Critical analysis of the duties owed by directors of listed Companies set out in the Act 2006.

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Abstract – The paper will focus on the critical evaluation of the duties owed by directors of listed companies set out in the Companies Act 2006. This title was inspired by the current global economic turmoil where companies which hitherto declared mind blowing profits; with over the top bonuses to the top management are suddenly going burst and yet very little is heard of the responsibilities of those culpable.

The Financial Reporting Council - Combined Code on Corporate Governance of June 2008, is the main regulation with regard to corporate governance for listed companies in the UK.

Due to the need to re-organise the UK business communities, the establishment of a committee on the Financial Aspects of corporate governance,[1] addressed issues such as the relationship between the Chairman and Chief executive, the role of non-executive directors (NEDs) and reporting on internal control and the company's position.[2]

In the UK, every private company must have at least one director, while every public company must have at least two directors on the board of directors.[3] The main function of these boards is to be responsible for the strategy and management of the company. This, in general, entails that it is also responsible for overseeing the company's operations including ensuring an adequate system of internal control, competent management team, and compliance with statutory and legal requirements.[4]

The central recommendation of the committee set up by the Financial Reporting Council, the London Stock Exchange and Accountancy profession, was that boards of all listed companies should comply with the Code of Best Practise, which has now been replaced by the 'Combined code on corporate governance'. According to the Cadbury report:[5]

> *"By adhering to the code, listed companies will strengthen both their control over their businesses and their public accountability....."*

The combined code, also addresses various aspects of board structures and management, and indicates best practice for improved standards of corporate governance for listed companies.[6]
The UK system observes corporate governance as a tool to improve the board's ability to manage the company effectively as well as provide accountability to shareholders.

However, the report focused attention on the board of directors and recognised that '*the board was the most important corporate governance mechanism',* thus, the report was not legally binding on the board of directors. Eventually, there is a strict compliance rules in the 'Yellow Book'[7] with the combined code.[8] Furthermore, only companies listed on the

[1] This committee was chaired by Sir Adrian Cadbury, known as 'Cadbury Report', 1992.
[2] Financial Reporting Council, "*The UK approach to Corporate Governance",* (2006).
[3] Companies Act, 2006, s.154
[4] Law/Wong, "Corporate Governance", p. 354
[5] "Report of the committee on the Financial Aspects of Corporate Governance"; the setting for the Report, (1992), at para. 1.5
[6] L. Sealy & S. Worthington, *Cases and Materials in Company Law,* 8th edition, (Oxford University Press: Oxford), p. 243
[7] These were set by the stock exchange itself which are now administered by the Financial Service Authority, and effectively have the force of law.
[8] This "combines" a statement of principles of good governance with a code of best practise for listed companies, and its current edition dated June, 2008.

Stock Exchange are required to report on whether they have complied with the combined code,[9] otherwise, a reason must be given for non-compliance. In other words, this is a statutory requirement and a continuing obligation, pursuant to the UK Listing Authority's Listing Rules (the 'UK Listing Rules').[10]

Keywords: Financial Reporting Council, Corporate Governance, Code of Best Practise and combined code

I. INTRODUCTION

DIRECTORS' DUTIES AND COMPANIES ACT 2006

The focus of this paper is, however on the issue of directors' duties and how it relates to listed companies in the UK. The directors exercise these powers either directly or through managers appointed by them. It is, therefore, of paramount importance to see what duties are owed by directors and managers in the exercise of their powers.

Traditionally, the statutory duties of directors were developed by the courts of equity, largely by analogy with the rules applying to trustees, to certain level of similarities, as well as certain important differences. One of the most significant changes introduced by Companies Act 2006, part 10 is to codify these common law and equitable duties applying to directors.[11]

According to the Hodge, M, she noted that[12]:

> "*there are two ways of looking at the statutory statement of directors' duties: on the one hand it simply codifies the existing common law obligations of company directors; on the other – especially in section 172: the duty to act in the interests of the company – it marks a radical departure in articulating the connection between what is good for a company and what is good for society at large".*

Before the Companies Act 2006, the duties of directors of a company were mostly governed by the equitable principles of fiduciary duty and the common law of negligence.[13] Under the current common law rules, the directors' duties to act in good faith for the best interest of the company, were considered by the government to have lacked certainty and not easily accessible.[14]

Therefore, the government recommended codification of the statutory duties of directors, so as to make relevant rules clear and accessible[15]. Hence, within the limits allowed by the rules of precedent, courts can develop and adjust equitable principles and common law rules in a way which they are not normally allowed to do with the words of statute, codification risks losing this adaptability in exchange for the certainty and accessibility of fixed statutory wording.[16]

As Lord Goldsmith,[17] noted at col. 254:

> *"The main purpose in codifying the general duties of directors is to make what is expected of directors clearer and to make the law more accessible to them and to others."*

Both the Company Law Review and Law Commission were of the opinion that there was a need to make the law concerning directors' duties, more consistent, certain, accessible and comprehensible, and recommended that there should be a statement of directors' duties.[18]

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[9] Law/Wong, "Corporate Governance", p. 352.
[10] Law/Wong, "Corporate Governance", p. 352; The UK Listing Rules applies to all listed companies published by the UK Listing Authority.
[11] Sealy/Worthington, *Cases & Materials,* p. 243.
[12] Ministerial Statement; Companies Act 2006: Duties of Company Directors (June, 2007)
[13] French *et al, Company Law,* p. 456
[14] http://www.bytestart.co.uk/content/legal/35_2/companies_act_directors_duties.shtml [26th Nov. 2009]
[15] *Company Directors: regulating Conflicts of Interest and Formulating A Statement of Duties* (Law Comm. No 261, Cm 4436); (Scot Law Comm. No 173), Part 4.
[16] French *et al, Company Law,* p. 456
[17] *Hansard HL* , 6th February, 2006, col. GC; Companies Act 2006: Duties of Directors, 2007 (Google search [20th Nov, 2009])

The Government however agreed that directors' duties are fundamental to company law, and that it is very important that the duties are widely known and understood.[19] According to the Company Law Review, the importance of the statement of duties was noted to enable the law respond to changing business circumstances and needs. It will, therefore leave scope for the courts to interpret and develop its provisions in a way that reflects the nature and effect of the principles they reflect.[20]

The Law Commission and Scottish Law Commission even proposed two main options for codifying directors' duties: *Full Codification or Partial Codification.*[21] According to paragraph 4.15, some respondent were not in favour of the full codification. One of the most common arguments against it was that in an effort to retain some flexibility and allow for judicial development, the duties would have to be stated widely and in general terms.[22] Thereafter, the paper noted the recommendation that partial codification would modernise the law, which would make company law more coherent and more accessible.

The Company Law Reform noted that the statutory duties of directors would apply to all persons acting as directors, even a "shadow director"[23], although there are some aspects of these duties that must apply to such shadow directors.[24]

In an article reviewed by D. Mark[25], it was noted that *"the subject of directors' duties prompts a criticism of the weighty decision of Lewison J. in* ***Ultraframe (UK) Ltd v Fielding****, and the learned judge's view in that case that fiduciary duties do not apply to shadow directors as a general principle..... and it is difficult to see how the discussion can be improved on at least in the absence of developing case law which is only now emerging in the wake of the 2006 Act."*

However, this codification supersedes the older case law. But the cases will remain relevant to the interpretation of the new statutory provisions, since the codified duties are generally formulated in a way that quite faithfully reflects the older case law. Hence, commentators have noted that all the rules are formulated as 'duties'.[26]

Here, Lord Goldsmith again noted that[27]:

> *"One proposition [is] that the result of this codification will be increased litigation. That is not how we see it ..... as in existing law; the general duties are owed by the director to the company. It follows that, as now, only the company can enforce them. Directors are liable to the company for loss to the company, and no more widely. It is quite rare for companies to sue their directors for breach of duty that may well continue to be the position."*

However, s.170 (3) states that the general duties specified in Ss 171-177:

> *"...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 duties owed to a company by a director."*[28]

The statutory duty of directors to promote the success of the company for the benefit of its members as a whole was provided for under the Act,[29] with high regards to the interest of its shareholders. As Lord Hoffman observed:[30]

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[18] *Company Law Reform* (Cm 6456), 2005, para. 3.3
[19] ibid
[20] ibid
[21] *Company Directors: regulating Conflicts of Interest and Formulating A Statement of Duties* (Law Comm. No 261, Cm 4436); (Scot Law Comm. No 173), Part 4, para. 4.3 – 4.9
[22] ibid
[23] Companies Act 2006, s.170 (5)
[24] *Ultra (UK) Ltd v. Fielding [2005] EWHC 1638*
[25] D. Mark, "Gower and Davies: 'The Principles of Modern Company Law'", (2009) 20(4), *International Company and Commercial Law Review,* pp. 152-154
[26] Sealy/Worthington, *Cases & Materials,* p. 274
[27] Companies Act 2006: Duties of Directors, 2007 (Google search [30th Nov, 2009]); *Hansard HL* , 6th February, 2006, col. GC 242
[28] French *et al, Company Law,* p. 456
[29] Companies Act, 2006, ss. 170-178

> "*A company, as an association of persons, exists to perform an economic purpose agreed to by those persons constituting its composite members. By acquiring shares in a corporation, shareholders automatically become privy to the terms of the corporation documents.*"

However, a company needs real people to execute and act on its behalf, as an artificial person cannot perform its own act. As Lord Cairns noted:[31]

> "*The company itself cannot act in its own person..... It can only act through directors*".

Also Lord Wensleydale noted:[32]

> *"[The shareholders] can only act through their directors, and the acts of the individual shareholders have no effect whatever on the company at large."*

In other to prevent abuse of powers, directors are subject to certain duties imposed by law. For instance, they owe a duty of care and skill. These duties were developed by judges over the years on a case by case basis.[33] In addition, directors of companies owe certain fiduciary duties which are based on the principles of trust and confidence to the company,[34] thus, they stand in a fiduciary relationship towards the company, and shall observe the utmost good faith towards the company in any transaction with it or its behalf. However, cases on directors' fiduciary duties and duty of care and skills had become complex and sometimes inconsistent.[35]

In the case of *Industrial Development Consultants v. Cooley,*[36] a former director of a company was held liable to his former company for profits made on a contract into which he entered into by virtue of his position as a director of his former company. It was held that the director was liable as he had allowed his interest and duty to conflict while acting as a director of the company, and failed to disclose to the company information which he had obtained prior to his resignation.[37]

Also in a later case of *British Midland Tool Ltd v. Midland International Tooling,*[38] the court noted that a director also has an equitable duty to disclose breaches of duty committed by fellow directors if this is what the director, acting *bona fide*, considers to be in the best interests of the company.[39]

Finally, the duties of a director of a company are now principally set out in a statutory statement of directors' duties introduced by the Companies Act, 2006. This came into force on 1st October, 2007, except for certain provisions relating to conflicts of interest which came into force on 1st October, 2008. However, it is important to note that this statement is still not an exhaustive list of the duties of directors.[40] Consequently, the total of seven statutory duties was codified under the Companies Act, 2006, relating to listed companies in the UK.

The first statutory duty of a director was provided under s.171, codified under the common law rules that directors must act within the powers that were granted to them, by the company's constitution. The Companies Act, 2006 provides that a director of a company must act in accordance with the company's constitution, and only exercise powers for the purposes for which they are conferred.

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[30] I. O. Bolodeoku, "Economic Theories of the Corporation and Corporate Governance: A Critique", (2002) *Journal of Business Law,* pp. 418
[31] French *et al, Company Law,* p. 409; *Ferguson V. Wilson (1866) L.R 2 Ch. App. 77 at pp. 89-90*
[32] *Ibid; Ernest v. Nicholls (1857) 6 H.L Cas 401 at 419*
[33] Hicks/Goo, *Cases & Materials,* p.356
[34] Law/Wong, "Corporate Governance", p. 355.
[35] Hicks/Goo, *Cases & Materials,* p.356
[36] *[1972] 2 All ER 162; 2 All ER 86; 1 WLR 443.*
[37] Law/Wong, "Corporate Governance", p. 355.
[38] *[2003] EWHC 466*
[39] Sealy/Worthington, *Cases & Materials,* p. 296.
[40] http://www.manches.com/download/briefings [30th Nov, 2009]

Subsequently, s.171 (b) is based on the equitable principle that a director of a company has a duty to exercise the company's powers for the purposes for which they were granted.[41] Thus, codifying the *proper purpose doctrine* as it applies to directors, by putting to rest earlier debates about whether such duty exists.[42] Although, it has been argued that the equitable duty conferred on a director to 'act *bona fide'* in the interest of the company, and not for any collateral purpose, has been a strong contention, to mean that such power was to be considered by the director themselves, not what the court considers.

However, the emergence of Companies Act 2006 separates the two limbs, with the proper purposes aspect appearing in s.171, and the interests of the company reformulated as the '*duty to promote the success of the company'* under s.172. Therefore, the separation, and the particular objective test embraced by the proper purposes doctrine, allows for greater judicial intervention in corporate decision-making than might otherwise be the case.

In a most recent case of *Lex Holdings (In Administration) v. Luqman*[43] at para. 33, Briggs J noted:

> *"Each individual director owes duties to the company to inform himself of its affairs and to join with his co-directors in supervising and controlling them....."*

However, it was noted that the limits on the exercise of a power of director may be stated in the article of association. In general, it is not possible to lay down in advance, as rule of law, the limits beyond which directors may never pass in exercising a particular power.[44] As Lord Wilberforce stated:[45]

> *"The discretion is not in terms limited in this way: the law should not impose such a limitation on directors' powers....."*

In *Peskin v Anderson*[46], the English Court of Appeal rejected a claim of fact-based liability. Again the claim was that the directors were under a positive duty to disclose.[47]

Justice Mummery recognised that, while directors generally do not have fiduciary responsibilities to shareholders, special circumstances could give rise to fiduciary duties:

> *"Those duties are, in general, attracted by and attached to a person who undertakes, or who, depending on all the circumstances, is treated as having assumed, responsibility to act on behalf of, or for the benefit of, another person...."*

The duty to promote the success of the company, set out in s.172 of the Act, is one of the more important and controversial provisions in the Act.[48] As earlier discussed this statutory provision purports to end the debates over the meaning of *'the company',* and *'in the interest of the company'.*[49]

This duty is developed from one of the heads of the paramount principles of the fiduciary duties, that is, duty of good faith to act in the company's best interest.[50] This provision specifies that the directors' duty is to promote the success of the company for the benefit of its members as a whole, and not for the benefit of shareholders or constituencies.[51] As Lord Greene MR[52] noted at para 306:

> "*Directors of a company must act.....bona fide in what they consider- not what a court may consider- is in the interests of the company, and not for any collateral purpose".*

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[41] French *et al, Company Law,* p. 459
[42] Sealy/Worthington, *Cases & Materials,* p. 284
[43] *[2008] EWHC 1639 (Ch); [2008]2 BCLC 725*
[44] French *et al, Company Law,* p. 460
[45] Howard Smith Ltd v. Ampol Petroleum Ltd [1979] AC 821
[46] [2001] 1 BCLC 372
[47] R. Flannigan, "Fiduciary Duties of Shareholders and Directors", (2004), *Journal of Business Law,* pp. 277-302.
[48] Sealy/Worthington, *Cases & Materials,* p. 293
[49] Sealy/Worthington, *Cases & Materials,* p. 293
[50]http://www.bytestart.co.uk/content/legal/35_2/companies_act_director_duties.shtml
[51] Sealy/Worthington, *Cases & Materials,* p. 293
[52] *Re Smith and Fawcett Ltd [1942] Ch 304*

As noted in an article[53] that:

> *"certain controversial concern surrounds the Act's direction that the director must act in the way he/she considers, in good faith, to promote the success of the company for the benefit of its members as a whole, The essential requirement that directors consider in their decision-making is still the obligation to promote the success of the company for the benefit of its members as a whole. It is claimed by many legal writers that the new duties in the Act allow directors to pay lip service to the factors and that the requirement to consider these additional six factors will make negligible difference to how boards make decisions. It is even claimed that the new Act gives less protection for the interests of employees compared with the previous law, which required directors to balance the interests between shareholders and employees; this is no longer available."*[54]

Moreover, Keay has pointed out that the Act does not seem to provide any framework to ensure that directors are held accountable for their decision-making process. This is especially the case with the daily affairs of the company, as shareholders will not know what the directors have done, or it will be too late when they do. Directors will always argue that they did have regard to all of the matters mentioned in the Act, and simply believed that what they did was to promote the success of the company for the benefit of the members.[55]

These arguments are true in only one respect, that the reasonableness test under s.172 is subjective, not objective. In this light, the court will not consider the duty broken merely because, in its opinion, a particular factor did not promote the success of the company for the benefit of its members. Nonetheless, these arguments have neglected that it is clear that this section does not permit a defence based on ignorance as the director is at the same time required, under s.174, to act with reasonable care, skill and diligence, and this duty in particular, has an objective test.[56]

Although, in other to exercise the duty of s.172, directors are opted to give full regards to various non-exhaustive list of factors under s.172 (1). In deciding whether a particular is in the interest of the company, the directors must give regard to all six factors. However, there are no priorities between these factors but individually; they do not override the primary obligation to promote the success of the company. The aim of this duty is to '*promote success*' but not to the detriment of other fiduciary duties when taking account of these consideration.[57] It is, however admitted that there is a lack of definitions in the statute regarding the precise meaning of "*to have regard to*" and "*to promote the success of the company*", as no definite standards have yet been drawn for them.[58]

In *JJ Harrison (properties) Ltd v. Harrison,*[59] Chadwick LJ, also combining the two duties, said at [25][60]:

> *".....the powers to dispose of the company's property, conferred upon the directors by the article of association, must be exercised by the directors for the purposes, and in the interests, of the company."*

Also, in *Item Software (UK) Ltd v. Fassihi*,[61] at [41], Arden LJ stated that:

> *".....the fundamental duty to which a director is subject, that is, the duty to act in what he in good faith considers to be interest of his company.... It is dynamic and capable of application in cases where it has not previously been applied but the principle or rational of the rule applies. It reflects the flexible quality of the doctrine of equity."*

Finally, *'success'* is not defined in the Act, although the Department of Trade and Industry has stated that, for commercial companies it will normally mean "*long term increase in value".*[62]

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[53] M. Almadani, "Derivative actions: does the Companies Act Offers a Way Forward?", (2009) 30(4), C*ompany Lawyer,* pp. 131-140
[54] Almadani, "Derivative actions", p. 137
[55] *ibid*
[56] *ibid*
[57] http://www.brcconline.eul/library/directors_duties_uk_companies_act.pdf [30th Nov. 2009]
[58] Almadani, "Derivative actions", p. 137
[59] *[2001] EWCA Civ 1467; [2002] 1 BCLC 162*
[60] French *et al, Company Law,* p. 464
[61] *[2004] EWCA Civ 1244; [2005] ICR 450*

Also, the Companies Act provides the duty that directors must act independently, under s.173. A concerned voiced during the consultation period for the 2006 Act, was whether the duty to act independently means that directors will be unable to rely on the opinions of independent experts.[63] This provision of the Act reflects the equitable principle that it is legitimate for the directors of a company to enter into a binding agreement that they will act as directors in a particular way if, at the time of making the agreement, they bona fide consider that it is in the interest of the company.[64]

The rationale for the duty in s.173 is obviously that directors who do fetter their discretion could well be acting in a way that is opposed to the company's interests. In the language of s.172, they might be acting in a way that fails to promote the success of the company. Additionally, the directors could be placing themselves in a conflict situation, that is, future action that would benefit the company might be inconsistent with the undertaking or agreement that the directors have made earlier to limit their independence.[65]

However, it was noted in the explanatory notes accompanying the 2006 Act that directors will be able to continue to consult experts, as well as delegate decision to appropriate committees of the board, but such delegation must be in accordance with the company's constitution.[66]

One of the main issues that have been encountered in relation to this duty is with nominee directors, that is, those directors who have been nominated to the board by particular parties with the idea that the nominee would represent their interests.[67] This duty applies equally to such nominee directors, who cannot blindly follow the judgement of those who appointed them; although they may rely on their advice provided they make the judgement their own.[68]

Finally, the nominee director owes its main duties to the company and not to its nominator.[69] As Lord Denning, M.R.[70] noted at p. 626:

> *"…. [T]ake a nominee director..... There is nothing wrong in it. It is done every day. Nothing wrong, that is, so long as the director is left free to exercise his best judgment in the interests of the company which he serves. But if he is put upon terms that he is bound to act in the affairs of the company in accordance with the directions of his patron, it is beyond doubt unlawful, or if he agrees to subordinate the interests of the company to the interests of his patron…"*

The Act also codifies the 'duty to exercise reasonable care, skills and diligence', under the provision of S174. Although, the court did not require directors to exercise a high degree of skills than, reasonably expected from a director to perform, with their knowledge and experience.[71] As Reed noted[72]:

> *"The Company Law Reform Bill, as introduced to Parliament on November 1, 2005, sets out to codify the general duties of a director, including his common law duty to exercise reasonable skill, care and diligence. The DTI draftsman has simply borrowed the relevant wording from s.214 (4) of the Insolvency Act 1986 as adopted by Hoffmann L.J. in* ***Re D'Jan of London****[73], as the applicable common law standard. In particular, cl.158 (2) provides that 'reasonable skill, care and diligence', means:*
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> *"the care, skill and diligence that would be exercised by a reasonably diligent person....".*

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[62] http://www.brcconline.eul/library/directors_duties_uk_companies_act.pdf [20th Dec. 2009]
[63] ibid
[64] French *et al, Company Law,* p. 475; *Fulham Football Club Ltd v. Cabra Estates plc [1994] 1 BCLC 363*
[65] A. Keay, "The Duties of Directors to Exercise Independent Judgement", (2008) 29(10), *Company Lawyer,* pp. 290-296.
[66] http://www.brcconline.eul/library/directors_duties_uk_companies_act.pdf [28th Nov. 2009]
[67] Keay, "The Duties", p. 293
[68] Sealy/Worthington, *Cases & Materials,* p. 298
[69] J. De Lacy, "The Concept of a Company Director: Time for a New Expanded and Unified Statutory Concept?", (2006), *Journal of Business Law,* pp. 267-299
[70] *Boulting v Association of Cinematography, Television and Allied Technicians,[1963] 2 QB 606*

[71] Sealy/Worthington, *Cases & Materials,* p. 300
[72] R. Reed, "Company Director- Collective or Functional Responsibility", (2006) 27(6), *Company Lawyer,* pp. 170-178
[73] *[1994] 1 BCLC 561*

However, s 174 (2) provides for the 'objective/subjective' standard for the statutory duty of care, skill and diligence. As Romer J noted[74]:

> *".....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. To the question of what is the particular degree of skill and diligence required of him, the authorities do not, i think, give any very clear answer..."*

However, there is no statutory implied term in a contract for the supply of services as a director that the director will carry out services with reasonable care and skill[75], due to their exemption.[76]

Another statutory duty provided under s. 175, that a director must not place himself in a situation where his interests may conflict with the interest of the company. Also, this duty applies to the exploitation of any property, information or opportunity of the company.[77]

As noted, this section is the first of the general sections, appearing in succession that addresses the true fiduciary duties of loyalty owed by the directors to their companies. This has replaced the equitable *no-conflict rule,* although only as it applies to conflicts of interest arising from third party dealing by a director.[78]

An old case has set the ground for this provision, in the instances where this rules applies in situation where a director sells his own property to the company.[79] Here, Lord Cranworth[80] noted:

> *"This, therefore, brings us to the general question, whether a director of a railway company is or is not precluded from dealing on behalf of the company with himself or with a firm in which he is a partner....."*

Therefore, a director must not place themselves in a position in which there is a conflict between their duties to the company and their personal interest; as the provision case law offers some clarification. However, the company can seek compensation and profit (if any) from a director as a result of breaches to such fiduciary duties.[81]

In other words, this general rule bars unauthorised conflicts of the director's personal interests with the interests of the company, not with the duties to the company.[82]

The duty not to accept benefits from third parties was provided under s.176 of the Act. Also, an individual who ceases to be a director continues to be subject to the duty not to accept benefits from third parties as regards action done or omitted by him before ceasing to be a director.[83] Therefore, this provision reformulates and replaces the equitable principle that fiduciaries must not accept bribes or secret commissions.[84]

In the case of *Attorney-General for Hong Kong v. Reid*[85], Lord Templeman held that where a fiduciary accepted a bribe in breach of duty, equity insisted that the fiduciary must not benefit from his breach but should account for the bribe as soon as he received it.

Until recently it was relatively well settled law that an employee could (but only in specific circumstances) have an obligation of disclosure with regard to fellow employees' misdeeds but that this duty could not extend to the employee being required to disclose his own defaults. The recent cases in this area have therefore provided an

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[74] French *et al, Company Law,* p. 476; *Re city Equitable Fire Insurance Co. Ltd [1925] Ch 407*
[75] *ibid*
[76] Supply of Goods and Services Act, S. 13
[77] Hicks/Goo, *Cases & Materials,* p.397; this is also based on the equitable corporate opportunity doctrine
[78] Sealy/Worthington, *Cases & Materials,* p. 300; *Bhullar v. Bhullar [2003] EWCA Civ 424*
[79] *Aberdeen Railway Co. V. Blaikie Bros [1843] All ER Rep 249*
[80] *Ibid*; Hicks/Goo, *Cases & Materials,* p.397
[81] Law/Wong, *Corporate Governance*, p. 355.
[82] Sealy/Worthington, *Cases & Materials,* p. 300
[83] Companies Act, 2006 s.170(2) (b); French *et al, Company Law,* p. 487
[84] Sealy/Worthington, *Cases & Materials,* p. 330
[85] *[1994] 1 AC 324*

opportunity for the issue to be revisited in the context of the modern fiduciary duties, both of directors and senior employees.[86]

Also Peter Smith J[87] noted that an individual employed at senior level, was under a duty to disclose breaches of trust by other employees, as well as disclose his own wrongdoing. As Stephenson LJ[88] stated:

> *"...there is no general duty to report a fellow servant's misconduct or breach of contract; whether there is such a duty depends on the contract and upon the terms of the particular servant".*

The seniority and contractual terms of the employee in question are therefore crucial in establishing the application of the duty. The argument was also rejected that an employee could not be held subject to a duty to disclose on the basis that compliance with it would entail revelation of his or her own misconduct.[89]

Finally, s.177 of the Act which is the third of the general rule designed to reformulate and codify the fiduciary duties owed by directors, deals with conflict of interest in proposed transactions or arrangement with the company.[90] However, this requires a director to declare the nature and extent of the interest, directly or indirectly to the other directors.[91]

In *Aberdeen Railway Co. Ltd v. Blaikie Bros*[92], Cranworth LC noted:

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

As Mather, noted[93]:

> "*....an influential and oft-quoted passage in the judgment of Mummery L.J. in* ***Gwembe Valley Development Co Ltd (In Receivership) v Koshy (No.3)*** *has considerable potential to mislead....The case against Mr Koshy was that he did not disclose to the board of GVDC his interest in Lasco, or the profits that Lasco made on the loans to GVDC. It was held that his liability to account did not fall within class 1, although the presence of fraud nonetheless brought it within the scope of the subsection (a matter on which the present article shall have more to say below). Giving the judgment of the Court, Mummery L.J. analysed extensively the law on fiduciary duties and limitation...."*

The Court of Appeal noted, in *Gwembe Valley Development Co. Ltd v. Koshy*[94], that the duty to disclose arises from the *no-profit rule*, but Arden LJ[95], in a different opinion noted, that directors' fiduciary obligations of disclosure is based on *'fundamental duty'* to act bona fide in the interests of the company, and not for collateral purpose.[96] Thus, s.177 (5) provides that such disclosure must be made where a director is considered 'ought reasonably to be aware of', the conflicting interest.

Furthermore, the significant reform introduced in by this provision, under s. 180, '*subject to the company's constitution',* that the compliance with s.177 prevents such interest or transaction from being liable to be set aside by virtue of the usual equitable rule requiring the consent of the company's members.[97]

Although, the remedies for the breached of the duties of directors are not yet codified, s. 178 Companies Act 2006 provides that the for breaches of the principles in Ss 171-177 are to be same as if the corresponding common law

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[86] C. Wynn-Evans, "Self Incrimination in English Employment Law", (2005) 34(2), *Industrial Law Journal,* 178
[87] *Tesco stores Ltd v. Pook [2003] EWHC 823; [2004] IRLR 618*
[88] *Sybron Corporation v. Rochem [198]) Ch 112 (CA)*
[89] Wynn-Evans, "Self Incrimination in English Employment Law", p. 178
[90] Sealy/Worthington, *Cases & Materials,* p. 331
[91] http://www.bytestart.co.uk/content/legal/35_2/companies_act_directors_duties.shtml [26th Nov. 2009]
[92] *(1854) 1 Macq 461 HL*
[93] J. Mather, "Fiduciaries and the Law of Limitation", (2008) 4, *Journal of Business Law,* p. 354
[94] *[2004] 1 BCLC 131*
[95] *Item Software (UK) Ltd v. Fassihi [2004] EWCA Civ 1244*
[96] French *et al, Company Law,* p. 489
[97] Sealy/Worthington, *Cases & Materials,* p. 331

rule or equitable principle were breached.[98] At present, there are a number of remedies for breaches of the duties, including the payment of damages by way of compensation where the director's action is considered negligent and the restoration of company property where assets have been misappropriated. The statement of duties will not change this.[99]

As Etherton, J noted[100]:

> "*.....the general principle is that a fiduciary is obliged by the strict rule of equity to disgorge all the profits that he has made from the transaction, which has involved his breach of duty.....*"

In the Court of Appeal, Jonathan Parker LJ, noted[101] at [108]:

> *"It is thus clear on authority, in my judgement, that the 'no conflict' rule is neither compensatory nor restitutionary: rather, it is designed to strip the fiduciary of the unauthorised profits he has made whilst he is in a position of conflict...."*

A characteristic feature of a fiduciary duty is that the remedies provided by equity for breach of the duty are designed to deter breaches rather than compensate for loss. The primary remedy for a breach of a director's fiduciary duty to the company is to confiscate any profit made by the director from the breach, and hand it over to the company, regardless of whether the company has suffered any loss.[102]

II. CONCLUSION

This paper has critically evaluated the statutory duties owed by the directors, under both common law and equitable principles, in line with the new codification under the Companies Act, 2006. It has also reflected the situations that gave rise to director's liability and exercise of their statutory duties, as well as the difficulties and complexities these directors, in the exercise of these new duties. The Law Commission and Scottish Law Commission, and the Company Law Review did made mention of the need, and importance of these statutory duties, in relation to its impact on the capital market. According to a survey report from the 2002 White paper, it is believed that codification of general duties of directors of corporations would generate huge benefits from £30 - £105 Million per year. Consequently, it is believed that director will no longer or less likely needs to take advice in the areas of their statutory duties.

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