



# THE DUTIES AND RESPONSIBILITIES OF DIRECTORS

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## **1.0 INTRODUCTION: WHAT TYPES OF DUTIES ARE THERE?**

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This note is a brief summary of the main duties and responsibilities which directors of companies have. We look at those duties in the following three categories:-

### **1.1 DIRECTORS' FIDUCIARY DUTIES AND RESPONSIBILITIES**

Directors are in what is called a "fiduciary" relationship with the Company, which means they have to act for the benefit of the Company rather than themselves. Many of these duties apply not only to directors of companies, but to trustees of charities and committee members of unincorporated associations.

At the moment, these duties come from decided court cases and general legal principles, but they have also now been "codified" in the Companies Act 2006. When the relevant part of the Act comes into force, then the new list there will replace the current law.

### **1.2 OTHER STATUTORY DUTIES AND RESPONSIBILITIES**

These are duties imposed on directors of companies by Acts of Parliament in addition to the fiduciary duties mentioned above.

### **1.3 OTHER DUTIES, RESPONSIBILITIES AND LIABILITIES**

Other duties and liabilities may arise out of the work that the company carries out. The two most common ones arise because:-

- a wrong recognised in law (called a "tort") has been committed against an individual or organisation;
- or
- they are duties which the company has agreed to take on when entering into contractual arrangements with other individuals or organisations.

## 2.0 FIDUCIARY DUTIES

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### 2.1 DUTY: TO ACT IN GOOD FAITH

To act in good faith as a director means you must:-

#### **Act in the Best Interests of the Company**

A director must act in what he/she reasonably believes to be the best interests of the company. This means that when considering an issue of company business, your duty is to the company and not to any other person or organisation. You must not make your decisions as a director on the basis of the interests of the organisation which may have been responsible for appointing you as a director, nor your own interests, those of the local council, your employer, a next door neighbour or a friend. When the new Act comes into force, this will extend to a duty to “promote the success” of the company, including taking account of its impact on the community and the environment.

#### **Not put yourself in a position where your personal interest or a duty you owe to another conflicts with the duties you owe to the company**

You should not put yourself in a position where your personal interest or a duty you owe to another conflicts with the duty you have to the company as a director. You must make decisions which are entirely unaffected by outside influences. A director cannot enter into an agreement with another person as to how he/she will vote at Board meetings.

Under the new Act there will be a specific duty to declare an interest in any proposed transaction involving the company, and to fail to do so will be an offence; getting any benefits from 3rd parties will also be prohibited.

The general rule is that if there is a conflict of interest a director should not play a part in the decision-making process unless there is an exception set out in the company's Articles. If there is an exception a director must follow the terms of the exception but must still ensure that he/she can act in a way that serves the best interests of the company.

#### **Only use company property for the benefit of the company and not for your own benefit**

Directors are under a duty to use the company's property exclusively for proper purposes. For example, using a minibus owned by or lent to the company for private purposes would be a breach of this duty.

### 2.2 DUTY: TO MANAGE THE COMPANY'S AFFAIRS WITH THE PROPER DEGREE OF SKILL AND CARE

Generally speaking a director must exercise the same degree of CARE as would be reasonably expected from a “prudent vigilant business person dealing with his/her own affairs” and the same degree of SKILL as would be reasonably expected of someone with his/her own knowledge and experience. For example, a director with accountancy skills would be expected to use the skills of a reasonably competent accountant when making decisions. There is an even higher degree of care and skill imposed on directors of charitable companies when making investments.

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### 2.3 DUTY: TO ACT STRICTLY WITHIN THE PROVISIONS OF THE CONSTITUTION AND TO SATISFY YOURSELF OF ITS TERMS

A director can only do what he/she is authorised to do by the constitution. Directors must therefore ensure that they know what it contains.

For example, before a contract is entered into a director must ensure that:-

- the contract furthers the objects of the company;
- there is a power to enter into the contract in the constitution; and
- the contract is not in any way contrary to general law.

### 2.4 DUTY: TO ACT WITHIN THE SCOPE OF ANY GIVEN AUTHORITY FOR PROPER PURPOSES

Directors must ensure that if an act or task is delegated to them, they act within the terms of the authority given to them. A director must not abuse his/her authority by using it for an improper purpose. For example, if a director is given authority to spend £50 on publicity material, he/she should keep to this limit and ensure that he/she complies with any conditions that the Board may have attached to the authority, such as buying it from a particular supplier.

### 2.5 DUTY: TO ACT PERSONALLY

Directors must act in person and decisions must be taken by them acting together. Directors share responsibility for their decisions but the Articles usually allow the Board to:-

- invite a smaller number of the directors to look in further detail into a matter and then report back to the Board with recommendations (working parties);
- set up Committees with the power to make decisions on specific issues; and
- delegate day to day management matters to employees.

### 2.6 DUTY: NOT TO TAKE A PERSONAL BENEFIT/PROFIT

In the case of charitable or not-for-profit companies, directors cannot receive any payment or benefit from the charity. There are limited exceptions to the general principle, for example, the ability for directors to receive reasonable and necessary out of pocket expenses incurred whilst carrying out their role as a director.

However, an example of a benefit that would not usually be allowed, is accepting a payment in recognition of the services provided by a director (“an honorarium”) to the company.

In all companies, directors must not use information gained from their position as a director to make a secret profit personally. Under the new Act this duty continues even after a person stops being a director.

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## 2.7 DUTY: SECURE THE PROPER AND EFFECTIVE USE OF PROPERTY

A director should make sure that:-

- company property is only used for company business;
- all of the company's property is under the control of the Board and kept in good condition;
- activities and property are properly and adequately insured;
- funds are properly invested and reviewed regularly to ensure that they remain suitable for the company's needs; and
- proper procedures are in place to control finances.

## 2.8 WHAT HAPPENS IF A DIRECTOR BREACHES A FIDUCIARY DUTY?

Where a director breaches a fiduciary duty, that director can be personally liable for any loss incurred by the company as a result of the breach or any profits made by the director arising out of the breach.

## 3.0 STATUTORY DUTIES

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### 3.1 DUTIES RELATING TO INSOLVENCY: WRONGFUL TRADING

A director could be made responsible for acts of “wrongful trading” under section 214 of the Insolvency Act 1986 if the company goes bust and he/she:-

- carries on trading at a time when he/she knew or ought to have known that there was no reasonable prospect that the company could avoid going bust; and
- took insufficient steps to minimise the potential loss to creditors (for example by continuing to receive supplies).

If this happens, an application could be made to the Court to ask that a director be required to personally contribute their own money or property to cover the losses and that he/she also be disqualified from acting as a director or as a trustee of a charitable company.

### 3.2 DUTIES RELATING TO INSOLVENCY: FRAUDULENT TRADING

Under section 213 of the Insolvency Act 1986 if the company is in financial difficulties a director must not carry on business with the intention of “defrauding creditors”. This is what is known as “fraudulent trading”. This is also a criminal offence and a director would be at risk of having to contribute personally to meet the debts of the company.

### 3.3 NOT TO ACT WHILST DISQUALIFIED AS A COMPANY DIRECTOR OR A CHARITY TRUSTEE

#### 3.3.1 As a Director

Under the Company Directors Disqualification Act 1986 a person cannot without the permission of the Court, be a director or be involved in the promotion or management of a company if either:-

- there is an unexpired disqualification order against him/her;
- he/she is an un-discharged bankrupt; or
- there is an administration order against him/her which has been revoked by the Court because he/she has not kept to its terms.

It is a criminal offence if an individual were to act in contravention of this law and he/she could be made personally liable for any debts which were contracted during the time when he/she was improperly acting as a director.

#### 3.3.2 Charity Trustee

Similarly under sections 72 and 73 of the Charities Act 1993 a person will be guilty of a criminal offence if he/she acts as a charity trustee (director of a charitable company) whilst disqualified and without the Charity Commissioners’ consent. Some of the reasons for disqualification are:-

- (unspent) convictions involving dishonesty or deception;
- un-discharged bankruptcy;
- removal for mismanagement/misconduct; and
- disqualification as a company director.

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### 3.4 OTHER DUTIES UNDER COMPANY AND CHARITY LAW

3.4.1 There are a number of duties under both company and charity law, which include:-

- accounting requirements under both the Companies Act 1985 and Charities Act 1993;
- filing information, including accounts, annual returns and details of changes of directors' particulars, both at Companies House and the Charity Commission;
- displaying information about the name, registered office and nature of the company on official stationery;
- displaying the name of the company outside its offices;
- maintaining the company's official records which are called its statutory books;
- keeping minutes of Board meetings; and
- declaring conflict of interest situations.

3.4.2 Breach of many of these statutory provisions is a criminal offence and can lead to criminal liability without proof of fault on the part of the director. Persistent breaches of companies legislation can also lead to a director being disqualified as a director under the Directors Disqualification Act 1986.

### 3.5 CORPORATE CRIMES

A company has duties which arise from the activities it carries out, its status as an employer and under general law. For example there are duties in relation to health and safety, environmental law, data protection, national insurance, VAT and taxation, consumer credit and financial services. Many of these areas impose personal liability on directors if the offence is committed with the consent or connivance of, or is attributed to the neglect of, an individual director. In some cases, breach of these duties could lead to prosecution of individual directors.

## 4.0 OTHER LIABILITY

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### 4.1 PERSONAL LIABILITY FOR TORTS

4.1.1 Normally the company will be liable for acts of the company which cause a wrong (known as a “tort”) to individuals or other organisations. This would include acts of negligence, nuisance, libel and trespass. However, a director may be personally liable to the person who suffers the harm where:-

- he/she assumed responsibility for, or was personally responsible for, the act or omission which resulted in the damage or harm caused;
- he/she personally authorised or assisted the company to commit the harm; or
- the harm was a result of the action of the company’s employees which he/she directly ordered or brought about.

4.1.2 However, actions are normally brought against the company rather than individual directors since the claim against a company is easier to prove and the company is more likely to have adequate resources to satisfy the claim.

### 4.2 LIABILITY FOR TRADING LOSSES AND CONTRACTUAL LIABILITIES

Generally individual directors face no personal civil liability to third parties for debts incurred in conducting the business of the company. This is because the company has its own legal personality and therefore enters into contracts in its own name and it bears those responsibilities.

As such where the company enters into contracts with third parties the company will normally be liable for contractual duties and liabilities providing the contract is entered into by or on behalf of the company. If however, a director is responsible for fraudulent or wrongful trading or enters into a contract in his/her own name or outside the scope of his/her authority then he/she opens himself/herself up to the risk of personal liability.

## 5.0 REASSURANCE

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### 5.1 REASSURANCE

- 5.1.1 People who are considering being directors or who are directors should however be reassured. There are many people who are directors of companies who carry out their roles without any problems.
- 5.1.2 Whilst it is true that the duties and responsibilities which individual directors have are personal to them, it is important to note that directors are supported in their performance of these duties by:-
- a company secretary;
  - a chief officer and a team of staff;
  - contractual arrangements with service providers;
  - a series of procedures and standing orders; and, where necessary
  - professional advisors.
- 5.1.3 Directors can also be awarded some degree of protection in the following ways:-

#### **Insurance**

Directors can, to some extent, be protected from liability by insurance. Such policies cover the directors for the liability which they may incur for “wrongful acts” committed as directors. The policy would also cover the company’s loss should it indemnify the directors.

A director will not be covered, however:-

- for a breach of duty which he/she knew was a breach of duty; or
- if he/she was reckless as to whether or not the action was a breach of duty.

#### **Indemnity**

The Articles may provide that the directors may be “indemnified” by the company against liability incurred in the discharge of their duties in certain circumstances.

#### **Relief Granted By the Court**

If proceedings are ever taken against a director for breach of duty, the court has the discretion to relieve him/her from liability if, even though he/she is technically liable, the court believes that:-

“he has acted honestly and reasonably, and.....he ought fairly to be excused”.

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#### 5.1.4 Practical Guidance

Practical measures which are easy to put in place and which indicate that you have exercised the appropriate degree of care and skill and are carrying out your duties in good faith include:-

- regularly attending and preparing for meetings;
- contributing to and raising concerns at meetings;
- ensuring that the Board regularly monitors and reviews its compliance with and performance of its policies;
- encouraging the Board to seek and to act upon legal, financial and other professional advice whenever necessary;
- checking minutes to ensure they accurately reflect any concerns raised at meetings;
- ensuring proper arrangements are in place for handling money;
- ensuring when you delegate matters that it is to honest and competent staff and there are adequate reporting procedures in place;
- making sure staff are properly supervised; and
- ensuring that company property is looked after and is properly insured.

The best way for a director to avoid liability is not to breach their duties in the first place. It is, therefore, imperative that directors should seek out and act upon good advice wherever possible.



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