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DIRECTORS' DUTIES

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THE FUNCTION OF DIRECTORS

- The articles of a company typically contain a provision that vests the management of the company in the board of directors.
- The board of directors manages the company, subject to the control of the shareholders laid down in the articles and legislation. In practice this means the directors manage the company, but are capable of being removed by the shareholders as a body. It is the board of directors that is the primary decision making body of the company.

HOW DIRECTORS MANAGE

- Delegation is the norm. The Board does not itself undertake the day to day management of the company.
- The company normally employs or otherwise obtains the services of managers who undertake the day to day management of the various aspects of the company's business.
- It is common for the board to contain persons who are employed to manage the company. "Executive" directors.

EXECUTIVE AND NON-EXECUTIVE DIRECTORS

- Directors not involved in the day to day management of the company are known as “non-executive”.
- The presence of non-executive directors on the board is considered to be necessary in most larger companies in the interest of good corporate governance.
- Companies operated as mutual funds in the Cayman Islands typically have non executive directors serving on the board, supervising an investment manager and various service providers.

DUTIES OF NON EXECUTIVE AND EXECUTIVE DIRECTORS

- The fundamental duties are the same, but the particular activities and conduct required to discharge of the duties differ because the function is different.
- Duties under Cayman law are those imposed by the common law. Certain aspects of those duties were recently examined in Weavering Fixed Income Macro Fund Ltd v Peterson and Ekstrom [2011] 2 CILR 203.

DUTIES AT COMMON LAW AND IN EQUITY

- Not going to look at duties imposed by laws, under the articles or the terms of a service contract, but by those imposed by common law and equity.
- Directors' common law duties are fiduciary and non fiduciary. Most of the duties we will be looking at are fiduciary. Aspects of the duty of care are non fiduciary.

THE LIST

- To act in the best interest of the company.
- Not to exceed powers.
- To exercise independent judgment.
- To exercise reasonable care, skill and diligence.
- To avoid conflicts of interest and of duty.
- Not to make a personal profit.

TO ACT IN THE BEST INTEREST OF THE COMPANY

- This is the paramount duty of a director.
- It is a fiduciary duty.
- It is worth reflecting on why it is there.
- A company director takes the company's decisions. The company is a legal fiction. The board of directors manages and disposes of a company's property and creates and modifies its legal relations with outsiders. Individual directors to whom authority has been granted on behalf of the company do the same thing.

THE DIRECTOR AS FIDUCIARY

- The fiduciary is a person to whom the principal has ceded autonomy.
- If the director's powers may be exercised for the director's benefit they become a part of the director's personal wealth.
- They do not form part of the director's personal assets but tools conferred on the director for the purpose of performing his function.
- They are there for the benefit of the company and that affects how they have to be exercised.
- The fact that the powers are not the director's personal property is the feature that defines how they have to be exercised. It defines the whole relationship.

LOYALTY

- Loyalty to the company is the director's fundamental, fiduciary obligation:
  - "the distinguishing obligation of a fiduciary is the obligation of loyalty"
  - Bristol & West Building Society v. Mothew [1998] Ch.1 at 18.
  - "the fundamental duty to which a director is subject"
  - Item Software (UK) Ltd v. Fassihi [2004] EWCA Civ 1244
- The duty of loyalty is an inherent consequence of the director's (fiduciary) position.

BEST INTEREST OF THE COMPANY

- Loyalty requires the director to ask himself what is in the best interest of the company.
- He breaches his duty only if he fails to ask this question. He does not breach his duty if he asks himself the question and the judge thinks he got the wrong answer.
- That is because his duty to be loyal not to be right.
- The logic of acting for another person leads to the conclusion that there is only one right way to do it.

PERCEIVED OR BELIEVED BEST INTEREST

- Loyalty requires consideration of the best interest.
- The duty is to identify bona fide what is perceived to be the best interest and then act accordingly.
  - "*I prefer to base my conclusion in this case on the fundamental duty to which a director is subject, that is the duty to act in what he in good faith considers to be the best interests of his company. This duty of loyalty is the time-honoured rule*."

    Goulding J. in Mutual Life of New York v. Rank Organisation Ltd [1985] BCLC 11.
- The two steps, consideration and action.
- It is a breach of fiduciary duty to fail to consider what is in the best interest of the company.

DUTY NOT TO EXCEED POWERS

- Not to enter into transactions that are prohibited (whether by the Companies or any other law). E.G. not to pay a distribution or dividend from share premium account unless company able to pay its debts immediately after the payment is made.
- Not to enter into transactions not connected with the purposes for which the company was incorporated – typically judged by reference to the company's objects clause.
- Not to enter into transactions that are outside the scope of the authority delegated to the director by the company. A director has no authority to act on behalf of the company other than what is specifically conferred upon him/her. Transactions beyond authority are not simply potentially void, they are a breach of fiduciary duty.

DUTY TO EXERCISE INDEPENDENT JUDGMENT

- This can be seen as an aspect of the duty to act in what the director perceives to be the best interest of the company.
- The director is obliged to follow his/her own judgment not somebody else's.
- The director is obliged to consider the interest of the company, not somebody else's.
- The director is obliged not to fetter his/her discretion in regard to future decisions.

PARTICULAR ASPECTS

- Nominee directors. A director who is nominated by somebody else is entitled to take into account the view of the person who nominated, but must ultimately exercise their own judgment.
- Acting on professional advice. A director is entitled to take and act on professional advice, but in doing so must still exercise his/her own judgment. The distinction is between blindly following somebody else's suggestion and using the benefit of professional advice to form an independent view.

REASONABLE SKILL, CARE AND DILIGENCE

- Duties of care are usually objective. The standard to be met does not usually depend on the attributes of the particular person who owes the duty they usually depend on what he has held himself out as.
- The director's duty is twofold: it is objective and subjective. See the judgment at first instance in Weavering in which the CICA concurred on this point.

OBJECTIVE DUTY

- The objective requirement is that the director must exercise the skill, care and diligence that may reasonably be expected of a person carrying out the same functions as that director in relation to the company.
- The objective requirement takes no account of any special skill that the director may have, as a valuer, accountant, lawyer, because it is based on the function performed not the skill set of the director.

SUBJECTIVE DUTY

- The subjective duty does bring in the particular skills that the director actually possesses. A director is obliged, in addition to being required to meet the objective test, to perform his/her duties skillfully, carefully and diligently using the knowledge skill, care and experience that he/she actually possesses.
- The practical consequence of this for professionals who sit on boards is that they may be held to a higher standard than lay directors.

ASPECTS OF THE DUTY OF SKILL AND CARE

- Directors have, individually and collectively, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors.
- The content of this duty may differ markedly according to whether a person is an executive director (and therefore engaged in and responsible for day to day management) or a non executive (whose involvement may be limited to three or four meetings of the board each year).

DELEGATION

- The directors are normally entitled to delegate aspects of the management of the company to others. Larger companies would be unmanageable if the board could not delegate.
- The ability to delegate does not mean that the director can pass off his responsibilities. Where there is delegation the delegation must be appropriate, the person to whom functions are delegated must be suitably qualified to perform them adequately and the directors have a continuing duty to monitor and supervise the performance of the delegated functions.

SUPERVISION OF DELEGATED FUNCTIONS

- The requirement to supervise (and the duty to stay informed) entails that the directors satisfy themselves that they are provided with a sufficient degree of information about the performance of delegated functions and that they give sufficient attention to that information to satisfy themselves that delegated functions are being performed adequately.

TO AVOID CONFLICTS OF INTEREST AND DUTY

- Conflicts of interest occur when the director has a personal interest in a transaction affecting the company.
- The director's duty in this situation is to abstain from acting on the company's behalf, potentially to vacate office (see e.g. Table A, Article 71).
- This principle is significantly diluted in the corporate context by provisions commonly found in articles allowing a director to continue acting where the interest has been declared or the situation has been authorised by the company.
- Conflicts of duty occur when the director's duty to the company is in conflict with the director's duty to another person. English common law has been ambivalent about the position of those who are directors of rival companies.

NOT TO MAKE A PROFIT

- Sometimes said (wrongly) to be an aspect of the no conflict rule.
- Information or opportunities presented to a director in the course of his directorship belong to the company and cannot be exploited by the director for his own benefit. Any profit from doing so is held by the director on trust for the company, reflecting the ownership of the original information or opportunity.
- The no profit rule has a distinct and separate rationale from the no conflict rule. One is based on property the other on the need to secure judgment unaffected by self interest.

DIRECTOR WHO RESIGNS

- A director may not by resigning free himself from the no profit rule.
- A director who resigns and profits from information or opportunities arising before he resigned is caught by the no profit rule because the information or opportunity is treated in equity as the company's as are the fruits of its exploitation.

TO WHOM THE DUTIES ARE OWED

- The company and not the shareholders.
- But the interests of the company are normally those of the shareholders (when the company is clearly solvent).
- In cases of insolvency or doubtful solvency, the interests of the company become the interests of the creditors.