



## corporate | directors' duties

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### statutory statement with effect from 1 October 2007

For the first time, directors' duties are codified; until now the extent of such duties has been developed by case law and equitable principles. These duties have been placed into statutory form with the aim of providing greater clarity on what is expected of directors and to make the law more accessible.

The principal duties are set out in ss.170-181. Four of these came into force on 1 October 2007; the remainder including the provisions relating to conflicts of interest were introduced on 1 October 2008

The duties now in force are:

**1. To act within their powers (S.171 CA2006)** – directors must act in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred. Accordingly, a company's articles of association must continue to be consulted to ascertain the extent of a director's powers and any limitations placed upon them.

**2. To promote the success of the company (S.172 CA2006)** – a director must "act in the way he considers in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard" to certain matters. The words "success of the company for the benefit of its members" replaces the previous common law duty to act "in the best interests of the company". This now forms the central duty of the new regime. During debate on the company law bill, it was suggested that 'success' will normally mean 'long-term increase in value'; the Government also advanced the concept of "enlightened shareholder value". S.172 sets out the matters to which directors should have regard:

- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct, and
- the need to act fairly as between members of the company.

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Enshrining these matters in statute goes beyond a mere codification of the existing law. For the first time, various 'stakeholders' to whose interests directors must have regard, are specifically identified. A director's principal duty continues to be owed to the company and its members but in pursuing this duty, directors must have regard to all these matters, including the interests of other stakeholders.

**3. To exercise independent judgement (S.173 CA2006)** – this duty codifies a current principle of law under which directors must exercise their powers independently, without subordinating their powers to the will of others, whether by delegation or otherwise. The section makes it clear that this duty is not infringed by a director acting in accordance with an agreement entered into by the company that restricts the future exercise of discretion by its directors or by acting in accordance with the company's constitution, which would include resolutions of shareholders.

**4. To exercise reasonable care, skill and diligence (S.174 CA2006)** – the existing duty placed on a director to exercise reasonable care, skill and diligence is codified. Traditionally, the courts did not require directors to exhibit a greater degree of skill than may reasonably be expected from a person with their knowledge and experience (a subjective test). Recent case law requires that there should also be an objective assessment of a director's conduct. The new section reflects this. Accordingly, s.174 provides that a director owes a duty to his company to exercise the same standard of care, skill and diligence that would be exercised by a reasonably diligent person with:

- the general knowledge, skill and experience that may reasonably be expected of the person carrying out the same functions as a director in relation to that company (an objective test), and
- the general knowledge, skill and experience that the director actually has (a subjective test). For example a Finance Director could be expected to have a greater knowledge of accounting issues than, say, a Human Resources Director.

**5. To avoid conflicts of interest (s.175 CA2006)** – this relates to a situation where a director's interest may conflict with the interests of the company. Conflicts may arise in respect of any property, information or opportunity relating to that director. Examples of such situations are:

- a director holding a directorship on the Board of a supplier or customer
- a director appointed to the Board by a major shareholder for a joint venture or similar

Persons connected with a director should be considered in deciding whether a conflict situation exists. There are three exceptions to the duty to avoid a conflict of interest. The duty is not infringed:

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- if the conflict arises in relation to a transaction or arrangement with the company. (However under Section 177 conflicts in such a situation must be declared to the company and its other directors)
  - if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest.
  - if the matter has been authorised by the independent directors without the conflicted director either counting towards the quorum or voting on the resolution.

Conflict situations may now be authorised by the Board. However if the company was formed before 1 October 2008 its Articles must be changed to give the directors this authority.

Directors authorising such conflicts must comply with their other statutory duties when deciding whether to so authorise.

**6. Not to accept benefits from third parties (s.176 of the 2006 Act)** – another statutory duty now in force is the duty not to accept benefits from third parties. This duty applies to all manner of benefits but does not apply if the matter “cannot reasonably be regarded as giving rise to a conflict of interest.” Therefore the size of the benefit and comparative wealth of the director are likely to be factors in determining whether a director is in breach of this duty.

It is also recognised that benefits from a company used to provide the directors’ services to the company of which he is a director would not be regarded as a benefit conferred upon that director.

If the director is receiving a benefit, it can be authorised by the members of the company.

The common law provisions on ratification of the acts of directors are retained but with one significant change. S239 now requires ratification to be by shareholder resolution in respect of any conduct by a director amounting to negligence, default, breach of any duty or breach of trust and any vote in favour of the resolution by the director concerned or by any member connected to him, must be disregarded.

The statutory statement of directors’ duties does not cover all the duties that a director may owe to the company; only the common law duties are codified. Many duties are imposed elsewhere in legislation, such as the duty to keep accounting records, to protect the health and safety of employees, to preserve the environment through the proper disposal of waste etc.

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