

## **Directors' duties and your reputation...**

***The Companies Act 2006 has introduced some new obligations for company directors and charity trustees using a company by limited guarantee format. Many directors are still not aware of these. This article provides an overview of the changes and some practical advice to help you to manage the risks, including to your personal reputation!***

### **Developments in Governance Duties**

There has been a major redefinition of the duties of directors of companies and those of trustees for the many charities which use a company limited by guarantee format. While many of the new rules codify old practises, there are new and somewhat convoluted obligations particularly with the management of conflicts of interest.

The Companies Act 2006 which brought these changes in, spells out for the first time in statute what a director's duties are. Some are fairly straightforward and self-explanatory, but others on management of conflict of interests will require new steps to be taken if directors are not to breach these statutory obligations.

### **Directors' Duties**

The main statutory duties are called "general duties". The overarching duty is to promote the success of the company for the benefit of its members if it is a commercial company. If the company is set up like a charity to benefit people other than its members, then the duty is to promote the success in achieving its purposes. When the directors make decisions, they now have to have regard to a list of statutorily defined issues which include the interests of the staff, the impact on the environment and the community and the need to maintain a reputation for high standards of business conduct.

The reason the other directors' duties need to be taken seriously, given the broadened right under the Act for shareholders to make claims against directors. These are known as derivative claims and the Act has expanded the ability of shareholders to make claims to include allegations that the directors have been negligent.

It has to be said that despite this expansion of the right for shareholder action and a general increase in shareholder activism, there has not been a rash of cases where directors have been successfully sued by shareholders, not least because taking such an action requires the court's consent, but particularly in these difficult times directors need to be aware of this new weapon in the armory of shareholders and other members of the company.

Directors also have duties to:

- Act within the powers.
- Exercise independent judgment.
- Avoid accepting benefits from third parties.
- And to exercise reasonable care and diligence.

The Act makes it clear that doing your best is not good enough. A director has to be able to show they have exercised the level of care skill and diligence of a diligent person with the knowledge, skill and experience that would be expected of someone carrying out the functions of director. This is likely to mean that a higher degree of skill is required for directors of large companies. It may also create problems for some charities bent on achieving the maximum level of user involvement. It is difficult to see how some users, particularly those with a learning disability or mental health issues can readily be involved as directors when they have to meet a test like this.

### **Conflict of Interest**

The unfortunately complex rules apply when any sort of conflict of interest or conflict of duty occurs. The Act introduces a clear division between conflicts that arise in transactions between the organisation and the director, for example, if directors provide services to it. Here the duty is to make full declaration.

There is a specific duty to avoid other conflicts of interest situations where there is no transaction between the company and directors. Here declaration alone is not enough. What will be required is that the board specifically approves the conflict by passing a resolution which will need to be carefully minuted and set out any conditions that apply. The types of examples of this sort of conflicts of interest situation which are likely to occur are:

- A director is also a director of a potential competitor or has a financial interest in a competitor.
- A trustee who is a director is also a trustee of another charity in the same field or a funder.
- A director or trustee advises another organisation which may have differing interests.
- A director becomes aware of some information through its board membership which the company decides not to follow up. He will still be prevented from utilising this in another context.

All these problems can be managed, but unfortunately, there are technical hurdles. For charities the process of approving conflicts arising from “situations” will only generally be possible where the articles are specifically changed to allow approval. For other companies, the shareholders can approve. Again, for charitable companies, transactions by the director with the charity will normally only be permissible if the Charity Commission order or if the Articles or Memorandum actually permit it.

## Some Practical Solutions

Without wanting to introduce too much bureaucracy, companies are going to need to set up systems which ensure that they don't trip over these new rules. Key tools will be:

- Clear job descriptions for directors with pointers to these new statutory duties.
- A well-run process for declaring interests. Generally, this involves a register of interests.
- A form of recording of board resolutions as to the management of conflicts.
- Occasional legal advice to ensure that things are being done correctly.

These rules backed up by the risk of breaching a statutory duty and even the risk of litigation by members of the company or the company itself. However, frankly, the real risk is the reputational damage to individuals, who because of some later difficulty, find themselves accused of acting in clear breach of their statutory duties.

For more information please contact:

**James Sinclair Taylor** is a Partner at Russell-Cooke, a Top 100 firm of solicitors, and is head of its specialist Charity Team. He acts for a broad range of charities and is a member of the Charity Law Association. He writes and lectures extensively and is co-author of the Voluntary Sector Legal Handbook.

### **James Sinclair Taylor**

Partner

020 8394 6480

James.Taylor@russell-cooke.co.uk

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