

# Directors Duties & Responsibilities

A guide to some of the key considerations for directors of private companies in England and Wales.

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## Introduction

The purpose of this guide is to summarise some of the key duties and responsibilities of directors of companies incorporated in England and Wales.

This guide relates to unlisted private companies. Directors of public and listed companies will be subject to additional duties, procedures and responsibilities which are not covered in this guide.

### Terminology used in this guide

**2006 Act** The Companies Act 2006. This Act replaced the previous companies act and came into force in stages from 2007. The 2006 Act was introduced to simplify and modernise company law in England and Wales. As the longest piece of legislation in the UK, it is very debatable whether it achieved its objectives.

A copy of the 2006 Act can be found [here](#).

**Articles** Articles of association. Each company has a set of articles of association which are its constitution. A company's articles set out the administrative procedures by which the company will operate.

Companies are free to adopt bespoke articles but there are standard forms which can be adopted (see references to Model Articles and Table A below). Typically companies adopt standard form articles of this type but with some amendment.

**Companies House** The registrar of companies for companies incorporated in the United Kingdom. Companies have obligations to file returns, accounts and other documents at Companies House.

Companies House also maintains registers which can be searched by the public.

The Companies House website can be found [here](#).

**Insolvency Act** The Insolvency Act 1986. This is the act which sets out much of the legislation relevant for companies in financial difficulties.

A copy of the Insolvency Act can be found [here](#).

**Model Articles** These are the standard articles for companies incorporated *on or after* 1<sup>st</sup> October 2009.

A copy can be found [here](#).

**Shareholders agreement** A generic description for an agreement between all or some of the shareholders of a company which regulates their dealings with each other and/or the operation of the company. Companies are often also parties to shareholders agreements which may contain specific

obligations on the company, its shareholders and/or its directors.

**Table A**

These are the standard articles for companies incorporated *before* 1<sup>st</sup> October 2009.

A copy can be found [here](#).

## Part A – appointment and removal of directors

How many directors should a company have?

Under the 2006 Act, private companies must have at least one director. A company's articles or a shareholders agreement may increase the number of directors that is required.

Can corporate entities act as directors?

Yes, but each company must have at least one director who is a natural person.

Are there any persons who are restricted from being directors?

Yes, these include:

- people under 16
- people who have been disqualified from acting as a director
- undischarged bankrupts (unless approved by a court).

How are directors appointed?

Typically a company's articles provide that directors can be appointed by:

- a resolution of the existing directors; or
- a resolution of the company's shareholders.

Directors should check their company's articles and, if applicable, any shareholders agreement to check the procedure for their company.

How are directors removed?

Again, the procedure for individual companies will be set out in their articles and, if applicable, any shareholders agreement. The 2006 Act also sets out a procedure by which a person can be removed as a director by the passing of an ordinary resolution of the shareholders.

Removing someone as a director will not necessarily terminate his employment nor will terminating the employment of a person automatically remove him as a director. In either case, the employment contract should be reviewed and specialist employment law advice taken.

Are companies permitted to have foreign directors or directors who live abroad?

Yes, companies can have directors who are overseas nationals and directors who live abroad. There is no requirement for any of the directors to be British nationals or to live in England and Wales.

Are companies required to have a company secretary as well as a director?

No. Under the 2006 Act, private companies are no longer required to have a company secretary. However, this position may be varied by a company's articles or under the terms of a shareholders agreement.

Where should the appointment and removal of directors be recorded?

- For appointments [a form APO1](#) should be completed and filed at Companies House.
- For removals [a form TMO1](#) should be completed and filed at Companies House.
- In either case, the company's register of directors should be updated.

## Part B – company law duties

### Who owes the duties?

All directors. Whether a director is full or part time, an executive or a non-executive director, he has the same legal duties.

### To whom are the duties owed?

The company. It is therefore the company that will be able to bring an action against the director if the duties are breached. However, in certain circumstances, the company's shareholders will be able to bring an action on behalf of the company.

### Is compliance with directors' duties the collective responsibility of the board or are the duties the individual responsibility of each director?

Directors owe the duties individually as opposed to the board collectively. That means that each director has to act independently as he sees fit rather than simply relying on what other directors are doing.

### What are the duties?

Directors' duties have been developed over a long period. Prior to the 2006 Act, there were established fiduciary duties (duties relating to acting in good faith) and established duties about acting with skill and care. Because these duties had been established by the courts they were not set out in any legislation. These fiduciary duties are still relevant and this guide refers to them as "common law duties".

The 2006 Act codified some, but not all, of the common law duties but also provided that certain new duties set out in the 2006 Act will be interpreted and applied in the same way as the common law duties. The fact that there is not a single source which sets out all directors' duties is unhelpful.

#### *Duties under the 2006 Act*

The 2006 Act sets out 7 duties:

- to act within powers
- to promote the success of the company
- to exercise independent judgement
- to exercise reasonable care, skill and diligence
- to avoid conflicts of interest
- not to accept benefits from third parties
- to declare an interest in a proposed transaction or arrangement with the company.

The Annexure to this guide sets out these duties in full.

### *Common law duties*

Common law duties which were not codified by the 2006 Act but are still applicable include:

- the duty of confidentiality
- the duty to act in the interests of creditors on insolvency (see Part C below).

### *Duties on insolvency*

If the company is insolvent there are particular considerations for directors and these are explored in more detail in Part C.

### *Are any duties more important than the others?*

No: the directors must comply with each duty.

That said, the duty to promote the success of the company is central to the role of directors and it is worth making particular reference to it:

*"A director of a company must act in good faith in the way 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, and in doing so have regard (amongst other matters) to –*

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

### *If a director breaches a duty can this breach be ratified?*

Yes, a company's shareholders can ratify the breach by passing a resolution. Under the 2006 Act, the votes of the director concerned and persons connected with him will not be counted in determining whether or not such a resolution has been passed.

### *Can a company exempt its directors for any liability for negligence, default, breach of duty or breach of trust?*

No, except in certain limited circumstances.

### *Can a company purchase insurance for its directors for any liability for negligence, default, breach of duty or breach of trust?*

Yes. But when purchasing insurance always check the terms carefully: for example, insurance may not cover breaches occurring before the term of the insurance.

## Part C – insolvency

Do directors have any additional duties when a company is in financial difficulties?

Yes. In these circumstances, the directors owe a duty to act in the best interests of the company's creditors.

Are there any ways in which directors can be personally liable if a company is in financial difficulties?

Yes, these include:

- *Fraudulent Trading.* Section 213 of the Insolvency Act provides that "If in the course of the winding up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose ....." then a court can declare that any persons who were knowingly parties to the carrying on of the business in this manner are liable to make contributions to the company's assets
- *Wrongful Trading.* Section 214 of the Insolvency Act provides that in the course of the winding up of a company the court may order a director to make a contribution to the company's assets if at "some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation"
- *Liability for breach of duty to the company's creditors*
- *Liability under personal guarantees.* If a director has personally guaranteed the debts of a company and the company is not going to be able to pay those debts then the director will be personally liable for the debts if the guarantee is enforced.

Does the above mean a company should cease trading as soon as it gets into financial difficulty?

Not necessarily. The directors need to make a judgement as to whether the creditors would be best served by the company continuing to trade or whether continuing to trade is likely to reduce the chances of the company being able to pay its debts. Often, this is not an easy judgment for directors to make and in these circumstances the directors should:

- obtain appropriate external advice (for example from a lawyer, an accountant or an insolvency practitioner)
- document the reasoning behind any decision
- ensure they have up to date and reliable financial information which is regularly reviewed.

## Part D - other duties and responsibilities

Other than the duties referred to in Parts B and C above, are there other legal duties and responsibilities which directors must comply with?

Yes, these include:

- *Health and Safety law and manslaughter.* The Health and Safety at Work etc Act 1974 imposes duties on companies, its directors, its managers and its employees in relation to health and safety. If an offence is committed by a company, directors can incur personal liability:

*"Where an offence under any of the relevant statutory provisions committed by a body corporate is proved to have been committed with the consent or connivance of, or to have been attributable to any neglect on the part of, any director, manager, secretary or other similar officer of the body corporate or a person who was purporting to act in any such capacity, he as well as the body corporate shall be guilty of that offence and shall be liable to be proceeded against and punished accordingly." (Section 37).*

Although convictions are rare, individual directors have been prosecuted for manslaughter where the death has been caused as a result of a company's activities.

- *Duties as an employee.* If the director is also an employee he will owe his employer additional duties. He will also be bound by the provisions of his service agreement.
- *Paying tax and national insurance.* The company and its directors have the responsibility to ensure that amounts are paid to HMRC when due. In certain, limited, circumstances directors can be personally liable for unpaid tax.
- *Employment law.* Directors can be sued personally in certain employment related claims including claims for unfair dismissal and discrimination.
- *Filing of returns.* Under the 2006 Act directors must ensure that the company files returns, forms and accounts at Companies House. Failure to do so can lead to a fine and ultimately to the company being struck off.
- *General legal considerations.* Directors have a responsibility to ensure that companies operate within the confines of all applicable laws.

## Part E – entering into contracts and using company property

Can a director or a person connected with him be a party to a contract with the company?

Yes, but there are a number of restrictions and points to watch, these include:

- the need to declare an interest in the contract (see Part F)
- shareholder approval is required for the acquisition of substantial assets from a company by directors or persons connected with them (section 190 of the 2006 Act)
- directors must always be mindful of their duties (see Part B above), in particular, duties concerning acting in the best interests of the company and conflicts of interests
- certain transactions could be challenged and unwound if the company is or becomes insolvent
- a company's articles and shareholders agreements may contain restrictions
- there are specific restrictions under the 2006 Act on directors borrowing from companies (section 197)
- under the 2006 Act employment contracts with *guaranteed* terms of over 2 years require shareholder approval (section 188 of the 2006 Act)
- the entry into certain contracts (for example, a purchase by the company of shares from a director) is subject to certain restrictions and approvals under the 2006 Act.

Can a director or a person connected with him use the property of the company?

Yes, but this may well amount to a conflict of interest. If this is the case, prior authorisation will be required. This authorisation can be given by shareholders.

Section 175 of the 2006 Act (see extract in the Annexure to this guide) also provides that conflicts can be authorised by the other directors. However, for companies incorporated before 1 October 2008 (the date section 175 came into force), directors will only be able to authorise conflicts in this way if the shareholders have resolved that this is permissible.

In certain circumstances, unless approval is obtained, directors can be liable to account to the company for any personal benefit they receive as a result of the exploitation of any property, information or opportunity of the company. For example, if a director exploits a business opportunity that was introduced to him in his capacity as a director (even if the company has chosen not to exploit that opportunity).

Where there is a conflict of interest, the articles and shareholders agreements are likely to contain specific provisions which need to be considered and the directors should have regard to all their duties and not just those relating to conflicts of interest.

## Part F – decision making

### How are decisions made in companies?

There are different levels of decision making within companies:

- some key decisions are reserved for consideration by the entire board of directors
- the board may delegate certain issues to committees of the board
- most day to day decisions are made by directors, managers and employees informally.

Responsibilities of employees, managers and directors should be set out so there is a clear understanding of (i) who is responsible for what and (ii) what approval is required for particular decisions.

### Are some decisions reserved for shareholders?

Yes. However, in very broad terms, most day to day decisions companies make can be made by the directors and are not reserved for shareholders. This position can be varied in a company's articles and shareholders agreements.

### How should decisions be recorded?

It is not practical for every decision made to be recorded formally. However:

- formal board meetings and meetings of board committees should be properly minuted, with copies circulated to all directors/members of the committees. This ensures that there is a clear record of what decisions have been made
- for decisions which are not made at board/board committee level, there should be clear reporting procedures so that all decision makers know what decisions they should report and to whom they should be reported.

### What is the procedure for board meetings?

The procedure will vary for individual companies and directors should review their company's articles to understand the procedures. If there is a shareholders agreement relating to the company this may also contain relevant provisions. The articles (and some shareholders agreements) will provide:

- how much notice must be given of a board meeting to directors
- how many directors need to be present for meetings of directors to be valid
- whether the directors can appoint a chairman and whether he will have an additional vote in the event that there is an equal number of votes for and against a matter
- whether directors are permitted to attend or vote at board meetings when they are personally interested in the subject matter of the meeting.

### Is the decision making process the same for each company?

No. Although directors are subject to the same duties (see Part B above), the decision making process and the way decisions are recorded will (and should) vary for each company depending upon its size and structure:

- in a small company with a few employees, decisions are likely to be made informally and quickly and mostly by the directors themselves. There is likely to be less need to hold formal board meetings and to have formal procedures setting out the responsibilities of directors and employees
- in a large company with many employees, decisions are likely to be made by a number of people and not just the directors. In these companies there will be a greater need for formal structures (such as regular board meetings and formal procedures setting out the responsibilities of directors and employees)
- directors are ultimately accountable to the company's shareholders. So where companies have shareholders who are not directors and/or directly involved in the day to day operation of the company there is a greater need for more formal structures. This will then enable directors to demonstrate that decisions are being made sensibly and in accordance with the directors' duties
- a company's articles and shareholders agreements may set out specific requirements as to how decisions are made and recorded.

### If a director or a person connected to him is personally interested in a transaction or arrangement does this prevent him from voting at a board meeting in respect of it?

This will depend on the company's articles and any shareholders agreement. Table A and the Model Articles both contain restrictions on directors voting in these instances. However, in the articles of many companies, these provisions are dis-applied or amended.

Regardless of what a company's articles say, the 2006 Act requires all directors to declare their interests (whether direct or indirect) in transactions or arrangements which exist or are proposed with the company (sections 177 and 182). A declaration must cover both the nature and the extent of the interest. These notices can be made at a board meeting, in writing to all directors or by giving general notice to the directors (there are formalities laid down in relation to each of these by the 2006 Act).

## Part G – avoiding liability

Ensure the company has proper procedures

Such as:

- holding regular board meetings (how formal these should be will depend on the nature of the company – see part F)
- providing regular information to all directors and shareholders
- properly and appropriately recording decisions and the reasons for them
- having proper controls and procedures for all areas of the business such as accounting, health and safety and employees

Be informed

- obtain up to date information about the company (particularly, if the company is in financial difficulty, financial information)
- if in doubt, take appropriate external advice especially if the company is in financial difficulty
- be aware of your duties and responsibilities
- understand the company's articles and any shareholders agreement relating to the company

Be open

- fully and clearly declare all interests
- if you are to enter into a contract with the company or use its property, check what approval is required and obtain it

Limit your liability

- avoid personal guarantees
- obtain directors' liability insurance and review the terms
- take regular professional advice, especially if the company is in financial difficulty
- have regular audits and reviews

## Annexure - extract from the 2006 Act

### **170 Scope and nature of general duties**

- (1) The general duties specified in sections 171 to 177 are owed by a director of a company to the company.
- (2) A person who ceases to be a director continues to be subject—
  - (a) to the duty in section 175 (duty to avoid conflicts of interest) as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director, and
  - (b) to the duty in section 176 (duty not to accept benefits from third parties) as regards things done or omitted by him before he ceased to be a director.

To that extent those duties apply to a former director as to a director, subject to any necessary adaptations.
- (3) The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.
- (4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.
- (5) The general duties apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply.

### *The general duties*

### **171 Duty to act within powers**

A director of a company must—

- (a) act in accordance with the company's constitution, and
- (b) only exercise powers for the purposes for which they are conferred.

### **172 Duty to promote the success of the company**

- (1) A director of a company must act in the way 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, and in doing so have regard (amongst other matters) to—
  - (a) the likely consequences of any decision in the long term,
  - (b) the interests of the company's employees,
  - (c) the need to foster the company's business relationships with suppliers, customers and others,
  - (d) the impact of the company's operations on the community and the environment,
  - (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
  - (f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

**173 Duty to exercise independent judgment**

(1) A director of a company must exercise independent judgment.

(2) This duty is not infringed by his acting—

(a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or

(b) in a way authorised by the company's constitution.

**174 Duty to exercise reasonable care, skill and diligence**

(1) A director of a company must exercise reasonable care, skill and diligence.

(2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with—

(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.

**175 Duty to avoid conflicts of interest**

(1) 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.

(2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).

(3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company.

(4) This duty is not infringed—

(a) if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or

(b) if the matter has been authorised by the directors.

(5) Authorisation may be given by the directors—

(a) where the company is a private company and nothing in the company's constitution invalidates such authorisation, by the matter being proposed to and authorised by the directors; or

(b) where the company is a public company and its constitution includes provision enabling the directors to authorise the matter, by the matter being proposed to and authorised by them in accordance with the constitution.

- (6) The authorisation is effective only if—
- (a) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the director in question or any other interested director, and
  - (b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.
- (7) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

**176 Duty not to accept benefits from third parties**

- (1) A director of a company must not accept a benefit from a third party conferred by reason of—
- (a) his being a director, or
  - (b) his doing (or not doing) anything as director.
- (2) A “third party” means a person other than the company, an associated body corporate or a person acting on behalf of the company or an associated body corporate.
- (3) Benefits received by a director from a person by whom his services (as a director or otherwise) are provided to the company are not regarded as conferred by a third party.
- (4) 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.
- (5) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

**177 Duty to declare interest in proposed transaction or arrangement**

- (1) If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors.
- (2) The declaration may (but need not) be made—
- (a) at a meeting of the directors, or
  - (b) by notice to the directors in accordance with—
    - (i) section 184 (notice in writing), or
    - (ii) section 185 (general notice).
- (3) If a declaration of interest under this section proves to be, or becomes, inaccurate or incomplete, a further declaration must be made.
- (4) Any declaration required by this section must be made before the company enters into the transaction or arrangement.
- (5) This section does not require a declaration of an interest of which the director is not aware or where the director is not aware of the transaction or arrangement in question.
- For this purpose a director is treated as being aware of matters of which he ought reasonably to be aware.
- (6) A director need not declare an interest—

- (a) if it cannot reasonably be regarded as likely to give rise to a conflict of interest;
- (b) if, or to the extent that, the other directors are already aware of it (and for this purpose the other directors are treated as aware of anything of which they ought reasonably to be aware); or
- (c) if, or to the extent that, it concerns terms of his service contract that have been or are to be considered—
  - (i) by a meeting of the directors, or
  - (ii) by a committee of the directors appointed for the purpose under the company's constitution.



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