DMH Stallard

Directors Duties Explained

All directors need to ensure that they understand their duties and how company decision making takes place. Directors responsibilities are defined in the Companies Act 2006.

Who is classed as a director?

If you are registered as a director at Companies House you clearly have a responsibility as a director but those who act as a director or in the capacity of a director still have a legal responsibility and this applies to non-executive directors too. It is a misconception that non-execs face less risk, they can all still be held accountable.

What is the personal liability of a director?

If a director is found to be in breach of their duties, there can be serious consequences and depending on the type of misconduct this could have severe financial consequences. It is therefore important that every director understands their responsibilities and how their company delegates decision making power.

The seven statutory directors’ duties that form the basis of what is expected and required of company directors.

Duty to act within their powers: Directors are responsible for managing their companies and they are given certain powers to do that. However, a director must act and make decisions in accordance with the company's constitution (which normally comprises the company's memorandum (if applicable) and articles of association) and should only exercise his/her powers for the purposes for which they are conferred.

Duty to promote the success of the company: This duty states that a director must act, in good faith, to promote the success of the company for the benefit of its members as a whole, and provides a non-exhaustive list of factors which the director must consider in order to fulfil this duty. A director must have regard (amongst other matters) to:

- the likely consequences of any decision in the long term;
- the interests of the employees;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company on the community and the environment;
- the company's reputation for, and desire to maintain, high standards of business conduct; and
- the need to act fairly as between the members of the company.

For larger companies (over 250 employees), with financial years beginning on or after January 2019, there is a requirement to produce a report, which must include a statement describing how the directors have complied with this duty.

Duty to exercise independent judgment: Directors must not compromise their independence. They must exercise independent judgment to form a view when making decisions and not follow the judgment of others without due consideration. This duty is not infringed if the director is acting (a) in accordance with an agreement entered into by the company that restricts the exercise of the director's discretion or (b) in a way authorised by the company's constitution.

This duty will not prevent directors from relying on advice, provided that the directors exercise their own judgment in deciding whether or not to follow that advice.

Duty to exercise reasonable care, skill and diligence: There are two tests to assess the standard required of a director.

(i) An objective test that requires the director to have the knowledge, skill and experience that would be reasonably expected of a person occupying that position. This test must be met by all directors at a minimum. Directors are expected to supervise and control, as well as to keep themselves educated on, the company's affairs.

(ii) A subjective test which takes into account the general knowledge, skill and experience that the director in question actually has. This second test would apply where a director has specialist knowledge, skill or experience. When applying this second test, the specific responsibilities and function of that particular director, as well as the circumstances of the company, will be considered.

Duty to avoid conflicts of interest: Directors must avoid situations in which they have, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. The scope of this duty is very wide and covers actual and possible conflicts of interests. This duty applies in particular to the exploitation of any property, information or opportunity.

This duty will continue to apply after a person is no longer a director, in regard to the exploitation of any property, information or opportunity which they found out about when they were a director.

The Act allows conflicts of interest to be authorised by the directors instead of the shareholders, subject to the terms of the articles of association of the company. It is therefore important to ensure that the constitution of the company permits the directors to authorise a conflict of interest.

Duty not to accept benefits from third parties: A director must not accept any benefit, including bribes, from a third party conferred because of his/her position as a director. This duty is not infringed if the benefit cannot reasonably be regarded as likely to cause a conflict, but directors should be cautious and be transparent with the Board as to any benefits received. This duty will continue to apply in relation to things done or omitted by a person before that person ceased to be a director.

Duty to declare interest in proposed transaction on arrangement with the company: A director must declare to other directors the nature and extent of any interest in a proposed transaction or arrangement with a company as soon as reasonably practicable. This could be relevant if a director is an employee, director, shareholder or adviser of another organisation with whom the company is entering an arrangement.

A director must make a disclosure under this duty if he/she is directly or indirectly interested in the transaction or arrangement even if he/she is not a party to the transaction. No disclosure is required if the director is not aware of his/her interest, but directors are expected to be aware of matters of which they ought reasonably to be aware of. If a previously made declaration is or becomes inaccurate or incomplete, the director must make a further disclosure.

Consequences of failure to comply

A director in breach of a duty could be required to compensate the company for any loss suffered as a result of that breach. Additionally, failure to comply with the various obligations imposed by the Act could result in the officers and/or the company becoming liable for a fine and/or a criminal offence. If a court concludes that a director is unfit, he/she could be disqualified from being a company director.

In brief

- Directors must make themselves aware of their duties and obligations and ensure that adequate procedures are in place to comply with the law and so that all their board understand their responsibilities.
- Directors should note that there are other obligations under the Companies Act 2006. Such as, for example, keeping proper books and records and filing annual accounts at Companies House.
- Companies should also review the terms of their directors and officers insurance in the light of these duties to ensure that they provide adequate cover for their needs.

Contact us

If you have any concerns about your company or personal responsibility contact one of our legal experts today via enquiries@dmhstallard.com.

Call us on 03333 231 580
e-mail us enquiries@dmhstallard.com