

Directors' Duties

September 2012 Edition

Common Law

The duties of company directors to the company were originally established through case law. The key common law duties included:

- Duty to exercise reasonable care and skill;
- Duty to act in good faith;
- Duty to act in the best interests of the company;
- Duty to act within the powers conferred by the company's memorandum and articles of association and to exercise such powers for proper purposes;
- Duty not to fetter discretion;
- Duty to avoid conflicts of interests and duties; and
- Duty not to make a secret profit.

Companies Act 2006

The Companies Act 2006 ("the Act") introduced a statutory list of duties that codified directors' duties, updating or replacing many of the existing duties. However, it should be noted that some remaining duties have not yet been codified in statute and a company may impose additional duties through its articles of association.

The duties in the Act apply to all directors (including shadow directors) and, in the case of the duty to avoid conflicts of interest and the duty not to accept benefits from third parties, even former directors of the company.

Relevant sections of the Act

- Section 171 – duty to act within powers. Directors must act in accordance with the company's constitution (that is, its articles, decisions made pursuant to the articles and other decisions made by the company through

its shareholders) and must only exercise his powers for their proper purpose.

- Section 172 – duty to promote the success of the company. Directors must act in a way that they consider, in good faith, promotes the success of the company from the shareholders' perspective or any other specified purposes of the company.

In order to abide by the duty in section 172, directors must consider (among other matters) the following:

(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 as between members of the company.

- Section 173 – duty to exercise independent judgement. It should be noted that a director does not breach this duty by acting in accordance with an agreement made by the company that restricts the future exercise of his discretion or in a way that is authorised by the company's constitution.

- Section 174 – duty to exercise reasonable care, skill and diligence. The level of care, skill and diligence expected is that of 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; and

- (b) the general knowledge, skill and experience that the specific director actually has.

- Section 175 – duty to avoid conflicts of interest. A director must not have any conflicts of interest with the company. Even a possible, indirect conflict may lead to a breach of this duty. This duty does not apply to situations where the proposed transaction is between the director and the company itself (this is dealt with by section 177) or in the case of existing transactions (dealt with by section 182). There is no breach of this duty if the situation cannot reasonably be regarded as likely to give rise to a conflict, or where the other directors have authorised the matter in a board meeting.

- Section 176 – duty not to accept benefits from third parties. Directors must not accept benefits (or bribes) from third parties, which result from the director's being a director or his doing (or not doing) anything as director. The exceptions to this duty are where the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest, where the benefit is conferred by the company or another company in the group, where the benefit is given under the director's service contract, or where the benefit has been authorised by the shareholders (NB: rather than by the other directors as with section 175 above).

- Section 177 – duty to declare interest in proposed transaction or arrangement with the company. Directors must declare to the other directors the nature and extent of any direct or indirect interest in a proposed transaction with the company. The duty applies even where the director is not a party to the transaction. The declaration must be made before the company enters into the transaction.

Stone Rowe Brewer's company & commercial department can advise on all aspects of company directors' duties and how they relate to the successful running of a business.

If you have any queries in relation to the above or any related matter, please contact John Andrews (j.andrews@srb.co.uk) or Tim Lucas (t.lucas@srb.co.uk) for further information.



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