The Association of Corporate Treasurers

Comments on proposed statutory statement of directors duties contained in clause 19 of, and Schedule 2 to, the draft clauses set out in the White Paper.

Schedule 2

We believe that **the proposed statement of director's duties is in principle a useful summarisation**.

However, it is not a particularly easy read for someone not used to reading the language of legislation. Nonetheless, we welcome it. The company's qualified company secretary or in-house lawyer will have new hooks on which to base briefing of new directors, both executive and non-executive, rather than having to quote precedents and persuasive overseas rulings.

Attention to the drafting of Schedule 2 to make it more readable could make this a really useful and meaningful document, particularly for new directors and make them less dependent on expert interpretation.

The new statement sets out certain duties. To some extent they codify existing common law and in other respects the schedule sets out specific examples of what would, in most circumstances, be commercial reality or common sense from the point of view of the company. We do have some concerns about the Schedule, which we explain below.

"Success of the company" (paragraph 2(a) of Schedule 2 to the draft Companies Bill)

We believe that **"success of the company" needs further qualification.**

Importantly, the director is only required to "take into account" the "material factors", so that it is clear that the "success of the company for the benefit of its members" is the overriding concern, other stakeholders' interests being merely factors to be taken into account. (This is similar in emphasis to the existing duty in s.309 CA85 to "have regard to" the interests of employees.)

However, it would be of concern if the references to "the success of the company" could be construed as, for example, constraining the ability of the board to recommend a bid for the company that seemed to be good value for current shareholders and yet ran the risk of not promoting the long term interests of the company itself under its new ownership. Examples may be board being aware of an intention on the part of the prospective new owners to cannibalise parts of the company or even to transfer the whole of its assets and undertaking (for use elsewhere in the new owner's group) and shut it down.

Care, skill and diligence (paragraph 4 of Schedule 2 to the draft Companies Bill)

The wording of paragraph 4 of Schedule 2 talks about what "may reasonably be expected of a director in his position". It is modelled closely on s.214, Insolvency Act 1986, which has been "adopted" by the courts as correctly stating the degree of knowledge, skill and experience required of a director

generally, not just for the purposes of wrongful trading with which s.214 is concerned.

This means that, whilst there is no explicit distinction between executive and non-executive directors, the differences in their respective roles in relation to the company may properly lead to the conclusion that there are different levels of knowledge, skill and expertise that they should respectively have.

However, there are some drafting differences between Schedule 2, paragraph 4, and s.214 IA86 which give rise to concern.

"in his position" (paragraph 4(a) of Schedule 2)

We would recommend the addition after "in his position" at the end of paragraph 4(a) of the words "in relation to the company", to make it clear that the objective part of the test has to be looked at in the context of the director's role in relation to the company itself, not more generally. If in fact the director happens to have other (general) knowledge, etc., it may be caught by 4(b), i.e. the subjective part of the test.

"additional knowledge," etc. (paragraph 4(b) of Schedule 2)

In para 4(b), the use of the word "additional", rather than "general" (see s.214), could catch specific matters known to the director which he is not at liberty to disclose to the company or its board, e.g. knowledge acquired by him in his capacity as a director of another company or as a former government minister or civil servant. **We therefore recommend replacing in paragraph 4(b), "additional" by "general" (as in s.214IA 86) in paragraph 4(b).**

Fiduciary duties (re paragraph 3 of Schedule 2)

We are concerned by the note to paragraph 3 and its impact in respect of a director's fiduciary duties.

At present, the wording appearing in an irrevocable undertaking, in respect of the director's own holding of shares, to accept a takeover offer which is recommended by the board often tries to impose on the director, in his capacity as such, the obligation to continue to support the offer, notwithstanding a subsequent, more attractive bid. At present, it is recognised that such an obligation is overridden by the director's fiduciary duty to the company (even though the director, in his capacity as a shareholder, may continue to be bound by his undertaking to accept the first bidder's offer in respect of his own shares).

It is questionable whether the wording of the note to para 3 would continue to leave the director with that "out". The position could of course be made clear by appropriate drafting in the irrevocable undertaking, but this would become a bargaining point which the director might not be able to achieve.

Therefore, **it is desirable that some clarification to the note to paragraph 3 be made which recognises that the director's fiduciary duty overrides a conflicting contractual obligation binding on him personally.**

Benefits from third parties (paragraph 7 of Schedule 2)

The Association, while supporting the principles, is concerned that drafting of paragraph 7 of Schedule 2 of the draft Bill is rather too restrictive.

The paragraph concerns acceptance by directors of "benefits" from third parties. It is drafted very broadly. Its effects need considerable narrowing to focus on the mischief at which it is aimed.

Consider an honour proposed for a director of a company limited by guarantee administering a charity or a professional body. The citation "for services to charity" or "the actuarial profession" may make the honour a "benefit conferred by way of reward for any exercise of his powers as director" and the Schedule may require the director to refuse the honour.

It is common for companies which are marketing products which are novel or complex to sponsor seminars, "teach-ins" or conferences on the subjects and invite company representatives, including directors, to attend free of charge. There may be meals provided, accommodation in the case of longer events or some kind of entertainment. At a smaller scale, many professional services firms, personnel agencies at all levels, accountancy and actuarial firms etc, will invite relevant staff of clients, including directors, to "business briefings" on a variety of subjects, perhaps over breakfast or lunch, as a way of keeping awareness of their firm high. Some aspects of the events may fall under paragraph 7 as worded, being not "necessarily incidental".

In practice, however, such sessions are cheap, easy and convenient ways of a company's staff, including directors, securing education and training as well as being networking opportunities.

As worded, the paragraph would probably also catch, for example, the acceptance by a director of entertainment offered to him because of his position with the company in question. In other words, it would be a breach of duty by the director to accept an invitation to Twickenham by, say, investment banking advisers to the company, who have issued the invitation because of the director's position with the company, if the invitation has not been approved by a shareholders' resolution and is not "necessarily incidental to the proper performance of any of his functions as director", which it would not be.

These examples illustrate the difficulty that can be encountered when an attempt is made to codify in legislation a principle or rule that has existed in the common law, where common sense, applied to each individual case, dictates whether and how it is to be applied.

Most companies have rules on acceptance of benefits including gifts and entertainment. They usually include terms such as

- "approved in advance of acceptance by …"
- "reasonable",
- "if entertainment, of a level or value which the company itself would reciprocate",
- "if goods, of a nominal value and with the name or logo of the company making the gift"
- "reasonably incidental to a business activity"

- (for employees, including executive directors) “unless for a business purpose, not involving absence during business hours, not taken as part of annual leave entitlement”,

Many companies also follow the good practice of requiring a register to be kept of all benefits received, which must regularly be appropriately reviewed. Review of registers is often part of the duties of the internal audit function as part of their visit to sites.

We suggest that if regulation is required on benefits from third parties, it be limited to requiring companies to adopt a code of practice to be followed by directors and to be made available by the company to shareholders or, in the case of public companies, to the public generally, on application if not permanently displayed, for example, on a company’s website.