McCann FitzGerald

Briefing
Update on Directors' Duties

INSTITUTE OF DIRECTORS IN IRELAND

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Recent decisions handed down by the High Court and Court of Appeal have provided a useful reminder of how directors must act and to whom their duties are owed; one case concerned the restriction of a director and the other considered the exercise of discretion by directors.

No protection for a "passive" director

The case of ***Fennell v Appelbe*** [July 2022] concerned the director of an insolvent company who appealed a restriction order made against him. The order prevented the appellant from acting as a company director or secretary for a 5-year period under section 819 of the Companies Act 2014 (the "**2014 Act**"). The Court of Appeal dismissed the appeal as the appellant failed to satisfy the court that he acted responsibly in the conduct of the company's affairs.

The principal ground for the application for a restriction order was the making of two payments by the company the day before NAMA appointed a statutory receiver. One of these payments was made to another director against whom the liquidator sought a disqualification order on the grounds that the payment was an unfair preference. The liquidator accepted that Mr Appelbe was not aware of, nor had he benefited from, the payment, but sought to restrict him as the payments had been made while the company was "grossly insolvent". The liquidator argued that Mr Appelbe's lack of knowledge constituted "irresponsibility" within the meaning of section 819.

Section 819

Section 819 provides that "the court shall make a declaration" that, for a period of five years, the person subject to the application, "shall not be appointed or act in any way, directly or indirectly, as a director or secretary of a company, or be concerned in or take part in the formation or promotion of a company". The court shall make an order unless it is satisfied of all three matters laid out in section 819(2):

a) the person concerned has acted honestly and responsibly in relation to the conduct of the affairs of the company in question, whether before or after it became an insolvent company,

b) he or she has, when requested to do so by the liquidator of the insolvent company, cooperated as far as could reasonably be expected in relation to the conduct of the winding up of the insolvent company, and

c) there is no other reason why it would be just and equitable that he or she should be subject to the restrictions imposed by an order under [section 819(1)].

The High Court judgment

Mr Appelbe argued that he had "little knowledge" of the company's management prior to the appointment of the statutory receiver and after that appointment, NAMA "deprived" him of information regarding the affairs of the company.

The High Court rejected this and restricted Mr Appelbe for a period of five years. Mr Appelbe's contention that he had "little knowledge" of the company's affairs revealed his "fundamental misunderstanding" of the serious nature of the duties of directors. His "lack of action" could not be used as a defence.

The onus on a director under section 819 is to provide evidence of acting responsibly, and it is not an onus to demonstrate that he was unaware of the impugned transactions.

The Court of Appeal judgment

Mr Appelbe's first ground of appeal was that the High Court erred in making the order against him because the liquidator failed to put forward a case for him to answer. The Court of Appeal dismissed this as a misunderstanding of section 819. It is not a question of whether the liquidator made out a case for Mr Appelbe to answer, rather once a restriction application is made in the context of insolvency, the onus is on to the director to evidence his or her honesty and responsibility.

Secondly, Mr Appelbe contended that he could not be considered to have been irresponsible because he had never been "called upon" to engage in the affairs of the company. Essentially, Mr Appelbe argued that his status as a "passive" director is a defence to a restriction application. The court disagreed. This could not absolve him of his duties as a director and the court expressed disbelief that the appellant had "little knowledge" of the company's affairs given the extent of the deficit. Rather than his lack of involvement being a defence, this "copper fastened" his irresponsibility and the need for his restriction.

The High Court found that Mr Appelbe was not responsible for the Company's insolvency. On appeal, Mr Appelbe took issue with the fact, despite this finding, he was not totally absolved of responsibility for the company's failure. This was dismissed by the Court of Appeal which noted that there seemed to be some

confusion between being the cause of the insolvency and being responsible for the affairs of the company.

Directors must act in what they consider to be the interests of the company

In ***Pat Keating v Shannon Foynes Port Company*** [September 2022], the High Court held that the CEO of Shannon Foynes Port Company was entitled to a number of performance-related-payments ("**PRP**"), the amounts of which were approved by the remuneration committee, but which the board of directors had declined to pay on the basis of a stated policy of the Minister of Transport, Tourism and Sport, the company's main shareholder, that PRP should not be made to CEOs of semi-state entities.

Key Findings:

1. No directive was ever issued to the directors under the Harbours Act to direct the company not to make such payments. (The court did not need to consider whether a directive, if issued, could only operate prospectively rather than adversely impact on accrued contractual rights).
2. The directors were entitled under the relevant contractual arrangements to exercise a discretion in relation to whether or not to pay the PRP; the directors were entitled, under the Harbours Act, to have regard to the government's policy on payment of PRP.
3. The directors were subject to a fiduciary duty under the Companies Act to the company to act in good faith and solely in the interests of the company (rather than its shareholders, including the Minister).
4. The duty of directors under the Companies Act to have regard to the interests of members/shareholders and employees is of dubious value as only the company can enforce those duties.
5. The discretion was required to be exercised by the directors bona fide and in a manner which was not irrational, perverse or capricious. In this case the only basis on which the PRP was not paid was that the directors considered that they could not go against the clearly expressed wishes of the company's shareholders.
6. The fiduciary responsibility of the directors included a duty not to take into account irrelevant matters or matters which should not inform the exercise of the discretion.

7. The fiduciary duty was owed to the company – not to Mr Keating- however the failure by the directors to exercise their discretion appropriately, particularly in circumstances where a discretion exercised in the best interests of the company would have resulted in payment of the PRP which Mr Keating had earned, constituted a breach by the company of the contract with Mr Keating, which caused damage and loss that he could recover.

Comment

The judgment in *Appelbe* emphasises that the role of a director requires active engagement in the affairs of a company. Mr Appelbe's argument that he was never "called upon" to engage in the affairs of the company confirmed to the court that restriction was warranted. Mr Appelbe failed to provide any evidence that would rebut the statutory presumption in favour of restricting a director of an insolvent company under section 819. This is to be contrasted with the "extensive evidence" provided to the High Court by another director which led to that court refusing to restrict that director.

Whilst the *Keating* decision is of interest to all directors of all types of company, directors of semi-state companies, in particular, must always act in what they consider to be the interests of the company, and not what they think (or are told) the relevant Minister or the Department of State wants them to do: an exception to this is where a specific legislative provision allows a Minister to issue a directive to the board of a semi-state company and in such circumstances, the board must follow that directive.

In summary, these decisions reinforce the need for directors to be actively engaged in the affairs of the company whilst also highlighting the importance for directors to be cognisant of the duties which they owe and to whom they are owed.

Further information is available from

Garreth O'Brien
Partner
+353 1 607 1489
garreth.obrien
@mccannfitzgerald.com

David O'Dea
Partner
+353 1 607 1737
david.odea
@mccannfitzgerald.com

Alternatively, your usual contact in McCann FitzGerald will be happy to help you further.

INSTITUTE OF DIRECTORS
IN IRELAND

Institute of Directors in Ireland, Europa House, Harcourt Street, Dublin 2
01 411 0010 | info@iodireland.ie | www.iodireland.ie