



Directors' Responsibilities

Companies

You can undertake business in the UK as either:

- an unincorporated entity, i.e. a sole trader or a partnership or
- an incorporated body.

An incorporated business is normally referred to as a company. Although there are limited liability partnerships and unlimited companies the vast majority of companies are limited by shares. This means the liability of shareholders is limited to the value of their share capital (including any unpaid).

A limited company can be a private or public company. A public company must include 'public' or 'plc' in its name and can offer shares to the public.

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Directors

When you are appointed a director of a company you become an officer with extensive legal responsibilities. For a director of an incorporated body, the Companies Act 2006 sets out a statement of your general duties. This statement codifies the existing 'common law' rules and equitable principles relating to the obligations of company directors that have developed over time. The Companies Act 2006 highlights the connection between what constitutes the good of your company and a consideration of its wider corporate social responsibilities.

The legislation requires that directors act in the interests of their company and not in the interests of any other parties (including shareholders). Even sole director/shareholder companies must consider the implications by not putting their own interests above those of the company.

The Act outlines seven statutory directors' duties, which also need to be considered for shadow directors. These are detailed on the following pages.

Duty to act within their powers

As a company director, you must act only in accordance with the company's constitution, and must only exercise your powers for the purposes for which they were conferred.

Duty to promote the success of the company

You must act in such a way that you feel would be most likely to promote the success of the company, for the benefit of its members as a whole. This is often called the 'enlightened shareholder value' duty. However, you must also consider a number of other factors, including:

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

Duty to exercise independent judgment

A director is on the board to act in the best interests of the company as a whole, not to represent the interests of just one shareholder or even a group of like minded investors. That rule applies irrespective of the circumstances in which the director has been appointed.

Duty to exercise reasonable care, skill and diligence

The Act sets out a double test. First, there is an objective standard: a board member must have the knowledge, skill and experience that would reasonably be expected of anyone doing that job. Second, a subjective standard must also be met: a director has to perform according to the knowledge, skill and experience they actually have.

So there is a basic level of competence that will be expected from all board members; but there is also a higher standard expected of those with some special skill or experience.

Duty to avoid conflicts of interest

This dictates that, as a director, you must avoid a situation in which you have, or may have, a direct or indirect interest which conflicts, or could conflict, with the interests of the company.

This duty applies in particular to a transaction entered into between you and a third party, in relation to the exploitation of any property, information or opportunity. It does not apply to a conflict of interest which arises in relation to a transaction or arrangement with the company itself.

This clarifies the previous conflict of interest provisions, and makes it easier for directors to enter into transactions with third parties by allowing directors not subject to any conflict on the board to authorise them, as long as certain requirements are met.

Duty not to accept benefits from third parties

Building on the established principle that you must not make a secret profit as a result of being a director, this duty states that you must not accept any benefit from a third party (whether monetary or otherwise) which has been conferred because of the fact that you are a director, or as a consequence of taking, or not taking, a particular action as a director.

Duty to declare interest in a proposed transaction or arrangement

Any company director who has either a direct or an indirect interest in a proposed transaction or arrangement with the company must declare the 'nature and extent' of that interest to the other directors, before the company enters into the transaction or arrangement. A further declaration is required if this information later proves to be, or becomes either incomplete or inaccurate.

The requirement to make a disclosure also applies where directors 'ought reasonably to be aware' of any such conflicting interest.

However, the requirement does not apply where the interest cannot reasonably be regarded as likely to give rise to a conflict of interest, or where other directors are already aware (or 'ought reasonably to be aware') of the interest.

Enforcement and penalties

The Companies Act states that penalties will be enforced in the same way as the Common Law, although under Company Law. As a result there are no penalties in the Companies Act 2006 for failing to undertake the above duties correctly.

Enforcement is via an action against the director for breach of duty. Currently such an action can only be brought by:

- the company itself (i.e. the Board or the members in a general meeting) deciding to commence proceedings; or
- a liquidator when the company is in liquidation.
- an individual shareholder can take action against a director for breach of duty. This is known as a derivative action and can be taken for any act of omission (involving negligence), default or breach of duty or trust.

Where the company is controlled by the directors these actions are unlikely.

For further information contact us at info@raffingers.co.uk.