



*"Where a company is in financial difficulty the duty to promote the business for the benefit of members will be modified by a duty to act in the interests of creditors.*

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## Directors' Responsibilities

*It has long been the view of the Courts that any person who accepts the appointment as a director of a corporate body must carry out their duties with responsibility, exercise adequate skill and care, and demonstrate proper regard to the interests of creditors and employees. The Company Directors Disqualification Act 1986 introduced tougher rules against directors involved in the failure of a company and whose conduct called into question their fitness as a director. The Companies Act 2006 has set out the general duties of directors in statute for the first time.*

### Directors General Duties - The Companies Act 2006

Of the seven separate general duties stated, particular significance is given to directors acting in such a way, in good faith, to:

- promote the success of the company for the benefit of members as a whole, whilst having regard to matters such as:
  - the likely long term consequences of any decision;
  - the interests of employees;
  - the need to foster business relationships with suppliers and customers;
  - the desirability of the company maintaining a reputation for high standards of business conduct;
  - the impact of the company's operations on the community and environment;
  - the need to act fairly between members of the company.

The decision as to what will promote and what constitutes success, is one for a director's good faith judgement. In making that judgement a director will need to exercise the reasonable care, skill and diligence (a separate duty) he has, and that which may reasonably be expected given his position and responsibilities to the company. Directors must also exercise independent judgement (a separate duty) when deciding to bind the company to a future course of action remembering that they must act in the interests of the members as a whole.

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The three fiduciary duties, which came into force in October 2008, relate to conflicts of interest. They state that a director:

- must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or may possibly conflict with the interest of the company. This applies particularly to the exploitation of any property, information or opportunity;
- must not accept benefits from a third party due to his being a director or doing/not doing anything as a director unless it can reasonably be shown not to give rise to a conflict of interest;
- must be open and honest with other directors regarding any direct or indirect transactions and arrangements with the company.

### Definition of Director

The disqualification legislation applies to "directors" of any company which may be wound up under Part IV and V of the Insolvency Act 1986, this includes unregistered companies, building societies, insolvent partnerships, NHS foundations and incorporated friendly societies. The title "director" includes labels such as "Governor" or "Trustee" of a corporate body.

Disqualification legislation also applies to those carrying out the functions of a director such as a:

- Defacto director
- Shadow director
- Inactive/non-executive directors

regardless of whether or not they receive payment for their services.

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## Disqualification

If a company enters into a formal insolvency procedure, a report is submitted to the Secretary of State on all directors in office during the preceding three years. Particular importance is attached to:

- attempts to conceal assets, disappearing assets and any unexplained deficiency;
- transfer of assets to other companies for no consideration;
- preferences;
- personal benefits obtained by directors;
- overvaluing assets in order to mislead creditors;
- loans to directors in making share purchases;
- dishonoured cheques;
- use of delaying tactics;
- non payment of Crown debts to finance trading;
- phoenix operations;
- misconduct in relation to the operation of a factoring account;
- taking deposits for goods or services ultimately not supplied;
- cases where criminal convictions have resulted.
- the position of any civil recovery actions;
- the adequacy of the accounting records;
- evidence available in support of insolvent (wrongful) trading;
- professional advice taken by the directors and specific correspondence which sheds light on directors' conduct, for example, with banks, solicitors, accountants or creditors.

The minimum period for disqualification is two years, the maximum 15 years, depending upon the level of unfitness and gravity of the offence.

Disqualification can give rise to restrictions of employment, for example:

- Police - may prevent membership of the police authority.

- Charities - cannot be a Trustee without Court permission. If it is an unincorporated charity it will require permission for the Charity Commissioner.
- Pension Trustee - cannot be a Trustee of an occupational pension scheme without leave from the Regulatory Authority.
- Solicitors, barristers, accountants and other professionals - are required to report disqualification to their professional body which may affect membership.

## Avoiding Disqualification

All directors and anyone who reports to the board eg the management or company secretarial team, need to fully understand the statutory duties to ensure compliance.

Other practical issues we would suggest are:

- review the procedures for preparing papers for consideration for the board, the conduct of board discussions and the way decisions are minuted to ensure that compliance with the new duties is appropriately documented, particularly the duty to promote the success of the company;
- review any existing corporate policies eg ethical/environmental/social responsibilities, to ensure they reflect compliance;
- ensure that there is an effective system of financial control and that customers, suppliers, Crown departments and creditors are dealt with properly;
- ensure the company is under proper control and it fully complies with the Companies Act 2006 and supporting legislation, particularly the filing of accounts and returns;
- take early corrective action if the company shows signs of getting into financial difficulties. This includes seeking and taking professional advice.

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