**SUMMARY QUESTIONS**

**ESSAY QUESTIONS**

1. Discuss the implications for directors’ duties to the company since the enactment of the Companies Act 2006. Explain where the statute has expanded the duties previously established through the common law, and what steps the company should take to ensure compliance with the Act.

**Indicative content outline answer:**

* The CA 2006 had a significant impact on the duties imposed on directors through codification and extension of duties that, prior to the enactment of CA 2006, had been developed through the common law.
* The provisions under Part 10 A of the CA 2006 (other than the issues of conflict of interest, the directors’ residential addresses and age of the directors) came into effect on the 1st October 2007. The remaining provisions take effect from the 1st October 2008.

## *Directors Duties under the Companies Act 2006*

* Chapter Two of the CA 2006 identifies the duties of the directors and that the duties under ss. 171 – 177 are owed by the director to the company (rather than those outside of the company - *JJ Harrison (Properties) Ltd v Harrison* [2001]). It provides instructions as to how these sections are to interpreted when the director ceases to be a director of the company: such as the duty to avoid conflicts of interest and the duty not to accept benefits from third parties continues after the director has left office.
* Whilst this is a new piece of legislation, s. 170 continues that these general duties imposed on directors are to be interpreted and applied in the same way as the common law rules and equitable principles on which they were based.

### *Duty to Act Within their Powers*

* The director must act in accordance with the company’s constitution (now the articles of association rather than the memorandum) and only exercise powers for the purposes for which they had been conferred. As such, where authority is provided for a specific purpose, the power must only be used for this purpose and will not be extended (even if the director acted in good faith and for the best interests of the company - *Fraser v B N Furman (Productions) Ltd* [1967]).

### *Duty to Promote the Success of the Company*

* This was based on the common law duty of the director acting in good faith. The act requires the director to fulfil this requirement in the way he/she considers would 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 have regard to the likely consequences of decisions in the long term; the interests of the company’s employees; the need to foster relationship with outside organizations (suppliers / customers and so on); the impact of the company’s operations on the community and environment; the company’s reputation; and the need to act fairly as between the members of the company.

***Duty to Exercise Independent Judgment***

* The director has an obligation to exercise independent judgment although this will not be infringed by his/her acting in accordance with an agreement entered into with the company that restricts the future exercise of discretion by its directors, or in a way authorised by the constitution of the company.
* This codifies existing requirements in the common law, but also reinforces the director’s duty to act for the best interests of the company and, not necessarily, following the instructions of shareholders whose interests may be selfish and not being made for the company. This situation comes to prominence, as the shareholders appoint the director, and where this appointment has been made on a personal basis, the director must remain independent of the person(s) that made the appointment.

#### *Duty to Exercise Reasonable Care, Skill and Diligence*

* The director has to exercise reasonable care, skill and diligence. This duty is based on what a reasonably diligent person with the general knowledge, skills and experience for carrying out the functions required of the director to the company would consider, and the general knowledge, skill and experience that the director themself actually possess.
* A directorship (whether executive or non-executive) of a company is a very important role involving significant responsibilities, and it should not be accepted without consideration of the implications of the position and the obligations to the company – with reference made to the CA 2006 and the company’s constitution. Diligence was already a common law duty and requires the director to be vigilant for acts that require appropriate investigations to be made and questions to be answered. A director will fail in their duty by not taking the appropriate steps when faced with such scenarios.

***Duty to Avoid Conflicts of Interest***

* A director has an obligation to avoid situations where they have, or can have, a direct or indirect interest that conflicts (or has the potential to conflict) with the interests of the company.
* This duty applies particularly to the exploitation of any property, information or opportunity and it is immaterial whether or not the company could take advantage of the property, information or opportunity.

### *Duty not to Accept Benefits from Third Parties*

* A director of a company is not allowed to accept a benefit from a third party that is due to them being a director of the company and their acts or omissions as a director.

### *Duty to Declare Interest in Proposed Transaction or Arrangement*

* The director has a duty if in any way, directly or indirectly, they have an interest in a proposed transaction or arrangement with the company. This interest must be declared to the other directors with specific regard to the nature and extent of the interest. The declaration may be made in the following way, although others may be used:

(a) at a meeting of the directors, or

(b) by notice to the directors in accordance with s. 184 (notice in writing) or s. 185 (general notice).

* The declaration must be complete and accurate and if it proves to be, or subsequently becomes, incomplete and / or inaccurate, then a further declaration is required.

***Duty of the Director to Disclose Interests in Contracts***

* Beyond the codification of the common law duties imposed on directors, the CA 2006 imposes duties on the director who has an interest (direct or indirect) in a contract or proposed contract with the company to disclose this. This disclosure must be made as soon as is reasonably practicable (such as where the matter is first discussed by the board) and include the nature and extent of the interest, and be made at a meeting of the directors; or by notice in writing; or by general notice. The provisions of such disclosures apply to loans, quasi-loans and credit transactions and arrangements.
* The directors and the board should take steps, having been made aware of these duties, to ensure they adhere to the requirements of the Act and the common law. Clear strategies and guidelines are necessary to ensure compliance.

2. How may members of a company remove a director before the expiry of their term of office? What protection is afforded to directors when faced with such a resolution?

**Indicative content outline answer**

* Directors may leave office for numerous reasons. They may die in office or may resign (although once a resignation has been accepted the director cannot retract it - *Glossop v Glossop* [1907]); and on the dissolution of the company the directors are automatically dismissed (*Measures Bros Ltd v Measures* [1910]). The articles of the company may provide for a proportion or number of directors to retire annually (retirement by rotation) and these directors may then be replaced or re-elected to office. However, the company, through the other directors’ action or the members, may wish to remove a director before his/her term of office has expired.
* A director may be removed from office through an ordinary resolution to that effect. Special notice is to be provided of 28 days to the company secretary of the resolution and the meeting at which the resolution is to be passed must be called with at least 21 days’ notice.
* There are many reasons why the shareholders may wish for a director to be removed and the CA 2006 provides for the procedure of such a decision. The company may achieve this through an ordinary resolution at a meeting to remove the director before the director’s term of office was due to expire (CA 2006 s. 168). However, as a director may also be shareholder with voting rights, his/her removal may prove to be problematic (*Bushell v Faith*).
* The CA 2006 provides the director with the right to be heard on the resolution at the meeting. He/she may also, upon this notice, provide a written representation to the company (not exceeding a reasonable length) and request that this is notified to the members of the company. If the use of this procedure would be to abuse the rights provided in s. 169, the representations need not be sent out.
* Beyond the use of the CA 2006 for this removal, there may be provision in the company’s articles to achieve the same result. For example, the company may incorporate a clause into the articles that the director could be removed with a majority vote by the board by notice in writing. The main use of a removal through the articles rather than through s. 168 is simply that in the case of subsidiary companies, a holding company is not entitled to use s. 168 to remove directors of the subsidiary, but through the articles this is achievable.

**PROBLEM QUESTIONS**

1. John is the managing director of Widgets and Gadgets Plc and is aware that the company is the target of a takeover by Build ‘em up, Knock ‘em down Plc. John does not believe that such a takeover would be in the best interests of the company and therefore a board decision is made to increase the allotment of shares under an employee share scheme. This will increase the shareholding of the company and prevent the takeover.

Advise Widgets and Gadgets Plc on the implications of this action.

**Indicative content outline answer:**

* Where a company wishes to allot new shares, a contract has to be established between the parties that identifies the important information such as the amount of capital involved, when this capital is to be contributed, the nature and class of the shares to be allotted, and when the shares will provide the allottee with their rights attached to the shares.
* Chapter Two of the CA 2006 governs the allotment of shares and identifies the authority of directors allot (s. 549).
* Where a private company has only one class of share, the director(s) is empowered to allot shares in the company unless the articles prevent this (s. 550). Where a company has more than one class of share, or the company is a Plc, there must be authority provided by the company’s articles or through a resolution of the company.
* This authority may be conditional or unconditional, and it must state the maximum amount of shares that may be allotted, and specify the date on which the power will expire (which must not be more than five years from the date of incorporation (where the power is from the company’s articles) or the date that the resolution was passed). This power may be extended for a period not exceeding five years.
* Having received the authority to allot shares, any further resolution will identify the maximum amount of shares to be allotted and identify the expiry date of the power. To maintain the company’s capital, it is not permitted to issue the shares at a discount, although the company may pay the subscriber a commission for his/her subscribing or agreeing to subscribe. Having allotted shares, the company must inform the Registrar (of Companies) as soon as practicable and in any event within two months after the date of allotment, and within one month of making the allotment, the company must deliver to the Registrar a return of allotment detailing the statement of capital.
* The company’s constitution may allow the allotment of a sufficient number of shares to prevent the takeover. However, there are strict rules on where and how shares may be allotted, such as to raise funds, reward employees, but the procedure is not to facilitate the board’s protection of its position and/or prevent a take-over.

2. Sarah is the company secretary of Picture Perfect Ltd, an advertising agency. The company regularly hires limousines to collect important clients from their offices and airports. Without authorization from the company, Sarah hires several cars to transport herself and her friends on nights out on the company’s business account with the hire firm. When the company receives the invoice, Sarah’s actions are discovered and the company refuses to pay the bill.

Advise the parties of their rights and obligations.

**Indicative content outline answer:**

* The CA 2006 made an important change to the previous requirements under the Companies Acts by removing the requirement for private (but not public) companies to have a secretary.
* The secretary is considered to be an employee of the company and this must be taken into account with regards to the rights of employees and the duties on employers, and also if the company is wound up this employment status has implications for the payments of creditors.

***Appointment***

* A private company is entitled to make an appointment of a secretary and where it chooses to do so, that officer of the company has to undertake statutory duties and those imposed through the articles, and they have authorisation to perform various functions on the company’s behalf.
* The board of directors will choose the secretary (a power usually authorised in the company’s articles) and will usually determine the terms and conditions upon which the appointment is to be made, including the term of office.
* The company secretary does not take part in the management of the company (they do have responsibilities for the company) although the position does provide certain powers (but these are generally restricted to administrative tasks).
* A public company must have a secretary. Unlike a secretary for a private company, a public secretary must have the qualifications required to hold such a position.
* The main role of the secretary is to undertake many of the administrative burdens that a limited company has to comply with as a result of its members enjoying limited liability status. The secretary completes these documents, signs them, and returns them on behalf of the company. These include: maintaining the company’s registers; arranging the company’s meetings and forwarding the notices of these meetings and any resolutions to be moved to the members; submit the company’s annual return and so on.
* The secretary has the power to bind the company in contracts, even in the absence of any authority in this respect, where this relates to administrative proceedings such as employing staff and hiring transport. This power is associated with the usual authority of such a position (under agency) and will only extend that far. Where the secretary attempts to bind the company which would be obviously beyond their authority such as taking loans on the company’s behalf, register the transfer of the company’s shares and so on, as these would be powers vested in the directors rather than the secretary, the secretary enjoys no powers in this respect. However, the law of agency applies in these situations and the company must ensure that third parties are not misled as to the authority possessed by the secretary (see *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd* [1971]).