



### **Rights and duties of directors**

**Martha Bruce**

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### **Book review by Sally Ramage**

#### **'Rights and duties of directors'**

The fourteen chapters in this book are all very useful. They cover directors' rights, duties including statutory duties, financial responsibilities, breach of duty concerning employment issues such as health and safety, and insolvency issues that affect directors and indemnity of directors. The CA 2006 sets out on a statutory basis, the general duties owed by a director to his or her company.

The CA 2006 states that 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*'. The act provides that 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*'.

The duties include the duty to promote the success of the company for the benefit of its members and to have regard to six specified factors including a greater transparency of directors' duties; and the new derivative claims procedure. It is important that directors take appropriate steps to ensure compliance and thereby minimize the risk of litigation. The general duties of directors as set out in ss.171-177 of the CA 2006, in force since 1 October 2008.

#### **A director**

Although the Companies Act 2006 does not specifically define a director, section 250 does provide a term that includes any person occupying the position of director by whatever name called. Martha Bruce states that '*a company may therefore describe its directors as governors, trustees or council members, etc without affecting their legal status as directors*'.

#### **Fiduciary duties of directors**

There are two kinds of fiduciary duties owed by officers and directors, as described in chapter 7. These are: the duty of due care, which requires the director to act as a reasonably prudent person and the duty of loyalty, which requires a director to act in good faith for the benefit of the company. A breach of fiduciary duty can expose a director to personal liability. Generally, courts will find that a company is insolvent when it has liabilities in excess of assets or is unable to meet its obligations. Directors always owe fiduciary duties directly to their company and, when the company is solvent those duties are also owed to the company's shareholders. When a company becomes

insolvent, creditors replace shareholders as the residual risk-bearers and the fiduciary duties owed to shareholders shift to the company's creditors. As the company approaches insolvency, many courts find that fiduciary duties are owed to both shareholders and creditors.

### **Directors acting 'in good faith' as per CA 2006, s.172**

Chapter 4 states that it is important to note that the obligation on the directors is to act in good faith, which would be most likely to promote the success of the company. Historically, the Courts have been reluctant to overturn directors' commercial decisions provided they have been made in good faith and we would expect that this will continue to be the case.

### **Directors and employment issues**

Directors found guilty of serious health and safety offences, tackled in chapter 11, are likely to be banned from running a company. Company Directors Disqualification Act 1986 allows the courts to disqualify directors who are in breach of their duties and to date, the majority of disqualifications are for financial reasons, such as insolvency. Now the Health and Safety Executive (HSE) can disqualify a director for serious breaches of health and safety rules. Directors risk a large fine as well as being banned from running a company.

The Corporate Manslaughter and Corporate Homicide Act 2007 is an attempt to establish corporate criminal liability. This criminal liability exists even though corporations cannot be imprisoned and it is not clear that corporate criminal liability is the best way to influence corporate behaviour. Section 2(1) (d) makes the duty of care a custody provider owes to a person who is detained a relevant duty of care for the purposes of the Act. This section was not commenced when the rest of the Act came into force on 6 April 2008, but the Government has committed to commence these provisions within three to five years of 6 April 2008 with regard to prisons. With regard to HMRC who are aware that policies relating to the safety and medical care of internal drug smugglers require review to reflect the latest medical advice on best practice. As a result, HMRC have approached the Chief Medical Officer, Sir Liam Donaldson, for advice. In response Sir Liam is establishing an expert working group chaired, by Dr Anita Thomas OBE, to report with recommendations to him. This work is being funded by the Department of Health. The first draft of the expert group's recommendations will be presented to the Chief Medical Officer in December 2009, and the completed guidance will be presented by the Chief Medical Officer to the HMRC. HMRC were to have developed a national policy for the clinical care of drug traffickers being held in custody by March 2010. For all organizations, not having a policy to prohibit corporate manslaughter can be said to be a nonfeasance or omission.

### **Directors' misfeasance**

However, ever since 1846, Lord Denman ruled in *The Queen v Great North of England Railway Co* (All ER, Rep. 1294 (Q.B. 1846) that corporations could be criminally liable for misfeasance or creating a nuisance, relying on vicarious guilt rather than personal fault. The key changes to directors' duties under English law made by the Companies Act 2006 came into force on 1 October 2007. At the same time, the CA 2006 also introduced a new statutory process under which shareholders can, in certain circumstances, bring claims against directors on behalf of the company for breach of duty. Representative bodies and the Government have recently issued guidance on directors' duties under the CA 2006. In August 2007, the BERR (as the DTI is now called) published revised FAQs on the CA 2006. This is possible using the Civil Procedure Rules and Practice Directions which provide for the new two stage procedure for permission to proceed with derivative actions under the CA 2006. The duties in relation to the preparation of accounts are outside the statement of general.

**Personal liability of directors**

At all times, but especially as a company becomes insolvent, there are measures that can be taken to limit directors' risk of personal liability on account of a claim for breach of fiduciary duty. These include the following: verifying whether the corporate charter documents or by-laws provide for indemnification of directors and officers, but do not rely upon indemnification when making proper decisions; verifying whether applicable corporate law provides for indemnification or limitation of liability for certain decisions and under certain circumstances; and obtaining sufficient and appropriate directors' and officers' insurance coverage.

**Conclusion**

'The rights and duties of directors' by Martha Bruce, published by Tottel Publishers, now Bloomsbury Professional, is a very useful book indeed.