



The duties that directors have to perform are one of the most important aspects of company administration. Directors (and the company secretary (if there is one)) must be aware of. This Guide explains these duties in light of the Companies Act 2006 (most particularly concerning directors, including their duties, directors' remuneration, loans to directors, shareholder litigation and insurance.

## Directors' Duties

The board of directors has control over the management of a company's business. They make the strategic decisions of a company.

Prior to 1<sup>st</sup> October 2008, the duties of directors were derived from several sources, including the common law, the Companies Act 1985 and other statutes.

Following the introduction of the Companies Act 2006, directors' common law duties were codified in a statutory statement of duties set out in sections 171-177 of the Companies Act 2006. However it would be wrong to say that the provisions of the Act in this area not only codify the more fundamental aspects of the common law on directors' duties but develop them further.

These duties apply to executive directors (and shadow directors). The duties are owed to the company. A director for breach of duty (acting on the company's behalf, see below) can bring a derivative action.

The general duties under the Companies Act 2006 are as follows:

- **Act within powers.** A director must exercise powers only in accordance with the company's constitution and the powers conferred on them (section 171).

The company's constitution includes the company's articles of association, resolutions and agreements of a constitution (including shareholder agreements).

- **Promote the success of the company.** In other words, a director must act in a way that he or she believes to be most likely to promote the success of the company as a whole (section 172).

(This section 172 duty is subject to the provisions that directors must act in good faith in the performance of their duties. There is a number of factors that directors need to consider, including: the likely consequences of their decisions for the company's employees; the need to consider the interests of the company's customers and others; the need to consider the company's operations on the community and the environment; the need to maintain a reputation for high standards of business conduct.

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standards of business conduct (section 172 of the Companies Act 2006 (the company).)

- **Exercise independent judgment** (section 173).

This would not prevent a director from acting in accordance with the company's constitution or an agreement entered into.

- **Exercise reasonable care, skill and diligence** (section 174).

The expected standard is that of a reasonably diligent person in the same position. A director's actual understanding and skill may not be enough if more could reasonably be expected of them.

- **Avoid conflicts of interest** (section 175).

Directors must avoid situations where they have, or could have, a conflict of interest with the company. This applies in particular to the exploitation of any business opportunity regardless of whether or not the company could take it.

- **Not accept benefits from company** (section 176). A duty to not accept benefits from the position of director or as a director, except where authorised to do so by the company (by a resolution of the shareholders).

- **Declare interests in proposed transactions or arrangements with the company.** A duty to declare the company's interest in a proposed transaction or arrangement of the company (section 177).

Any director, directly or indirectly, who is or has been involved in a transaction or arrangement with the company must declare the interest to the other directors.

The statement of general duties is a statement of the way directors are expected to act and for how they account to the company.

## Duties owed to the Company

These general duties are owed to the company, not the individual shareholders. As described above, it is the company that can bring an action against a director for breach of duty. A breach of duty means the director concerned and allows the company to claim damages or compensation from the director and an injunction as well. Failure to disclose an interest in an existing transaction or arrangement with the company also carries the risk of criminal fine.

## Shareholder Litigation and Derivative Claims

However notwithstanding that the Companies Act 2006 allows shareholders to bring an action against a director in the company's name (known as a "derivative claim") for a loss arising from an actual or proposed act or omission in breach of duty or breach of trust by a director of the company.

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party (or both), including form before or after the person se shareholder of the company.

However, it is only the compa derivative claim. In addition, th must go through, including cou sue. It is not therefore a straig need to approach with caution. those without any real merit.

### Ratification

If a director commits negligenc can ratify the breach by passin shareholder, any votes he or sh family or other 'connected pe whether a simple majority has unanimous.

### Conflicts of Interest

Company secretaries and com about conflicts of interests. Th duties specified under the Cor follows:

- **Section 175** - A duty proposed transaction
- **Section 176** - A duty
- **Section 177** - A d transaction or arrang

### Duty to avoid conflicts of interest

A **conflict of interest** occurs interests, one of which could po A conflict of private interest aris be perceived as being capable

For example, suppose the boa property. One of the directors increase in value subsequent to of interest, as his judgement m neighbouring property rise in va

Other potential conflict situation company (e.g. an accountant to to a person who is or may be in

### Prior authorisation by the board

not matter whether the loss occurred hne the derivative claim became a

who may obtain compensation in a o an action and criteria that the claim eholder is actually able to proceed to one that potential shareholders will ect directors from spurious claims or

y or breach of trust, the shareholders n. If the director in breach is also a favour (as well as votes of his or her ed for the purposes of determining the votes of all the members are

ould be prepared to advise directors as three out of the seven directors' ern conflicts of interest. They are as

rest (except where they arise out of a section 177 below). om third parties. erest a director has in a proposed to the company's other directors.

organisation) is involved in multiple tion for an act in relation to the other. any interest which *might* influence, or udgement even unconsciously.

any is discussing an investment in a property, which has the potential to company. That director has a conflict sire to see his own investment in his

ctorships, advisory positions with the director as well) and being connected

A conflict situation can potentially arise where a director's duty is not infringed.

- the matter has been authorised by the board of directors;
- the director is not connected with the matter; and
- the matter is agreed by the independent non-executive directors.

*For companies incorporated since 1 October 2008:*

The company's articles must be consistent with the provisions that could invalidate an authorisation.

*For companies that were in existence before 1 October 2008:*

The shareholders should pass a resolution enabling the board to authorise conflicts, (See: [Shareholders' Conflicts of Interest](#)). This resolution then needs to be passed by the Companies House – File Resolution.

The interested director must consider the matter with a view to the company's interests, not his own. An existing or proposed transaction.

- at a meeting of the board of directors ([Conflicts of Interests](#)); or
- by notice in writing, (See: [Declaration of Director's Interest in Proposed Transaction](#)); or
- by general notice, (See: [General Notice of a Director's Interests](#)).

Often a director will take advantage of his position to give a general notice of interest to a person connected with him. Such a notice should always be recorded in the minutes.

Even once the board has authorised a transaction, the director concerned is still under a duty to act in a way that he or she is likely to promote the success of the company (section 172 duty).

Where a director is not aware of a transaction or arrangement in connection with the company, the director is treated as being aware.

### Considerations for the board

When the board considers whether to authorise a transaction, each director must consider the duty to act in a way that he or she is most likely to promote the success of the company.

The board may also want to inquire whether the director in question may not be able to discuss the matter.

board of directors. The general rule is that a director's duty is not infringed.

and the meeting at which the matter is considered. The director is not to be counted in or against any vote cast by the interested director.

that there is nothing in the articles that would invalidate an authorisation.

*For 2008:*

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The board may also want to inquire whether the director in question may not be able to discuss the matter.

## Some situations where a declaration of interest is advisable

There are several situations where a director may need to declare a conflict of interest.

For example:

- Where a director sits on or holds shares in a company or directorships authorised by the company
- Where a director holds shares in a potentially competing company.
- Where a director owns or has an interest in the company's property, or the value of its assets or business activities.
- Where a director has a business relationship with the company, or an interest in a business or company – for example, accountants, legal or consultancy.

## Situations where there is no need to declare a conflict of interest

A director need not declare an interest in the following circumstances:

- if it cannot reasonably be expected to give rise to a conflict of interest; or
- if the other directors are aware of the interest and for this purpose the other directors are treated as being aware; or
- if it concerns terms of a contract that have been or are to be considered by a meeting of the directors.

## Who are connected persons

Connected persons include the following:

- Family members (spouse, children and step-children, anybody with whom the director lives in the same household, parents)
- Trustees of a trust of which the director or a family member, is a beneficiary
- Corporate bodies to which the director or a family member, is a beneficiary
- A director's business partner

'Connected persons' interests also fall under the remit of section 177 of the Companies Act 2006.

For example, if a director's spouse or child is a director of a potentially competing business, a potential conflict of interest may arise. A declaration of his indirect interest must be made, and the board should give prior authorisation for the purchase, and the director should consider it does not interfere with their duty as directors.

## Substantial property transactions

A substantial property transaction is a transaction involving the transfer of non-cash assets to or from directors or connected persons. There are restrictions in the Companies Act 2006 to prevent a company from entering into such transactions without the approval of the shareholders.

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directors of the company, or from the company, unless the consent is obtained.

Shareholder approval is required if the asset being transferred is either:

- more than £100,000,
- more than 10% of the value of the company's net assets (as shown in the company accounts), or

(See: [Shareholders' Duties and Powers](#) and [Shareholders' Duties and Powers](#)).

Payments under directors' service contracts are excluded from the scope of the substantial property disposal provisions where an acquisition or disposal is made in the capacity as a shareholder of the company.

Members' approval is also not required if the company is being wound up (unless pursuant to a members' voluntary liquidation). The requirement for approval remains in force if the company is in receivership or administrative liquidation.

## Proceedings of Directors

Under both Table A (Companies Act 2006) and the Model Articles, decisions can be made by the directors (by a majority vote in a meeting), or unanimously in writing. Under Table A - the directors are able to make decisions when not all of them are physically present, provided that they can communicate with each other (for example, by telephone or video conference).

Under both Table A and the Model Articles, the quorum for a meeting of directors, but the quorum may be waived for companies with one director, the quorum is one.

The directors may appoint one or more directors to act as a chairman, and if there is an equality of votes then the chairman will have a casting vote.

## Remuneration, Expenses, and Indemnification

Article 82 of Table A and article 82 of the Model Articles both state that directors are entitled to remuneration. Table A states that the remuneration is decided by the passing of an ordinary resolution of the shareholders. The Model Articles permit the other directors to determine the level of remuneration.

Under the Model Articles, a director is entitled to receive remuneration not only for his services as a director but for any other services he may perform for the company. In both cases, the remuneration is deemed to be for the company. In the absence of any provision to the contrary.

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resolution), where the value of the asset being transferred is either:

by reference to the last set of accounts, or more than £5,000.

(See: [Shareholders' Duties and Powers](#) and [Shareholders' Duties and Powers](#)).

Payments for loss of office are excluded from the scope of the substantial property disposal provisions, and approval is not required if the company is being wound up (unless pursuant to a members' voluntary liquidation).

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Model Articles (Companies Act 2006), decisions can be made by the directors (by a majority vote in a meeting (i.e. a board meeting), or unanimously in writing. The Model Articles allow slightly more flexibility than Table A when not all of them are physically present, provided that they can communicate with each other (for example, by telephone or video conference).

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Article 83 of Table A and article 87 of Table A both state that directors may be paid for out of pocket expenses in the discharge of their duties.

Article 87 of Table A and article 83 of Table A both allow directors to receive gratuities and pensions. Table A states that a director *no longer holds any executive office* with the company, whereas the Model Articles state that gratuities are included as part of a director's remuneration.

Note that if a director's service contract provides for a guaranteed term of more than two years, prior approval by way of resolution is required.

## Loans to Directors

### Loans to directors and the Companies Act 2006

The Companies Act 2006 removed the requirement for a company to obtain shareholder approval for loans to directors, replacing it instead with a requirement for loans to be approved by the directors.

A private company may make a loan to a director, or give a guarantee or provide security in connection with a loan to a director, if the transaction must first be approved by the shareholders (See: [Shareholders' Ordinary Resolution for a Director](#)).

### Exception for loans under s.115

If the aggregate value of the loans to a director does not exceed £10,000, there is no need to obtain shareholder approval (note that the £10,000 is an aggregate value, meaning that if several loans to a director combine to a value over £10,000, it would require shareholder approval).

#### Other exceptions to the requirement for shareholder approval

There are other exceptions to the requirement for shareholder approval. For example, where the loan or expenditure (of under £50,000) on behalf of a director with funds to defend civil or criminal proceedings in connection with the company business, or where the loan or expenditure is for the purposes of the company business, or where the loan or expenditure is for the purposes of the company business, or where the loan or expenditure is for the purposes of the company business.

### Note 'connected persons'

Companies should watch out for transactions with a director requires shareholder approval. Where a transaction is 'connected' with the director, shareholder approval will also be required in respect of the transaction.

Thus a loan to a 'connected person' requires shareholder approval.

Connected persons include the following:

- Members of the director's family (including civil partner, live-in partner, children or step children, children of a live-in partner, and parents).

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Connected persons include the following:

- Members of the director's family (including civil partner, live-in partner, children or step children, children of a live-in partner, and parents).

- A company in which the director exercises more than 20% of the share capital, or can exercise more than 20% of the share capital.
- A trustee, where the director is a trustee of the trust.
- A partner of the director, where the director is a partner connected with the director.
- A legal firm where the director is a partner, where a connected person is a partner.

## Practical steps for approval

In practical terms;

1. The first step is to call a general meeting. [Board Minutes – Consider Director's Loan and Call General Meeting](#)
  - a. A declaration of interest must be made by the director requesting a loan (note the 'disinterested interests' of the director, where the director is not the director above).
  - b. Discuss the proposed loan. If the loan is less than £10,000, shareholder approval is not required. If the loan is more than £10,000, the loan will need board approval. When approving such a loan, the board should be mindful of their duties; the board should only approve the loan if it will *promote the success of the company*.
  - c. If the board approves the loan, a memorandum must be prepared, setting out the terms of the memorandum, the nature and purpose of the loan.
    - The nature of the transaction
    - The amount of the loan
    - The extent of the company's liability
  - d. Resolve to call a general meeting to seek a shareholders' written resolution.
2. Secondly, the memorandum must be made available to shareholders by being sent to them. The general meeting is to be held, being made available before the general meeting and at the general meeting itself.
3. Finally, hold the general meeting to seek the shareholders' approval. Then arrange for the execution of the loan agreement. The loan agreement should have been approved at the previous general meeting.

## Simply Docs Loan Agreement

Simply-docs offers three templates for loan agreements over joint property. These are secured, unsecured and secured over joint property.

The secured loans grant the company a weaker form of security than a mortgage. We also provide guidance on the company's equitable charge.

– unsecured, secured and secured over joint property. See [Directors' Loan Agreements](#).

charge over the director's home. This is a weaker form of security than a mortgage. Land Registry formalities are simpler. We also provide guidance on the company's equitable charge.



## Consumer Credit Act

The company should ensure that it complies with the Consumer Credit Act 1974, either by complying with the requirements of the Act or by bringing the loan terms within one of the exemptions. Information on the exemptions, including licensing and exemptions, is available on the Office of Fair Trading website: <http://www.offt.gov.uk>.

## Loans from Directors' to a Company

A director (or shareholder) can make a loan to the company if the company makes a loan to the director for the director's requirements, particularly if the loan is for the director's personal requirements. If a director may make the loan to the company, this will particularly apply if the director is the sole director and sole shareholder of the company. The loan must be on the same basis as any commercial loan, and the director will need to include conditions of precedent, representations and warranties.

Whether the director will require to pay interest on the loan is a commercial matter. However, the director should consider their own personal tax position and may need to consult a tax advisor and consult HMRC.

A loan from a director to a company will need to satisfy the requirements of the Companies Act 2006 (section 177). If the director of the borrower, that director must declare the nature of his interest in the company to the other directors. The Companies Act (again see above) prohibits a director from voting on the resolution to approve the loan.

Our loan and finance documents should be drafted to reflect the above.

## Indemnity and Insurance

Under the 2006 Act, a company can indemnify its directors for negligence, default, breach of duty or breach of trust.

However, this does not prevent a company from purchasing insurance for its directors against negligence, default, breach of duty or breach of trust. The purchase of such insurance must be authorised by a resolution of the shareholders (or the directors if there is no equivalent provision in the company's articles).

any on the same basis as any commercial loan. It may be to ease a company's cash flow or to provide other sources of funding. It is likely that the loan will be on more onerous terms than a commercial loan. If the director is the sole director and sole shareholder of the company, the director will need to include conditions of precedent, representations and warranties.

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A director from any liability for negligence, default, breach of duty or breach of trust. Any attempt to do is void.

However, this does not prevent a company from purchasing insurance for its directors against negligence, default, breach of duty or breach of trust. The purchase of such insurance must be authorised either by the articles or by a resolution of the shareholders (or the directors if there is no equivalent provision in the company's articles – note that article 53 of the Model Articles – note that