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Legal risk: Directors' responsibilities

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Structure of presentation

- Codification of directors' duties
- Enlightened shareholder value
- GC 100 comments
- Statutory derivative action

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Codification of Directors' duties

- Aim: to give directors a clear, authoritative statement of their duties
  - but future case law
- Continuity with existing common law
  - but note use of new terminology (eg "success")
- Some duties not codified
  - duties to creditors

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Codification of Directors' duties

- S. 171: duty to act within powers
- S. 172: duty to promote success of the company
- s. 173: duty to exercise independent judgment
- s. 174: duty to exercise reasonable care, skill and diligence
- s. 175: duty to avoid conflicts of interest
- s. 176: duty not to accept benefits from third parties
- s. 177: duty to declare interest in proposed transaction or arrangement

Enlightened shareholder value

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What is ESV?

- DTI comments on objectives
  - to ensure that directors make decisions based on "the longer-term view and not just the immediate return"
  - to ensure that directors have regard to other factors (eg the environment)
  - "to drive long-term company performance and maximise overall competitiveness, wealth and welfare for all"
- Enlightened shareholder value
  - "…directors will not be successful in promoting the success of the company if they focus on only the short-term financial bottom line. Successful companies see business prosperity and responsible business behaviour as two sides of the same coin." (Lord Sainsbury in the House of Lords (11 January 2006))

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ESV in the Act

1. The likely consequences of any decision in the long term
2. The interests of the company's employees
3. The need to foster the company's business relationships with suppliers, customers and others
4. The impact of the company's operations on the community and the environment
5. The desirability of the company maintaining a reputation for high standards of business conduct
6. The need to act fairly as between members of the company

ESV: context

- 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…
  - Subjective judgement, subject to good faith
  - Note apparently no distinction between the company and its members
- Basic duty is still to enhance shareholder value
  - Aligned factors and non-aligned factors
- Meaning of success (Lord Goldsmith)
  - "what the members collectively want the company to achieve"
  - "will usually mean long-term increase in value"

ESV: context

- Directors' duty to exercise reasonable care, skill and diligence applies
  - Not sufficient to pay lip service to ESV
- "Have regard to"
  - A mandatory process?
  - One size fits all?
  - Resolution of conflicting factors?
- List of factors non-exhaustive
- Duty applies to **all** acts and decisions of directors (board and committee meetings, individual acts and decisions)

Practical guidance for directors (GC 100)

- GC 100 guidelines
  - To develop best practice guidelines for boards of public companies
  - To assist in complying with the new law
- Ensure directors, those in office and new appointees, aware of scope and nature of duties

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Practical guidance for directors (GC 100)

- Structure and terms of reference of board committees should be reviewed to ensure appropriate consideration given to statutory factors
- Briefing papers and management presentations should consider and analyse any of the relevant factors including those set out in the Act

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Practical guidance for directors (GC 100)

- If statutory factors are clearly irrelevant to the decision making process they do not need to be referred to
- For particularly difficult or controversial decisions directors could consider consulting independent shareholders for views
- Board minutes themselves need only reflect the decision reached by the directors after their consideration of the briefing papers
- Procedure for minuting board meetings and recording corporate decisions should be reviewed – good housekeeping procedures ie minutes written up, signed and approved and kept for statutory minimum period of 10 years

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The statutory derivative action

"To put it in vulgar, non-legal terms, people who have spoken to us fear a double whammy. In Part 10 of the Bill, directors' duties are widened, while Part 11 makes it easier for shareholders to commence actions against directors. There is concern." Lord Hodgson, House of Lords Committee

What is a derivative action?

- An action brought by a shareholder on behalf of a company against the company's directors
- Any damages awarded will be paid to the company

The current position

- Limited circumstances in which a derivative action is permitted
- Wrongdoers in control of the company and have misappropriated the company's assets
- Negligence by director(s) not sufficient

The new statutory derivative action

- Wrongdoer control and misappropriation of company's assets not necessary
- Can be based on an actual or proposed act or omission involving a director's:
  - Negligence
  - Default
  - Breach of duty
  - Breach of trust

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Factors taken into account by court

- Whether member is acting in good faith
- Importance that a person seeking to promote the success of the company would attach to continuing the claim
- Whether act or omission has been/would be likely to be ratified/authorised by company
- Whether company has decided not to pursue the claim
- Whether member could pursue an action in his own right
- Court shall have *particular* regard to any evidence before it as to the views of "independent" shareholders

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The Attorney-General's view

- No major change of principle
- Damages payable to company, so no direct benefit to litigant shareholder
- Litigant would be deterred by costs of action
- Tight judicial control is expected

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