

## Directors' Duties – Changes from 1 October 2007 James Hutchinson, October 2007

On 1 October 2007, directors' fiduciary and common law duties will become codified and enforceable under the Companies Act 2006.

The Act emphasises the requirement on directors to promote the success of the company for the benefit of its shareholders and facilitate "enlightened shareholder value" – the concept that directors will be more likely to achieve long-term success for the benefit of shareholders if their companies behave responsibly. These principles are set out in the following changes to the current law:

- **Duty to act within powers (s.171)** – a director must act within the company's constitution and only exercise powers for the purposes for which they are conferred.
- **Duty to promote the success of the company (s.172)** – 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. In fulfilling this duty, a director must have regard to:
  - o the likely consequences of any decision in the long term;
  - o the interests of the company's employees;
  - o the need to foster the company's business relationships, customers and others;
  - o the impact of the company's operations on the community and the environment;
  - o the desirability of the company maintaining a reputation for high standards of business conduct; and
  - o the need to act fairly between members of the company.
- **Duty to exercise independent judgment (s.173)** – a director must exercise independent judgment but this duty will not be infringed by his acting in accordance with an agreement entered into by the company restricting the directors' future discretion or in a way authorised by the company's constitution.
- **Duty to exercise reasonable care, skill and diligence (s.174)** – a director must exercise the care, skill and diligence that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company and the general knowledge that the director has.
- **Duty to avoid conflicts (s.175)** – a director must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict with the interests of the company.
- **Duty not to accept benefits from third parties (s.176)** – a director must not accept a benefit from a third party conferred by reason of his being a director, or his doing (or not doing) anything as a director. The duty is not infringed if the acceptance of the benefits cannot reasonably be regarded as likely to give rise to a conflict of interest, or if the benefits are conferred by the company, its holding company or a subsidiary.
- **Duty to declare interest in proposed transaction or arrangement (s.177)** – if a director is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors.

Our view is that the codification of directors' duties will increase the burden of bureaucracy on directors, make it easier for shareholders to bring derivative actions (a claim where the shareholders acting on behalf of the company can start legal proceedings against the company's directors) and potentially stifle entrepreneurialism. Companies should ensure that:

- **Directors are aware of their duties** – existing and new directors should be provided with suitable training and directors' service agreements should refer specifically to the codified duties.

- **Board and committee meetings must formally deal with each of the duties** – board and committee meetings will need to take on a more formal process by ensuring that each of the duties are addressed when making decisions.

If you would like further information on implementing the changes to directors' duties introduced by the Companies Act 2006, please contact:

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