Chapter 1

Introduction

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This Guide for practitioners – company directors and their professional advisers – is now in its third edition. Practitioners are only too aware that there is no simple model role for the company director. This is partly because of the way in which company law and the codes of corporate governance have developed in the UK, but also because of the diverse nature of the purposes and interests which corporate structures serve. Practitioners will want to master all aspects of the regulatory regime, both legal and voluntary, which prescribe the conduct to be expected of directors, as the consequences for breach can be serious. Further, practitioners need to be aware of, and be in a position to react to, changes which occur in the regulatory regime with which they are faced.

The roles of directors and their duties and responsibilities will vary according to the type of company they serve and, to some extent, to the nature of their position, as well as the level of regulation. But as a preliminary, practitioners may ask whether there is any underlying framework to which they may refer for guidance and from which they may infer what is expected of them.

Since the second edition of this Guide was published, much has changed. Potentially, the most far-reaching change has come with the introduction of the Companies Act 2006 ("CA 2006"). This received Royal Assent on 8 November 2006. Parts of it have already come into force, with the remaining sections to be brought into law in phases during 2007 and 2008. The CA 2006 will apply to all UK companies, small or large, private or public. The Government's promise to simplify company law and deregulate small companies has led to an Act of 1,300 sections and 16 schedules, some of which simply restate the existing law, but many of which bring about a fundamental

change in how companies will need to be governed in the future. Perhaps the most notable change for directors is that their duties have been codified for the first time (Part 10 of the Act).

Other changes in the legislative and regulatory landscape have also occurred – for example, an updated version of the Combined Code has been published, which applies to listed companies for accounting years beginning on or after 1 November 2006. At European level, the Transparency Directive imposes obligations on listed companies to make further notifications to the market in a bid to improve market transparency. For companies regulated by the Financial Services Authority ("FSA"), new developments have affected the way in which the FSA looks to supervise firms and the conduct of their directors.

1.1 CA 2006 reforms

The CA 2006 is a complex piece of legislation, the consideration of much of which is outside the scope of this Guide. The following chapters, however, pick out and examine a number of areas of particular relevance to directors' duties and responsibilities, a few of which are highlighted in this introduction.

1.1.1 Codification of directors' duties

For the first time in the UK, directors have what appears to be an authoritative statement given by statute of what their duties actually are. The general duties owed by directors had been built up over the years by case law. The Company Law Review ("CLR") (commissioned in 1998 and comprising an independent group of experts, practitioners and business people) believed that there was a need to make the law in this area more consistent, certain, accessible and comprehensible, and recommended that there should be a statutory statement of directors' general duties.[1] The Law Commission and the Scottish Law Commission also recommended that there should be a

[1] The Company Law Review Steering Group presented its Final Report (*Company Law Reforms: Modern Company Law for a Competitive Economy*) to the Secretary of State for Trade and Industry on 26 July 2001.

statutory statement of a director's main fiduciary duties and his duty of care and skill.[2] The CLR recommended that the statutory statement should largely be a codification of current law. However, the CLR also wanted greater clarity on what is expected of directors and to make the law more accessible, as well as to make development of the law in this area more predictable (but without hindering development of the law by the courts).

The Government accepted the recommendations and, thereby, set itself a challenge: as the Government has acknowledged in the Explanatory Notes to the CA 2006, codification is not just a matter of transposing wording taken from judgments into legislative propositions; judgments are directed at particular cases and any principles which may be stated will rarely be exhaustive. The Government considered it important that the connections with other areas of the law (such as trusts and agency) should not be lost so that company law may continue to reflect developments elsewhere. Simply put, the challenge was to balance precision against the need for continued flexibility and development.

The Act specifies in Sections 171 to 177 the general duties that are owed by a director to the company. These duties are set out in more detail in Section 1.2 below. As for the inter-relationship with the common law rules and equitable principles, the Act provides:

> "(3) The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.
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> (4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties."[3]

[2] Joint report *Company Directors: Regulatory Conflicts of Interest and Formulating a Statement of Duties*, September 1999 (Law Com No 261, Scot Law Com No 173).

[3] Section 170 CA 2006.

That these duties are to be interpreted in the same way as the common law duties which the specified general duties have effect in place of may cause some difficulties, as the wording of the new statutory duties does not necessarily correlate exactly with how those duties were previously expressed or understood.

The majority of the sections of the CA 2006 imposing the general duties will come into force on 1 October 2007, but the duty to avoid conflicts of interests will not come into force until 1 October 2008, to give companies more time to amend their articles of association to reflect the new provisions.

Of course, the specified general duties do not cover all the duties that a director may owe to the company. They are the general duties for a director to have in mind in carrying out his duties but there are other specific duties imposed (such as the duty to file accounts and reports with the registrar of companies[4]).

The CA 2006 makes changes to the manner in which a breach, or possible breach, of a director's duty may be ratified. The Act abolishes the right of a director to ratify his own breach of duty by providing that the necessary majority must be obtained disregarding votes in favour at the shareholder meeting by the director and any member connected with him.[5] Curiously though, it does not abolish the right for directors to vote in their capacity as shareholders to authorise in advance acts which may be in breach of their duties. Directors will therefore have an incentive to seek prior authorisation of acts which would otherwise constitute a breach of their duties. Helpfully, the CA 2006 does confirm that a substantial property transaction with a director may be entered into conditional upon shareholder approval; previously there was some doubt as to whether this was allowed, or whether the approval had to be obtained before the transaction could be entered into.[6] The Act also allows loans to be made by a company to its directors, provided that they are first approved by shareholder resolution.[7]

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[4] Section 441 CA 2006.
[5] Section 239 CA 2006.
[6] Section 190 CA 2006.
[7] Section 197 CA 2006.

1.1.2 Derivative claims

Closely linked to the codification of directors' duties is the new provision in the CA 2006 putting derivative claims by shareholders on to a statutory footing.[8] A derivative claim is a claim by a member in respect of a cause of action vested in the company and seeking relief on behalf of the company. These claims can be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company (including the duty to exercise reasonable care, skill and diligence). Once a shareholder has commenced a derivative action, he will have to apply to the court for permission to continue the action. If it appears to the court that the application and the evidence filed in support of it do not disclose a *prima facie* case for giving permission, the court must dismiss the application and may make any consequential order that it considers appropriate.[9] Permission must be refused if the court is satisfied that:

(a) a person acting in accordance with Section 172 CA 2006 (duty to promote the interests of the company) would not seek to continue the claim;
(b) the act or omission has not yet occurred and has been authorised by the company; or
(c) the act or omission has occurred, but was authorised before it occurred or has since been ratified by the company.[10]

The court must also consider further factors before deciding whether or not to grant permission, including whether the member is acting in good faith and whether the relevant act or omission could be authorised or ratified by the company. The court is required to have particular regard to any evidence before it as to the views of members of the company who have no personal interest in the matter.

The scope and effect of these new provisions are uncertain with opinion divided between those who consider that the new provisions will encourage activist shareholders to commence (or at least to threaten

[8] Section 260 CA 2006.
[9] Section 261 CA 2006.
[10] Section 263(2) CA 2006.

to commence) proceedings more readily and those that believe the attitude of the courts will prevent a significant increase in the number of actions. Since the proceeds of any successful derivative claim must be returned to the company, it remains to be seen whether shareholders will regard this as a more useful or accessible remedy than the seldom-used common law derivative action. However, whatever the long-term effects, there is concern that there could be an increase in litigation as shareholders test the courts' willingness to entertain derivative claims.

1.1.3 Directors' reports

Prior to the second edition of this Guide, the Government had announced that quoted companies would be required to prepare and publicise an operating and financial review. However, this was dropped in November 2005, as part of the Government's drive to stop "gold plating" European legislation. Instead, companies must prepare a "business review" as part of their directors' report under the CA 2006. The Act imposes miscellaneous requirements in respect of reports that are required to be produced.

The Act also provides that a director is liable to compensate the company for any loss suffered by it as a result of any untrue or misleading statement in the directors' report, the directors' remuneration report or a summary financial statement derived from such report, or any omission from such reports. Importantly, however, a director is only so liable if he knew the statement to be untrue or misleading or was reckless as to whether the statement was untrue or misleading or he knew the omission to be dishonest concealment of a material fact.[11] Moreover, the director will not be subject to any liability to any person other than the company resulting from reliance by that person or another on information in respect to which the section applies (although this does not affect liability for a civil penalty or for a criminal offence). There is, it would seem, consequently much to be gained by ensuring that as much of the narrative reporting of the company as possible is brought within this safe harbour by including it within the applicable directors' reports.

[11] Section 463 CA 2006.

1.1.4 Shadow directors

A shadow director is any person in accordance with whose directions or instructions the directors of the company are accustomed to act, although a person is not deemed to be a shadow director by reason only that directors act on advice given by him in a professional capacity.[12] Under the Act, the general directors' duties are expressed to apply to shadow directors where, and to the extent that, they would have applied previously under the corresponding common law rules or equitable principles.[13] This means that the laws relating to shadow directors are not comprehensively dealt with in the Act itself, but instead practitioners are forced to fall back on the previous, uncertain common law in this area. Time will tell precisely how the common law rules and equitable principles relating to shadow directors will sit alongside the codified directors' duties.

1.1.5 Register of directors' addresses

The current provisions, which allow directors who are subject to the risk of violence or intimidation to keep their home addresses confidential, are replaced by broader provisions in the CA 2006. The Act permits a director to provide a service address for the public record rather than his home address and this service address may be the company's registered office. The directors must also provide their usual residential addresses to the company, and the company must maintain a new register of directors' usual residential addresses, which will not be open to public inspection. The Act imposes an obligation on the Registrar of Companies not to disclose information as to a director's usual residential address as part of the material available for public inspection.[14]

1.2 Duties and responsibilities

Previously this area of the law has been fragmented and difficult, owing in large part to its common law origins superimposed by

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[12] Section 251 CA 2006, restating the definition in Section 741(2) and (3) of the Companies Act 1985.
[13] Section 170(5) CA 2006.
[14] Section 242 CA 2006.

statutory (and even self-regulatory) provisions. The CA 2006 now provides a list of the general duties of directors, namely:

(a) to act in accordance with the company's constitution and only exercise powers for the purposes which they are conferred;[15]
(b) to promote the success of the company;[16]
(c) to exercise independent judgment;[17]
(d) to use reasonable care, skill and diligence;[18]
(e) to avoid conflicts of interest;[19]
(f) not to accept benefits from third parties;[20] and
(g) to declare an interest in a proposed transaction or arrangement.[21]

As mentioned above, these general duties are based on certain common law rules and equitable principles and apply in place of those rules and principles as regards the duties owed to a company by its directors.[22] However, the general duties are to be interpreted and applied in the same way as the previous common law rules or equitable principles, and regard is to be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.[23] Hence, the extent to which they actually increase clarity is debatable. The obvious benefit for directors is that they now have a list of their general duties available in one place.

All of the above duties will come into force on 1 October 2007, aside from the duty to avoid conflicts of interest which will not come into force until 1 October 2008. Exactly how the new duties will fall to be interpreted is not yet certain. Although these duties will be examined in more detail in other Chapters, it is worth touching briefly on some aspects.

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[15] Section 171 CA 2006.
[16] Section 172 CA 2006.
[17] Section 173 CA 2006.
[18] Section 174 CA 2006.
[19] Section 175 CA 2006.
[20] Section 176 CA 2006.
[21] Section 177 CA 2006.
[22] Section 170(3) CA 2006.
[23] Section 170(4) CA 2006.

1.2.1 The duty to promote the success of the company

This requires a director to "act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole".[24]

The concept of the members as a whole is discussed in more detail later in this Chapter. A useful starting point was given during the Company Law Review, when the Attorney-General stated in the House of Lords:

> ". . . what is success? The starting point is that it is essentially for the members of the company to define the objectives that they wish to achieve. Success means what the members collectively want the company to achieve. For a commercial company, success will usually mean long-term increase in value. For certain companies, such as charities and community interest companies, it will mean the attainment of the objectives for which the company has been established. But one can be more refined than that. A company's constitution and the decisions that a company makes can also go on to be more specific about what is the appropriate success model for the company. I have indicated that usually for a company it will be a long-term increase in value, but I can imagine commercial companies that would have a different objective as to their success."[25]

1.2.2 The duty to avoid conflicts of interest

This section will not be brought into force until 1 October 2008, to enable companies to make provision in their articles to allow conflicts of interest to be authorised. A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts with the interests of the company. There will, however, be no breach of duty if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest.[26] This duty has

[24] Section 172(1) CA 2006.
[25] House of Lords, *Hansard*, 6 February 2006.
[26] Section 175(4)(a) CA 2006.

been controversial as it raised the question of whether directors who hold multiple directorships would be in breach of their duties as a result of this new express duty.

The duty will also not be infringed if the matter has been authorised by the directors.[27] There is an argument that authorisation obtained ahead of a director's appointment in respect of possible future conflicts would be sufficient authorisation, but it seems that the better view is that a specific authorisation will be required in respect of a matter arising after the appointment.

For private companies whose constitution does not prevent it, authorisation may be given by directors who have no interest in the matter giving rise to the conflict.[28] This represents a departure from the previous law, which required that any such matter had to be authorised instead by the members of the company. A public company's constitution must include a provision enabling the directors to authorise the matter and the authorisation must be given by directors who have no interest in the matter.[29]

1.2.3 The level of reasonable care, skill and diligence

Directors are required to exercise reasonable care, skill and diligence.[30] This begs the question "what does that mean?" Traditionally, it was thought that the level of care and skill required to be a director was fairly minimal. Directors need no qualification to hold their post, and so the test appeared to be a subjective one against each individual director's own level of knowledge and skill. This has found less favour with time, and is now completely replaced by a dual (objective and subjective) standard of care, skill and diligence in the CA 2006. The Act expressly provides:[31]

> "[t]his means the care, skill and diligence that would be exercised by a reasonably diligent person with –

[27] Section 175(4)(b) CA 2006.
[28] Section 175(5)(a) CA 2006.
[29] Section 175(5)(b) CA 2006.
[30] Section 174 CA 2006.
[31] Section 174(2) CA 2006.

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and

(b) the general knowledge, skill and experience that the director has."

This replicates the test set out in Section 214 Insolvency Act 1986 and consequently the case law in relation to that area will remain of great importance in setting the scope of the new duty. Hoffmann LJ had previously held that the duty of care for a director was set out accurately in Section 214, and applied that principle more widely in relation to directors' duties generally.[32] Cases under the Company Directors Disqualification Act 1986 may also be helpful in determining whether a director is in breach of his duty of reasonable care, skill and diligence. A notable case is *Re Continental Assurance Co of London plc*,[33] where a non-executive director was disqualified, even though he did not know of the wrongful conduct in question. It was held that any competent director in his position would have known what was going on and, by virtue of the fact of his ignorance of what was going on, he was incompetent. It seems that this would also lead to a breach of his duty to exercise reasonable care, skill and diligence under the CA 2006.

In *Re Barings plc (No 5)*,[34] it was established that there is a continuing obligation on directors to acquire and maintain a sufficient knowledge and understanding of the company's business for the proper discharge of their duties. It is therefore critical that a person accepting the office of director is aware not only of the nature of the duties that he owes to the company and its members and keeps up to date with the nature of the duties, but also acquires and maintains an appropriate knowledge of the company's business.[35] Exact parameters will vary according to the nature of the company and the individual experience and skill that the director in question possesses.

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32 *Re D'Jan of London Ltd* [1993] BCC 646.
33 [1996] BCC 888.
34 [1999] 1 BCLC 433.
35 Indeed, as regards listed companies, paragraph A5 of the Combined Code requires that all directors "should receive induction on joining the board and should regularly update and refresh their skills and knowledge".

1.3 Further regulation

Although the codification of directors' duties in the CA 2006 is helpful in bringing certain duties together, it should be remembered that it is not an exhaustive list of directors' duties. As well as the specific duties and obligations imposed elsewhere in the CA 2006, there are numerous other regulatory requirements. Thus, for example, directors of listed companies are required to comply with a series of other sets of rules, such as the Listing Rules, the Takeover Code, the Disclosure and Transparency Rules (which implement the Transparency Directive into UK law) and the Combined Code of Corporate Governance. The growth in the number of companies listed on the Alternative Investment Market ("AIM") since the last edition of this Guide has meant that the AIM Rules for Companies now apply to a significant number of companies, and these also contain various regulations and duties of which directors of AIM listed companies need to be aware.

The emphasis of these rules and codes remains on the need for transparency and accountability. The rules are increasingly being put on a statutory footing – for example, Part 28 of the CA 2006 gives the Takeover Panel statutory authority to make rules and regulations in relation to takeovers and mergers of companies, and gives it the power to demand information from companies and to impose sanctions for non-compliance.

The FSA is moving increasingly towards more principles–based regulation, which will require directors of companies regulated by the FSA to take a more active role in how their business is run. The FSA operates an approved persons regime, whereby people wishing to be directors or controllers of regulated companies need to apply to the FSA for approval. Such people will need to demonstrate that they have the necessary skill, expertise and integrity to take on such a role.

1.4 The company's interests

The established common law rules provide that directors owe their duties to their company. There was much debate at the beginning of the Company Law Review process as to whether directors' duties should continue to be owed solely to the company, except in limited cases, or

whether directors should be required as a matter of law to account directly to third parties (e.g. suppliers, local communities, the environment, employees, etc.). The conclusion was that the existing position should remain, and this is confirmed by the CA 2006.[36] However, as part of their duty to promote the success of the company, as outlined above, directors must have regard to what the Government has termed "enlightened shareholder value". Consequently, a director must act in the way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

(a) the likely long-term consequences of any decision;
(b) the interests of the company's employees;
(c) the need to foster business relationships with suppliers, customers and others;
(d) the impact of the company's operations on the community and the environment;
(e) the desirability of the company maintaining a reputation for high standards of business conduct; and
(f) the need to act fairly as between members of the company.[37]

It is important to note that this list is not an exclusive or exhaustive list – the director is to have regard "amongst other matters" to those listed.

The Government's desire to introduce this list gave rise to considerable debate during the process. The Government has made it clear that directors will have to do more than merely pay lip service to each of these factors, but must give each due and careful consideration when making decisions. Critics have consequently argued that this will make decision-making more onerous, result in an increase in documentation and an increased likelihood that directors' decisions come under the scrutiny of the courts. This may lead directors to be more risk-averse, which may not be in the interests of their company.

However, there is considerable support for the argument that directors of well-run companies already have regard to these sorts of factors in their decision making in any event, and that having them

[36] Section 170(1) CA 2006.
[37] Section 172 CA 2006.

listed in statute will not have much effect on such companies. The Attorney-General, Lord Goldsmith, confirmed that he felt it was unlikely that the duty to have regard to these factors would have much practical effect on well-run companies and, when pressed as to why they were to be included in the CA 2006, stated:

> "If there are people at the moment who do not have regard to these factors then – on the basis of the best business practices that we have had explained to us by some of the best business leaders in this country – they should."[38]

Further, directors are only required to *have regard* to these factors; a director is entitled to take a decision that would, for example, inevitably have an adverse environmental impact, provided that he had regard to the impact and weighed up what he considered, in good faith, would be most likely to promote the success of the company. There will be no breach of statutory duty unless the directors fail to have regard to the factors listed. Indeed, as the director's duty is owed to the company, there may be situations where a decision would need to be taken for the success of the company as a whole despite it having such an adverse impact. It would seem prudent for directors to ensure that their decisions are appropriately documented, reflecting the due regard paid to the list of factors set out above (and any other relevant factors). That said, one should guard against turning compliance into a "box-ticking" exercise. Practice will naturally develop, but it seems unlikely that practice for well-run companies will necessarily have to change dramatically.

The general duty owed by a director to the company is to act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of the members as a whole. Maximising value for shareholders over the long-term may well be the primary aim, but it is possible that the constitution of a company provides that the company should have different aims, such as achieving a particular goal (e.g. completing a construction project) or even maximising dividend revenues in the short term. It would be for the members of the company to set the purposes of the company, and

[38] House of Lords, *Hansard*, 9 May 2006.

these could be amended subsequently by special resolution passed at an annual general meeting ("AGM") or extraordinary general meeting ("EGM"). Where, or to the extent that, the purposes of the company consist of or include purposes other than the benefit of its members, the reference to promoting the success of the company for the benefit of its members can be taken as a reference to achieving those purposes.[39]

Certain situations may qualify these general principles. For example, on a takeover offer, the best price available to current shareholders may be the primary concern for the current board of directors of the target company. While the relationship between director and shareholder does not of itself give rise to direct responsibility, directors may assume a responsibility to shareholders directly when the circumstances require. An example would be where a director makes a personal representation to shareholders to induce them to transfer shares in his company and the director has a high degree of inside knowledge in relation to the shareholders.[40]

When a company is in financial difficulties, the interests of creditors become paramount. Directors will still need to have regard to the matters (and those stakeholders) set out above (e.g. the company's members and its employees), but the duty to promote the success of the company is expressly stated to have effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the best interests of the creditors of the company.[41] It will not always be easy for directors to see when the "tipping point" is reached, and the company is no longer able to trade its way out of trouble but must instead prepare for the onset of insolvency. In practice, it could lead to some very difficult decisions which directors will have to make, to attempt to minimise the loss to creditors but still act to promote the success of the company as a whole.

[39] Section 172(2) CA 2006 CA 2006.
[40] This was the situation in *Platt and another* v *Platt* [1999] 2 BCLC 745.
[41] Section 172(3) CA 2006.

1.5 Nature of companies

General principles and the background to their development provide a good framework for practitioners determining the duties and responsibilities of directors. However, it has always been important to apply these general principles in the context of the type of company and of the particular role of that director. As the general duties under the CA 2006 are to be interpreted by using common law and equitable principles, it would seem that this should still be the case even now that the duties have been codified.

The majority of companies in the UK are private limited companies. Many are owner-managed, in some cases effectively housing a sole trader, in others operating more like partnerships. For many of these companies, there will be little practical need to distinguish between the interests of directors and shareholders. However, there remains a need for legal safeguards to be in place should things go wrong. The luxury of limited liability enjoyed by the owners of these companies calls for at least minimum standards of behaviour for the benefit of third parties. The CA 2006 specifies what many of these standards are, and the duties under the Insolvency Act 1986 will also apply for the protection of creditors when things go wrong.

The Government has attempted to deregulate small, private companies in the course of drawing up the CA 2006. The idea is that certain minimum standards should apply to all companies, and as companies get larger, becoming listed or otherwise, further standards should then be imposed. Private companies will benefit from:

(a) shorter *pro forma* articles of association;
(b) the removal of the requirement for a company secretary;
(c) the removal of the requirement to hold an AGM;
(d) the removal of the requirement for unanimity in respect of written resolutions;
(e) the abolition of the prohibition on granting financial assistance; and
(f) the introduction of a streamlined procedure for capital reductions.

In companies in which there are numerous shareholders, especially those that are listed, there is much more of a distinction between

management and ownership. The duties and responsibilities of directors are not blurred by the coincidence of ownership. Directors will have substantial freedom to carry on the business of the company, but will find that there are many regulatory potholes into which they could potentially fall. By way of example, the CA 2006 imposes personal liability on directors should they knowingly or recklessly allow untrue or misleading statements to be published in certain directors' reports (although as mentioned above, there is a potentially useful safe harbour as a director will only be liable if he knew or was reckless as to whether the statement was untrue or misleading and he is only liable to compensate the company and not any other party).[42]

In addition, in the context of regulated entities, the FSA has the power to remove its approval of a director if it considers that the director is no longer a fit and proper person to carry on a regulated business, effectively preventing such a person from being the director of any regulated entity. Regulated and listed companies must comply with very high standards of disclosure and transparency in their dealings with the public, and the responsibility for these high standards rests with the directors and managers of those companies.

1.6 The particular role of non-executive directors

The role of non-executive directors remains the subject of much discussion and debate, particularly in relation to listed companies. Similar to the position prior to its enactment, the CA 2006 makes no distinction between the duties owed to a company by its executive directors and its non-executive directors,[43] and so all directors owe similar duties. As mentioned above, developments in the law (both through the courts and statutory reform) as well as corporate governance developments have meant that the duties of the non-executive director now go far beyond simply attending board meetings. Their duty of care has arguably expanded along with this, and they will clearly owe duties to the company according to their role on the board and committees of the board, as well as having the general CA

[42] Section 463 CA 2006.
[43] Section 250 CA 2006 states that "director" includes any person occupying the position of director, by whatever name called.

2006 duties, including the duty to exercise reasonable care, skill and diligence. Pursuant to Section 174(2) CA 2006 the duty to exercise reasonable care, skill and diligence is tested against the care, skill and diligence that would be exercised by a reasonably diligent person with:

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (an objective test), and
(b) the general knowledge, skill and experience that the director has (a subjective test).

There appears to be a tendency towards non-executive directors taking on the crucial role of preserving good governance standards on the board of any major company, listed or otherwise, as evidenced by the Combined Code. For example, one of the supporting principles to paragraph A1, which states that every company should be headed by an effective board, provides that:

> "As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. Non-executive directors should scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance. They should satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust and defensible. They are responsible for determining appropriate levels of remuneration of executive directors and have a prime role in appointing, and where necessary removing, executive directors, and in succession planning."

1.7 Group company directors

Directors of companies which are members of groups of companies often find themselves having to consider their position with great care when intra-group transactions or group interests are in issue, the more so when they are directors of more than one of the companies involved. A director of any company within a group owes a duty to

act in the best interests of that company, whatever the competing interests of a subsidiary, parent, group holding company or sister company. While in certain circumstances, European legislation is framed so as to hold a group as a single economic entity in relation to creditors, as well as in the regulation of competition and employment issues and for capital adequacy purposes, there remains no English law doctrine which permits the directors of one company to take into account the interests of other group companies as such. Given the advantages of limited liability enjoyed by each company within the group, the Government and the courts seem keen to ensure that the assets of each company are protected for their individual creditors.

The statutory duty to avoid conflicts of interest, once it comes into force on 1 October 2008, is likely to be significant here, and companies will need to give a lot of thought to how their articles of association deal with such possible conflicts as well as how their ratification procedures work. It may be that each board within a group will look to independent directors, to take advantage of the CA 2006 provisions for ratification by fellow directors for certain acts. The issue surfaces most frequently in relation to two situations: financings, where the lender often seeks to achieve exposure on a group basis for contractual arrangements, with the obtaining of cross-guarantees and the like; and in intra-group reorganisations, whether undertaken for taxation or other purposes. In the latter context, transactions at an undervalue and the practice of transferring assets intra-group for a nominal consideration give rise to particular difficulties, notwithstanding the relaxation of the rules prohibiting financial assistance for private companies.[44] Some acts are not capable of ratification by either fellow directors or shareholders, and so directors may find themselves with difficult decisions to be made. The position remains that the directors of a subsidiary company (or parent company) owe a duty to that company, even if they owe duties to other companies within the group by virtue of their fellow directorships. They may have regard to the interests of the group if, but only if, it is in the interests of the relevant company to do so.

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[44] CA 2006 Chapter 2 of Part 18.

1.8 Conclusion

Although the codification of directors' duties in the CA 2006 had the stated aim of reflecting in statute the common law position, there are some significant changes. Moreover the codified duties are not all the duties a director may owe to a company. Directors continue to owe their duties solely to the company (except in limited cases, such as in an insolvency), but the CA 2006 provides a statutory basis for shareholders to bring derivative claims.

The following chapters go into more detail in areas touched on above and other areas.