

APPENDIX TO CABINET REPORT 13TH OCTOBER 2011

DUTIES OF DIRECTORS UNDER THE COMPANIES ACT 2006

Summarised below are the seven general duties set out in ss.170 to 181 of the Companies Act 2006 ('the Act').

1. Duty to act within their powers

This duty is set out in section 171 of the Act and codifies the common law rules that directors should exercise their powers under the terms that were granted for a proper purpose. A director's powers are set out in the articles of association and in the Shareholders Agreement. It should be noted that the Shareholders Agreement reserves a number of key decisions to the Shareholder Councils and so these decisions will not be exercisable by the directors of the company

2. Duty to promote the success of the company

This duty is set out in section 172 of the Act. It imposes a duty to act in the way a director considers, in good faith, would be most likely to promote the success of the company. Although this duty is still owed to the Shareholders as a whole, when exercising this duty the director is required to have regard to various factors, including, the following:

- (a) the likely consequences of any decision in the long term,
- (b) the interests of the company's employees,
- (c) the need to foster the company's business relationships with suppliers, customers and others,
- (d) the impact of the company's operations on the community and the environment,
- (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
- (f) the need to act fairly as between members

It can be seen that among other things, this duty introduces wider corporate social responsibility into a director's decision making process.

It is important that detailed minutes are taken when exercising decisions to document the fact that directors have had regards to various factors listed in section 172.

3. Duty to exercise independent judgment

Section 173 of the Act imposes a positive duty on a director of a company to exercise independent judgment. It is important to recognise that a Council nominated director cannot subordinate the interests of the company to those of the Council.

4. Duty to exercise reasonable care, skill and diligence

This duty is set out in s. 174. It prescribes the degree of 'care, skill and diligence' expected from a director as follows:

- a. 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
- b. the general knowledge, skill and experience that the director has.

If a director is appointed to undertake a particular function, then that director will be expected to exercise the skills required of that post in all aspects of decision making e.g. the Finance director.

5. Duty to avoid conflicts of interest

This duty is set out in section 174 of the Act. It applies to a transaction between a director and a third party, such as the exploration of any property, information, opportunity. The duty does not extend to a transaction between a director and his own company, in respect of which s177 applies which requires a director to declare his interest to the other directors. It should be noted that such transactions can be authorised by the non-conflicted directors on the board provided that certain requirements as listed in s175 (5) (6) including who can participate and vote on such authorisation are complied with.

6. Duty not to accept benefits from third parties

This duty is set out in section 176 of the Act and states that a director is not permitted to accept a benefit from a third party by reason of (a) his being a director or (b) his doing or not doing anything as a director.

7. Duty to declare interest in proposed transaction or arrangement with the company

Section 177 of the Act requires a director to disclose his interest to the board of the company when a transaction is proposed between a director and his company. The requirement for disclosure is dispensed in circumstances where the interest cannot reasonably be regarded as likely to give rise to a conflict of interest or if other directors are already aware or 'ought reasonably to be aware' of the director's interest.

LIABILITIES OF DIRECTORS UNDER THE COMPANIES ACT 2006

Personal liability

Directors act as agents of the company. The general principle, therefore, is that liability associated with LA Co's operations will rest with the company and its assets. There are, however, a number of exceptions to this principle which, when applicable, could result in a director being held personally liable for company debts.

- Wrongful Trading - A director could be found guilty of wrongful trading if, at some point prior to the company going into insolvent liquidation, they knew or ought to have concluded that the company would have no reasonable prospect of avoiding insolvent liquidation. If a director is found to be guilty of wrongful trading, the Court may make an order to require a contribution to the assets of the company, to be distributed amongst its creditors.
- Fraudulent Trading – A director would be found guilty of fraudulent trading if it appeared to the liquidator that the company carried on business with the *intent* to defraud its creditors or for any other fraudulent purpose. It is not enough to show that the directors continued to run up debts whilst the company was insolvent, it must be shown that there was actual dishonesty, involving real moral blame.
- Misfeasance or breach of fiduciary duty - A director has a duty to act in the best interests of the company. Therefore if, in the course of a winding up the company, it appears that a director has misapplied or retained, or become

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accountable, for any money or other property of the company; or been guilty of any misfeasance or breach of any fiduciary or other duty, the Court may order the director to restore money or property with interest or pay compensation to the company. Some examples include: where a director enters into a contract on behalf of the company, but fails to disclose the company's interest; or if a director signs a cheque or places an order without stating that they are acting on the company's behalf, the other party may hold him liable. If the company avoids the transaction, the director may be left to deal with the financial consequences.

It is worth noting that the primary catalyst for directors' external personal liability is the imminent insolvency or winding up of the company. It is rare for directors to experience personal financial liability whilst the company is a going concern.