

Briefing Note

Directors' Duties

Directors can wield a significant amount of power in the day-to-day management of a company, which could be a problem for shareholders if directors don't use their powers appropriately. As a result there are various obligations imposed on directors through ss171 - 177 of the Companies Act 2006 and at common law. This Briefing Note looks at these duties imposed on directors by the Companies Act 2006 (CA 2006).

1. A Summary of the Duties set out in CA 2006

Although shareholders are the owners of the company, directors owe their duties to the company directly (s.170 CA 2006). Companies are separate legal entities and directors act on their behalf. These duties are summarised as follows:

CA 2006	Duty
s.171	A director must act in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred.
s.172	A director must act in the way 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.
s.173	A director must exercise independent judgment.
s.174	A director must exercise reasonable care, skill, and diligence.
s.175	A director must avoid a situation in which they have, or can have, a direct or indirect interest that conflicts, or may conflict, with the interests of the company.
s.176	A director must not accept a benefit from a third party conferred by reason of their being a director or their doing anything as director.
s.177	If a director has a direct or indirect interest in a proposed transaction with the company they must declare that interest to the other directors.

2. Duty to Act within Powers – s.171

This duty can be broken down into two parts: 1) acting in accordance with "the company's constitution", and 2) only exercising their powers for the purposes for which they were conferred. In relation to the first part, a company's constitution includes the Articles (s.17 CA 2006) and certain resolutions and agreements, such as special resolutions (s.29 CA 2006). In essence, the directors can only act within the powers granted to them by the Articles and relevant resolutions. Any action taken outside of this would result in a breach.

3. Duty to Promote the Success of the Company – s.172

This duty applies to all actions/decisions taken by a director. When deciding whether or not an intended action is likely to comply with this duty, s172(1) CA 2006 provides a non-exhaustive list of factors to help the director come to their conclusion. Directors should consider:

1. the likely consequences of any decision in the long term;
2. the interests of the company's employees;
3. the need to foster the company's business relationships with suppliers, customers and others;
4. the impact of the company's operations on the community and the environment;

5. the desirability of the company maintaining a reputation for high standards of business conduct; and
6. the need to act fairly as between members of the company.

If a director considers these factors (and any others that are relevant to the circumstances surrounding the intended decision) and comes to the conclusion that the intended action will be the most likely one to promote the success of the company, then they can argue that they have complied with this duty.

4. Duty to Exercise Independent Judgment – s.173

Exercising independent judgment, for the purposes of this section, means that a director cannot take a decision/action as a result of being forced or manipulated into doing so. The director must act independently when coming to a decision to do with the company.

5. Duty to Exercise Reasonable Care, Skill, and Diligence – s.174

S.174(2) CA 2006 requires the exercised care, skill, and diligence to be the same as that of a reasonably diligent person with (1) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as that director; and (2) the general knowledge, skill and experience that the director has.

6. Duty to Avoid Conflicts of Interest – s.175

Directors are under a general duty to avoid any situation in which they have a direct or indirect interest that conflicts with the interests of the company. Although this is a wide ranging restriction, it emphasises the importance of the relationship between the director and the company – the former should always be acting on behalf of the latter for its benefit. If a director does breach this duty, they will have to account to the company for any profit that they have made (unless an exception applies).

7. Duty not to accept Benefits from Third Parties – s.176

This duty is fairly self-explanatory and aims to dissuade directors from accepting bribes or gifts from third parties that are given with the aim of influencing that director. Adherence to this duty is particularly important as certain gifts or benefits could also fall within the remit of the Bribery Act 2010, which carries with it more serious penalties for a director such as imprisonment.

8. Duty to Declare an Interest in a Proposed Transaction with the Company – s.177

This duty aims to ensure that a board of directors is made aware of any personal interest that a particular director has in a specific transaction that they are contemplating entering into before they enter into it.

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