

Directors' duties: an overview

The duties owed by directors of a company are prescribed by the Companies Act 2006 ("the Act").

In summary, the seven "general duties" set out in the Act are as follows:

A duty to act in accordance with the constitution of the company and to use powers only for the purposes for which they were conferred

This duty requires directors to act in accordance with a company's Memorandum of Association and Articles of Association. This duty cannot be diluted by the company's constitution.

A duty to promote the success of the company for the benefit of the members

This replaces the previous duty to act in good faith in the best interests of the company. The term "success" is not defined in the Act and may well be determined by a link to the profitability of a company. It may be appropriate for companies to consider defining success in their constitutional documentation so as to try and avoid the duty being too widely construed.

The Act also sets out a non-exhaustive list of factors that directors are to have regard to in satisfying this duty and these are as follows:

- the likely long-term consequences of any decision that is taken;
- the interests of the employees of the company;
- the need to foster the company's business relationships with suppliers, customers and other third parties;
- the impact of the company's proposed actions on the community and the environment;
- the desirability of maintaining a reputation for high business standards; and
- the need to act fairly between the members.

The provisions of the Act do not require every factor to be considered in relation to every decision but it is thought prudent to draft board minutes to reflect the factors that have been considered in reaching decisions, particularly regarding decisions that are being made in relation to one or more of the areas covered by the factors. At the very least there should be a documented record of the manner in which any relevant decision taken at board level has been considered beforehand.

A duty to exercise independent judgment

This duty requires a director to exercise their powers personally and not to allow others to unreasonably exercise powers on his behalf except by way of appropriate delegation which should be allowed by and provided for in the company's constitution. Where a director delegates his powers in accordance with the constitution he will not be liable for breach of this duty.

A duty to exercise reasonable care, skill and diligence

The Act sets out the test to be applied in respect of this duty. A director must satisfy the higher of two tests, one being an objective test and the other a subjective test. The objective test applies the general skill, knowledge and experience that might reasonably be expected of a person who is fulfilling the function of a director of the company in question. The subjective test looks at the actual knowledge, skill and experience of the director in question. This duty does not operate as a fiduciary duty and, as such, the remedy for breach would be a claim for damages against the director. It is possible for a company to set out the precise nature of the duty owed by any given director in their service contract.

A duty to avoid conflicts of interest

This duty relates to any conflict of interest, whether actual or potential, between the interests of the company and the directors save where there are specific arrangements allowing such conflicts to arise. The duty specifically deals with conflicts relating to the exploitation of company property, information and opportunities where this is done for the personal benefit of directors, and there is no requirement to show that the company would have been able to take any advantage from any circumstances had the conflict not arisen. It is possible for directors who have no conflict to approve any conflict that is referred to them.

A duty not to accept benefits from third parties

"Benefits" in the context of this duty relate to the receipt of a financial benefit, including bribes, received from a third party, and does not relate to benefits receivable by a director under a service contract. It is possible to prescribe what benefits directors may receive from third parties in the company's constitution.

A duty to declare to the other directors any interest that a director has in any proposed transaction or arrangement with the company

This duty includes transactions which involve any person said to be "connected" in law to the directors, which includes extended family members. There is a specified procedure within the Act for the notification of any such interest to the other directors. It is also possible to require shareholder approval be given for any such transaction. The act also incorporates a duty to declare any interest in an existing transaction or arrangement involving the company.

For more information, or if you have any specific queries relating to corporate governance or directors' duties, contact our Corporate team.

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