

Directors' duties and responsibilities

The purpose of this information sheet is to provide you with an overview of the general duties and responsibilities owed by directors of a company.

Directors are responsible for the company carrying on its business and exercising its powers. Primarily, a director's responsibility is to the company, but responsibility may also be owed to co-directors, employees and creditors of the company. Directors' duties do not fall into distinct categories, but broadly comprise of the general duties of directors set out in the Companies Act 2006 (2006 Act), fiduciary duties, other common law duties and other statutory duties. Any or all of these may be relevant to a particular situation.

1. GENERAL DUTIES UNDER THE COMPANIES ACT 2006 AND FIDUCIARY DUTIES

1.1. Duty to act within powers (section 171, 2006 Act)

A director must act in accordance with the company's constitution and must only exercise his/her powers for their proper purpose (that is, the power for which they were conferred, and not, for example, to protect his/her own position as a director or to make matters difficult for a particular member). You should be aware that this prohibition applies even if the director believes, in good faith, that his/her conduct will promote the success of the company for the benefit of the members as a whole (paragraph 1.2 below).

A company's constitution is widely defined to include:

- (a) The company's articles (including any provisions of the company's memorandum that are deemed to form part of the articles under the 2006 Act).
- (b) Any resolutions and agreements affecting a company's constitution that are required to be filed with the Registrar of Companies.

Directors should familiarise themselves with the constitution of the company, particularly with any limitations on the powers of the company or the directors.

1.2. Duty to promote the success of the company (section 172, 2006 Act)

A director must act in the way he/she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In fulfilling this duty, he/she must have regard to (among other matters) the following factors:

- (a) the likely consequences of any decision in the long term;
- (b) the interests of the company's employees;
- (c) the need to foster the company's business relationships with suppliers, customers and others;

- (d) the impact of the company's operations on the community and the environment;
- (e) the desirability of the company maintaining a reputation for high standards of business conduct; and
- (f) the need to act fairly between members of the company.

If the company is insolvent (or in danger of becoming so), the director's primary responsibility will be to consider the interests of company's creditors, see paragraph 4.

This is essentially a subjective duty and, provided that the director has exercised his/her powers as a director diligently and in good faith, it is irrelevant that his/her conclusion may not be the same conclusion that a court might reach on the same facts.

1.3. **Duty to exercise independent judgment (section 173, 2006 Act)**

A director must not restrict him/herself from exercising independent judgment on the company's behalf. A director cannot agree with any member that appoints him/her to vote at board meetings in any particular way (even if voting in that way would not otherwise be a breach of his/her duties as a director to the company). An exception to this rule is where a director and his/her co-directors decide that entering into an agreement on behalf of the company, under which a director will be bound to vote in such a way as to ensure that the company performs its obligations under that agreement, would be most likely to promote the success of the company for the benefit of its members as a whole.

This duty will not prevent a director from relying on advice, as long as he/she exercises his/her own judgment in deciding whether or not to follow the advice.

1.4. **Duty to exercise reasonable care, skill and diligence (section 174, 2006 Act)**

A director must exercise due skill and care in fulfilling his/her functions. Under section 174, a director must exercise the care, skill and diligence that would be exercised by a reasonably diligent person with both:

- (a) 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 (the "objective" test).
- (b) The general knowledge, skill and experience that the director actually has (the "subjective" test).

Therefore, a person must be sufficiently qualified or experienced to be able to fulfil the functions that might reasonably be expected to be carried out by him/

her as a director, and if the person is particularly highly qualified or experienced then he/she would be expected to exercise a high level of skill and expertise.

A director is also required to exercise his/her directors' duties diligently, keep him/herself informed about the company's affairs and, with his/her co-directors, to supervise and control them. Overall, this responsibility cannot be delegated to any party. However, this does not prevent him/her from relying on the experience and expertise of his/her colleagues or, generally, from sensibly delegating or allocating tasks to others, provided that he/she does not attempt to absolve him/herself entirely of responsibility.

1.5. Duty to avoid conflicting interests and duties (section 175, 2006 Act)

A director must avoid a situation in which he/she has, or can have, a direct or indirect interest that conflicts, or may possibly conflict, with the interests of the company. This duty extends to the exploitation of information, property or opportunity for personal purposes, regardless of whether the company itself could take advantage of it, and continues to apply once he/she leaves the company in relation to knowledge gained while in office.

A director should also consider the interests of any person "connected" to him/her. The definition of "connected" is very wide and includes family members and corporate bodies.

The 2006 Act provides that this duty will not be infringed if the situation cannot reasonably be regarded as likely to give rise to a conflict or, provided the company has passed an ordinary resolution to allow them to do so, if the independent directors have authorised the matter in advance. This authorisation may be given subject to certain conditions, such as providing that an interested director may:

- (a) not receive certain papers;
- (b) not vote on certain issues;
- (c) be required to withdraw from certain meetings;
- (d) not pass on information; and/or
- (e) not participate in committees to which certain matters in which he/she has an interest are delegated.

In addition, this duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company, which is dealt with as a separate duty (see paragraph 1.7 below).

1.6. Duty not to accept benefits from third parties (section 176, 2006 Act)

A director must not accept any benefit (which includes any kind of financial inducement or bribe) from a third party which is conferred because he/she is a director, or because he/she does (or does not do) something as a director.

Although there is no formal minimum threshold to exempt minor "benefits" such as corporate entertainment, the 2006 Act makes it clear that the duty is not infringed:

- (a) if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict; or
- (b) if the benefit is conferred by the company, associated companies or persons acting on their behalf.

However, in contrast to situational conflicts, the acceptance of benefits from third parties cannot be blessed by the directors. Only members can approve or ratify a breach of this duty.

1.7. Duty to disclose interest in proposed or existing transactions or arrangements with the company (sections 177 and 182, 2006 Act)

If a director is (directly or indirectly) personally interested in a proposed or existing transaction or arrangement with the company in any way, he/she have a duty to declare the nature and extent of this interest to the other directors.

If he/she fails to comply with the duty to disclose an interest in an existing transaction or arrangement, he/she may commit a criminal offence and be liable to a fine.

Both duties also require him/her to update any declaration that is or becomes inaccurate or incomplete. It is important to note that he/she need not be a party to the transaction to have an interest in it. He/she should therefore consider the interests of persons "connected" to him/her when deciding whether to make a declaration.

A declaration in relation to:

- (a) a proposed transaction or arrangement must be made before the transaction is entered into and can be made by any method; and
- (b) an existing transaction must be made as soon as practicable but must be made at a directors' meeting or by written notice or by general notice.

A declaration will not be required under section 182 of the 2006 Act if or to the extent that a declaration has been made already under section 177 of the 2006 Act.

As with the other statutory duties, there are a number of exclusions to these two duties:

- (c) a director need not make a declaration where he/she is unaware of his/her interest or the transaction, although he/she will be treated as being aware of anything of which he/she ought reasonably to be aware;
- (d) similarly, a declaration in relation to matters of which the other directors are aware or ought reasonably to be aware will not be necessary;
- (e) these duties will not be infringed if the matter cannot reasonably be regarded as likely to give rise to a conflict of interests; and
- (f) finally, a declaration will not be needed if the interest concerns the terms of the director's service contract that have been (or are to be) considered at a board meeting.

2. DUTY OF CONFIDENTIALITY

A director owes a duty of confidentiality to the company of which he/she is a director. This duty overlaps with the duties to promote the success of the company, to avoid situational conflicts and not to accept benefits from third parties (see paragraph 1).

The duty of confidentiality is such that, even if a director were appointed by a member, the director must not, without the authority of the company, disclose any confidential information relating to the company which has been gained by him in his position as a director of the company to the member.

A director will obtain a significant amount of information relating to the company. For example, a director is entitled to receive notice of, and attend, board meetings and can also inspect and take copies of the records of the company (including minutes of meetings). However, it would be a breach of a director's duty to pass on all company information to his appointing member where there is a conflict between the interests of the company and those of his appointing member. To avoid difficulties, it is good practice for the board of a company to agree in advance with any member what categories of information can be passed to the member by its nominated director.

In some cases, a competitor of the company may be permitted to participate on the board of a company. The presence on the board of such a competitor's representative may inhibit the willingness of other directors to make full disclosure to the board. In certain circumstances, mere notification that a subject is to be discussed may be potentially damaging if that fact is known to a competitor. As a competitor-appointed director is also subject to the duty to avoid situational conflicts (see paragraph 1.5), it may be prudent for the independent directors to address any concerns in the conditions attaching to

a section 175 conflict authorisation, for example excluding that director from board meetings relating to the situational conflict or where there are good grounds to believe he may divulge confidential information without the necessary authority.

3. OTHER STATUTORY DUTIES: COMPANIES ACT 2006

3.1. Accounts and financial duties

A director has a personal responsibility to ensure that accounting records are maintained so that at any time they are able to demonstrate and explain the financial position of the company. Failure to do this will cause every defaulting officer of the company to be liable to a fine, imprisonment or both.

In addition to this, it is the responsibility of a director to ensure that full annual accounts are produced each year and sent to all members within the required time. If it is proposed that the company takes advantage of certain exemptions in relation to the preparation of the annual accounts, he/she will also need to be satisfied that the company is a private company that meets the qualifying criteria for such exemptions.

He/she also has a duty to deliver the annual accounts and reports to Companies House. Failure to submit the accounts within the required period carries an automatic civil penalty payable by the company in default, which increases according to how late the accounts have been filed.

3.2. Duty to maintain statutory registers and records

The directors are required by the 2006 Act to maintain a set of statutory books and records which detail important aspects of their companies' operations and structure. Companies usually keep these official documents in a company register, where they can be ordered in a logical fashion. They must be written up on incorporation and amended from time to time to reflect any changes, so that they are always up to date. If not, the company and any director in default may be liable to a fine.

Examples of these statutory registers include the register of the company's members, the register of directors of the company and the register of directors' residential addresses.

3.3. Duty to make directors' service contracts open to inspection

The directors are responsible for ensuring that the company keeps copies of all directors' service contracts open to inspection by any member of the company, without charge, throughout their duration and for a period of at least one year from the date of termination or expiry of the contract.

4. STATUTORY DUTIES: INSOLVENCY

In an insolvency situation, the interests of the creditors (as a whole) will become the most significant element in determining how a director should discharge his/her duty to promote the success of the company under section 172 of the 2006 Act (see paragraph 1.2). From a practical point of view, it is crucial to regularly call full board meetings if the company is in financial difficulties and to fully report the commercial decisions of the directors in the company's minutes.

4.1. Misfeasance and breach of duty

If a director wrongfully performs a normally lawful act (misfeasance) or commits a breach of fiduciary duty, he/she may be obliged to repay, restore or account for money or property with interest or pay a contribution to the company's assets for losses arising from that act.

4.2. Fraudulent trading

If, in the course of the winding up of a company, it appears that any business of the company has been carried on with the intent to defraud creditors of the company, the liquidator can apply to the court to obtain a contribution from any director who knowingly carried on the business in such a manner. There has to be actual dishonesty involving real moral blame on the part of a director for this offence to apply (for example, where a director took positive steps to continue to trade and incur debts at a time when he/she was aware that there was a reasonable prospect of the company being unable to repay such debts, thus defrauding creditors). Fraudulent trading is also a criminal offence which may result in any guilty director having a disqualification order made against him/her.

4.3. Wrongful trading

Where the company has gone into insolvent liquidation and, at some point before the commencement of the winding up of the company, any director knew (or ought to have concluded) that there was no reasonable prospect that the company would avoid this, that director could be required by the court, on the application of a liquidator, to contribute. The court will not make an order for wrongful trading if the director took every step with a view to minimising the potential loss to the company's creditors.

Legal advice should be taken immediately if the directors suspect that there is a reasonable prospect of the company becoming insolvent. To avoid wrongful trading, it may even be necessary for the company to cease trading. Dishonesty is not required for this offence, and there is a lower burden of proof than that required to prove fraudulent trading. This offence is primarily compensatory, not penal, and there is no criminal liability for wrongful trading.

5. LIABILITY OF DIRECTORS

Courts and policy makers alike acknowledge that directors are in control of an entrepreneurial venture and that a degree of commercial risk taking is a necessary part of earning a sufficient return on the capital invested. However, if a director is in breach of his/her director's duties, the following types of liability may arise:

5.1. Liability to the company

A director's breach of duty may result in him/her being personally liable to the company. In a case where he/she has profited from his/her breach, he/she may have to account to the company for any profit made. Even if he/she has not made any personal gain, he/she may still be liable to the company for any loss it has suffered as a result of his/her breach.

5.2. Liability to third parties

A director acts as agent of the company, so members or third parties will normally only have a cause of action against the company and not against a director.

However, a director may incur liabilities to members and third parties if he/she acts in a manner which creates a personal obligation. This is not lightly implied, but could be assumed, for example, if a director (in his/her capacity as a director) gave an express representation to a member or third party, accepting a personal obligation.

The overview in this information sheet is designed to highlight the key duties and responsibilities applicable directors. Please do not hesitate to contact us if you have any queries in relation to this, or if you require further information on a particular topic.