

## DIRECTORS' DUTIES

Notes on a seminar given for Messrs Houghton Stone by Michael Griffiths LL.B., LL.M., A.C.I.Arb. Co-editor of Loose on Liquidators and of Loose on the Company Director, contributor to Jordan's Corporate Administration and Governance, Gore-Browne on Companies and Charlesworth's Business Law, founding editor of the Journal of Insolvency Law and Practice, author of Insolvency of Individuals and Partnerships, co-author of Insolvency of Individuals and Partnerships, The Insolvency Act 1985, The 1985 Table A, Company Law, The Companies Act 1985 - A Guide for Lawyers, Accountants and Secretaries, and The 1986 Company and Insolvency Legislation, writer and consultant on company and commercial law, Partner, Mike Griffiths and Associates, Blossom Farm, Chatley, Worcestershire, WR9 0AP – telephone 01905 620430, Email Mike@blossomfarm.co.uk

### Meaning of Director

A director includes any person occupying the position of a director by whatever name called<sup>1</sup>.

A shadow director means a person in accordance with whose directions or instructions the directors of the company are accustomed to act<sup>2</sup>.

Some judges distinguish between:

De jure directors;  
De facto directors; and  
Shadow directors.

See *Re Hydrodan (Corby) Ltd*<sup>3</sup> (Millett J) and *Re H Laing Demolition Contractors Ltd*<sup>4</sup> (Evans-Lombe J).

### Number of Directors

A private company must have at least one director and a public company at least two<sup>5</sup>. Every company must have at least one director who is a natural person.

Moreover this requirement is satisfied if the office is held by a natural person who is a corporation sole<sup>6</sup>. A corporation sole is an office e.g the bishop of Chester.

---

<sup>1</sup> S. 250 which replaced s.741 CA 1985 on 1<sup>st</sup> October 2007.

<sup>2</sup> S. 251 which replaced s.741 CA 1985 on 1<sup>st</sup> October 2007.

<sup>3</sup> [1994] BCC 161.

<sup>4</sup> [1998] BCC 561.

<sup>5</sup> S. 154 which will replace s.282 CA 1985 coming in on 1<sup>st</sup> October 2008.

<sup>6</sup> S. 155 coming in on 1<sup>st</sup> October 2008.

Therefore it is only a corporation aggregate which is barred from being a sole director. The Secretary of State may give appropriate instructions to a company which fails in either of these requirements<sup>7</sup>.

No new company will be formed after this comes into force with exclusively corporate directors.

Existing companies have, however, until 1<sup>st</sup> October 2010 to find themselves a human director.

### **Minimum Age**

There is introduced a new minimum age for directors of 16 years<sup>8</sup>.

However, the Secretary of State may make provision by regulations for cases in which a person who is not yet 16 may be appointed a director. He also can by regulation make different provision for different parts of the UK<sup>9</sup>. The mind boggles at what could be done here!

Any existing director who is under the age of 16 will cease to be a director when these provisions come into force. In such an event the company must amend its register of directors (though no amendment need be made to the register of directors' interests because it ceased to be a statutory book on 6<sup>th</sup> April 2007<sup>10</sup>) but it need not inform the Registrar<sup>11</sup>.

### **Appointment of Directors**

Directors of public companies must be voted individually unless a resolution has first been passed unanimously to permit block voting<sup>12</sup>.

### **Validity of Directors' Acts**

As before, the validity of the acts of directors are unaffected by defects in their appointment<sup>13</sup>. This replaces s.285 of the 1985 Act. This includes instances where the director is disqualified from holding office or where he has ceased to hold office.

### **The Register of Directors**

The traditional rules regarding the register of directors will continue but directors will have the right to set out a service address rather than their actual address<sup>14</sup>.

A service address may be stated to be the company's registered office. This is clearly so as to enable directors with a chance of preserving the sanctity of their families, their homes and

---

<sup>7</sup> S. 156.

<sup>8</sup> S. 157(1) coming into force on 1<sup>st</sup> October 2008.

<sup>9</sup> S. 158.

<sup>10</sup> S. 325(1) CA 1985 is not replicated in the 2006 Act.

<sup>11</sup> S. 159.

<sup>12</sup> S. 160 which replaced s.292 CA 1985 on 1<sup>st</sup> October 2007.

<sup>13</sup> S. 161 which replaced s.285 CA 1985 on 1<sup>st</sup> October 2007.

<sup>14</sup> S. 163 which comes into force on 1<sup>st</sup> October 2009.

themselves from animal rights terrorists, political activists and similar malevolent lunatics. (More detail follows below).

There will no longer be a need to include in the register details of other directorships held. This is in fulfilment of a government commitment given in March 1998.

There are also changes to the requirement to provide the director's name. There must now be included any name by which the individual was formerly known for business purposes.

Where a member has or has had more than one name, all names must be stated. In this regard there is no longer an exception for a married woman's former name. Thus a married woman's former surname must be stated.

The Secretary of State may make regulations that add or remove items from the particulars that have to be entered on the register of directors<sup>15</sup>. This is a new provision.

The Criminal Justice and Police Act 2001 inserted new ss.723B to 723F into the Companies Act 1986. These allow directors to apply to the Secretary of State for a confidentiality order where the latter is satisfied that there is a serious risk that the director or any person living with him will be subject to violence or intimidation. It would seem that this facility will be repealed when the new provisions depending on a director's own decision to enjoy confidentiality come in<sup>16</sup>.

### **Register of Directors' Residential Addresses**

Every company must keep a register of directors' residential addresses. This must refer to a director's usual residential address. The section applies only to directors who are individuals<sup>17</sup>.

### **Shadow Directors**

As before (see s. 288(6) of the 1985 Act), shadow directors are under a duty to ensure that their particulars are entered on the register of directors<sup>18</sup>. However, this is a rather stupid provision since, almost by definition, a person will not know whether he is a shadow director until so pronounced by the court.

It must be said that the Explanatory Notes to the Act state that this requirement does not extend to shadow directors and indeed CA 1985 s.288(6) is not replicated in the new provision<sup>19</sup>. However, since shadow directors are expressly stated to be amongst the officers who can be fined in the event of default, it would seem logical to suggest that they have an obligation to include their particulars in the registers.

### **Removal of Directors**

---

<sup>15</sup> S. 166.

<sup>16</sup> Schedule 16.

<sup>17</sup> S. 165 coming in to force on 1<sup>st</sup> October 2009.

<sup>18</sup> S. 167(4).

<sup>19</sup> Para 295.

Section 168 re-enacts s.303 of the 1985 Act<sup>20</sup>. There is no substantive change in the law. As before, it will still be sensible for most companies to have a special article for the summary removal of directors without the need to resort to the 28 day special notice procedure required by this provision.

It must be remembered that the statutory provision for the removal of directors is a gloss on the earlier law. For directors appointed prior to 18<sup>th</sup> July 1945, appointment and removal was essentially a matter for the articles. Frequently it is desirable to retain a right to remove a director in special articles. The following are possibilities:

- the board may remove one of their number by notice given to him by all members other than himself;
- the board may call upon a director to resign; or
- the members may remove a director by special resolution.

Where advantage is taken of special articles such as these, the need for the holding of a general meeting under the statutory procedure is obviated.

### **Directors' Duties**

For the first time there is a codification of directors' duties. These are said to be based on the general duties owed under common law rules and equitable principles. They should be interpreted as such and "regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties"<sup>21</sup>. Rather ridiculously, again, they apply to shadow directors<sup>22</sup>. The statement that this is ridiculous is made with considerable circumspection. A shadow director is a person in accordance with whose directions or instructions directors are accustomed to act<sup>23</sup>. Having regard to the fact that shadow directors can be found liable for fraudulent and wrongful trading and can be disqualified as directors, the requirement that shadow directors should admit that they are shadow directors even before it is suggested that they might be shadow directors is not dissimilar to requiring a person to confess to a criminal offence even before he knows with what he is being charged.

The Company Law Review had three particular desires in regard to directors' duties:

- clarification of what is expected of directors, especially the question of in whose interests companies should be run.
- making the development of the law in this area more predictable but without hindering the development of the law by the courts.
- correcting what were perceived to be defects in the present duties relating to conflicts of interest.

---

<sup>20</sup> The relevant provision of the 2006 Act came into force on 1<sup>st</sup> October 2007.

<sup>21</sup> S. 170(4).

<sup>22</sup> S. 170(5).

<sup>23</sup> S. 251.

In regard to conflicts of interest there is one significant change. Transactions and arrangements between a director and his company must be declared rather than, as now, approved by either the board or the members in general meeting<sup>24</sup>.

### **To Whom are Duties Owed?**

Directors' duties are owed to their companies<sup>25</sup>. The Explanatory Notes state that it follows that, as now, only the company can enforce them. Members can, in appropriate circumstances, avail themselves of derivative actions and claims for unfair prejudice. However, see further comments below.

### **General Duty to Act within Powers**

Directors must act within their powers and in accordance with the company's constitution<sup>26</sup>. More specifically they must "only exercise powers for the purposes for which they are conferred"<sup>27</sup>.

It is envisaged that companies may through their articles go further than the general statement of directors' duties by the imposition of more burdensome requirements. For example, a special article might require members' approval of directors' remuneration.

Generally, special articles cannot dilute the duties imposed upon directors except where permitted in the following sections:

- By s.173 a director will not be in breach of the duty to exercise independent judgement if he has acted in a way which is authorised by the constitution;
- By s.175 there can sometimes be an authorisation of some conflicts of interest by independent directors subject to the constitution;
- S.180(4)(a) preserves any rule of law enabling the company to give authority for anything that would otherwise be a breach of duty;
- S.180(4)(b) provides that a director will not be in breach of duty if he acts in accordance with any provisions in the company's articles for dealing with conflicts of interest;
- There are restrictions on the provisions that may be included in the company's articles. However, nothing in the section prevents companies from including in their articles any such provisions as are currently lawful for dealing with conflicts of interest.

### **Duty to Promote Success of Company**

---

<sup>24</sup> S. 182 which comes into effect on 1<sup>st</sup> October 2008.

<sup>25</sup> S. 171(1) which came into force on 1<sup>st</sup> October 2007.

<sup>26</sup> S. 171

<sup>27</sup> S. 171(b).

They must act in a way in which they consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. In so doing they 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<sup>28</sup>.

However, if insolvency approaches, the directors must have regard to the interests of the company's creditors<sup>29</sup>.

The problem with expressing duties in this way, with directors having to have regard to "stakeholders" generally, lies in their enforcement. A duty is only as useful in law as it is enforceable. Directors have, and still do, owe their duties to the company. Thus enforceability is by the company through either the board, the members in general meeting or, if the company is in liquidation, through the liquidator, for example for misfeasance under s.212 of the Insolvency Act 1986 or wrongful trading under s.214 of the same Act. This, of course, is the basis of the rule in **Foss v Harbottle**<sup>30</sup>. Directors' duties are enforceable by the company and generally not by individual members, creditors or anyone else.

The theory behind the expression of the duty in this way is that a board should sit down and consider the interests of these various stakeholders before reaching a corporate decision. Whether this is going to prove to be the reality remains to be seen.

*Quaere: could regulatory bodies such as the FSA use this duty to discipline their members?*

### **Duty to Exercise Independent Judgement**

Directors must exercise independent judgement. This is said to codify the current principle of law whereby directors must exercise their powers independently, without subordinating their powers to the will of others<sup>31</sup>. The exercise of such a power may well be difficult for nominee directors of subsidiary companies.

However, the duty is not infringed by a director's acting:

---

<sup>28</sup> S. 172(1) which came into force on 1<sup>st</sup> October 2007.

<sup>29</sup> S. 172(3).

<sup>30</sup> (1843) 2 Hare 461.

<sup>31</sup> S. 173(1) which came into effect on 1<sup>st</sup> October 2007.

- in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or
- in a way authorised by the company's constitution<sup>32</sup>.

Thus, while the duty does not confer on a director a power to delegate, there is nothing to prevent the company's constitution permitting delegation.

*Quaere; should one consider introducing a special article into the constitution of subsidiary companies to the effect that nominee directors are acknowledged to be on the boards as representatives of their appointors?*

### **Duty to Exercise Reasonable Care, Skill and Diligence**

Directors must exercise reasonable care, skill and diligence. This means that they must show the skill which they actually have or that which might reasonably be expected of such a director, whichever is the higher<sup>33</sup>. This confirms that the standard expected of directors is in line with that for wrongful trading under s.214 of the Insolvency Act 1986 and the decision of Hoffmann LJ in **Re D'Jan of London Ltd**<sup>34</sup>. The 30 years qualified accountant must show the care, skill and diligence of a 30 years qualified chartered accountant, whereas those directors who might not be considered to be amongst the sharpest knives in the drawer cannot hide behind their subjective stupidity; they must show the care, skill and diligence that a sensible observer would expect of such a director of such a company. The former subjective standard expected of directors in **Re City Equitable Fire Insurance**<sup>35</sup> has now be replaced by the dual test.

### **Duty to Avoid Conflicts of Interest**

Directors must act in such a way as to avoid a situation in which he has or could have an interest which conflicts with the interests of the company. In particular this applies to the exploitation of any property, information or opportunity available to the company. It applies whether the company could or could not take advantage of such property, information or opportunity<sup>36</sup>.

It may be that this reverses cases such as the **In Plus Group Ltd v Pike**<sup>37</sup> and **London and Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd**<sup>38</sup> where it was suggested that sometimes a breach of duty may be justified.

Potential conflict situations must be authorised by the board. In the case of a private company this is so long as there is nothing in the company's constitution invalidating the authorisation. In the case of a public company, the constitution must specifically permit authorisation<sup>39</sup>. For methods of declaration of interest see below<sup>40</sup>.

---

<sup>32</sup> S. 173(2).

<sup>33</sup> S. 174.

<sup>34</sup> [1993] BCC 646.

<sup>35</sup> [1925] 1 Ch 407.

<sup>36</sup> S. 175(1) coming in to force on 1st October 2008.

<sup>37</sup> [2002] EWCA Civ 370

<sup>38</sup> [1891] WN 165.

<sup>39</sup> S. 175(5).

<sup>40</sup> S. 182 et seq.

See draft model article for public companies regulation 16; for private companies limited by shares see article 14.

Whenever authorisation is sought of the board, the interested director must not count in the quorum<sup>41</sup>.

### **Duty Not to Accept Benefits from Third Parties**

A director must not accept a benefit from a third party conferred by reason of his being a director or his doing or not doing anything as a director<sup>42</sup>. There appears to be a de minimis applied to this. This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.

*Quaere: Does this mark the end of corporate hospitality? At what point can it be said that a benefit cannot reasonably be regarded as likely to give rise to a conflict of interest? Should it be measured by the objective value of the benefit or the subjective personal wealth of the director concerned?*

### **Duty to Declare Interest in Proposed Transaction**

If a director is in any way, whether 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<sup>43</sup>. Such declaration must be made before the company enters into the transaction or arrangement. Again there is a de minimis applied to this and a director need not declare an interest if it is not such as could reasonably be regarded as likely to give rise to a conflict of interest<sup>44</sup>. Subject to the company's articles of association, conflicted directors may participate in decision making.

The ability of the members to authorise acceptance of benefits which would otherwise be a breach of duty is retained<sup>45</sup>.

Under the draft model articles of association for both public and private companies, the directors must in most circumstances disregard the views of an interested director when taking a majority decision on a matter relating to such transactions with the company.

### **Enforcement of Duties**

The consequences of a breach of any of the newly codified duties are the same as would apply if the corresponding common law rule or equitable principle were applied with the exception of the duty to exercise reasonable care, skill and diligence<sup>46</sup>. In other words, duties generally are enforceable in the same way as fiduciary duties. Why there should be an exception for the duty of care, skill and diligence is unclear. Could it mean that this duty is unenforceable? It is thought that this is probably not the case because it is expressly stated

---

<sup>41</sup> S. 175(6).

<sup>42</sup> S. 176(1) coming in to force on 1<sup>st</sup> October 2008.

<sup>43</sup> S.177(1) in force 1<sup>st</sup> October 2008.

<sup>44</sup> S. 177(6).

<sup>45</sup> S.180(4).

<sup>46</sup> S. 178(2).

that the consequences of a breach of duty are the same as would apply at common law<sup>47</sup>. However, the drafting is somewhat confused.

### **Declaration of Interest**

A declaration of interest may be made at a meeting of the directors, by notice in writing or by general notice<sup>48</sup>. Failure to declare an interest is a criminal offence<sup>49</sup>.

Rather ridiculously the rules governing a declaration of interest apply to shadow directors<sup>50</sup>.

*Quaere: is a shadow director likely to be present at a board meeting?*

*Quaere: at what point might a solicitor become a shadow director notwithstanding the express exception if he acts in a professional capacity? ). See Secretary of State v Deverell<sup>51</sup> where the Court of Appeal stated that “professional” in this context had to be very narrowly interpreted.*

Presumably the possibility of avoiding any transaction where the declaration should have been, but was not in fact, made continues. See *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald*<sup>52</sup>. This rule appears to be preserved by section 178 which provides that: “the consequences of breach ... are the same as would apply if the corresponding common law rule or equitable principle applied”.

### **Directors’ Service Agreements**

Any service agreement of more than two years requires the consent of the members<sup>53</sup>. This is a reduction from the present five years. (Interestingly, the original Bill contained a reference to five years, but the Lords felt that in the current climate this was excessive and reduced it further). Failure to obtain such approval means that the notice provision is void and the director is entitled merely to reasonable notice<sup>54</sup>. It is thought that approval is not needed in the case of existing companies and service agreements already in force so long as the previous five year provision has not been breached.

### **Substantial Property Transactions**

The rules regarding these remain substantially the same, the approval requirement being triggered when the asset exceeds £100,000 or 10% of the company’s net assets whichever is the lesser, with the exception that the de minimis is set at £5000<sup>55</sup>. There are exceptions in the case of a company which is being wound up or which is in administration (the latter of which is innovatory) – but not for companies in administrative or other receiverships<sup>56</sup>, as

---

<sup>47</sup> S. 178(1 in force 1<sup>st</sup> October 2008).

<sup>48</sup> S. 177(2).

<sup>49</sup> S. 180(1).

<sup>50</sup> S. 170(5).

<sup>4</sup> [2000] 2 All ER 365.

<sup>52</sup> [1995] 3 All ER 811

<sup>53</sup> S. 188(1) in force 1<sup>st</sup> October 2007.

<sup>54</sup> S. 189 in force 1<sup>st</sup> October 2007.

<sup>55</sup> S. 19 in force 1<sup>st</sup> October 2007.

<sup>56</sup> S. 193.

well as for transactions between companies within the same group<sup>57</sup>. Thus the decision in *Demite v Protec Health Ltd*<sup>58</sup> remains good law.

---

<sup>57</sup> S. 192.

<sup>58</sup> [1998] BCC 637