HERITAGE RAILWAY ASSOCIATION

INFORMATION PAPER

37: DUTIES & ROLES of COMPANY DIRECTORS & CHAIRMEN

A. Introduction

The coming into force of the Companies Act 2006 has clarified and extended the duties of Directors of companies. An overview of the new provisions, set out in section B below, has been contributed by Simon Smith, a partner in the firm of Ironmonger Curtis of Sheffield. Several persons have also asked for clarification of the roles of Company Chairmen and Boards of Directors, particularly since the Companies Act 2006 came into force. This information paper aims to satisfy that need.

Sections A and C to F of this paper have been prepared by Geoffrey Claydon, Bill Hillier and David Morgan with the help of information provided by the Institute of Directors (IoD) which in 2003 adopted a code of practice for Directors in connection with its development of the Chartered Director qualification.

Whilst this paper addresses the roles of the Directors of a company, the same principles should be applied where the governing body is a Trust; in which case the term Director should be read as Trustee. There are also additional requirements imposed on trustees, especially those of charitable bodies.

It is crucial that the Tasks of Direction and Management are not blurred or confused.

“Management is doing things right; leadership (i.e. Direction) is doing the right things.” [Peter F. Drucker, Management Expert, Author and Teacher]. Boards should therefore seek to lead and inspire.

Where people take on both Direction and Management roles they should be clear which of the roles they are undertaking at any particular time.

This paper is concerned with the role of Direction.

B. Overview of Directors’ Duties under the Companies Act 2006

The purpose of Directors’ duties is to ensure that companies' interests are protected in the way that Directors exercise their legal powers. Previous principles, while long established in case law and previous statutes, lacked certainty and were inaccessible and therefore codification of Directors' duties should make the law clearer. The Act codifies Directors' duties into seven general duties. Summarised below are the duties set out in Sections 170 to 177 of the Act with particular reference to the new additions.

The precise wording of these Sections of the Act is given in Annex 1 to this document.

1. Duty to act within their powers (Section 171)

Directors should exercise their powers under the terms that were granted for a proper purpose. A Director's powers are derived from the company's constitution, i.e. its memorandum and articles of association.

2. Duty to promote the success of the company (Section 172)

The Act imposes a duty to act in the way a Director considers, in good faith, would be most likely to promote the success of the company. Although this duty is still owed to the members as a whole, when exercising this duty the Director is required to have regard to a non-exhaustive list of factors including:

2.1 long-term consequence of the decision;

2.2 interests of the employees;

2.3 relationships with suppliers and customers;

2.4 impact of the decision on the community and environment;

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2.5 desirability of maintaining a reputation for high standards of business conduct;

2.6 need to act fairly as between members of the company.

It can be seen that amongst other things, this duty introduces wider corporate social responsibility into a Director's decision-making process.

Success is not defined in the Act. From a commercial perspective it is probably a long-term increase in value of the company. It remains to be seen how in practice a Director is to balance these (at times) conflicting factors in decisions; for example, an environmental consideration might not always be consistent with members' interests.

However, it is suggested that a Director will need to exercise the same level of care and skill as he carries out any other functions in deciding which factors he will take into consideration when making a decision subject to his overall responsibility to the success of the company. Inevitably, in time, the courts will set out the parameters in the interpretation of this duty.

It is important that detailed minutes are taken when making decisions to document the fact that Directors have had regard to the various factors.

This duty is also subject to a Director being legally required to act in (or at least to consider) the interests of company creditors in certain circumstances.

3. Duty to exercise independent judgment (Section 173)

There is a positive duty on a Director to exercise independent judgment ie to exercise judgment and then to do so independently. This duty is not infringed by a Director acting :-

(a) in accordance with an agreement entered into by the company that restricts the future exercise of discretion by its Directors, or

(b) in a way authorised by the company's constitution.

4. Duty to exercise reasonable care, skill and diligence (Section 174)

The degree of care, skill and diligence expected from a Director is 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; and

b. the general knowledge, skill and experience that the individual Director has.

The first element is a minimum objective standard (a hypothetical reasonable person) expected of any Director.

The second test is subjective and requires a Director to carry out his duty with the general knowledge, skill and diligence he in fact possesses. Therefore, a Director who has more experience, knowledge and skill will have a higher threshold in discharging this duty. For example, a qualified accountant as a Financial Director would have his specific expertise taken into account when considering whether he has complied with his duty.

5. Duty not to accept benefits from third parties (Section 176)

This restates the existing rule known as 'non-profit' in that a Director is not permitted to accept a benefit from a third party (ie another company or associated body or a person acting on their behalf) by reason of (a) his being a Director or (b) his doing or not doing anything as a Director.

Benefits cover both monetary and non-monetary including, for example, appointments to other bodies and even corporate entertainment. However, a Director will not be in breach of this duty if the acceptance of such benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.

6. Duty to declare interest in proposed transaction or arrangement with the company (Section 177)

If a company proposes to enter into a transaction in which a Director of the company has an interest, then that Director must disclose the nature of that interest to the other Directors. Further, disclosure must be made where a Director ought reasonably to be aware of the conflicting interest. Disclosure also extends to a person connected with the Director, for example, his wife and children.

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The requirement for disclosure is dispensed with in circumstances where the interest cannot reasonably be regarded as likely to give rise to a conflict of interest or if other Directors are already aware or ought reasonably to be aware of the Director's interest.

7. Duty to avoid conflicts of interest (Section 175)

The Act restates, amends, and simplifies these provisions to make them more accessible. A Director must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.

This duty applies to a transaction between a Director and a third party or otherwise arising from the exploitation of any property, information or opportunity. It does not extend to a transaction between a Director and his own company where different rules apply which require a Director to declare his interest to the other Directors (see Part 6 above).

The Act makes it easier for Directors to enter into transactions with third parties when Directors' interests conflict with the company's interests. Previously, shareholders' approval was required. Now, such transactions can be authorised by the non-conflicted Directors provided that certain voting requirements are complied with.

Some points to note:

1. There is no definition of "interest" or "conflict of interest", although a reference to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

2. The conflicting interest can be direct or indirect.

3. The duty applies in particular to the exploitation of any property, information or opportunity, whether or not the company could itself take advantage of it.

4. The prohibition refers to a "situation" in which the Director has or can have an interest that conflicts or possibly may conflict with the interests of the company. However, the duty is not infringed if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest.

5. It appears that it is not necessary for a Director to have any influence over a particular situation for a conflict to arise.

6. The duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company. Conflicts arising in these circumstances are covered by two separate provisions:

> 6.1 duty to declare an interest in a proposed transaction or arrangement with the company; (see Part 6 above); and
>
> 6.2 must declare an interest in an existing transaction or arrangement with the company - in this case, failure to comply is a criminal offence (see Part 7 above).

7. This duty is not infringed if the matter has been authorised by the Directors. Authorisation may be given by the Directors:

> 7. 1. The authorisation is effective only if any requirements as to the quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director, and the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

Some possible examples:

1. If a Director of Company A is a competitor in some respects of Company A.

2. If a Director of Company A is a major shareholder in Company A.

3. If a Director of Company A owns property adjacent to Company A's property, the value of which could be affected by the activities of Company A.

4. If a Director of Company A is also a Director of Company A's pension trust company.

Authorisation

Companies incorporated before 1 October 2008 will need to consider including a provision in the articles that any authorisation may exempt a Director from disclosing confidential information to the company which he

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has received otherwise than through his position as Director. However, authorisation cannot be retrospective and does not apply to other breaches of duty.

Consider procedures to:

1. Identify existing conflicts or potential conflicts and ensure that any conflict is properly presented to the board and the extent to which those conflicts should be authorised and clarify the circumstances when authorisation can be withdrawn.

2. Ensure that all future conflicts are reviewed and which persons will undertake the review and which body should be authorised to amend or withdraw authorisations.

C. Health & Safety

The Institute of Directors and the Health & Safety Commission have issued detailed guidance for Directors concerning their general Health & Safety responsibilities; "Leading Health and Safety at Work - Leadership Actions for Directors and Board Members", HSE reference indg417. Copies of this guidance and more information can be obtained from:

www.hse.gov.uk/leadership

D. Role of the Board of Directors

The IoD has described the role of the Board as: "To ensure the company's prosperity by collectively directing the company's affairs, whilst meeting the appropriate interests of its shareholders and relevant stakeholders". Stakeholders include employees, volunteers, customers (passengers and other visitors), suppliers, creditors and the local community; especially neighbours. For "shareholders" read "members" in the case of companies without shares, such as companies limited by guarantee.

This means that Directors are expected to run a company in a viable, businesslike way. This does not mean that creation of profit should necessarily be the prime aim, especially where the company has charitable status or is recognised as a 'not-for-profit organisation'; but it does mean that Directors should try to avoid making losses, especially in the long term, if only because the company would become unsustainable.

The Board is responsible for the good management of the organisation but the exercise of this function should be delegated to the management. The role is therefore:

1. To make decisions promoting the company's continuing prosperity and success.
2. To provide leadership.
3. To choose and appoint a Chief Executive/Managing Director who will ensure the implementation of its decisions.
4. To determine the ethos of the company, its values, standard of behaviour, pace, attitude to risk and change.
5. To provide a sense of direction and establish policies.

The IOD Guide makes the point that the Board is "responsible for directing the company when there is a principal agent of risk taking". This means focusing on providing overall leadership, judgment and enterprise and on making those decisions that are essential to protecting and enhancing the interests of the company over time. This cannot be done if the Board is bogged down with day-to-day matters that are the proper concern of executive management".

The IoD has described the four key tasks for the Board as:

1. Establish and maintain vision, mission and values:
    i. Determine/maintain the company's vision and mission to guide and set the pace for its current operations and future development.
    ii. Determine/maintain the values to be promoted throughout the company.
    iii. Determine/maintain and review company goals.
    iv. Determine/maintain company policies.
2. Decide strategy and structure.

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   i. Review and evaluate present and future opportunities, threats and risks in the external environment; and current and future strengths, weaknesses and risks relating to the company (SWOT).
   ii. Determine strategic options; select those to be pursued; and decide the means to implement and support them.
   iii. Determine the business strategies and plans that underpin the corporate strategy and provide, where possible, the relevant resources.
   iv. Ensure that the company's organisational structure and capability are appropriate for implementing the chosen strategies.

3. Delegate to management.
   i. Delegate authority to management, and monitor and evaluate the implementation of policies, strategies and business plans.
   ii. Determine monitoring criteria to be used by the Board.
   iii. Ensure that internal controls are effective.
   iv. Communicate with senior management.
4. Exercise accountability to shareholders and be responsible to relevant stakeholders.
   i. Ensure that communications both to and from shareholders and relevant stakeholders are effective.
   ii. Monitor relations with shareholders and relevant stakeholders by the gathering and evaluation of appropriate information.
   iii. Promote the goodwill and support of shareholders and relevant stakeholders.

E. Suggested essential tasks of the Board Chairman

1. Providing leadership to the Board;
2. Taking responsibility for the Board's composition and development;
3. Ensuring proper information for the Board;
4. Planning and conducting Board meetings effectively;
5. Getting all the Directors involved in the Board's work;
6. Ensuring the Board focuses on its key tasks;
7. Engaging the Board in assessing and improving its performance;
8. Overseeing the induction and development of Directors;
9. Supporting the Chief Executive/Managing Director;
10. Ensuring that there are no gaps left unfilled in respect of Director appointments and activities; and
11. Acting as front man for the company and its ambassador, except when it is more appropriate for the Managing Director or other designated Director or officer to do so.

F. Attributes to be displayed by a successful Chairman

In 2003, the Higgs Report was published which gave detailed guidance for Chairmen, non-executive Directors etc. and also on the attributes to be sought of company Chairmen.

1. Personal integrity and authority, without domination;
2. Intellectual capacity;
3. Decisiveness and insistence to get things done;
4. Ability to ensure that the Board properly addresses all the major strategic issues that will affect the company's prosperity, viability and reputation;
5. Having a proper focus on the Board's key tasks and ensuring that they are addressed;
6. Taking responsibility for the Board's constitution and development, including succession matters;

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7. Providing a sense of purpose, a vision and a set of priorities and objectives, with skill in guiding the Board to focus on the relevant issues;
8. Engaging the Board in assessing and improving its effectiveness;
9. Overseeing the induction of new appointees and the development of individual Directors;
10. Ability in planning and managing the Board's business;
11. Employing political skills and an ability to engage all the Board members and manage their relationships; and
12. Acting as an effective mentor, sounding board and advisor to the Chief Executive/Managing Director (and other Directors).

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Annex 1

Specific Duties of Directors (Companies Act 2006)

Sections 171 to 177 of the Companies Act 2006 places seven specific general duties on Directors; these are reproduced below:

171 Duty to act within powers

A director of a company must—

(a) act in accordance with the company's constitution, and

(b) only exercise powers for the purposes for which they are conferred.

172 Duty to promote the success of the company

(1) A director of a company must 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, and in doing so have regard (amongst other matters) to—

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's 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.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

173 Duty to exercise independent judgment

(1) A director of a company must exercise independent judgment.

(2) This duty is not infringed by his acting—

(a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or

(b) in a way authorised by the company's constitution.

174 Duty to exercise reasonable care, skill and diligence

(1) A director of a company must exercise reasonable care, skill and diligence.

(2) This means 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, and

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

175 Duty to avoid conflicts of interest

(1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.

(2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).

(3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company.

(4) This duty is not infringed—

(a) if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or

(b) if the matter has been authorised by the directors.

(5) Authorisation may be given by the directors—

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(a) where the company is a private company and nothing in the company's constitution invalidates such authorisation, by the matter being proposed to and authorised by the directors; or

(b) where the company is a public company and its constitution includes provision enabling the directors to authorise the matter, by the matter being proposed to and authorised by them in accordance with the constitution.

(6) The authorisation is effective only if—

(a) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the director in question or any other interested director, and

(b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

(7) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

176 Duty not to accept benefits from third parties

(1) A director of a company must not accept a benefit from a third party conferred by reason of—

(a) his being a director, or

(b) his doing (or not doing) anything as director.

(2) A "third party" means a person other than the company, an associated body corporate or a person acting on behalf of the company or an associated body corporate.

(3) Benefits received by a director from a person by whom his services (as a director or otherwise) are provided to the company are not regarded as conferred by a third party.

(4) This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.

(5) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

177 Duty to declare interest in proposed transaction or arrangement

(1) If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors.

(2) The declaration may (but need not) be made—

(a) at a meeting of the directors, or

(b) by notice to the directors in accordance with—

(i) section 184 (notice in writing), or

(ii) section 185 (general notice).

(3) If a declaration of interest under this section proves to be, or becomes, inaccurate or incomplete, a further declaration must be made.

(4) Any declaration required by this section must be made before the company enters into the transaction or arrangement.

(5) This section does not require a declaration of an interest of which the director is not aware or where the director is not aware of the transaction or arrangement in question. For this purpose a director is treated as being aware of matters of which he ought reasonably to be aware.

(6) A director need not declare an interest—

(a) if it cannot reasonably be regarded as likely to give rise to a conflict of interest;

(b) if, or to the extent that, the other directors are already aware of it (and for this purpose the other directors are treated as aware of anything of which they ought reasonably to be aware); or

(c) if, or to the extent that, it concerns terms of his service contract that have been or are to be considered—

(i) by a meeting of the directors, or

(ii) by a committee of the directors appointed for the purpose under the company's constitution.

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