Feature

KEY POINTS

- A director appointed by a board to negotiate and execute a loan facility acts as the company's agent, the terms of which agency can be varied or revoked.
- A board should consider the terms of such delegation carefully and provide appropriate supervision once an appointment is made.
- Changing circumstances can alter the suitability of approved loan agreements, and existing authority may no longer be sufficient to cover new terms.
- The remaining members of the board and the appointed director(s) should be alive to the possibility of changes, and act in accordance with their duties to the company at all times.
- The article makes some suggestions for best practice in relation to both companies and lenders.

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Pitfalls with board resolutions authorising loan facilities

directors sometimes express doubt as to what role a company's board should play, once authority to negotiate and enter into a loan facility has been delegated to one or more of their number. if new terms are offered or circumstances change, which alter the suitability of the proposed finance, what can, or should the remaining directors do? in turn, what should the appointed director(s) do? this article explores some of the issues and considers how some pitfalls might be avoided.

INTRODUCTION

After resolving to borrow, for convenience or perhaps reasons of urgency, boards will commonly delegate the process of finalising arrangements to a particular director or group of directors.

Such resolutions will give varying degrees of flexibility to the appointee. A director might be given a wide discretion to source, negotiate and enter into a facility; but, more commonly, resolutions are made by reference to draft documentation, where proposed terms with a particular lender are already in an advanced, if not final, form.

Where the execution of draft documents appears to be nothing more than a formality, the board may feel that it has no further role to play and can rely upon the appointee. In turn, the authorised director may feel that he need give little further thought to the matter, beyond ensuring that he gets the loan across the line on the approved terms.

However, the directors would be wrong to make these assumptions. Both the appointed director and the rest of the board must, to at least some degree, continue to assess the suitability and circumstances of the loan after a resolution to enter into it has been agreed. Much can change between such a resolution and the actual execution of a facility. Appointed directors and boards should be astute to potential legal pitfalls.

THE DELEGATION

Assuming that it is permitted by a company's constitution, there is nothing wrong in principle with the board delegating borrowing decisions. Most company articles permit directors to delegate their powers as they see fit (eg Table A,[1] Art 72; Model Articles, Art 5 for both private and public companies). Sometimes, articles expressly provide for certain powers, authorities or discretions to be exercised by the board alone; but these will also often include a provision clarifying the circumstances and extent to which these powers can also be delegated.

When meeting to assess a proposed facility and what role should be delegated, the members of a board will be required to act in accordance with their duties in the usual way. This includes their obligation to act with care, skill and diligence (s 174 Companies Act 2006 (CA 2006)) and to promote the interests of the company (s 172 CA 2006).

A board will therefore need to give careful consideration to the terms of reference authorising the relevant director to finalise and execute the proposed loan. It will not be enough just to appoint any director to undertake the task: consideration should be given to the suitability of the person chosen, taking into account their expertise, experience and the responsibility they are being given. It is also important that the board addresses what measures are needed in the circumstances to monitor and supervise the appointment. The more significant the proposed facility, the more important these considerations will be.

Once a decision has been made to delegate to an appointee, the remaining members of the board cannot simply wash their hands of the matter. Their continuing duty to exercise reasonable care, skill and diligence will require them to engage with the systems they have put in place for checking the performance of the authorised director, and also "to be sufficiently informed about the nature of the company's business to understand the warning signals which the supervisory system may generate" (*Palmer's Company Law* at 8.2818).

As with any form of delegation in a company, a balance must therefore be struck between the convenience of entrusting one person to carry out a function on the board's behalf, and the board's ultimate supervisory responsibility for managing the conduct and affairs of the company.

CHANGES IN CIRCUMSTANCES

Even with loan documentation at an advanced stage, perhaps with execution apparently imminent, circumstances can arise which materially alter the commercial justification for the loan, or which cause concern about whether the relevant director is still authorised to enter into it.

Such changes might involve an alteration to the terms upon which the facility is offered. A lender might, for example, decide that it wishes to confine the purpose for which the loan is to be used, preventing the business from applying it to its general outgoings at its discretion. Or changes might be proposed to borrowing base structures in a subscription credit facility, substantially reducing its size and

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usefulness. In such circumstances, other lenders might be prepared to offer similar finance, but without the same restrictions. External events can also have an impact, such as an unexpected change in interest rates or exchange rates. Equally internal events, such as the sudden loss of an important client or a large number of investor redemptions, might render the loan unaffordable or no longer needed.

In these kinds of circumstances, both the appointed director and the board will need to give careful consideration to whether any steps should be taken, to ensure that such eventualities are appropriately identified and then what should happen when they are.

EXTENT OF THE AUTHORITY

A director authorised by a board to enter into a loan is appointed as the board's/company's agent. As such, they are obliged to get on and execute their authority with reasonable dispatch. However, they may do no more than act within the authority and powers that they have been given. An appointee may not generally, for example, further delegate any of their powers unless that falls within their terms of reference.

The starting point is therefore to consider whether the board's resolution in fact covers any changes that have arisen, and so whether the relevant director is authorised to act at all. The minutes will likely be construed in accordance with the usual contractual principles that apply to any agent's authorisation.[2]

In construing the board's words, it may assist to take into account what is permitted by the articles;[3] but in many cases these are likely to be of limited direct relevance, and so the minutes may have to be considered on their own terms in the context of the background in which they were made.

Resolutions are usually construed as entitling an authorised person to carry out matters necessary or reasonably incidental to the effective execution of the authority,[4] so immaterial changes to documentation or matters concerning the execution process are unlikely to be problematic.

Where the authority is given by reference to particular loan terms, material changes are likely to mean a relevant director is not authorised to execute them. The relevant director will therefore have to return to the board, or risk the consequences of exceeding their authority and becoming liable for any loss caused.

In accordance with general principles of contractual construction and agency, authority beyond the express terms of a resolution may sometimes be inferred from the conduct of the board and the circumstances of the case.[5] As noted in *Bowstead & Reynolds on Agency* 23rd ed at 3-043:

> **"Thus in *Hely-Hutchinson v Brayhead Ltd* [1968] 1 QB 549 the chairman of a company acted as de facto managing director and chief executive of it, and entered into larger transactions on its behalf which he would sometimes merely report to the board without seeking prior authority or subsequent ratification. The Board acquiesced in this course of dealing. The chairman was held to have had actual authority equivalent to that of a managing director, though he was acting beyond the normal powers of a chairman."**

Equally, such conduct or circumstances can mean that limits are implied on an otherwise permissive authority. The extent to which such circumstances will impact the construction or extent of an authority will necessarily depend on the particular facts of each case.

If, for example, there was a sharp increase to prevailing bank base rates, or the company suffered a sudden financial downturn so as to transform the impact of the proposed loan, it might be implied that an authority given to enter into a loan agreement would come to end in such circumstances.

This could be the case even where the authority gave a wide discretion to the director to enter into the loan agreement and to make such changes as that director sees fit, which is a commonly used form of wording. If the authority was premised upon a particular set of assumed circumstances, then the wide discretion would need to be understood in that context. An analogy might perhaps be drawn with the purview doctrine in the context of guarantees and anti-discharge provisions.

In more extreme circumstances, such changes of circumstances might be considered to be events that frustrate the purpose of the authority, so as to bring it to an end. In less extreme ones, it may be that an appointee ought reasonably to infer that the board would not wish his authority to continue, in which case it would again come to an end. When in material doubt, the likelihood is that the director, acting reasonably, would be expected to return to the board for guidance or a further resolution.[6]

CONTINUING ROLE

Whether or not there is a sufficient authority to meet the changes that have arisen, the directors' duties will require them to consider their significance. If, therefore, either the authorised director or any member of the board believes that new terms should be rejected, or that the loan should not otherwise be agreed, they should take steps to address the position.

This might be particularly important if the financial position of the company changes, so as to put the company at probable or greater risk of insolvency. Such an eventuality may require weight or greater weight to be given to the interests of creditors than was the case when the matter was first addressed.[7] Obviously, if the company enters actual or provisional liquidation, the authority would likely terminate in any event (*Pacific and General Insurance Co Ltd v Hazell [1997] L.R.L.R. 65*).

If there is a disagreement between any of the directors, including but not limited to the authorised director, then the matter will have to be resolved at board level. The board is entitled at any point to revoke the authority that it has previously granted. Thus, even if there is sufficient authority under an existing resolution, the board can stop a director who intends to press on with an existing arrangement. Equally, the board is entitled to revisit the terms that it previously considered to be appropriate and alter the terms of the authority accordingly. If a previously authorised director is against the majority of the board, or in other appropriate circumstances, the majority may prefer to appoint another.

BEST PRACTICE: THE COMPANY

In many cases, best practice will be to try and get documents into an agreed form before authorising any execution and the signing of minutes. Delegation of a wide discretion may only be suitable for less significant or problematic funding arrangements.

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Best practice also generally requires that consideration is given to ensuring the relevant person has the requisite skills, knowledge, authority and support to take on the role assigned to them.[8]

The terms of any authority should be carefully considered, so that everyone is clear about its extent and what is reserved to the board. That authority should be communicated clearly to relevant persons within the company and, as necessary, to the proposed lender and others outside the company as well.

The board retains ultimate supervisory responsibility for the company, including risk management, and should continue to review the suitability of any delegated powers.[9] Suitable processes should generally be provided for in the minutes or otherwise put in place to ensure that progress is properly supervised, and these processes should then be followed. This may involve an obligation to report any changes to the draft terms and/or regular updates within a fixed timeframe. The more significant or problematic the loan, the more proper oversight will be needed. Depending on the circumstances, it may be appropriate to identify particular risks in the minutes, or to confirm that any discretion is given on the basis that there have been no material changes to the company's economic outlook.

Given the possibility that an authorised director might decide to act before the rest of the board have a chance to issue a countermand, consideration might also be given to how potential problems are to be identified. If there is a real concern that an individual might agree an unwanted change, or ignore an important consideration, it is likely that no signing authority should be given. Each case will turn on its facts, and what the board considered appropriate on one occasion may not be fit for purpose on another.

The appointed director will continue to be subject to his duties to the company and will therefore be obliged to reflect on any changes to terms or circumstances before execution. Where such circumstances arise, the director must decide first whether he remains within his authority to execute. Then he must assess whether it is in the best interests of the company to proceed. If he is materially unsure, he would probably be best advised to return to the board for directions and/or a revised resolution. In many cases, it will be advisable for the director to record their decision.

In turn, the rest of the board should consider to what extent (if any) they should accept or are required to challenge or request clarification or documentation to support, any information reported by the authorised director. If any member of the board properly considers that a problem has arisen, they should also look to raise it and convene a further board meeting as necessary, with a view to reviewing matters, giving guidance and, where appropriate, revoking or amending the authority.

BEST PRACTICE: LENDERS

From a lender's perspective, there are a number of ways that the apparent authority of a director might ensure that a financial arrangement is contractually enforceable.[10] However, lenders will not want to rely on such arguments or take any risk that there might be a challenge to those arrangements. It will be important therefore, to require production of a resolution confirming that at a properly convened meeting, at which all relevant interests were disclosed, the board considered the proposed loan arrangement and determined that it was in the company's best interests. The minutes should, to a greater or lesser extent as appropriate, record the reasons behind this decision. They should also refer to and approve the material documents that form part of the arrangement.

Lenders should also ensure that clear authority is given to an identified person or persons to agree any amendments to these documents. The minutes should provide for a suitable signing authority regarding all relevant documents, and for any other steps to be taken that are required by the loan arrangement. It may also be appropriate to require the resolution to cover any drawdown authority.

If what is proposed is an amendment to an existing facility, then this may be covered by the resolution that authorised the original loan. However, if there is any uncertainty or if the change is obviously a material one, further resolutions should be sought. These might be required in any event as conditions precedent or subsequent to the release of any sums. It may also be necessary or appropriate to seek a director's certificate. Subject to the terms of the company's constitution and CA 2006, it may also be necessary or appropriate to seek a shareholder's resolution. ■

1 Link to all model and Table A articles at gov.uk and link to Westlaw version of Table A.
2 For a general discussion of how to construe an agent's authority, see *Bowstead & Reynolds on Agency* 23rd ed, 3-014 to 3-017.
3 *Palmer's Company Law* at 8.2134.
4 *Shackleton on the Law and Practice of Meetings* 16th ed at 9-02 – at (c) and see Bowstead & Reynolds at 3-022+.
5 See the general discussion regarding agents generally in *Bowstead & Reynolds on Agency*, 23rd ed, 3-042-3-044.
6 See the discussion about agents generally in this position in *Bowstead & Reynolds on Agency*, 23rd ed, 10-002-10-003 and at 3-020.
7 Section 172(3) CA 2006 and *BTI 2014 LLC v Sequana SA* [2022] 3 WLR 709.
8 Note the FRC's Corporate Governance Code Guidance published 29 January 2024 and last updated 6 March 2024 (consolidating the three previous guidance documents which supported the 2018 UK Corporate Governance Code, the latter being replaced from 1 January 2025 with the 2024 UK Corporate Governance Code) at paras 229-231.
9 Note the FRC's Corporate Governance Code Guidance published 29 January 2024 and last updated 6 March 2024 including as to risk and internal controls at paras 221-247.
10 Sections 40(1), 44 and 161 of the Companies Act 2006. Also, the company's own articles, eg Art 92 of Table A.

Further Reading:

- Companies Act 2006: checking constitutional documents – business as usual for lenders' advisers? (2010) 5 JIBFL 275.
- *Sequana* in the Supreme Court: cautious confirmation of the creditor-extension to the director's duty of loyalty (2023) 2 JIBFL 74.
- Lexis+® UK: Banking & Finance: Practice Note: Board minutes for the approval of a company's entry into loan and security documents.