

# **Directors' Responsibilities**

## **Content**

- 1 Introduction**
- 2 Companies**
- 3 Directors**
- 4 New responsibilities from 1 October 2007**
  - 4.1 Duty to act within their powers**
  - 4.2 Duty to promote the success of the company**
  - 4.3 Duty to exercise independent judgment**
  - 4.4 Duty to exercise reasonable care, skill and diligence**
- 5 New responsibilities from 1 October 2008**
  - 5.1 Duty to avoid conflicts of interest**
  - 5.2 Duty not to accept benefits from third parties**
  - 5.3 Duty to declare interest in a proposed transaction or arrangement**
- 6 Enforcement and Penalties**
- 7 How We Can Help**
- 8 Contact details**

# Directors' Responsibilities

## 1 Introduction

The position of director brings both rewards and responsibilities upon an individual.

Whether you are appointed to the Board of the company you work for or you are involved in establishing a new business and take on the role of director you will feel a sense of achievement.

However the office of director should not be accepted lightly. It carries with it a number of duties and responsibilities. We summarise these complex provisions below.

This is particularly important following the advent of the Companies Act 2006. The Act received Royal Assent on 8 November 2006, and is being introduced in a series of stages. All of the provisions of the Act will be implemented by October 2008\*. The legislation will replace all existing Company Law, except for the provisions relating to company investigations and community interest companies (CICs).

## 2 Companies

You can undertake business in the UK as either:

- an unincorporated entity, ie 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.

The responsibilities and penalties are more onerous if you are a director of a public company.

## 3 Directors

When you are appointed a director of a company you become an officer with extensive legal responsibilities. The Companies Act 2006 sets out a new statement of the general duties of directors. This statement codifies the existing 'common law' rules and equitable principles relating to the obligations of company directors. The existing common law had focused on the interests of shareholders. The new law extends this by highlighting the connection between what constitutes the good of the company and a consideration of its wider corporate social responsibilities.

The legislation stipulates that directors must act in the interests of the 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 aim of the codification of duties is to make the law more consistent and accessible. It should be noted that other existing duties will continue to apply alongside the new statutory duties.

The Act outlines seven new statutory directors' duties, as detailed below. Four of these took effect on 1 October 2007; the remaining three provisions come into force on 1 October 2008.\*

## **4 New responsibilities from 1 October 2007**

### **4.1 *Duty to act within their powers***

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

### **4.2 *Duty to promote the success of the company***

This duty replaces the previous duty of directors to act 'in good faith and in the best interests of the company'.

A company director must act in such a way that he or she feels would be most likely to promote the success of the company (ie. its long-term increase in value), for the benefit of its members as a whole. However, the director 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.

### **4.3 *Duty to exercise independent judgment***

A director has an obligation to exercise independent judgment. This duty is not infringed by acting in accordance with an agreement entered into by the company which restricts the future exercise of discretion by its directors, or by acting in a way which is authorised by the company's constitution.

### **4.4 *Duty to exercise reasonable care, skill and diligence***

This duty codifies the common law rule of duty of care and skill, and imposes both 'subjective' and 'objective' standards. A director must exercise reasonable care, skill and diligence using their own general knowledge, skill and experience (subjective), together with the care, skill and diligence which may reasonably be expected of a person who is carrying out the functions of a director (objective). So a director with significant experience must exercise the appropriate level of diligence in executing their duties, in line with their higher level of expertise.

## **5 New responsibilities from 1 October 2008 \***

### **5.1 *Duty to avoid conflicts of interest***

This dictates that a director must avoid a situation in which he or she has, 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 a director 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.

### **5.2 *Duty not to accept benefits from third parties***

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

This duty applies unless the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.

### **5.3 *Duty to declare interest in a proposed transaction or arrangement***

Again there is an existing requirement for directors to disclose an interest in a proposed transaction. The new duty extends this further and requires that 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.

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.

*\* On 7 November 2007 the government announced that a final commencement timetable for the Act will be issued in December 2007 and that many 1 October 2008 provisions will be put back to 1 October 2009.*

## **6 Enforcement and Penalties**

Although the common law duties have been extended and incorporated into Company Law, the Act states that they will be enforced in the same way as the common 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 (ie the Board or the members in general meeting) deciding to commence proceedings; or
- A liquidator when the company is in liquidation.

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

However the Act has also introduced new legislation whereby 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.

## 7 How We Can Help

You will now be aware that the position of director must not be accepted lightly.

- The law is designed to penalise those who act irresponsibly or incompetently.
- A director who acts honestly and conscientiously should have nothing to fear.

We can provide the professional advice you need to ensure you are in the latter category.

Please come and talk to us if you would like more information.

## 8 Contact Details

For further information and to discuss audit and assurance issues please contact one of the team:

Steven Scarlett  
Partner  
Lovewell Blake, Norwich  
Tel: (01603) 663300  
[sps@lovewell-blake.co.uk](mailto:sps@lovewell-blake.co.uk)

Simon Watson  
Partner  
Lovewell Blake, Norwich  
Tel: (01603) 663300  
[scw@lovewell-blake.co.uk](mailto:scw@lovewell-blake.co.uk)

Christopher Dicker  
Partner  
Lovewell Blake, Great Yarmouth  
Tel: (01493) 335100  
[chd@lovewell-blake.co.uk](mailto:chd@lovewell-blake.co.uk)

Paul Briddon  
Partner  
Lovewell Blake, Lowestoft  
Tel: (01502) 563921  
[pb@lovewell-blake.co.uk](mailto:pb@lovewell-blake.co.uk)

Brian Floringer  
Partner  
Lovewell Blake, Thetford  
Tel: (01842) 755032  
[bjf@lovewell-blake.co.uk](mailto:bjf@lovewell-blake.co.uk)

Brian Bale  
Partner  
Lovewell Blake, Halesworth  
Tel: (01986) 873163  
[bcb@lovewell-blake.co.uk](mailto:bcb@lovewell-blake.co.uk)

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