Directors’ Duties under the Companies Act 2014

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Abstract

Part 5 of the Companies Act 2014 (the “2014 Act”) codifies and sets out the law relating to directors’ duties. Whilst heralded as one of the major innovations of the 2014 Act,¹ one must ask is this just a case of the Emperor’s new clothes?

In short, the answer is no. It is undeniable that the changes to the law on directors’ duties have simplified the law in this area and made it more accessible to those to whom it applies.²

This article addresses the changes introduced by the 2014 Act to this area through an analysis of the newly codified fiduciary duties. It also provides an overview of other general duties imposed on directors by the 2014 Act, a review of the role of the compliance statement, and the consequences of a breach of duty. Finally, it concludes by illustrating that directors will face difficulty under the 2014 Act should they plead ignorance of their duties.

Introduction

Directors have extensive powers in relation to a company’s business undertakings and assets. The potential for abuse of those powers is well documented in scholarship and in case law. In order to counterbalance this, the duties and responsibilities owed by directors to their companies were developed by the courts and the legislature. However, the complexity of these common law rules, equitable principles and statutory obligations often led to directors being unaware of the duties and obligations imposed on them by virtue of their position. In this regard, the 2014 Act introduces many welcome improvements tailored to suit the needs of directors of Irish companies. The 2014 Act achieves this through the codification of the eight principal fiduciary duties of directors for the first time in the history of Irish company law. The 2014 Act has also extended the category of persons to whom the duties apply. Thus, it is important to remember that duties owed by directors to their companies (as set out in Pt

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5), are applicable not only to de jure directors, but also shadow directors and de facto directors.5

Fiduciary Duties

It is well established that a director, by virtue of his or her position, is in a fiduciary relationship with the company.4 However, the scope of such fiduciary duties was difficult to determine, as they were scattered across equitable principles, the common law and statute. The 2014 Act now codifies these duties, and expressly states that these duties shall have effect in place of those rules and principles.5 Interestingly, the 2014 Act further provides that regard should be had to the corresponding common law rules and equitable principles when interpreting these duties.6 Thus, the case law on these duties remains relevant. The English courts have also experienced the uncertain consequences of codification. In *Coppage v Net Security Ltd*,7 the English Court of Appeal stated: “What is not clear, however, is how the new statutory provisions and existing common law principles are intended to bed down together.”

Section 228(1) of the 2014 Act sets out the eight fiduciary duties of directors as follows:

1) To act in good faith in what the director considers to be in the interests of the company.
2) To act honestly and responsibly in relation to the conduct of the affairs of the company.
3) To act in accordance with the company’s constitution and exercise his or her powers only for the purposes allowed by law.
4) Not to use the company’s property, information or opportunities for his or her own or anyone else’s benefit unless:
   (i) this is expressly permitted by the company’s constitution; or
   (ii) the use has been approved by a resolution of the company in general meeting.

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3 Companies Act 2014 Pt 5, Ch.1, s.222.
4 Per Farwell J. in *Re City Equitable Fire Insurance Co Ltd* [1925] Ch. 407.
5 Companies Act 2014 s.227(4).
6 Companies Act 2014 s.227(5).
7 [2013] EWCA Civ 1176.
(The codification of this duty reflects the strict approach taken by the English Court of Appeal in *O’Donnell v Shanahan*.)

5) Not to agree to restrict the director’s power to exercise an independent judgment unless:

(i) this is expressly permitted by the company’s constitution;

(ii) the case concerned is one where the director considers in good faith that it is in the interests of the company for a transaction or engagement to be entered into and carried into effect; or

(iii) the director’s agreeing to such has been approved by a resolution of the company in general meeting.

6) To avoid any conflict between the director’s duties to the company and the director’s other interests unless the director is released from this duty to the company in relation to the matter concerned, whether in accordance with provisions of the company’s constitution in that behalf or by a resolution of it in general meeting;

7) To exercise the care, skill and diligence which would have been exercised in the same circumstances by a reasonable person having both:

(i) the knowledge and experience that may reasonably be expected of a person in the same position as the director; and

(ii) the knowledge and experience which the director has.

8) In addition to the duty to have regard to the interests of the company’s employees in general, have regard to the interests of the company’s members.

Whilst many of these newly codified duties are merely a restatement of the common law rules, with which we are familiar, some are worthy of brief analysis. First, the duty to act honestly and responsibly is a newly codified duty introduced by the 2014 Act; however, the concept of this duty is not a novel one. This duty, or fact, of having acted honestly and responsibly was previously a defence to an application for restriction of a director under the Companies Act 1990, and continues to be part of the defence under s.819 of the 2014 Act.

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9 Companies Act 2014 s.228(1)(b).
10 Companies Act 1990 s.150(2).
Although the law has long recognised that directors owe an overriding duty to the company, Ahern argues that company law in Ireland is evolving and now also serves a public interest function. This can be seen in the duty to act honestly and responsibly, adopted from the law on restriction. The protection of the public is the primary rationale behind restriction of certain directors of certain insolvent companies. Thus, the inclusion of a positive duty to "act honestly and responsibly" suggests that the legislature recognises the wider duties of directors beyond those owed just to the company. However, the rationale for the introduction of this duty in the affirmative was provided by the Company Law Review Group, who asserted that the words “honestly” and “responsibly” have received considerable judicial consideration as to their meaning in the context of directors’ duties. Guidance as to what constitutes acting honestly and responsibly in the context of directors’ duties can be found in the seminal case of La Moselle Clothing Ltd.

Secondly, the duty to act in accordance with the company’s constitution and to exercise powers only for the purposes allowed by law has long been recognised by the common law. However, it is particularly relevant in the case of Designated Activity Companies (DACs) which continue to have objects. Whilst the validity of an act done by a DAC shall not be called into question on the ground of lack of capacity, the 2014 Act asserts that “it remains the duty of the directors to observe any limitations on their powers flowing from the DAC’s objects”. Thus, directors of DACs should pay particular heed to this provision.

Finally, the 2014 Act acknowledges the traditional common law rule that a director must exercise care, skill and diligence. However, whilst this duty has been placed on a statutory footing, the standard has also changed and increased from the traditional common law position. Section 228(1)(g) provides that directors must exercise the care, skill and diligence which would have been exercised in the same circumstances by a reasonable person having both (i) the knowledge and experience that may reasonably be expected of a person in the same position as the director, and (ii) the knowledge and experience which the director has.

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1. *Percival v Wright* [1902] 2 Ch. 421; *Companies Act 2014*, s.227(1).
7. For example, see *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] UKPC 3.
8. *Companies Act 2014* s.973(3).
9. *Companies Act 2014* s.228(1)(g).
Thus, on the basis of this, a dual objective and subjective standard must be satisfied—a test first formulated in *D’Jan of London Ltd.* Time will tell how this test will develop in practice, but it is anticipated that the provision will raise the standard expected of directors.

Clarke sees evidence of the courts having been influenced by the higher standards set for businesses in the form of self-regulatory corporate governance codes, such as the Cadbury Code and the Combined Code.21

In *Brumder v Motornet Service and Repair Ltd.* Beatson L.J. in the English Court of Appeal explained that the objective standard sets a floor (or minimum), while the subjective test provides a ceiling where the particular director has more knowledge, skill and experience than might be expected. Interestingly, in *Re Kilashee Schools Co Ltd.*, Charleton J. described this duty as “stringent in the context of more recent amendments to the code of company law”, and opined that earlier cases which suggested a relaxed or half-hearted nature of directors’ duties had fallen “into considerable doubt”.

**Other Duties**

The 2014 Act also provides for a number of specific statutory duties focusing primarily on directors’ dealings with the company in a personal capacity. These duties supplement the fiduciary duties previously discussed. General duties include compliance with the provisions of the 2014 Act and the various tax Acts, ensuring that the company secretary is suitably qualified, and acknowledgement of their duties by signing a declaration to that effect.

The 2014 Act has also introduced significant changes to the law relating to loans between directors and the company. The most notable change in this area relates to the new evidential provisions. Courtney, in explaining the rationale for these provisions, details that historically undocumented loans between directors and their companies were particularly problematic in instances where the company is being wound up and directors claim to be creditors.22

loan is made by a director to a company and the agreement is not in writing, it will be assumed that it is not a repayable advancement.\textsuperscript{28} However, where a loan is made by a company to a director, the loan will be treated as repayable on demand and as bearing interest.\textsuperscript{29} Thus, whilst the 2014 Act does not require these agreements to be in writing, it is advisable in practice that they are.

The 2014 Act has also introduced a statutory obligation on directors to include a statement in their directors’ report confirming that, so far as the director is aware, there is no relevant audit information of which the company’s auditors are unaware. The statement must also confirm that he or she has taken all the steps necessary to make him or herself aware of any relevant audit information, and to establish that the company’s auditors are aware of that information.\textsuperscript{30}

**Compliance Statement**

Directors of relevant companies should also be aware of their obligations under the 2014 Act in relation to the compliance statement. The compliance statement, although newly implemented by the 2014 Act, is not a novel concept.\textsuperscript{31} The compliance statement is set out in section 225 of the 2014 Act and must be included in the director’s report, but that requirement is only applicable to certain companies. Those companies include all PLCs,\textsuperscript{32} LTDs,\textsuperscript{33} DACs,\textsuperscript{34} and CLGs,\textsuperscript{35} where their balance sheet for the financial year exceeds €12.5 million, and the amount of their turnover for the year exceeds €25 million.

The compliance statement is essentially a document drawn up by the directors, which states the company’s policies as regards compliance with its relevant obligations. It also acknowledges the responsibility of company directors to ensure the compliance of the company with the provisions of the 2014 Act.\textsuperscript{36} Directors of companies to which section 225

\textsuperscript{28} Companies Act 2014 s.236.
\textsuperscript{29} Companies Act 2014 s.237.
\textsuperscript{30} Companies Act 2014 s.330(1)

\textsuperscript{31} The proposal to include a compliance statement in the director’s report was first put forward by the Review Group on Auditing. Following this, the compliance statement was introduced by the Companies (Auditing and Accounting) Act 2003, through the insertion of ss.205E and 205F into the Companies Act 1990. However, those sections were never commenced.

\textsuperscript{32} Companies Act 2014 s.1002(4). Companies Act 2014 s.1387(4) exempts investment companies from the compliance statement.
\textsuperscript{33} Companies Act 2014 s.225(7).
\textsuperscript{34} Companies Act 2014 s.964(1).
\textsuperscript{35} Companies Act 2014 s.1173(1).
\textsuperscript{36} Companies Act 2014 s.225(2)(a).
applies will have to confirm that a compliance policy statement has been drawn up,\textsuperscript{37} that appropriate arrangements are in place to ensure compliance,\textsuperscript{38} and that a review has been conducted during the financial year, or explain why not.\textsuperscript{39}

Effectively, the aim of the compliance statement is to raise the level of compliance on the part of directors. However, it will be interesting to see how the statement will work in practice and whether companies will seek to avail of the “opt out and explain” alternative.

**Consequences of Breach of Duty**

Section 227(3) provides that breaches of directors’ duties are enforceable “in the same way as any other fiduciary duty owed to a company by its directors”, namely a company may sue for damages. Furthermore, breach of certain fiduciary duties can result in a director being made liable to the company for any gain made by him or her and liable to indemnify the company for any loss incurred by it as a result of the breach.\textsuperscript{40}

An important aspect of the 2014 Act is the increase in penalties for non-compliance with company law by directors. Section 871 of the 2014 Act introduces the categorisation of offences, which in some instances apply for breach of duty. The offences are set out in a clear and concise manner, and the sanctions are detailed below:

- **Category 1:** conviction on indictment can result in imprisonment for a term of up to 10 years and/or a fine of €500,000.
- **Category 2:** conviction on indictment can result in imprisonment for a term of up to five years and/or a fine of €50,000.
- **Category 3:** conviction of a summary offence can result in imprisonment for a term of up to six months and/or a class A fine.\textsuperscript{41}
- **Category 4:** conviction of a summary offence can result in a class A fine only.

Similar to the codification of duties, the classification of offences clearly sets out the consequences of breaching provisions in the 2014 Act. Thus, a deviant director will have trouble pleading ignorance of his or her duties, or of the consequences of breaching same.\textsuperscript{42}

\textsuperscript{37} Companies Act 2014 s.225(2)(b); Companies Act 2014 s.225(3)(a).
\textsuperscript{38} Companies Act 2014 s.225(2)(b); Companies Act 2014 s.225(3)(b).
\textsuperscript{39} Companies Act 2014 s.225(2)(b); Companies Act 2014 s.225(3)(c).
\textsuperscript{40} Companies Act 2014 s.232.
\textsuperscript{41} Defined by s.3 of the Fines Act 2010 as being a fine not exceeding €5,000.
Conclusion

Over the past number of decades there have been several attempts to encourage corporate compliance in Ireland. Following the McDowell Report, which observed that directors had “little reason to fear detection or prosecution”, the Office of the Director of Corporate Enforcement (ODCE) was established. Since the establishment of the ODCE, several commentators have observed increasing compliance with this area of the law. Notwithstanding the increase in corporate compliance, it should be noted that prior to the 2014 Act, the fiduciary duties of directors were beyond the remit of the ODCE, as these duties were derived from common law rules. This position has now changed, and the ODCE has the power to investigate alleged breaches of fiduciary duties, and may bring public proceedings.

Thus, the introduction of codified duties by the 2014 Act is a welcome addition to the Irish company law landscape, which should have practical consequences. The easily accessible nature of the duties should create a greater awareness of the duties owed by directors, and in turn increase corporate compliance.

As is often the case with legal rules, the codification of the duties may be viewed by many Irish directors as a double-edged sword. Their introduction, and further obligations such as the compliance statement, make it “easier for directors to understand their responsibilities and more difficult to deny their existence”. It will be interesting to see how the courts interpret and apply these principles, and whether the provisions will bring an intensified focus on troublesome directors.

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47 Companies Act 2014 s.949(1)(c).
48 Companies Act 2014 s.949(1)(c).
49 Deputy Richard Bruton, Minister for Jobs, Enterprise and Innovation, Dáil Éireann Debate, vol.800, no.3 (23 April 2013).