



DIRECTORS: DUTIES & RESPONSIBILITIES

It is true to say, at least in legal terms, that a company is a separate entity. A company cannot function however, without its board of directors who are collectively responsible for the management of the company on behalf of its owners. The board of directors must consider the shareholders' interests in everything they do. In addition to its members, directors have duties and responsibilities to the company's employees, its trading partners and the state. The role of the director is clearly not to be taken on lightly.

It was a common criticism of the old law on directors' duties that there was no one place for directors to look for an exhaustive list of their responsibilities. Major changes have recently been made to U.K. company law, however, including the codification of directors' duties. The general duties of directors are now all accessibly set down in the Companies Act 2006. Broadly speaking, these can be categorised as follows:

1. General duty of skill and care

Directors generally have responsibility for the day to day running of the company and the management of its business. Simply speaking, a director must exercise reasonable skill and care in carrying out these responsibilities. To make matters more complicated, however, the degree of skill and care required is judged from both objective and subjective standpoints¹. There is no *single* professional standard for company directors. The standard required therefore varies according to the directors' personal knowledge and experience, functions carried out and the amount of time that they are required to devote to their duties.

Historically, a director could get away with being as inept and as absent as he liked.² Indeed, it was even possible to adopt Articles specifically absolving a director of any future liability, irrespective of how incompetent he or she may prove to be.³ Today, it is evident certain displays of incompetence will no longer be tolerated. However, the law is still careful not to completely deter enterprising directors and future entrepreneurs and the decided cases underline

that something more than a mere error of judgement is required before directors can be said to be in breach of the duty of care they owe to the company.

2. General duties of honesty and good faith known as "fiduciary duties"

Apart from the duty to act with due skill and care, the general duties set down in the 2006 Act are all fiduciary in nature. The six fiduciary duties of a director are:

- to act within his powers;
- to promote the success of the company for the benefit of its members as a whole;
- to exercise independent judgement;
- to avoid conflicts of interest;
- not to accept benefits from third parties; and
- to declare to the other directors any interest in a proposed transaction or arrangement with the company.

The above fiduciary duties are based on the concept that a director is in a special position of responsibility in relation to the company. He is therefore held to a higher standard of responsibility than most, which can lead to liability even where he has acted honestly. Fundamentally, a director must act in good faith in the *best interests* of the company, irrespective of the fact he may have a substantial shareholding in that company. In essence, just because he is the boss, he may not take unauthorised advantage of his position.

A director has a duty not to profit from his position, for example by taking a business opportunity that came to him through the company, even if the company does not want to take it itself. If a director wishes to benefit personally outside what has already been accorded to him in the Articles of Association he must declare such benefit and have it approved by the members. In short, if a director gains any form of unauthorised benefit, he must offer it to the company or alternatively indemnify the company for its loss.

3. Specific Duties

¹ See *Re D'Jan of London* [1993] BCC 646, per Hoffman LJ; Companies Act 2006, section 174.

² See *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 CH 425 and *Re Cardiff Savings Bank* [1892] 2 CH 100.

³ See *Re City Equitable Fire Insurance Company Ltd* [1925] CH 407.

Various pieces of legislation impose specific duties on directors and consequently directors can be penalised for a range of statutory breaches falling out with the realms of the general duties set down in the new Act. These include:

- failure to provide a safe working environment in terms of Health and Safety legislation;
- failure to pay employees PAYE in terms of Inland Revenue rules; and
- failure to pay the company's VAT in terms of Customs and Excise legislation.

It is also the personal responsibility of every director to ensure that statutory documents such as accounts and returns are delivered to the Registrar on time. In addition to the late filing penalties that are imposed on the *company* as standard, more than 1,000 directors are individually prosecuted each year for failing to deliver such documents to the Registrar on time. Accountants and financial advisers are not the ones prosecuted for late filing. Directors are! So unless you want to end up with a criminal record and a fine of up to £5,000 for each offence, it is imperative that your company complies with all its filing obligations.

Summary

The office of a director is unquestionably an onerous one. Codification of directors' duties by the 2006 Act has improved matters insofar as there is now at least one single place for a director to look for an exhaustive list of his responsibilities. It is worth noting however, that the general duties set down in the Act are to be interpreted and applied in the same way as corresponding common law rules and equitable principles. The upshot is that interpretation of the general duties set down in the Act may still be influenced by future developments in common law and equity, meaning it is still a complex and uncertain area where directors will often need to seek specific advice. Still, it's not all doom and gloom and directors and prospective directors should take a great deal of comfort from the case of *Lagunas Nitrate Co v Lagunas Syndicate*⁴. The case was decided at the end of the 19th Century but the words of Lindley MR without doubt endure:

"As directors, I am not aware that there is any difference between their legal and their equitable duties. If directors act within their powers, if they act with such care as is reasonably to be expected from them, having regard to their knowledge and experience, and if they act honestly for the benefit of the company they represent, they discharge both their equitable as well as their legal duty to the company. The amount of care to be taken is difficult to define; but it is plain that directors are not liable for all the mistakes they may make, although if they had taken more care they might have avoided them."

This legal briefing is intended to provide the recipient with a brief outline of the main areas of law to which it applies. It is not to be regarded as an exhaustive overview of the area of law in question. Readers are advised not to apply or rely on any of the information contained therein without first seeking legal advice. Should you have any queries in relation to this briefing or would like clarification on any particular area covered please feel free to contact us.

⁴ [1899] 2 Ch 392