



DIRECTORS' DUTIES

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1. Introductory Reminder: the Statutory Codification

1.1 The code in sections 171 to 177 of the Companies Act 2006.

1.2 The legislative technique underpinning the code

1.2.1 Sections 170 (3) and (4) provide as follows.

“(3) The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.

(4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.”

1.3 Relevance of the old and new case-law

1.3.1 This means that in principle, the pre-codification case-law is still relevant. But note the words “in principle”, because although in some cases the codification

precisely replicates the pre-existing law, in other cases it does not. This means that there will be occasions when the pre-codification law is not in point.

- 1.3.2 Because the underlying common law rules and equitable principles apply not only to directors but, more generally, to trustees and fiduciaries, we cannot exclude the possibility that, in future, developing case-law in “non-director” cases will leach over into the interpretation of the directors’ duties as codified.

2. The Duties in Brief

- 2.1 Duty to act within powers (s. 171)
- 2.2 Duty to promote the success of the company (s. 172)
- 2.3 Duty to exercise independent judgment (s. 173)
- 2.4 Duty to exercise reasonable skill, care and diligence (s. 174)
- 2.5 Duty to avoid conflicts of interest (s. 175)
- 2.6 Duty not to accept benefits from third parties (s. 176)
- 2.7 Duty to declare interest in proposed transaction or arrangement (s. 177)

3. The Duties in Further Detail

3.1 Duty to act within powers

Section 171 provides:

“A director of a company must–

- (a) act in accordance with the company's constitution, and
- (b) only exercise powers for the purposes for which they are conferred.”

- 3.1.1 Section 171(b) enshrines the so-called “proper purpose rule”, which has recently been examined in detail by the Supreme Court in the *Eclairs* case (*Eclairs Group Ltd v JKX Oil & Gas Plc* [2015] UKSC 71).

1. JKX Oil and Gas plc is, as its name suggests, an oil and gas company. Its shares are listed on the London Stock Exchange. At the time with which we are concerned, two of its shareholders were Eclairs (with just over 27 per cent of the issued share capital) and Glengary (with just over 11 per cent.). In 2013, the directors of JKX formed the view that the ultimate proprietors of Eclairs and Glengary, a Mr Kolomoisky and a Mr Zhukov (who had a reputation for being corporate raiders) were trying to acquire joint control of the company without making a formal bid.

2. In March 2013 Eclairs called upon JKX to call a general meeting to consider a motion to remove two of its directors (the CEO and the Commercial Director) and appoint new directors. In March and May 2013 JKX issued disclosure letters under section 793 of the Companies Act 2006 to Eclairs and Glengarry, whom they considered to be associated with the corporate raiders, requesting information about (1) the number of shares held, (2) the beneficial owners of those shares and (3) whether there existed any agreements or arrangements among those persons. The shareholders replied promptly, providing the information requested about share ownership and denying that there were any agreements or arrangements in place.
3. Meanwhile, in April 2013 the board of JKX has issued a notice of annual general meeting to be held in June for the purpose of *inter alia* reappointing the CEO, approving the directors' remuneration report and allowing the company to allot shares for cash (disapplying pre-emption rights) and to make a market purchase of some of its issued shares. About two weeks before the date of the AGM, Eclairs published an advertisement in the FT and issued an open letter to JKX's shareholders inviting them to oppose those resolutions. The practical position at this stage was summarised by Lord Sumption as follows: "Since the resolutions to authorise market purchases and to disapply pre-emption rights required a special resolution, this meant that as matters stood they were certain to fail. The other resolutions required only an ordinary resolution but would be difficult to get through in the face of opposition from two blocks together controlling 39% of the company."
4. About a week before the date of the AGM the board held a meeting at which it considered the responses to the disclosure letters. They thought that the disclosure letters were inadequate because, in their view, there were indeed agreements and arrangements among the beneficial owners of the shares in question. At this stage, the Company could have applied to the court under section 794 of the 2006 Act for an order applying restrictions to those shares. However, one of the company's articles (Article 42) gave the directors themselves the power to apply restrictions - by issuing "restriction notices" - "in circumstances where the board knows or has reasonable cause to believe that the information provided is false or materially incorrect." So at the board meeting the board resolved to issue restriction notices in respect of the shares in question. Basically, the effect of the notices was to suspend the voting rights attached to the shares and to restrict transfers of the shares. This meant, of course, that Eclairs and Glengarry would not be able to prevent the passing of the resolutions being proposed at the AGM.

5. Eclairs and Glengarry then commenced proceedings in the Chancery Division to have the restriction notices struck down. They were successful on one single ground, namely, that in resolving to issue the restriction notices the board had acted in breach of its “proper purpose” duty under section 171(b) because they had exercised their power to issue the notices for an “improper or collateral” purpose. The argument in a nutshell was that the only proper purpose for which the power could be exercised was to obtain the information requested in the notices, whereas the real purpose of the board had been to ensure that the resolutions at the forthcoming AGM would be passed. What happened next was that the Court of Appeal (by a majority of two to one) reversed the decision of the Chancery Division. Eclairs and Glengarry then appeared to the Supreme Court, which reversed the Court of Appeal and, subject to a bit of fine tuning, re-instated the decision of the Chancery judge.
6. What makes the case interesting and important is not so much the practical conclusion to which the Supreme Court came as the reasoning which led it to that conclusion. The reasoning is important because when lawyers are advising their clients on the applicability or otherwise of the *Eclairs* judgment to a particular set of facts, that advice requires an analysis of the court’s reasoning. Unfortunately for us, different justices adopted different reasons, so a proper analysis of the case can be a bit messy. The starting point is to consider the detailed and predictably lucid opinion of Lord Sumption, with whom Lord Hodge agreed.
7. By way of background, Lord Sumption rehearsed the general law on the “proper purpose” rule in its general equitable context. The points which he made included the following.
 - (1) The rule is not concerned with acting beyond the scope of a power; it is concerned with doing acts which are within its scope but are done for an improper purpose.
 - (2) So the test of impropriety is necessarily subjective (“The state of mind of those who acted, and the motive on which they acted, are all important¹”).
 - (3) The exercise of a director’s fiduciary power is limited to the purpose for which the power was concerned.
 - (4) “One of the commonest applications of the principle in company law is to prevent the use of the directors’ powers for the purpose of influencing the outcome of a general meeting. This ... offends the constitutional distribution of powers between the different

¹ *Hindle v John Cotton Ltd* (1919) 56 Sc LR 625.

organs of the company, because it involves the use of the board's power to control or influence a decision which the company's constitution assigns to the general body of shareholders."

8. Lord Sumption was much exercised by hypothetical circumstances where the power is exercised for multiple purposes, all of which influenced the board's decision and some of which are proper and others of which are not. His approach was this.

- (1) In the company law context the test is not the public law test of whether the directors took account of irrelevant considerations. It is whether the primary or dominant purpose for which the decision was made was improper.
- (2) There are two possible ways of identifying the primary or dominant purpose. One approach is to identify the purpose about which the directors felt most strongly: but this is not the right approach. The other approach, the right one, is to identify the "weightiest" purpose, meaning the one which caused the decision to be made as it was.
- (3) "The fundamental point, however, is one of principle. The statutory duty of the directors is to exercise their powers "only" for the purposes for which they are conferred. That duty is broken if they allow themselves to be influenced by *any* improper purpose ... One has to focus on the improper purpose and ask whether the decision would have been made if the directors had not been moved by it. If the answer is that without the improper purpose(s) the decision impugned would never have been made, then it would be irrational to allow it to stand simply because the directors had other, proper considerations in mind as well, to which perhaps they attached greater importance. "
- (4) "Correspondingly, if there were proper reasons for exercising the power and it would still have been exercised for those reasons even in the absence of improper ones, it is difficult to see why justice should require the decision to be set aside."

This approach to the question came to be referred to in the judgments as the "but for" test.

9. In applying all of this to the appeal in question, the relevant facts had been found at first instance and were not challenged.
 - (1) All the directors knew that the purpose of the restriction notices was to get information.

- (2) They all appreciated that the effect of restrictions would be (unless the information was provided before the AGM) that Eclairs/Glengary would be prevented from voting, with the effect that all the resolutions would be likely to be passed, or that there was a very enhanced prospect of that happening.
 - (3) They all saw that as operating for the benefit of the company as a whole, and as hindering the cause of the 'raiders'.
 - (4) The majority of the voting directors saw that as a sort of stand-alone proper and useful objective, and achieving it was a substantial purpose of voting for the restrictions, separate from the need to have information. Those directors did not have in mind the protection of the company pending the provision of the information; they had in mind protecting the company full stop. The restrictions were thus a useful weapon to be used against the 'raiders'. The disfranchisement of the 'raiders' at the AGM was not just an incidental effect of the imposition of restrictions; it was the positively desired effect, seen as beneficial to the company in the long term.
 - (5) The *bona fides* of those directors, and the genuineness of their desire to benefit the company as a whole, were not and could not be challenged.
 - (6) It followed that the primary purpose of the board in issuing the restriction notices was to influence or determine the fate of the resolutions before the AGM.
10. Determining the proper purpose of a power conferred on the directors by an instrument such as the articles had nothing to do with seeking to find an impied term, which as a matter of law would need to be "necessary for the purposes of business efficacy". Rather, "ascertaining the purpose of a power where the instrument is silent depends on an inference from the mischief of the provision conferring it, which is itself deduced from its express terms, from an analysis of their effect, and from the court's understanding of the business context."
11. The proper purpose of Article 42 was in fact three closely related purposes.
- (1) The first is to induce the shareholder to comply with a disclosure notice.
 - (2) Secondly, the article is intended to protect the company and its shareholders against having to make decisions about their respective interests in ignorance of relevant information.

- (3) Thirdly, the restrictions have a punitive purpose. They are imposed as sanctions on account of the failure or refusal of the addressee of a disclosure notice to provide the information for as long as it persists, on the footing that a person interested in shares who has not complied with obligations attaching to that status should not be entitled to the benefits attaching to the shares.
12. By contrast, it was not the case that failure to comply with a disclosure notice was a mere “gateway” or condition precedent to the directors’ right to impose and maintain the restrictions for any purpose which they *bona fide* conceived to be in the interests of the company.
13. In concluding, Lord Sumption flagged up a further question as to what the position would have been if it had been shown that the outcome of the board’s decision would have been just the same even if there had been no improper purpose. Having identified the question, he declined to answer it because it was not before the court².
14. What about the other three justices? Lord Mance (with whom Lord Neuberger agreed) had four reservations, of which I mention the following three
- (1) First, he identified a tension between (i) the “old law”, according to which, where the directors exercised a power with two purposes, of which one was proper and the other was improper, the dominant intention had to be established and (ii) the fact that section 171(b) provided that directors must exercise their powers “only” for the purpose for which they were intended. He concluded that further submissions would be required – presumably in a subsequent case – before this tension could be resolved.
- (2) Secondly, he considered that, although the “but for” test (“but for the directors having this particular purpose, in addition to their other purposes, they would not have acted as they did”) offered the advantage of simplicity, there had not been full argument on that test, so it was not appropriate to accept it at this stage.
- (3) Finally, if the correct test was indeed the “but for” test, there was a question as to the standard to which the directors would have to show that they would have reached the same decision even if they had not had the illegitimate purpose in mind. Would probability be enough, or would the test be whether their decision would inevitably have been the same?

² Or so he said – but see paragraph 8(4) above.

15. That leaves Lord Clarke (with whom Lord Neuburger also agreed). Essentially, Lord Clarke agreed that the appeal should be allowed for the reasons stated by Lord Sumption, but agreed that no decision should be reached on the points raised by Lord Mance until they arose for a decision and full argument had been heard.
16. So where does this leave us? The position seems to be this. Given that on the facts of the case a majority of those directors who voted on the resolution to issue the restriction notices did so for the improper purpose of seeking to influence the outcome of the AGM, the power to issue the notices had been exercised for an improper purpose and the notices fell to be struck down. What the position would be in a case where it was found on the facts that the directors were motivated both by a proper purpose and by an improper purpose was a question to be decided where those facts emerged and the point had been fully argued. In such a future case, the tension between the “but for” test on the one hand and the presence of the word “only” in section 171(b) would have to be considered.

3.2 **Duty to promote the success of the company**

3.2.1 Section 172 provides:

- “(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to–
- (a) the likely consequences of any decision in the long term,
 - (b) the interests of the company's employees,
 - (c) the need to foster the company's business relationships with suppliers, customers and others,
 - (d) the impact of the company's operations on the community and the environment,
 - (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
 - (f) the need to act fairly as between members of the company.
- (2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.”

- 3.2.2 What is striking about this section is not merely the list - a non-exhaustive list - of matters to which directors are to have regard but also, and perhaps above all, the subjective nature of the duty. It is not a duty to do that which is objectively likely to promote the interests of the company as a whole. Rather, it is a duty to do what the director subjectively - and, of course, in good faith - thinks is likely to promote those interests.
- 3.2.3 The subjective nature of the duty obviously raises an acute question. If a director does something which, objectively speaking, is manifestly damaging to the interests of the company as a whole, is it a get-out-of jail card for him to say that he genuinely thought otherwise? Essentially, this is a question of evidence: the more grossly commercially unsound a director's alleged opinion was, the less likely is it that a court will believe that he genuinely held that opinion.
- 3.2.4 *Regentcrest plc v Cohen* [2001] 2 BCLC 80 is a case under the uncodified law but it is still good law and it summarises the position rather well. Regentcrest was a listed property development company. In 1988 it purchased a company called Greenground, because Greenground owned a desirable development site. The share sale agreement contemplated deemed practical completion of Greenground's development occurring by 1990 and provided that if by that date the value of the land had risen, then Regentcrest would pay additional consideration for the Greenground shares, whereas if the value had gone down Regentcrest would be entitled to claw back part of the share purchase price. In fact the value went down and Regentcrest became entitled to claw back £1.5 million. However, the directors of Regentcrest agreed with the vendors to waive the clawback payment in consideration of the vendors providing free services to Regentcrest for the next three years. When Regentcrest subsequently went into liquidation its liquidators sued the directors for breach of their duty to act in the best interests of the company, the alleged breach being their agreement to waive the clawback clause. The judge, Jonathan Parker J, dismissed the case, holding that the directors had acted in what they genuinely believed to be the best interests of the company. The facts brought out in the litigation are quite complex but the importance of the case resides, not in its facts, but in the manner in which the judge set out the applicable law. He said this³.

"The duty imposed on directors to act bona fide in the interests of the company is a subjective one ... The question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director's state of

³ At paragraph 120.

mind. No doubt, where it is clear that the act or omission under challenge resulted in substantial detriment to the company, the director will have a harder task persuading the court that he honestly believed it to be in the company's interest; but that does not detract from the subjective nature of the test."

3.3 **Duty to exercise independent judgment**

Section 173 provides:

- "(1) A director of a company must exercise independent judgment.
- (2) This duty is not infringed by his acting-
 - (a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or
 - (b) in a way authorised by the company's constitution."

3.4 **Duty to exercise reasonable skill, care and diligence**

3.4.1 Section 174 provides:

- "(1) A director of a company must exercise reasonable care, skill and diligence.
- (2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with-
 - (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
 - (b) the general knowledge, skill and experience that the director has."

3.4.2 It is tempting to say that there is a mixture of subjective and objective elements here but in fact both branches of the test for the standard of care, skill and diligence are purely objective, in the sense that they do not depend on the director's state of mind. It would be more accurate to say that one branch of the test is concerned with what would reasonably be expected of someone carrying out this or that particular function (sales director, FD, *etc.*), whether or not the director in question actually possesses the requisite general knowledge, skill and experience, whilst the other branch is concerned with the general knowledge, skill and experience which a director actually possesses, whether or not it is different from (and even goes beyond) what one would reasonably expect. Essentially, section 174(2) is not only setting out two potentially different standards for assessing the skill, care and diligence of a director: it is providing that if one standard is higher than the other then the higher standard prevails.

- 3.4.3 So if someone is acting as the FD of a company, he must perform to the standards of someone who possesses the qualifications and experience of an FD, whether or not he possesses them, whilst if a director happens to be a chartered accountant by training, then he will be judged by the standards of someone who is a chartered accountant, even if his is not the FD.
- 3.4.4 There is a potentially important relationship between the section 172 duty (promoting the interests of the company) and the section 174 duty of skill, care and diligence. As I have already mentioned, a director who is accused of breaching his section 172 duty may succeed in establishing that, rightly or wrongly, he genuinely believed that he was acting in the company's best interests. But that may not protect him from a parallel attack under section 174, because it might be possible to show that, although he did act on the basis of a misguided view which he genuinely held, the reason why he held that misguided view was that he had failed to inform himself properly of the facts which were relevant to his decision-making, so the argument would be that, in failing to inform himself properly, he had failed to act with reasonable care, skill and diligence.
- 3.4.5 I shall have more to say about section 174 later on.

3.5 **Duty to avoid conflicts of interests**

3.5.1 Section 175 provides:

- “(1) A director of a 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.
- (2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).
- (3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company.
- (4) This duty is not infringed–
 - (a) if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or
 - (b) if the matter has been authorised by the directors.
- (5) Authorisation may be given by the directors–
 - (a) where the company is a private company and nothing in the company's constitution invalidates such authorisation, by the matter being proposed to and authorised by the directors; or
 - (b) where the company is a public company and its constitution includes provision enabling the directors to authorise the matter,

by the matter being proposed to and authorised by them in accordance with the constitution.

- (6) The authorisation is effective only if-
 - (a) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the director in question or any other interested director, and
 - (b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.
- (7) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties."

3.5.2 Unlike the duty to promote the best interests of the company (section 172), the duty to avoid conflicts of interest is judged, not subjectively, according to the director's state of mind, but objectively: *Richmond Pharmacology Limited v. Chester Overseas Ltd* [2014] EWHC 2692 (Ch) – so it does not even matter whether the director is aware that what he is doing is a breach of duty.

3.5.3 One of the key expressions in this section is the phrase "the exploitation of any property, material or opportunity", because that wording brings on board a whole tract of case-law which goes back to the nineteenth century and is perhaps best exemplified by two twentieth-century Canadian cases, *Cook v Deeks* [1916] AC 554 and *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592. *Cook v Deeks* concerned the actings of certain directors of the Toronto Construction Company, which specialised in building railways. The company had carried out a series of contracts building railway lines for the Canadian Pacific Railway Company. All of those contracts had been negotiated on behalf of the Company by Mr Deeks and one of his fellow directors, Mr Hinds. In 1911 they negotiated with Canadian Pacific to construct the "New Shore Line" from Toronto to Guelph and Hamilton, telling Canadian Pacific that this time the contract was to be with them personally, not with the Toronto Construction Company. Only when they were certain of obtaining the contract did they tell their company that they had negotiated it on their own behalf. Then, as directors, they convened a general meeting of the company at which they and their associates, being 75 per cent stockholders, resolved that the Company had no interest in the Shore Line contract. A shareholder with whom the directors had fallen out raised proceedings (we would say, in the nature of a derivative claim) seeking an order that Deeks, Hinds and their associates account to the company for the profits of the Shore Line contract. The plaintiff was unsuccessful at first instance and before the Ontario Court of Appeals but succeeded in his appeal to the Privy Council. The Privy Council's judgment was based on the principle that: "[M]en who assume the complete control of a company's business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and, while ostensibly acting for the company, divert in their own

favour business which should properly belong to the company they represent.” For good measure, it was held that the resolution which the respondents had procured the company to pass at its general meeting was of no effect. The reason for this was not fully developed but it seems that, seen from today’s perspective, the passing of the resolution would have been considered as unfairly prejudicial conduct of the affairs of the company.

- 3.5.4 The theme of directors “diverting in their favour business which should properly belong to the company” was further developed in the *Canadian Aero Service* case. I need mention this case only for two purposes. First, because this is the case in which the court (the Ontario Court of Appeals) first used what is now the well-established phrase “a maturing business opportunity” to describe the sort of contract which directors were not entitled to divert to themselves, and secondly because, before taking for their own benefit a contract which should have been taken by the company, the rogue directors took the precaution of resigning from the board. The decision was to the effect that their ceasing to be directors did not relieve them of the duty not to profit from a contract, the opportunity for which had come their way whilst they were directors and because they were directors.
- 3.5.5 Notice the concluding words of section 175(2): “[I]t is immaterial whether the company could take advantage of the property, information of opportunity”. In order to get the full flavor of what these words are getting at we need to re-read the old House of Lords case of *Regal (Hastings) Limited v Gulliver* [1967] 2AC 134. The plaintiff company (Regal) ran a cinema business. As part of a commercial transaction it was to acquire (by subscription) the shares in a new subsidiary (Amalgamated) which had the benefit of certain cinema leases. The necessary subscription moneys were £5,000 but Regal could not afford to expend more than £2,000. The directors of Regal, genuinely thinking that it was in Regal’s interests for the transaction to proceed, dipped into their own pockets to acquire the remaining shares. Shortly afterwards the subsidiary was sold and they disposed of their shares at a profit. In the meantime, Regal acquired a new board of directors. The new board caused Regal to sue the directors for an account of the their profits on the sale of their shares. At first instance the court found for the directors and the Court of Appeal subsequently did likewise. The House of Lords allowed Regal’s appeal. The main reasoning is in the speech of Lord Russell of Killowen. The key points were that the directors were fiduciaries of their company and that they had acquired they opportunity to acquire shares in Amalgamated by virtue of their directorships of Regal. That being so, they were liable to account to the company for their profits and – and this is the real point – it made no difference that Regal itself could not have subscribed for the shares which they took. When the Companies Bill which was to become the 2006 Act was proceeding through Parliament, the question whether to reverse the rule in *Regal (Hastings)* was specifically considered but Parliament decided to leave the rule intact. That is why section 175(2) says what it says.

3.6 **Duty not to accept benefits from third parties**

Section 176 provides:

- “(1) A director of a company must not accept a benefit from a third party conferred by reason of–
 - (a) his being a director, or
 - (b) his doing (or not doing) anything as director.
- (2) A “*third party*” means a person other than the company, an associated body corporate or a person acting on behalf of the company or an associated body corporate.
- (3) Benefits received by a director from a person by whom his services (as a director or otherwise) are provided to the company are not regarded as conferred by a third party.
- (4) This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.
- (5) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.”

3.7 **Duty to declare interest in proposed transaction or arrangement**

Section 177 provides:

- “(1) If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors.
- (2) The declaration may (but need not) be made–
 - (a) at a meeting of the directors, or
 - (b) by notice to the directors in accordance with–
 - (i) section 184 (notice in writing), or
 - (ii) section 185 (general notice).
- (3) If a declaration of interest under this section proves to be, or becomes, inaccurate or incomplete, a further declaration must be made.
- (4) Any declaration required by this section must be made before the company enters into the transaction or arrangement.
- (5) This section does not require a declaration of an interest of which the director is not aware or where the director is not aware of the transaction or arrangement in question.

For this purpose a director is treated as being aware of matters of which he ought reasonably to be aware.

- (6) A director need not declare an interest–
 - (a) if it cannot reasonably be regarded as likely to give rise to a conflict of interest;
 - (b) if, or to the extent that, the other directors are already aware of it (and for this purpose the other directors are treated as aware of anything of which they ought reasonably to be aware); or
 - (c) if, or to the extent that, it concerns terms of his service contract that have been or are to be considered–
 - (i) by a meeting of the directors, or
 - (ii) by a committee of the directors appointed for the purpose under the company's constitution.”

4. Remedies for Breach

- 4.1 I do not propose to spend much time dealing with remedies for breach of duty. Such remedies are touched upon (“dealt with” would be too strong a term) in section 178, entitled “Civil consequences of breach of general duties”. The section is slightly curious but mercifully short, so I shall set it out in full.

- “(1) The consequences of breach (or threatened breach) of sections 171 to 177 are the same as would apply if the corresponding common law rule or equitable principle applied.
- (2) The duties in those sections (with the exception of section 174 (duty to exercise reasonable care, skill and diligence)) are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors.”

- 4.1.1 The reference to “consequences” paves the way for all manner of remedies, including declarator that a given resolution is invalid, or an order to account for profits, or interdict or reduction, *etc.* As for enforcement, it is striking that the section 174 duty to exercise reasonable care, skill and diligence is explicitly excluded from this provision. There is at least one possible reason for this: a breach of the section 174 duty amounts in effect to negligence, so that the appropriate remedy is on the face of it an ordinary action in negligence rather than an action for breach of fiduciary duty.

- 4.1.2 The main point about breaches of fiduciary duty is that, if the company concerned has gone into insolvent liquidation, then the liquidator can raise proceedings against the directors (or former directors) under sections 212, 213 and/or 214 of the Insolvency Act 1986. Section 212 provides a summary

remedy against an officer of a company who has “misapplied or retained, or become accountable for, any money or other property of the company, or been guilty of any misfeasance or breach of any fiduciary or other duty in relation to the company”, section 213 provides a liquidator with a remedy for fraudulent trading (though remember that directors’ duties can be breached without any fraud on the part of the directors concerned) and section 214 provides a liquidator – and now an administrator as well – with a remedy for “wrongful trading”. I shall have another look at section 214 in a moment.

- 4.2 In relation to such claims, remember that under section 1157 of the Companies Act 2006 the court may relieve a director who is or may be liable for negligence, default, breach of duty or breach of trust if it appears to the court that he “acted honestly and reasonably, and that having regard to all the circumstances of the case ... he ought fairly to be excused”.

5. Cross-connections

5.1 Internal cross-connections

- 5.1.1 I have already mentioned that where a breach of one duty (such as the section 172 duty) is difficult to prove, it may be easier to rely upon a breach of another duty (such as the section 174 duty): so the codified duties are not mutually exclusive; a given act or omission may amount to, or at least involve, a breach of several duties at once.

5.2 Cross-connections with equity and the common law

- 5.2.1 What I want to look at here is section 170(2) of the Act (bearing in mind that section 170 is entitled “Scope and nature of general duties”).

“A person who ceases to be a director continues to be subject –

- (a) to the duty in section 175 (duty to avoid conflicts of interest) as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director, and
- (b) to the duty in section 176 (duty not to accept benefits from third parties) as regards things done or omitted by him before he ceased to be a director.

To that extent those duties apply to a former director as to a director, subject to any necessary adaptations.”

- 5.2.1 *Canadian Aero Service*, which I mentioned earlier, is the classic example of what this is getting at, because, as you will recall, in that case the rogue directors resigned from their directorships before diverting to themselves a maturing business opportunity which belonged to the company but were held

to liable to account to the company nevertheless. This exemplifies the point, now made explicit in the statute, that the duties may apply to former directors as well as present directors.

5.3 Cross-connections with insolvency law

5.3.1 In dealing earlier with section 174 I mentioned that the reasonable care, skill and diligence required of a director was “the care, skill and diligence that would be exercised by a reasonably diligent person with–

- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
- (b) the general knowledge, skill and experience that the director has.”

Anyone familiar with corporate insolvency law will recognise the obvious similarity between that test and the one formulated in section 214 Insolvency Act 1986 (wrongful trading). The section provides a liquidator or administrator with a remedy against a director who “knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation” and who failed to take every step with a view to minimising the potential loss to the company’s creditors which he ought to have taken. For the purpose of those provisions (subsections (2) and (3)):

“the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both–

- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and
- (b) the general knowledge, skill and experience that that director has.”

This of course is the language of section 174 setting out the standard of the directors’ duty of skill, care and diligence.

5.3.2 The section 172 duty to promote the success of the company is subject to this important qualification in terms of section 172 (3): “The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.” This section is in fact invoking a rule which was enunciated by the High Court of New South Wales in the case of *Kinsella v Russell Kinsella Pty Ltd* (1986) 4 NSWLR 722. The facts of the case are not important. What is important is the following observation from the judgment of Street CJ:

“Where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company’s assets. It is in a practical sense their assets and not the shareholders’ assets that, through the medium of the company are under the management of the directors, pending either insolvency, return to solvency or the imposition of some alternative administration.”

- 5.3.3 It follows from this that where a company is insolvent or approaching insolvency, the members have no power to ratify the actings of the directors, at least if to do so would be disadvantageous to the creditors: see *Jetivia SA v Biltta* (UK) Ltd [2015] UKSC 23.

“A company has its own separate legal personality and duties owed to it by those officers who constituted its directing mind and will. All the shareholders of a solvent company acting unanimously may in certain circumstances be able to authorise what might otherwise be misconduct towards the company, but even the shareholders of a company which is insolvent or facing insolvency cannot do this to the prejudice of its creditors, and the company’s officers owe a particular duty to safeguard the interest of such creditors.”

5.4 Cross-connections with derivative proceedings

- 5.4.1 The law of Scotland concerning derivative proceedings is now set out in sections 265 to 269 of the Companies Act 2006. All that I want to mention today is the fact that, under section 268(1), the court must refuse leave to raise or continue derivative proceedings if it is satisfied that a person acting in accordance with section 172 (duty to promote the success of the company) would not seek to raise or continue the proceedings.
- 5.4.2 How is the court supposed to know whether such a director would or would not decide to raise or continue the proceedings? In *Lesini v Westrip Holdings Ltd* [2009] EWHC 2526 (Ch) Lewison J observed (at paragraph 85) that:

“[T]here are many cases in which some directors, acting in accordance with s.172, would think it worthwhile to continue a claim at least for the time being, while others, also acting in accordance with s.172, would reach the opposite conclusion. There are, of course, a number of factors that a director, acting in accordance with s.172, would consider in reaching his decision. They include: the size of the claim; the strength of the claim; the cost of the proceedings; the company’s ability to fund the proceedings; the ability of the potential defendants to satisfy a judgment; the impact on the company if it lost the claim and had to pay not only its own costs but the defendant’s as well; any disruption to the company’s activities while the claim is pursued; whether the prosecution of the claim would damage the company in

other ways (e.g. by losing the services of a valuable employee or alienating a key supplier or customer) and so on. The weighing of all these considerations is essentially a commercial decision, which the court is ill-equipped to take, except in a clear case.”

5.5 Cross-connections with unfair prejudice

There is no time to do much more than hint at this particular cross-connection, but it is fairly obvious that a breach of director’s duty may amount to unfairly prejudicial conduct of the company’s affairs. This was hinted at in the leading case of *Cook v Deeks*, where the unfairness resided in the delinquent directors using their own majority voting power at a general meeting to procure the company to whitewash their misdeeds. An obvious example from the modern case-law on unfair prejudice would be where the board resolved to issue new shares, not merely in the knowledge that a particular member could not afford to subscribe for his part of the issue but also with the intention of diluting his shareholding (if you want authority for this, look at the case with the unforgettable name of *Re a Company (No. 007623 of 1984)* (1986) 2 BCC 99191). We are back, here, in the territory of the “proper purpose rule” which is now set out at section 171(b) and which was the subject of the recent Supreme Court decision in *Eclairs*.

6. The Take-away

- 6.1 This area of the law is still on the move.
- 6.2 Its development involves looking backwards at the old cases, sideways at “trustee” and “fiduciary” cases which do not involve directors (and sideways at Commonwealth cases as well) and forwards (especially where, as in *Eclairs*, the Supreme Court has identified an area of the law which requires further argument in an appropriate case).
- 6.3 Although the codification gives an impression of being self-contained, the law on directors’ duties leaches out into other areas such as insolvency law, derivative actions and unfair prejudice.
- 6.4 So if you have occasion to read sections 171 to 177, please do not wear blinkers when doing so.

15 June 2017

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