CHAPTER 17: COMPANY II – COMPANY OFFICERS AND LIABILITIES

QUESTION 1

Under the Companies Act 2006, directors owe various duties to a company. Outline the seven general duties of directors which are set out in sections 171–177 of the Companies Act 2006.

Answer:

- Duty to act within powers s171 – This requires directors not to exceed powers given to them by the company. In particular must only exercise powers for the purpose for which they were conferred.
- Duty to promote the success of the company s172 –The principle of 'enlightened shareholder value' requires directors to act in a way which is most likely to promote the success of the company for the benefit of the members as a whole.
- Duty to exercise independent judgement s 173 – Directors must exercise independent judgement. They must not delegate their powers or be swayed by the influence of others.
- Duty to exercise reasonable skill, care and diligence s174 – Directors have a duty to exercise the same standard of care, skill and diligence that would reasonably be expected of a reasonably diligent person with the general knowledge, skill and experience which may be reasonably expected of a person in their position and the general knowledge skill and experience they actually have
- Duty to avoid conflicts of interest s175 – The Act suggests a number of circumstances where a director's personal interest may conflict with the company's interest. Directors have a duty to avoid such circumstances.
- Duty not to accept benefits from third parties s176 – This duty prevents directors from accepting benefits from parties outside the company (bribes), and supports the duty under s175 by preventing a potential conflict of interest.
- Duty to declare an interest in proposed transaction or arrangement s177 – Directors must declare the nature and extent of any proposed arrangement or transaction they may be involved in with the company, either personally or through a third party. Disclosure may be given by written or general notice or at a Board meeting, but must be made to directors.

QUESTION 2

Explain where a director gets authority to act on behalf of a company and how third parties are -protected if a director acts outside his authority.

Answer:

- The authority to act on behalf of a company lies with the Board of Directors. The Board can give directors actual authority which can be expressed or implied to take actions on behalf of the company. A director may also have apparent authority to carry out certain functions.

- Where directors act without any authority or beyond the authority they have been given either in the articles or delegated by the Board then the position is governed by Companies Act 2006 s40.
- Under section 40 the powers given to directors, or persons authorised by them, to enter into any transactions between a company and a third party acting in good faith are deemed to be free of any limitations under the company's constitution.
- The third party is presumed to be acting in good faith unless the contrary is proved by the company. A third party is not regarded as 'acting in bad faith' just because he knows that an action is beyond the powers the director has under the company's constitution.
- s40 does not apply when the 'third party' is a director of the company or a person connected with a director (CA s41). If this is the case the contract may be voidable by the company.

QUESTION 3

Herb Ltd has three directors: Parsley, Sage, and Rosemary. Occasionally Parsley and Rosemary come into the company's premises but all decisions about running the company are left to Sage, who acts as managing director although he has never been appointed as such. In January, Sage enters into a contract with Supermarkets Ltd to supply organic herbs at a fixed price for a year. Shortly afterwards the price of organic herbs increases enormously, and Herb Ltd seeks to have the contract with Supermarkets Ltd set aside on the grounds that Sage had no authority to act on his own. Advise Herb Ltd if they are bound by the contract.

Answer:

- A company as an artificial person can only act through its agents. When the Board of Directors' acting collectively or one director acting on his own, enters into a contract on behalf of the company, provided the actions are within their authority, the contract will be binding on the company.
- A director may have express actual authority and implied actual authority to act on behalf of a company, in addition a director may also have apparent (or ostensible) authority.
- Apparent authority is where actual authority does not exist but the company, permits a director to exceed his authority. The company will be bound by any resulting transaction the director enters into with a third party.
- In this scenario the directors have allowed Sage to act as managing director, although he was never appointed. If a Board of Directors allows a director to behave as if he were a managing director or give the impression that he is, even though he has not been appointed as managing director, then he will have the apparent authority of a managing director, *Freeman & Lockyer v Buckhurst Park Properties Ltd.* (1964)
- Herb Ltd will be bound by any business contracts Sage enters into if a reasonable person would have assumed that he was in fact a managing director.

QUESTION 4

Pike, Harri, and Raj are directors of a beauty products company. Pike is responsible for negotiations with suppliers and customers. He agrees a contract between the company and Bleach Ltd for the supply of various chemicals. Bleach Ltd give Pike a commission of £3,000 which he does not declare. Pike enters into negotiations for the supply of hair dye with Julie, who owns a fleet of hairdressers. Unknown to Pike, Julie is Harri's wife. Raj is responsible for research into new products and, during trials to produce a new face cream, he accidentally discovers a formula that promotes rapid hair growth. Raj does not inform the other directors of his discovery but resigns and forms a new company on his own to market the hair growth product. The new company is very successful and makes substantial profits. Discuss.

Answer:

- There are a number of potential breaches of director's duties set down in s171 – s177 Companies Act 2006 s171 – s177.
- Pike: s176 - duty not to accept benefits from third parties. By accepting and not declaring the £3,000 commission from bleach suppliers, Pike is potentially in breach of s176. It is possible for Harri/Raj to ratify Pike's actions as members of the Board of Directors.
- Harri: s175 duty to declare a conflict of interest and a breach of s176. Harri is under an obligation to disclose both the nature and extent of an interest which is either direct or indirect (Julie owning a chain of hair salons) in relation to a proposed transaction or arrangement with the company. Harri has a duty to notify the company by written notice, general notice or at a board meeting. A director must avoid situations where he can have a direct or indirect interest that conflicts with the interests of the company. Indirect interests can occur as a result of the involvement of other family members, *Odyssey Entertainment Ltd v Kamp & Others* (2012)
- Harri may be absolved of liability if it is believed that it was not reasonable to regard Julie's role as director of a chain of hair salons, as one of giving rise to conflict. Harri may also be unaware of the proposed transaction.
- Raj: s172- duty to act in good faith as to the best interests of the company and to promote the success of the company as a whole. Raj has a duty to act honestly, in good faith and with due care, skill and diligence. Raj: s174 - a duty to exercise reasonable skill care and diligence. Breach of this duty may be ratified at a general meeting providing there has been no fraud committed on the minority of shareholders. (Unlikely as Raj's new company has made substantial profits), *Brumder v Motornet Service & Repairs Ltd* (2013)