

# Directors' Service Agreements

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Note: This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

## Introduction

An Executive Director has rights and obligations arising as an employee as well as a director of the company. It is important to remember that these two roles are separate but related. A director's Service Agreement is a more complex contract of employment than the basic contract of employment. It can comprise one or more documents but generally the main terms will be contained in the Service Agreement.

The Service Agreement will usually incorporate the following information and provisions:

- Names and address of the parties including the registered office and registered number of the company. Where a company trades under a trading name or a trading division, the proper legal name of the company should be used although this may be followed by "trading as....";
- Date that the employment has commenced or will commence;
- Period of employment. This may:
  - (a) commence on a specified date and continue until terminated by notice given by either party. The period of notice to be given by the director to the company need not be the same as that to be given by the company. The minimum period of notice that is generally contained in a director's Service Agreement is 6 months but it can be 12 months or longer depending on the seniority of the director and whether this is a new contract or the re-negotiation of an existing contract; or
  - (b) be for a specified period and thereafter subject to notice given by either party; or
  - (c) be for a fixed term of months or years.



## Special Clauses and Provisions

### Payment in lieu of notice

In the case of directors, it is particularly important for the company to reserve the right to give pay in lieu of part of or the whole of the notice period. If the company does not have this right, it will be in breach of contract should it proceed to do so. A party that is in breach of a contract can no longer rely on its terms, which means that the company will be unable to enforce any post termination provisions, such as restrictive covenants.

With a new appointment this will be the date the current employment commences but if the director is being issued with a new contract, the date will be the date that employment originally commenced whether or not the individual was a director at that time.

### Job Title

This should include ability for the company to assign the director to other duties (both within the company and a group company if relevant) that are commensurate with his or her status as a director and to require the director to act as an officer of other group companies for no additional remuneration or fees.

### Restrictions

It is usual to prohibit a director from engaging in business or professional activities outside the employment other than holding a minimum number of shares (generally 3%) in a publicly quoted company.

### Best Interests Clause

It is implied in every director's contract that the director will act in the best interests of the company at all times and in good faith but it is usual to include this in the contract as a specific term. The Service Agreement may include provisions to ascertain the standard of performance to be achieved by the director.

### Duties

A director should understand and abide by the duties incumbent on him/her as laid down by the Companies Act.

Note – it used to be possible to exclude the right to claim unfair dismissal and a statutory redundancy payment if a fixed term contract came to an end simply by expiry of the term. This is no longer the case.

### Directors Duties

As part of the Companies Act 2006 the Government has codified the duties of directors so that from October 2008 directors are expected to:

- act in a way that promotes the success of the company for the benefit of all the shareholders;
- take account of the **company's need** to foster relationships with its employees, customers and suppliers, its need to maintain its business reputation and its need to consider the **company's impact** on the community and the working environment;
- to exercise the care, skill and diligence of a reasonably diligent person with both the knowledge, skill and experience which may reasonably be expected of a director in his/her position and with any additional knowledge, skill and experience which the particular director has;
- exercise his/her powers for their proper purpose, use independent judgement when exercising those powers and will not be able to delegate powers unless authorised by **the company's** constitution;
- not to be able to transact with the company or allow the company to enter into transactions if he/her has an interest therein which he/her is required to disclose but has not disclosed; and
- not to accept any benefit conferred by a third party because of his/her powers or by way of reward for the exercise of those powers unless (a) the benefit is conferred by the company, or (b) the company has consented to it by ordinary resolution, or (c) the benefit is necessarily incidental to the proper performance of the **director's functions**

subject always to the director acting within the **company's constitution** as well as avoiding conflicts of interest.

## Warranty - Previous Employment

Many directors are subject to restrictions post termination of employment and in the case of a new appointment, it is advisable to include a warranty that in entering into the Service Agreement, the director will not be in breach of any previous contract or obligation.

## Directors' and Officers' Insurance

If the company is to maintain directors' and officers' insurance, the director will usually want the comfort of including this obligation on the company in the Service Agreement.

## Hours of work

Although a director will normally be required to work the hours that are necessary to carry out the functions of the job, the normal working hours of the company should be stated. The Service Agreement should also refer to The Working Time Regulations 1998 and the contents of the Agreement will depend on the degree to which the director can be said to be in control of the hours that are worked.

## Place of Work

The normal place of work should be stated with the flexibility to allow the company to change this as may be reasonably required from time to time. As a related but separate matter most companies need the contractual ability to require the director to travel and work on business both in the UK and, if appropriate, abroad.

## Pay

A Clause is required to cover Pay including the amount, the fact that it accrues from day to day, when it is payable, how it is payable and whether it includes all director's fees. It is also usual to include any mechanism to review salary (for example, through a remuneration committee) and whether there is any automatic increase such as an increase in line with the RPI. The company should reserve the right to make deductions from salary for any amount that is due to it from the director, both during the term of the agreement and on its termination.

The provision of benefits, if any, should also be covered - see separate section on "Benefits" on page 5.

## Process for the director to reclaim expenses

It is usual to reimburse directors for reasonable travelling and other expenses properly incurred in the course of the director's duties. Receipted accounts should be provided by the director and some companies require the director to obtain authority in advance.

## Provisions relating to absence due to sickness or accident

These should indicate if the director is entitled to payment of normal salary and if so, for how long. It is usual to state that any payment includes any entitlement in respect of statutory sick pay. In the event of the director being able to make a claim for damages against anybody responsible for the sickness or accident, the agreement will frequently state that salary paid in these circumstances is to be treated as a loan and repayable in the event of the director having a claim against the third party. It is common to include a provision to adjust entitlement to bonus in the event of long-term absence due to sickness or accident.

In the case of long term absence it is also common to provide the company with the right to terminate the employment on a shorter period of notice than would normally be the case. Such a prolonged period may be defined by reference to both a continuous period of absence and several short-term absences within any period of, say, twelve calendar months.

It is advisable for the Service Agreement to state that the company has the right to require the director to be examined by a medical practitioner from time to time throughout the employment and that the director will consent to such examination and for the results to be disclosed to and discussed with the company.

Note – it is always advisable to take into account any claim or potential claim that the director may have under permanent health or disability insurance scheme of the company. Some schemes require the individual to remain as an employee even though no longer entitled to draw salary.

## Directors Indemnities

From 6 April 2005, companies can indemnify their directors in relation to non-criminal liabilities to third parties and to fund director's defence costs incurred in civil and criminal proceedings (subject to refund if judgment is given against the director or the director is convicted). Indemnities against directors' defence costs will be possible where the action is taken by the company itself but is settled out of court or ends in favour of the director.

Unfortunately, these new provisions will not automatically apply and in most cases it will be necessary to amend the company's Articles of Association to take advantage of them. The drafting of the indemnity is crucial, as an indemnity that goes beyond the scope of the new legislation is void in its entirety.

## Protecting the company's confidential information

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It is common practice to provide that the director shall not disclose confidential information of the company or its clients, nor make copies of such information, or retain after leaving the company such information or copies of it. It is also common to provide that all inventions made during, or in connection with the employment are the property of the company.

To avoid misunderstanding, the Agreement should specify in as much detail as possible, the information that the company considers to be confidential. It should also specify that wherever possible, confidential information shall be identified as such at the time it is disclosed to the director but failure to mark information in this way will not preclude it from being confidential.

Provisions relating to inventions should provide that if the company does not wish to patent or to exploit them, the director shall have the right to apply for patents and to exploit them.

The company should have a policy controlling copyright in papers written by employees for publication in journals or delivered at seminars. Unless the company retains copyright, this may pass to some third party such as the publisher and be used by competitors or others.

Note - employees may enjoy statutory protection in respect of disclosures they make concerning criminal offences, danger to health and safety, damage to the environment, failure to meet legal requirements, miscarriage of justice, or concealment of any of these. There are restrictions on the circumstances under which such protection is granted.

## Retirement

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The agreement should specify the normal retirement date for employees of the company and a statement that the employment will automatically terminate on the director reaching that age or at the end of the month during which the birthday falls. It is also usual to state that the employment will automatically terminate if the director is prohibited by law from being a director.

## Termination

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The agreement should cover the circumstances under which the company can terminate the agreement without notice or payment in lieu of notice (otherwise known as summary dismissal). These usually include circumstances where the director:

- (a) commits an act of gross misconduct or continues in breach of the Agreement after warnings;
- (b) is convicted of any criminal offence (parking and similar specified offences are usually excluded);
- (c) becomes bankrupt or makes an arrangement with creditors;
- (d) resigns or vacates the office of director without consent;
- (e) engages in conduct tending to bring the company into disrepute;
- (f) is in the opinion of the Board incompetent in the performance of his or her duties.



## Return of company property

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The company should have the right to require the return of company property in the possession or control of the director at any time either during or at the end of the employment. It should be specified that such property will be returned promptly, in good condition, at the cost of the director and that no copies of documents or such items will be retained.

## Attorney Clause

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It is sometimes specified that if a director fails to complete or sign any documentation required on termination of employment, one of the other directors for the time being is entitled to do so as the director's attorney. If this provision is included, it is necessary for the Service Agreement to be executed as a deed.

## Garden Leave

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It is useful for a company to have the right to require a director to serve part of or the whole of the notice period on garden leave meaning that the director is prohibited from entering company premises, having access to the company's computer systems or having contact with company clients, suppliers and employees. If a company wants to proceed in this way it must have the right in the Service Agreement and it is important to state the terms of the garden leave in writing to the director at the time that it commences, for example, that the director is prohibited from working for others during the period and that apart from the duty to work, the terms of the contract of employment will continue, including payment of basic salary. Some companies retain the right to appoint a replacement for a director on garden leave.

## Restrictive Covenants

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Most Service Agreements will contain restrictions that will apply both during and after termination of employment. In order to be enforceable post termination restrictions must be carefully drafted, be considered to be in the public interest and restrict no more than what the courts refer to as a company's legitimate business interest. Restrictive covenants should be tailored to each specific company and often to each specific director depending on the circumstances of the business and the individual. Any period of restriction after termination of employment must be reasonable and the Agreement should state that time spent on garden leave will be set off against the period of restriction after the employment has come to an end.

## Disciplinary Matters

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Many companies state that directors are not subject to any specific disciplinary rules but that all disciplinary matters will be dealt with by the Board. Similarly grievances are normally referred to the Board. It is important to try to ensure that any appeal against a disciplinary matter or a grievance is heard, and decided, by persons different to those to whom the director puts a grievance or who disciplines the director. Some companies retain the final appeal to the Chairman (who should not have taken part in the earlier parts of the proceedings). A director, in his capacity as an employee, may have a claim for unfair dismissal if the procedures followed are not fair in all the circumstances. It is useful for a company to retain the right to suspend a director (usually on full pay and benefits) for a reasonable period of time in order to investigate a disciplinary matter. The Service Agreement should state that a director who has been suspended is prohibited from entering company premises and contacting clients and suppliers, as under garden leave.

## Data Protection Act

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The company is inevitably going to be processing personal data on the director. The Service Agreement should therefore reserve the right for the company to process such information in accordance with The Data Protection Act 1998.

## General

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If a contract comprises more than one document, it is advisable to stipulate which (such as the Service Agreement) prevails in the event of conflict between any of them. Care must also be taken to avoid conflict with the Memorandum and Articles of Association of the company.

If a standard form of Service Agreement is used in respect of all directors of the company, matters that are private, (such as salary), or which vary between individuals (such as to ascertain the standard of performance to be achieved and restrictive covenants) may be set out in an attachment provided it is clear within the Service Agreement that the attachment forms part of the contract.

Difficulties may arise in respect of the taxation of benefits and expenses in the hands of individuals. Restrictive covenants also need careful drafting. Accordingly, both the company and the director should seek the advice of Solicitors having specialised knowledge of employment law.

If necessary, the date of the Agreement and the date on which the employment, or any other provision, is to take effect may differ from one another. The date of the Agreement should be that on which the last party to sign does so. It is unlikely that it can be inserted in advance; it must not be backdated.

As in the case of any contract of employment, no provision in the Agreement may be varied by the company without the consent of the director. The Agreement must be approved by the Board and signed by whoever it authorises. Accordingly, the director should obtain confirmation that such approval has been given, and that the company's signatory is so authorised.

## Law and Jurisdiction

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The Service Agreement should state that it is subject to the Laws of England and the exclusive jurisdiction of the English courts and Tribunals (or, if applicable, the laws of the country in which the director works).



## Benefits

These may include:

### Bonus

The wording of any bonus entitlement should be very carefully drafted. Note that even if a bonus is stated to be discretionary, a court may hold that there is a contractual right to participate in the scheme, depending on the wording of the clause, the basis on which the bonus is calculated and other relevant circumstances. The Service Agreement or other document will need to be clear about the basis on which the bonus is calculated, when it is paid and whether termination of employment will affect the director's entitlement to bonus, including any time spent on garden leave.

### Private medical insurance for the director and family if relevant

It is important to strike a balance between giving details which may change and inserting provisions that lack certainty. The company should reserve the right to change the service provider.

### Company car

Provision should be included covering who may drive and who pays for what, especially private mileage and whether the car can be taken abroad. If the insurance is comprehensive, this should be stated. If a car allowance is given it is usual to state that the amount is non-pensionable. The use of the car will usually be subject to company regulations.

### Holiday entitlement

Holiday entitlement should indicate the dates of the company's holiday year and whether holiday can be taken over from one year to the next. A company usually reserves the right to require a director to take unused holiday entitlement in the notice period. There should also be a method for calculating a payment to the company or the director in the event of the employment terminating and the director having accrued holiday or where holiday has been taken by the director in excess of entitlement.

### Pension arrangements

These will vary depending on whether the company has an occupational pension scheme that the director will join. In these circumstances it is possible for the Service Agreement to refer to the Deed and Rules of the Scheme. Again, it is important for the contract to retain flexibility for the company to terminate the Scheme and the director's membership of it. This will usually be subject to the company having a contractual obligation to procure the director's participation in an equivalent scheme. Alternatively, the company may agree to make contributions of an agreed percentage of the director's basic salary into a personal pension.

### Permanent health and/or disability insurance

If the company is to provide cover for permanent health and disability insurance, a Clause should be included specifying what is covered and when a claim may be made.

## Further Information

This guide is for general interest - it is always essential to take advice on specific issues.

We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

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