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Directors' general duties

Guidance note

SPORT ENGLAND

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Contents

If you have any feedback on the content of these resources, or additional questions that you'd like to discuss, please contact the SGA: **020 7612 7029 | info@sportsgovernanceacademy.org.uk**

Introduction

This guidance has been produced for those sports organisations incorporated as companies that wish to provide directors with practical guidance on their general duties under the Companies Act 2006 (CA06). Not all of the guidance below will be applicable to every company and sports bodies should adapt it to their needs. However, as the duties are laid out in law care must be taken to ensure that they are met. Where the organisation is also a charitable body, such as a charitable company limited by guarantee, the directors will have duties as trustees under charity law. These are covered in a separate document.

Directors' general duties are set out under ss171–182 CA06. The individual duties are not to be looked at in isolation because, as s179 states, more than one of the general duties may apply in any given case. Directors must act in accordance with their company's constitution and companies may, through their Articles of Association ('Articles'), go further by placing more onerous requirements on their directors. However, the Articles may not dilute the duties set out in CA06 except to the extent that this is permitted by ss173, 175, 180 (4) (a) and (b) and 232.

These general duties are owed to the company not to its shareholders. There are civil consequences if they are breached. Furthermore, s183 provides for criminal sanctions for the director if he or she fails to comply with the requirements of s182 (Declarations of interest) and, under Part 11 CA06, members can bring a derivative claim against an individual director on behalf of the company. The general duties are owed by a de facto director (i.e. shadow director) in the same way and to the same extent that they are owed by a properly appointed director.

It should be noted that 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.

2 The key elements of the provisions under the Companies Act 2006 and practical guidance for directors

2.1 Section 171: Duty to act within powers

2.1.1 This section sets out a director's duty to comply with the company's constitution and only exercise powers for the purposes for which they are conferred.

2.1.2 A director should exercise his or her powers only in accordance with the terms for which they were granted and for a proper purpose. What constitutes a proper purpose must be ascertained in the context of the specific situation under consideration.

2.1.3 Practical guidance: It is important for directors to appreciate that the liability for not complying with the company's constitution is strict. Some examples are as follows:

- Formal procedures should always be followed when a meeting of the board is held, with a distinction always being made between a meeting of the board or a formally constituted committee of the board and other meetings involving directors, e.g. a chief executive's senior management committee which assists him in the exercise of his personal delegated financial and/or other authority from the board. Having a clear and comprehensive schedule of matters reserved for the exclusive decision of the board of the company and of subsidiaries may help to provide clarity of what may and may not be decided outside board meetings.
- Directors should be conscious of their company's Articles and the powers in the constitution. For example, this is relevant when considering the issuing of shares, situations where the directors should be referring to shareholders, and the rules for establishing a quorum.
- If in doubt, directors should always seek the advice and guidance of the company secretary.

2.2 Section 172: Duty to promote the success of the company

2.2.1 The overriding duty, as set out in s172, is that a director is required to act in the way he or she considers, in good faith, will be most likely to promote the success of the company for the benefit of its members as a whole. In doing so, he or she must have regard (amongst other matters) to the six factors below. Examples of decisions where a factor may be relevant are given in each case.

1 The likely consequences of any decision in the long term (e.g. a company cutting its research and development budget).

2 The interests of the company's employees (e.g. closing down facilities or terminating a project, leading to redundancies among the existing staff).

3 The need to foster the company's business relationships with suppliers, customers and others (e.g. the finance department proposing a tightening of supplier terms of trade in order to improve cashflow).

4 The impact of the company's operations on the community and the environment. For this it is first necessary to identify the community or communities of which the company is a part (e.g. the board may need to consider the impact on the community in certain localities of a proposed programme of facility closures or an alteration to the delivery of activities and services. On the environment, a company would need to consider the effect of proposed new building projects such as a stadium or training complex.).

5 The desirability of the company maintaining a reputation for high standards of business conduct (e.g. directors need to consider the reputational risks – positive and negative –involved in a proposal put to them).

6 The need to act fairly as between members of the company (e.g. the directors need to ensure that private shareholders are not disadvantaged by the structure of corporate transactions or share issues, or by lack of information. The company website is a useful way to address the latter potential inequality).

2.2.2 At times these six factors, and any others that are being considered, may be in conflict but the key issue for decision making is that the directors should choose the action that will promote the success of the company for the benefit of members as a whole, even if that may sometimes have a negative impact on one or more of the six factors.

2.2.3 The application of s172 will depend on the purposes of the company (see s172 (2)), and may include purposes other than the benefit of its members, e.g. if the company is a charity or a community interest company.

2.2.4 Practical guidance: s172 has given rise to some concerns, but to a large extent it simply re-enacts and consolidates previous statutory provisions, the common law and best practice. Some key practical points are:

- The six factors discussed above are matters which directors must 'have regard to' but 'traditional considerations' such as profitability, the financial effects on shareholders, etc are still of critical importance as they are central to the duty to 'promote the success of the company for the benefit of the members as a whole'.
- In the decision-making process there is generally no absolute wrong or right approach; the directors must make a judgment in good faith for the success of the company, having regard to all the information and having taken advice when appropriate.
- Papers written for the board, which are not merely information papers, need to refer to the six factors where they are relevant to the decision being made, but not in circumstances where any of those factors does not arise. To ensure that this happens, it is recommended that each person below board level responsible for writing board papers should understand the implications of s172 for board decision making and when the six factors should be referred to.
- The minutes should record decisions taken but do not necessarily need to give detail on how each factor was considered because the board paper should have provided the relevant information.
- A system of reviewing board papers before final inclusion in the board pack is good practice, and this should include a check that all the factors regarding a decision that are relevant to directors' duties have been adequately covered in the paper. This review process would normally be conducted by the company secretary or by the chair. Either would have authority to seek amendments to the paper to address the relevant points.
- For periods beginning on or after 1 January 2019, all large companies will be required to include a separate statement in their strategic report explaining how its directors have had regard to wider stakeholder considerations when performing their duty under s172.
- Application will depend upon the purposes of the company. Where purposes exist that may not be considered in the interests of the members, for example a community interest company or a charity, s172 (2) allows for these purposes to be regarded as to promote the success of the company.

2.3 Section 173: Duty to exercise independent judgment

2.3.1 This section reflects the principle that a director must exercise his or her judgment independently of the influences of others.

2.3.2 The provision explains that this duty would not be infringed by a director if he or she is acting in:

a) accordance with an agreement or previous collective board decision which has duly been entered into by the company or board; or
b) a way authorised by the company's constitution.

2.3.3 Practical guidance:

- A director should ensure that he or she does not allow personal interests, for example in a particular contract, to affect his or her independent judgment in the interest of the company. A director should ideally excuse himself or herself from any meeting at which a decision is to be taken in respect of his or her own property or interest. This is also relevant when a director is considering conflict of interest duties under ss175–177.
- Importantly, where someone is an executive director, he or she must not promote a collective executive line, but should give the board the benefit of his or her own independent judgment, including his or her appreciation of the risks involved in a particular course of action.
- This duty does not prevent a director from exercising his or her power to delegate, but he or she must still exercise his or her own judgment in deciding whether to follow the action suggested by that person(s).
- Similarly, a director would not be prevented by this duty from seeking legal or other professional advice but, ultimately, the director's final judgment would need to be independent.
- A director associated with a major interest group – such as a significant section of shareholders or members, or when a director is elected or nominated by a part of the organisation – should set any 'representative' function aside and make decisions on their own merits. However the Act states that this duty is not infringed by a director acting in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or in a way authorised by the company's constitution.

- A director of a subsidiary would need to take into account the interests of the parent company and the other subsidiaries, but not insofar as this would prejudice the solvency of the subsidiary itself. This might apply, for instance, in relation to a transfer of assets within a group.

2.4 Section 174: Duty to exercise reasonable care, skill and diligence

2.4.1 This section sets out a director's duty to exercise reasonable care, skill and diligence. Section 174 was modelled on the provisions of s214 of the Insolvency Act 1986, which relates to wrongful trading.

2.4.2 A director owes a duty to the company to exercise the same standard of 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).

2.4.3 Practical guidance: The use of both tests means that each director must exercise his or her duty to a minimum standard, as suggested by the objective test, and then the standard is raised under the subjective test if that director has specific skills or expertise. So if, for example, a non-executive director had an accounting qualification, he or she would be expected to exercise more active scrutiny of the accounts (such as on the appropriateness of accounting policies) than a director without such a qualification.

2.5 Section 175: Duty to avoid conflicts of interest

2.5.1 This section of CA06 provides that a director must avoid a situation in which he or she has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. This duty includes both a conflict of interest and a conflict of duties and applies in particular to the exploitation of any property, information or opportunity. The duty does not apply if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest or if it has been authorised by the directors.

Section 175 (3) states that the duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company. Transactions

or arrangements with the company are dealt with under s177 (in the case of proposed transactions) or under s182 (in the case of existing transactions). Directors have a duty to declare conflicts of interest relating to transactions unless an exception specified under those sections applies. The duty applies particularly to the exploitation of any property, information or opportunity and it is immaterial whether a company is able to take advantage of the property, information or opportunity.

2.5.2 Practical guidance:

- **Private companies:** Directors who are independent of the conflict may authorise it, unless there is a provision in the company's constitution stating otherwise. In practice it would be rare for there to be a provision requiring authorisation to be given by the members.
- **Public companies:** The authorisation can only be given if the company's constitution includes a provision for the directors to authorise conflicts of interest, so the company's Articles should provide for this. Authorisation must be given by directors who are independent of the conflict.
- Directors should remember that when giving authorisation they must consider whether their action is most likely to promote the success of the company – see s172. When a director has a potential conflict of interest in a particular activity, authorisation may be given by the directors but, as s175 (6) states, the authorisation is only effective if that director is ignored for the purposes of the quorum and voting on any board resolution to authorise the matter. It is good practice for a conflicted director to leave the meeting when discussions take place on matters in which he or she has some personal interest.
- Another practical point to consider is whether a director who has the opportunity to take on a new directorship outside the company has a problem in relation to this duty. Multiple directorships would not necessarily need to have formal authorisation from the board – the question is whether having such directorships is likely to give rise to a conflict of interest.
- Furthermore, it is recommended that each director should consider if he or she has a conflict of interest through a connected person. Therefore it is important that the director informs those individuals that would be regarded as connected persons. A list defining connected persons can be found in s252 (essentially these are certain family members, certain companies with which the director is connected, trustees of a trust, certain partners and certain firms with legal personality).
- The board needs to consider how it approaches conflicts of interest. Many companies have a register documenting all conflicts for each director, which is

reviewed by the board periodically. It is essential that any potential conflicts of interest are presented to the board and authorised before the activity commences.

- Likewise, any activities of a new director that are potential conflicts of interest should be approved by the board before the director's appointment.

2.6 Section 176: Duty not to accept benefits from third parties

2.6.1 A director must not exploit his or her position for personal benefit. However, only those benefits which could reasonably be regarded as likely to give rise to a conflict of interest fall within the scope of this duty.

2.6.2 The Act does not permit the acceptance of benefits which fall within the ambit of this section to be authorised by the board; it has to be approved by the company's members.

2.6.3 Practical guidance: This duty opened up some interesting debates on how far these 'benefits' may extend. Some benefits are easily identified, such as financial rewards or money's worth such as tickets to prestigious sporting events. Questions arise as to how far this duty will cover the giving or receipt of corporate hospitality. Whether the giving or receipt of corporate hospitality may be considered as creating a conflict of interest should be decided according to the context in which it is given or received but, in practice, most companies take a very cautious approach. The following should be considered.

- If a director is currently involved in negotiating a new contract with another person or company and that party offers corporate hospitality it may be considered to infringe this duty.
- Proportionate and defensible policies should be developed which outline how to deal with benefits offered by or received from third parties and which state what levels of corporate entertainment are significant for this policy or which need prior authorisation. The policies (including any updates) should be approved by the board, perhaps on a recommendation from the audit committee, where there is one. All relevant employees and contractors should be informed of the policy and any updates and, for the company's protection, required to sign a receipt and acknowledgement to study and comply with the terms of the policy and any updates to it.
- It is good practice to set up a register of benefits offered, received and refused above whatever level is decided on by the board. It is suggested that

the company secretary should report annually to the audit committee on compliance and any issues arising.

2.7 Section 177: Duty to declare an interest in a proposed transaction or arrangement

2.7.1 This section requires a director to declare to the other directors any interest, whether direct or indirect, in a proposed transaction or arrangement with the company. The extent of the interest must also be declared. However, s177 (6) states that a director does not need to declare an interest if it cannot reasonably be regarded as likely to give rise to a conflict of interest.

2.7.2 Some companies may wish to require shareholder approval for such a procedure but will need to include this in their Articles.

2.7.3 A director is not required under this duty to disclose facts of which the other directors should already know or ought reasonably to be presumed to know. If a director becomes aware that some of the information declared is not accurate or complete before the transaction or arrangement has taken place, he or she must correct the initial declaration so that it is accurate.

2.7.4 Practical guidance:

- A director must declare his or her interest before the transaction or arrangement is entered into by the company. It is good practice for the board to take decisions on related matters without the director present.
- The duty may still apply even if the director is not party to the transaction, e.g. if the director's spouse would be entering into the transaction or arrangement the director may need to declare an indirect interest in the transaction.

2.8 Section 182: Declaration of interest in existing transaction or arrangement

2.8.1 A director is required to declare an interest, whether it is direct or indirect, in any existing transaction or arrangement into which the company has entered. If that director has already declared an interest in the transaction or arrangement and that information has not changed, then he or she will not need to make a further declaration. As with s177 CA06, the director would still need to make a declaration even if not party to the transaction or arrangement.

2.8.2 Practical guidance:

- Section 183 provides that it is a criminal offence if a director fails to comply with the requirements of s182.
- A director only needs to declare any interest that would be regarded as likely to give rise to a conflict of interest. The declaration must be made to the directors.
- A director would not need to declare an interest if the directors already knew about, or ought reasonably to have known about, a transaction or arrangement. Furthermore, he or she would not need to declare an interest if it was in relation to his or her service contract or remuneration that had been or was to be considered by the directors in a meeting or by a committee of the directors who had been appointed for that purpose under the company's constitution.

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