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COMMERCIAL DISPUTES **KNOW-HOW GUIDES**

ACTIONS FOR BREACH OF DIRECTORS' DUTIES

Directors are responsible for the management of a company's business and so are subject to certain duties to safeguard the interests of the company. The key duties of a director are as set out in the Companies Act 2006 ("CA 2006"), together with other uncodified duties (such as not to misapply company funds) and a fiduciary duty. Director obligations also arise from other legislation such as health and safety, and environmental.

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ACTIONS BY THE COMPANY FOR BREACH OF DUTY

A director owes their duties to the company (except in circumstances of the company's insolvency, where the duties are owed to creditors). The company can act against a director for breach of duty if the company has suffered loss. Remedies can include:

- **Damages:** where the company has suffered loss because of a director's negligent conduct.
- **An injunction:** to stop the director carrying out the breach or continuing the breach.
- **Restitution of profit:** if the director has made a personal profit from their misconduct, they can be ordered to pay that gain to the company.
- **Rescission of a contract:** a contract entered into by the director in breach of duty can be reversed (although the company has the option to ratify the agreement instead).
- **Restoration of company property:** the director can be required to return property which rightfully belongs to the company.

In certain circumstances the company, by resolution of the shareholders, can agree to ratify the director's conduct where it amounts to negligence, default, breach of duty or breach of trust in relation to the company (section 239 CA 2006). It cannot be ratified, however, where the breach of duty results in a decision that threatens the solvency of the company or causes loss to its creditors.

ACTIONS BY THE SHAREHOLDERS FOR BREACH OF DUTY

Shareholders do not have a right to claim for their loss even though the impact of a breach of duty committed by a director against a company can be a reduction in the company's value.

It is long established that the proper claimant in wrongs committed against a company, whether by directors or by third parties, is the company itself (*Foss v Harbottle* (1843) 2 Hare 461; *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204). Consequently, the decision whether to sue will generally lie with the board of directors.

DERIVATIVE CLAIMS

Directors may decline to authorise the company to make a claim against a fellow director and the law has developed to provide a process whereby, with the permission of the court, shareholders of a company can pursue a claim on behalf of the company to recover the company's loss.

These derivative claims by shareholders, which are generally founded on breaches of a directors' duties, may only be brought for causes of action arising from an actual or proposed act or omission involving any negligence, default, breach of duty or breach of trust by the director (Section 260(3) CA 2006

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Part 11 of the CA 2006 sets out the regime for derivative claims (which has largely replaced the common law jurisdiction for such actions) and the test which will be applied to determine whether the court will give its permission for the claim to continue.

The court will first determine if there is a prima facie case, and if this is established consider the factors in section 263 of the CA 2006 including any evidence that has been provided to the court about the views of shareholders who do not have a personal interest in the matter. The court must refuse permission to continue the derivative action if it concludes:

1. A person acting in accordance with their duty to promote the success of the company would not pursue the claim; or
2. The act or omission giving rise to the claim has been authorised or ratified by the company.

ACTIONS BY A LIQUIDATOR OR ADMINISTRATOR FOR BREACH OF DUTY

Where a company is faced with insolvency the directors' have to act in the interests of the company's creditors. A liquidator or administrator is under a duty to consider a claim against a director where a breach of duty occurs. Specific offences that can be considered include:

- **Wrongful trading:** where the director(s) knew or ought to have known that there was no reasonable prospect of the company avoiding insolvency and continued to allow the company to trade, failing to minimise the potential cost to creditors.
- **Fraudulent trading:** this can constitute a criminal offence and occurs where any business of the company has been carried on with the intent to defraud creditors of the company. For example, continuing to accept orders from customers knowing that the orders will never be supplied.

This is part of a series of practical know-how guides for those involved in commercial disputes whether the dispute has led to litigation or not. They provide basic information on a wide-range of disputes topics but are not a substitute for specific legal advice. For further guidance on the topic please contact Nichola Leach at nichola.leach@collyerbristow.com or on +44 (0) 7793 168795 or contact any member of the commercial disputes team.



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