

GENERAL DUTIES OF DIRECTORS

and their Personal Liability

This paper looks at the various duties that a director owes to his company and others, both under the new Companies Act 2006 ("CA 2006") and as a consequence of other legislation.

Chapter 2 of Part 10 of CA 2006 (SS.170-181) has codified old common law duties. These are explored further below. Directors have numerous other duties under the Companies Acts ("the Acts"), such as ensuring that accounting records are maintained and statutory returns and accounts are filed, together with other responsibilities derived from laws governing health and safety, employment, the environment, tax, consumer protection, data protection and others. This paper concentrates on the generic duties of a company director and does not examine the particular duties that a director of a public company may owe under the Acts and the Listing Rules.

Statutory – General Duties of Directors under CA 2006

A director's prime duty, which he holds together with his fellow directors, is to manage the company for the benefit of its members. The extent of a director's authority is set out in the company's Articles of Association. The Articles normally permit the directors to exercise the powers of the company, subject to the provisions of the Acts, the company's Memorandum and Articles of Association and any further directions given by the members. Sometimes, the board of directors will delegate some or all of their powers to particular directors (perhaps constituting a committee of the board) and/or other senior officers in the company, but they can not delegate their duties.

Since 1 October 2007, the following directors' duties have been codified:

1. **To act within their powers (S.171 CA 2006)** – directors must act in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred. The company's Articles of Association should be consulted to ascertain the extent of a director's powers and any limitations placed upon them.



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2. **To promote the success of the company (S.172 CA 2006)** – 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 (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; and
 - the need to act fairly as between members of the company.
3. **To exercise independent judgement (S.173 CA 2006).**
4. **To exercise reasonable care, skill and diligence (S.174 CA 2006)** – S.174 requires that a director owes a duty 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, the Finance Director would be expected to have a greater knowledge of finance issues than say the HR Director (the objective test); but if the HR Director is a qualified accountant, then he would be expected to have a greater knowledge than would normally be expected of a HR Director (the subjective test).

The provisions relating to the codified duties to avoid conflicts of interest, not to accept benefits from third parties and to declare interests in proposed transactions or arrangements (SS 175-177 CA 2006) will be introduced by 1 October 2009. The current provisions of the 1985 Act (see in particular S.317, duty to disclose interests in contacts) will continue to apply to the declaration of interests and the resolution of conflicts until then.

Department for Business Enterprise & Regulatory Reform’s website
<http://www.dti.gov.uk/bbf/co-act-2006/index.html>

Statutory – Specific Duties of Directors under CA 1985 and CA 2006

1. **Filing Obligations** – directors have a duty under the Companies Acts to file with Companies House particular documents on the occurrence of certain events. The main events that carry filing obligations are:
 - changes in the directors or company secretary or any of their personal details;
 - share allotments;
 - the company’s annual return;
 - members’ resolutions and agreements affecting the company’s constitution (eg special resolutions); and
 - statutory accounts.

2. **Accounting records, Accounts and the Company's Audit** – directors are responsible for ensuring that the company maintains accounting records and that the company prepares accounts. The directors each have a duty to make themselves aware of any “relevant audit information” and ensure that the auditors have been made aware of that information. A disclosure stating that each director has complied with that duty has to be given in the Directors' Report of the company's accounts (S.234ZA CA 1985, to be replaced on 6 April 2008 by S.418 CA 2006).

Guidance notes on various company law and secretarial matters may be found on the Companies House's website:

<http://www.companieshouse.gov.uk/about/guidance.shtml>

Duties of Directors beyond CA 1985 and CA 2006

1. Employment

A director of a company that has employees must ensure that the company provides its employees with an employment contract or written particulars of employment and ensure that the terms of the contract are observed. An employer should also ensure that there is no discrimination in the workplace (such as sexual, racial, on age or on grounds of disability) and ensure that the employee's statutory rights are observed.

It should be noted that if a company employs an illegal immigrant or overstayer, then under section 9 of the Asylum and Immigration Act 1996, the directors can also be found personally guilty of the offence as well (fine of up to £5,000) if it can be shown that the offence was committed with their consent, connivance or caused by their neglect.

Further information on employment matters may be found on the Department for Business Enterprise & Regulatory Reform's website:

<http://www.dti.gov.uk/employment/index.html>

2. Employer's Liability Insurance

If the company has employees, it must have employer's liability insurance in place, with a minimum cover of £5 million for each claim. It is a criminal offence not to have effected employer's liability insurance or to fail to display the certificate of insurance. Previous insurance certificates should be kept for 40 years.

3. Health & Safety

The directors have a general duty to the company's employees to ensure their health, safety and welfare at work. Employees must be provided with safe conditions and systems of work and receive appropriate training and supervision. The directors, if the company employs five or more people, must put in place a formal written health and safety policy, which is communicated to the employees. As part of formulating the health and safety policy, employers are required to assess formally the risks to employees whilst at work and to implement measures to mitigate such risks by the assessment. Failure to undertake such a risk assessment is a criminal offence.

The Health and Safety Executive recommends that health and safety should be a Board matter and recommends a health and safety director is appointed.

Further information on health and safety may be found on the Health and Safety Executive's website: <http://www.hse.gov.uk>

4. Disability Discrimination

Directors of companies that provide services, under Part III of the Disability Discrimination Act 1995 (which has been amended by the Disability Discrimination Act 2005), should take positive steps to ensure that the services provided are available to disabled people and prevent discrimination on the grounds of a person's disability. A person (including a director) who aids the unlawful discrimination of a disabled customer, can face a civil action being brought against them for financial loss and injury to feelings, in addition to any action brought against the company itself. For example, a partially sighted customer of bank would be entitled to receive statements with extra large print. If the Operations Director of the bank refused to make such statements available, then not only the bank could face action from the customer, but the Operations Director as well.

The Department for Work and Pensions is responsible for the Disability Discrimination Acts and further information may be obtained on the Acts from its website: <http://www.dwp.gov.uk/aboutus/business.asp>

5. Data Protection

The Data Protection Act 1998 ('DPA 1998') sets out the requirements for processing personal data, whether it is stored electronically or in a manual system. A company that processes data is required to notify its activities to the Information Commissioner. The notification would include details of the purposes for which data is being processed, who are the data subjects (ie whom the information is being kept about), the types of information being kept (eg personal, financial, etc) and any recipients of the information.

It should be noted that if a company commits an offence under the DPA 1998, then the directors can also be found personally guilty of the offence as well if it can be shown that the offence was committed with their consent, connivance or caused by their neglect.

Best practice guides and further information on Data Protection and registration with the Information Commissioner are available from the Information Commissioner's website: <http://www.ico.gov.uk>

6. Trade Descriptions, Consumer Credit and Protection and Competition

The Trade Descriptions Act 1968 and Part III of the Consumer Protection Act 1987 impose strict criminal liability for a false description of goods made in the course of a trade or business. The directors, as well as the company, may be personally liable for such an offence where it was committed with their knowledge or consent or was due to their negligence. It is therefore essential to ensure no breaches occur whether in advertising the goods, describing them or packaging them. Directors can also be personally liable in giving a false description or indication of the price of goods or services, if given with their consent, connivance or caused by their neglect.

The Consumer Credit Acts of 1974 and 2006 require companies to obtain a consumer credit licence if they offer goods or services on credit, or lend money to consumers. It is a criminal offence (punishable by imprisonment and/or a fine) to operate without a consumer credit licence, where one is required. Directors, therefore, must ensure that their companies comply with the requirements of the Acts.

The Competition Act 1998 prohibits uncompetitive practices, such as price-fixing, cartels and concerted practices. The Act has brought UK law into line with EU requirements. The Office of Fair Trading polices compliance with the Act and can make referrals to the Competition Commission. It should be noted that directors of companies can be made personally liable under the Act, if with their consent, connivance or caused by their neglect, the company does not cooperate with an investigation, or destroys or falsifies documents, or provides false or misleading information.

Further information for businesses on consumer protection, consumer credit and competing fairly may be found on the Office of Fair Trading's website: http://www.offt.gov.uk/advice_and_resources/small_businesses/

7. **The Environment**

There is now a mass of legislation to protect the environment and punish polluters. These include the Environmental Protection Act 1990, the Environment Act 1995 and the Pollution Prevention and Control (England and Wales) Regulations 2000. This legislation imposes criminal liability on the company for infringement, as well as making directors personally liable for offences committed with their consent or connivance or resulting from their negligence.

Further information on businesses and the environment may be found on the Department for the Environment, Food and Rural Affairs' website: <http://www.defra.gov.uk/environment/business/index.htm>

8. **Taxation (Tax, VAT, NIC and PAYE)**

The directors are responsible for ensuring the calculation of taxes due and payable by the company (and in the case of NIC and PAYE, for its employees as well), the filing of returns, making payments to Her Majesty's Revenue and Customs and the maintenance and retention of tax records. Normally, these tasks would be delegated to a competent person, but this delegation would not relieve the directors of their ultimate responsibility for tax matters.

Further information on taxation may be found on Her Majesty's Revenue and Customs' website: <http://www.hmrc.gov.uk>

9. **Money Laundering**

The new Money Laundering Regulations 2007 came into force on 15 December 2007. The regulations require various steps to be taken by credit and financial institutions, auditors, insolvency practitioners, external accountants, tax advisers, legal providers, trust and company service providers, estate agents, high value dealers and casinos to detect and prevent money laundering and terrorist financing. If a company commits an offence under the Regulations, then any officer (including a director) is also personally liable for prosecution alongside the company for any offences committed with their consent or connivance or resulting from their negligence.

Further information on money laundering may be found on the Joint Money Laundering Steering Group's website: <http://www.jmlsg.org.uk>

10. **Fraudulent Trading and Wrongful Trading**

Under S.213 Insolvency Act 1986, the court can require a director to make a personal contribution to the assets of a company in liquidation, if it can be shown that the director knew that the company's operations were being carried on with an intent to defraud the creditors of the company or of other people.

Similarly, under S.214 Insolvency Act 1986, the court can require a director to make a personal contribution to the assets of a company in insolvent liquidation, if it can be shown that at some time before the company entering into liquidation, the director knew or ought to have known, that there was no reasonable prospect that the company could avoid insolvent liquidation.

In addition, either of these factors can be considered by the Court in determining whether the director should be disqualified from acting as a director under the Company Directors Disqualification Act 1986. A person, who acts as a director whilst disqualified, will be jointly and severally liable with the company for the relevant debts incurred by the company.

Further information on insolvency and disqualification of directors may be found on the Insolvency Service's website: <http://www.insolvency.gov.uk>

Please ask us for further information or assistance on any of the matters raised. It is essential that directors understand their duties and we will be pleased to arrange briefing sessions for individual directors or company boards. Please speak to one of our partners – David Venus, Douglas Armour, Martha Bruce or Susan Wallace – on 01372 465330.