's service agreement can provide express protections over certain interests by way of restrictive covenants. These can offer protection to the legitimate interests of the business such as trade secrets and confidential information regarding clients and employees.

To offer the best protection, a service agreement should include a comprehensive confidentiality clause which prohibits the use or disclosure of confidential information both during and after the director's appointment. Implied protection for confidentiality is limited to trade secrets so it is important to draft a precise confidentiality clause that specifically details the extent of the information a company wishes to cover. This will provide a company with better means of seeking remedy should a director breach this clause.

Directors as shareholders

In many businesses, the directors may also be a shareholder. In such cases, their removal as a director can pose difficulties in relation to their shareholding.

After a director is removed from office, they will continue to own shares in the company and may be entitled to dividends. In such circumstances, the company may find it commercially imprudent for that individual to remain a shareholder, particularly if the

director has been removed due to gross misconduct or has breached their restrictive covenants.

In this case, leaver provisions will be of great benefit and should be drafted within the shareholders agreement or articles of association. Leaver provisions provide for the purchase of shares by either the company or remaining shareholders, depending on the reasons for their departure. Generally, these provisions are divided into two distinct types: good leaver and bad leaver.

Share valuation can pose difficulties if a valuation method is not provided in the shareholders' agreement and may require an expert accountant to assist, which can create additional unwanted cost for a company.

GOOD LEAVER

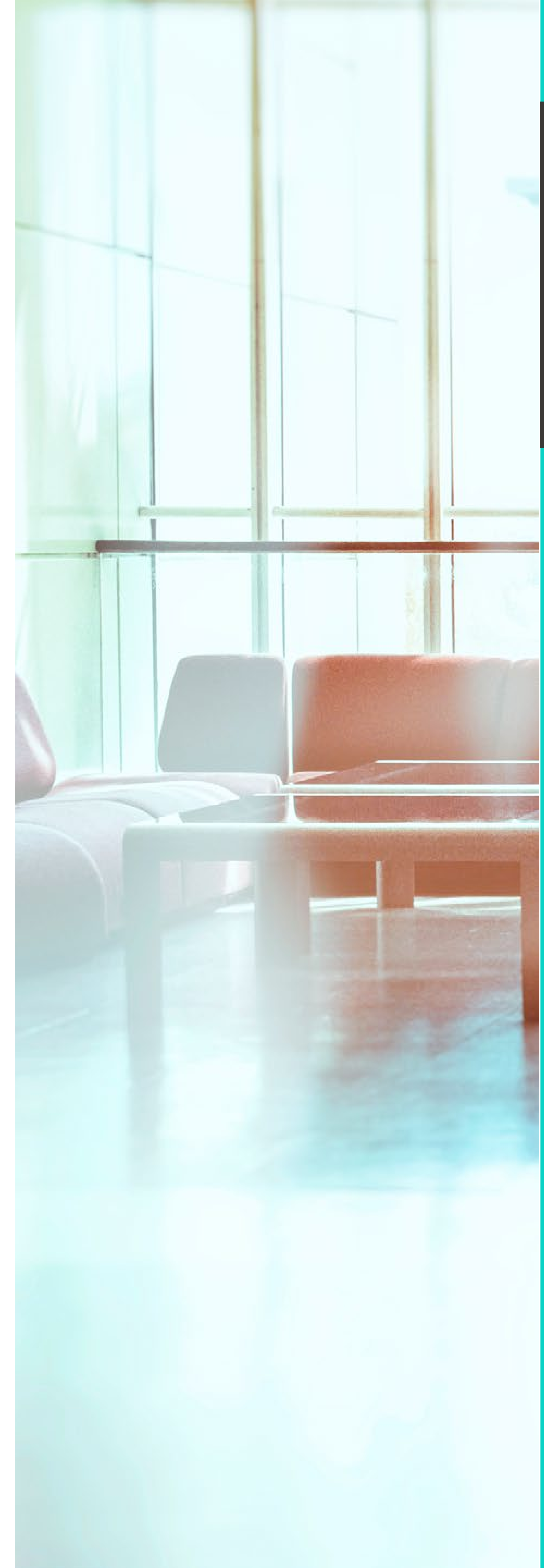
Good leaver provisions cover individuals who are leaving the company under circumstances such as retirement, ill health, death or unfair or constructive dismissal. In such cases, the individual will be paid the market value for their shares.

BAD LEAVER

Bad leaver provisions cover individuals who are leaving the company under circumstances such as fraud, dismissal for gross misconduct, breach of the shareholders' agreement, disqualification as a director or in a scenario, which has caused damage to the business. In such cases, the 'bad leavers' shares will be purchased at the nominal value of the shares.

Minority shareholders – Risk of Unfair Prejudice

Section 994 of the Companies Act 2006 allows a shareholder of a company to petition the court for relief on the grounds that the company's affairs are being or have been conducted in a way which unfairly prejudices the interests of the shareholders. If successful, the court will commonly order that their shares are purchased at fair market value. Such petitions can be particularly common where a shareholder challenges the reasons behind their removal as a director or the bad leaver provisions under which they are being removed as a shareholder. It is therefore key that a company has sufficient evidence to prove the reasoning behind their decision to remove that individual.



Conclusion

Prior to removing a director, it is important that the company fully assesses the contractual agreements that are in place to ensure that they are protected against any potential liability. Creating comprehensive agreements from the outset is the best way to guarantee that your business is protected if a director acts rogue and warrants removal.

For further information in relation to this topic, please contact Gareth Walls, Partner within our Belfast Employment & Incentives team, and Ciaran McCorry, Senior Associate within our Belfast Litigation team.

A&L Goodbody

Key contacts

Gareth Walls
Partner
+44 75 9511 8090
gwalls@algoodbody.com

Ciaran McCorry
Senior Associate
+44 77 3629 6979
cmccorry@algoodbody.com

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