

Directors' Duties under the Companies Act 2006

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A Summary

Chris Biggs, August 2010

Introduction

Under the Companies Act 2006 ("the Act") the general duties imposed upon a director have been codified. The statutory duties derive from the duties, responsibilities and liabilities of directors owed to their companies which were developed and interpreted through equitable and common law rules – for example, through the decisions made by the English Courts (known as "common law" rules as they were not set out in legislation). The duties contained in the Act replace those equitable and common law rules, although they should be interpreted, applied and upheld in the same way as the common law principles from which they derive.

Directors

There is no specific definition of a director contained in the Act. However, a general provision details that a "director" includes "any person occupying the position of director, by whatever name called". A director would therefore include a person who is treated by the Board as a director, despite not having been formally and validly appointed as such.

Please note that the duties, responsibilities and liabilities also fall upon any person (which may be a company) who is a "shadow director", which is "a person in accordance with whose directions or instructions the directors of the company are accustomed to act". As indicated, a shadow director has to comply with the duties etc imposed and may be held liable for his acts – a shadow director will not avoid liability simply because there is no formal appointment as a director.

Directors are responsible for the management of the company and may exercise the powers given to it – these powers are exercised by passing resolutions at board meetings. However, the extent of the powers and authorities that may be exercised may be limited by the Act and the company's articles of association.

General duties

There are seven codified duties contained in the Act (sections 170 to 177). The general duties apply to all directors of the company, which includes shadow directors and can also include former directors of the

company (for example, duty to avoid conflict of interest and duty not to accept benefits from third parties). An outline of these seven duties is set out below.

1. Duty to act within constitution and powers (section 171)

A director of the company must act in accordance within their powers – i.e. they must act in accordance with its memorandum and articles of association and only exercise powers for the purposes for which they are conferred. The director must not act outside this remit and must exercise any powers given for their proper purpose.

2. Duty to promote the success of the company (section 172)

The Act provides that a director must act in a way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.

3. Duty to exercise independent judgement (section 173)

A director of a company must exercise independent judgement. Therefore, a director must not take decisions which are influenced by others nor act in accordance with someone else's wishes.

4. Duty to exercise reasonable care, skill and diligence (section 174)

A director of a company must exercise reasonable care, skill and diligence with regard to: -

- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and
- (b) the general knowledge, skill and experience that the director has.

5. Duty to avoid conflicts of interest (section 175)

Under this section, a director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.

6. Duty not to accept benefits from third parties (section 176)

A director of a company must not accept a benefit from a third party which is conferred by reason of him being a director or of his doing (or not doing) anything as a director.

7. Duty to declare interest in proposed transaction or arrangement (section 177)

If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with a company, he must declare the nature and extent of that interest to the other directors.

The Act also provides that compliance with the general duties (as specified above) does not obviate the need for approval of the members of the company in respect of the following:

- i) Directors' long-term service contracts;
- ii) Substantial property transactions involving directors;
- iii) Loans or quasi-loans or credit transactions to and with directors;
- iv) Payments as compensation for loss of office.

Breach of duty

The duties described above are owed by a director of a company to the company and therefore only the company will be able to enforce them (although in some circumstances the members of the company may be able to bring a derivative action on the company's behalf).

Remedies

The usual remedy for a breach of the duty to exercise reasonable care, skill and diligence will usually be damages. Remedies for breaches of other general duties may include:

- i) An injunction;
- ii) Setting aside of the transaction, restitution and account of profits;
- iii) Restoration of company property held by the director

- iv) Damages or compensation for loss suffered by the company; and/or
- v) Termination of the director's service contract.

Liability

Generally speaking, the director of a limited liability company does not have personal liability as a result of acts carried out by the company itself. However, there are some circumstances where a director may incur both civil and criminal liability in the event of a breach of his duties.

Ratification

It may be possible for a company to ratify the actions of a director after the particular event has occurred. Of course, the action or transaction must have been within the company's objects as provided for in its memorandum and articles of association and not be one which a director is prohibited from undertaking.

Relief from the Court

The Act provides that where proceedings for negligence, default, breach of duty or breach of trust are brought against the director, the Court may relieve him from liability if it considers both that the director has acted honestly and reasonably and having regard to all of the circumstances of the case he ought fairly to be excused. Further, it is open for a director to apply to the Court for relief if he has reason to believe that a claim will or might be made against him in respect of negligence, default, breach of duty or breach of trust.

Other liability

It is also possible for a director to be found responsible or liable in actions concerning a breach of duties and obligations under health and safety provisions and environmental regulations and there are a number of provisions in the Company Directors' Disqualification Act 1986 and Insolvency Act 1986 which can have serious implications for a company director.

Please note that this document is only aimed at providing a general and brief overview of the various duties imposed upon a director of a company under the Act and is not intended to provide an exhaustive commentary on all matters. As such, if further advice or information is required, you should seek full and comprehensive legal advice.

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Chris Biggs

[e-mail](#)
[profile](#)

Telephone: 01844 268322