

*These notes refer to the Companies Act 2006 (c.46)
which received Royal Assent on 8 November 2006*

COMPANIES ACT 2006

EXPLANATORY NOTES

TERRITORIAL EXTENT AND DEVOLUTION

Chapter 2: General Duties of Directors

Sections 170 to 181: General comments

298. The general duties form a code of conduct, which sets out how directors are expected to behave; it does not tell them in terms what to do. More particularly, the duties address:
- the possibility that a director may put his own or other interests ahead of those of the company;
 - the possibility that he may be negligent.
299. The duties are derived from equitable and common law rules, and are not at the moment written down in statute.
300. The Law Commission and the Scottish Law Commission recommended that there should be a statutory statement of a director's main fiduciary duties and his duty of care and skill in their joint report *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties*. The CLR's main recommendations in respect of directors' general duties are summarised in chapter 3 of the Final Report.
301. The CLR recommended that there should be a statutory statement of directors' general duties, and that this should, with two exceptions, described in the next paragraph, be a codification of the current law. In particular they wanted:
- to provide greater clarity on what is expected of directors and make the law more accessible. In particular, they sought to address the key question "in whose interests should companies be run?" in a way which reflects modern business needs and wider expectations of responsible business behaviour;
 - to make development of the law in this area more predictable (but without hindering development of the law by the courts);
 - to correct what the CLR saw as defects in the present duties relating to conflicts of interest.
- The Government has accepted these recommendations.
302. There are two areas, both relating to the regulation of conflicts of interest, where the statutory statement departs from the current law:
- under section 175, transactions or arrangements with the company do not have to be authorised by either the members or by the board; instead interests in transactions or arrangements with the company must be declared under section 177 (in the case of proposed transactions) or under section 182 (in the case of existing transactions) unless an exception applies under those sections;

- section 175 also permits board authorisation of most conflicts of interest arising from third party dealings by the director (e.g. personal exploitation of corporate resources and opportunities). Such authorisation is effective only if the conflicted directors have not participated in the taking of the decision or if the decision would have been valid even without the participation of the conflicted directors. Board authorisation of conflicts of interest will be the default position for private companies, but public companies will need to make provision in their constitutions to permit this. Board authorisation is not permitted in respect of the acceptance of benefits from third parties (section 176).
303. Both reforms implement recommendations of the CLR, which noted that the basic principles in the current law relating to directors' conflicts of interest are very strict:
- they noted that in practice most companies permit a director to have an interest in a proposed transaction or arrangement with the company, provided that the interest is disclosed to his fellow directors. The statutory statement therefore reflects the current position in most companies;
 - they also took the view that the current strict rule relating to conflicts of interest in respect of personal exploitation of corporate opportunities fettered entrepreneurial and business start-up activity by existing company directors. The statutory statement therefore provides for board authorisation of such conflicts.
304. These reforms are modified for charitable companies in England and Wales and Northern Ireland by section 181.

Codification of common law rules and equitable principles

305. Codification is not a matter of transposing wording taken from judgments into legislative propositions. Judgments are, of necessity, directed at particular cases. Even when they appear to state general principles, they will rarely be exhaustive. They will be the application of (perhaps unstated) general principles to particular facts. In the company law field, the principles being applied will frequently be taken from other areas, in particular trusts and agency. It is important that these connections are not lost and that company law may continue to reflect developments elsewhere. Frequently the courts may formulate the same idea in different ways. In contrast legislation is formal. It is not easy to reconcile these two approaches but the draft sections seek to balance precision against the need for continued flexibility and development. In particular:
- *subsection (3)* of section 170 provides that the statutory duties are based on, and have effect in place of, certain common law rules and equitable principles;
 - *subsection (4)* of section 170 provides that the general duties should be interpreted and applied in the same way as common law rules and equitable principles. The courts should interpret and develop the general duties in a way that reflects the nature of the rules and principles they replace;
 - *subsection (4)* of section 170 also provides when interpreting and applying the statutory duties, regard should be had to the common law rules and equitable principles which the general duties replace; thus developments in the law of trusts and agency should be reflected in the interpretation and application of the duties;
 - section 178 provides that the civil consequences of breach (or threatened breach) of the statutory duties are the same as would apply if the corresponding common law rule or equitable principle applied. It also makes clear that the statutory duties are to be regarded as fiduciary, with the exception of the duty to exercise reasonable care skill and diligence which is not under the present law regarded as a fiduciary duty.
306. The statutory duties do not cover all the duties that a director may owe to the company. Many duties are imposed elsewhere in legislation, such as the duty to file accounts and

reports with the registrar of companies (section 441). Other duties remain uncodified, such as any duty to consider the interests of creditors in times of threatened insolvency.

Duties owed to the company

307. [Section 170\(1\)](#) makes it clear that, as in the existing law, the general duties are owed by a director to the company. It follows that, as now, only the company can enforce them. Part 11 (derivative claims and actions by members) describes the mechanism whereby members may be able to enforce the duties on behalf of the company.

Who are the duties owed by?

308. The duties are owed by every person who is a director of a company (as defined in section 250). They are therefore owed by a de facto director in the same way and to the same extent that they are owed by a properly appointed director.
309. Certain aspects of the duty to avoid conflicts of interest and the duty not to accept benefits from third parties continue to apply even when a person ceases to be a director; this is necessary to ensure that a director cannot, for example, exploit an opportunity of which he became aware while managing the company's business without the necessary consent simply by resigning his position as director. The closing words of section 170(2) provide that these duties apply to a former director subject to any necessary adaptations. This is to reflect the fact that a former director is not in the same legal position as an actual director.
310. The statutory duties apply to shadow directors where, and to the extent that, the common law rules or equitable principles which they replace so apply (section 170(5)). This means that where a common law rule or equitable principle applies to a shadow director, the statutory duty replacing that common law rule or equitable principle will apply to the shadow director (in place of that rule or principle). Where the rule or principle does not apply to a shadow director, the statutory duty replacing that rule or principle will not apply either.

The relationship between the duties

311. Many of the general duties will frequently overlap. Taking a bribe from a third party would, for example, clearly fall within the duty not to accept benefits from third parties (section 176) but could also, depending on the facts, be characterised as a failure to promote the success of the company for the benefit of its members (section 172) or as an aspect of failing to exercise independent judgment (section 173).
312. The effect of the duties is cumulative, so that it is necessary to comply with every duty that applies in any given case. This principle is stated in section 179. One exception relates to the duty to avoid conflicts of interest (section 175). This particular duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company. In such cases the duty to declare interests in proposed transactions or arrangements (section 177) or the requirement to declare interests in existing transactions or arrangements (section 182) will apply instead. Section 181 modifies these provisions for charitable companies in England and Wales and Northern Ireland.
313. The cumulative effect of the duties means that where more than one duty applies, the director must comply with each applicable duty, and the duties must be read in this context. So, for example, the duty to promote the success of the company will not authorise the director to breach his duty to act within his powers, even if he considers that it would be most likely to promote the success of the company.
314. As well as complying with all the duties, the directors must continue to comply with all other applicable laws. The duties do not require or authorise a director to breach any other prohibition or requirement imposed on him by law.

Relationship between the duties and the company's constitution

315. Under section 171 a director must act in accordance with the company's constitution.
316. Companies may, through their articles, go further than the statutory duties by placing more onerous requirements on their directors (e.g. by requiring shareholder authorisation of the remuneration of the directors). The articles may not dilute the duties except to the extent that this is permitted by the following sections:
- section 173 provides that a director will not be in breach of the duty to exercise independent judgment if he has acted in a way that is authorised by the constitution;
 - section 175 permits authorisation of some conflicts of interest by independent directors, subject to the constitution;
 - *subsection (4)(a)* of section 180 preserves any rule of law enabling the company to give authority for anything that would otherwise be a breach of duty;
 - *subsection (4)(b)* of section 180 provides that a director will not be in breach of duty if he acts in accordance with any provisions in the company's articles for dealing with conflicts of interest;
 - section 232 places restrictions on the provisions that may be included in the company's articles. But nothing in that section prevents companies from including in their articles any such provisions as are currently lawful for dealing with conflicts of interest.
317. The company's constitution may also set out the purposes of the company, especially in the case of an altruistic company which has purposes other than the benefit of the company's members. It is very important that directors understand the purposes of the company, so that they are able to comply with their duty to promote the success of the company in section 172.

Relationship between the duties and the detailed rules requiring member approval of conflicts of interest

318. Under the provisions in Chapter 4 of this Part, the directors must sometimes obtain prior shareholder approval for the following types of transaction involving a director (or, in some cases, a person connected to a director): long-term service contracts; substantial property transactions; loans, quasi-loans and credit transactions; and payments for loss of office.
319. [Section 180](#) provides that:
- compliance with the general duties does not remove the need for member approval of such transactions (*subsection (3)*);
 - (subject to the exception set out in the bullet point below) the general duties apply even if the transaction also falls within Chapter 4 (because it is a long-term service contract, substantial property transaction, loan, quasi-loan, credit transaction or payment for loss of office). So, for example, the directors should only approve a loan to a director if they consider that it would promote the success of the company. This is so, even if the loan does not require the approval of members under Chapter 4 because it falls within a relevant exception, such as the exception for expenditure on company business in section 204;
 - if the transaction falls within Chapter 4 (because it is a long-term service contract, substantial property transaction, loan, quasi-loan, credit transaction or payment for loss of office) and approval of the members is obtained to the transaction in accordance with that Chapter, or an exception applies, so that approval is not necessary under that Chapter, then the director does not need to comply with the duty to avoid conflicts of interest (section 175) or the duty not to accept benefits

from third parties (section 176) in respect of that transaction. All other applicable duties will still apply. For example, a director would not be acting in breach of the duty to avoid conflicts of interests if he failed to obtain authorisation from the directors or the members for a loan from the company in respect of legal defence costs. Section 181 modifies this provision for charitable companies in England and Wales and Northern Ireland.

Relationship between the duties and the general law

320. **Section 180(5)** provides that the general duties have effect notwithstanding any enactment or rule of law except where there is an express or implied exception to this rule. For example, section 247 provides that directors may make provision for employees on the cessation or transfer of a company's business even if this would otherwise constitute a breach of the general duty to promote the success of the company.

Consequences of breach

321. **Section 178** preserves the existing civil consequences of breach (or threatened breach) of any of the general duties. The remedies for breach of the general duties will be exactly the same as those that are currently available following a breach of the equitable principles and common law rules that the general duties replace.

322. **Subsection (2)** of that section makes it clear that the duties are enforceable in the same way as any other fiduciary duty owed to a company by its directors (except for the duty to exercise reasonable care, skill and diligence, which is not considered to be a fiduciary duty). In the case of fiduciary duties the consequences of breach may include:

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