
**Cheshire and Warrington Local Enterprise Partnership
Directors' duties and liabilities in relation to the proposed transfer
or cessation of LEP functions
5 September 2023**



Cheshire and Warrington Local Enterprise Partnership ("CWLEP") Directors' duties and liabilities in relation to the proposed transfer or cessation of LEP functions

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1 Introduction and Scope

- 1.1 **Introduction:** the purpose of this briefing paper is to consider at a high level the key duties and liabilities of the directors of CWLEP under three possible future scenarios for the CWLEP, being:
- 1.1.1 **Option 1:** retaining the CWLEP in its current legal form (a company limited by guarantee) as a joint venture company between the Local Authorities, with the private sector members resigning. The existing directors resign (or are removed by the members) and replaced by directors nominated by the Local Authorities.
- Option 2:** the CWLEP is placed into solvent liquidation and, following the satisfaction of its liabilities, its assets and personnel are transferred to the Local Authorities as part of the liquidation procedure. Alternatively, the business, assets and personnel (and potentially liabilities) of the CWLEP may be transferred to the Local Authorities without the use of a formal liquidation procedure. Following the completion of the transfer of its business, assets and personnel, and the satisfaction or transfer of its liabilities, the CWLEP is struck off using the voluntary strike-off procedure under the Companies Act 2006. For the purposes of this note, we are treating these alternatives together as Option 2; and
- 1.1.2 **Option 3:** the CWLEP becomes insolvent and is placed into insolvent liquidation (it is assumed that an insolvent liquidation is more likely than an administration, given the nature of the CWLEP's business).
- 1.2 In relation to Options 2 and 3 above, we have also been asked to consider an alternative scenario where the existing directors resign (or are removed from office) and replaced with new directors appointed by the Local Authorities, who then proceed to place the CWLEP into solvent or insolvent liquidation (as the case may be).
- 1.3 **Scope:** this high-level note is structured as follows:
- 1.3.1 Summary of the key director's duties and liabilities;
- 1.3.2 Application of directors' duties to the CWLEP strategic options;
- 1.3.3 Practical steps to mitigate potential risks to the directors.
- 1.4 Unless the context requires otherwise, references in this paper to:
- 1.4.1 "**Articles**" are to the articles of association of the Company adopted on 6 May 2020;

We have prepared this advice for the sole benefit of Cheshire & Warrington Local Enterprise Partnership and solely for the purpose of the matter to which it relates, unless we have agreed otherwise in writing. If you decide to share this advice with anyone else, there is a risk that both its confidentiality and its legally privileged nature will be lost. Please contact us if you require advice about how best to prevent this happening.

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- 1.4.2 “**CA 2006**” means the Companies Act 2006;
- 1.4.3 “**Company**” means the CWLEP; and
- 1.4.4 “**Local Authorities**” refers to Cheshire East Borough Council, Cheshire West and Chester Borough Council and Warrington Borough Council as the constituent local authority members of the CWLEP.

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- 2 Summary of directors' duties and liabilities** The Companies Act 2006 sets out the core general duties owed by company directors under English law. The directors of the CWLEP will all be required to comply with these duties in making decisions about the CWLEP including deciding on the future of the CWLEP. In brief, the core duties comprise:
- 2.1.1 **the duty to act within powers (s 171 CA 2006):** Directors must act in accordance with a company's constitution and exercise their purpose only for the purposes for which they are conferred;
 - 2.1.2 **the duty to act in good faith to promote the success of the company for the benefit of its members as a whole (s 172 CA 2006)** In doing so, each director must have regard to six non-exhaustive statutory factors listed in s 172 (1)(a) to (f), as well as (in certain cases) the interests of a company's creditors (the so-called "**creditor duty**");
 - 2.1.3 **the duty to exercise independent judgment (s 173 CA 2006);**
 - 2.1.4 **the duty to exercise reasonable care, skill and diligence (s 174 CA 2006):** '*reasonable care, skill and diligence*' means the care, skill and diligence that would be exercised by a reasonably diligent person with:
 - (i) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and
 - (ii) the general knowledge, skill and experience that the director has.
 - 2.1.5 **the duty to avoid conflicts of interest (s 175 CA 2006):** a director must avoid a situation in which such director has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company;
 - 2.1.6 **the duty not to accept benefits from third parties (s 176 CA 2006):** a director must not accept benefits from third parties which are conferred: (a) by reason of the director being a director of the company; or (b) the director doing, or omitting to do, anything as a director; and
 - 2.1.7 **the duty to declare an interest in a proposed transaction or arrangement (s 177 CA 2006).** Directors are also under a separate obligation to declare to the other directors the nature and extent of their interest in an existing transaction or arrangement with the company (s 182 CA 2006).
- 2.2 Time periods for directors' duties:** In general, a director's duties to the company under s 171 to 177 CA 2006 come to an end when they cease to hold office, whether of their own volition (e.g. retirement or resignation) or because they are removed by the board of directors or the members. **This position is subject to a number of exceptions, where the duties continue after termination of the role:**
- 2.2.1 **Conflicts of interest:** a person who ceases to be a director continues to be subject to the duty (under s 175 CA 2006) to avoid conflicts of interest as regards the exploitation of any property, information or opportunity of which the director became aware while acting as director;
 - 2.2.2 **Benefits from third parties:** a director remains liable under the s 176 CA 2006 duty not to accept benefits from third parties as regards things done or omitted to be done by him before ceasing to be a director. A director who is induced to act in

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a particular way while in office cannot then resign in order to take a benefit which was promised to him to induce him to act in that way;

2.2.3 **Other directors' breaches:** a director who resigns in circumstances where they knew, or alternatively there was a reasonable basis to believe, that the other directors were intending or contemplating a course of action which would constitute a breach of duty may themselves be held liable for the wrongful actions of the other directors carried out after their resignation; and

2.2.4 **Resignation prior to execution of actions put in train:** a director who resigns prior to the company taking any relevant substantive actions will not necessarily avoid liability for breach of duty in respect of that action. Whether the director remains liable for breach of the duty will depend on the facts, and in particular whether the director knew that the action would be undertaken after his resignation and whether, prior to resignation, the director had been involved in preparatory steps in respect of that action.

2.3 Liability of directors:

2.3.1 **Liability to the company:** Directors' duties are owed to the company, and the company is the proper claimant for a remedy in respect of breaches of duty. A breach of duty by a director may result in the director being personally liable to the company. In a case where a director has profited from the breach, such director may have to account to the company for any profit made. Even if the director has not made any personal gain, they may still be liable to the company for any loss it has suffered as a result of their breach.

2.3.2 **Members' ability to claim:** In certain circumstances, it is possible for a member to bring a derivative claim on behalf of the company for breach of directors' duties on behalf of the company, but there are a number of procedural hurdles that need to be satisfied before such a claim can be brought.

2.3.3 **Indemnities and insurance:** Companies are permitted to indemnify directors against claims by third parties against directors for breach of duty (including in respect of legal fees incurred) where such claims are successfully defended (if not prevented from doing so by their constitutional documents). It is also possible for a company to take out (and pay the premiums for) directors' and officers' insurance for the benefit of directors or former directors. The specific terms of any policy should be checked to ensure that they provide run-off cover to former directors, as well as covering current directors.

2.4 **Insolvency:** There are a number of additional liabilities that the directors (and former directors) may face in an insolvency-type situation:

2.4.1 **Wrongful trading:** the court has a discretion to declare a director (or former director) of a company in insolvent liquidation to be liable to make a contribution to the company's assets if, at a time before the commencement of the winding up and when the director was in office as a director, the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid insolvent liquidation or insolvent administration.

(i) **Defence:** The court will not require a director to make a contribution to the assets if (after the time when that person first concluded, or ought to have done, that an insolvency would not be avoided) the director took every step with a view to minimising the potential loss to the company's creditors as the director ought to have taken.

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- 2.4.2 **Fraudulent trading:** if, in the course of administration or winding up the company, it appears that any business of the company has been carried on with intent to defraud creditors, or for any other fraudulent purpose, the administrator or liquidator can seek a court declaration that anyone (including current and former directors) who was knowingly party to the fraudulent business make a contribution to the company's assets. This is also potentially a criminal offence under the Companies Act 2006.
- 2.4.3 **Misfeasance:** if, in the course of winding up the company, it appears that a director (or former director) has misapplied or retained, or become accountable for, any money or other property of the company, or been guilty of any misfeasance or breach of any other fiduciary or other duty (such as the duty to take into account the interests of creditors where that duty applies), the court may order the director to repay the money or property with interest or contribute such sum to the company's assets by way of compensation as the court thinks just.
- 2.4.4 **Disqualification:** A disqualification order may be made against a director if the company becomes insolvent and such director's conduct makes the director unfit to be concerned in the management of a company. Cases refer to a variety of forms of misconduct, including breach of standards of commercial morality, danger to the public and gross irresponsibility. If such a disqualification order was made against a director, for a specified time, such director would not be able to be a director of any company or directly or indirectly, in any way, be concerned or participate in the promotion, formation or management of a company without the permission of the court. A disqualification order may be made for a period of between two years and fifteen years.

3 Application of directors' duties to CWLEP strategic options

	Option 1 (retention of the CWLEP)	Option 2 (solvent liquidation or strike-off)	Option 3 (insolvency)
Position of existing directors	<ul style="list-style-type: none"> • Decision-making processes: The directors will need to continue to consider the general directors' duties as part of their usual decision-making process about CWLEP. For example: <ul style="list-style-type: none"> ○ Promoting the success of CWLEP and acting in powers: The directors will need to consider whether the retention of the CWLEP under the on-going company model, but with different members will promote the success of CWLEP for the benefit of its members as a whole. In the context of the CWLEP, this will include consideration of whether or not the proposed retention of the CWLEP will fulfil the CWLEP's objects or purpose as set out in the Articles – namely, the promotion and furtherance of the economic, cultural and social well-being of, investment and growth in, and economic development and regeneration and employment in the Local Authorities administrative areas. This is also relevant to the directors' obligation to act within 	<ul style="list-style-type: none"> • Decision-making processes: The directors will need to continue to consider the general directors' duties as part of their decision-making process. <ul style="list-style-type: none"> ○ The same considerations will apply as set out in Option 1. ○ In addition, the constitution of CWLEP may need to be amended to allow directors to act in accordance with the company's constitution (which currently restricts the distribution of assets to the Local Authorities). • Liability of directors: Powers of directors cease upon the voluntary appointment of a liquidator (unless the members or liquidator sanction their continuance) but this does not fully discharge the directors from their directors' duties (though they are much more limited in scope). This will not apply on a strike-off application, where the directors' duties will continue in full until dissolution. • Additional responsibilities on as part of entry into liquidation or strike off application: The directors may have additional responsibilities 	<ul style="list-style-type: none"> • Modified s.172 CA 2006 duty (the "Creditors' duty"): Directors are required to take into account the interests of CWLEP's creditors from the time when they form (or ought to form) the view that CWLEP is insolvent (in this context, this means that its assets are exceeded by its liabilities (the balance sheet basis) or that CWLEP cannot pay its debts as they fall due (the cash-flow basis), or is bordering on such an insolvency. The closer an insolvency becomes, or the more likely, the more the interests of the creditors must be prioritised. • Wrongful trading: if a director allows CWLEP to continue to incur liabilities at a time when they know, or ought to know, that there is no reasonable prospect of the company avoiding an insolvent liquidation or insolvent administration (in this context, meaning on a balance sheet basis), they may incur personal liability for the losses sustained by the CWLEP's creditors. • Reviewable transactions: As part of the liquidation process, the

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Option 1 (retention of the CWLEP)	Option 2 (solvent liquidation or strike-off)	Option 3 (insolvency)
<p>their allotted powers.</p> <ul style="list-style-type: none">○ Conflicts of interest: The directors should continue to ensure that any interests that they may have in any proposed or existing arrangements or transactions are fully declared to ensure that they can benefit from the safe harbour provisions contained in the Articles.○ Reasonable care, skill and diligence: Directors should continue to exercise a reasonable level of care, skill and diligence (regardless of the fact that they intend to subsequently resign). This may include holding and attending board meetings regularly, taking professional advice where required and actively supervising CWLEP's activities (to a level commensurate with the director's role – a non-executive director may need to do less to discharge their duty than an executive director).● Liability of directors: Liability of directors appointed by the private sector members will cease upon resignation, save for any responsibilities that continue post resignation (as set out above).	<p>depending on the preferred route of dissolution (e.g. considering and declaring a solvency statement in the case of a members' voluntary liquidation, or ensuring that the conditions for voluntary strike off are met before making the necessary application).</p>	<p>liquidator will review antecedent transactions with connected persons to assess whether or not they should be challenged e.g. on the basis of a transaction at an undervalue or preference.</p>

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	Option 1 (retention of the CWLEP)	Option 2 (solvent liquidation or strike-off)	Option 3 (insolvency)
<p>Position of the existing directors if such directors resign and/or are replaced prior to implementation or entry into insolvency</p>	<ul style="list-style-type: none"> • Effect of resignation on existing directors' duties: Most of the general directors' duties will cease on resignation. Directors will remain liable for any breaches of their general statutory and other duties committed prior to this time. The potential residual duties and other consideration set out in paragraph 2.2 above may be relevant: <ul style="list-style-type: none"> ○ Conflicts of interest: Position of any current directors appointed by the Local Authorities needs to be carefully considered. ○ Other directors' breaches/unrealistic future planning: Directors may not avoid responsibility for breach of duty where they are responsible for planning the future plans of the CWLEP and such plans would constitute a breach of duty, notwithstanding that they may not implement the actual plans. 	<ul style="list-style-type: none"> • Effect of resignation on existing directors' duties: Most of the general directors' duties will cease on resignation. Directors will remain liable for any breaches of their general statutory and other duties committed prior to this time. The potential residual duties and other consideration set out in paragraph 2.2 above may be relevant: <ul style="list-style-type: none"> ○ Conflicts of interest: Position of any current directors appointed by the Local Authorities needs to be carefully considered. ○ Other directors' breaches/unrealistic future planning: Directors may not avoid responsibility for breach of duty where they are responsible for planning the future plans of the CWLEP and such plans would constitute a breach of duty, notwithstanding that they may not implement the actual plans. 	<ul style="list-style-type: none"> • Resignation to avoid responsibility for insolvency: Resignation will not absolve outgoing directors from responsibility. Resignation may itself be treated as a failure by the director to take every step with a view to minimising the potential loss to the CWLEP's creditors for the purposes of the defence to a claim for wrongful trading (see paragraph 2.4.1 above). • Grounds for resignation: Directors should consider resigning primarily where they disagree with the approach that the majority of the company's board proposes to adopt or where the majority of the board refuses to adopt proposals made by such director concerning the steps to be taken to deal with the company's financial difficulties.
<p>Practical steps to mitigate potential risks to directors</p>	<ul style="list-style-type: none"> • Board minutes: Ensure all board meetings are fully minuted and directors' decision making processes (including consideration of their directors' duties) are recorded. • Member authorisation: Consider seeking prior formal member 	<ul style="list-style-type: none"> • Board minutes: Ensure all board meetings are fully minuted and directors' decision making processes (including consideration of their directors' duties) are recorded. • Consider merits of solvent liquidation vs voluntary strike-off: A 	<ul style="list-style-type: none"> • Board meetings: Hold regular full board meetings and ensure that all meetings are minuted fully and as soon as possible following each meeting. • Financial records and position: Ensure that the financial position of

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<p>authorisation from CWLEP’s members to the proposed actions to limit the scope for future claims for breach of duty (though some limits exist on the ability to authorise a breach of duty)</p> <ul style="list-style-type: none"> • Realistic long-term planning: Regardless of whether or not the current directors resign, the current directors should act as if they were planning to implement the strategic option without resigning to avoid putting in place unrealistic long-term plans. • D&O insurance: Review the terms of any D&O insurance policy to ensure that it adequately covers current and former directors. • Professional advice: Continue to take professional advice to support decision making. 	<p>formal liquidation process offers superior protection for the company and its directors from creditors, but is more expensive.</p> <ul style="list-style-type: none"> • Member authorisation: Consider seeking prior formal member authorisation from CWLEP’s members to the proposed actions to limit the scope for future claims for breach of duty (though some limits exist on the ability to authorise a breach of duty). • Realistic long-term planning: Regardless of whether or not the current directors resign, the current directors should act as if they were planning to implement the strategic option without resigning to avoid putting in place unrealistic long term plans. • D&O insurance: Review the terms of any D&O insurance policy to ensure that it adequately covers current and former directors. • Professional advice: Continue to take professional advice to support decision making. 	<p>CWLEP is monitored regularly and accurate financial records maintained.</p> <ul style="list-style-type: none"> • Professional advice: Take professional advice as soon as possible aimed at reviewing whether insolvent liquidation is inevitable or whether there is some way of resolving or mitigating the company’s financial difficulties. • Reviewable transactions: Any transactions with parties which are “connected” with CWLEP for the purposes of insolvency law (e.g. the Local Authorities and the directors of CWLEP) at any time where there is prospect of insolvency should be very carefully considered (with the benefit of professional advice) prior to implementation to avoid entering into any reviewable transactions. • New liabilities: Do not allow CWLEP to incur any new substantial liabilities until it is clear how such liabilities will be paid. • D&O insurance: Review the terms of any D&O insurance policy to ensure that it adequately covers current and former directors.

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To discuss any of the issues raised in this document please contact:



Poppy Short
Partner, Corporate
T: +44 (0) 1223 222398
E: poppy.short@mills-reeve.com



Sam Sutton
Senior Associate, Corporate
T: +44 (0) 1603 693312
E: sam.sutton@mills-reeve.com