

Directors' duties under the companies act 2006



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Executive Summary

This paper explains about the directors' duties that is implemented in the Companies Act 2006. It is significant that every director have to act within the legal principles in order to prevent any dispute from company's interest with their personal interest. In the Companies Act 2006, there are several duties that every director has to act with the duties that are provided in Section 171 to Section 177. However, the directors did not put the duties into practice when carrying their responsibility as a director in a company. As a result, it has caused a great impact to many aspects such as employment rate, economy and others.

Question 1

1. Introduction: Directors' Duties in Companies Act 2006

In this modern globalization, every company must have at least one director for non-public listed company and at least two directors for public listed company as it had mentioned under the Companies Act 2006 in Section 154 (Davies, 2007). The reason of having a director in each company is to represent the company to act due to the 'artificial' legal entities of the company. In a company, the directors are the persons who represents its owners to manage and solve the problems of a company. According to the Cornell University Law School (2015), the directors of a company are called as fiduciaries because they are owing the fiduciary duties of the company while the people who owes the fiduciary duties is called as principal. Fiduciary duty is a legitimate obligation where it act exclusively in another party's interest, which is the company where the fiduciaries are representing

of. In the legal systems of United Kingdom, fiduciary duty is the most rigorous duty of care and duty of loyalty because the fiduciaries have to obey the duty that had implemented to prevent themselves from any irreconcilable circumstances with their principals or with different fiduciaries' customers. In order to prevent conflict of interest, the Companies Act 2006 has implemented several fiduciary duties to the company's director that has mentioned in sections 171 to 177.

2. Directors' duties in Companies Act 2006

In the Company Act 2006, there are several directors' duties that are necessary for a director to act when carrying the responsibility of its position in a company, which is duty to act within their powers, duty to exercise independent judgement as well as duty to avoid conflicts of interest.

2. 1Duty to Act within Powers

This is one of the most important duties that every directors of a company should act on. This duty requires the directors to perform their authority accordingly with the rights they have assigned by the company and utilise it in a proper purpose to give the best interests to the company. It is stated in the Section 171 of Companies Act 2006 that:

A director of a company must

1. act in accordance with the company's constitution, and
2. only exercise powers for the purposes for which they are conferred.

Davies (2007) explains that the directors of the company are required to take after all the directions with reference to how the company's

undertakings ought to be sorted out and regulated that are set down in the company's constitution in order to agree with any constraints that is set down in the constitution on what exercises an organization might legitimately participate. In the Section 171 (b), he explains that the directors' powers should be utilized just for the proper purposes doctrine. This is to deal with the directors' affairs by implement those powers that the company wish in order to avoid any conflicts with the company. Unfortunately, the directors have abuse their powers and their acts are not in line with the company's constitution. This matter is clearly seen in the case of *Hogg v Cramphorn Ltd* [1], where it concerns about the distribution of shares by the directors of Cramphorn Ltd in order to avoid a take-over in the honest belief as they believe that the take-over would not be in the interest of the company and they want to protect their position as a director in the board of directors. As a result, Mr Hogg, one of the shareholder of the company sued the directors for being misused of their powers accordingly and the new distribution of shares was not legally distributed, so the court announced that this distribution of new shares are invalid (Lawteacher, 2015). However, there's a case in Western Australia, which is *Whitehouse v Carlton Hotels Pty Ltd* [2] where Mr. Charles MacDonald Whitehouse is being sued for issuing the shares to his son in order to prevent his former's wife or daughter to take over the company when he dies. In this case, the High Court of Australia held that Mr Whitehouse does not breach the directors' duty although he distributed it for improper usage and therefore, the appeal is dismissed with costs (UnistudyGuides, 2013).

2. 2Duty to Exercise Independent Judgement

Besides that, the directors must practice this fiduciary duty by using their power autonomously without influence by the other interests. In order to prevent the breach of this duty, the directors have to practice the duty in the Section 173 of Companies Act 2006, whereby they have to act:

1. in accordance with an agreement which has been duly entered into by the company; or
2. in a way authorised by the company's constitution.

In this fiduciary duty, it does not mean to give powers on the directors to delegate or avoid them from utilizing the power that is given by the company's constitution to delegate. According to the Institute of Chartered Secretaries and Administrators (2015), the directors have to ensure that they will give the best interest entirely for its own company and shareholders instead of their own interests offered by the third party. Also, the directors of the company are allowed to consult other professions for the legal advice but, the final decision has to be judge independently by themselves. It is clearly seen in the case of *Fulham Football Club Ltd. v Cabra Estates plc* [3] that the directors did not exercise their powers accordingly with its independent judgement. This is happened where the Hammersmith and Fulham Borough Council consented to an agreement to expand the Craven Cottage, the football ground for housing purposes and assure that they will not restrict the advancement at a later date or bolster a compulsory purchase order. As a result, the directors of Fulham Football Club were held that they breached the duty of exercising independent judgement because they had not restricted the future exercise of their discretion accordingly (Quizlet, 2015). As mentioned in the AustLII (2015), the directors of the

organization in the case of *Thorby v Goldberg* [4] was held by the High Court of Australia that they did not fetter on their discretion upon the interest of the organization in entering into a contract.

2. 3Duty to Avoid Conflicts of Interest

Moreover, this directors are put into practice with this duty in order to dodge in a circumstances where a director can obtain either a direct or an indirect benefits from the conflict with the company's interests. In conjunction of this, the Section 175 of Companies Act 2006 has clearly mentioned that this duty is not violated if:

1. the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or
2. the matter has been authorised by the directors.

Based on the Institute of Chartered Secretaries and Administrators (2015), the breach of this duty is applied when the directors take advantages from the third party in terms of property, unofficial information and opportunities. At the same time, it is not a breach of duty in a circumstance that it is arise unreasonably or it has been approved by the directors. Unfortunately, the directors always face the conflict of interest with the competitor, major shareholder, or a supplier and it has been increasing from years to years. This is because the Act does not explained clearly on what is " interest" or the " conflict of interest" means. This issue has showed clearly in the case of *Boardman v Phipps* [5] where Mr Broadman and Tom Phipps buy the company shares with the acknowledgement of Mr Fox as they believe that they could turn the company around. Nevertheless, Mr Broadman and Tom

Phipps did not entirely acquired to all beneficiaries and they have made a great profit with Mr Fox. As a result Johnn Phipps has sued them for breaching the duty to avoid conflicts of interest (Webstroke Law, 2014). In Australia, the directors are also charge for breaching this duty, which is stated in the case of Chan v Zacharia[6]where the High Court of Australia was held that Dr Chan has breached the duty. This is because Dr Chan acted in his personal interest instead of legitimate the interest of the partnership as a whole (Oxbridge Notes, 2014).

3. Conclusion: Prevention rather than cure?

In conclusion, it is essential for every directors to act within the directors' duties that is stated in the Companies Act 2006 to ensure that they do not breach the duty when carry out their responsibility to a company. There are several duties that is important among all of the directors' duties, which is the duty to act within powers, duty to exercise independent judgement as well as duty to avoid conflicts of interest. It is mentioned in the LawTeacher (2015) that those directors who have breached the duties will caused the company to have financial losses and at the same time, the directors will also be charged for such as imprisonment, fines, and commercial consequences. The directors will also be barred from its position under the Company Directors Disqualification Act 1986 in the Section 6 if they breach the directors' duties. In order to prevent the breach of duties rather than cure it, the Corporate Governance is a better system than the directors' duties where the Cadbury Report 1992 states that it is a system where the companies are controlled and directed accordingly (SA Technical, 2012). This has led to more sharpness to the director's responsibilities where they have

the executive responsibilities and monitoring role to prevent the breaching of their duties as a directors.

[1]Hogg v Cramphorn Ltd. [1967] Ch 254, Chancery Division

[2]Whitehouse v Carlton Hotels Pty Ltd. [1987] 162 CLR 285

[3]Fulham Football Club Ltd. V Cabra Estates plc [1992] BCC 863

[4]Thorby v Goldberg [1964] HCA 41; (1964) 112 CLR 597

[5]Boardman v Phipps [1966] UKHL 2

[6] *Kak Loui Chan v John Zacharia* [1984] 58 ALJR 353