EARLY DRAFT[1]

Chapter 7

Directors' Duties

DIRECTORS AND COMPANY LAW

Introduction

While companies are treated by English law as being distinct legal persons, all of the activities of a company must necessarily be conducted through the medium of human beings. A company cannot pick up a telephone, or post a letter or type an email, even though company law theory treats companies as having sufficient legal personality to create contracts, to own property and so forth. In general terms, the most significant human beings in the conduct of the activities of a company are its directors. The management of a company's affairs are ordinarily entrusted ultimately to its directors.[2] The legal responsibilities and powers of directors are the concerns of this chapter. Company law has requirements as to the requisite number of directors and as to those directors' ordinary duties and powers. Among other things, this chapter deals with the appointment, remuneration and removal of directors. It also shows that the directors of a company act as a board, that articles of association ordinarily give the directors extensive powers to manage the company's business, that usually the company in general meeting cannot overrule the directors provided that they act within their powers, and that the articles of association can empower the directors to appoint a managing director and to delegate any of their powers to him or her. The most important topics dealt with in this chapter are the general fiduciary duties and duties of care which a director owes to his company in exercising these powers: the analysis of those duties comprises the bulk of this chapter.

The structure of this chapter

This chapter is divided up as follows. The first section defines what a "director" is. The second section continues with a brief summary of the previous case law principles (to provide a map through the remaining discussion) and an introduction to the over-arching provisions of the statutory code. The bulk of this chapter is made up of the discussion in the second section considers the statutory code for directors' general duties in Part 10 of the Companies Act 2006 and of the old case law dealing with those same principles. The discussion of the

[1] Based on a part of Alastair Hudson's contribution to *Charlesworth's Company Law* (18e, Sweet & Maxwell, 2010), by Stephen Girvin, Alastair Hudson and Sandra Frisby.
[2] However, in larger companies middle and junior management may well conduct important functions.

statutory code considers each statutory principle in turn, and then, because those statutory principles are explicitly predicated on the old case law, that discussion considers the case law applicable to each statutory principle. The third section of the chapter considers other aspects of fiduciary law which are significant in the liabilities of directors beyond the statutory code.[3] The fourth section of the chapter considers other aspects of the law relating to directors.[4] The fifth section of this chapter considers the disqualification of directors from their office.[5] The sixth section of this chapter considers the non-legal requirements of corporate governance regulation which have been introduced in recent years in an effort to impose practical controls on the behaviour and remuneration of directors particularly in large public companies.

The legal nature of directorship

What is a director?

The nature of directorship is central to company law. Directors are fiduciaries, as considered below, but they may also have other capacities: not least their personal capacities. For example, in a private company the directors are usually substantial shareholders as well as being the company's managers. Therefore, there is a possibility for conflicts between such a person's fiduciary and personal capacities. In a public company, the directors normally have few shares as a proportion of the total shareholding in the company, and so their fees and other emoluments, rather than their dividends from their shareholding, are their main source of profit from the company. Consequently, in the context of public companies, the management and the ownership of the company are more likely to be separated.

Importantly, there are also different types of directors. In practice, companies will have different grades of director. There will usually be full-time, executive directors, and part-time, non-executive directors. In large public companies, good corporate practice generally requires that executive directors may not control all aspects of management (as considered below), especially decisions relating to their own salaries. Consequently, non-executive directors (generally drawn from backgrounds which give them useful perspectives on the company's business) are used to decide issues which directors ought not to decide alone, and are used to advise the executive directors on the most appropriate way for the company to act in a number of circumstances. The more complex the company or group of companies, the more likely it is that different directors will have very different responsibilities within the organisation: whether managing a particular trading unit, or supervising the organisation's financial affairs, or personnel, or whatever. Consequently, there can be differences in the levels of power, influence and remuneration of directors. A number of different types of people may be treated as being a director, as considered next.

[3] At p.
[4] At p.
[5] At p.

Who is a director?

The exact name or title which is given to a person who occupies the position of director is immaterial because under s.250 of the CA 2006 the term “director" is defined so as to include “any person occupying the position of director, by whatever name called”. Although there is some dispute, the current view is that this provision only applies to persons properly appointed as “directors" but who operate under a different title, e.g. as a “governor".[6] A person who has been lawfully appointed as a director is known as a “de jure" director; as opposed to people who may appear to discharge the functions of a director in practice but without having been appointed as a director. However, on a normal interpretation, the definition in s.250 allows for others who are not properly appointed as directors to be regarded as directors. There are two such categories of director beyond those people who have been officially appointed as directors: “de facto" directors and “shadow" directors. Each category is considered in turn in the sections to follow. [*DISCUSSION TO FOLLOW*]

De facto directors

In *Re Hydrodan (Corby) Ltd*, Millett J. held that[7]:

> "A de facto director is a person who assumes to act as a director. He is held out as a director by the company, and claims and purports to be a director, although never actually or validly appointed as such. To establish that a person was a de facto director of a company, it is necessary to plead and prove that he undertook functions in relation to the company which could properly be discharged only by a director. It is not sufficient to show that he was concerned in the management of a company's affairs or undertook tasks in relation to his business which cannot properly be performed by a manager below board level."

Although that definition was applied in *Secretary of State for Trade and Industry v Morrell*,[8] it was criticised by Lloyd J. in *Re Richborough Furniture Ltd*[9] principally on the basis that there ought not to be a requirement that such a person should be holding himself out as being a director nor that he be held out by the company as being a director. Instead Lloyd J substituted a revised version of the principle in the following terms:

> "It seems to me that for someone to be made liable . . . as a de facto director, the court would have to have clear evidence that he had either been the sole person directing the affairs of the company . . . or, if there were others who were true directors, that he was acting on an equal footing with the others in directing the affairs of the company. It also seems to me that, if it is unclear whether the acts of the person in question are referable to an assumed directorship, or to some other capacity such as a shareholder

[6] *Re Lo-Line Electric Motors Ltd* [1988] B.C.L.C. 698 at 706 per Browne-Wilkinson V.-C.; cf. *Re Eurostem Maritime Ltd* [1987] P.C.C. 190, per Mervyn Davies J.
[7] [1994] 2 B.C.L.C. 180, 183.
[8] [1996] B.C.C. 229.
[9] [1996] 1 B.C.L.C. 507.

or, as here, a consultant, the person in question must be entitled to the benefit of the doubt."[10]

Shadow directors

Several of the statutory provisions in both the Companies Act and the Insolvency Act relating to directors also apply to "shadow directors".[11] Section 251 of the 2006 Act[12] provides that these are persons in accordance with whose instructions the directors are accustomed to act, excluding purely professional advice. These types of directors are different from "de facto directors" because they do not purport to act as directors. On the contrary, they claim not to be directors and so seek to hide behind those who are. In that sense, they "lurk in the shadows". [*DISUCSSION TO FOLLOW*]

Directors as fiduciaries

Directors as fiduciaries and agents

A director owes fiduciary duties to the company and will act as an agent of the company.[13] The director's fiduciary duties and duties of care to the company, as will be considered in detail below. As Lord Cranworth L.C. held:[14]

> "The Directors are a body to whom is delegated the duty of managing the general affairs of the Company. A corporate body can only act by agents, and it is of course the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect".

[*DISCUSSION TO FOLLOW*]

[10] ibid. at p.524.
[11] Fiduciary duties could also apply to such persons: see *Yukong Line Ltd v Rendsburg Investments Corporation of Liberia (No. 2)* [1978] 1 W.L.R. 294, 311.
[12] See also s.251 of the IA 1986.
[13] "Directors of a company are fiduciary agents, and a power conferred upon them cannot be exercised in order to obtain some private advantage or for any purpose foreign to the power": per Dixon J. in *Mills v Mills* (1938) 60 C.L.R. 150 at p. 186.
[14] *Aberdeen Rlwy. Co. v Blaikie Bros*. (1854) 1 Macq. 461 at p. 471.

II. DIRECTORS' GENERAL DUTIES

Directors' duties at the heart of company law

The nature of directors' duties is one of the most interesting aspects of company law. Given that the activities of companies are in fact conducted by human beings, albeit under the disguise of corporate personality, and given that a company's directors are its principal human actors, then the duties of those directors to the company, and the effect of those duties on third persons such as the shareholders, employees, creditors and others, are central to the legal control of companies. The Companies Act 2006 introduced a statutory code of directors' general duties for the first time. Interestingly, this statutory code expressly preserves the effect of the previous case law and allows the precise nature of those duties to develop with any later case law. The case law relates specifically to the common law on directors' duties and significantly applies the equitable principles which govern the liabilities of all fiduciaries, including directors. The purpose of the statutory code was to formalise directors' duties so that non-lawyers could understand their duties as directors more clearly.

THE STATUTORY SCHEME IN OUTLINE

The extent of the statutory scheme on directors' general duties in Part 10, CA 2006

The ambit of the statutory scheme

The statutory scheme on directors' duties is contained in Chapter 2, Part 10 of the CA 2006 titled "General Duties of Duties". That Chapter covers the principles in s.170 through to s.177, and attendant legislation. The ambit of the statutory scheme is set out in s.170 of the CA 2006 in the following terms:

> "(1) The general duties specified in sections 171 to 177 are owed by a director of a company to the company."

Significantly, then the director owes the duties considered below to the company itself and not, for example, to the shareholders of the company. Therefore, the company is confirmed as being the proper plaintiff in relation to claims for any breach of such a duty by a director.

The term "director" in this context is expanded by s.170(5) of the CA 2006 so that "[t]he general duties apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply". Therefore, as considered at the beginning of this chapter, shadow directors are treated as being directors. As a result, a person who controls a company or who performs the duties of a director without being formally appointed as such, may not avoid liability for breach of duty simply by virtue of not being appointed formally as a director if he is in truth a shadow director, as discussed immediately above.

The inter-action of the statutory scheme with the case law

It is very important to understand the unusual inter-action between the statute and the case law. The statutory scheme is best understood as a statement of a director's general obligations *qua* director, and as such as an attempt to reduce the case law principles to a short, comprehensible code. To this effect, s.170(3) of the CA 2006 provides as follows:

> "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."

Therefore, the statutory scheme can be interpreted in accordance with the pre-existing case law in that the general duties are based on those common law and equitable principles. Significantly, the statutory principles have effect "in place of" the case law. Therefore we might assume that, in the ordinary course of events, the statute has displaced all of the pre-existing case law, except to the extent that the pre-existing case law might be referred to in the event that the statutory principles are unclear or their genesis is obscure. However, s.170(4) of the CA 2006 provides as follows:

> "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."

Therefore, while the statutory rules act "in place of" the pre-existing case law, the statutory rules are nevertheless to be interpreted as though they were themselves case law principles. That means that the high-level principles set out on ss.171 through 177 of the CA 2006 are capable of being developed by subsequent case law. What is unclear is how we can understand these principles as being a sort of case law principle given that presumably the courts are not permitted to overrule nor materially alter the sense of the statutory rules. Furthermore, as s.170(4) provides, "regard shall be had" to the case law principles in the development of the statutory principles. In effect, then, it is suggested that the effect of this statutory scheme is that the previous case law principles have been distilled down to the statutory code (and therefore that any earlier cases which conflict with this statutory scheme are deemed to be of no further effect) but that in the future the courts may develop those principles as with any case law principle which is (presumably) binding upon it.

The purpose and effect of the statutory scheme

The purpose behind creating a statutory code for directors' duties for the first time was to enable non-lawyers to understand their duties as directors more easily. The Companies Act 2006, as with its predecessor legislation, is drafted in as accessible a way as possible. Therefore, having all of a directors' general duties reduced from reams of complex case law down to a brief code of statutory principles means that all directors should be able to understand what their obligations are. The continued importance of the old case law and the natural development of the case law principles means that those general principles are still illustrated by centuries of jurisprudence. On a more cynical note, one might think that the principal effect of the statutory code (which contains clear expression of the limitations on each principle) is to provide directors with clear instructions as to how they can avoid their duties. For example, in relation to the principles on conflicts of interest it is made clear in s.175 how directors can give one another authorisation to take profits from their fiduciary duties, as well as setting out a conceptualisation of the core principle. Therefore, the effect is likely to be that the legislation enables directors to avoid their obligations and consequently has the practical effect of reducing the strictness of fiduciary and similar duties in the corporate context.

The statutory scheme provisions in outline

Those duties on each director in outline are: a duty to act within the terms of his powers under the company's constitution;[15] a duty to promote the success of the company as the director sees it in good faith;[16] a duty to exercise independent judgment;[17] a duty to exercise reasonable care, skill and diligence;[18] a duty to avoid conflicts of interest;[19] a duty not to accept benefits, such as bribes and secret commissions;[20] and a duty to declare interests in transactions.[21] It should be noted that under s.179 of the CA 2006 that more than one of the general duties may apply at the same time. Each is considered in turn below.

The methodology of this chapter in discussing the statutory code

In the discussion to follow, each of the statutory general duties is taken in turn. This chapter takes the approach that, if the statutory provisions now act "in place of" the case law, then the discussion must begin with an analysis of the statutory principles. Then, after the discussion of each statutory principle, our focus turns to an analysis of the case law applicable to that principle. By knitting the discussion of the case law together with the statutory provisions in this way it is possible to see more clearly how the statutory provisions relate to the case law principles and how they may be interpreted in the future.

[15] Companies Act 2006, s.171.
[16] Companies Act 2006, s.172.
[17] Companies Act 2006, s.173.
[18] Companies Act 2006, s.174.
[19] Companies Act 2006, s.175.
[20] Companies Act 2006, s.176.
[21] Companies Act 2006, s.177.

DUTY TO ACT WITHIN POWERS

The statutory principle

A company is a person which must act not only in compliance with the general law but also in accordance with the terms of its own constitution. Its directors are therefore similar constrained. Consequently, s.171 of the CA 2006 provides that:

> "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."

Under s.171(a) each director is obliged to act in accordance with the company's constitution. This means both that the director must use his own powers within the terms specified in the company's constitution and that the director must not seek to make the company act outwith the terms of its own constitution. Furthermore, under s.171(b), in relation to the director's powers, the director must only exercise those powers for the purposes for which they were granted. Under the case law there have been a number of situations in which, for example, directors have used a power to issue new shares, which was intended to enable the company to raise capital, so as to frustrate a takeover attempt without asking the shareholders whether or not they wanted that takeover to go ahead. Consequently, a power intended for one purpose was being used for a different, inappropriate purpose. In *Re Smith and Fawcett Ltd* it was held that the directors were required to act "bona fide in that they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose".[22] If a director breaches any of the obligations under s.171, then that director will be liable to compensate the company for any loss suffered by the company as a result.

The principle in the case law

As was set out above, in *Re Smith and Fawcett Ltd* it was held that the directors were required to act "bona fide in that they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose".[23] This principle has given birth to two statutory principles: the principle that directors must act in accordance with the company's constitution and their powers, and the principle that directors must promote the success of the company (under s.172, considered next). As considered above, one of the ways in which directors have abused their powers has been to obstruct takeovers. In *Punt v Symons*[24] it was found by Byrne J that the power to issue shares had been given to the directors "for the purpose of enabling them to raise capital when required for the purposes of the company. … but when I find a limited issue of shares to persons who are obviously meant and intended to secure the necessary statutory majority in a particular interest [to prevent a

[22] [1942] Ch 304, 306, *per* Lord Greene MR.
[23] [1942] Ch 304, 306, *per* Lord Greene MR.
[24] [1903] 2 Ch 506.

vote in favour of a takeover], I do not think that is a fair and bona fide exercise of the power."[25]

Similarly, in *Hogg v Cramphorn*[26] the controlling director, Colonel Cramphorn, wanted to stop Baxter from taking the company over and so convinced his compliant fellow directors to issue shares to people who would vote against the takeover. It was held that the power to issue share capital was a fiduciary power which could be set aside if it was exercised for an improper motive even if the issue was made in good faith in the belief that it was in the interests of the company. Consequently, the use of the power was held to be *ultra vires*. It was, however, ratifiable (and eventually ratified) by the shareholders in that case, and so that ratification made the exercise of the power enforceable as a result.[27]

An alternative approach to *Hogg v Cramphorn* was taken in Canada in the case of *Teck Corporation Ltd v Millar*[28] on the basis that, when new shares were issued to prevent a takeover, directors were entitled to consider the reputation, experience and policies of anyone seeking to take over the company. If they decided on reasonable grounds that the takeover would cause substantial damage to the company's interests they were entitled to use their powers to protect the company. Consequently, it was held that it was not correct to say that issuing shares otherwise than to raise capital was always a breach of duty.

What may be significant about the drafting of s.171(b) is that it imposes a positive obligation on directors to act in accordance with the company's constitution and to operate their powers properly. This differs from the *Smith and Fawcett* formulation which requires that directors refrain from committing a breach of their duties.[29]

The question is then how the court is to identify an improper exercise of a power. The case law approach to the obligations of directors to the exercise of their powers was set out by Jonathan Parker J in *Regentcrest Ltd v Cohen*:[30]

> "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 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."

[25] *Ibid*, 515.
[26] [1967] Ch 254.
[27] That a breach may be ratified was approved in *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821.
[28] (1972) 33 D.L.R. (3d) 288.
[29] See *Hunter v Senate Support Services Ltd* [2004] EWHC 1085, [2005] 1 BCLC 175; *Edge v Pensions Ombudsman* [2000] Ch 602, 627, CA.
[30] [2001] 1 B.C.L.C. 80 at 105b. See also *Re Smith and Fawcett Ltd* [1942] Ch. 304.

Therefore the court will not substitute its own view of what a director should have done for the director's own decision.[31] Instead, the court is concerned to identify whether or not the director acted honestly in the exercise of his power. The appropriateness of the director's actions will be thrown into relief, in his lordship's opinion, by whether or not it causes detriment to the company. However, it is suggested that a director may act in good faith in the exercise of a power but nevertheless cause loss. The better approach, it is suggested, would be whether or not, on a proper interpretation of the purpose of the power, the directors were genuinely pursuing that purpose or whether they were pursuing some alternative goal. Therefore, it is not enough that a director have been honest, but rather they must also be exercising their powers for the purpose for which they were granted. So, as considered above, a power to allot new shares may not be used to prevent a takeover bid.[32] In this vein, in *Colin Gwyer & Associates v London Wharf (Limehouse) Ltd*,[33] it was said that where the directors had failed to separate their own interests from those of the company, their assertion that they had acted in the best interests of the company should be examined with particular care. In essence, would an intelligent and honest man in the directors' position have reasonably believed that a particular course of action was for the benefit of the company?

The duty to consider the best interests of the company is also considered below in relation to the duty in s.172 of the CA 2006. An issue clearly arises not only as to whether or not the director is acting honestly but also as to whether or not the action which the directors propose to take is in the company's interests. In that sense, the directors may choose to be conservative as well as progressive in choosing to protect the company's position instead of moving into new territory. The Privy Council in *Howard Smith Ltd v Ampol Petroleum Ltd*[34] considered similar facts to *Hogg v Cramphorn* where shares were allotted so as to frustrate an attempted takeover by one company so as to improve the chances of another bidder. In essence, the directors allotted enough shares to convert a majority shareholding into a minority shareholding because the majority shareholding was considered likely to vote for what they considered to be the "wrong" takeover bid. It was established on the facts that the primary purpose of the allotment was not to raise money but was intended instead to destroy the existing majority shareholding; although it was also found that the directors were not motivated by the advancement of their own self-interest, but their rather their view of the interests of the company. The Privy Council rejected both the argument that allotments of shares can only be carried out to raise capital and also the argument that any finding of self-interest in the exercise of the power necessarily invalidates it. Instead it was held that no limitation can be placed in advance on the exercise of the directors' powers. Rather, the court must examine the purpose for which the power was exercised and consider whether that purpose was proper or not. This requires a close interpretation of the precise power in the articles of association on which the directors were relying. It was held on those facts that the power to allot shares had been exercised improperly because it had been used solely to frustrate a takeover offer.

It was held further in *Howard Smith v Ampol* that the court must respect the directors' opinion on questions of management; although that is a question to be considered on the

[31] The final sentence of that quote allows the court in effect to import some basic reasonableness test in the sense that the alleged honest belief must be credible. Sometimes the word is actually used: see e.g. *Re Pantone 485 Ltd* [2002] 1 B.C.L.C. 266.
[32] *Piercy v S. Mills & Co. Ltd* [1920] 1 Ch. 77; *Hogg v Cramphorn Ltd* [1967] Ch. 254; *Bamford v Bamford* [1970] Ch. 212, CA.
[33] [2003] 2 B.C.L.C. 153.
[34] [1974] A.C. 821, PC.

circumstances of each case. In the abstract there could be two ways in which the law could operate: either the law could take an objective view of what the court thinks the director ought to have done, or the law could leave the decision subjectively to the director and consider whether or not the directors were acting in the best interests of the company. The law takes the latter approach. In *Mutual Life Insurance v The Rank Organisation*,[35] Goulding J. applied this distinction between questions relating solely to management of the company and other questions in upholding a rights issue which was not made available to certain U.S. shareholders. Unlike the *Howard Smith* case it was held that this particular arrangement did not upset the status quo within the company but rather maintained the investment policy of the company. As considered above, in *Howard Smith v Ampol* it was held that it was unconstitutional for the directors to exercise their powers purely for the purpose of destroying an existing majority or creating a new majority which had not previously existed, and consequently it was not a question relating solely to the management of the company over which the directors had exclusive competence.

The company's constitution is separate and distinct from the powers themselves. Thus it would be a breach of duty for the directors to operate contrary to the memorandum or articles of the company or to enter into a contract on behalf of the company whereby they remained in post as directors so that the shareholders could not exercise their constitutional rights to appoint new directors.[36] Similarly, using company funds other than for the commercial purposes of the company is contrary to the purpose for which management is delegated to the board.[37] In other cases which are regarded as being management areas, however, the courts will simply apply the bona fide test to decide whether the directors have acted in breach of their duty in exercising a power under the articles, for example to vary the terms of the managing director's service contract.[38]

If the directors act in breach of their duty, then they will be liable to account for any profits made and to compensate the company for any loss incurred. If the director actually obtains corporate assets for himself, he becomes a constructive trustee of those assets and the company will be able to recover the property or its proceeds from him. These various remedies, together with any defences, are discussed later in this section. But there is one further issue. If the directors, in abuse of their powers, have entered into a contract with a third party, clearly the members can ratify it, but in what circumstances can that third party nonetheless enforce the contract against the company? This issue arose in *Criterion Properties Ltd v Stratford UK Properties LLC*.[39] The alleged abuse of power was an agreement entered into by the then managing director of a company which allowed for the sale of certain assets to S if another party obtained control of Criterion. This is known as a "poison pill" in the world of takeovers, since it makes the company less attractive to outside predators because valuable assets could be sold off. Since there was evidence that this contract would damage the company more than an outsider gaining control of the company, the Court of Appeal held that it was an abuse of power. The question, however, was whether the contract could be enforced by S. The Court of Appeal held that it was a question of whether it would be unconscionable for S to retain the benefit of the contractual right. The House of Lords disagreed on that issue. In their view the situation was purely one of agency:

[35] [1985] B.C.L.C. 11.
[36] *Lee Panavision Ltd v Lee Lighting Ltd* [1992] B.C.L.C. 22, CA.
[37] *Extrasur Travel Insurances Ltd v Scattergood* [2003] 1 B.C.L.C. 598.
[38] *Runciman v Walter Runciman plc.* [1992] B.C.L.C. 1084. See also *CAS (Nominees) Ltd v Nottingham Forest FC plc* [2002] B.C.L.C. 613, where a statutory provision was not regarded as being mandatory.
[39] [2004] 1 WLR 1846 (HL) cf. [2003] 2 B.C.L.C. 129 CA.

that is, did the managing director have authority to make that contract? If he did, then it was enforceable; whereas if he did not, then it was not.

DUTY TO PROMOTE THE SUCCESS OF THE COMPANY

The statutory principle

The genesis of the principle; and the significance of the six factors

One of the most interesting innovations in the CA 2006 is the creation of a statutory duty for directors "to promote the success of the company". The policy behind this development was set out in the *Company Law Review* in the following terms:

> "We believe there is value in inserting a reference to the success of the company, since what is in view is not the individual interests of members, but their interests as members of an association with the purposes and the mutual arrangements embodied in the constitution; the objective is to be achieved by the directors successfully managing the complex of relationships and resources which comprise the company's undertaking."[40]

The breadth of this duty is potentially enormous and, significantly, is not focused exclusively on the profitability of the company alone, but rather takes a much more 'three-dimensional'[41] approach to the company's place in the community and in its interactions with third parties other than the shareholders. It is important, however, to note that the statutory principle requires the promotion of the success of the company "for the benefit of its members", which does focus attention on the members' needs as opposed to success in a more general sense. If this concept is read in accordance with the paragraph quoted from the *Company Law Review* above, then it could be interpreted as requiring that it is the *collective* interests of the members as a body which must be considered by the directors and not the individual interest of any one member. The statutory principle does also require that other factors are to be borne in mind at the same time, even though those other factors may be of lesser importance within s.172. Section 172 of the CA 2006 provides that:

> "(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,

[40] Company Law Review, *Modern Company Law for a Competitive Economy: Developing the Framework* (URN 00/656), para 3.51.
[41] Apologies: the term is my own. It suggests that instead of looking solely at profit, or solely at the interests of shareholders, the directors should also properly consider the broader role of a company within society.

(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."

It is suggested that while the statutory principle requires the promotion of the success of the company "for the benefit of its members", this does suggest that even though other factors should be borne in mind (or, more importantly, may be borne in mind by the directors without them having breached their duties) nevertheless pursuing the interests of the members does remain first among equals: that is, pursuing the interests and promoting benefits of members is the primary objective of the directors in promoting the success of the company, although other factors may be borne in mind so as to deviate from a course of action which might otherwise advance the naked financial interests of the shareholders in high dividends and a buoyant share price. Historically, Anglo-American company law was focused on the best financial health of the company. There were celebrated cases in the USA where, for example, directors were precluded from using the company's money for any purpose other than developing the business or distributing profits to shareholders.[42] Consequently, on this limited model of company law, charitable contributions or non-salary benefits for employees were prohibited. However, company law thinking has developed since. From the perspective of business theory, investment in good public relations and in a happy workforce are considered to be more important now than used to be the case.[43] So, the inclusion of this list of factors which directors may take into account in considering the success of the company, we see company law moving beyond the longstanding debates in the cases and the journals about what constituted the "best interests of the company" – a concept which was mentioned briefly in the previous section relating to directors under the case law being required to exercise their powers in the best interests of the company. In essence, it might be said that some of these principles derive from the old case law and from s.391 of the now-repealed Companies Act 1985, but the discussion of this provision was one of the most controversial in the passage of the 2006 Act and marks a departure in many senses from the old law because of the inclusion of the six further factors in statutory form.

Interpreting the six factors

In relation to the six factors listed in s.172(1), three things should be observed. First, a natural reading of the prefatory words of s.172(1) *requires* the director to consider the six

[42] *Dodge v Ford* 204 Mich. 459, 170 N.W. 668, Michigan Supreme Court.
[43] See, for example, in England: *Hutton v West Cork Railway* (1883) 23 Ch D 654 where it was held that there may be "cakes and ale" on a limited scale. For a more modern discussion of the role of public relations in company management, see R. Reich, *Supercapitalism* (2008).

factors. The subsection opens with the verb "must" and ends by saying that "in doing so" regard is to be had to the six factors. Therefore, it is suggested that the verb "must" qualifies the entire provision and so requires that the six factors are considered, even if the directors decide that they are not of overriding importance in any given context. This is important because, if the directors are required to consider these factors, then those factors become (arguably for the first time) issues which directors are compelled to consider. Secondly, the prefatory words in s.172(1) make it clear that these factors should be considered "amongst other" factors not included on the list. Consequently, the directors may establish what in their professional judgment is most likely to promote the success of the company. In that sense, the legislation encapsulates the principle set out by Jonathan Parker J in *Regentcrest Ltd v Cohen*[44] to the effect that the court will not substitute its view of what the directors ought to have done for what the directors actually did do, because the power and the responsibility rests with professional directors to make their own decision. What the directors must be able to do, it is suggested, is to justify the actions they have taken or not taken as being sufficiently likely to promote the success of the company at the time. This idea is mirrored in the opening words of s.172(1) to the effect that "a director of a company must act in a way which *he* considers … would be most likely to promote the success of the company": therefore, each director individually bears a responsibility as well as holding a power (It is suggested that this chimes in with the requirement that each director exercise independent judgment (considered below) in that each director has this power and responsibility.) Thirdly, each director must be acting in good faith in supposing that a given course of action will promote the success of the company. Each provision is considered in turn. It should be recalled that s.172(1) places the benefit of the members as a principal aspect of the success of the company, as discussed above.

The six factors

First, it has long been a complaint among radical economists that capitalist markets are orientated too closely around short-term considerations. In stock markets the key determinant for much investment activity is the return that is generated on each share by way of dividend in each financial year. Therefore, to ensure easy access to capital, there is pressure on management to maximise short-term earnings per share at the expense, it is said, of the long-term health of the company and of the economy more broadly. Therefore, the first factor is "the likely consequences of any decision in the long term". This chimes in with the concerns of the Blair-Brown administrations, being social democratic, approximately left-of-centre governments, to ensure investment for the longer term and the operation of companies for the longer term benefit of the economy and all involved.

Second, the traditional matrix of English company law focuses on the rights of the company, the rights of the shareholders and the duties of the directors. No-one else had a *right* to be considered. In practice, management would consider the need for good industrial relations

[44] [2001] 1 B.C.L.C. 80 at 105b. See also *Re Smith and Fawcett Ltd* [1942] Ch. 304.

(up to a point) and the need to keep creditors and others content so that the company could continue to function. However, there was no legal *right* for those people to be considered by the company's directors when managing a company. The inclusion of the second factor that "the interests of the company's employees" must be considered has the effect of empowering the directors to consider the interests of employees. This is not the same as giving the employees rights to act against the management or the company itself, but it does free the directors from liability for breach of duty for considering employees instead of shareholders, and the directors are required to "have regard" to the interests of employees inter alia when making decisions.

Thirdly, a successful economy requires that all participants in the economic chain – whether suppliers, customers, service providers, or whoever – are entitled to rely on one another. Particularly in difficult economic times, it is important that companies do not decide arbitrarily not to pay moneys owed to other people or to treat customers badly. Therefore, requiring directors to consider the position of such people is hoped to have a beneficial effect on the economy: thus, "the need to foster the company's business relationships with suppliers, customers and others" is included in s.172.

Fourthly, and following on from the discussion of the social role of companies in the previous paragraph, the director are to have regard to "the impact of the company's operations on the community and the environment". As opposed, for example, to pursuing solely profitable but potentially polluting activities, the directors may now consider the effect of the company's operations on both the community more broadly and also on the environment without being held liable for breaching a common law obligation to act in the best interests of the company. It is an important development in the scope of company law that directors are to have regard to the impact of the company's operations. In an age where more responsible business practices are required by policymakers and by consumers, this is an important maturing in the law.[45]

Fifthly, the movement away from a single-minded focus on profit is also part of an ethical project to raise standards of behaviour among commercial people. Therefore, paragraph 172(1)(e) of the CA 2006 provides that directors must have regard to "the desirability of the company maintaining a reputation for high standards of business conduct". Whereas a quick profit might be earned by unscrupulous conduct, this provision empowers directors to consider the need to maintain high standards in their business ethics. The concomitant benefit in the broader economy is then a higher mean level of ethical business behaviour in the economy. Importantly, directors cannot be held liable for breach of duty on the basis that they acted reasonably in putting business ethics before profit.

Sixthly, the ensuring of equal treatment of shareholders and members of a company is an important part of company law. The provisions ensuring minority protection from abusive behaviour in ss.994 et seq of the CA 2006 are one aspect of this process. Relieving the directors from a claim for breach of duty where they act so as to ensure equal and fair

---

[45] See Alastair Hudson, *Understanding Company Law* (Routledge-Cavendish, 2010), Chapter 14 "Corporate Social Responsibility".

treatment of the company's members is another aspect of that process. Hence, s.172(1)(f) requires that directors have regard to "the need to act fairly as between members of the company."

The nature of the success of the company: consequent provisions

The success of any given company must be decided on its own merits, specifically by reference to the objectives of that company on its formation as expressed in its constitutional documents. Subsections (2) and (3) of s.172 are new. Section 172(2) of the CA 2006 provides that:

> "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."

Therefore, if the company is created with constitutional purposes which are beyond the mere benefit to members (much as a co-operative industrial and provident society is organised around a common bond between members such that the altruistic goals of the organisation outweigh the individual rights of individual members[46]), then those alternative purposes may be taken to constitute a part of the evaluation of the success of that company.[47]

Section 172(3) of the CA 2006 provides that:

> "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."

Section 214 of the Insolvency Act 1986, for example, requires the directors to contribute to the company's assets in the event of wrongful trading. More generally, it is a contested idea in company law whether or not the company and its directors should owe more than contractual duties to its creditors.[48] On one view, the common law held that the directors owed their duties in this sense to the company and not to third parties.[49] In any event, the directors' duties were to ensure that the creditors were not placed in a worse position by the insolvency proceedings, as opposed to advancing their interests actively.[50]

[46] See Alastair Hudson, *The Law of Finance* (Sweet & Maxwell, 2009) 1310 et seq.
[47] *CAS (Nominees) Ltd v Nottingham Forest FC Plc* [2002] 1 BCLC 613.
[48] See, for example, *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250.
[49] *Kuwait Asia Bank v National Mutual Life* [1991] 1 AC 187, 217; *Yukong Line Ltd v Rendsburg Investments (No2)* [1998] 1 WLR 294.
[50] *Re Weldfab Engineers Ltd* [1990] BCLC 833, Hoffmann J. However, identifying where reasonable continuation of activities has been carried on by the directors, as opposed to looking after creditors, is difficult to establish: *Facia Footwear Ltd v Hinchcliffe* [1998] 1 BCLC 218, 228.

The principle in the case law

The "best interests" approach

The case law did not have a principle relating to the promotion of the success of the company directly. Instead, the case law was concerned that the directors should act in the best interests of the company. As considered in the previous section, there were cases such as *Punt v Symons*,[51] *Hogg v Cramphorn*[52] and *Howard Smith v Ampol*[53] in which the directors had sought to obstruct potential takeovers of their companies by using their powers to allot new shares (so that there would not be a majority of shareholders able to vote in favour of the takeover). In those instances it was held that the directors must use their powers for the purposes for which they were intended and also that they must act in the best interests of the company, and not for some collateral purpose. So, in *Punt v Symons*, Byrne J held that issuing shares so as to frustrate the takeover was not "bona fide for the general advantage of the company". In relation to the use of director's powers, this also involved identifying the proper purpose behind that power in the company's constitution.

Interpreting the "success of the company" where there are different interests

It is possible that the ongoing interests of the company are at odds with the short-term goals of shareholders: for example, the company may need to invest in its plant and machinery so as to make profits in the future, whereas some of the shareholders may prefer to receive a large dividend pay-out immediately. It is suggested that it would be a breach of duty if the directors chose in the abstract to prefer the interests of one group of shareholders over another group of shareholders.[54] Alternatively, a shareholder may be in competition with the company and so may wish to have the directors protect his own personal interests as opposed to advancing the company's business. That the directors owe their duties to the company under s.170 is important because it means that the directors must look to the company's interests as an abstract entity; and when taken with the prefatory words to s.172(1), it would suggest that the directors must consider the interests of the shareholders as a collective group (and thus as a "company" or association of people) instead of looking at the separate interests of individual shareholders.[55]

The court's response

On the decided cases, it is not always a straightforward matter to know how to deal with a contention that a director was not promoting the success of the company in good faith. On the

[51] [1903] 2 Ch 506.
[52] [1967] Ch 254.
[53] [1974] AC 821.
[54] *Mills v Mills* (1938) 60 CLR 150, HCA.
[55] See, perhaps, *Mutual Life Assurance Co of New York v Rank Organisation* [1985] BCLC 11, 21, Goulding J; *BSB Holdings Ltd (No2)* [1996] 1 BCLC 155, 251, Arden J.

basis, as discussed above, that the court will not substitute its own decision for the director's decision, then it will be necessary to show that the director could not have believed either reasonably[56] or in good faith that his decision was likely to promote the success of the company. So, it is likely that it is only in cases of egregious default that the court will be confident in upholding a breach of duty, and furthermore it is only in such cases that a claimant will be confident in commencing an action.[57] For example, in *Item Software (UK) Ltd v Fassihi*[58] a director of IS encouraged a distributor company dealing with IS to make its terms more stringent and to consider dealing with him directly. In the event negotiations between IS and the distributor company collapsed, as a result of the director's intervention. In such circumstances the director was clearly not acting in the best interests of the company (nor promoting its success, in modern parlance), and was operating on the basis of a conflict of interest. Similarly, if a director invoices a company fraudulently so as to divert money to himself, then that director would not be promoting the success of the company (and would also be involved in a conflict of interest).[59] However, the cases are unlikely always to be so clear cut.

DUTY TO EXERCISE INDEPENDENT JUDGMENT

It is an essential part of the duties of any fiduciary that that fiduciary is responsible for acts which he performs and also that he is responsible for acts which he ought to have performed: otherwise a fiduciary would be able to avoid liability for breach of duty in circumstances in which he simply failed to act. This would be an opiate on the conscience of fiduciaries.[60] Therefore, company directors are required to perform their duties under Part 10 of the CA 2006 and, under s.173 specifically, they are required to act independently of control by any other person. Therefore, from the perspective of fiduciary law at the very least, company directors are required to exercise their own judgment as to the discharge of their duties and as to the issues which confront the board of directors. Company directors may not simply act as the proxies or nominees of other people. It will certainly not be a good defence to an action for breach of a fiduciary duty that a director was simply taking instructions from another person. Section 173(1) of the CA 2006 provides that:

> "A director of a company must exercise independent judgment."

However, it is not only direction from a third person which is considered (such as the person who ultimately controls a shareholding in the company, or who employs or retains the director in question), but rather it also encompasses senior executives or shadow directors in the company who exercise a de facto power over the directors. In *Re City Equitable Fire*

---

[56] It is suggested that, given that this was originally a common law test, a notion of reasonableness is appropriate.
[57] *Item Software (UK) Ltd v Fassihi* [2004] EWCA Civ 1244, [44].
[58] [2004] EWCA Civ 1244.
[59] *Tesco Stores Ltd v Pook* [2003] EWHC 823. See also *Fulham FC v Tigana* [2004] EWHC 2585.
[60] To borrow from *Bahin v Hughes* (1886) 31 Ch D 390.

Insurance there was a senior executive, Bevan, who controlled the other directors so that Bevan was able to commit numerous frauds with the company's property. The collapse of the Mirror group of companies revealed that Robert Maxwell had the same control over the directors in those companies. The Enron and WorldCom collapses revealed similar patterns of control by a small group of senior executives. It is a feature of many human organisations that one or two people may exercise de facto control far in excess of their legal powers. These sorts of control are also phenomena against which directors are expected to be strong enough to exercise independent judgment.

There are then two exclusions from that duty in s.173(2) in the following terms:

> "(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."

First, if the company has properly entered into an agreement that the company will act in a particular way, then it is permissible for its directors to fetter their judgment and act in accordance with that agreement. Secondly, the company's articles of association and other constitutional documents may authorise the directors to fetter their discretion by acting in a way required by the company's constitution. The case law provided that a director could not fetter his own discretion.[61] Similarly it was held that a director may not excuse himself from liability in general terms simply by arguing that another person has instructed him how to act.

DUTY TO EXERCISE REASONABLE CARE, SKILL AND DILIGENCE

The statutory principle

Section 174 of the CA 2006 creates a statutory duty to exercise reasonable care, skill and diligence. This encapsulates one trend in the case law before 2006 as to the duties of directors. Section 174(1) provides as follows:

> "A director of a company must exercise reasonable care, skill and diligence."

This is an obligation, as indicated by the word "must". There is a question as to whether or not there is a need to exercise reasonable care or alternatively skill or alternatively diligence, or whether there is one, single duty which is a duty to exercise reasonable care, skill and diligence as one composite expression. The statute does not make this clear. The cases have not differentiated between these three terms and therefore it is supposed that there is one composite obligation imposed on directors.

[61] See variously: *Kregor v Hollins* (1913) 109 LT 225; *Fulham FC Ltd v Cobra Estates Plc* [1994] 1 BCLC 363; *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1990] 1 AC 187.

An important question which has arisen on the case law is whether the director must be measured subjectively against his own level of competence or whether the director must be measured against an objective concept of what constitutes reasonable care, skill and diligence for any director. Section 174(2) provides in this context as follows:

> "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."

Therefore, the statute requires us to consider both the objective knowledge of anyone acting as a director and also the individual director when deciding whether or not that individual director has breached this duty. What is measured is the general knowledge (as opposed specifically to technical knowledge, it appears) and the skill and also the experience associated with an ordinary director, even if the defendant in a particular case does not have, for example, that level of experience. Therefore, all directors are required to live up to standards expected of an objective director. The alternative would be an opiate on the conscience of directors everywhere because directors could rely on being ill-informed, lacking skill and having little or no experience so as to avoid any effective liability as a director. In effect, then, an individual director will not be able to rely on his subjective level of experience and so forth unless that subjective level of experience is higher than would be expected from an objective director. In the case law, as will emerge below, the approach drifted from a subjective to an objective test in the late twentieth century. This effect of this drift has been embodied in the statute.

The principle in the case law

The roots of the principle in Re City Equitable Fire Insurance Co Ltd

In essence, the case law history of this principle begins with the decision of Romer J in of *Re City Equitable Fire Insurance Co. Ltd*[62] and then is traced by more recent decisions resiling from that judgment on the basis, in effect, that the uses of companies in the modern context have made the approach of Romer J appear to be a little antique. Principally, Romer J took the approach that directors bore little personal responsibility to turn up for anything more than board meetings and that they could delegate the day-to-day administration of the company's business to subordinate managers and employees. This gloriously Edwardian approach to the idea of the gentleman director attending at meetings, lending his good name to the company, but taking only light responsibility for the day-to-day machinations of the corporation seems very old-fashioned. If one were to read some of the great Victorian novels

[62] [1925] Ch. 407, at p.428.

which consider companies then this attitude to directors seems less unusual. In Anthony Trollope's novel *The Way We Live Now*, for example, the powerful financier Melmotte created a company to build a railroad in America and filled the board of directors with aristocratic idiots who would do his bidding and whose family names lent allure to the company's reputation. Meetings of the board took place at speed and it was clear that no-one except Melmotte really understood the business which was being conducted nor the decisions which were being made. Board meetings were in effect an excuse to have lunch together. This is not how directors of companies are expected to behave today. It is expected that executive control will be exercised by professional directors who are well-paid for their hard work and expertise. The modern understanding of the responsibilities of directors necessitates a more hands-on approach and direct responsibility for the failings of the company. However, duties of care, as is the case with fiduciary duties, can always be ratified by the company.[63] The case law has, it is suggested, recognised this drift in the understanding of the role of directors.

The facts of *Re City Equitable Fire Insurance Co. Ltd* are interesting. They are typical of those corporate frauds where one senior executive tends to dominate the organisation with the result that the other directors follow his orders and either wittingly or unwittingly assist him to commit fraud. So, in *Re City Equitable Fire*, the leading light of the company, Bevan, committed widespread fraud in a notorious corporate collapse in the 1920's. The issue was whether or not some of his fellow directors and the company's auditors were liable to the company for allowing Bevan to do what he did: in particular, those directors who had signed blank cheques for Bevan and the auditors who were alleged to have overlooked fraud with "wilful default". Romer J acknowledged that the "position of a director of a company carrying on a small retail business is very different from that of a director of a railway company", in that large businesses had different challenges for a director from smaller businesses. As Romer J held, "in discharging the duties of his position thus ascertained a director must, of course, act honestly; but he must also exercise some degree of both skill and diligence".[64] It was held that the directors who had signed blank cheques in favour of third parties had not done so in circumstances in which there was anything to have caused them to be suspicious and so they were not liable.

So, to begin at the beginning, directors' duties of care towards the company were, for many years, defined in three propositions laid down by Romer J. in *Re City Equitable Fire Insurance Co. Ltd*.[65] These principles, which have been doubted in more recent cases and by s.174 of the CA 2006, were set out as being three in number in his lordship's judgment. Each is considered separately in the sections to follow, including subsequent case law dealing with them.

[63] *Pavlides v Jensen* [1956] Ch. 565.
[64] *Ibid*, 427.
[65] [1925] Ch. 407, at p.428.

(1) The subjective level of skill

First, Romer J held that, on the basis of earlier authority, "[a] director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience".[66] As Lindley M.R. held elsewhere: "[i]f directors act within their powers, if they act with such care as is reasonably to be expected from them, having regard to their knowledge and experience, and if they act honestly for the benefit of the company they represent, they discharge both their equitable as well as their legal duty to the company".[67] This means that a director was to have been held to his own, subjective standard of ability, knowledge and experience, and not that of the reasonable man. Such a director was required, however, to take the same level of care in the performance of his duties as an ordinary man might be expected to take when acting on his own behalf.

This understanding of a director's standard of care in relation to the company was first modified in respect of an executive director: that is, by someone who has a service contract with the company. There is an implied term in such a contract that the director will use reasonable skill in the performance of the duties of the office based on what might reasonably be expected from a person in his position.[68] However, more significantly, the general standard of care for all directors has been restated by Hoffmann L.J. in two cases, with virtually no discussion as to the rationale for the change, as being the same as the test for establishing wrongful trading under s.214(4) of the Insolvency Act 1986. These cases are significant. In *Norman v Theodore Goddard*,[69] the standard of care expected of directors was stated as being that of a reasonably diligent person having the knowledge, skill and experience both of a person carrying out that director's functions and of that person himself. Thus the test was expressed as being both objective and subjective.

This test was also applied by Hoffmann L.J. in *Re D'Jan of London Ltd*[70] to establish the negligence of a director in signing an inaccurate fire insurance proposal form to insure the company's property. The facts of that case are interesting. The director signed an insurance form without having read it. As a result, the company failed to disclose the information required by the insurance company so as to make the insurance contract binding. Consequently, when the company's warehouse caught fire and destroyed a large amount of stock worth £174,000, the company was uninsured. It was found by his lordship that the director "did not strike [his lordship] as a man who would fill in his own forms".[71] Hoffmann LJ considered that the amount of work and the amount of diligence required of a director would differ from circumstance-to-circumstance:

> "I do not say that a director must always read the whole of every document which he signs. If he signs an agreement running to 60 pages of turgid legal prose on the assurance of his solicitor that it accurately reflects the board's instructions, he may well be excused from reading it all himself. But this was an extremely simple document asking a few questions which Mr D'Jan was the best person to answer."

[66] [1925] Ch. 407, at p.428.
[67] *Lagunas Nitrate Co. v. Lagunas Syndicate* ([1899] 2 Ch 392, 435.
[68] *Lister v Romford Ice and Cold Storage Co. Ltd* [1957] A.C. 555.
[69] [1991] B.C.L.C. 1028. The director was excused liability on the basis of reasonable reliance on another under the third of Romer J.'s propositions.
[70] [1994] 1 B.C.L.C. 561, CA, see also *Cohen v Selby* [2001] 1 BCLC 176, CA.
[71] [1994] 1 B.C.L.C. 561, 562.

Therefore, the director was personally liable to compensate the company on these facts because this was a simple form which the director should personally have read and dealt with, even though there might be circumstances in which a director might be absolved from liability. In essence, it is suggested that a director is well-advised to seek advice in more complex circumstances so that he cannot be held to have negligently failed to attend to this sort of duty. On either test, whether subjective or objective, it was held that the director in *D'Jan* had failed to act with reasonable diligence. The remedy was expressed to be an obligation to "compensate" the company.[72]

Since it is now accepted that the wrongful trading standard is the standard of care for negligence,[73] the cases on wrongful trading (and disqualification) on what is expected of a director, set out later in this chapter, will be of great significance in any negligence action.

(2) The quality of attention which a director must give to the affairs of the company

Secondly, and somewhat at odds with the modern understanding of the duties of a director, Romer J held that:

> "A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings, and at meetings of any committee of the board upon which he happens to be placed. He is not, however, bound to attend all such meetings, though he ought to attend whenever, in the circumstances, he is reasonably able to do so."[74]

A more modern and appropriate approach, it is suggested, is that set out in *Dorchester Finance Co. Ltd v Stebbing*,[75] in which two non-executive directors were held to be negligent in not attending board meetings of a subsidiary company even though it was shown that it was not commercial practice to do so. Directors also signed blank cheques for a director who rarely attended the company's offices, with the result that that director embezzled money from the company. Foster J approved the test set out by Romer J,[76] although he came to conclusions on the facts in front of him which seemed different from those which Romer J would have reached. It was held that it was important to recognise that the directors were accountants and people with long experience of acting in the financial affairs of various bodies, and consequently that they could not assert that non-executive directors had no duties to perform. Foster J expressed himself as being "alarmed" at the very suggestion. The signing of blank cheques was held to have been negligent. As for the director who misused the blank cheques, such that he took £400,000 from the company, it was held that he had "knowingly and recklessly misapplied the assets" of the company with the effect that he had committed gross negligence and so was liable for "damages".[77]

[72] [1994] 1 B.C.L.C. 561, 564.
[73] See e.g. the Government's position as set out in Modernising Company Law, Cmn 5553-1, paras. 3.2-3.7, accepting the suggestions of the Company Law Review.
[74] [1925] Ch. 407, at p.428.
[75] [1989] B.C.L.C. 498.
[76] [1989] BCLC 498, 501.

[77] [1989] BCLC 498, 505.

(3) The extent to which a director may delegate responsibilities to another person

Thirdly, it was held by Romer J that a director is entitled to trust a manager or other official to perform any duties which are delegated to him honestly, provided that this is in compliance with the exigencies of business and the articles of association, and provided that there were no grounds for suspicion when delegating tasks to that official.[78] This proposition is of particular relevance to the supervisory role of the non-executive directors in larger companies.[79] In *Equitable Life Assurance Society v Bowley*,[80] it was said, without a detailed examination of the issue since it was a summary application, that the law in this area is developing and that the third proposition in *City Equitable Fire* no longer represents the modern law. It was plainly arguable that a company may look to its non-executive directors for independence of judgement and supervision of the executive management.

An alternative formulation of the third proposition is that set out by Jonathan Parker J. and approved by the Court of Appeal in the disqualification case of *Re Barings plc (No. 5)*:[81]

> "(i) Directors have, both collectively and individually, 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. (ii) Whilst directors are entitled (subject to the articles of association of the company) to delegate particular functions to those below them in the management chain, and to trust their competence and integrity to a reasonable extent, the exercise of the power of delegation does not absolve a director from the duty to supervise the discharge of the delegated functions. (iii) No rule of universal application can be formulated as to the duty referred to in (ii) above. The extent of the duty, and the question whether it has been discharged, must depend on the facts of each particular case, including the director's role in the management of the company."

That formula was concerned with delegation by all directors down the chain of management but it could equally well apply to supervision of those above the non-executive directors in that chain. It is suggested that this approach is more successful in understanding the modern expectation of directors, particularly in public companies. Securities regulation expects that management and in particular the board of directors will understand the company's obligations under those regulations.[82] Investors will expect that the directors and the company's management structure maintains a firm hand on the tiller in relation to all business issues and also in relation to its understanding of any changing market in which it operates. The corporate world has changed radically from the world of Trollope's characters in *The Way We Live Now* or the non-existent board of the Anglo-Bengali Disinterested Life Assurance Company in Dickens's *Martin Chuzzelwit*, into an age of professional directors taking responsibility for the success or failure of a business. The *Barings* litigation dealt with a cadre of management in a long-standing bank which had failed to supervise or to put in place systems which would supervise the activities of one employee in particular in

[78] As Romer J put the same idea, somewhat inelegantly: "In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly": *ibid*, 428.

[79] For the situation of a non-active director of a small company see the sections on wrongful trading and disqualification, below.

[80] [2004] 1 B.C.L.C. 180.

[81] [1999] 1 B.C.L.C. 433 at 489, approved [2000] 1 B.C.L.C. 523 at 535-536, CA.

[82] See Alastair Hudson, *Securities Law* (Sweet & Maxwell, 2008), para 6-07.

Singapore who was able as a result to manufacture large numbers of false transactions which bankrupted the entire institution when they unwound. In an era of gentleman directors it might have been appropriate to excuse them for liability for the fraudulent acts of a single employee many thousands of miles away, but in the modern era it is not. Particularly in relation to banking, there are regulatory requirements in the FSA Handbook's "SYSC" rulebook on financial institutions to maintain adequate systems and management processes. In this new world, the company director bears positive obligations to ensure the well-being of the company which were not understood to be the norm in 1925 when *Re City Equitable Fire Insurance Co* was decided.

DUTY TO AVOID CONFLICTS OF INTEREST

Introduction

One of the core tenets of the law on fiduciary duties is the obligation to avoid conflicts of interest. This is a core principle of equity.[83] The conflict of interest which is referred to here is a conflict between a director's fiduciary's duties and his personal interests. For example, there would be a conflict of interest in a situation in which a director of a company was also carrying on business as a sole trader in competition with the company and so voted at a meeting of the board of directors against exploiting a specific business opportunity so that he could exploit it on his own account. That the fiduciary must avoid conflicts of interest has two consequences in equity. First, the fiduciary will be required to account for any unauthorised profit acquired as a result of a conflict of interest.[84] This account takes the form of holding any profit on constructive trust for the beneficiaries of that fiduciary duty, or of holding any property acquired with that profit on constructive trust for the beneficiaries of that fiduciary duty, or (if the property or its traceable proceeds cannot be identified) of accounting personally to the beneficiaries of that fiduciary duty for the amount of the profit.[85] Secondly, the fiduciary must not only avoid actually taking profits from such a conflict but must also prevent any possibility that there has been a conflict of interest.[86] In consequence the general equitable principles have been applied very strictly indeed, as Lord Chancellor King intended in the early case of *Keech v Sandford*.[87] Recent decisions of the Court of Appeal in the company law context have suggested a distaste for the rigour of these fiduciary obligations.[88] It will be suggested that this drift in the cases does not, however, show

[83] See Alastair Hudson, *Equity & Trusts* (6e, Routledge-Cavendish, 2009), section 12.5.
[84] *Regal v Gulliver* [1942] 1 All ER 378; *Boardman v Phipps* [1967] 2 AC 47.
[85] *Boardman v Phipps* [1967] 2 AC 47; *CMS Dolphin Ltd v. Simonet* [2001] 2 BCLC 704, Lawrence Collins J; *Sinclair Investment Holdings SA v Versailles Trade Finance Ltd (No 3)* [2007] EWHC 915, 10 ITELR 58, Rimer J.
[86] Companies Act 2006, s.175. See also the decisions of variously constituted Houses of Lords asserting the need to avoid potential conflicts of interest as part of the equitable principle in *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461, 471, [1843-60] All ER Rep 249, 252, *per* Lord Cranworth; *Bray v Ford* [1896] AC 44, at 51; [1895-99] All ER Rep 1009, at 1011, *per* Lord Herschell; *Regal v Gulliver* [1942] 1 All ER 378; *Boardman v Phipps* [1967] 2 AC 47 relating to the need under the general equitable principle to avoid conflicts of interest.
[87] (1726) 2 Eq Cas Abr 741.
[88] *Murad v Al-Saraj* [2005] EWCA Civ 959; *Foster v Bryant* [2007] Bus LR 1565, considered below.

sufficient appreciation for the significance of the fiduciary principles. We shall begin with the statutory expression of the principle.

The statutory expression of the principle

The core duty

The duty to avoid conflicts of interest[89] is contained in s.175 of the CA 2006 in the following terms:

> "(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."

The obligation is incumbent on each individual director separately. The duty specifically is a duty to avoid situations where there may possibly be conflicts of interest, and not simply a duty to refrain from benefiting from a conflict of interest. The duty is therefore much broader than, for example, a duty simply to avoid taking profits from conflicts of interest or of causing loss to the company or to its shareholders by means of exploiting a conflict of interest. Therefore, the duty is breached (subject to the defences considered below) simply by failing to avoid a situation where there may be a conflict of interest. The precise conflict of interest which is at issue here is a conflict between the director's personal interests and the interests of the company. The director's interest may be direct, for example where he stands to take a fee for providing a personal service to the company; or it may be indirect, for example where the director owned shares in a company which would have taken a profit from a transaction.

It is important that it is the interests of the company which are at issue and not, for example, the personal interests of some of the shareholders nor of any particular shareholder.[90] Thus, to take two hypothetical examples: there may be a distinction between the interests of the company in developing a successful business in the long-term in relation to which a director may benefit personally from supplying that company with raw materials, which would be a conflict of interest falling under s.175 because it relates to the interests of the company; and a situation in which one of the minority shareholders wished to have the company earn large short-term profits so as to realise a large dividend in the short-term as opposed to contracting with the director to acquire raw materials at a fair price in the long-term, where that would concern an interest of the shareholder personally and not necessarily an interest of the company. The question as to whether or not the duty had been breached would centre on the interests of the company and not on the interests of the shareholder. Therefore, if the dealing

[89] It is provided in CA 2006, s.175(7) that "Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties."

[90] This is the key difference between companies and trusts because it would be the equitable interests of the beneficiaries which would be important because a trust has no distinct legal personality, whereas because companies have distinct legal personalities and because s.170 CA 2006 requires that it is company which is owed these duties then the particular, personal interests of the shareholders are not significant.

between the director and the company was considered to be appropriate (on the basis of s.175(3) CA 2006 considered below) then it would not matter if it conflicted with the wishes of one of the minority shareholders to earn a short-term dividend profit. The remaining provisions of s.175 qualify this general duty, as considered next.

The application of s.175 to former directors

At first blush, there would seem to be a very simple way of avoiding this duty if a director were to resign his directorship either immediately before or immediately after taking a profit from a conflict of interest and so claim an entitlement to keep it. With this sort of problem in mind, s.170(2) CA 2006 provides that:

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

Section 175 therefore applies both to current directors and also to former directors. The issue is therefore whether the conflict of interest related to "the exploitation of any property, information or opportunity" and furthermore whether or not the director "became aware at a time when he was a director" of that "exploitation".[91]

Application of the general duty

The scope of the duty is illustrated by s.175(2) in the following terms:

> "(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)."

This provision gives one clear example of circumstances in which the general duty applies. That relates to an "exploitation", which is a term which could be interpreted either narrowly as a pejorative abuse of property or equally as simply any use of property with a view to a personal profit for a director. It is suggested that the broader interpretation of exploitation as any use of property with a view to profit fits better with the general statement of the principle in s.175(1). Where that exploitation relates to the company's property then that would be

[91] The syntax of the subsection requires that it is the "exploitation" which must have been within the director's contemplation, and not the presence of a conflict of interest. This is a rather odd limitation given that it focuses the director only on avoiding exploitation of property, etc., and not straightforwardly on avoiding all forms of conflict of interest (whether or not they relate to exploitation of property, etc.).

straightforwardly to misapply property belonging to another person (i.e. the company) for personal gain. In relation to the company's commercial activities, it will also be important to cover "information" or an "opportunity" because information which is of commercial value (whether because it is confidential information in the form of intellectual property, or simply information which has general commercial worth), or an opportunity which could have been exploited profitably by the company itself are akin to property in that they may generate profit for a trading company.[92]

Limitations on the general duty in relation to transactions

The entire statutory scheme of directors' duties is hemmed in by exceptions, and (if you will pardon the expression) s.175 is no exception to that. The scope of the duty is further qualified by s.175(3) in the following terms:

> "(3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company."

The provisions relating to dealings with the company are dealt with by s.177 of the CA 2006, as considered below.

Limitation on the duty where there has been authorisation

The central principle that fiduciaries may not permit conflicts of interest is clear, and the case law has always upheld that general principle strictly. Consequently, the heart of the case law on fiduciaries being involved in conflicts of interest has always been deciding whether or not any given defendant has had authorisation to permit or to profit from a conflict of interest so that no liability to account attaches to him. This concept of authorisation is therefore effectively a defence to the general duty. In s.175, the ambit of this defence and the procedure which must be followed so as to benefit from it are set out in the following four subsections of s.175. To be being with, s.175(4) provides that:

> "(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."

There are effectively two defences to a claim based on a conflict of interest. Thus paragraph (a) permits the introduction of a modicum of common sense to be used to decide whether or not a conflict of interest is likely. Alternatively, paragraph (b) provides for a defence where the directors (which, in the plural, is taken to constitute a majority of the board of directors,

[92] See for example *Don King v Warren* [1998] 2 All ER 609 where it was held that the benefit which would flow from a non-transferable contract could itself form the subject matter of a trust and was therefore property.

as considered below) have "authorised" the particular matter at issue. The definition of what constitutes authorisation is considered in s.175(5) in the following terms:

> "(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."

The concept of authorisation therefore applies differently to private companies and public companies. In relation to a private company, the articles of association may prevent an authorisation being granted by the directors. If there is no such prevention of authorisation being granted in the private company's constitution, then the directors may authorise something which might otherwise be a conflict of interest. By contrast, in relation to public companies the company's constitution must contain a power for directors to authorise what would otherwise be a conflict of interest. What is less clear is whether the constitution may empower the directors to authorise such conflicts of interest in general terms, or whether only one particular transaction may be authorised at a time. It is suggested that the subsection would be satisfied if the constitution permitted the directors in general terms to approve what would otherwise be conflicts of interest.

The statute appears to anticipate simply that a majority of the directors is permitted to authorise a conflict of interest. An alternative reading would be that the use of the term "the directors" means *all* of the directors agreeing to the authorisation. However, the manner in which authorisation must take place is qualified by s.175(6) of the CA 2006 in the following terms, which appears to suggest that any quorum permitted in the company's constitution is sufficient:

> "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."

Thus the statute provides a mechanism for directors avoiding liability stemming from conflicts of interest. In essence, s.175 provides that a director bears an obligation to avoid even potential conflicts of interest, although that duty does not exist if the directors have authorised the conflict of interest, or if there is not likely to be any reasonable conflict of interest.

The principle in the case law

The principle in essence

As considered above, the principle in s.175 is predicated on the case law which has come before it. The earliest decision of the House of Lords in this context is that in *Keech v Sandford*[93] which held that a fiduciary may not take unauthorized profits from his office.[94] The basis for this principle is said to be that the fiduciary may not permit conflicts between his personal capacity and his fiduciary capacity.[95] The proper approach to the nature of the company's rights when a fiduciary acquires an unauthorised profit is set out by Rimer J in *Sinclair Investment Holdings SA v Versailles Trade Finance Ltd (No 3)*[96] and by Lawrence Collins J in *CMS Dolphin Ltd v. Simonet*.[97] The company's rights have always been generally described by the courts on the basis that the fiduciary is "liable to account" for the unauthorised profit. The question then is: what is meant by this obligation to account? The answer is that the principal right of the company (or beneficiary under a trust or principal in an agency arrangement) is to have the fiduciary's personal profit held on constructive trust (and in turn any property acquired with that profit[98]). If there is no property which can be separately identified as being held on trust (for example, because the profits have all been dissipated), then the director owes a personal obligation to the company to account in money or money's worth for the amount of the profits. Rimer J has explained this doctrine accurately in *Sinclair Investment Holdings SA v Versailles Trade Finance Ltd (No 3)*[99] in the following terms:

> "… any identifiable assets acquired by fiduciaries in breach of their fiduciary duty are, and can be declared to be, held upon constructive trust for the principal[100] (*Boardman v Phipps,*[101] *AG Hong Kong v Reid,*[102] *Daraydan Holdings Ltd v Solland*[103]) … There will in practice often be no identifiable property which can be declared by the court to be held upon such a constructive trust, in which case no declaration will be made and the principal may at most be entitled to a personal remedy in the nature of an account of profits. In Boardman's case the court made a declaration that the shares that had been acquired by the fiduciaries were held on constructive trust (a proprietary remedy), and directed an account of the profits that had come into their hands from those shares (a personal remedy). Boardman's case can be said to have been a hard case as regards the fiduciaries, whose integrity and

[93] (1726) 2 Eq Cas Abr 741.
[94] This principle is discussed in detail in Alastair Hudson, *Equity & Trusts* (6e, Routledge-Cavendish, 2009), section 12.5, p.535-564.
[95] *Boardman v Phipps* [1967] 2 AC 47.
[96] [2007] EWHC 915, 10 ITELR 58.
[97] [2001] 2 BCLC 704.
[98] As is suggested by *Attorney-General for Hong Kong v Reid* [1994] AC 324 and *Westdeutsche Landesbank v Islington* [1996] AC 669.
[99] [2007] EWHC 915, 10 ITELR 58.
[100] In the context of company law, the "principal" is the company further to s.170 of the Companies Act 2006.
[101] [1967] 2 AC 47.
[102] [1994] AC 324.
[103] [2005] Ch 1.

> honesty was not in doubt; and it well illustrates the rigours of the applicable equitable principle. The recovery by the trust of the shares was obviously a valuable benefit to it; and equity's softer side was reflected in the making of an allowance to the fiduciaries for their work and skill in obtaining the shares and profits. On the very different facts of *Reid's* case, there was no question of any such allowance being made."

Therefore, the position is clear: the company's primary right is for a proprietary constructive trust over the director's profits; the secondary right (if there is no property over which the constructive trust can take effect) entitles the company to a personal remedy in the form of an account of profits from the director; and thirdly the court may make some equitable accounting to reduce the amount of any such account if the court considers the circumstances to be appropriate for the equitable relief of such a defendant (as considered below).[104]

The primary form which the liability to account takes is in the form of a constructive trust, whereby a proprietary right is imposed over those profits such that the fiduciary becomes a constructive trustee over those profits. Because the company acquires a proprietary right over the profits, that beneficiary also has a proprietary right over any property that is acquired with those profits. This constructive trust right also means that even if those profits are mixed with other money, then the beneficiary acquires a right to trace into that mixture or into any substitute property and to impose a proprietary right over it.[105] The secondary form which the liability to account takes is predicated on the idea either that the profits cannot be traced or that the property substituted for the profits can be traced but has become worthless. In such a situation, the proprietary right would be worthless. In this second context, the fiduciary's liability is instead to account for the amount of the unauthorised profits personally by paying money or money's worth to the company equal to the amount of the profits. Therefore, equity provides the company with a remedy in one way or the other.

So, in the leading case of *Boardman v Phipps*[106] the beneficiaries suffered no loss when Boardman, a solicitor who advised their trustees, acquired shares in a private company on his own account while advising the trustees as to the trust's shareholding in that same company, but the beneficiaries were nevertheless entitled to force Boardman to account for the unauthorised profits which he made through his fiduciary office on those shares.[107] The basis of this liability is predicated on an actual or even a potential conflict between the fiduciary's personal interests and his fiduciary office.[108]

---

[104] See also *Markel International Insurance Co Ltd v Surety Guarantee Consultants Ltd* [2008] EWHC 1135 (Comm) illustrating the principle that secret profits made by a fiduciary must be subject to an account.
[105] *Westdeutsche Landesbank v Islington* [1996] AC 669. See Alastair Hudson, *Equity & Trusts* (6e, Routledge-Cavendish, 2009), Chapter 19.
[106] [1967] 2 AC 46.
[107] Consequently this is not a restitutionary remedy because the fiduciary need not have earned her profits at the beneficiaries' expense, as the theory of restitution of unjust enrichment requires. Instead, it is enough that the equitable wrong of earning unauthorised profits from a fiduciary office has been committed.
[108] E.g. *Boardman v Phipps* [1967] 2 AC 46.

The roots of the principle are in equity and in the need to prevent fiduciaries from acting unconscionably in the sense of permitting conflicts of interest.[109] As this principle was expressed by Lord Herschell in *Bray v Ford*:[110]

> "It is an inflexible rule of the court of equity that a person in a fiduciary position … is not, unless otherwise expressly provided [in the terms of that person's fiduciary duties], entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as had been said, founded upon principles of morality.[111] I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to lay down this positive rule."

So, the rule is considered to be a strict rule, as was accepted by separately constituted Houses of Lords in *Regal v Gulliver*[112] and in *Boardman v Phipps*,[113] considered in detail below. As Lord King held in *Keech v Sandford*:[114]

> "This may seem hard, that the trustee is the only person of all mankind who might not have [the property]: but it is very proper that rule should be strictly pursued, and not in the least relaxed; for it is very obvious what would be the consequence of letting trustees have the [property]…"

That same principle applies mutatis mutandis to company directors, instead of trustees. Its base is the need to avoid conflicts of interest between a fiduciary's personal and fiduciary capacities, and is not dependent on proof of bad faith. As Lord Cranworth expressed this principle:[115]

> "… it is a rule of universal application that no one having such duties to discharge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect."

---

[109] See *Yugraneft v Abramovich* [2008] EWHC 2613 (Comm), [2008] All ER (Comm) 299, para [373], *per* Clarke J where this explanation of the principle in *Attorney-General for Hong Kong v Reid* [1994] 1 AC 324 is advanced, further to the speech of Lord Browne-Wilkinson in *Westdeutsche Landesbank v Islington* [1996] AC 669 asserting that unconscionability is the central, organising principle in cases of constructive trust, and indeed all trusts.
[110] [1896] AC 44, at 51; [1895–99] All ER Rep 1009, at 1011.
[111] Although see, eg, Parker LJ in *Bhullar v Bhullar* [2003] 2 BCLC 241, para [17] referring to the 'ethic' in these cases.
[112] [1942] 1 All ER 378.
[113] [1967] 2 AC 47.
[114] *Keech v Sandford* (1726) Sel Cas Ch 61.
[115] *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461, 471; [1843–60] All ER Rep 249, 252.

Nevertheless, it is important that the defendant be shown to have been acting in a fiduciary capacity for this principle to take effect. As emerges from Lord Cranworth's dicta, it is necessary that the defendant had appropriate duties before the principle would apply.[116]

The application of this principle in Boardman v Phipps *and in* Regal v Gulliver

The most recent decision of the House of Lords considering this equitable principle in general terms was that in *Boardman v Phipps*,[117] a case which relates to trusts. This case followed and applied the decision of the House of Lords in *Regal v Gulliver*,[118] relating to companies. The respondent, Boardman, was solicitor to a trust who was taken to be acting in a fiduciary capacity. The trust fund included a minority shareholding in a private company. While making inquiries as to the performance of the company on behalf of the trust, Boardman and the one active trustee learned of the potential for profit in controlling the company through information which they obtained as a result of being permitted to attend a general meeting of this private company on behalf of the trust. Boardman and the trustee decided to acquire enough shares personally so that they would hold a majority shareholding in the company together with the trust's shareholding. Boardman informed the active trustee that he intended to do this. However, it was held that Boardman had not provided all of the trustees with enough information to be able to rely on the defence of their authorisation for his plans. Boardman was able to assume control of the company and to generate a large profit for all concerned. The question arose whether or not he was liable to account for the personal profits which he had earned from the transaction. The majority of the House of Lords held that Boardman should hold the profits on constructive trust for the beneficiaries of the existing trust. The minority, Viscount Dilhorne and Lord Upjohn, dissented on the basis that Mr Boardman had not acted in bad faith and therefore that he ought not to be subjected to a constructive trust. Mr Boardman was entitled to some compensation (known as 'equitable accounting') for his efforts in spite of the imposition of the constructive trust. All of their lordships agreed on the core equitable principle, however; they disagreed only as to their application to the particular facts of this case. As Lord Upjohn held:

> 'Rules of equity have to be applied to such a great diversity of circumstances that they can be stated only in the most general terms and applied with particular attention to the exact circumstances of each case. The relevant rule for the decision of this case is

[116] So, in *Re Biss* [1903] 2 Ch 40, a son was entitled to take possession of a renewed lease where, acting in good faith, he had sought a renewal in his own name of a lease which had formerly been held by his father's business, after his father had died intestate. It was held that the son did not occupy a fiduciary position in respect of his father's business, unlike the trustee in *Keech v Sandford* (1726) 2 Eq Cas Abr 741, who clearly occupied the fiduciary position of trustee in relation to the infant's settlement. Therefore, the son in *Re Biss* would not be subject to a constructive trust over the renewed lease in his own name. So, if those profits were not earned in a fiduciary capacity, then an account for the profits earned will not be ordered: see e.g. *Experience Hendrix LLC v PPX Enterprises Inc* [2003] EWCA Civ 323; [2003] 1 All ER (Comm) 830; [2003] EMLR 515, where royalties had not been paid to a musician further to a contract, but in circumstances in which the defendant was not in a fiduciary relationship to the claimant, there was a right to contractual recovery of money but no equitable accounting.

[117] [1967] 2 AC 46, 67. See also *Blair v Vallely* [2000] WTLR 615; *Ward v Brunt* [2000] WTLR 731.

[118] [1942] 1 All ER 378.

> the fundamental rule of equity that a person in a fiduciary capacity must not make a profit out of his trust which is part of the wider rule that a trustee must not place himself in a position where his duty and his interest may conflict.'

These dicta contained the central statement of principle to the effect that the constructive trust in this case is predicated on the need to prevent conflicts of interest.

The House of Lords in *Regal v Gulliver*[119]considered a situation in which four directors of a company which operated a cinema sought to divert a business opportunity to acquire two further cinemas to a separate company which they controlled. The first company could not afford to acquire the rights to all of the cinemas out of its own resources and its directors were reluctant to give personal guarantees for the extra sums needed. Therefore, the four directors of the plaintiff company and a solicitor subscribed for shares in the second company which took up the opportunity. Control of the original company passed into new hands and so that company brought proceedings against the four directors to account for the profits which they had realised from these transactions. It was held that the directors' profits on these shares were profits made from their fiduciary offices as directors. Therefore, they were required to account for those profits to the company. Lord Russell was clear that the obligation to account for profits was in no way predicated on proof of fraud or mala fides on the part of the directors. "The liability arises from the mere fact of a profit having, in the stated circumstances, been made", in the words of Lord Russell, by a fiduciary. Because the four directors were acting as directors of the plaintiff company at the time they entered into this transaction and made their profits, they were liable to account for them to the plaintiff company. Lord Russell relied on the principle in *Keech v Sandford* and the other cases referred to above in finding that this was intended to be a strict rule. All of their lordships delivered concurring speeches affirming the importance of the strict principle that fiduciaries may not earn unauthorised profits from their fiduciary offices. The four directors were not able to rely on their purported grant of authorisation to themselves to pursue this opportunity on their own account. Equally, if a director seeking authorisation from the other directors fails to make sufficiently full disclosure of all the relevant facts, then that director will not be taken to have acquired authorisation to earn personal profits.[120] It was held by Lord Russell that the directors could have acquired authorisation by seeking a vote of the general meeting of the company's shareholders to agree to the transaction. Under s.175(4) and (5) of the CA 2006, that would no longer be required, as discussed above.

The general principle that the profit must relate to a conflict of interest

The general principle is predicated on the need for any person acting in a fiduciary capacity to avoid conflicts of interest, and will therefore not be excluded where the fiduciary suggests

---

[119] [1942] 1 All ER 378.

[120] *IDC v Cooley* [1972] 1 WLR 443; *Gwembe Valley Development Co Ltd v Koshy (No 3)* [2004] 1 BCLC 131, where the managing director of a company formed to farm in Zambia failed to disclose his personal interest in activities in which the company was engaged and therefore was held to be liable to account to the company for the profits which he had made.

that the profit was earned outwith the scope of his precise duties or that it was not predicated directly on misuse of the company's property. So, in the Court of Appeal in *Bhullar v Bhullar*,[121] the principle has been reasserted that the constructive trust in this context is not dependent on any interference with the company's property, but rather is based on the avoidance of conflicts of interest. In that case, the directors of a family company learned of an opportunity to acquire land neighbouring the company's land but acquired it on behalf of a second company which was under their exclusive control. The background circumstances were that the various family members who owned shares in the family company had fallen out and consequently it was difficult to forge a consensus among the shareholders as to how the company should proceed. It was held by Jonathan Parker LJ that the principle is a simple one, even if it may occasionally be difficult or seemingly harsh to apply. The directors were bound by their fiduciary duties to the family company, the acquisition of the neighbouring land was an opportunity which would have been attractive to the family company, but the directors had not made that opportunity known to the family company. Therefore, the directors had not acquired authorisation to proceed on their own account. Consequently, it was held that there was a "sensible possibility of conflict" on these facts and therefore the equitable principle in *Regal v Gulliver* applied. An Australian decision has similarly held that this form of constructive trust is based on the fiduciary's obligation to permit no conflict between his personal benefit and his duties to others.[122]

Furthermore, it has been held that there is no need to demonstrate that the profit was earned directly "from the fiduciary office" as opposed to being made in general terms in a manner which involved a conflict between the fiduciary's personal interest and her fiduciary duties.[123] So, as Morritt VC has held:[124]

> 'If there is a fiduciary duty of loyalty and if the conduct complained of falls within the scope of that fiduciary duty as indicated by Lord Wilberforce in *NZ Netherlands Society v Kuys*[125] then I see no justification for any further requirement that the profit shall have been obtained by the fiduciary "by virtue of his position". Such a condition suggests an element of causation which neither principle nor the authorities require. Likewise it is not in doubt that the object of the equitable remedies of an account or the imposition of a constructive trust is to ensure that the defaulting fiduciary does not retain the profit; it is not to compensate the beneficiary for any loss.'

Therefore, if, for example, a director took some advice from the stockbrokers advising a company which was in the business of investing in shares that there was only one remaining parcel of shares which were expected to realize a massive profit, and if the director acquired those shares for herself rather than for the company, it would not be open to the director to argue that she acquired the shares on her own account and not while working for the

---

[121] [2003] 2 BCLC 241, para [27], *per* Parker LJ.
[122] Deane J in *Chan v Zacharia* (1984) 154 CLR 178.
[123] *United Pan-Europe Communications NV v Deutsche Bank* [2000] 2 BCLC 461; *Button v Phelps* [2006] EWHC 53.
[124] *United Pan-Europe Communications NV v Deutsche Bank* [2000] 2 BCLC 461, para [47]; approved in *Button v Phelps* [2006] EWHC 53, para [66].
[125] [1973] 1 WLR 1126.

company. Otherwise it would be too simple for fiduciaries to argue that they were acting in a different capacity when taking direct or indirect advantage of their office. Instead, the strict principle in *Keech v Sandford* and *Bray v Ford* is to be enforced so that no possible conflict of interest can be allowed to exist. This, it is suggested, is the reason for supporting the decision of the majority of the House of Lords in *Boardman v Phipps*: if Boardman had been permitted to retain his profits, then the purity of the principle derived from *Keech v Sandford* and from *Bray v Ford* would have been fatally compromised.

The defence of authorisation in the case law

There is, effectively, a defence to an action for constructive trust on grounds of making personal profits that the fiduciary had authorisation so to do. The effect of s.175(5) of the CA 2006 is that it formalises the way in which fiduciaries can acquire the necessary authorisation, whereas on the authorities there were few circumstances in which authorisation was found to have been granted. It was suggested by the House of Lords in *Boardman v Phipps* that the solicitor could have avoided liability had he made a disclosure of his intention to make share purchases on his own account, whereas on the facts no such disclosure was made and moreover one of the trustees had been too ill to have received such a disclosure. Similarly, in *Regal v Gulliver* there was no disclosure and therefore no authorisation, except in the form of a purported authorisation by the directors themselves for the action which they proposed to take. It was held, in essence, that the fiduciaries could not authorise themselves. As s.170 of the CA 2006 provides, while the directors owe their duties to the company they may nevertheless acquire authorisation from the other directors in accordance with s.175(5).[126] The cases on authorisation may nevertheless retain some significance.

In the Privy Council decision in *Queensland Mines v Hudson*,[127] the defendant had been managing director of the plaintiff mining company and had therefore been in a fiduciary relationship with that company. The defendant had learned of some potentially profitable mining contracts. The board of directors of the company decided not to pursue these opportunities after they had had all of the relevant facts explained to them. The board of directors decided not to pursue the opportunity in the knowledge that the managing director intended to do so on his own account. Importantly, then, one director received the informed consent of the remainder of the board that this opportunity would not be pursued by the company, thus impliedly giving that individual director the authorisation to pursue the opportunity on his own account. The managing director resigned and pursued the business possibilities offered by the contracts on his own account, taking great personal risk in so doing. When that individual director made profits from the opportunity, the company sought to recover the profits generated by the contract from the director. The court held that the repudiation of the contracts by the company meant that the director was entitled to pursue them on his own account without a conflict with his fiduciary responsibility to the company, even though the opportunity had come to the managing director's attention originally by

[126] Companies Act 2006, s.174.
[127] (1977) 18 ALR 1. See also *Framlington Group plc v Anderson* [1995] BCC 611.

means of the fiduciary office. This decision was, however, a rare case in which authorisation was found.

The mainstream English law was illustrated in *Industrial Development Consultants Ltd v Cooley*,[128] where a managing director was offered a contract by a third party. The offer was made expressly on the basis that the third party would deal only with the managing director, not with his employer company. Without disclosing this fact to the company and claiming to be in ill-health, the managing director left his employment and entered into a contract with the third party within a week of his resignation. It was held that the managing director occupied a fiduciary position in relation to his employer company throughout. He was therefore required to disclose all information to the company and to account for the profits he made under the contract. It was significant, in the judgment of Roskill J, that the director had misled his employer on these facts.

Similarly, in *Crown Dilmun v Sutton*,[129] a director learned of an opportunity to develop a football ground which he exploited on his own account once his contract of employment had been terminated. It was found that he had not made full disclosure to the claimant company of the extent of the opportunity. Consequently, he was liable to account to the claimant for the personal profits realised from the transaction. Equally, if a director sought to tempt a client away from her employers, that would constitute a breach of fiduciary duty with the effect that any profits so earned would have to be accounted for by way of constructive trust to the employer company.[130]

What remains unclear is whether the case law principles will continue to apply over-and-above the means of acquiring authorisation under s.175, for example relying on the dicta of Lord Russell in *Regal v Gulliver* to the effect that a vote by the shareholders in general meeting would constitute authorisation (even if, for example, the directors had voted against the transaction, or if all of the directors stood to take a benefit from the transaction and so there were no directors without a conflict of interest who could vote). It is suggested that this general equitable principle, that the company (by means of a shareholder vote) can ratify the directors' actions,[131] ought to continue to apply in such circumstances even after the passage of the 2006 Act.

The corporate opportunity doctrine

Company law has developed a concept whereby the directors will be liable for breach of duty only if an opportunity is taken from the company by the director, or if the company's property is misused. (The way in which this ties in with the equitable principle is considered below.) There are, it is suggested, three circumstances in which a company director may earn

[128] [1972] 2 All ER 162.
[129] [2004] 1 BCLC 468.
[130] *Item Software (UK) Ltd v Fassihi* [2003] EWHC 3116; [2003] 2 BCLC 1.
[131] It is suggested that it is important to ratify the directors' decision and not simply to agree not to sue because the company may in time be taken over by other shareholders who may not agree with the policy of agreeing not to sue.

personal profits: first, if he has authorization to do so, in line with s.175 of the CA 2006; secondly, if he has resigned from his employment before commencing the activities which led to the profit; and, thirdly, if the director had no powers at all to act as a director in practice before then making those personal profits. Each of these approaches is taken in turn.

First, the complex question of the acquisition of authorization in relation to companies. Before considering this question in detail, it is important to understand the subtle differences between companies and trusts. A number of cases dealing with companies have been considered already. More recent cases in company law have suggested that this corporate opportunity doctrine will be pursued so that a director may be absolved from liability for secret profits if the company is not intending to pursue the opportunity from which the director earned his profits. So, in *Island Export Finance Ltd v Umunna*,[132] the company had a contract with the government of Cameroon to supply the government with post boxes. Mr Umunna resigned from the company once the contract was completed, having worked on that contract and acquired a great deal of expertise in that particular activity. The company ceased pursuing this line of business and after his resignation Mr Umunna entered into a similar contract on his own behalf. The company sued him for the personal profits which he made for himself under this second contract. The court held that Mr Umunna's fiduciary obligations towards the company did not cease once he resigned from its employment. This makes sense: if it were not the case, then no fiduciary could ever be bound by their fiduciary office if they had the good sense to resign immediately before breaching their duties. However, in this instance, the court found that the company had not been seeking to develop this sort of business opportunity at the time Mr Umunna had done so and therefore he had not interfered with a corporate opportunity.

Secondly, we should consider the position of directors who have resigned from their employment and who then seek to exploit an opportunity on their own account. In *Balston v Headline Filters Ltd*,[133] a director had resigned from a company and leased premises with a view to starting up in business on his own account before a client of the company approached him and asked him to work for the company. Falconer J held that there was no breach of duty in these circumstances because there was nothing wrong with a director leaving his employment and setting up in business on his own account and, furthermore, there had not been any maturing business opportunity in this case which the director had diverted to himself. Therefore, in company law, it has been held that company directors may, assuming nothing in their contracts to the contrary prohibiting such an action under contract law, resign from their posts and on the next day begin activities which would previously have been in breach of their fiduciary duties.[134] Although, a director may not, even after resigning from her post, use either the company's property or information which she had acquired while still a director of the company to generate personal profits.[135] Clearly, if such behaviour were

[132] [1986] BCC 460.
[133] [1990] FSR 385.
[134] *CMS Dolphin v. Simonet* [2001] 2 BCLC 704 (Lawrence Collins J); *Quarter Master UK Ltd v. Pyke* [2005] 1 BCLC 245, 264 (Mr Paul Morgan QC) and *British Midland Tool Ltd v. Midland International Tooling Ltd* [2003] 2 BCLC 523 (Hart J).
[135] *Ultraframe UK Ltd v Fielding* [2005] EWHC 1638 (Ch), [2005] All ER (D) 397, *per* Lewison J.

possible then it would constitute all too easy a method for eluding the principle against fiduciaries earning unauthorized profits: one could learn commercially useful information at work on Monday, resign on Tuesday, and make a huge personal profit on Wednesday from that information. Instead, the law of contract permits a person to leave one employment and begin work elsewhere, but the law on constructive trust prevents that person also taking advantage of a conflict between her personal interests and her fiduciary office for that previous employer.

Thirdly, we must consider the position of directors who have no effective powers to act as a director. In the case of *In Plus Group Ltd v. Pyke*[136] Mr Pyke was a director of a company, In Plus Ltd, but he had “fallen out with his co-director” and in consequence he had been “effectively excluded from the management of the company”. Mr Pyke decided to set up a company on his own while he was still a director of In Plus Ltd. So, he set up his own company and that company entered into contracts on its own behalf with a major customer of In Plus Ltd. Remarkably, the Court of Appeal held that Mr Pyke was not in breach of his fiduciary duties to In Plus Ltd because he had not used any property belonging to In Plus Ltd and also because he had not made any use of any confidential information which he had acquired while he was a director of In Plus Ltd. As Sedley LJ held:

> "Quite exceptionally, the defendant's duty to the claimants had been reduced to vanishing point by the acts (explicable and even justifiable though they may have been) of his sole fellow director and fellow shareholder Mr Plank. Accepting as I do that the claimants' relationship with Constructive was consistent with successful poaching on Mr Pyke's part, the critical fact is that it was done in a situation in which the dual role which is the necessary predicate of [the claimants'] case is absent. The defendant's role as a director of the claimants was throughout the relevant period entirely nominal, not in the sense in which a non-executive director's position might (probably wrongly) be called nominal but in the concrete sense that he was entirely excluded from all decision-making and all participation in the claimant company's affairs. For all the influence he had, he might as well have resigned."

It is suggested that this is an exceptional decision and it is difficult to square with the strictness of the approach in cases such as *Regal v Gulliver*. Had Mr Pyke been a non-executive director of In Plus it would still have been difficult to see how he could have used information acquired while on company business for his personal gain without there being some suggestion that there was at the very least a conflict between his personal interests and the fiduciary duties which he owed to the company.

This case does raise a more general point which is of importance in relation to company law – and one which is little discussed in the cases: how should equity deal with people who are directors of more than one company? In practice such matters would be dealt with by a well-drafted contract of employment for that director or by the company’s constitutional documents (in the form of its articles of association) and so may not be a question for equity

[136] [2002] 2 BCLC 201; considered in *Ultraframe UK Ltd v Fielding* [2005] EWHC 1638 (Ch), [2005] All ER (D) 397.

to resolve necessarily. The question is still likely to arise in practice, especially in relation to directors of subsidiary companies within a group where each company is strictly a separate entity with its own interests.[137] In part it is resolved by the principle whereby a fiduciary is bound by duties of confidentiality and therefore ought to respect the confidence of the company on whose business that confidential information was learned. The effect of s.175(7) of the CA 2006 is that the duty applies to conflicts between various duties between, it is suggested, different directorships.[138]

The way in which Collins J conceived of this company law form of the doctrine was explicitly by way of analogy with the law of trusts. So, in *CMS Dolphin Ltd v. Simonet*[139] Simonet left a company, an advertising agency, after a falling-out with his co-founder of that agency, Ball. Both men had been directors of that company. Simonet established a rival agency and attracted clients from his former employer. The first advertising agency claimed that Simonet was in breach of his fiduciary duties as a director in diverting business opportunities from the first advertising agency to his new agency. Lawrence Collins J upheld Simonet's liability for diverting a corporate opportunity and so made him liable to account as a constructive trustee for the profits that had been earned from this activity. What is particularly important for present purposes is that manner in which Lawrence Collins J concluded his judgment by explaining the operation of this doctrine, as his lordship saw it:

> "In my judgment the underlying basis of the liability of a director who exploits after his resignation a maturing business opportunity of the company is that the opportunity is to be treated as if it were property of the company in relation to which the director had fiduciary duties. By seeking to exploit the opportunity after resignation he is appropriating for himself that property. He is just as accountable as a trustee who retires without properly accounting for trust property. In the case of the director he becomes a constructive trustee of the fruits of his abuse of the company's property, which he has acquired in circumstances where he knowingly had a conflict of interest, and exploited it by resigning from the company."

Therefore, in summary, if a director diverts a maturing business opportunity away from the company to himself personally or to some entity under his control, then he will be required to account for any profits made by way of constructive trust and to account to the company for any loss suffered by the company as a result. It is suggested that this approach must be correct in principle.

Cases suggesting a dilution of the principle

In two recent cases there have been signals that the Court of Appeal is reluctant to persist with the strict approach of the principle against secret profits being made by fiduciaries. The

[137] It may be, of course, that one subsidiary is sold off such that "the company" after the sell off may seek to enforce its rights differently from "the company" before the sell-off.
[138] Cf. *London Mashonaland Exploration Co Ltd v New Mashonaland Exploration Co Ltd* [1891] WN 165.
[139] [2001] 2 BCLC 704.

principal concern among these judges has been the perceived strictness of the test. So, in *Murad v Al-Saraj*[140] the Murad sisters entered into a joint venture with Al-Saraj to buy a hotel but Al-Saraj did not disclose that he stood to earn personal profits in the form of a commission from the vendor for setting up the transaction. It was found that he had committed fraudulent misrepresentations in relation to the Murad sisters and furthermore that he had owed fiduciary duties to them. The profits had been earned from his fiduciary office without authorisation. Accordingly, he was held liable to account to the Murad sisters for his profits. Arden LJ chose to cast doubt on the suitability of the doctrine in the leading cases to the extent that that doctrine imposed liability to hold property on constructive trust on people who had not been demonstrated to have acted wrongly. She expressed a preference for liability being based on some fault by the defendant. However, speaking in the Court of Appeal she acknowledged that it was not open to her to overrule *Regal v Gulliver* and *Boardman v Phipps*.[141] It should be noted that the majority in *Boardman v Phipps* were all-too-aware that they were imposing a constructive trust on a person who had acted in good faith. Rix LJ in *Foster v Bryant*[142] was similarly equivocal to Arden LJ about the inflexibility of the test in *Boardman v Phipps*. His lordship, with respect, became overly concerned in his survey of the cases with the notion that the defendant must be misusing trust (or company) property in some way so as to be liable to hold his profits on constructive trust, and thus overlooked the central point of the principle reiterated by Lord Upjohn in *Boardman v Phipps* that its purpose was to prevent both actual conflicts of interest and even the possibility that there was a conflict of interest. The purpose of that principle is to provide that once one acts in a fiduciary capacity it is simply impossible to take personal profits from a transaction in which the trust (or company) has or may have a direct or an indirect interest.

In *Foster v Bryant*[143] the defendant director of a company was effectively forced to resign by his co-director (who was also the majority shareholder of the company). The defendant resigned from the company after his co-director "truculently" made the defendant's wife redundant. The defendant was found to have been excluded from the operation of the business, just like the defendant in *In Plus* above. One of the company's principal clients wanted to retain the services of both directors. Before the defendant's resignation came into effect (i.e. while he was still technically a director but after he had tendered his resignation) the client began to talk to the defendant about the way in which the defendant could work with this client. Importantly, the defendant had resigned at this stage. When the defendant's resignation took effect, he began to work for the client. The company sued the defendant on the basis that he had been a director of the company when the business opportunity came to light and therefore it was argued that any profits earned from that opportunity should be subject to an account in favour of the company. While it was the company which brought the action, in practice it was the majority shareholder (who was also the defendant's co-director) who was driving the litigation. It was the same person who had driven the defendant to resign his directorship. Consequently, the sympathy of Rix LJ was evidently with the defendant.

[140] [2005] EWCA Civ 959.
[141] In that case, On the facts, the principle was not one which was at all harsh in the final analysis.
[142] [2007] Bus LR 1565.
[143] [2007] Bus LR 1565.

Rix LJ sought to distinguish the decided cases considered in previous sections on the basis severally that they concerned a misuse of the company's property, that many of them concerned "faithless fiduciaries" who took wrongful or deceitful advantage of their employers (as in *IDC v Cooley*), or that they were diversions of maturing business opportunities by the fiduciary. Rix LJ did not doubt that a director needed to deal in good faith with the company nor that a fiduciary could not earn profits in secret from her office from an opportunity which belonged to the company or for which the company was negotiating. However, those principles must be applied in a "fact-sensitive" way – considering the ripeness of the business opportunity, the specificity of the opportunity, and thus whether the director had diverted the specific opportunity open to the company. It was held that the position changed in this company after the defendant's resignation such that he was excluded from the business and thus had only to act honestly in his role as director, and therefore that he was not required to account for his subsequent profits. Importantly, while agreeing with Rix LJ, Buxton LJ pointed out that just because a fiduciary had not sought to create a conflict of interest, that did not necessarily mean that there was no conflict of interest. Furthermore, the fiduciary is required to account for profits in general terms even if no loss is suffered by the company.

It is suggested that the developments mooted in these three cases are unfortunate and should be resisted. Three points emerge. First, when one is a fiduciary then one may not take an unauthorised profit from one's fiduciary capacity: end of story. We live in a world where we expect to be able to take whatever we want, to earn quick profits, and to please ourselves. The concept of a fiduciary derives from the idea that in some contexts people should be required to act selflessly for others, especially where they have voluntarily accepted that office and are being paid for it (like directors of trading companies). As Moses LJ put it in *Foster v Bryant*,[144] the need to take a "fact-sensitive" approach to each case might almost "make one nostalgic for the days in when there were inflexible rules, inexorably enforced by judges who would have shuddered at the reiteration of the noun-adjective [fact-sensitive]". One such inflexible rule is the rule that a fiduciary may not take an unauthorised profit in circumstances in which there may possibly be a conflict between her personal interests and her fiduciary duties. Secondly, this rule is not so strict as all that. Equity does have an ability to relieve a worthy defendant (as in *Boardman v Phipps*) by requiring some account to be given to him for the work that he had done in the transaction, in that case, so as to generate large profits for the beneficiaries of a trust. Thirdly, for those who argue that equity is too uncertain for commercial use, it is not open to them to criticise the ancient doctrine which was put to work in *Boardman v Phipps* which unquestionably has the virtue of predictability about it.

[144] [2007] Bus LR 1565, 1598.

DUTY NOT TO ACCEPT BENEFITS FROM THIRD PARTIES

The statutory principle

Section 176 of the CA 2006 provides that a director bears a duty not to accept benefits from third parties in the following terms:

> "(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."

In this context, s.176(2) provides that the term "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". However, a director does not take a benefit if that benefit is paid "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".[145] The kernel of the directors' liability is based on conflicts of interest under s.176. Consequently, s.176(4) of the CA 2006 provides that "[t]his duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest."[146]

The application of s.176 to former directors

Section 170(2) provides that:

> "A person who ceases to be a director continues to be subject--
>
> (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."

Therefore s.176 applies to former directors as well as to current directors.

[145] Companies Act 2006, s.176(3).

[146] Further to s.176(5), "Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties".

The principle as developed in the case law

Bribes

As considered above, the principle in s.176 is predicated on the case law which has come before it. The Privy Council in *Attorney-General for Hong Kong v Reid*[147] established the modern principle that a bribe received by a fiduciary must be held on constructive trust from the moment of its receipt and consequently that any property acquired with that bribe is also held on constructive trust. The former Director of Public Prosecutions for Hong Kong had accepted bribes not to prosecute certain individuals accused of having committed crimes within his jurisdiction. The bribes which he had received had been profitably invested. The question arose whether or not the property bought with the bribes and the increase in value of those investments should be held on constructive trust. Lord Templeman, giving the leading opinion of the Privy Council, held that a proprietary constructive trust is imposed as soon as the bribe is accepted by its recipient, with the effect that the employer is entitled in equity to any profit generated by the cash bribe received from the moment of its receipt. Similarly, Lord Templeman held that the constructive trustee is liable to account to the beneficiary for any *decrease* in value in the investments acquired with the bribe, as well as for any increase in value in such investments. There are therefore two forms of liability: first, to hold the bribes and any property acquired with the bribes on constructive trust; and, secondly, if the value of any property held on such a constructive trust should decrease in value, the defendant is required to account personally for that diminution in value as well as holding the property on constructive trust. As Lord Templeman has expressed the basis for this principle:[148]

> "A bribe is a gift accepted by a fiduciary as an inducement to him to betray his trust. A secret benefit, which may or may not constitute a bribe is a benefit which the fiduciary derives from trust property or obtains from knowledge which he acquires in the course of acting as a fiduciary. A fiduciary is not always accountable for a secret benefit but he is undoubtedly accountable for a secret benefit which consists of a bribe. In addition a person who provides the bribe and the fiduciary who accepts the bribe may each be guilty of a criminal offence. In the present case the first respondent was clearly guilty of a criminal offence."

The fiduciary is thus liable to account to the beneficiaries for the receipt of a bribe. Lord Templeman considered bribery to be an 'evil practice which threatens the foundations of any civilised society'. As such, the imposition of a proprietary constructive trust was the only way in which the wrongdoer could be fully deprived of the fruits of his wrongdoing.

It has been held latterly that the reason for the constructive trust in *Reid* was that it would have been "as a fiduciary unconscionable for him to retain the benefit of it";[149] even though that was not the precise rationale used by Lord Templeman. The manner in which Lord Templeman constructed his proprietary remedy started from the premise that equity acts *in personam*. The defendant had acted unconscionably in accepting the bribe in breach of his

[147] [1994] 1 AC 324, [1994] 1 All ER 1.
[148] [1994] 1 AC 324, 330–31; [1994] 1 All ER 1, 4–5.
[149] *Yugraneft v Abramovich* [2008] EWHC 2613 (Comm), [2008] All ER (Comm) 299, para [373], *per* Clarke J.

fiduciary duty. In consequence of that breach of duty, it was held that the bribe should have been deemed to pass to the beneficiary of the fiduciary power at the instant when it was received by the wrongdoer. Given that equity considers as done that which ought to have been done, it was held that the bribe should have been considered to have been the property of the beneficiary from the moment of its receipt. The means by which title passes to the beneficiary in equity in such circumstances is a proprietary constructive trust. As such, the bribe, any property acquired with the bribe and any profit derived from such property fell to be considered as the property of the person wronged in equity.[150]

The approach of the Privy Council in *Attorney-General for Hong Kong v Reid* has been applied in a number of High Court cases.[151] So, in *Tesco Stores v Pook,*[152] Mr Pook had tendered invoices in the aggregate of about £500,000 for services which had not in fact been rendered. Out of these amounts, the case concerned a total sum of £323,749 which had allegedly been paid as a bribe indirectly to Pook, who had been appointed as a manager in Tesco's e-commerce business in South Korea, by third parties. Pook claimed that the money had been paid to him as a loan to help him start up in business. It was held by Peter Smith J that these payments should be taken to have been a bribe because they were documented by the payer by means of false invoices and a fraudulent VAT claim, rather than as an ordinary loan. His Lordship applied the decision in *Attorney-General for Hong Kong v Reid* to the effect that this bribe should be held on constructive trust.[153] He approved the idea both that the bribe is held on constructive trust and also that when there is any decrease in the value of any property acquired with the bribe then the fiduciary 'is required to make up the difference'. On these facts, because the bribe had been made by means of a false invoice together with a fraudulent claim for recovery of VAT (that is, a claim for recovery of VAT which had purportedly been paid under this false invoice for a service rendered), it was held that the value of the bribe which should be accounted for was the amount of the invoice falsely rendered together with the VAT amount. Thus, any value received as part of the transaction comprising the bribe will be deemed to be held on constructive trust.

Similarly, in *Daraydan Holdings Ltd v Solland International Ltd,*[154] a married couple, who were directors of a company which was involved in the refurbishment of property in London, connived in the appropriation of a secret commission which was procured by arbitrarily increasing the budget for a refurbishment project by 10% and then diverting that extra 10% so as to pay 'kickbacks'[155] to K. It was found as a fact that K was employed by the person who ultimately controlled a group of organisations which included the company, and thus was acting as a fiduciary. The secret commission, or 'kickback', of 10% was held to have been equivalent to a bribe in this case. Lawrence Collins J began his judgment by quoting that sentence from Lord Templeman in *Reid* to the effect that '[b]ribery is an evil practice which

---

[150] Applied in *Corporacion Nacional Del Cobre De Chile v Interglobal Inc* (2003) 5 ITELR 744; and *Sumitomo Bank v Thahir* [1993] 1 SLR 735.

[151] *Ocular Sciences Ltd v Aspect Vision Care Ltd* [1997] RPC 289; *Fyffes Group Ltd v Templeman* [2000] 2 Lloyd's Rep 643 (where this case was *obiter*); *Dubai Aluminium Company Ltd v Alawi* [2002] EWHC 2051; *Tesco Stores Ltd v Pook* [2003] EWHC 823; *Daraydan Holdings Ltd v Solland International Ltd* [2004] EWHC 622. In relation to interlocutory relief, such as Mareva injunctions, the *Lister v Stubbs* approach has also been displaced in favour of the approach in *Attorney-General v Reid: Mercedes Benz AG v Leiduck* [1996] AC 284, 300. This approach has not been followed in *Attorney-General v Blake* [1997] Ch 84, 96, *per* Sir Richard Scott VC; *Halifax Building Society v Thomas* [1996] Ch 217, 229, preferring the approach in *Lister v Stubbs*.

[152] [2003] EWHC 823.

[153] [2003] EWHC 823, para [45] and [69].

[154] [2004] EWHC 622, [2004] 3 WLR 1106; [2005] Ch 1.

[155] [2004] EWHC 622; [2004] 3 WLR 1106, para [63].

threatens the foundations of any civilised society'. It was held that an agent ought not to put herself into a situation in which her duty and her personal interest conflict. Thus, the constructive trust here was based on avoidance of conflict of interest as well as the need to deal with the 'evil practice' of bribery. It was explained that the constructive trust in this case was further justified because the bribes were drawn from the claimant's property (being the payments for the refurbishment) and also on the basis that the bribes were paid as part of a fraudulent misrepresentation exercised by S. It was held further that where, as on these facts, a bribe has been paid here by an employee (S) to a third party (K), and when that third party is acting in a fiduciary capacity, then both parties are required to account jointly and severally for the receipt of that bribe.[119] Consequently, the bribe was deemed to have been held on constructive trust, just as in *Reid*.

Secret commissions

There are occasions on which the principles relating to "bribes" are treated together with "secret commissions". A secret commission is in many cases synonymous with a bribe, in that a person is in receipt of money covertly. Usually the purpose of such a transaction would be to induce the recipient to act in a corrupt manner. An example of patterns of secret commissions are set out in *Pakistan v Zadari*,[156] a case which – at a purely interlocutory stage – relates to allegations that payments were made at the behest of the husband of a former Prime Minister of Pakistan through a series of companies to acquire a 350 acre estate in Surrey and in connection with a variety of other transactions. While it was not necessary to dispose of the facts at this interlocutory stage in the proceedings, in the event that it could be proved that the estate was acquired with secret commissions or bribes then Lawrence Collins J indicated that that estate would be held on constructive trust for the state of Pakistan.

DUTY TO DECLARE INTEREST IN PROPOSED TRANSACTION

The statutory principle

The core principle

It is a key facet of fiduciary law that a fiduciary may not permit conflicts of interest so that he deals, for example, with a company for which he acts as a director in circumstances in which he has some interest of his own bound up in the transaction (the "self-dealing" rule). This principle is clearly covered by s.175 of the CA 2006, as considered above. However, there is a duty which can be thought of as being connected with it, and that is the duty in s.177 of the CA 2006 which requires that a company director must disclose any personal interest in a proposed transaction. Section 177 provides as follows:

> "(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."

[156] [2006] EWHC 2411 (Comm), [2006] All ER (D) 79 (Oct).

That a director has an interest in a transaction may arise in a number of circumstances. The term is not defined in the legislation. It would clearly encompass a situation in which the director was acting as a sole trader and was the other party to a contract with the company. If the reference to "interested" is taken in a property law sense, then it would include a transaction in which the company contracted with a trust in which the director held an equitable interest. The interest in the transaction may be indirect as well as direct. Consequently, it is suggested, the principle would cover transactions with a subsidiary company in which the director owns shares or in which the director also acts as a director; or even a transaction in which the director's spouse has a direct interest so as to grant the director an indirect interest in that transaction.[157] The former example would mean that the director's indirect interest was constituted through his shareholding in the company entering into the transaction, whereas the latter example requires that the concept of an indirect interest includes a tangible benefit (in the form of more money in the marriage) without any personal legal rights under the contract.

The methodology for making a declaration

The statute identifies a manner in which the director may make this declaration. Section 177(2) of the CA 2006 provides that:

> "(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)."

Therefore, the director may either make a declaration at a meeting of the board of directors[158] or by means of a notice under s.184 or s.185. The declaration may be made in other ways which are not defined in the section. It is suggested that for a director to acquire authorisation for continuing to have that interest in the transaction, a majority of the directors who have no interest in the transaction must agree to the company continuing with the transaction in which one of their number has an interest. It may be that, if there was only a subset of the directors who were authorised by the company's constitution or management structure to effect the particular transaction at issue (for example, because it relates to business conducted with a particular business unit) then there may be situations in which authorisation on behalf of the company could be given by the relevant director or directors. However, it is suggested that this would be a worse mechanism than enabling all of the directors to know of the circumstances and to activate a broader corporate policy as to the treatment of such transactions.

[157] This last proposition depends on meeting the argument that a husband does not own his wife's property and therefore an "indirect" benefit in this context would have to encompass the context of taking a practical benefit in that more money would come into the marriage even if the husband-director himself did not have any personal rights under the contract.
[158] This is suggested by the term "*the* directors" which suggests all of them.

It is important that the director involved must keep the other directors informed of any changes in circumstance. Section 177(3) provides that:

> "If a declaration of interest under this section proves to be, or becomes, inaccurate or incomplete, a further declaration must be made."

Significantly, all such declarations must be made *before* the company enters into the transaction. Section 177(4) provides that:

> "Any declaration required by this section must be made before the company enters into the transaction or arrangement."

It makes complete sense the declaration must be made before the transaction is completed so that the other directors are able to enter into that transaction with informed consent as to the interests of any of their fellow directors.

Exclusions of liability and exclusions from the need to make a declaration

Section 177 provides for situations in which there will not be an obligation to comply with the duty in s.177. So, s.177(5) provides:

> "(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."

Consequently, the s.177 duty does not apply to a person who is not aware of the transaction. It is not enough that one is not aware or does not remember that one has an indirect interest in the transaction. Rather, for example in a complex corporate group, it is anticipated that a director may not know of all of the transactions created by that company and so may not know that he has some interest in the transaction.

There are three situations in which the director is not obliged to declare an interest:

> "(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."

In essence the common root of these principles is that there is no genuine conflict of interest.

The principle in the case law

The self-dealing principle in equity

The basis of the original equitable principle was expressed in the following dicta of Lord Cranworth in *Aberdeen Railway Co v Blaikie Bros*:[159]

> " … it is a rule of universal application, that no one, having such [fiduciary] duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect. "

The effect of s.177 of the CA 2006 is that a director may be involved in such a transaction provided that a declaration of that interest has been made in the manner considered above before the transaction was created. In equity, the self-dealing principle entitles the beneficiary to avoid any such transaction on the basis, set out in *Keech v Sandford*,[160] that even the possibility of fraud or bad faith being exercised by a fiduciary is to be resisted.[161] Megarry VC in *Tito v Waddell (No 2)*[162] enunciated the self-dealing principle in the following terms:

> 'If a trustee purchases trust property from himself, any beneficiary may have the sale set aside ex debito justitiae, however fair the transaction.'

The right of the beneficiary under the case law is therefore to set aside the transaction. The effect of s.177, however, is to preserve the effect of the transaction provided that the director in question has complied with the s.177 procedures considered above. There is no defence to the exercise of such a right that the transaction was entered into as though it was created between parties acting at arm's length. The same principle applies to purchases by directors from their companies,[163] although most articles of association in English companies expressly permit such transactions, as is considered below.[164] Where the beneficiary acquiesces in the transaction, that beneficiary is precluded from seeking to have that transaction set aside.[165] A fiduciary will not be able to avoid this principle simply by selling to an associate or a connected company or similar person – although the authorities on this point relate primarily to sales to relatives,[166] to trustee's children[167] and to trustee's spouses.[168]

---

[159] (1854) 2 Eq Rep 1281.
[160] (1726) 2 Eq Cas Abr 741.
[161] *Ex p Lacey* (1802) 6 Ves 625.
[162] [1977] Ch 106. Cf *Prince Jefri Bolkiah v KPMG* [1999] 1 All ER 517 – with reference to 'Chinese walls'.
[163] *Aberdeen Railway Co v Blaikie Brothers* (1854) 1 Macq 461.
[164] As in *Ireland Alloys Ltd v Dingwall* 1999 S.L.T. 267, O.H., where the disclosure requirements in the articles were not followed and this invalidated decisions taken at a meeting of the directors of the company.
[165] *Holder v Holder* [1968] Ch 353.
[166] *Coles v Trecothick* (1804) 9 Ves 234 – which may be permitted where the transaction appears to be conducted as though at arm's length.
[167] *Gregory v Gregory* (1821) Jac 631.

Disclosure of directors' interests in corporate transactions under the self-dealing rule

Before the 2006 Act was passed, the application of fiduciary principles to directors allowed a company automatically to avoid any contract which the board entered into on its behalf in which one or more of the directors had an interest, unless that interest had been disclosed to the company and approved by the general meeting.[169] This was so, whether or not the director was acting bona fide for the benefit of the company. Any benefit derived by the director from such a contract could also be recovered.[170] This is, broadly speaking, the effect of s.177 as discussed above. This need to disclose an interest was extended to include not only contracts made directly with a director (such as a director’s service contract) but also those in which he had an interest (for example as a shareholder[171] or as a partner[172] of the other contracting party). It does not apply to interests of a director's spouse or other personal contacts. In such a case only the usual fiduciary duty will apply but it has been suggested that the burden of proving good faith and so forth should be placed on the directors.[173]

What constitutes an interest which must be disclosed

Another difficult issue in the case law related to the sorts of material which would amount to an interest which must be disclosed. In *Cowan de Groot Properties Ltd v Eagle Trust*,[174] the question arose as to whether in a contract of sale between A Ltd and B Ltd a director of A who was either a creditor of B, or of shareholders of B, had a disclosable interest. The judge was of the opinion that in most cases that would not amount to a disclosable interest but that circumstances could exist where the director would have an interest in B making that contract. He did, however, state that a director who was a bare trustee for another would not have a disclosable interest. In *Runciman v Walter Runciman plc*,[175] this was expressly decided despite the “apparent absurdity" of requiring such a disclosure where it is patently obvious that the director has an interest.

Whether disclosure can be implied in the circumstances

Situations in which a director has an interest in a transaction but in which it is contended that the other directors ought to have known that fact, however, raise the further question of

---

168 *Ferraby v Hobson* (1847) 2 Ph 255; *Burrell v Burrell’s Trustee* 1915 SC 333.
169 *Aberdeen Ry. Co. v Blaikie Bros.* (1854) 1 Macq. 461. The right to avoid a contract for non-disclosure is not affected by the provisions of the first E.C. directive: *Coöperative Rabobank ‘Vecht en Plassengerbeid' BA v Minderhoud* [1998] 2 B.C.L.C. 507, ECJ.
170 *Parker v McKenna* (1874) L.R. 10 Ch.App. 96 at p.118, per Lord Cairns L.C.
171 *Transvaal Lands Co. v New Belgium (Transvaal) Land, Co.* [1914] 2 Ch. 488, CA.
172 *Costa Rica Ry. v Forwood* [1901] 1 Ch. 746, CA.
173 *Newgate Stud Company v Penfold* [2004] EWHC 2993 (Ch).
174 [1991] B.C.L.C. 1045.
175 [1992] B.C.L.C. 1084. See also *Re Neptune (Vehicle Washing Equipment) Ltd (No. 1)* [1995] 1 B.C.L.C. 352.

whether there can ever be implied disclosure to the board. This issue arose in *Lee Panavision v Lee Lighting*[176] where the directors all knew of each others' interest in the agreement being discussed by the board. The Court of Appeal, unlike Harman J. at first instance, were reluctant to regard this as a breach of duty. However, it could be argued that that approach might seem to miss the point that a formal declaration would not only require the other directors to expressly consider the conflict of interest position, it would also be recorded in the minutes of the directors and there could be no suspicion of secret dealings. For those reasons, and the possible abuses concerning shadow directors, Lightman J. in *Re Neptune (Vehicle Washing Equipment) Ltd*[177] held that a single director was obliged to disclose a redundancy payment he authorised for himself to a ‘meeting' of the board and record that fact in the minutes. It remains, however, to be decided what the penalty might be for such a technical non-disclosure.[178]

That issue was left open by Lightman J. in the *Neptune* case. In the *Runciman* case, Simon Brown J. also declined to give any definitive view but he did refuse to allow the company to rescind the contract. Rescission is a discretionary remedy which the courts may refuse to allow even where it has not been lost by acquiescence or delay. In *Re Dominion International Group plc*,[179] Knox J. held that where there was genuine informed consent by all the directors, a failure to make a declaration would be a technical and not a substantive default, although he did not say what, if any, consequences would follow. Other cases have also stressed the need for a formal rather than an informal disclosure; "piecemeal and informal" information gathered by the directors would not suffice.[180] However, in one case the lack of a formal minute as to disclosure was held not to be decisive of the matter.[181]

Whether rescission is available in cases of non-disclosure

A more complex situation arose under the case law where there was no disclosure of an interest by a director: does non-disclosure allow the company to rescind the contract? All three members of the Court of Appeal in *Hely-Hutchinson v Brayhead Ltd*[182] held that the fact of non-disclosure under the section simply brought the normal principles of equity into play. The emphasis of each judge was, however, different. It is arguable that Lord Denning M.R. thought that the contract would be voidable since the articles could not allow the

[176] [1991] BCLC 575; affirmed [1992] BCLC 22, CA.
[177] [1995] 1 B.C.L.C. 352.
[178] At a subsequent full trial the non-disclosure in that case was held to be substantive and not technical and further that the director had no authority anyway to authorise the payment: *Re Neptune (Vehicle Washing Equipment) Ltd (No. 2)* [1995] B.C.C. 1000. The *Company Law Review* recommended that there should be no need to disclose interests, the material provisions of which were known to the board: *Completing the Structure* (2000) paras 4.11-4.16
[179] [1996] 1 B.C.L.C. 572.
[180] *Gwembe Valley Development Co Ltd v Koshy (No 3)* [2004] 1 B.C.L.C. 131, CA; *Re MDA Investment Management Ltd* [2004] 1 B.C.L.C. 217.
[181] *Re Marini Ltd* [2004] B.C.C. 172.
[182] [1968] 1 QB 549.

directors to contract out of their statutory duty to disclose. This was also the opinion of Lord Templeman in *Guinness v Saunders*.[183]

CONSEQUENCES OF BREACH OF DUTY

It is provided in s.178(1) of the CA 2006 that the consequences of any breach or threatened breach of a director's general duties under ss.171 to 177 of the CA 2006 "are the same as would apply if the corresponding common law rule or equitable principle applied". Except for the duty in s.174 to exercise reasonable care, skill and diligence, which takes effect as a common law principle, the directors' general duties are "enforceable in the same way as any other fiduciary duty owed to a company by its directors".[184] Therefore there is no codification of the appropriate remedies relevant to each duty, and instead one is thrown back on the case law remedies which were considered in relation to each section in the discussion above.

Section 180 of the CA 2006 deals with consent, approval or authorisation by the company's members. In cases where the duty to avoid conflicts of interest or the duty to declare an interest in a proposed transaction or arrangement) is complied with, then "the transaction or arrangement is not liable to be set aside by virtue of any common law rule or equitable principle requiring the consent or approval of the members of the company".[185]

FIDUCIARY DUTIES OUTWITH PT.10, COMPANIES ACT 2006

Introduction

Beyond the reach of Part 10 of the Companies Act 2006, a company or any person (whether employee, agent or otherwise) advising or acting of behalf of a company (or in relation to any other fiduciary office) may be held liable for dishonest assistance in a breach of fiduciary duty or for unconscionable receipt of property further to a breach of fiduciary duty. The defendant's liability is a personal liability to account to the company or any other beneficiary of a fiduciary duty for the whole of loss occasioned by the breach of fiduciary duty. Each head of liability is considered in turn.

Dishonest assistance

The principle in outline

A person, even if otherwise unconnected with the fiduciary duty, who dishonestly assists in a breach of fiduciary duty will be personally liable to account to the company for any loss

[183] [1990] 2 A.C. 663 at p.695.
[184] Companies Act 2006, s.178(2).
[185] Companies Act 2006, s.180(1).

caused by that breach.[186] The dishonest assistant himself will not need to be a fiduciary; it is enough that he assists the breach of some other person's fiduciary duty.[187] It is a pre-requisite that there was a breach of fiduciary duty.[188] There is very little authority as to what will constitute "assistance" in a breach of fiduciary duty – it seems that any act which facilitates the breach of fiduciary duty will suffice. The bulk of the discussion in the case law has revolved around the question of what constitutes "dishonesty".

The test for dishonesty

The source of the current law on the meaning of "dishonesty" in relation to dishonest assistance is the decision of the Privy Council in *Royal Brunei Airlines v. Tan*[189] in the judgment of Lord Nicholls. In that case a company carried on business as a travel agency and entered into a contract to sell the claimant airline's tickets on the basis that all receipts for ticket sales were to be held on trust by the company prior to being paid to the airline periodically. The defendant was the managing-director of the company who organised for trust money to be used to pay the company's debts. The issue arose whether or not the defendant was liable for dishonest assistance in the breach of trust committed by the company. It was held that the managing director had dishonestly assisted in that breach of trust: there was no requirement that the company as trustee had to be shown to have acted dishonestly. The principal issue was as to the nature of the test for "dishonesty". In this regard, Lord Nicholls held the following:

> 'Before considering this issue further it will be helpful to define the terms being used by looking more closely at what dishonesty means in this context. Whatever may be the position in some criminal or other contexts (see, for instance, *Reg. v. Ghosh*[190]), in the context of the accessory liability principle acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstances. This is an objective standard. At first sight this may seem surprising. Honesty has a connotation of subjectivity, as distinct from the objectivity of negligence. Honesty, indeed, does have a strong subjective element in that it is a description of a type of conduct assessed in the light of what a person actually knew at the time, as distinct from what a reasonable person would have known or appreciated. Further, honesty and its counterpart dishonesty are mostly concerned with advertent conduct, not inadvertent conduct. Carelessness is not dishonesty. Thus for the most part dishonesty is to be equated with conscious impropriety. However, these subjective characteristics of honesty do not mean that individuals are free to set their own standards of honesty in particular circumstances. The standard of what constitutes honest conduct is not subjective. Honesty is not an optional scale, with higher or lower values according to the moral standards of each individual. If a person knowingly appropriates another's property, he will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour.'

[186] *Royal Brunei Airlines v Tan* [1995] 2 AC 378.
[187] *Ibid.*
[188] *Ibid.*
[189] [1995] 2 A.C. 378; *Twinsectra v. Yardley* [2002] UKHL 12.
[190] [1982] Q.B. 1053.

What is important to take from this passage, it is suggested, is that Lord Nicholls stressed the objective nature of the test for dishonesty. It may be argued that within this objectivity is a need to consider the circumstances in which the defendant was acting, and by considering those circumstances to admit some subjectivity. However, this should not be overstated and is in any event subjectivity is not what Lord Nicholls intended. By taking into account the circumstances, one is simply asking what would an objectively honest person have done in this context and not asking what the defendant personally considered appropriate in that context. Lord Nicholls is clear that the test is a strictly objective one. His lordship was even careful to dismiss any instinct to suppose that dishonesty is connected to a subjective state of mind. The most significant section of this passage, it is suggested, is the following:

> '… acting dishonestly, or with a lack of probity, which is synonymous, means simply not acting as an honest person would in the circumstance. This is an objective standard.[191]

The test of "dishonesty" in this context is actually a test asking whether or not the defendant did or did not do what an honest person would have done in the same circumstances. Thus, the court will ask what an objectively honest person would have done. That this test is clearly stated by Lord Nicholls to be an objective test means that it does not matter that the defendant may have thought that what she was doing was honest: instead the question is what an objectively honest person would have done in those circumstances. Interestingly, this test does not require that there is any active *lying* on the defendant's part.[192] Rather, it is sufficient that the defendant fails to live up to an objective standard of probity.[193] It is also not required that the assistant be proved to have been acting fraudulently, as indeed it could not be shown that the defendant in *Royal Brunei Airlines v Tan* was because he had aimed to return the money to the trust fund: it is enough that an honest and reasonable person would not have behaved in the way that the defendant behaved.

The development of the test for dishonesty

The precise nature of the test for dishonesty has seemed to change and then to change back in subsequent cases. In the House of Lords in *Twinsectra v. Yardley*[194] Lord Hutton suggested that the test for dishonesty should be a hybrid test combining elements of objectivity and subjectivity. This meant that the test for dishonesty required *both* that objectively an honest person would not have behaved as the defendant behaved (being the test in *Royal Brunei Airlines v Tan*) and also that the defendant appreciated that her actions would be considered to be dishonest by honest and reasonable people. The effect of this change to the test would have been that a defendant would have been able to resist a finding of dishonesty if her

[191] [1995] 2 AC 378, 386.
[192] Cf. *Eagle Trust plc v. SBC Securities Ltd.* [1992] 4 All E.R. 488, 499, *per* Vinelott J; *Polly Peck International v. Nadir (No.2)* [1992] 4 All E.R. 769, 777, *per* Scott LJ.
[193] This is to be contrasted with the action for knowing receipt which, in the judgement of Scott LJ in *Polly Peck v. Nadir (No.2)* [1992] 3 All E.R. 769, sets out a form of subjective test of whether or not the recipient "ought to have been suspicious" and thereby have constructive notice of the breach of trust in those particular circumstances.
[194] *Twinsectra v. Yardley* [2002] UKHL 12; approving *Abbey National PLC v. Solicitors Indemnity Fund Ltd* [1997] P.N.L.R. 306.

personal morality would not have considered the behaviour to have been dishonest or would not have recognised that other people would have thought it dishonest. In this way, a person with questionable morals would be able to rely on moral relativism to escape liability for dishonesty. In *Twinsectra v Yardley* itself, a solicitor escaped liability for dishonest assistance when he passed moneys in breach of trust to his client on the basis that he had not appreciated the trust obligations on him and importantly on the basis that he had not appreciated that honest people would have considered his behaviour to have been dishonest.[195]

This interpretation of the correctness of Lord Hutton's test was doubted in the decision of the Privy Council in *Barlow Clowes v Eurotrust*[196] when the defendant argued, in spite of assisting the unlawful transmission of large amounts of money out of investment funds in breach of fiduciary duty for a client, in a manner which the judge at first instance decided was dishonest, that his personal morality meant that he would never ask questions of a client and that he did not appreciate that such behaviour would be considered to be dishonest by honest people. The defendant relied explicitly on Lord Hutton's test in *Twinsectra v Yardley*. The unanimous Privy Council found that the test for dishonesty in this context should be an objective test in the manner argued for by Lord Nicholls in *Royal Brunei Airlines v Tan*.[197] The defendant was held to have been dishonest, relying principally on the finding of the judge at first instance (having heard lengthy evidence from the defendant) that he was simply dishonest and must have known that the money came from a tainted source.

Importantly, an intervening decision of the House of Lords in *Dubai Aluminium v Salaam*[198] found that the test for dishonesty should be that set out by Lord Nicholls in *Royal Brunei Airlines v Tan*.[199] but without making reference to the decision in *Twinsectra v Yardley*. The leading speech was delivered by Lord Nicholls, not surprisingly approving his own judgment in *Royal Brunei Airlines v Tan*. In *Dubai Aluminium v Salaam* a partner in an accountancy firm had assisted a client to commit a breach of fiduciary duty, and the question arose, *inter alia*, whether or not he should have been held liable as a dishonest assistant in the breach of fiduciary duty.[200] It was found that the appropriate test was an objective one. The objective test approach in *Royal Brunei Airlines v Tan* has been supported latterly by a majority of the Court of Appeal in *Abou-Rahmah v Abacha*,[201] albeit that the phrasing used by Arden LJ suggested that the defendant must not only be objectively dishonest but also must subjectively appreciate this interpretation of her behaviour. It is suggested that this is a

---

[195] While the extent to which each member of the House of Lords intended to agree with Lord Hutton's re-expression of the test, the analysis that Lord Hutton intended to introduce subjectivity to the test was accepted by Lewison J in *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch), [2005] All ER (D) 397, although it was contested by Lord Hoffmann in *Barlow Clowes v Eurotrust* [2006] 1 All ER 333.

[196] [2006] 1 W.L.R. 1476, [2006] 1 All E.R. 333.

[197] See Alastair Hudson, *Equity & Trusts*, (6e, Routledge-Cavendish, 2009) p.855 *et seq*.

[198] [2002] 3 WLR 1913; [2003] 1 All ER 97.

[199] [1995] 2 AC 378.

[200] The case relates primarily to the transmission of liability to the partnership as a whole from the individual partner. This, it is suggested, is why so few commentators have noticed it in spite of the extensive discussion of the test of dishonesty.

[201] *Abou-Rahmah v Abacha* [2006] EWCA Civ 1492, [2007] Bus LR 220.

straightforward misreading of the judgment of Lord Nicholls in *Royal Brunei Airlines v Tan*.[202]

Unconscionable receipt of property further to a breach of fiduciary duty

The concept in outline

The doctrine of personal liability to account on grounds of unconscionable receipt of fiduciary duty property concerns people who are neither directors nor the company itself who receive some fiduciary duty property when that property has been transferred away from the company in breach of some fiduciary duty. This doctrine used to be referred to in the cases as "knowing receipt" because liability was predicated on both the receipt of company property and on the defendant having "knowledge" that there had been a breach of fiduciary duty.[203] Latterly, a number of Court of Appeal decisions have taken the view that liability should be based on receipt of company property and on the defendant having acted "unconscionably", as opposed simply to having had one of the identified forms of "knowledge" of the breach of fiduciary duty.[204] While there are some cases which have resisted this development,[205] it is suggested that the weight of authority is now that the test has developed into one of unconscionability:[206] as considered below. It is suggested that this concept of "unconscionability" should be understood as encompassing "knowledge" of the breach of fiduciary duty as traditionally understood, "dishonesty" of the sort considered above in relation to dishonest assistance,[207] and then more general forms of unconscionability such as breach of extant regulatory rules prescribing commercially acceptable and unacceptable behaviour[208] for a person in the defendant's circumstances (such as being an investment firm governed by financial services regulation).

That there must have been a breach of fiduciary duty

There must have been a breach of some fiduciary duty, before the stranger will bear liability for unconscionable receipt of property passed out of the fund held subject to the fiduciary duty.[209] If the property had been passed from the company to the stranger within the terms of the fiduciary duty then no liability could lie. As Morritt V-C put it: "[a] claim for 'knowing receipt' is parasitic on a claim for breach of fiduciary duty in the sense that it cannot exist in the absence of the breach of fiduciary duty from which the receipt originated."[210] Once a breach of fiduciary duty has been proved, it is incumbent on the claimant to demonstrate that the defendant had acted unconscionably or that he had the requisite knowledge.

---

[202] See Alastair Hudson, *Equity & Trusts*, (6e, Routledge-Cavendish, 2009) 868.
[203] *Baden v Société General pour Favoriser le Developpement du Commerce et de l'Industrie en France SA* [1993] 1 WLR 509; *Re Montagu's Settlements* [1987] Ch 264.
[204] *BCCI v Akindele* [2000] 4 All ER 221; *Criterion Properties Ltd v Stratford UK Properties* [2003] 1 WLR 218, CA; *Charter plc v City Index Ltd* [2008] 2 WLR 950, CA.
[205] *Twinsectra v Yardley* [1999] Lloyd's Rep Bank 438, CA.
[206] *BCCI v Akindele* [2000] 4 All ER 221; *Niru Battery v Milestone Trading* [2004] 2 WLR 1415; *Criterion Properties Ltd v Stratford UK Properties* [2003] 1 WLR 218, CA; *Charter plc v City Index Ltd* [2008] 2 WLR 950, CA.
[207] See the discussion of *Charter plc v City Index Ltd* [2008] 2 WLR 950, [31], *per* Carnwath LJ.
[208] See for example the discussion of the judgment of Knox J in *Cowan de Groot Properties Ltd v Eagle Fiduciary duty plc* [1992] 4 All ER 700, 761 below.
[209] *Eagle Fiduciary duty plc v SBC Securities Ltd* [1992] 4 All ER 488; *El Ajou v Dollar Land Holdings* [1994] 1 BCLC 464, 478, *per* Hoffmann J; *Brown v Bennett* [1998] EWCA Civ 1881.
[210] *Charter plc and another v City Index Ltd* [2006] EWHC 2508 (Ch), [2007] 1 WLR 26.

The nature of 'receipt'

The first question is what actions will constitute 'receipt' in this context.[211] There are, in essence, two competing views. On the one hand, it could be said that there has been receipt when the defendant takes company property into his possession or has it under his control; whereas on the other hand, it could be said that there has been receipt only when the defendant has purportedly acquired sufficient rights in that property to have satisfied an equitable tracing claim: which would have the effect, it is suggested, of potentially narrowing the claim. An example of the former approach appears in the decision of Millett J in *Agip v Jackson*,[212] his lordship held that "there is receipt of fiduciary duty property when a company's funds are misapplied by any person whose fiduciary position gave him control of them or enabled him to misapply them". An example of the second, narrower approach to what constitutes "receipt", which has been cited in numerous cases in this context,[213] was set out by Hoffmann LJ in *El Ajou v Dollar Land Holdings* to the effect that[214] "the plaintiff must show, first, a disposal of his assets in breach of fiduciary duty; secondly, the beneficial receipt by the defendant of assets which are traceable as representing the assets of the plaintiff; and thirdly, knowledge on the part of the defendant that the assets he received are traceable to a breach of fiduciary duty."

The concept of "knowledge" of a breach of fiduciary duty

Knowledge was held by Lord Browne-Wilkinson in *Westdeutsche Landesbank v Islington* to be a central aspect of liability for knowing receipt:

> 'If X has the necessary degree of knowledge, X may himself become a constructive trustee for B on the basis of knowing receipt.[215] But unless he has the requisite degree of knowledge he is not personally liable to account as trustee.[216] Therefore, innocent receipt of property by X subject to an existing equitable interest does not by itself make X a trustee despite the severance of the legal and equitable titles.'[217]

The key to liability for knowing receipt is that the defendant has acted wrongfully by receiving property with the requisite knowledge as to the breach of fiduciary duty which led to his possession of the property. Given this acceptance by his lordship in the House of Lords that knowledge is the foundation of knowing receipt, it remains arguable that the development of a concept of unconscionability by variously constituted Courts of Appeal can only be effective so long as they are interpreted in accordance with this need for knowledge in relation to knowing receipt.

The question is as to what a person can be taken to 'know'. The most significant judicial exposition of the various categories of knowledge was set out by Peter Gibson J in *Baden v Sociéte Générale pour Favoriser le Développement du Commerce et de l'Industrie en France*

[211] Lack of proof of receipt with prevent a claim for knowing receipt being commenced, such a claim will be struck out: *Fraser v Oystertec* [2004] EWHC 2225; see also *Compagnie Noga D'Importation et D'Exportation v Abacha* [2004] EWHC 2601.

[212] *Agip v Jackson* [1990] Ch 265, 286, *per* Millett J; CA [1991] Ch 547.

[213] E.g. *Charter plc v City Index Ltd* [2007] 1 WLR 26, 31, *per* Morritt C.

[214] [1994] 2 All ER 685, 700

[215] [1996] AC 669.

[216] *Re Diplock* [1948] Ch 465 and *Re Montagu's Settlement Trusts* [1987] Ch 264.

[217] [1996] 2 All ER 961, 990.

SA[218] and then whittled down to the following three categories for the purposes of liability for knowing receipt by Megarry V-C in *Re Montagu*:[219] first, actual knowledge;[220] secondly, wilfully shutting one's eyes to the obvious;[221] thirdly, wilfully and recklessly failing to make inquiries which an honest person would have made. In *Re Montagu* Megarry V-C wished to exonerate a defendant from liability who had knowledge of circumstances which would have put an honest person on inquiry, but had forgotten what he had been told and so was considered by his lordship not to have acted willfully. As Scott LJ held in *Polly Peck*, these categories are not to be taken as rigid rules and 'one category may merge imperceptibly into another'.[222]

The concept of 'unconscionability'

The evolution of the doctrine of 'knowing receipt' into a doctrine predicated more generally on 'unconscionability' emerged from the decision of the Court of Appeal in *Bank of Credit and Commerce International v Akindele*[223] where Nourse LJ held:[224]

> 'What then, in the context of knowing receipt, is the purpose to be served by a categorisation of knowledge? It can only be to enable the court to determine whether, in the words of Buckley LJ in *Belmont Finance Corpn Ltd v Williams Furniture Ltd (No 2),*[225] the recipient can "conscientiously retain [the] funds against the company" or, in the words of Sir Robert Megarry V-C in *In re Montagu's Settlement*,[226] "[the recipient's] conscience is sufficiently affected for it to be right to bind him by the obligations of a constructive fiduciary dutyee". But, if that is the purpose, there is no need for categorisation. All that is necessary is that the recipient's state of knowledge should be such as to make it unconscionable for him to retain the benefit of the receipt.
>
> For these reasons I have come to the view that, just as there is now a single test of dishonesty for knowing assistance, so ought there to be a single test of knowledge for knowing receipt. The recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt. A test in that form, though it cannot, any more than any other, avoid difficulties of application, ought to avoid those of definition and allocation to which the previous categorisations have led. Moreover, it should better enable the courts to give commonsense decisions in the commercial context in which claims in knowing receipt are now frequently made…"

Therefore, the defendant is taken to have acted unconscionably if his knowledge was such that (to borrow from Nourse LJ) it would be unconscionable for him to retain any benefit

[218] [1993] 1 WLR 509.
[219] [1987] Ch 264.
[220] Where there is proof that a defendant actually knew, then that will be sufficient to make out the claim: *Bank of Tokyo-Mitsubishi Ltd v Baskan Gida* [2004] EWHC 945, [2004] 2 Lloyd's Rep 395.
[221] See *Manifest Shipping Co Ltd v Uni-Polaris Shipping Co Ltd* [2003] 1 AC 469.
[222] *Polly Peck International v Nadir (No 2)* [1992] 4 All ER 769.
[223] [2000] 4 All ER 221.
[224] [2001] Ch 437, 455.
[225] [1980] 1 All ER 393, 405.
[226] [1987] Ch 264, 273.

taken from the receipt of the property, or (preferably, it is suggested) it would cause the beneficiaries uncompensated loss without the defendant having a good defence or an absence of knowledge. The significance of this model is the approximation of "unconscionability" to the pre-existing test of "knowledge". What remains unclear, however, is the range of other factors which may be considered "unconscionable" beyond the requirement of knowledge.

In *Bank of Credit and Commerce International v Akindele*[227] itself Chief Akindele, the defendant, was a client of the bank, which later collapsed amid endemic and systematic fraud among many of that bank's officers.[228] The defendant had effectively been promised a very high return on his investments by the bank's officers and those bank officers sought in breach of their fiduciary duties to the bank to procure the defendant that return on his investments even though his investments had not performed nearly so well. The question at issue was whether in relation to a series of payments to the defendant he had at any time had knowledge of the breaches of fiduciary duty involved. It was found on the facts that the defendant had heard rumours about skulduggery inside the bank. Under the test for knowledge set out in *Baden v Societe Generale*, it might have been enough to demonstrate knowledge to show that the defendant had had knowledge of factors which would have put an honest and reasonable man on inquiry as to the propriety of the actions of the bank's officers. However, Nourse LJ held that in general terms there was nothing on the facts to demonstrate that the defendant had acted unconscionably in general terms and therefore it was held that the defendant would not be liable for knowing receipt. The effect of the notion of unconscionability was to permit the court to absolve the defendant of liability when the stricter test of "knowledge" would have made him liable to account to the bank because he had had knowledge of factors which might have put a reasonable person on inquiry.

Carnwath LJ took a similar approach to Nourse LJ in the Court of Appeal in *Charter plc v City Index Ltd*.[229] Carnwath LJ (with whom Mummery LJ agreed) took the view that the test of unconscionability in *BCCI v Akindele* is now to form part of the appropriate test in cases of receipt of property in breach of fiduciary duty.[230] As his lordship put it:

> '… liability for "knowing receipt" depends on the defendant having sufficient knowledge of the circumstances of the payment to make it "unconscionable" for him to retain the benefit or pay it away for his own purposes'.

The notion of unconscionability is therefore linked to the requirement of knowledge. On this model of the test, it is not that the defendant has acted unconscionably in general terms which imposes liability, but rather it is a question as to whether or not the defendant had such knowledge of the circumstances so as to make his retention or dealing with the property unconscionable.

[227] [2000] 4 All ER 221.
[228] See, for example, J Adams and D Frantz, *A Full Service Bank* (Simon & Schuster, 1991).
[229] *Charter plc v City Index Ltd* [2008] 2 WLR 950.
[230] *Charter plc v City Index Ltd* [2008] 2 WLR 950, [31].

Attributing knowledge to companies

A company will be taken to have knowledge of something if the controlling mind or the directing will of the company had that knowledge. So in *El-Ajou v Dollar Land Holdings*[231] the plaintiff had been defrauded of his money in Geneva by an investment manager who diverted that money into companies controlled by two men who had bribed him to do so. The plaintiff's money was moved around the world in an attempt to disguise its source before the traceable proceeds of that money were ultimately invested in a London property company called "DLH". The investment had come to DLH through its non-executive chairman, a man who ordinarily took no part in the day-to-day management of the company. It was found that only the chairman had sufficient knowledge of the manner in which the money had come to be invested in DLH, but not any of the other directors of DLH. It was held at first instance by Millett J that while it was possible to trace the moneys into the hands of DLH, it was nevertheless not possible to prove that DLH had knowledge of the fraud because only the chairman, who did not participate in the ordinary management of the company, had had the requisite knowledge. The matter was then appealed to the Court of Appeal.

It was confirmed by the Court of Appeal that the test for demonstrating that a company has knowledge of something is that "the controlling mind" or "the directing mind and will" of the company had knowledge of whatever has been alleged. On these facts, there were different people within DLH who acted as the directing mind and will of DLH in different contexts. In that case, it was necessary to identify the person who was the directing mind and will in the particular context in relation to the act or omission which was the basis of the complaint. On these facts, even though the non-executive chairman of the company ordinarily played no part in the day-to-day management of the company, he had been the person who had organised the investment by the Canadians in DLH and he had acted without any of the requisite resolutions of the board of directors in so doing: these factors suggested that the chairman was the directing mind and will in this particular context for this particular transaction because he had assumed managerial control of this transaction. Therefore, any knowledge which the chairman had about these transactions could be attributed to DLH. Consequently, on the facts it was held that the chairman and consequently DLH had had the requisite knowledge of the circumstances which had led to the Canadians making the investment in DLH. By contrast, a person who had been merely the chairman of a company, but who never carried out the day-to-day management of that company nor took control of *any* given transaction, would not be the controlling mind of that company. Therefore, sometimes one must look for the person or people who actually control the company, and not simply look at the people who are installed as figureheads. The issue, therefore, is as to the seniority or influence of the person who has the requisite knowledge of the breach of fiduciary duty so as to fix the company with that same knowledge and make it liable to account to the beneficiaries of that fiduciary duty relationship. If the person with the knowledge is a junior employee acting outside the limits of his authority, then the company might not be fixed with his knowledge.

[231] [1994] 2 All ER 685, [1994] 1 BCLC 464, [1994] BCC 143.