Directors managing their company must do so in accordance with the company’s articles of association and ensure that the company complies with its numerous statutory obligations. But there are also certain general statutory duties, the aim of which is to protect shareholders, which directors are personally subject to in managing the affairs of the company, and with which they must also comply.

What are directors' general statutory duties?

Who owes the duties and who are they owed to?

What are the consequences of breach?

Is there a continuing duty once a directorship has ended?

What about the interests of creditors?

Indemnities and D&O insurance

Points to consider

What are directors' general statutory duties?

The Companies Act 2006 (the Act) codified certain common law and equitable duties of directors. Sections 171 to 177 of the Act set out the seven general duties, an overview of which is given below:

- **to act within powers** - i.e. to act in accordance with the company’s constitution (i.e. its articles of association) and only exercise powers for the purposes for which they were
• to promote the success of the company - by acting, in good faith, in a manner considered for the benefit of the company’s members as a whole. In so doing, a director must consider:
  ○ the likely long term consequences of any decision;
  ○ 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.

This duty does not trump the duty to act within powers and is also subject to the need to act in the interest of creditors in certain circumstances, as to which see further below;

• to exercise independent judgment - directors must make their own decisions and not be dominated by fellow directors or shareholders;

• to exercise reasonable care, skill and diligence - to the same extent that would be exercised by a reasonably diligent person with both:
  ○ the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company; and
  ○ the knowledge, skill or experience that the particular director has.

So an objective and subjective test;

• to avoid (direct or indirect) conflicts of interest - between the director and the company particularly in relation to the exploitation of property, information or opportunities, and even if the company could not take advantage of that interest. The duty is not infringed however if the company has given proper informed consent or the specific situation cannot, on proper analysis, reasonably be regarded as likely to give rise to a conflict;

• not to accept benefits from third parties - which arise from being a director or doing, or not doing, something as a director;

• to declare an interest (direct or indirect) in a proposed transaction or
arrangement with the company - before the proposed transaction or arrangement is entered into. If the interest is in an existing transaction, the duty to declare that interest arises under s182 of the Act.

Directors must comply with all the duties where more than one applies in a given case.

Although the general statutory duties replace the corresponding common law and equitable duties, they will be interpreted in accordance with the previous case law applicable to those common law and equitable duties.

Directors also owe other duties under the Act (such as to deliver accounts and the annual report) as well as under other legislation and regulations which are outside the ambit of this article.

Who owes these duties and who are they owed to?

The duties apply equally to:

- executive directors who are involved in the day to day running of the company;
- non-executive directors who attend board meetings and whose role it is to bring an objective and independent perspective;
- shadow directors who are not appointed directors but on whose instructions the board will act;
- de jure directors who are validly appointed as directors; and
- de facto directors who are not properly appointed as directors but who assume the status and functions of directors.

The duties are owed to the company of which he/she is a director and not to other group companies or individual shareholders.

What are the consequences of breach?

In some cases, breaches of these duties can be ratified by the company. In the absence of such ratification, the company, or in limited circumstances the shareholders by way of derivative action, can take proceedings to enforce the duties owed to the company. Civil proceedings can be brought to stop further breach (by way of injunction) and to set aside affected transactions, restore company property, seek an account of any personal profits made by the director, or recover damages.
Is there a continuing duty once a directorship has ended?

Most, but not all, of the general statutory duties cease to apply following resignation. However, the duty to avoid conflicts of interest and not to accept benefits from third parties will continue in so far as they arise out of the exploitation of any property, information or opportunity of which the director became aware, or are paid for things done or not done, before they ceased being a director.

What about the interests of creditors?

Where a company is in financial difficulties and directors have grounds for believing that the company may be insolvent, the general duty to act in the best interests of the company and its members is modified: the director must act instead in the best interests of the company’s creditors as a class. Directors should seek independent professional advice from an accountant or insolvency practitioner as soon as they are aware the company is in financial difficulty. Failure to do so and to continue to trade whilst insolvent could lead to a director being made personally liable under s214 (and s246ZB) and s213 (and s246ZA) of the Insolvency Act 1986 for any wrongful or fraudulent trading undertaken by the company, or for any breaches of duty as described above (and note that ratification of a director’s actions by the shareholders is not generally possible when a company is insolvent). The director could be made to contribute to the deficit in the company’s assets (so losing the benefit of limited liability) and/or be disqualified.

Can a director be indemnified or insured against breaches of a general statutory duty?

A company may not generally exempt or indemnify a director against liability and damages awards arising from claims in negligence, default, breach of duty or breach of trust in relation to the company. It can however indemnify the director for defence costs if successful. A director can be indemnified in respect of certain proceedings brought by third parties to cover the cost of the claim and the costs of defending but again not in so far as that liability relates to the cost of an unsuccessful defence or fines imposed in criminal proceedings or penalties imposed by regulatory bodies.

A company may take out directors and officers insurance (D&O insurance) to protect directors from liability arising out of claims in negligence, breach of duty etc. This would
indemnify the director for damages awards and defence costs made in respect of negligence, breaches of duty etc, but this would not generally cover fraud, dishonesty or criminal fines or penalties, or matters which are deemed uninsurable at law. Such policies generally do provide cover for defence costs on fraud related matters, until a final judgment on fraud or criminal activity is handed down but are likely also to provide for those costs to be repaid in the event of an adverse finding.

Such insurance may also provide for reimbursement of any indemnity provided by the company and can extend to cover non-executive directors.

**Points to consider**

- Newly appointed directors should be fully briefed on their general statutory obligations to ensure they comply with them;
- Only sufficiently qualified or experienced individuals should be appointed as directors to fulfil the functions expected of them and don't forget, more highly qualified or experienced directors will be expected to exercise a higher level of expertise and skill in carrying out their functions;
- For directors sitting on more than one board, issues of conflict of interests and confidentiality may need to be considered upfront and provided for in the company's articles;
- Keeping clear, contemporaneous and thorough records of the decision making process will provide protection for directors against claims that they have acted in breach of their duties;
- Regulating behaviour and obtaining prior approval by the company will help stop issues arising regarding conflicts of interest;
- Many companies' articles will permit directors to accept benefits from third parties (often in relation to corporate hospitality) up to a specified value without breaching their duty to the company;
- Certain duties will continue to exist even after a director has ceased to act as a director, such as the duty to avoid conflicts of interest, so run off D & O insurance should be considered.

**Related** Dispute Resolution, Litigation & Dispute Resolution, Commercial Litigation, ThinkHouse
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