

Implementing the Companies Act 2006 codification of directors' duties

Introduction

The Companies Act 2006 (the “**Act**”) has codified and extended the common law duties of directors of UK companies, and given shareholders additional rights to bring claims for breach of directors' duties. This note provides a brief checklist to in-house lawyers, to assist them with implementing appropriate measures and reviewing compliance. Whether your company is large or small, we hope that this checklist is useful.

Ten steps for implementing the codification of directors' duties

1. Update board policies to reflect the new directors' duties

Consider updating board policies to ensure that the directors fulfil their duties, especially the duties to promote the success of the company and to take account of the “stakeholder factors”. You may want to include a requirement for directors to comply with their statutory duties, and a procedure for responding to derivative actions (see below). Include these policies (or a summary of them) in the directors' annual report.

2. Review articles of association

Consider whether your company's articles of association should be amended to reflect the statutory duties. For example, one of the statutory duties is to promote the success of the company for the benefit of its members; however, it is open to the company to provide its own definition of “success” in its articles. Another duty (which will come into force on 1 October 2008) is to “*avoid a situation in which [the director] has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company*”. If your company is public, then this duty will not apply to a particular conflict if the company's constitution permits the board to authorise conflicts and it is then authorised.¹ If your company is private, check whether the articles might invalidate such authorisation and, if so, consider whether they should be amended so as to enable the board to authorise conflicts – or whether it would be more appropriate for this right to be retained by your shareholders.

3. Review your D&O insurance policy

Consider whether your company's D&O insurance policy should be amended to provide cover in respect of the statutory duties and derivative actions. It is still the case that a company may provide an indemnity in relation to liabilities incurred by a director to third parties (i.e. not the company or associated companies, except in relation to costs for a successful defence). However, as the company will be the ultimate beneficiary under the new derivative action provisions, the directors

cannot be protected by such indemnities from a successful derivative action. It may therefore be appropriate to update the D&O insurance policy to provide for this risk, and to update the definition of “wrongful act” accordingly. However, this should not be an automatic decision.ⁱⁱ

4. Review directors’ service contracts

Review directors’ service contracts to make sure that they are up to date. However, take care before including compliance with statutory duties as a specific requirement in such contracts, as this will convert breaches of statutory duty into breaches of contract, with different principles in determining loss, remedies, etc.

5. Train the board on the new duties

Ensure that the directors are given training on their duties. In addition to new director induction training, it may be useful to include this as part of an annual update to directors and senior management on company law and governance issues. Advise the board and the individual directors on their duties in the context of specific transactions and developments.

6. Ensure management takes the new duties into account when preparing board papers

Give training and/or guidance on the new duties and the stakeholder factors to managers who prepare board papers for the directors’ consideration, so that they can take the duties into account and highlight any issues when presenting proposals and recommendations for the board’s consideration, and can provide an audit trail that they have done so.

7. Minute board decisions appropriately

There are different schools of thought as to whether board minutes should be used to provide an audit trail showing that the duties and the stakeholder factors have been taken into account in formulating board decisions, if only to protect the individual directors from subsequent claims that they failed to do so. Indeed, there may sometimes be occasions when this is desirable, for example, with particularly large, important and/or difficult decisions, where special emphasis is required. However, provided that the relevant board papers set out adequately all the factors that the directors need to consider, then the board papers and the minutes together should provide a suitable record that decisions have been taken with reference to the relevant duties and stakeholder factors.ⁱⁱⁱ

8. Assess directors’ compliance with their statutory duties

If your board carries out an annual performance review, then advise the chairman to assess individual directors’ compliance with their statutory duties as part of the review. This should include an assessment of whether the directors’ duties have been taken into account in formulating the annual business review in the annual report.

9. Develop a policy on dealing with derivative actions

Develop a policy on dealing with derivative actions. If a derivative action is brought by a shareholder and not rejected by the court at the first stage (which is

ex parte), then the company should take the complaint seriously, and investigate it carefully to ensure that there has been no breach of the directors' duties. In case of doubt, it should consult any shareholders of the company who have no personal interest in the matter (particularly as this is one of the factors for the court to consider in determining whether to give the complaining shareholder permission to continue a claim). Consider whether internal legal advice that you have given about specific transactions or incidents, which may normally be legally privileged, might be disclosable in favour of the complaining shareholder. The contents of any board performance review, Turnbull risk review and annual business review are likely to be disclosable.

10. Develop a conflicts of interest policy and register

Develop or update guidance for the directors on conflicts of interest and the issues to consider when authorising a conflict. When the statutory duties regarding conflicts of interest come into force^{iv}, it will be necessary to keep records of directors' declarations of conflicts of interest, benefits received from third parties, etc. It is generally prudent for directors to take advice on and declare potential conflicts, no matter how small; they should not just form their own view that there is no potential conflict.

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ⁱ GC100 Companies Act 2006: Directors' conflicts of interest (18 January 2008) contains useful guidance on how the board should exercise its power to authorise conflicts of interest.

ⁱⁱ Guidance on D&O insurance and corporate governance issues is planned in a future C&I Corporate Governance Committee publication.

ⁱⁱⁱ GC100 Companies Act 2006: Directors' conflicts of interest (18 January 2008) states that, "...board minutes should not be used as the main medium for recording the extent to which each of the factors of the Companies Act were discussed. Board minutes do not, after all, do so today insofar as either the common law or statutory duties require directors to consider particular factors. The minimum requirement for minutes should only be that they clearly state the decision reached..."

^{iv} The duty to "avoid a situation in which [the director] has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company" will come into force on 1 October 2008.