

## Directors' Duties under the Companies Act 2006

The Companies Act 2006 (the **Act**) became an Act of Parliament in 2006. Whilst much of the Act is being phased into force over the course of the next year or two, on 1 October 2007, one of the most significant changes to company law came into force in relation to the codification of the directors' fiduciary duties in the Act.

Prior to the enactment of the Act, directors' duties were governed by the common law and certain statutory requirements which were scattered amongst various pieces of legislation. One of the stated aims of the Act was to codify, and therefore, simplify directors' fiduciary duties and place a list of such duties in one place. This was designed to aid directors in assessing and complying with their duties. Although this was the laudable intention and whilst the Act contains a new statement of certain codified fiduciary duties of directors in sections 171 to 177 (the **codified duties**), the new legislation does not cover in one clearly defined area all duties that a director may owe to a company – for example, some duties will still remain at common law (such as the duty to take into account creditors if an insolvency situation may be likely) and other duties are to be found elsewhere in the Act (such as the duty to file annual accounts or hold an annual general meeting). For this reason, great care still needs to be taken by all directors and, if there is any doubt as to an application of the law, legal advice should be sought.

The codified duties apply to all directors of a company (including shadow directors and, in certain circumstances, former directors) and are owed to the company and only the company may enforce them.

- The most significant changes in relation to directors' duties from the old common law position are:
- there is now a statutory requirement for directors to have regard, amongst other things, to a list of factors in exercising their duty of good faith when deciding upon the business and transaction of the company; and
- it is now permitted for independent directors to authorise a director's conflict of interest where a conflict arises between that director and the company.

To go into more detail, the general codified duties of directors in the Act (as set out in sections 171 to 177 of the Act) are as follows:

- a duty to act within the directors' powers – a director must act within the designated powers of the constitution of the company and may only exercise his powers for their proper purpose;
- a duty to promote the success of the company – in assessing what will make the success of a company, the directors need to consider the following factors for each transaction they contemplate:

Teacher Stern LLP 37-41 Bedford Row London WC1R 4JH

t+44 (0)20 7242 3191 dx177 Chancery Lane w www.teacherstern.com

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- the likely consequence 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 and customers;
  - the impact of the company's operations on the community and the environment;
  - the desirability of the company maintaining its reputation; and
  - the need to act fairly as between the shareholders in the company;
- a duty to exercise independent judgement;
  - duty to exercise reasonable care, skill and diligence – this sets a subjective test (being the care, skill and diligence of each individual director based on his own experience) and an objective test (being the care, skill and diligence that may be reasonably expected of a director in a company). This creates an onerous obligation and director should take great care in exercising their powers;
  - a duty to avoid conflicts of interest;
  - a duty not to accept benefits from third parties – this duty does not, however, take effect if the accepting of a benefit would not give rise to a conflict of interests; and
  - a duty to declare an interest in a proposed transaction or arrangement with the company.

Although there has been much criticism of the codification of directors' duties in the Act, the fact remains that now these duties are set out in legislation, all directors must abide by the new provisions and, to the extent that there are inherent conflicts or lacunas in the legislation particularly between its interpretation and the interpretation of common law duties (or other duties set out elsewhere in the Act), it will be up to the directors to exercise their good faith judgement to resolve any conflicts that may arise.

The intent of the government was to simplify directors' understanding of their roles and duties. The result has seemingly led to greater confusion and opaqueness.

This article is only a brief summary of the new position as set out in the Act and each of the issues dealt with above are more complex and nuanced than this short article has capacity to deal with. If you are in any doubt as to your duties as a director, you should contact us for full legal advice given within the context of your particular matrix of facts.

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