



The responsibilities and duties of a company director

Contents

Introduction	page 3
The role	page 4
The general duties	page 5
Other duties and responsibilities	page 9
Indemnities and insurance	page 11

Introduction

The general duties owed by a director to his or her company are set out in the Companies Act 2006. However, these general duties, which have been so topical over the last few years, are just one piece in the jigsaw of directors' responsibilities. This Guide provides directors with a general overview of the key duties and obligations of the role.

This Guide does not look at the wider responsibilities of the public company director in the context of the UK Corporate Governance Code, the Listing Rules, Prospectus Rules or Disclosure and Transparency Rules, the AIM Rules or PLUS Rules. Nor does it look at the specific responsibilities of a director involved in a regulated industry. If you would like to know more about your obligations in these areas please contact us.

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The role

What is my role as a director?

A company acts through two bodies of people - its shareholders and its board of directors. The board of directors are in charge of the management of the company's business; they make the strategic and operational decisions of the company and are responsible for ensuring that the company meets its statutory obligations. Your role as an individual director is to participate in board meetings to enable the board to reach these decisions and make sure that the company's obligations are fulfilled.

The directors are effectively the agents of the company, appointed by the shareholders to manage its day to day affairs. The basic rule is that the directors should act together as a board but typically the board may also delegate certain of its powers to individual directors or to a committee of the board.

You may also be a shareholder or employee of the company (or both) and, if so, will have additional rights and duties going beyond those purely connected with your office as a director. It is crucial that you draw a distinction between these separate roles and "wear the right hat for the job". This Guide is not intended to deal with the separate rights and duties which you may also have as an employee or shareholder.

The general duties

What are my general duties under the Companies Act 2006?

As a director you must:

- 1 **Act within powers** You must act in accordance with the company's constitution, and only exercise your powers for the purposes for which they were given.

The company's constitution includes its articles of association and resolutions and agreements of a constitutional nature (e.g. shareholder or joint venture agreements).

- 2 **Promote the success of the company** You must act in the way you consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.

"Success" will generally mean a long-term increase in value but fundamentally it is up to each director to decide, in good faith, whether it is appropriate for the company to take a particular course of action. There is a non-exhaustive list of factors which each director should consider in this context (see these on page 6).

- 3 **Exercise independent judgment** You must exercise independent judgment and make your own decisions.

This does not prevent you from acting in accordance with the company's constitution or an agreement which the company has entered into.

- 4 **Exercise reasonable care, skill and due diligence** You must 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 you in relation to the company; and
- the general knowledge, skill and experience that you actually possess.

The expected standard is measured against both objective and subjective yardsticks. A director's actual understanding and abilities may not be enough if more could reasonably be expected of someone in his or her position.

- 5 **Avoid conflicts of interest (a "conflict situation")** You must avoid a situation in which you have, or could have an interest that conflicts, or may conflict, with the interests of the company. This applies in particular to the exploitation of any property, information or opportunity, regardless of whether the company could take advantage of it.

This duty is not infringed if:

- the situation you are in cannot reasonably be regarded as likely to give rise to a conflict of interest. On a proper analysis of the circumstances will there actually be a conflict or potential for conflict with the interests of the company? Some examples of possible conflict situations are set out on page 6; or
- the situation has been pre-authorised. Authorisation may be given in the articles of association, by specific shareholder resolution or, in certain circumstances, by the other directors who do not share the same conflict.

- 6 **Not accept benefits from third parties** You must not accept a benefit from a third party given because you are a director or because you do (or do not do) anything as a director.

This duty is not infringed if your acceptance cannot reasonably be regarded as likely to give rise to a conflict of interest.

7 **Declare interests in proposed or existing transactions or arrangements with the company** If you are in any way, directly or indirectly, interested in a transaction or arrangement with the company, you must declare the nature and extent of that interest to the other directors. In the case of a proposed transaction you must do this before it is entered into. In the case of an existing transaction you must do this as soon as reasonably practicable.

This duty is not infringed if:

- your interest in the transaction cannot reasonably be regarded as likely to give rise to a conflict of interest; or
- an interest has not been declared because you are unaware you have the interest or the other directors are already (or ought reasonably to be) aware of it.

What do I need to think about in terms of my duty to promote the success of the company?

When considering what is most likely to promote the success of the company, the legislation states that a director must have regard to:

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

This list is not exhaustive but is designed to highlight areas of particular importance to responsible business behaviour. Other relevant factors should also be properly considered.

What is a conflict situation?

There is no convenient set of rules to determine which situations will or will not give rise (or potentially give rise) to a conflict of interest. The following are examples of arrangements which may potentially give rise to a conflict situation:

- **Multiple directorships** – you are also on the board of a major shareholder, the pension scheme trustee company, a competitor or a customer or supplier of the company.
- **Personal interests** – you are a major shareholder, a competitor, a customer or supplier of the company or you own property adjacent to the company's property which could be affected by the company's activities.
- **Advisory positions** – you have another hat as an advisor (e.g. accountant or consultant) to the company or to a competitor of the company.
- **Other profits** – you make personal use of the company's information or opportunities, want to take up an opportunity declined by the company or are in any situation where you can make a profit as a result of your directorship.
- **Connected persons** – if any of the above situations apply to a person connected with you, e.g. spouse, partner, parent, child or other close family member.

The responsibilities and duties of a company director

I think I may be in a potential conflict situation – what should I do?

Seek approval Potentially a conflict situation can be approved by the board. If the board does not have the power to authorise conflicts or is otherwise unable to approve the conflict situation it could refer the matter to the shareholders for approval.

Check the articles of association The company's articles may contain provisions relating to conflicts of interest, including:

- Provisions "pre-authorising" common conflict situations – these may list a limited set of circumstances allowing you to put yourself in a situation which may otherwise give rise to a potential conflict of interest without obtaining specific approval. Typical examples include cross-directorships of group companies or positions relating to the company pension scheme.
- Conduct provisions – these may set out how you are expected to conduct yourself in relation to an authorised conflict and may also confirm that you will not be in breach of other duties to the company if you act accordingly. These typically cover:
 - protecting the confidential information of the company and the third party;
 - inclusion or exclusion from board meetings and receipt of board papers;
 - any benefit received as a result of the authorised conflict.

Regulate behaviour Even if a potential conflict situation has been authorised or is permitted by the articles of association you should still act appropriately, remembering your obligation to promote the success of the company. You must take care to act in accordance with the articles of association and any terms and conditions attached to the authorisation.

Who do I owe my general duties to?

Your general duties are owed to the company which you are a director of and not other group companies or individual shareholders. It is the company itself which can take enforcement action against a director if there has been a breach of duty. The decision to start proceedings against a director would be made by the board or, in an insolvency situation, a liquidator. In certain circumstances and subject to certain hurdles, an individual shareholder or group of shareholders can also bring a claim against a director for breach of duty on behalf of the company (known as a derivative action).

What penalties are there if I breach my general duties?

A breach of a general duty typically gives the company a number of potential remedies including an injunction, damages or compensation. Failure to disclose an interest in an existing transaction or arrangement with the company also carries the risk of a criminal fine.

Is there any form of relief for a breach of the general duties?

If a director finds he or she has acted in a way which breaches the general duties owed to the company the following help may be available:

- the breach may be ratified by resolution of the company's shareholders;
- in certain circumstances the court may grant relief if the director acted honestly and reasonably;
- the company may have arranged insurance for the benefit of its directors;
- the company may offer to assist the director by indemnifying him or her against costs incurred in successfully defending a claim for breach of duties owed to the company.

See further details relating to insurance and indemnities more generally on page 11.

Other duties and responsibilities

Do I have any other responsibilities under the Companies Act 2006?

The Companies Act 2006 imposes an array of other obligations on you as a director. Some are personal in nature and are specifically addressed to the directors. Others arise from the responsibility of the directors to ensure that the company carries out its obligations (where both the company and the directors may face liability in the event of a failure). Potential penalties depend on the specific obligation breached but typically involve a fine or rarely, for the most serious offences only, imprisonment.

Probably the most significant are the duties of the directors relating to the preparation, content, circulation and filing of the company's annual reports and accounts where many of the obligations fall directly on the directors.

Some other key obligations relate to the restrictions and conditions placed on transactions between a director and his or her company and loans made by the company to a director.

What about other duties and obligations?

Obligations are also imposed on you as a director from other sources beyond the main companies legislation. Some examples are:

- A directors owes a duty of confidentiality to his or her company and must use or disclose the company's confidential information only for the benefit of the company.
- Directors are responsible for ensuring that the company complies with its obligations relating to the health, safety and welfare at work of its workers, under health and safety legislation.
- Similarly, obligations arise under environmental legislation and anti-corruption legislation.

And what are my responsibilities on insolvency?

Where a company is in financial difficulties the directors should seek independent advice as soon as possible if they are to avoid potential personal liability under insolvency legislation. The potential risks for a director in this area are complex and include the risk of being disqualified from holding the position of director or being involved in the promotion or management of a company for a period of up to 15 years.

This Guide does not look at this area in detail. However, some of the key issues for a director of a company which is insolvent or approaching insolvency are:

- **Modification of the general duty to promote the success of the company** The general duty is modified where a company is (or is on the verge of being) insolvent so that you must act instead in the best interests of the company's creditors.
- **Wrongful trading** A director can be ordered by the court to contribute towards the general pool of assets which are available to a company's creditors where he or she:
 - knew or ought to have concluded that there was no reasonable prospect of the company avoiding insolvent liquidation; and

- continues to allow the company to trade after he or she knew or ought to have concluded; and
- does not take all the steps he or she should from that time to minimise creditors' losses.

A director does not need to have been dishonest to be liable for wrongful trading and he or she cannot avoid responsibility by resigning from the company when potential difficulties are spotted. This is a particularly thorny area for directors to navigate and proper advice should always be sought.

- **Fraudulent trading** This involves a degree of dishonesty on the part of the director as the offence requires an intention to defraud the company's creditors or some other fraudulent purpose. A director may be required to contribute to the company's assets available for distribution to creditors or may face criminal proceedings.
- **Misfeasance** A director can be guilty of this if he or she has misapplied or retained company assets or wrongly exercised authority. It does not necessarily involve moral blame. A director in breach may be ordered by the court to repay money or contribute to the company's assets available for distribution to creditors.

Indemnities and insurance

Can the company indemnify or insure me against claims?

A company may (but is not obliged to) indemnify you in respect of certain proceedings brought against you by third parties. An indemnity can potentially cover both the cost of the claim itself and the costs involved in defending it but never the following:

- the unsuccessful defence of or fines imposed in criminal proceedings; or
- penalties imposed by regulatory bodies.

It is common for a company to take out directors and officers insurance on behalf of its directors. Policy cover and terms vary from company to company and insurer to insurer but typically deal with directors' liabilities arising from claims of negligence, breach of duty or other default. Standard policy exclusions include fraud, dishonesty and criminal behaviour but the directors should ensure they understand any limitations on cover and that insurance policies are kept under regular review.

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