



Recodification of the directors' duties in the Company Act 2006

Actualité législative publié le 20/11/2008, vu 18821 fois, Auteur : [Corentin Kerhuel](#)

[PDF version HERE \(with references\)](#)

The codification, in the Companies Act 2006, of the general duties owed by a director has not lead to any significant changes or improvement in the law.

Critically discuss the truth of this statement with references to relevant statutory provisions and case law.

Introduction

"The early part of the 20th century marked a significant shift in the way the judges viewed the office of director. [...] A concern of both equity and common law courts was to develop a corpus of rules designed to prevent directors abusing their considerable powers". The directors' legal duties were developed by the judges on a case by case basis through time, until this restatement of 2006 (and before, the Company Act of 1985). In an objective of clarity, certainty and accessibility, the Company Law Review and the Law Commissions recommended the codification of the general duties owed by directors. The government endorsed this view, in what has now become the Part 10 of the Company Act 2006 (ss. 170-177).

Does this restatement lead to any significant changes or improvement in the law? To answer this question, I will deal with the reasons for this restatement and the steps which lead to it. Then I will look at the duties that have been codified to better understand what may be the changes made by this codification. Finally, I will have a look at the impacts of such a codification.

1. From a case by case basis to a statutory statement

1.1. The Law Commissions' Report and the Company Law Review proposals

The first proposition of a restatement is to be found in Regulating Conflicts of Interests and Formulating a Statement of Duties, by the Law Commission and Scottish Law Commission, in 1998. The Part 4 deals with the question "A statutory statement of directors' duties?", and is a main source to discuss the interest of such a codification. In this report, was discussed the following questions: Should be achieved a full or only a partial statutory statement? An Additional statutory statement or a restatement replacing existing law? A General or detailed restatement? In its report, the Law Commissions looked at the arguments for and against such a codification to give an answer. I first need to underline that the answer they found is formed of a strict balance of the arguments for and against the codification, to make the restatement acceptable by all. As a result, the Law Commissions' proposal was followed, but the impact of such a codification has been reduced.

Another report, from the Company Law review accepted this proposal but wanted to go much

further in the way the statutory restatement should be formulated: in its final report , it recommended a legislative statement of directors' duties as it would provide clarity on what is expected of directors, enable defects in the current law to be corrected, and give a modern reflect of business needs.

A critical analysis of the advice given by these proposals is now needed.

1.2. A balance of arguments for and against

The first question about making a restatement was to choose if either it was better to make a full or a partial codification. The Law Commissions argument (followed by the legislator) was in favour of a partial codification, by making a non exhaustive list of the directors' duties, and the argument for that is that a full codification would be impossible because "the law governing directors' duties is dynamic" . On this point, we can say that this restatement doesn't improve clarity of the law as it remains uncertain and that moreover, a new interpretation of the duties restated will need to be given by the lawyers and judges. But this argument should be rejected as being too wide and insufficient to reject the idea of such a restatement.

Then the fear was that such a restatement would result in a loss of flexibility of the law. This argument has to be rejected as the Company Act 2006 gives a non exhaustive list of the directors' duties, and that the Act states in its Section 170 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" . In addition, this argument is not acceptable as the directors' duties explained in the Act stay at a high level of generality.

On the contrary, such a restatement shall not be seen as creating a fear of becoming a director, but as a help for directors to understand what their duties are, in a modern view of the business needs. The survey made in 1998 By the Law Commissions showed that more than 80 per cent of the directors thought that the proposal of restatement "was about right in terms of content" .

2. The general duties owed by a director

Here we need to have a quick look at all the general duties owed by directors that have been codified in the Company Act 2006 to see if there is anything truly new in the Act, for which the intention of the Law Commission, according to Brenda Hannigan, was only to codify non exhaustive existing Common Law: "The intention, in the Law Commission's proposal, was to state the principal duties and not to alter them in any way" .

2.1. The duty to act within powers

This duty, now recognised in section 171 of the Company Act, is the codification (already existing under section 80 CA 1985) of the well-known proper purpose rule that can be found in *Hogg v Cramphorn Ltd and Howard Smith Ltd v Ampol Petroleum Ltd* , which state that the director must act in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred. Nothing has been changed between the existing Common law and the restatement.

2.2. The duty to promote the success of the company

Here, changes have been made: the Act codifies in its section 172 the fact that directors must act *bona fide*, as it existed before, through for example *Re Smith & Fawcett Ltd [1942]* . "However, s. 172 now provides a list of factors including other stakeholders' interests the director must take into account when discharging this duty" . This solution is wider than the one that already existed

before, as the directors have to take into account more than only the shareholders' interests.

2.3. The duty to exercise independent judgment

The directors owe a duty, in section 173, to exercise independent judgment. This no-fettering rule already existed in *Boulting v Association of Cinematograph, Television and Allied Technicians* [1963]. Nothing seems very new in this section.

2.4. The duty to exercise reasonable care, skill and diligence

The section 174 deals with this duty to exercise reasonable care, skill and diligence. The difficulty in codifying this duty was to choose, looking at case law, if the test to judge the standard of skill and diligence should be an objective or a subjective one. The answer was given by the Law Commission, which took model on what Hoffman J expressed in *Norman v Theodore Goddard* and *Re D'Jan of London Ltd*, that the test was a dual objective and subjective test which settled a minimal standard of skill and diligence. Thanks to the Law Commissions' proposal, the test is not uncertain anymore, and so an improvement of the law can be seen here.

2.5. The duty to avoid conflicts of interest

This duty replaces the old conflict-rule that can be found in the case *Aberdeen Railway Co v Blaikie Bros*, a case of 1843 which is still valid today in Section 175 of the Company Act: "A director must not place himself in a situation where his interest may conflict with the interests of the company". This duty appears as obvious for a director and didn't suffer any difficulty to be codified on the basis of the pre existing common law.

2.6. The duty not to accept benefits from third parties

The idea in the section 176, is that a director must not accept a benefit from a third party conferred by reason of his position as director or anything he does or doesn't do as a director. This duty is only the restatement of what has been settled in 1888 in *Boston Deep Sea Fishing & Ice Co Ltd v Ansell*.

2.7. The duty to declare interest in proposed transaction or arrangement

This duty can be found for example in the case *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald*, and is an equivalent in s 177, of the former section 317 of the Company Act of 1985, which now states: "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".

3. An improvement of the law?

Now that we have seen the changes that the restatement operated on the general duties owed by directors, we shall analyse its impact for the beneficiaries of such a restatement.

3.1. To whom benefits this codification?

The directors, the employees, the shareholders and other stakeholders are the beneficiaries of this restatement. The Law commission cared about everyone one when proposing this codification.

To directors, it will help them to understand what their duties are, without needing to have a look at all the existing common law. This restatement is good in that it now reflects the modern view of the directors in business needs. From an international point of view, because being a director nowadays often implies an international context, it will clarify the duties owed by a director to its foreign clients, shareholders and employees.

To the employees and shareholders, they now will be able to have a clearer view of the general duties owed by directors, and by so it will improve their situation. Moreover from now on the directors will have to take into account the interests of the stakeholders through the duty to promote the success of the company.

Conclusion

The codification of the general duties owed by a director in the CA 2006 improved the law, as it made it clearer thanks to the form, and because some little substantial changes were made. But these changes were reduced by the fact that the newly created list of duties is a non exhaustive one, and that it only, for the main part, restate already existing common law. Maybe a greater improvement of the law would have been made by a full codification of the general duties owed by directors, but which would have been written to remain flexible and opened to duties that will be discover in the future.

[PDF version HERE \(with references\)](#)