David Webster offers clarification of the roles and responsibilities of directors and partners under different business arrangements

What's in a name?

The choice of title given to those occupying senior roles in a business should be simple, and often is. However, well-meant intentions to bestow a particular status on an individual that does not reflect their actual standing, a blurring of terminology across different types of business structure, and a lack of appreciation of the responsibilities that particular roles entail can all cause confusion.

While the prospect of promotion to director or partner is understandably seized on, the benefits come with additional risks. These should not necessarily be determinative, but it is vital that for the benefit of both the individual concerned and the underlying business they go into this change of status with eyes open.

Roles and structures

The most common vehicles in modern business are limited companies and limited liability partnerships (LLPs). In addition, many general partnerships still exist. These are not legal entities in their own right, but rather businesses that exist by virtue of an agreement between the partners to carry on business together. They are usually smaller organisations that have partnership status either for historical reasons or for simplicity of administration.

For convenience, unless noted I use the term 'partner' to refer generically to partners in a general partnership and members of an LLP. The specific position of directors of listed companies is not considered here.

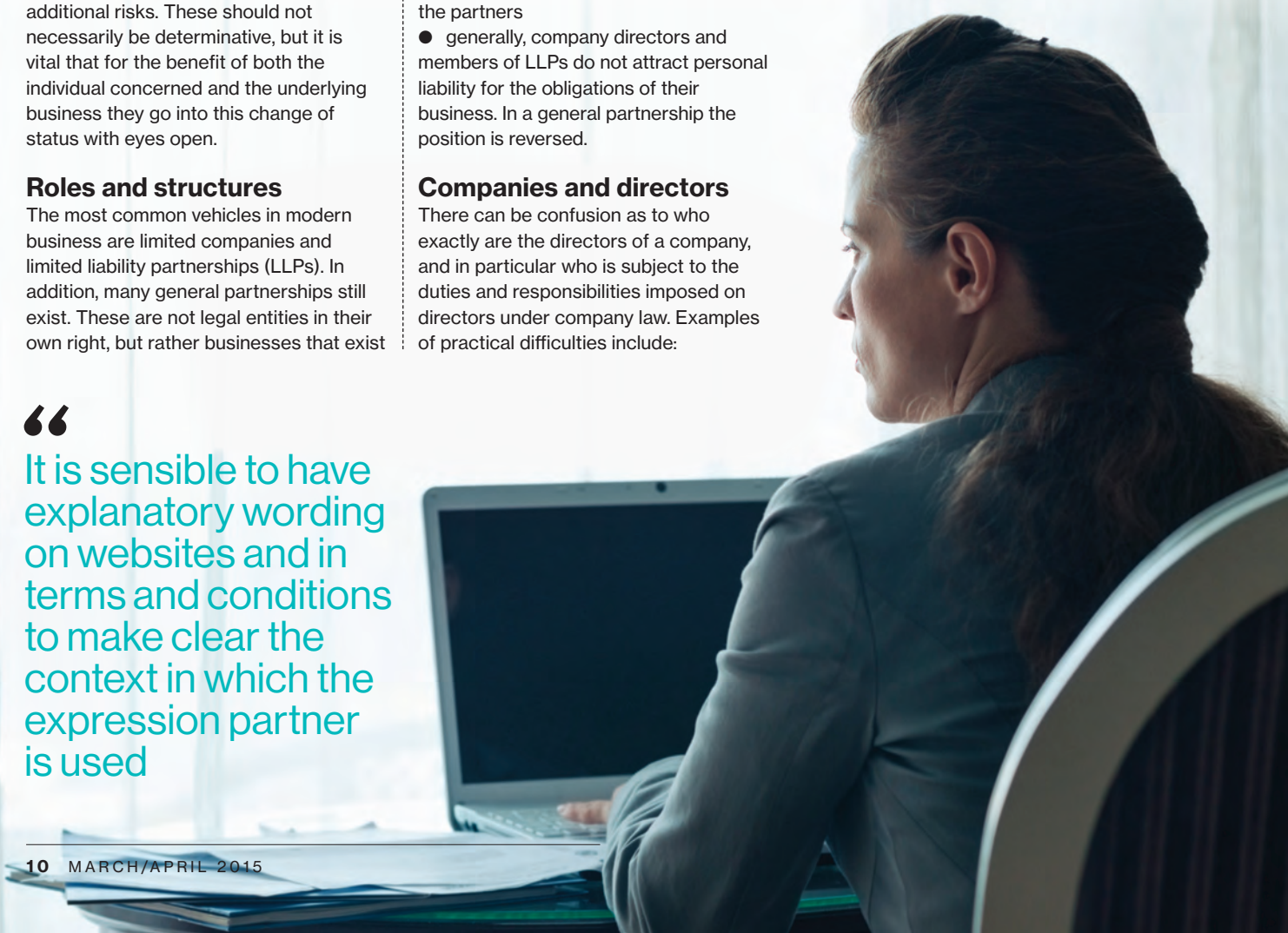
Two of the most relevant differences between the various structures are:

- companies have a legal separation between management (represented, ultimately, by the board of directors), and ownership (shareholders). In LLPs and general partnerships both are vested in the partners
- generally, company directors and members of LLPs do not attract personal liability for the obligations of their business. In a general partnership the position is reversed.

Companies and directors

There can be confusion as to who exactly are the directors of a company, and in particular who is subject to the duties and responsibilities imposed on directors under company law. Examples of practical difficulties include:

- while all those validly appointed as a director should be registered as such with Companies House, this registration only records the fact, it is not an appointment in itself
- directors generally have to be appointed by shareholder or board resolution; an individual does not become a director in the company law sense by having their job title changed to include the word
- conversely, it is not possible to escape the responsibilities of a director by avoiding formal appointment and/or registration; the provisions of company law relating to directors can also apply to:
  - shadow directors (someone in accordance with whose 'directions or instructions' the directors of a



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company are accustomed to act)
- *de facto* directors (someone who acts as a director without having been validly appointed).

Directors normally benefit from the limited liability of a company, and while acting in good faith will not usually suffer personal exposure to company obligations. However, this rule is not without exceptions. For example, those in smaller practices should ensure that business materials and correspondence (e.g. website, formal letterhead, email footers, signatures, business cards) make clear the capacity in which they are operating. If dealings with a client do not convey that you are acting on a company's behalf, you could be deemed to be acting in a personal capacity.

Directors in these practices should also be aware of the possibility of being required to give a personal guarantee, especially to banks/landlords. Being a director does not make this mandatory but it does mean that you are more likely to be in the firing line if a guarantee is demanded.

Generally, where company law imposes personal liability on directors for company obligations, an element of quasi-criminal behaviour is required, or at least a breach of duty. One important exception is 'wrongful trading' under section 214 of the Insolvency Act 1986. If a company enters insolvent liquidation, a director may be required to contribute to its assets if at some point before the commencement of the winding-up process they knew or ought to have known there was no reasonable prospect of it avoiding insolvent liquidation. However, it is important to note that while this emphasises the importance of behaving properly when a company is in financial difficulties, there is no offence or liability attaching to continuing to trade while insolvent *per se*.

For employees who are not also directors, their legal position with the company is governed almost exclusively by employment law and the employment contract. Once appointed as a director, the individual will retain their employee status, but have the additional company law status of director, with the additional rights and (mostly) responsibilities that entails. Individuals should be particularly aware of the statutory duties imposed by the Companies Act 2006 *(http://bit.ly/1zyjZrZ).*

One option for individuals who have concerns in this area is directors and officers (D&O) liability insurance, a policy that the company takes out for directors and officers to cover liabilities arising in the course of their activities. There are limits to what this can cover, but it can offer vital financial assistance if things do turn sour. Claims under D&O insurance are fairly rare in practice, but the reassurance provided by this type of policy can make it easier for directors to operate in a genuinely commercial way, rather than following an unnecessarily risk averse approach.

LLPs

LLPs, like companies, benefit from limited liability. Accordingly, many of the considerations set out above apply equally. As well as general legal concerns, members of an LLP will invariably be party to a members' agreement. It is vital that (potential) members familiarise themselves with its provisions and that the agreement is appropriately drafted for the particular business.

The agreement will generally deal with, for example, the extent of duties owed by individual members both to the LLP and other members.

As a legal entity created by the Limited Liability Partnerships Act 2000, an LLP has members rather than partners. Nevertheless, it is relatively common commercial practice for members of LLPs to use the term partner. Some academics have suggested that this exposes members to risk of partnership-style personal liability. This is extremely unlikely, but it is sensible to have explanatory wording on websites and in terms and conditions to make clear the context in which the expression partner is used.

Unlike companies, LLPs are tax transparent – so genuine members (as opposed to employees) are taxed as if they were self-employed. This can bring benefits in terms of tax savings. However, over the past year HMRC has been clamping down on those it deems to be employees claiming self-employed status as members of LLPs. Accordingly, to avoid being taxed as employees LLP members need to be self-employed as a matter of substance as well as form – for many professional practices this has seen a wave of recent capital injections from more junior members.

But it should be remembered that loss of employee status, while bringing tax savings, does mean the loss of many of the protections that employment law brings, such as from unfair dismissal.

Partnerships

Unlike companies and LLPs, partners in a general partnership will have joint and several personal liability to third parties. Any individual considering becoming a partner should therefore carefully consider both the prevailing legal and commercial context (such as insurance arrangements, the partnership's financial condition, and the provisions of the partnership agreement that regulate liability as between partners themselves), and the general risk profile of the business.

In this context it is worth noting that any partner can commit the partnership as a whole to a liability, which then becomes a joint responsibility of all the partners.

Similar issues to those on LLPs apply in relation to the tax treatment and employment status of partners.

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