DIRECTORSHIPS - DUTIES AND RESPONSIBILITIES
HANDY GUIDE
Directorships - duties and responsibilities

The Companies Act 2006 imposes certain general duties on a director of a UK limited company. This ‘handy guide’ provides directors with an overview of these fundamental duties.

The role of director

A company acts through two distinct bodies of people – its shareholders on the one hand, and its board of directors on the other. The shareholders (or members) are the people who own the company, while the board of directors has collective responsibility for the management of the company’s business. The board is effectively appointed by the shareholders to run day-to-day operational affairs of the company and to deal with the ‘nuts and bolts’ of the business.

A director must act in good faith to promote the success of the company for the benefit of the shareholders as a whole. A director may also happen to be a shareholder of the company and, if so, will have additional rights and powers which are separate from the office as a director. In particular, shareholders are allowed to act in their own self-interest, whereas directors have always to comply with their duties (which are owed to all shareholders) and act in the best interests of the company.

It is important not to confuse the two roles – blurring the lines between them is a common problem in companies where the directors and shareholders are one and the same, and it is important for the person to be able to separate the responsibilities of the two functions and act accordingly when serving in either capacity.

This guide focuses solely on the role of director.

What are the general duties of a director under the Companies Act 2006?

Act within their powers

Directors should not exceed the powers conferred on them by the company’s articles of association, and they should exercise these powers only for the purposes for which they are conferred.

However, it is not always clear for what purpose a power has been conferred. For example, there have been cases where directors have used their power to issue shares to dilute minority shareholders’ stakes in the company. The courts, however, have suggested that the purpose of this power is to raise capital. For potentially controversial decisions, directors should document their efforts to comply with the duty, providing explanations of the reasons behind their decisions to exercise such powers. This may help directors minimise the risk of breaching this duty.
Exercise independent judgment

Each director must exercise independent judgment and make their own decisions. They should not slavishly follow professional advice, or follow whatever fellow board members are doing, without thinking for themselves.

Exercise reasonable skill and care and diligence

A director should exercise the same 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 a person carrying out the same functions as a director in relation to the company (the objective yardstick); and

• the director actually possesses (the subjective yardstick).

Directors should attend board meetings (or as many as reasonably possible) to ensure they know at all times what is happening in the business. Ignorance is no defence.

Avoid conflicts of interest

Each director must avoid situations where they could have a direct or indirect interest that may conflict with the interests of the company. Many conflict situations are startlingly obvious on the face of it (e.g. where a director is also a director of a competitor company). However many others are more subtle (e.g. a nominee director appointed by a shareholder).

There are several ways in which a conflict situation can be authorised. If in doubt, it’s best to disclose all matters to the board as early as possible so that a decision on authorisation can be made in the appropriate way.

Do not accept benefits from third parties

A director must not accept a benefit from a third party that was offered because of the director’s position or because of anything they may do or not do as a director. Any benefits obtained in this way will have to be accounted for to the company, even if the company benefits as well. Again, some aspects of this duty are obvious (e.g. the taking of a bribe) but what about accepting corporate hospitality from a supplier? Directors will have to balance all relevant facts (e.g. whether a large tender is up for renewal which would make the acceptance of such hospitality inappropriate) before deciding on what they can and cannot do.

A director may accept the benefit if no reasonable person would see it as giving rise to a conflict, but that is certainly not always an easy decision to make.

Declare the nature and extent of any interest in a proposed transaction or arrangement

If a director is in any way, directly or indirectly, interested in a transaction or arrangement with the company, the nature and extent of that interest must be declared to the other directors (prior to the transaction being entered into or, in the case of an existing transaction, as soon as reasonably practicable).

In contrast to situational conflicts, the Companies Act does not prohibit directors from having interests in transactions or arrangements. However, they must check the company’s articles of association to see whether they contain any restrictions and whether a director would be allowed to participate in board decisions relating to such matters.
Other duties

The Companies Act imposes a number of administrative duties on directors e.g. responsibilities for preparing annual accounts and making statutory filings.

In addition to duties under the Companies Act, directors can also incur personal liability under other legislation, such as health and safety laws, anti-bribery law, and insolvency legislation. These are beyond the scope of this guide.

What happens if a director doesn’t comply?

These legal duties are owed to the company, and they are non-negotiable. A director could be held personally liable for breach of statutory duties, which could prove costly if they have to pay damages, or account for profits, to their company.

In certain circumstances, the company’s shareholders can authorise or ratify a director’s breach of duty. This is particularly useful where the directors and shareholders are the same people. It may be of less comfort to a director where the shareholders are different.

It is also common for larger companies to take out directors’ and officers’ (D&O) insurance on behalf of their directors. This typically deals with directors’ liabilities arising from claims of negligence, breach of duty or other default which is not linked to dishonesty.

Conclusion

The Companies Act helpfully sets out a list of directors’ duties so that they know what is expected of them. The law is not aiming to penalise honest, diligent and conscientious directors. Still, it can sometimes be uncertain how the duties would apply in practice.

If in any doubt about fulfilment of directors’ duties, directors should seek professional advice. This will give reassurance that they understand their responsibilities and let them concentrate on making their directorship a success. At Brodies we regularly advise on such matters and we would be delighted to help you.