

DIRECTORS

OVERVIEW AND THE SEVEN
GENERAL DUTIES

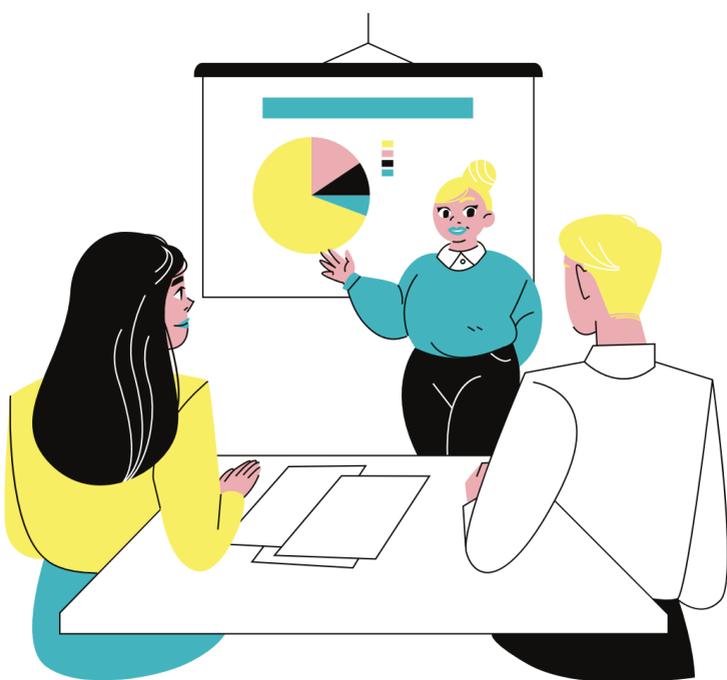


A UK incorporated company cannot be formed or operate without at least one director holding this position as an officer of the company. Although a company is a separate legal person, it cannot act on its own. It relies on its directors to act on its behalf and in its best interests.

Whether running a company with one or many directors, with the privilege and esteem of holding the position comes many onerous duties and responsibilities that directors must not fall foul to avoid potential personal liabilities and failure of the company.

What is a director?

Directors deal with the day-to-day management and running of a company and make the high-level decisions to be made in the best interests of the company, which usually means the shareholders. Directors are often also shareholders, but legally they are very different, and this results in a fiduciary relationship between them with directors having to uphold fiduciary duties.



A director is not comprehensively defined by statute, but generally it means a person who is responsible for the management of a company and occupying the position of a director.



A cautionary note is that the term “director” can include any person undertaking the duties of a director even though not specifically named as one, which means they too must comply with all duties of a director, carry the same risks and are generally subject to the same legal controls on their actions.

There are number of different categories of directors all of which have the same general and fiduciary duties to the companies:

De jure director

This type is formally appointed and registered as a director with the Registrar of Companies at Companies House. Every company must have at least one to be initially formed.

A de jure director might not actually undertake any day-to-day business matters but rather participate in board meetings.

Executive Director

This category is usually a full-time employee (even if also a shareholder) who carries out the daily operational duties and functions of running the company's business.



De facto director

This type is not formally appointed as a director, possibly due to an administrative error or has resigned as a director but still carries out all the duties of a director and makes decisions as a director. A de facto director has the authority to make high-level decisions, sign company papers and be treated across the company as a director.

A company can have many such directors, which will usually mean they individually have different operational functions.

An executive director can resign his office holder position but still continue in the company as a normal employee of it.

Non-executive director

This category is more common in larger companies and are usually external professionals with specific business skills. They do not have day - to - day operational responsibilities, but rather function in specific purpose committees and attend board meetings.

A non-executive director is not an employee of the company so are usually either paid or unpaid consultants.

This can be a risky category to accidentally fall into as director's liabilities can attach to it even though they were never contemplated.

Shadow Director

A shadow director is defined as a person in accordance with whose directions or instructions the directors of a company are accustomed to act.



The name suggests a background figure who deliberately conceals their real influence over the company's directors. However, that is not always the case, though frequently it is. For example, a person may own all the shares in a company but chooses to operate it through a board of directors. If they exert influence over the majority of directors, they could be classed as a shadow director.

For the same reason as de facto, this is a risky category to fall into.



The seven general duties

Before becoming a director, it is vital to know and understand the main duties and obligations of becoming one.

So, the seven general duties include:

1.To act within powers

A director must act in accordance with the company's constitution (generally meaning its Articles of Association) and only exercise powers provided by it for the purposes for which they are conferred, so directors must be familiar with its articles and not exceed the permitted powers.

In addition, decisions taken in accordance with the articles, and any resolutions and agreements that affect the constitution. All of these items place limits on a director's authority. If this authority is exceeded, the director will have breached the duty.

Directors need to be aware that shareholders have rights under the constitution, by which they can remove directors, instruct directors in certain matters and actually amend the constitution.

2.To exercise independent judgement

A director is required to act independently and exercise their judgment.

A director may seek professional advice, but the final decision to act upon that advice must be a director's in the best interests of the company.



A director can delegate powers to somebody else to act on their behalf as long as the company's articles permit such delegation and use their own judgment when deciding whom to delegate to.



3.To promote the success of the company

Using their own judgment, whether independent or based on sound advice, a director is required to promote the success of the company for the benefit of its members (meaning its shareholders).

To satisfy this duty, it is mandatory for a director to take the following into consideration:

- the long-term consequences of any decision
- the interests of the company's employees
- the company's business relationships including suppliers, customers and other relationships
- the impact of the decision on the environment and the community
- the benefits to the company of having and maintaining a reputation for high standards of business conduct
- the need to act fairly as between the company's members

The above is not exhaustive and a director should also consider any other relevant factors, issues and consequences of decisions to be taken.

Once the factors are taken into account, the decision can have negative consequences on one of the six factors, so long as the director believes that overall the action is most likely to promote the success of the company.

4.To exercise reasonable care, skills and diligence

In determining the necessary standard to apply for this duty, it is required to consider the care, skill and diligence that would be exercised by a reasonably diligent director who has:

- the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions performed by the director in relation to the company (an objective standard)



- the actual general knowledge, skills and experience that the director has (a subjective standard)

The minimum standard is that a director must act in a way expected of a reasonably diligent person with their general knowledge, skills and experience. But if a director has more specialist knowledge, such as when a specialist executes a function, then the higher standard will be applied. For example, an individual who is appointed as a finance director, but who has no experience in such matters will be in breach of this duty if they do not have the level of skills and experience required to fulfil that role.

5. Try to avoid conflicts of interest

A director must avoid a situation in which they have, or could have, a direct or indirect interest that conflicts, or may possibly conflict, with the interests of the company. Conflicts very often arise because of personal interests or duties owed to connected third parties.



A director can be impacted by this duty in a number of ways and so it is important that a director carefully considers their position, and that of those connected to them, in order to find out whether they may be breaching the duty. A breach of this duty does not depend on whether the director is aware that their actions are a breach.



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This duty applies particularly to the exploitation of an opportunity. For example, a director exploiting for their own personal gain a business opportunity which could have been taken up by the company, which applies regardless of whether the director can take advantage of the particular matter.

There are some exceptions to the duty, such as:

- a conflict that has been authorised by the other directors who do not have the same conflict
- a situation that cannot reasonably be regarded as likely to give rise to a conflict
- pre-authorised in the Articles of Association
- authorised by a shareholder resolution

Resigning as a director does not end the duty if a director became aware of an opportunity whilst in office.



6.To not accept benefits from third parties

A director must not accept a benefit from a third party provided by reason of being a director or by doing or not doing something as a director. This duty continues to apply after ceasing to be a director.

A “benefit” can mean many things including a direct payment to a director of a connected party, expensive gifts or a lucrative personal business deal. Therefore, small gifts or routine hospitality are not considered to be in conflict with this duty.

A “third party” is very broad and includes a person other than the company or an associated company or a person acting on behalf of either.

Generally, the duty exists to avoid the temptation of receiving bribes but has also been described as a ‘favourable or helpful factor, circumstance, advantage or profit’.

7.To declare interest in proposed transaction or agreement

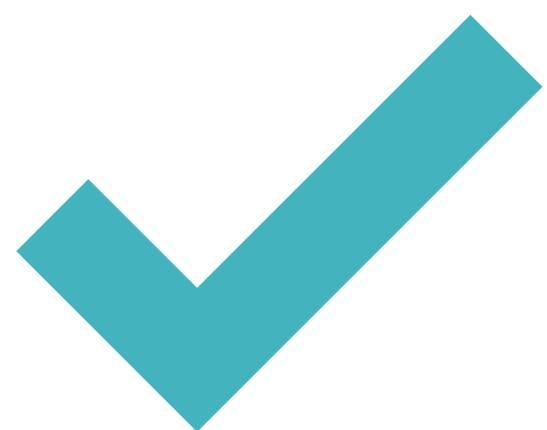
If a director is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company then they must declare both the nature and extent of this interest to the other directors before the company enters into the transaction or arrangement.



Although the statutory duty is only to declare an interest in such an arrangement, the company's articles may impose further restrictions on how the director can act in such circumstances. For example, the director may not be allowed to take part in any board meetings held to consider the relevant transaction.

A director must not only consider their own situation, but also that of those connected to them. For example, if the spouse of a director was a shareholder in a company with which the director's company was planning to enter into a contract, the interest would need to be declared.

The exceptions to this rule are similar to the ones in the 'no conflict duty' outlined above, in that if the interest cannot reasonably be regarded as likely to give rise to a conflict there will be no breach. Also, where the director is not aware of the interest or where the director is not aware of the transaction or arrangement, there will be no breach (directors will be treated as being aware of matters of which they ought reasonably to be aware). If the other directors are already aware of the interest, there will also be no breach.



In Conclusion

The seven general duties should not be considered singularly as they all function together and must be considered on that basis. A director's actions may be a breach of more than one duty. In addition, compliance with one duty does not ensure compliance with the others and compliance with one duty cannot justify the breach of another.

The duties when combined are rigorous and should cause existing directors and those considering becoming a director much contemplation before making decisions. That said, when acting professionally and with integrity as the majority of directors do, they all make perfect business sense and should not cause any difficult challenges.



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