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ICSA Guidance on Directors' General Duties

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   ld.practicallaw.com/0-201-2124

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Please note that a separate guidance note is shortly to be published on directors' duties as applied to charities.

1. Introduction and objective of this guidance

This guidance has been produced primarily for quoted/public companies that are looking to provide directors with practical guidance on their new general duties resulting from the Companies Act 2006 (the 'Act') in comparison with the previous common law duties, and how these duties affect the role of a director in a company. Much of the note can also be applied to private companies. Generally speaking, the relevant sections of the Act are a codification of existing common law rules and equitable principles. However, there are two areas found in the regulation of conflicts of interest where the statutory statement departs from the previous law,[1] and in section 172 the current law has changed in part to include a new requirement for directors to have regard to certain additional factors in their decision making.

The individual duties are not to be looked at in isolation because, as section 179 states, more than one of the general duties may apply in any given case. The Department for Business, Enterprise and Regulatory Reform (BERR) Explanatory Notes[2] ('Explanatory Notes') are clear that directors must act in accordance with their company's constitution. Companies may, through their Articles of Association ('Articles'), go further by placing more onerous requirements on their directors. The Articles may not dilute the duties set out in the Act except to the extent that this is permitted by sections 173, 175, 180(4)(a) and (b) and 232.

These codified general duties are owed to the company not to its shareholders. There are civil consequences if they are breached. Furthermore, section 183 provides for criminal sanctions for the director if he or she fails to comply with the requirements of section 182 (Declarations of interest). Under Part 11 (of the Act), it is now easier for members to bring a derivative claim against an individual director on behalf of the company. As the Explanatory Notes state, the general duties are owed by a de facto director (i.e. shadow director) in the same way and to the same extent that they are owed by a properly appointed director.

The Explanatory Notes also state that certain aspects of the duty to avoid conflicts of interest and the duty not to accept benefits from third parties continue to apply even when a person ceases to be a director.

The BERR Ministerial statement published in June 2007 (see Appendix B) gave a concise overview of directors' duties. These may be helpful when briefing company directors.

2. Commencement of the provisions

The sections of the Companies Act 2006 of particular relevance to this guidance note are:

2.1 Effective from 1 October 2007

Part 10:
Section 171 (Duty to act within powers)
Section 172 (Duty to promote the success of the company)
Section 173 (Duty to exercise independent judgment)
Section 174 (Duty to exercise reasonable care, skill and diligence)
Part 11:

1 Found in the Explanatory Notes, Chapter 2, point 302
2 The Explanatory Notes can be found at *www.opsi.gov.uk/acts/en2006/ukpgaen_20060046_en.pdf*.

Derivative Claims

Part 15:
Section 417 (Contents of directors' report: business review)

2.2 Effective from 1 October 2008

Part 10:
Section 175 (Duty to avoid conflicts of interest)
Section 176 (Duty not to accept benefits from third parties)
Section 177 (Duty to declare interest in proposed transaction or arrangement)
Section 182 (Declaration of interest in existing transaction or arrangement)

3. The key elements of the provisions under the Companies Act 2006 and practical guidance for directors

3.1 Section 171 (Duty to act within powers)

3.1.1. This section codifies a director's duty to comply with the company's constitution and only exercise powers for the purposes for which they are conferred.

3.1.2. The Explanatory Notes state that the duty codifies the current principles of law under which a director should exercise his or her powers only in accordance with the terms for which they were granted and for a proper purpose. What constitutes a proper purpose must be ascertained in the context of the specific situation under consideration.

3.1.3 The application of section 172 will depend on the purposes of the company (see section 172 (2)), e.g. is the company a charity or a community interest company etc. A separate ICSA guidance note for charities will be produced shortly.

3.1.4. **Practical guidance:** It is important for directors to appreciate that the liability for not complying with the company's constitution is strict. Here are some examples to think about:

- Formal procedures should always be followed when a meeting of the board is held, with a distinction always being made between a meeting of the board or a formally constituted committee of the board and other meetings involving directors, e.g. a chief executive's senior management committee which assists him in the exercise of his personal delegated financial and/or other authority from the board. Having a clear and comprehensive schedule of matters reserved for the exclusive decision of the board of the company and of subsidiaries may help to provide clarity of what may and may not be decided outside board meetings.
- Directors should be conscious of their company's Articles and the powers in the constitution. For example, this is relevant when considering the issuing of shares, the situations where the directors should be referring to shareholders, and the rules for establishing a quorum.
- If in doubt, directors should always seek the advice and guidance of the company secretary.

3.2 Section 172 (Duty to promote the success of the company)

3.2.1 This duty is the outcome of the extensive debate on 'enlightened shareholder value' versus 'pluralism' which was explored at length during the Company Law Review. It replaces the common law duty to act in good faith in the interests of the company. The overriding duty is that a director is required to act in the way he considers, in good faith, will be most likely to promote the success of the company for the benefit of its members as a whole. In doing so, he must have regard (amongst other matters) to the six factors below. Examples of decisions where a factor may be relevant are given in each case.

1. The likely consequences of any decision in the long term (e.g. cutting the research and development budget within a pharmaceutical company);
2. The interests of the company's employees (e.g. closing down a plant to outsource abroad, thus leading to redundancies among the existing staff);
3. The need to foster the company's business relationships with suppliers, customers and others (e.g. the finance department proposing a tightening of supplier terms of trade in order to improve cashflow);
4. The impact of the company's operations on the community and the environment. For this it is first necessary to identify the community or communities of which the company is a part (e.g. the board of a bank may need to consider the impact on the community in certain localities of a proposed programme of branch closures. On the environment, a manufacturing company would need to consider the effect of alternative proposed new industrial processes on its carbon footprint);
5. The desirability of the company maintaining a reputation for high standards of business conduct (e.g. directors need to consider the reputational risks involved in a proposal for the use of private information on competitor activities); and
6. The need to act fairly as between members of the company (e.g. the directors need to ensure that private shareholders are not disadvantaged by the structure of corporate transactions or share issues, or by lack of information. The website is a useful way to address the latter potential inequality).

3.2.2 At times these six factors, and any others that are being considered, may be in conflict but the key issue for decision making is that the directors should choose the action that will promote the overall success of the company for the benefit of members as a whole, even if that may sometimes have a negative impact on one or more of the six factors.

3.2.3 **Practical guidance:** Section 172 has given rise to concern, but to a large extent it only re-enacts and consolidates existing statutory provisions, the common law and best practice. Some key practical points are:

- The six factors discussed above are matters which directors must 'have regard to' but 'traditional considerations' such as profitability, the financial effects on shareholders, etc are still of critical importance as they are central to the duty to 'promote the success of the company for the benefit of the members as a whole'.
- In the decision making process there is generally no absolute wrong or right approach; the directors must make a judgment in good faith for the success of the company having regard to all the information and having taken advice when appropriate.
- Papers written for the board, which are not merely information papers, need to refer to the six factors where they are relevant to the decision being made, but not in circumstances where any of those factors does not arise. In order to ensure that this happens, it is recommended that each person below board level responsible for writing board papers should be educated on the implications of section 172 for board decision-making. This should usefully include being given guidance on when the six factors should be referred to.

- The minutes should record decisions taken and do not necessarily need to give

detail on how each factor was considered. This is because the board paper should have provided the relevant information. The GC100 paper in Appendix A of this guidance note provides useful guidance on writing board minutes.

- A system of checking before any paper is finally included in the board pack should be introduced in order to ensure that all the factors regarding a decision that are relevant to directors' duties have been adequately covered in the paper. This checking process would normally be conducted by the Company Secretary or by the Chairman. Either would have authority to seek amendments to the paper to address the relevant points.
- The directors' obligations in relation to their codified directors duties in sections 171–177 and, in particular, to the six factors described under section 172 should be brought to the attention of all directors on appointment.
- For the purposes of section 417 the directors of quoted companies are required to report in the business review on how they have discharged their duty under section 172.
- Application will depend upon the purposes of the company, for example, a community interest company or a charity. Where purposes exists that may not be considered in the interests of the members, s172(1) allows for the these purposes to promote the success of the company.

3.3 Section 173 (Duty to exercise independent judgment)

3.3.1 This section codifies the principle that a director must exercise his judgment independently of the influences of others.

3.3.2 The provision explains that this duty would not be infringed by a director if he or she is acting in:

a) accordance with an agreement or previous collective board decision which has duly been entered into by the company/board.
b) a way authorised by the company's constitution.

3.3.3 **Practical guidance:**

- A director should ensure that he or she does not allow personal interests, for example in a particular contract, to affect his or her independent judgment in the interest of the company. A director should ideally excuse himself or herself from any meeting at which a decision is to be taken in respect of his or her own property/interest. This is also relevant when the director is considering conflict of interest duties under sections 175–177.
- Importantly, where someone is an executive director, he or she is not there to promote a collective executive line, but is there, as is a non-executive director, in his or her own right and should give the board the benefit of his or her own independent judgment, including his or her appreciation of the risks involved in a particular course of action.
- The Explanatory Notes suggest that this duty does not prevent a director from exercising his or her power to delegate but he or she must still exercise his or her own judgment in deciding whether to follow the action suggested by that person(s).
- Similarly, a director would not be prevented by this duty from seeking legal or other professional advice but, ultimately, the director's final judgment would need to be independent.
- A director associated with a major shareholder should set any 'representative'

function aside and make final decisions on their own merits. This is of particular importance in joint venture situations where there may be constraints imposed by joint venture agreements. However, the Act states that this duty is not infringed by a director acting in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or in a way authorised by the company's constitution.

- Likewise, a director who is a family representative in the business may consult his or her family but be clear that he or she will make the final decision.
- A director of a subsidiary would need to take into account the interests of the parent company and the other subsidiaries, but not insofar as this would prejudice the solvency of the subsidiary itself. This might apply for instance in relation to a transfer of assets under a group tax planning arrangement.

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

3.4.1 This section codifies a director's duty to exercise reasonable care, skill and diligence. Section 174 is modelled on the provisions of section 214 of the Insolvency Act 1986 which relates to wrongful trading.

3.4.2 The Explanatory Notes state that a director owes a duty to the company to exercise the same standard of 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 (an objective test); and
b) the general knowledge, skill and experience that that director has (a subjective test).

3.4.3 **Practical guidance:** The use of both tests means that each director must exercise his duty to a minimum standard, as suggested by the objective test, and then the standard is raised under the subjective test if that director has specific skills or expertise. So if, for example, a non-executive director had an accounting qualification, he or she would be expected to exercise more active scrutiny of the accounts, for instance on such aspects as the appropriateness of accounting policies, than a director without such a qualification.

3.5 Section 175 (Duty to avoid conflicts of interest)

3.5.1 This section of the Act will not be implemented until 1 October 2008.

3.5.2 This section of the Act provides that a director must avoid a situation in which he or she has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. This duty would include both a conflict of interest and a conflict of duties and applies in particular to the exploitation of any property, information and opportunity. The duty does not apply if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest or if it has been authorised by the directors.

Furthermore, section 175 (3) states that the duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company. Transactions or arrangements with the company are dealt with under section 177 (in the case of proposed transactions) or under section 182 (in the case of existing transactions) unless an exception applies under those sections.
The duty applies particularly to the exploitation of any property, information or

opportunity. It is immaterial whether a company is able to take advantage of the property, information or opportunity.

3.5.3 **Practical guidance:**

- **Private companies:** hitherto and currently authorisation would be given by the members but when these provisions are commenced the default position will be that directors who are independent of the conflict may authorise it, unless there is a provision in the company's constitution stating otherwise. In practice it would be rare for there to be such a provision requiring authorisation to be given by the members except perhaps in the situation of a management buy-out.
- **Public companies:** the authorisation can only be given if the company's constitution includes a provision for the directors to authorise. Again, such authorisation must be given by directors who are independent of the conflict.
- Directors should remember that when giving authorisation they must consider whether their action is most likely to promote the success of the company – see section 172. When a director has a potential conflict of interest in a particular activity, authorisation may be given by the directors but, as section 175(6) states, the authorisation is only effective if that director is ignored for the purposes of the quorum and voting on any board resolution to authorise the matter. It is good practice for a conflicted director to leave the meeting when discussions take place on matters in which he or she has some personal interest.
- Another practical point to consider is whether a director who has the opportunity to take on a new directorship outside the company has a problem in relation to this duty. Multiple directorships would not necessarily need to have formal authorisation from the board – the question is whether having such directorships is likely to give rise to a conflict of interest.
- Furthermore, it is recommended that each director should consider if he or she has a conflict of interest through a connected person. Therefore it is important that the director informs those individuals that would be regarded as connected persons. A list defining connected persons can be found in section 252 (essentially these are certain family members, certain companies with which the director is connected, trustees of a trust, certain partners and certain firms with legal personality).
- It might be helpful to make provisions in the company's articles that deal with conflicts of interest which arise.
- The board needs to consider how it is approaching conflicts of interest; one suggestion might be to have a register of conflicts document that records all conflicts for each director. Good practice should be to present periodically the list of conflicts (including such things as other directorships) to the board, so that authorisation regarding any resultant conflict can be given.

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

3.6.1 This section of the Act will not be implemented until 1 October 2008.

3.6.2 This section has codified the common law rule that a director must not exploit his position for personal benefit.

3.6.3 Only those benefits which could reasonably be regarded as likely to give rise to a conflict of interest fall within the scope of this duty.

3.6.4 The Act does not permit the acceptance of benefits which fall within the ambit of the section to be authorised by the board; it has to be approved by the company's members.

3.6.5 **Practical guidance:** This duty has opened up some interesting debates on how far

these 'benefits' may extend. Some benefits are easily identified, such as financial rewards or money's worth such as tickets to prestigious sporting or cultural events. Questions have been raised too as to how far this duty will cover the giving or receipt of corporate hospitality. Whether the giving or receipt of corporate hospitality may be considered as creating a conflict of interest should be decided according to the context in which it is given or received. The following situations may be considered:

- If a director is currently involved in negotiating a new contract with another person or company and that party offers corporate hospitality it may be considered to infringe this duty, although it would depend on what was the 'norm' and whether it was excessive within the particular environment.
- Proportionate and defensible policies should be developed which outline how to deal with benefits offered by or received from third parties and which state what levels of corporate entertainment are significant for this policy or which need prior authorisation. The policies (including any updates) should be approved by the board, perhaps on a recommendation from the audit committee. All relevant employees and contractors should be informed of the policy and any updates and, for the company's protection, required to sign a receipt and acknowledgement to study and comply with the terms of the policy and any updates to it. Those forms of receipt and acknowledgement should be filed carefully at a central point, such as on each employee's personnel file.
- It is good practice to set up a register of benefits offered and received above whatever level is decided on by the board. It is suggested that the company secretary should report annually to the audit committee on compliance and issues arising.
- The Institute of Business Ethics provides practical guidance which directors and company secretaries can use to develop policies and codes of conduct for their organisations. (For more information visit *www.ibe.org.uk/codesofconduct.html)*

3.7 Section 177 (Duty to declare an interest in a proposed transaction or arrangement)

3.7.1 This section of the Act will not be implemented until 1 October 2008.

3.7.2 This section requires a director to declare to the other directors any interest, whether direct or indirect, in a proposed transaction or arrangement with the company. The extent of the interest must also be declared.

3.7.3 Section 177 (6) states that a director does not need to declare an interest if it cannot reasonably be regarded as likely to give rise to a conflict of interest. The default position that shareholder approval is required for such declarations not to be required will be reversed, although in practice many companies already remove the need for members' approval. Conversely some companies may wish to retain shareholder approval for such a procedure. However, many companies have already removed the need for members' approval in their articles of association.

3.7.4 A director is not required under this duty to disclose facts of which the other directors should already know or ought reasonably to be presumed to know. If a director becomes aware that some of the information declared is not accurate or complete before the transaction or arrangement has taken place, he or she must ensure that he or she corrects the initial declaration so that it is accurate.

3.7.5 **Practical guidance:**

- A director must declare his or her interest before the transaction or arrangement is entered into by the company. It is good practice for the board to take decisions on related matters without the director present.
- The duty may still apply even if the director is not party to the transaction, e.g. if the director's spouse would be entering into the transaction or arrangement the director may need to declare an indirect interest in the transaction.

3.8 Section 182 (Declaration of interest in existing transaction or arrangement)

3.8.1 This section of the Act will not be implemented until 1 October 2008.

3.8.2 Although this section does not fall into the list of statutory general duties for directors, it is still relevant as it replaces section 317 of the Companies Act 1985.

3.8.3 A director is required to declare an interest, whether it is direct or indirect, in any existing transaction or arrangement into which the company has entered. If that director has already declared an interest in the transaction or arrangement and that information has not changed, then he will not need to make a further declaration. As with section 177 of the Act, the director would still need to make a declaration even if not party to the transaction or arrangement.

3.8.4 **Practical guidance:**

- Section 183 provides that it is a criminal offence if a director fails to comply with the requirements of section 182.
- A director only needs to declare any interest that would be regarded as likely to give rise to a conflict of interest. The declaration must be made to the directors.
- A director would not need to declare an interest if the directors already knew about, or ought reasonably to have known about, a transaction or arrangement. Furthermore, he or she would not need to declare an interest if it was in relation to his or her service contract or remuneration that had been or was to be considered by the directors in a meeting or by a committee of the directors who had been appointed for that purpose under the company's constitution.

January 2008

4. Appendices

Appendix A: Companies Act (2006) – Directors' duties
Date of publication: 7 February 2007

1. Background

1.1 The new Companies Act seeks to codify directors' duties for the first time, as well as introduce the concept of enlightened shareholder value. The GC100 has no issue with these proposals in principle. However, together with other bodies such as the CBI and City of London Law Society, we have expressed concerns that the Act (coupled with the new provisions making it easier for shareholders to bring derivative actions) could have the effect of increasing bureaucracy in companies, making the decision process more cumbersome and potentially increasing the liability of directors.

1.2 Whilst we made representations to the Government and to the DTI about our views during the legislative process, the Act was not amended and our concerns were met with a mixed response. This varied from 'this is no real change to what responsible companies are doing now anyway' to 'of course it's a change, and we want you to take this seriously – it's not just a box-ticking exercise'. We now wish to engage with interested parties to achieve clarity for UK plc.

1.3 As the Companies Bill passed through parliamentary debates, the Government tried to provide some comfort to directors on the intended impact of the provisions. For example, the Attorney General, Lord Goldsmith, said in the Lords:

'There is nothing in this Bill that says there is a need for a paper trail... I do not agree that the effect of passing this Bill will be that directors will be subject to a breach if they cannot demonstrate that they have considered every element. It will be for the person who is asserting breach of duty to make that case good...[Derivative claims] will be struck out if there is no decent basis for them.'[3]

1.4 Against this background, we have decided that the GC100 should take a lead in identifying best practice guidelines for compliance with the new law.

1.5 This note is designed to set out that best practice. It considers the current law and practice and suggests how this may be adapted to the new law. Whilst it is not intended to be relied upon as legal advice, it represents the views of the GC100 as to how companies and their advisers can put the new law into practice.

2. The current law

The current law may be summarised as follows: directors must act in a way that they believe to be in the interests of the Company and its shareholders, both current and future, as a whole. This duty is owed to the Company itself, and not to individual shareholders. The current Companies Act states that directors are to have regard to the interests of the company's employees in general, as well as the interests of shareholders, but this duty is not owed directly to employees.

3 Hansard, 9 May 2006: col 841

3. Current practice

3.1 Levels of decisions

The way that directors currently perform their functions varies widely, depending upon the nature of the issues in question and the company concerned.

(a) There are invariably some matters that are formally reserved for the board. This is a requirement of the Combined Code and, arguably, some provisions of the Companies Act. Examples include: approval of financial statements, recommending dividends, major transactions and board appointments.
(b) Companies often delegate authority for other issues to an executive committee, usually led by the Chief Executive. The terms of reference for such a committee will authorise the committee or individuals to take decisions which are not reserved for the board, but also require certain decisions to be submitted to the committee or individual for approval.
(c) Issues that do not require approval at board, executive committee or designated director level will usually be taken informally by directors or other managers within the authority delegated to them by virtue of their appointment. In practice, the vast majority of day-to-day business will be handled in this way.
(d) Companies also operate through subsidiaries, which may have their own governance structures, similar to those referred to above. The proposals put forward in this paper are designed to be adaptable, as companies see fit, through any part of a corporate structure and, if thought appropriate, cascaded down to subsidiaries.

3.2 Formalities

The formalities supporting and recording decisions taken by companies, again, vary depending upon the nature of issue, the level at which it is taken and the company concerned.

(a) Board or committee meetings
In the case of a formal decision taken at a board or executive committee meeting, the process may typically involve:

(i) A briefing paper. This paper usually addresses all the issues which the directors are likely to take into account in making their decision, including for example the strategic rationale for the proposal, the financial effects, a summary of legal and regulatory issues, issues relating to employees and reputational issues. The precise form of paper varies from company to company and the detail depends on the type of proposal. The paper is circulated in advance of any meeting, unless the circumstances are exceptional, and is considered thoroughly by directors. Arguably it forms the most important documented support to the decision process.
(ii) A presentation. This may be used to supplement the briefing paper.
(iii) A discussion amongst board members leading to a decision.
(iv) A board minute. The minute may summarise the main points of any board or committee discussion, and will record any decision. Minutes may include wording to the effect that, taking all matters into account, the directors, consider that the proposal is in the interests of the Company as a whole. However, this practice is really only followed in situations where formal board minutes have to be disclosed to external third parties, for example as a condition to drawdown under a banking facility, and is rarely thought necessary otherwise.

As far as formal codification of factors that directors must consider stands today,[4] whilst boards often discuss the effect of any proposal on employees, it is virtually unheard of for minutes expressly to refer to this. In fact, some companies, particularly those with exposure to US litigation, largely omit the details of discussion from any minute, and simply record the decision reached.

The process for full board meetings is likely to be more formal, the process for executive committee meetings much less so.

(b) Decisions taken by individual directors on matters specifically reserved for them.

Where decisions are taken by individual directors, the process may, legitimately, involve much less formality, although in order to show that internal processes have been followed, there may be some form of briefing paper and/or record of the decision concerned.

(c) Other decisions

The way other decisions are supported or recorded varies as widely as the nature of the decisions concerned. In the vast majority of cases, it is simply not practicable for decisions to be supported by background papers or for the reasons, or in many cases even the decisions themselves, to be formally recorded. This has to continue to be the case if companies are to retain their operational flexibility and remain competitive.

4. The new legislation

Section 172 of the Companies Act will require a director to exercise his duties in a way that 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. So far, this is broadly in line with the current law. However, section 172(1) states that, in exercising those duties, directors must have regard to (amongst other matters) the following six factors:

(a) the likely consequences of the 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.

It is clear that these factors are subsidiary to the overall duty under section 172, and that the duty is owed only to the company, not to individual shareholders or to third parties. Whilst the wording of section 172(1) is mandatory (directors 'must act ... and in doing so have regard to'), it is also clear that the list of factors is not exhaustive. The GC100 is of the view that directors are not currently, and should not be, as a result of this legislative codification, forced to evidence their thought processes whether that is with regard to the stated factors or any other matter influencing their thinking. Apart from the unnecessary process and paperwork this would introduce into the boardroom, it would inevitably expose directors to a greater and unacceptable risk of litigation, especially in light of the new derivative action also being brought in by the Companies Act 2006.

4 s309 of the Companies Act 1985 requires that directors 'have regard to the interests of the company's employees in general'.

5. Aim of guidelines

5.1 The GC100's aim is to develop best practice guidelines for boards of public companies to:

(a) assist them in complying with the new law relating to directors' duties;
(b) reduce their potential liability to the company, whether directly or by means of derivative action;
(c) minimise the administrative burden through aiming for a pragmatic approach;
(d) demonstrate to all stakeholders that public companies and their directors are taking their wider duties seriously.

5.2 Any guidelines should:

(a) recognise the diverse ways in which decisions are taken by directors;
(b) have broad support from all stakeholders, including companies and their legal advisers; and
(c) recognise that individual companies choose to have differing governance arrangements.

6. Outline guidelines

6.1 Generally

Given the wide range of circumstances in which directors exercise their duties, it will not be possible to recommend a particular process which will apply for all decisions. It would, for example, be completely unworkable to require all decisions, and the reasons for them, to be recorded in writing. The suggested approach is therefore that:

(i) companies should ensure that all directors are aware of their duties under the new Companies Act; and
(ii) where the nature of the decision being taken by directors is such that it is supported by a formal process, that process need only specifically record consideration of those duties where the particular circumstances make it particularly necessary or relevant. The default position should be not to include these references.

6.2 Ensuring directors are aware of their duties

Companies should ensure that all board members are aware of their duties under the new Act. This can be done in all or some of the following ways:

(i) As a transitional move, boards should be given a thorough briefing on the new duties introduced by the Companies Act.
(ii) On appointment, all new directors should be briefed upon their duties under the Companies Act.
(iii) The terms of appointment and description of the role of any director should specifically refer to their duties.
(iv) The terms of reference of any board or committee may also refer to those duties.
(v) Companies should review their existing policies in areas such as human resources, ethics, compliance and corporate responsibility against the background of the new duties.
(vi) Care will need to be taken to ensure the duties are not inadvertently extended to give new rights of action to third parties.

6.3 Board and committee decisions

(a) As noted above, board (and to a lesser extent, committee) decisions are likely to have the greatest degree of formal process.
(b) In general, if a proposal is to be put to a board for a decision, it is likely to be an important one for the company. It will nearly always be supported by a background paper which will have been thoroughly prepared by the management team; possibly with the help of advisers. In practice, therefore, a thorough analysis of all the issues reflecting on the decision will already have been made by management. It is the job of the directors, at that stage, to review the papers, and any recommendations made in them, both in the light of the information supplied to them and using their own business judgement and, following discussion, to reach a decision. Without detracting from the importance of thorough debate at the boardroom table and the need for the directors to apply their own business judgement, the background paper (and any management presentations made at the meeting) is a key way of assisting directors in properly taking into account all relevant factors relating to their decision.
(c) It should therefore be best practice for those members of the management team responsible for preparing the paper to ensure that each of the relevant factors, including those referred to in the Companies Act, are properly considered whilst the paper is being prepared. They can then, if necessary, be included in the paper or any presentation made. Responsibility for considering relevant factors can properly be delegated to the members of the management team preparing the paper in the usual way.
(d) In some cases, one or more particular factors may clearly be irrelevant. GC100 does not believe that best practice should be prescriptive by requiring a negative statement.
(e) Directors will, of course, continue to have to be satisfied that they delegate the task of compiling the briefing to the appropriate people. Moreover, whatever the contents of any briefing, the directors concerned would still have to use their business judgement in considering the proposal.
(f) Board minutes also form an important part of process, in particular to the extent that they reflect the actual debate at a meeting and the decision taken. However, minutes are, of necessity, simply a summary and can never, in practice, be prepared with the thoroughness of a board paper. In some cases, companies have very brief minutes, for example, where there is a specific need to avoid detailed references to legal advice to ensure privilege is not lost. It is therefore recommended 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.
(g) Despite the importance of the briefing paper, its purpose should not be misunderstood; that is to assist directors in reaching a decision through exercising their own judgement – it should not be construed as the decision or a record of the directors' views.
(h) The advantages of this approach would be:

    (i) each of the factors relevant to a decision, whether those prescribed by the Companies Act or otherwise, will be properly considered by management before an issue is brought to the board;
    (ii) the board will have a written report on each relevant issue – even if brief – and each director will have had the opportunity of considering it in advance and of raising any questions at or before the meeting;
    (iii) it treats the factors as part of the overall commercial decision process;

(iv) there will be a clear written record of the issues addressed; and
(v) it will not be necessary to minute what was said on each factor, except to the extent appropriate to reflect points raised on them. This will avoid any substantial increase in the length of minutes.

6.4 Other decisions

When decisions are taken by directors in circumstances other than at a formal board meeting, it should be for the company concerned to decide, in its particular circumstances, the best approach to be adopted.

Where there is a clear scheme of delegation and a decision is to be taken by an individual director, it is unlikely to be appropriate for a paper to be prepared as described above. It has to be recognised that many decisions, even if taken in accordance with a formal scheme of delegation, have to be taken within a timeframe which does not allow for preparation of a formal paper; or for a formal minute of the decision. It is important that best practice recognises this – lack of formal process should not lead to any inference that factors have not been properly considered.

February 2007

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Background information to the GC100

1 The GC100 was officially launched on the 9 March 2005 and brings together the senior legal officers of more than 70 FTSE100 companies (see below for a full list of member companies).

2 The main objectives of the GC100 are to:

- Provide a forum for practical and business focused input on key areas of legislative and policy reform common to UK listed companies.
- Enable members to share best practice in relation to law, risk management, compliance and other areas of common interest.

3 At the Group AGM on the 16 January 2007 members voted in favour of extending membership to company secretaries in the FTSE 100. The formal name of the GC100 is now the 'Association of General Counsel and Company Secretaries of the FTSE 100' although it continues to be generally known as the GC100.

4 Officers to the GC100 for 2007 are:
Chair: Helen Mahy, National Grid
Vice-chair: Rosemary Martin, Reuters
Vice-chair: Peter Maynard, Prudential.
Treasurer: Richard Bennett, HSBC
Secretary: Mary Mullally, PLC

5 Other members of the Executive Committee for 2007 are:
Rupert Bondy, GlaxoSmithKline
Grant Dawson, Centrica
Nick Folland, Emap
Mark Harding, Barclays
Andrea Harris, WPP
Peter Kennerley, Scottish & Newcastle
Christopher Roberts, Reckitt Benckiser

6 As a matter of formality please note that the views expressed in this paper do not necessarily reflect the views of all of the individual members or their employing companies.

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Appendix B: Duties of Company Directors
Ministerial Statement
DTI June 2007

I know that the new statutory duties of directors set out in Part 10 of the Companies Act 2006 were keenly debated while the Bill was going through Parliament, and I am sure they will continue to be seen as one of the most significant parts of the Act.

During those debates, I and the other Ministers were questioned about the meaning of the provisions. Some of our responses and statements may be helpful to people interested in what the provisions mean, and I am pleased to be publishing this structured collection of what we believe are the most useful of them.

There are two ways of looking at the statutory statement of directors' duties: on the one the hand it simply codifies the existing common law obligations of company directors; on the other – especially in section 172: the duty to act in the interests of the company – it marks a radical departure in articulating the connection between what is good for a company and what is good for society at large.

Continuity

The statutory expression of the duties is essentially the same as the existing duties established by case law, the only major exception being the new procedures for dealing with conflicts of interest.

The simple high-level guidance for directors in the box on the following page illustrates the way in which the codification maintains continuity with the existing law: this advice on how a director has to live up to his position of trust is applicable to the pre-existing common law as well as to the new codification. For most directors, who are working hard and put the interests of their company before their own, there will be no need to change their behaviour.

Change

But compared with most text-book definitions of the common law duties of directors, the new statutory statement captures a cultural change in the way in which companies conduct their business. There was a time when business success in the interests of shareholders was thought to be in conflict with society's aspirations for people who work in the company or in supply chain companies, for the long-term well-being of the community and for the protection of the environment. The law is now based on a new approach. Pursuing the interests of shareholders and embracing wider responsibilities are complementary purposes, not contradictory ones.

I strongly believe that businesses perform better, and are more sustainable in the long term, when they have regard to a wider group of issues in pursuing success. That is a common-sense approach that reflects a modern view of the way in which businesses operate in their community: they interact with customers and suppliers; they make sure that employees are motivated and properly rewarded; and they think about their impact on communities and the environment. They do so at least partly because it makes good business sense.

Guidance for company directors:
1) Act in the company's best interests, taking everything you think relevant into account
2) Obey the company's constitution and decisions taken under it
3) Be honest, and remember that the company's property belongs to it and not to you or to its shareholders

4) Be diligent, careful and well informed about the company's affairs. If you have any special skills or experience, use them
5) Make sure the company keeps records of your decisions
6) Remember that you remain responsible for the work you give to others.
7) Avoid situations where your interests conflict with those of the company. When in doubt disclose potential conflicts quickly
8) Seek external advice where necessary, particularly if the company is in financial difficulty

The new expression of the duties is part of the wider recognition and encouragement of change in the Act. The enhanced business review, which for quoted companies must now include information on environmental, employee, social and community issues, is another key example that builds on the growing consensus that it is good business sense for companies to embrace wider social responsibilities.

I am sure that directors' duties will continue to evolve as times change and as societal norms are transformed. Corporate social responsibility has developed and evolved over time. The relationship between business interests and the wider world is changing all the time. The best way of achieving lasting cultural change is to go with the tide and the broad consensus of opinion.

Margaret Hodge

Appendix C: Acknowledgements

The working group was comprised as follows:

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