



THE ROLE OF THE NON-EXECUTIVE DIRECTOR

This briefing note is designed to give some practical guidance to non-executive directors of UK private companies.

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Traditionally, non-executive directors have been appointed to the boards of UK public companies. Their role is typically supervisory and they are not expected to be actively involved in the day-to-day management of the company. Non-executive directors provide an objective, independent and constructive view of the plans and decisions of the executive board. For this reason, individuals appointed as non-executive directors are often chosen for their breadth of experience in a particular field or industry, and they are expected to perform a valuable role in monitoring the executive board's performance, determining appropriate levels of executive remuneration and advising on succession planning.

Over the recent past, the practice has grown of larger private companies, where there may be a divergence of interests between the directors and the shareholders, appointing non-executive directors to the board. The role and what is expected of them is typically based on that for public company directors but diluted to take account of the private company status and the fact that they are not technically subject to the UK Corporate Governance Code (the "Code" – available from <http://www.frc.org.uk>). The value for the company may be considerable: a non-executive director in an owner managed company might offer a fresh and more objective viewpoint to the board. As the company grows, there may be a need to increase the numbers of non-executive directors. In a private equity or venture capital context, it is usual for the investor to seek protection for its investment by insisting on the right to appoint one or more non-executive directors to the investee company's board.

1. DUTIES AND RESPONSIBILITIES OWED BY NON-EXECUTIVE DIRECTORS

Note that in law there is no distinction between the duties and responsibilities owed by executive and non-executive directors, although executive directors will typically have a full time role and will have duties derived from their contract of employment. In the light of the emphasis that the Code places on the role of non-executive directors on the board and on its committees, prospective non-executive directors should consider carefully the likely time commitment involved in fulfilling the role before accepting the appointment.

The law recognises that non-executive directors cannot reasonably be expected to have the same detailed knowledge and experience of a company's affairs as executive directors. When considering whether a non-executive director has breached his or her statutory duty to exercise reasonable care, skill and diligence, a court will be likely to consider what steps a reasonably diligent non-executive director in the same position would have taken to become familiar with the company's business and operations. Prospective non-executive directors should refer to the elements in the Code which describe the role and responsibilities of a non-

executive director as these are likely to be relevant to a court's assessment of any allegation of breach of duty.

2. LIMITING THE LIABILITY OF NON-EXECUTIVE DIRECTORS

The two principal means of protection for a director facing an allegation that he or she has breached his or her duties are to seek recourse from the company using an indemnity, and/or to rely on the company's directors' and officers' liability insurance cover. As part of risk management, a prospective director should make enquiries as to what insurance cover is available to directors and what the company's policy is on indemnifying directors.

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The scope of any indemnity that a company is able to offer its directors is limited by the provisions of the Companies Act 2006, but in general a director is able to be indemnified against any liability owed to a third party and can ask the company to fund defence costs so long as certain conditions are satisfied and subject to any limits in the articles of association. In terms of directors' and officers' insurance, the Code recommends that the company should obtain appropriate insurance cover in respect of legal action against its directors.

3. ACTIONS TO BE TAKEN BY PROSPECTIVE DIRECTORS BEFORE JOINING A BOARD

Due diligence – prospective non-executive directors should carry out due diligence to establish that the company is an organisation in which the individual can have confidence and make a strong and value added contribution. They should satisfy themselves on issues such as the company's culture and values, its current financial position, key stakeholders and the company's strategy. Other important areas to investigate will be the competitive position of the business, threats and opportunities that may impact on that position, and the main challenges that the board faces.

Understand the level at which they will be expected to perform – more is expected from a director with a specific skill or experience. A director's duty is to exercise the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected (the objective test), and using the general knowledge, skill and experience that the particular director has (the subjective test). For example, a non-executive director who has had a career in the banking industry will be expected to have a higher level of knowledge with regard to financial matters and will be expected to bring such knowledge to bear on matters involving the company's accounts.

Recognise the importance of integrity - an important part of the non-executive director's role is to uphold high standards of integrity and probity. Prior to being offered a directorship, the prospective director should ask questions about and form a judgement on the culture, values and behaviours associated with the board.

Review the letter of appointment – with particular reference to the minimum time commitment required, and to satisfy themselves that they can meet such demands.

Conflicts of interest – directors are subject to approval and disclosure requirements derived from the Companies Act 2006 and, in particular, must declare and get approved any potential or actual conflicts of interest before accepting their appointment. This is likely to be of particular relevance to non-executive directors who may have multiple directorships and may be in a situation of potential conflict with the company from the outset. If this is the case, they must disclose that conflict and seek authorisation from the other directors.

4. ACTIONS TO BE TAKEN BY PROSPECTIVE DIRECTORS FOLLOWING APPOINTMENT TO THE BOARD

Tailored induction programme – best practice is that all newly appointed non-executive directors should receive a comprehensive, tailored induction programme into which they should have input and should have ongoing training as and when required.

Independent oversight – they should understand that their role is to provide constructive and robust challenge to the board, and contribute to the development of strategy, bringing their experience and expertise to bear.

Non-executive directors should be at liberty to speak to the company's executives at any time to raise concerns, and should speak to the company's advisers if they consider it necessary.

Preparation for meetings- directors should receive a schedule of future board and committee meetings planned well in advance, and insist on receiving high-quality information sufficiently in advance of meetings so they can make a meaningful contribution.

Take independent advice if necessary – non-executive directors should be at liberty to speak to the company's executives at any time to raise concerns, and should speak to the company's advisers if they consider it necessary. Independent professional advice should be sought at the company's expense if they consider it necessary to discharge their responsibilities as directors. Normally the letter of appointment (reflecting Code requirements) will confirm the basis upon which this may happen and when expenditure will be reimbursed.

Be aware of their statutory duties as directors- for example, all decisions should be made objectively in the interest of the company, and as a practical measure the director should not be sufficiently dependent on their income received from their directorship as to compromise their independence. In addition, they should familiarise themselves with the company's articles of association and any other procedures on dealing with conflicts or interest and recording gifts or hospitality, and comply.

Be aware of the option of resignation- appreciating that circumstances may arise such that a non-executive director may need to consider resigning. If this is the case they should talk first to the chairman or other senior individuals, and consider taking independent professional advice.



KEY CONTACT

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