

## DIRECTORS' DUTIES

### Statutory Statement Taking Effect from 1 October 2007

For the first time, directors' duties are codified; until now the extent of such duties has been developed and expanded by case law and equitable principles. These duties have now been placed into statutory form with the aim of providing greater clarity on what is expected of directors and to make the law more accessible.

There are seven principal duties set out in ss.170-181. Four of these come into force on 1 October 2007; provisions relating to conflicts of interest will not be introduced until 1 October 2008 and accordingly the current provisions of the 1985 Act (see in particular s317) will continue to apply to the declaration of interests and the resolution of conflicts until that date.

The four duties now coming into force are:-

1. **To act within their powers (S.171 CA2006)** – a director must act in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred. Accordingly, a company's articles of association must continue to be consulted to ascertain the extent of a director's powers and any limitations placed upon them.
2. **To promote the success of the company (S.172 CA2006)** – 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, and in doing so have regard" to certain matters. The words "success of the company for the benefit of its members" replaces the previous common law duty to act "in the best interests of the company". During debate on the company law bill, it was suggested that 'success' will normally mean 'long-term increase in value'. S.172 sets out the matters to which directors should have regard –
  - 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;



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

Enshrining these matters in statute goes beyond a mere codification of the existing law. For the first time, various 'stakeholders' to whose interests directors must have regard, are specifically identified. A director's principal duty continues to be owed to the company and its members but in pursuing this duty directors must have regard to all these matters, including the interests of other stakeholders.

3. **To exercise independent judgement (S.173 CA2006)** – this duty codifies a current principle of law under which directors must exercise their powers independently, without subordinating their powers to the will of others, whether by delegation or otherwise. The section makes it clear that 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 discretion by its directors or by acting in accordance with the company's constitution, which would include resolutions of shareholders.
4. **To exercise reasonable care, skill and diligence (S.174 CA2006)** – the existing duty placed on a director to exercise reasonable care, skill and diligence is codified. Traditionally, the courts did not require directors to exhibit a greater degree of skill than may reasonably be expected from a person with their knowledge and experience (a subjective test). Recent case law requires that there should also be an objective assessment of a director's conduct. The new section reflects this. Accordingly, s.174 provides that a director owes a duty to his company to exercise the same standard of care, skill and diligence that would be exercised by a reasonably diligent person with –
  - the general knowledge, skill and experience that may reasonably be expected of the person carrying out the same functions as a director in relation to that company (an objective test), and
  - the general knowledge, skill and experience that the director actually has (a subjective test). For example a Finance Director could be expected to have a greater knowledge of the company's accounts than, say, a Human Resources director.

The statutory statement of directors' duties does not cover all the duties that a director may owe to the company; only the common law duties are codified. Many duties are imposed elsewhere in legislation, such as the duty to keep accounting records, to protect the health and safety of employees, to preserve the environment through the proper disposal of waste etc.

Please do ask us for further information or assistance on this new regime for directors. It is essential that directors understand their new duties and we will be pleased to arrange briefing sessions for individual directors or company boards. Please speak to one of our partners.