



dated 28 April 2009

Waverley Borough Council

Briefing note on the role and responsibilities of board members

Trowers & Hamlins LLP
Sceptre Court
40 Tower Hill
London
EC3N 4DX

t +44 (0)20 7423 8000
f +44 (0)20 7423 8001
www.trowers.com
draft 1 dated 28 April 2009

trowers & hamlins

Waverley – Local delivery vehicle

Briefing note on the role and responsibilities of board members

1 The local delivery vehicle

1.1 The local delivery vehicle, Waverley Initiatives Limited (the Company), will be set up as a company limited by guarantee with limited liability. Its activities will be governed by its memorandum and articles of association (its written constitution) which state that it is managed by a board of management. The board will be responsible for the affairs of the Company and will owe a number of duties to it.

1.2 The primary duties owed by board members are the general fiduciary duties (duties of good faith) which lie at the heart of their relationship with the Company. These duties have now been codified under the Companies Act 2006 which sets out statement of 'general duties' about how directors (i.e. board members) are expected to behave. In addition, there are further requirements relating to board members' duties under general company law and insolvency law.

1.3 This note summarises the key role and responsibilities of board members mentioned above.

2 Statutory statement of directors' duties under the Companies Act 2006

2.1 The statutory duties of directors set out in the Companies Act 2006 are:

2.1.1 The duty to exercise reasonable care, skill and diligence (section 174)

For the board member of a non-charitable organisation, the test is such skill as can 'reasonably be expected of a person with his or her knowledge and experience.' This is a subjective level of skill and care and can produce a low threshold: a person with no particular housing, business or financial skills is not expected to show any of these attributes in carrying out their duties. In contrast, a leading banker or accountant would be expected to show considerable financial skill or care.

If on the other hand charitable status is adopted, board members are subject to a higher minimum standard, being the skill and care which can be expected of a 'prudent man or woman of business' in the exercise of their personal business affairs. This is not a subjective standard based upon the actual skill of the board member, but the objective standard of the reasonable businessman or businesswoman. Given this, board members of a charitable organisation should ensure that they either have the necessary skills or receive adequate training so as to acquire them.

2.1.2 The duty to act within powers (section 171)

Board members must take particular care to ensure that every proposed activity falls within the permitted objects of the Company as set out in the memorandum of association as well as any other documents affecting the constitution and use his or her powers solely for the purposes for which they are conferred. If in doubt, independent advice should be obtained.

2.1.3 The duty to promote the success of the Company (section 172)

A director of a company must act in the way he/she considers, in good faith, would be most likely to promote the success of the company for the benefit of the company as a whole and in doing so must have regard to a number of factors set out in section 172 of the Companies Act 2006. For a not-for-profit company, whose purpose is not to benefit members, the board members of the company must act in a way which achieves the objects of the company rather than in a way which benefits the company member(s).

2.1.4 The duty to exercise independent judgment (section 173)

Board members must use their own judgment when making decisions. This does not mean that external advice cannot be obtained, but board members must not unreasonably follow external advice.

2.1.5 The duty to avoid conflicts of interest (section 175)

A board member must not put himself or herself in a position where his or her own interests conflict directly or indirectly with those of the company. This is discussed in more detail in paragraph 3 below.

2.1.6 The duty not to accept benefits from third parties (section 176)

A board member must not accept a benefit from a third party conferred by reason of his/her being a board member or his/her doing (or not doing) anything as a board member. This duty will not be breached where the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict. This may, for example, permit board members to accept nominal gifts such as pens and pencils.

2.1.7 The duty to declare an interest in a proposed transaction or arrangement (section 177)

If a board member is in anyway directly or indirectly interested in a proposed transaction or arrangement with the company itself, he/she must declare the nature and extent of that interest to the other board members.

3 Duty to avoid conflicts of interest

3.1 The duty (section 175 of the Companies Act 2006)

The Companies Act 2006 provides that 'a director of the company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.'

The Act then effectively divides conflicts into two types, transactional and situational. Different provisions apply to both and the duty will also depend upon whether the company is to be charitable or non charitable.

3.2 A non charitable company

3.2.1 Transactional conflicts

The duty to avoid conflicts does not apply to transactions or arrangements with the company itself. Transactional conflicts do not need authorisation as is the case with situational conflicts (see below). Instead, board members must **declare the nature and extent** of any such interests either before the company enters into the transaction (section 177), or where the transaction has already been entered into and section 177 has not been complied with (section 182).

3.2.2 Situational conflicts

These conflicts (for example a conflict a board member has because he owes a duty of loyalty to one company that conflicts with his duty of loyalty to another) must be avoided unless **authorised**. No conflict will be deemed to have arisen where the situation cannot reasonably be regarded as likely to give rise to a conflict of interest (section 175(4)(a)).

Authorisation requires the non-conflicted board members to pass a resolution authorising the conflict. The conflicted board member(s) cannot count towards the quorum and should not vote on this resolution (section 175(6)). This kind of authorisation is only permitted where a company's articles do not prohibit it.

3.3 A charitable company

Slightly different provisions apply for charitable companies.

3.3.1 Transactional conflicts

The duty to avoid conflicts does not apply to transactions or arrangements with the company that are **specifically allowed in the company's articles**. This means that specific transactions or arrangements that are to be permitted should be listed in the articles (section 181(2)). However, transactions where a conflict may arise often require Charity Commission consent and therefore the articles should not allow these without referring to the requirement for consent.

Charity Commission consent is required for benefits to board members of charities, however, where the memorandum of association already permits certain payments to board members, these should be listed in the articles as permitted arrangements with the company.

3.3.2 Situational conflicts

Conflicts may only be authorised by board members where the constitution **includes a provision** enabling them to authorise that kind of conflict. Where the constitution does permit authorisation the board members must authorise in accordance with those provisions. Requirements as to the interested board member(s) not being counted in a quorum and that they should not vote still apply.

The Charity Commission has indicated they are unlikely to accept a general power in the articles of association allowing board members to authorise any conflict of interest, as many conflicts require Charity Commission consent. They are happier with specific provisions in the articles allowing specific types of conflict (much as with transactional conflicts).

4 Company law

4.1 The Companies Act 1985 (where still in force) and the Companies Act 2006 impose a number of statutory duties, prohibitions and restrictions on board members. Provisions include an obligation to prepare and file company accounts, the maintenance of registers, the submission of annual returns and the appointment of auditors.

4.2 Under section 415 of the Companies Act 2006 board members must prepare a director's report for each of the Company's financial years. Under section 417 for companies other than small companies the directors' report must also contain a 'business review'. The purpose of the business review is to inform members of the Company and help it to assess how the board members have performed their duty under section 172 of the 2006 Act to promote the success of the Company.

5 Insolvency law and other duties

5.1 A board member of a company which is facing financial difficulties should be aware of the scope of potential personal liability if he or she is found guilty of wrongful or fraudulent trading. Fraudulent trading requires an action to defraud creditors of the company or creditors of any other person or a similar fraudulent purpose. Wrongful trading can arise where a company has gone into insolvent liquidation and the board member knew or ought to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation and that once the board member knew or ought to have known this, he or she fails to take every step possible to minimise the potential loss to the company's creditors. This may include a situation where a company is unable to pay its debts as they become due, but still continues to trade.

5.2 A board member cannot escape liability by arguing that he or she did not take an active role in the affairs of the company or that he or she did not have access to adequate information concerning the company's trading position. It is one of the requirements of the fiduciary duties of directors that they should ensure that they take an active role and that they obtain adequate information from the company's officers and advisors.

5.3 Board members may also have statutory responsibilities (and also face potential personal liability) under other statutes such as Health and Safety legislation.

6 Consequences of breach of the duties – civil and criminal liability

6.1 Board members can be both civilly and criminally liable for breaching the various duties under the 2006 Act.

6.2 However, the actions of board members can in many instances be ratified by the company's members (subject to certain limitations) and board members may also be provided with indemnity for their actions by either the company or through indemnity insurance that the company may have in place.

6.3 In the case of those duties which are considered fiduciary duties, the consequences of breach may include:

- (a) Damages or compensation where the company has suffered loss;
- (b) Restoration of the company's property;

- (c) An account of profits made by the board member;
- (d) Recession of a contract where the board member failed to disclose an interest.

6.4 For these purposes, the duty to exercise reasonable care, skill and diligence under Section 174 is not considered to be a fiduciary duty.

6.5 There is a criminal offence under section 418 of the 2006 Act in relation to a company's directors' report. This must contain a statement to the effect that, in the case of each of the persons who are board members at the time the report is approved, so far as the board member is aware there is no relevant audit information of which the company's auditor is unaware and the board member has taken all the steps that he/she ought to have taken as a board member in order to make himself/herself aware of any relevant audit information and to establish that the company's auditor is aware of that information. Where a board member's report containing such a statement is approved but the statement is false, every board member who knew that the statement is false, or is reckless as to whether it was false, and fails to take reasonable steps to prevent the report from being approved, commits a criminal offence.

6.6 Section 463 of the 2006 Act also makes board members liable to compensate the company for any loss arising from a false or misleading statement in a board member's report, remuneration report or any omission from such a report of information required to be included in it.

6.7 A number of other provisions of the 2006 Act also provide for criminal liability for board members. In particular, failure to declare an interest in a proposed transaction or arrangement under section 182 is a criminal offence, as are failures to comply with filing and record keeping obligations.

7 **Claims against board members**

Where a board member has breached his duty to the company, any cause of action in respect of that breach vests in the company and it is the company that should make any claim in respect of that breach. In the case of the Company, such an action would be driven by the board or the Council as sole member.

8 **Practical decisions**

8.1 In practical terms, the duties of boards members require them to attend meetings and to become actively involved in the management of the company and its decision-making processes.

8.2 Board members may delegate the administrative duties of running the company to their staff and agents. However, board members cannot delegate their ultimate responsibility and consequently it is for them to set the policies which the officers implement and the parameters of any delegation must be clear.

8.3 In addition, it is for the board to monitor and review compliance with the policies it sets and the company's performance generally. Adequate reporting procedures from officers to the board are a vital component in protecting the board members and enabling them to fulfil their role.

8.4 The board should also authorise the appointment of external advisers: legal, financial, accounting, taxation, etc. Generally, board members will not be liable for any loss arising from a default of an agent of this nature provided that the agent was employed only to do acts in the scope of his or her normal business, the appointment was made on a reasonable basis and their activities were supervised with common prudence. In practice, the board should ensure through officers that any agent has relevant experience and qualifications.

8.5 The Company may also arrange or pay for insurance to be put in place to protect board members from personal liability in their roles as board members. This will protect board members against any actual or alleged 'wrongful act' that may be committed in the course of carrying out their duties (other than a dishonest, fraudulent or illegal act).

9 Conclusion

The role of board members is an extremely important one. While the above statements of the various duties imposed upon board members may sound onerous, it should be remembered that provided that a board member acts in good faith and with due skill and care he or she will not be likely to face criticism. In particular this means that the board member should seek advice from officers or from appropriate qualified advisers as appropriate.

Trowers & Hamlins LLP
28 April 2009

