

Directors Duties

1 Introduction

- 1.1 A director of a company owes numerous duties to that company. Some of these duties have been developed by the courts over hundreds of years from more general common law rules and some have been enshrined in statute.
- 1.2 This paper outlines the key duties for board members of Scottish Governing Bodies ("SGBs") incorporated as companies in sections 171 – 177 of the Companies Act 2006 (the "2006 Act"), which are often referred to as a director's **general duties**.
- 1.3 An SGB may, through its articles of association, place more onerous obligations on its directors than those set out in the 2006 Act, but its articles may not dilute the general duties, except to the extent that this is expressly permitted by specific provisions of the 2006 Act.

2 Directors' general duties

2.1 Duty to act within powers

A director must act in accordance with the company's constitution and must only exercise powers for their proper purpose. The 2006 Act defines a company's constitution, for the purposes of the general duties, as including the company's articles, decisions taken in accordance with the articles and other decisions taken by the members or a class of them if they can be regarded as decisions of the company.

2.2 Duty to promote the success of the company

A director must act in the way that the director considers, in good faith, to be most likely to promote the success of the company for the benefit of its members as a whole. In so doing, the director must take account of the following factors:

- 2.2.1 the likely consequences of any decision in the long term;
- 2.2.2 the interests of the company's employees;
- 2.2.3 the need to foster business relationships with suppliers, customers and others;
- 2.2.4 the impact of the company's operations on the community and environment;
- 2.2.5 the desirability of the company maintaining a reputation for high standards of business conduct; and
- 2.2.6 the need to act fairly as between the members of the company.

It is regarded as best practice for the company to keep records of decisions made by directors on behalf of the company to show that the directors did have regard to the factors listed in 2.2.1 to 2.2.6 above when they made a decision on behalf of the company. Whether a director has complied with the duty to promote the success of the company (and/or any other duty) will ultimately depend on the facts and circumstances of each individual decision.

2.3 Duty to exercise independent judgement

This duty is not infringed where a director acts in accordance with an agreement entered into by the company which restricts the future exercise of the directors' discretion or in a way authorised by the company's constitution. The duty does not confer a power on the directors to delegate, but neither does it prevent a director from exercising a power to delegate conferred by the company's constitution, provided that its exercise is in accordance with the company's constitution.

Further to this, a director may be in breach of duty if they fail to take advice when it is appropriate to do so. The director must exercise independent judgement in deciding whether or not to follow particular advice or to delegate matters to others.

Directors Duties

2.4 Duty to exercise reasonable care, skill and diligence

A director must exercise the care, skill and diligence which would be exercised by a reasonably diligent person with both the general knowledge, skill and experience that may be reasonably expected of a person carrying out the functions carried out by the director in relation to the company and the general knowledge, skill and experience that the director actually has.

There is a minimum objective standard for a director, based on their particular role and responsibilities. There is also a subjective standard which takes into account a director's specialist knowledge, skill and experience – for example, if one of the directors of a company is a qualified accountant, they will be expected to exercise the skill, care and diligence that would be exercised by a reasonably diligent person with their experience.

2.5 Duty to avoid conflicts of interest

A director must avoid situations in which the director has or can have a direct or indirect interest that conflicts with or may conflict with the company's interests. This applies, in particular, to the exploitation of property, information or opportunity (whether or not the company could take advantage of the property, information or opportunity).

The duty is not infringed if the situation cannot reasonably be regarded as being likely to give rise to a conflict of interest or if the matter is authorised by the directors. The duty to avoid conflicts of interest will continue to apply after a person ceases to be a director, particularly with regard to the exploitation of any property, information or opportunity of which the director became aware at a time of being a director.

2.6 Duty not to accept benefits from third parties

Directors must not accept any benefit (including a bribe) from a third party which is conferred because of being a director or doing or not doing anything as a director. This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.

Benefits conferred by the company, its holding company or subsidiaries and benefits given by the director's service contract are excluded.

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

Directors must declare to the other directors the nature and extent of any interest, direct or indirect, in a proposed transaction or arrangement with the company. The director need not be a party to the transaction for the duty to apply. An interest of another person in a contract with the company may require the director to make a disclosure under this duty if the other person's interest amounts to a direct or indirect interest on the part of the director. Such declarations must be made before the company enters into the transaction or arrangement.

The declaration may (but need not) be made at a board meeting or by way of notice in writing or general notice. No declaration is required where the director is not aware of the interest or where the director is not aware of the transaction or arrangement in question – for these purposes directors are treated as being aware of matters of which they ought reasonably to be aware.

2.8 Duty to declare interest in existing transaction or arrangement with the company

Directors must declare to the other directors the nature and extent of any interest, direct or indirect, in an existing transaction or arrangement that has been entered into by the company. The declaration may (but need not) be made at a board meeting or by way of notice in writing or general notice and must be made as soon as reasonably practicable. No declaration is required where the director is not aware of the director's interest or where the director is not aware of the transaction or arrangement in question.

Directors Duties

3 Consequences of breach of directors' general duties

Directors' general duties are owed to the company and only the company can enforce them. However, under the 2006 Act, the members of a company can bring a derivative action on the company's behalf against the director who has failed to comply with that director's duties. While action for breach of duty should be taken by the board of directors on behalf of the company, if the directors are unwilling, or unable, to take action against one or more of their fellow directors, then a derivative claim can be brought by one or more members on behalf of the company (the claim of the members is derived from the rights of the company).

The 2006 Act does not contain any detailed provisions on the consequences of a breach of directors' general duties and instead regard must be given to the common law rules and principles that have developed over the years on which the 2006 Act general duties are based. As the consequences of a breach may, amongst other things, include:

- damages or compensation where the company has suffered loss;
- restoration of the company's property;
- an account of profits made by the director; or
- rescission of a contract.

It may be possible for a director to be protected from liability in the event of a breach of the general duties by:

- directors' insurance;
- an indemnity from the company;
- ratification of the breach by the members of the company; or
- relief from the court for the breach of duty.

It is also worth highlighting that certain of the general duties continue to be relevant even after a person has ceased to be a director. A former director will remain subject to the duty:

- to avoid conflicts of interest as regards the exploitation of any property, information or opportunity that he/she became aware of when they were a director; and
- not to accept benefits from third parties as regards things done or omitted to be done by him/her when they were a director.

4 Other duties of company directors

The general duties summarised above are not intended to be an exhaustive list of all the duties owed by a director to a company.

There are other directors' duties that arise, as well as various legal requirements that a director must comply with in order to avoid liability. For example, a director, will also need to be aware of:

- 4.1 other duties they may have under the 2006 Act, such as the duty to call general meetings required by members or the duty to keep accounts;
- 4.2 duties and liabilities arising under other statutes, such as the Bribery Act 2010, the Modern Slavery Act 2015, employment legislation, health and safety legislation and environmental legislation; and
- 4.3 potential liabilities in an insolvency situation (when they may need to take into account the interests of creditors).