

Directors' duties under the Companies Act 2006 – guidance for charitable companies

New general duties of directors under Chapter 2 of Part 10 of the Companies Act 2006 came into force on 1 October 2007 with the exception of provisions relating to directors' conflicts of interest duties under sections 175 – 177 which will come into force on 1 October 2008. This information sheet summarises the implications of the changes for directors

Current law

A director's fiduciary and common law duties have not been codified into statute and have evolved over time through case law. Under current law the following duties exist:

- duty to exercise skill and care
- duty to act in good faith in the best interests of the company
- duty to act within the powers conferred by the company's memorandum and articles of association and to exercise those powers for proper purposes
- duty not to fetter the discretion of the trustees
- duty to avoid conflicts of interest and conflicts of duty
- duty not to make a secret profit

A breach of any of these duties makes a transaction voidable. On that basis, if there is no fraud on the minority of shareholders, the members can normally ratify a transaction following a breach by ordinary resolution. In the case of a charitable company legal advice should normally be taken as a breach of directors duties is very likely also to be a breach of charity law and may not be capable of remedy in this way.

Main changes under the Companies Act 2006

The 2006 Act proposes to codify directors' duties by introducing a statutory statement of duties that will replace many existing common law and equitable rules. The new statement of duties does not cover all duties that a director may owe to the company. Section 441 of the 2006 Act incorporates a duty to deliver accounts and there will remain some uncodified duties such as the duty to consider creditors' interests in times of threatened insolvency.

The most significant changes in relation to directors' duties are:

- the statutory requirement for directors to have regard, among other things, to a list of factors in exercising their duty of good faith;
- allowing independent directors to authorise a director's conflict of interest.

All codified duties are owed to the company and only the company will be able to enforce them although members may be able to bring a derivative action albeit essentially on a company's behalf (sections 260-264). They will apply to all directors of a company, including shadow directors and, in the case of duties to avoid conflicts of interest and not to accept benefits from third parties, even former directors of a company.

More onerous duties may be imposed on companies in their articles but the articles cannot dilute the duties except to the extent expressly allowed by the 2006 Act. Directors of charitable companies are also charity trustees and have other duties and responsibilities that apply to all charity trustees under general charity law.

The new directors' duties in more detail

Chapter 2 of Part 10 of the 2006 Act contains the provisions on the general duties of directors. These are as follows:

- duty to act within powers (section 171). A director must act in accordance with the company's constitution and must only exercise his powers for their proper purpose. The 2006 Act defines a company's constitution, for the purposes of the general duties, as including the company's articles, decisions taken in accordance with the articles and other decisions taken by the members or a class of them if they can be regarded as decisions of the company (section 257).
- duty to promote the success of the company (section 172). A director 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 (section 172(1)). In the case of charitable companies where the company's purposes consist of or include purposes other than for the benefit of its members, the director must act in the way he considers, in good faith, would be most likely to achieve these purposes (section 172(2)).

In fulfilling the duty in section 172, a director must have regard (amongst other matters) 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;
- the need to act fairly as between the members of the company.

This list of factors which the directors are required to "have regard to" is not exhaustive and in relation to the factors listed above, the duty to exercise reasonable care, skill and diligence will apply (section 174). The duty is set aside in favour of the interests of creditors of a company if the company is insolvent or threatened by insolvency (section 172(3)).

The duty to promote the success of the company broadly replaces the existing fiduciary duty to act in the company's best interests.

- Duty to exercise independent judgement (section 173). A director must exercise independent judgement. This duty is not infringed by a director acting in accordance with an agreement entered into by the company that restricts the future exercise of the directors' discretion or in a way authorised by the company's constitution.
- Duty to exercise reasonable care, skill and diligence (section 174). A director must exercise such care, skill and diligence which would be exercised by a reasonably diligent person with both the general knowledge, skill and experience that may be reasonably expected of a person carrying out the functions

carried out by the director in relation to the company and the general knowledge, skill and experience that the director actually has.

- Duty to avoid conflicts of interest (section 175). A director must avoid situations in which he has or can have a direct or indirect interest that conflicts with or may conflict with the company's interests. The duty applies in particular to the exploitation of property, information or opportunity (whether or not the company could take advantage of the property, information or opportunity).
- Duty not to accept benefits from third parties (section 176). Directors must not accept any benefit (including a bribe) from a third party which is conferred because of his being a director or his doing or not doing anything as a director.
- Duty to declare interest in a proposed transaction or arrangement with the company (s.177). directors must declare to the other trustees the nature and extent of any interest, direct or indirect, in a proposed transaction or arrangement with the company. The director need not be a party to the transaction for the duty to apply.

Many of these duties run in parallel with the duties of charity trustees which will apply to directors of charitable companies. There are a number of technical refinements of the duties to avoid conflicts of interest and the duty not to accept benefits from third parties and to declare interests which will allow directors of commercial companies a degree of latitude which is not available to directors of charitable companies. In general, the position of a charity trustee is that he or she must not benefit from his position unless specifically authorised by the memorandum and articles of association of the company and he must avoid a conflict of interests and act always in the best interests of the charitable company. Any deviation from these principles will require the authority of the Charity Commission or, in the case of payment of trustees, the specific requirements of the Charities Act 2006 in relation to making decisions to remunerate trustees must be strictly followed.

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