Who Is Running The Company? Secured Lender Influence over the Board of Debtor Companies.

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Thesis submitted for the award of M. Litt.

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ABSTRACT

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Who Is Running The Company? Secured Lender Influence over the Board of Debtor Companies.

Commercially secured lenders may be tempted to interfere in the running of debtor companies. This thesis investigates to what extent directors’ duties can act to potentially restrict that influence. It does this by providing a legal and theoretical argument that it would best for all participants if directors focus on maximising the wealth of the company as a separate legal entity. The entity focused approach requires directors to prioritise the interests of the company ahead of any stakeholders. Due to the implementation of a shareholder value approach, the board of directors of a company are currently limited in the approach they can take to such action with the duty to act ‘in the interests of the company’ being equated with the duty to act in the interests of the shareholders. However, with a reinterpretation from the Irish courts as to what it means to act ‘in the interests of the company’, an entity focused approach can be implemented. It is submitted that there is a sufficient legal basis for the Irish courts to make this reinterpretation. If such an undertaking was made by the judiciary, the directors of a company would be in a position whereby they could take into account the interests of a secured lender and potentially prevent occasions arising where a secured lender would actively seek to engage in the running of the company. It is also submitted that by doing so there will be sufficient basis for the courts to extend director duties to such lenders and thereby directly link any actions they take in the management of the company with the fiduciary duties owed by the directors of the company.

In near insolvency situations a secured lender can exercise a degree of control over the board of directors of the company concerned, but they are not deemed to inhabit director status. This thesis argues for the extension of directors duties to such secured lenders via the position of shadow directorship. To do so, this thesis examines existing theoretical frameworks relating to stakeholder interest. It analyses the interpretation of the phrase ‘in the interests of the company’ and the potential to expand the interpretation. The current jurisprudence in relation to secured lenders is considered and contrasted with the role of nominee and shadow directors to determine the potential for fiduciary duties to restrain such lenders.
CHAPTER 1 – Introduction

“[t]he appropriate goal of corporate law is to advance the aggregate welfare of all who are affected by a firm’s activities including the firm’s shareholders, employees, suppliers and ... third parties”.1

A. Introduction

Since the company has been given the status of a separate legal entity2 there has been a gradual change in its role. Companies have evolved from small family run enterprises to enormous multinational organisations with board members and directors. They can employ millions of individuals and exercise significant control over public services such as telecommunications,3 yet despite this impact on society, academics and lawmakers have been unable to come to an agreement on what the objective or purpose of a company should be. This is despite the view that all purposeful behaviour requires the existence of a clear objective.4 In whose interests must a director act? This goes to the root of the corporate objective.5 Is the function of a director of a company to simply increase the wealth of shareholders or do directors have a wider responsibility to all their stakeholders, such as secured lenders? An answer to this question requires an examination of in whose interests is a company best serviced and what exactly this means for those charged with the day-to-day running of the company, the directors.

The debate surrounding the corporate objective goes back to the 1930’s and the well-known debate between Adolf Berle6 and Merrick Dodd.7 Berle was of the opinion that all powers granted to the directors of a company are at all times to be exercised for the benefit of

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2 Companies Act 1862; Salomon v Salomon [1897] AC 22.
3 See Andrew Keay The Corporate Objective: Corporations, Globalisation and the Law (Elgar Publishing 2011) 5.
7 Merrick Dodd, ‘For Whom are Managers Trustees?’ (1932) 45 Harvard Law Review 1145.
shareholders only, for whom a profit is to be made. In response to this, Dodd argued that a company became a distinct legal entity once incorporated and therefore he viewed the company as being more than just a way of making profits for the shareholders. It is a debate which is still very much relevant today in Ireland and the enactment of the Companies Act 2014, which codified directors’ duties and provides that a “director of a company shall act in good faith in what the director considers to be ‘in the interests of the company’ ”. A strict adherence to a shareholder value approach fails to reflect on the fact that a company is unlikely to be successful in the long term if it consistently acts to the detriment of its other stakeholders such as its employees, suppliers, and lenders.

Directors, as the managers of a company, control the day to day decision making in a company. Directors have been described as “… the beating heart of corporate functionality”. They manage the company while balancing their responsibilities within the judicial and legislative controls which derive from a directors’ duties. Within this unique interplay between the entities that are the company, its shareholders, other stakeholders and the directors, the directors act as “the directing mind and will of the company”. The taut nature of the relationship between the need for directors to manage the company, the guiding principle of the duties placed on directors, the enforcement of the use of a shareholder value approach, how directors respond to their legal requirements and the potential intrusion of a secured lender in influencing the decision making of the board of directors lies at the centre of this thesis. The 2014 Act introduced the duty to act honestly and responsibly and this suggests that directors’ fiduciary duties include more than a duty to increase the wealth of the shareholders.

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8 Ibid, 1049.
9 Merrick Dodd, ‘For Whom are Managers Trustees?’ (1932) 45 Harvard Law Review 1145.
10 Part Five of the Companies Act 2014.
11 Section 228(1)(a) of the Companies Act 2014.
14 HL Bolton Engineering Co Ltd v TJ Graham & Sons Ltd [1956] 3 All ER 622 [630] per Denning LJ.
15 Section 228 of the Companies Act 2014.
16 Greenhalgh v Arderne Cinemas Ltd [1950] All ER 1120.
17 Section 228(1)(b) of the Companies Act 2014.
Directors engage with the common law and equitable duties owed by them to the company. These broadly-based non-statutory duties were largely formulated by the courts in the nineteenth century by analogy with those of trustees and refined over the ages. Redmond observed;

“Protection against management self-dealing is afforded by fiduciary duties of loyalty which impose obligations of good faith and conflict avoidance upon directors … Duties of care and diligence are directed towards the problem of shirking”.18

The duty which is central to this thesis being:

“A director of a company shall –

act in good faith in what the director considers to be ‘in the interests of the company’”.19

However, by requiring a director to “act in good faith in what the director considers to be ‘in the interests of the company’ ”,20 which has been interpreted as the interests of the shareholders by the courts,21 the duty is pursuing an opposite path to the doctrine of separate legal personality22 and the nature of directors’ duties. To understand this a normative determination of the duty to act in the interest of the company and a clearer determination of the legal framework which applies to secured lenders and their role within a debtor company is required. By pursuing a policy of shareholders first, the groundwork is being prepared for secured lenders to seek alternative methods of imposing their influence on a board of directors.

In Ireland, there are broadly, three categories of creditors; preferential;23 secured; and; unsecured whose security against a company is defined by a fixed or floating charge. Following the decision in Spectrum Plus24 it became clear that the one essential characteristic which distinguishes a floating charge from a fixed charge is;

19 Section 228 (1)(a) of the Companies Act 2014.
20 Ibid.
23 Section 621 of the Companies Act 2014.
“[T]he asset subject to the charge is not fully appropriated as a security for the payment of the debt until the occurrence of some future event. In the meantime, the chargor is left free to use the charged asset and to remove it from the security”.\textsuperscript{25}

It is section 621 of the \textit{Companies Act},\textsuperscript{26} which sets out the debts which may be proved including contingent and future debts. In the case of a fixed charge holder, they have the most senior protection if an insolvency should arise as they have specific assets that will collateralise their loans. It is submitted in this thesis that this is a situation which can be advantageous to a secured lender as the assets they secure a charge over in return for their financial commitment can play a role in the extension of their influence over the board of the company in question.

Secured lenders generally have the right to appoint a receiver on the property against which a charge is held when the borrower is to default. Advancing credit may involve the acquisition of a potentially risky asset. In minimising this risk requirement included are, \textit{inter alia}, a credit history, a repayment capacity and the taking of security. As the Irish financial crisis has demonstrated these basic fundamentals of lending were overlooked far too often and replaced with expediency, questionable financial packages, a lack of oversight and little or no governance. As Clarke J observed;

\begin{quote}
“It is becoming increasingly clear that there was, in many places, a lax attitude to credit arrangements and to putting in place proper security during the boom years of the bubble. The courts are now frequently faced with cases where there are at least doubts about the terms of credit arrangements or the adequacy of security documentation and, it might well be inferred, there are many more cases which do not come to court at all because the relevant documentation is accepted as being inadequate”.\textsuperscript{27}
\end{quote}

Being a secured lender, in the ordinary sense can be of great benefit as they are provided with the benefit of a security interest over some or all of the assets of the debtor. Secured lenders

\textsuperscript{25} Ibid, 111.
\textsuperscript{26} Section 621 of the \textit{Companies Act 2014}.
\textsuperscript{27} Mary Donnelly \textit{The Law of Credit and Security} (2nd ed., Round Hall 2015) 2.
may exercise their influence to encourage a company’s management to place the company in liquidation, what is less clear in such matters is the extent to which secured lenders have used their position to exercise ‘control’ over the company concerned. In essence, this being when a secured lender uses their opportunity to provide a loan to increase their influence and possibly establish a form of control over the company with which their secured lender status exists.

When it comes to the relationships which connect a company, traditionally the relationship between the directors who run the company and the shareholders is characterised by the fiduciary duties of the director. However, what can often be overlooked, in terms of analysis, is the relationship which is present between the directors of the company and the lenders of that company, in particular, the secured lenders. There is no doubt that there are some significant advantages to being a secured lender compared to being preferred or unsecured. One such advantage is when a situation of an insolvency arises, a fixed charge holder can enforce their security outside the liquidation against the assets of the debtor and avoid competing with any others for the distribution of the assets upon their liquidation. Central to this thesis is the nature and extent with which secured lenders influence the decision-making of directors on boards of debtor companies. Consideration is also given to the possibility of directors’ fiduciary duties extending to secured lenders, once they become involved in the management of the company.

It is the meaning given to the phrase ‘‘in the interests of the company’’ which determines not only the Irish approach to the corporate objective but also the position the directors of a company are in when deciding which interest they can take into account when making decisions in the interest of the company. Schall and Mines commented that “a strict adherence to shareholder value fails to reflect the fact that it is impossible for a company to be successful in the long term while consistently acting to the detriment wider interests such as [secured lenders].” Secured lenders must be reliant on situations such as a winding up where they will have a prior claim to the shareholders on any assets up to the amount of the debt they are owed.

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28 Section 228 of the Companies Act 2014.
Directors generally owe their duties exclusively to the company, and not the shareholders. There are exceptions to this such as inducement, breach of fiduciary duty, disclosure and misrepresentation. In terms of the Irish position, Henchy J. set down in *G&S Doherty v Doherty* that “directors’ are in a fiduciary position, and must exercise their power *bona fide* for the benefit of the company as a whole”. More recently this approach appears to have been endorsed in *Bloxham (in Liquidation) v The Irish Stock Exchange Ltd*, where Charleton J in citing *G&S Doherty* as evidence that the duty to act in the interest of the company is still the authority on this subject. Not only has the 2014 Act codified directors’ fiduciary duties, the Act has also set down that a director should act in good faith in what the director considers to be the interests of the company. This thesis examines how these interests converge with the influence of secured lenders and their input in the decision making of directors of debtor companies.

It is argued that in Ireland, a change in the way in which directors’ duties are considered within company law is required - changing them from serving the interests of shareholders to serving a public interest function. This is evidenced by the public enforcement of director’s duties and the inclusion of the duty to act honestly and responsibly, which has stemmed from the law on restriction. This signals an intention from the legislature to protect interests broader than just those of the shareholder, however, the level of change required to ensure secured lenders interests are, along with other stakeholders in a company, put on an even footing with shareholders has yet to come about.

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32. *Allen v Hyatt* (1914) 30 TLR 444.
39. Section 228 of the *Companies Act 2014*.
40. Section 228 (1)(a) of the *Companies Act 2014*.
42. Section 228 (1)(b) of the *Companies Act 2014*.
43. Section 819 of the *Companies Act 2014*. 
B. Research Question and Contribution

(1) Research Question

The aim of this thesis is to examine the potential for secured lenders to exercise influence over the board of debtor companies. Such lenders, by virtue of their legally enforceable rights, are in a position to exercise this influence over the board of a debtor company. The research question is answered by advocating the limiting of secured lender influence over the directors of a company while providing for consideration of their investment. In making this determination this thesis examines the interpretation of the directors’ fiduciary duty to ‘act the interests of the company’. The potential to extend the directors’ duties owed by a nominee director and shadow director directly to a secured lender is considered.

In answering this question, this thesis argues for a reinterpretation of what it means to act ‘in the interests of the company’ within an Irish context. To legally implement an entity focused approach to the directors’ duty to act ‘in the interests of the company’, it would need to be interpreted as exactly that, a duty to act for the company, as a separate legal entity. It is argued that this interpretation is more likely to meet the goal of maximising wealth for all company constituents and allow secured lenders a platform to voice their concerns. It also argues that, there is a changing context in the manner in which directors’ duties are viewed and that this should continue when considering secured lenders in the role of nominee or shadow directors. Should it be the case that directors’ fiduciary duties are extended to include a secured lender in cases where such a lender is exercising their influence over the company via a nominee director or shadow directorship than such lenders will be in no doubt that their actions will need to be undertaken in a manner which do not benefit their own interest solely.

(2) Original Contribution to Existing Research

This thesis makes a significant contribution to the existing body of work in two ways. Firstly, this research proposes a reinterpretation of the directors’ fiduciary duty to act ‘in the interests of the company’ to a more company focused approach to the corporate objective. By doing so,

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44 Section 228(1)(a) of the Companies Act 2014.
45 Section 228 of the Companies Act 2014.
directors can consider the needs of all stakeholders, including secured lenders and not just the shareholders when managing the day-to-day needs of the company.

Secondly, it argues that secured lenders should be capable of being classed as a shadow or nominee director and that directors’ fiduciary duties should apply to them. This is done by investigating the role of the shadow and nominee director and determining the possibility of either being a secured lender.

C. Literature Review

(1) Secured Lenders

In terms of academic commentary on the law relating to secured lenders, there are articles and books relating to the area, but they do not distinctly discuss the central issue of this thesis, which is the level of influence lenders have over the boards of debtor companies. There is a lack of comprehensive research on the area of secured lenders, with current papers relating to this area, including Lynch Fannon’s article, which only focuses on certain aspects of this thesis without addressing the central question. She considers the effects company law and lack of corporate governance had on the excessive lending and borrowing which occurred in the Irish economy during the “Celtic Tiger” period. Here the Irish property bubble and the pattern of events which culminated with a recession are used as a case study to examine why corporate governance and company law, in general, did not curtail the excessive lending of the time. It does not specifically address the issue of secured lenders within the context set out in this thesis or analysis whether such lenders provide a form of corporate governance.

LuPuki examined the issue of secured lenders from the point of view of how such lenders categorised. He highlighted the point that secured lenders have been differentiated from all other stakeholders due to the nature of the security they may hold. However, while a lender

is entitled to keep a close eye on what is done with their investment and to impose conditions on his support for the company, this does not mean they are running the company or emasculating the power of directors, even if the director feels they have to accede to the lenders requests.\textsuperscript{50} Marshall\textsuperscript{51} does not consider the potential for secured lender influence over the board. Stout highlights that shareholder value can be damaging to stakeholders and the company as an entity as it puts shareholder interests above all else.\textsuperscript{52}

A working paper produced by Clarke and Hardiman\textsuperscript{53} analysed the conditions which led to the economic crisis in Ireland and in doing so take account of the pattern of corporate governance and regulatory institutions and practices in Ireland. They highlight the different initiatives, prior to the crisis, which were considered for formulating and enforcing good corporate governance, such as mandatory directors’ compliance statements.\textsuperscript{54} While Clarke and Hardiman came to the conclusion that the codes of practice associated with good corporate governance provided little resistance to the incentives for increased lending practices, they did not analysis the lending practices of secured lenders and their potential to influence the companies in their debt.

Books published in relation to this area are few, with perhaps the most comprehensive being that by Donnelly,\textsuperscript{55} which gives an excellent overview of the mechanics of providing security. However, while this explores the regulation of credit providers, different forms of credit and the various types of security, the influence of lenders on the directors of the company once the credit is provided is a significant area which not only requires assessment but will contribute to the vast knowledge already in place\textsuperscript{56} in this area, without overly crossing over to the areas which have already been examined. Again, the influence of the lenders in the direction of the

\textsuperscript{50} Ulpraframe (UK) Ltd v Fielding & Others [2005] EWHC 1638 Ch 1268.
\textsuperscript{52} Lynn Stout, ‘Bad and Not-So-Bad Arguments for Shareholder Primacy’ (2002) 75 Southern California law Review 1189.
\textsuperscript{54} First suggested by a parliamentary committee in 2001 examining serious and sustained misconduct by banks in facilitating tax evasion.
\textsuperscript{55} Mary Donnelly The Law of Credit and Security (2nd ed., Round Hall Publications 2011).
directors, which may also influence the outcome for shareholders, is an area which has been underexplored.

(2) Directors Duties

Regarding a director’s duty to act ‘in the interests of the company’, which is central to this thesis, has been explored by Quinn. This paper explores the evolution of the company since it has been given the status of a separate legal entity and the dominance of the shareholder value approach. While he discusses this in detail and highlights alternative interpretations to the phrase ‘in the interests of the company’, he does not expressively do so within the context of reinterpretating the duty to consider the interests of lenders specifically. Marshall assesses the finding of two Australian government inquiries into how company directors balance the interests of other stakeholders, including secured lenders, employees, and shareholders. While he does not consider the potential for secured lender influence over the board of directors, he examines the extent to which Australian law permits directors to consider the interests of other stakeholders in the company.

Ahern highlights the shift in public enforcement viewing compliance with directors’ duties as serving the public interest rather than protecting interests of shareholders. Keay examines the position of directors when their company is in the vicinity of insolvency. He highlights the shift in the nature of the duties owed by directors, namely, directors have to take into account the interest of lenders when exercising their powers and discharging their duties. While the paper discusses the main problems that exist with this shift in the nature of duties, Keay does

57 Section 228 (1)(a) of the Companies Act 2014.
not discuss secured lender’s influence over the board of debtor companies. Witney\textsuperscript{63} highlights UK company law relating to the extent of the fiduciary duties owed by a company’s shadow directors. He argues that current case law has not clarified the position relating to this. He does not discuss Irish case law relating to shadow directors, the fiduciary duties owed by them under Irish legislation or the Irish judiciary’s position on whether financial institutions can be classed as a shadow director.

Teele & Ramsey\textsuperscript{64} examines the relevant judgments relating to whether the duty to act ‘‘in the interests of the company’’ is subjective, objective or a combination of both. She examines English and Australian case law and argues the preferred approach should combine a subjective and objective test. She also considers whether a director fails to give consideration to the interests of the company and is consequently in breach of duty. Teele & Ramsey is of the opinion there should be a breach of duty. Teele & Ramsey does not consider the possible reinterpretation of the duty to act ‘‘in the interests of the company’’ and whether directors might do with the interests of all stakeholders in mind, rather than just shareholders. Hadjinestoros\textsuperscript{65} analysed the test for shadow directorship from a UK case law perspective. He discusses the difference in the test for shadow directors when a financial institution is potentially in the role. His paper is specific to this issue and does not discuss Irish case law or the role of secured lenders.

Moore\textsuperscript{66} argues that shadow directors, from a UK perspective, should owe a full range of directors’ duties, both fiduciary and non-fiduciary. While he highlights UK case law, Moore does not discuss the Irish position relating to this or examine the role of secured lenders in the management of a debtor company.


\textsuperscript{64} Rosemary Teele & Ian Ramsay, ‘Directors’ Duty to Act ‘in the interests of the company’: Subjective or Objective?’ (2015) 2 \textit{Journal of Business Law} 173.

\textsuperscript{65} Evripides Hadjinestoros, ‘Fear of the Dark: Banks as Shadow Directors’ (2013) 34 \textit{Company Lawyer} 169.

\textsuperscript{66} Craig Moore, ‘Obligations in the Shade: The Application of Fiduciary Directors’ Duties to Shadow Directors’ (2016) 36(2) \textit{Legal Studies} 326.
The current legislation in Ireland in relation to company law is the Companies Act 2014. The Act requires a director to ‘act in good faith in what the director considers to be in the best interests of the company’. The Irish courts have interpreted this to provide for a shareholder value approach and have equated the common law duty to act ‘in the interests of the company’ with a duty to act in the interests of the shareholders. This thesis examines whether this approach has left directors between a rock and hard place when dealing with secured lenders. This thesis examines a reinterpretation of this duty from an entity focused approach to directors duties and consider if the duty to ‘act in the interests of the company’ should be interpreted as just that, a duty to act for the company, as a separate legal entity.

Cases have recognised that the interests of the company and the shareholders may well diverge and that in such cases it is the entity’s interests which should take priority. In *Re A Company* it was held that “it is long established and basic law that the directors of a company owe their fiduciary duties to the company and not to the shareholders”. Not only has this been established in Irish case law, it is also set down in the UK Companies Act 2006 and the Irish Companies Act 2014 both of which state that directors’ fiduciary duties are owed to the company. Unless a special relationship exists between a director and a shareholder directors have no fiduciary duty to act for the shareholders’ benefit. As a result they cannot be legally held to be agents for the shareholders. On the face of it, the Companies Act 2014 would seem to make improvement for both debtors and lenders, however, there does not appear to any specific measure coming into force to tackle issues relating to secured lender influence and the type of terms a secured lender may impose on a debtor in return for funding.

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67 Section 228(1) (a) of the *Companies Act 2014*.
70 *Re A Company (No. 004415)* [1997] BCLC 479 Ch D 491.
71 See *Smith v Cork and Bandon Railway Co* (1870) 5 IR EQ 63; *Bloxham (in Liquidation) v The Irish Stock Exchange Ltd* [2014] IEHC 93.
72 Section 170 of the UK *Companies Act 2006*.
73 Section 227(1) of the *Companies Act 2014*.
(4) Corporate Governance

The issue of separation of the ownership and control of a company has been identified since the eighteenth century by Smith who stated “the directors of such companies … cannot well be expected that they should watch over it with the same anxious vigilance [as if it were their own]”. Although this may tie in with the idea that secured lenders have invested within the company and, therefore, would have a significant interest, this does raise the question of their role within the organisation and issues relating to secured lenders comparability to that of a shadow director or de facto director. Almost a century later and Berle and Means discussed one of the fundamental explanations of the investor corporate relationship. They highlighted that the ownership and control of companies became separated against a backdrop within which the culture, values, and institutions within which corporate law operates have not provided the level of corporate governance required.

In terms of corporate governance, this is an area which, although having come to prominence broadly in the last decade or so, has theories which not only underlay its development and date back to much earlier times, as well as having been drawn from different disciplines including finance, law and economics, but is becoming the basis by which companies are expected to conduct their business with integrity and fairness while being transparent in their transactions. In Ireland, Corporate Governance is defined as the system, principles and process by which organisations are directed and controlled. The principles underlying corporate governance are based on conducting the business with integrity and fairness, being transparent with regard to all transactions, making all the necessary disclosures and decisions and complying with all the laws of the land. It is broadly concerned with the relationships between company boards and the company’s shareholders, accountability and responsibility.

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76 Section 221 of the Companies Act 2014.
77 Section 222 of the Companies Act 2014.
78 Adolf Berle & Gardiner Means The Modern Corporation and Private Property (Transaction Publishers 1932) 5.
80 In the United Kingdom, the UK Corporate Governance Code sets out the standards of good practice for listed companies on board composition and development, remuneration, shareholder relations, accountability and audit.
81 Some may be more appropriate and relevant to some countries than others.
82 Ireland and the United Kingdom have historically followed the lead set out in the United States regarding Corporate Governance.
towards the stakeholders. Good governance should facilitate efficient, effective and entrepreneurial management that can deliver shareholders value over the longer term.

It highlights the potential problems between the separation of the ownership and control of a company. Keay\(^{83}\) examines what determines a board of director’s makeup and their actions. He observes that these questions are fundamentally intertwined and that this complicates such a study because their makeup and actions are jointly endogenous. While raising the issue of corporate governance he does not discuss the possibility that secured lenders may provide a form of corporate governance.

(5) The Corporate Objective

The issue of the corporate objective first came to prominence in the 1930s and the debate between Adolf Berle and Merrick Dodd. Berle argued that all powers granted to the directors of a company were at all times exercisable only for the benefit of shareholders, for whom the money is to be made.\(^{84}\) He was of the opinion that as power had been delegated from the shareholders to the directors that they had the sole responsibility to run the corporation in the interest of the shareholders.\(^{85}\) Dodd argued that a corporation becomes a distinct legal entity upon incorporation.\(^{86}\) He viewed the company as being more than just representing shareholder interests and that it should be obligated to fulfil a social service role.\(^{87}\) Dodd stated that the company “as an institution directed by persons who are fiduciaries for the institution rather than for its members”.\(^{88}\) This debate is still relevant in Ireland as it was in the 1930s. The Companies Act 2014 codified directors’ duties and requires directors to act in ‘the interests of the company’.\(^{89}\)


\(^{84}\) Adolf Berle ‘Corporate Powers as Powers in Trust’ (1930) 44 Harvard Law Review 1049.


\(^{86}\) Merrick Dodd, ‘For Whom are Managers Trustees?’ (1932) 45 Harvard Law Review 1145.

\(^{87}\) Ibid, 1148.

\(^{88}\) Ibid, 1162, 1163.

\(^{89}\) Section 228 (1)(a) Companies Act 2014.
The application of an entity focused approach to the corporate objective has been discussed by Keay and Attenborough. They call for a new model of the corporate objective, which focuses on the maximisation of wealth and one which ensures the sustainability of the company as an entity. Unlike the concept of shareholder value, here the interest of the company as an independent entity has priority above all else. Instead of focusing solely on the individual stakeholder, the entity model to the corporate objective prioritises the interests of the company and enhancing its position.

Keay submits that this model will be of benefit to all of the company’s constituents. Attenborough is of the opinion that an entity driven approach will promote fairness between the various stakeholders to the company and increase the efficiency of the company compared to other models. This thesis submits that there is a legal basis and scope to implement such a model in Ireland. The Companies Act 2014 requires directors to “act in good faith in what the director considers to be ‘in the interests of the company’”. It is submitted that this fiduciary duty allows for a more entity driven approach rather than a shareholder value approach and by having such an approach directors will be in a position to take into consideration the needs of all stakeholders including secured lenders. What is ‘in the interests of the company’ is what should guide directors’ decision making. Milton Friedman advanced the idea that company managers are agents of the shareholders and that their only purpose is to increase the company stock price.

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93 Ibid 199.
95 Section 228 (1)(a) of the Companies Act 2014.
Of course the shareholder value approach is not short of critics. Blair and Stout argue that this short term approach to shareholder value discourages non-shareholders from investing in the company, investments which can be essential in ensuring the company’s success.

Witney highlights UK company law relating to fiduciary duties owed by shadow directors, however not the Irish position. Teele & Ramsey examines whether the duty to act ‘‘in the interests of the company’ ’ is subjective, objective or a combination of both. Teele & Ramsey does not consider the potential for reinterpreting the duty. Moore does not discuss the Irish position. Keay examines a board of director’s makeup and actions. While raising the issue of corporate governance he does not discuss the possibility of secured lenders providing a form of governance. Smith stated “the directors of such companies … cannot well be expected that they should watch over it with the same anxious vigilance [as if it were their own]. Although this ties in with the idea that secured lenders have invested in a company and, therefore, have a significant interest, it raises the question of their role within the company, a question which this thesis will address.

(6) Other Jurisdictions

From an American academic point of view, there has been some material which touches on the concept which is discussed in this thesis, with one particular article being by Harner and Marincic, which is of interest as it discusses the influence of lenders over a debtor. It does so from the point of view of a Chapter 11 bankruptcy reorganisation. In terms of comparing the level of secured lender influence over a company this article is significant as the Chapter

11 bankruptcy within America provides an excellent opportunity from the point of view of the lender to increase their overall influence, however, Harner and Marincic focus solely on this issue and do not go beyond those confines to assess issues of corporate governance, other jurisdictions or the behaviour of lenders in other situations or jurisdictions.

Baird and Ramussen\textsuperscript{105} look at the influence lenders can have over a company via the covenants that are included in the loan agreement. They approach the issue mainly from the point of view that loan covenants are playing a more significant role in corporate governance. They examine the level of influence and control a lender may have, but they do so from the point of view of integrating these with the role of corporate governance and the modern role of corporate law in general. Bird and Ramussen argue that there is a missing level of corporate governance, which is, in their opinion, the control which lenders exercise over a company by elaborate loan covenants contained within the loan agreement.

Although the above is evidence of some of the research carried out in areas such as corporate governance and lenders, this thesis is unique in that it will the investigate issues outlined in a distinct way which has not been previously undertaken. Issues such as duties of directors under Irish law and directors’ duties when a company is facing insolvency will need to be examined and analysed.

D. Methodology

(1) Methodology

The methodology for this thesis involves traditional legal doctrinal analysis of statutory material, case law, academic commentary and company law reform papers. This thesis focuses primarily on the law in Ireland and the United Kingdom with a comparative analysis of the two jurisdictions. The foundation of this thesis is built upon a detailed evaluation of the duty to act ‘in the interests of the company’, based on a review of case law and literature. This informed the provision of a critical narrative tailored to the specific legal framework which focuses on

the interpretation of the duty to act ‘in the interests of the company’. This enabled an assessment of a director’s duty owed to lenders and provided a basis from which to examine the level of influence lenders may have over the board of debtor companies. Working from this central point, the comparisons of shadow and de facto directors with a secured lender are set in context. Comparative analysis with other jurisdictions with similar common law and statutory history including the United Kingdom, Australia, New Zealand and Canada provided for an informed opinion on matters such as the interpretation of the duty to act ‘in the interests of the company’, the application of directors’ duties to secured lenders within the role of shadow and de facto directors and an analysis of the potential ability of secured lenders to provide a form of corporate governance.

In terms of the doctrinal developments, this is an area which has been covered in terms of analysis of a director’s duties to secured lenders, a review of directors’ fiduciary duties to secured lenders of financially distressed companies and interpreting directors’ duties relating to the corporate objective. The area which is the subject of this thesis is one which not only warrants close examination but is one which has been overlooked to a degree, despite its importance. If the company is considered the centre of the framework, it is the connections which come from the company in the direction of the lenders and vice a versa, which are to be examined.

E. Language and Terms Used

The terms director is used in the Irish Companies Act 2014 and the UK Companies Act 2006 as it applies to directors of companies including shadow, de facto and nominee directors. The discussion in this thesis regarding the corporate objective is most relevant to public companies where there is a separation of ownership and control. In small closely held companies there is less likely to be a divergence between the company’s interests and the shareholders’ interests.
F. Thesis Outline and Structure

Chapter two analyses the current interpretation of the phrase ‘in the interests of the company’ and puts forward the case for a reinterpretation.

Chapter three outlines the role of a nominee director in a company. It sets out the law relating to nominee directors and the potential issues faced by them. It also examines the main fiduciary duties attributed to nominee directors and discusses the position of nominee directors in an insolvency situation. Finally, it explores their potential for acting on the instructions of their nominator, a secured lender, to the detriment of the company.

Chapter four focuses on the potential for secured lenders to be deemed a shadow director. It details the law relating to shadow directors in Ireland and the UK and it examines the test for shadow directors in situations which involve a secured lender. It highlights the potential for an alternative approach and it investigates the extent of which directors’ duties may be owed by a secured lender.

Chapter five is the conclusion and outlines the answers to questions such as those outlined above and also contains recommendations for the future development in this area.
Chapter 2 – In Whose Duty do Directors Act?

A. Introduction

“The law does not say that there shall be no cakes and ale, but there are to be no cakes and ale except as such as are required for the benefit of the company”.

Since the landmark case of Salomon v Salomon\(^2\) where a company was given the status of being a separate legal entity, there has been a remarkable change in the role of companies. Companies have moved from being rather small organisations to large multinational enterprises, especially large public companies, can exercise an enormous influence both economically and socially.\(^3\) Their actions will not only affect directly connected stakeholders such as employees, lenders, and customers but they may also affect communities, the environment\(^4\) and perhaps even governments. However, despite the significant impact companies have on society, there is no agreement, between academics or lawmakers, as to what their objective or purpose should be. Is their function simply to increase the wealth of shareholders or do companies have a much wider responsibility to benefit all stakeholders in general? It is this debate, regarding the corporate objective, which has become inextricably linked to the duties of directors. Directors, as the day to day decision makers of the company, have legal requirements placed on them,\(^5\) and how directors choose to respond to these legal duties will be the primary factor in deciding the company’s objective.

This chapter examines the interpretation of the phrase ‘in the interests of the company’ and investigates the possible interpretations of it.\(^6\) This chapter will explore the shareholder value approach to the corporate objective and lay out a possible alternative to such an approach. It also outlines the theoretical frameworks which have been established relating to shareholder primacy and stakeholder theory, such as German codetermination and the hypothetical bargain

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1. *Hutton v West Cork Railway* (1883) 23 Ch D 654.
5. Section 228 of the *Companies Act 2014*.
6. While directors are required to have regard, in the performance of their functions, to the interests of the company’s employees in general as well as the interests of its members, this duty is owed to be company alone and is enforceable by the company alone as per section 224 of the *Companies Act 2014*. 

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theory. It argues that a reinterpretation of the phrase ‘in the interests of the company’ is required by the courts to ensure that this duty actually applies to the company and not just its shareholders. It argues that in allowing directors to take a more company orientated view of the duty they owe they can take account of stakeholder interests, such as secured lenders, and it provides them with an opportunity to make decisions with these interests in mind and potentially prevent a situation whereby a secured lender seeks to expand their influence over the running of the company.

The question of whether a director owes fiduciary duties to a secured lender when the company in question is nearing or within the zone of insolvency seems beyond doubt. In West Mercia Safetywear Ltd v Dodd the Court of Appeal, citing with approval the decision of the New South Wales Court of Appeal in Kinsela v Russell Kinsela, held that shareholders cannot absolve directors from a breach of their duties to lenders so as to bar a liquidator’s claim. As Street CJ stated in Kinsela v Russell Kinsela:

“In a solvent company, the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise … But where a company is insolvent the interests of the [secured lender] intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company’s assets. It is in a practical sense their assets and not the shareholders’ assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency or the imposition of some alternative administration.”

This chapter submits that interpreting the phrase ‘in the interests of the company’ to mean a duty to act ‘in the interests of the company’ as a separate legal entity is a superior approach. Such an approach would remove the negatives of the shareholder approach. The modern day company became its own entity when its capital was separated from the shareholders with the

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7 Section 228(1)(a) of the Companies Act 2014.
8 West Mercia Safetywear Ltd v Dodd [1988] BCLC 250.
10 Section 228 of the Companies Act 2014.
12 Ibid [223] per Street CJ. In Bloxham (in liquidation) v The Irish Stock Exchange Ltd [2014] IEHC 93, Charelton J cited with approval the decision in G&S Doherty as proof the duty to act ‘in the interests of the company’.
arrival of the general incorporation statutes of a company in the mid-nineteenth century.\textsuperscript{13} This division has been instrumental in the success of the modern day company and it is an implicit recognition of the outcome in \textit{Salomon v Salomon & Co Ltd} \textsuperscript{14}. Modern companies\textsuperscript{15} are descendants of, and share characteristics with, two earlier forms that existed prior to the general incorporation statutes of the mid-nineteenth century: the classic corporation and the old joint stock company. The combination of joint stock with the corporation, together with the statutory enablement of limited liability and the resulting requirement that corporate accounts be kept that distinguished capital, led to the severance between shareholders outside the company and capital inside the entity. Although the modern company and statutory limited liability existed from the middle of the nineteenth century, the consequences of and advantages of the modern corporate form were not fully recognized and exploited until the latter part of the nineteenth century leading to the inevitable concentration of economic power in the company.

To simply equate the interests of the company with the interests of the shareholders is a flawed approach. Watson argues that the focus on shareholders and indeed shareholder primacy ideas are based on an outmoded conception of the company.\textsuperscript{16} She states;

\begin{quote}
“Shareholders ownership rights are so attenuated in the modern company that shareholders are significant only because collectively, or individually with a block of shares, they can exercise indirect control”.\textsuperscript{17}
\end{quote}

It is one of the fundamental principles of company law that a company is a separate legal entity\textsuperscript{18} and taking the company as a separate legal entity, distinct from its stakeholders, would allow directors to make decisions which would benefit all the stakeholders where such a decision was ‘‘in the interests of the company’’. However, Irish law, along with other common law jurisdictions, has embraced the shareholder value approach when considering the interests of the company.

\begin{itemize}
\item \textsuperscript{13} David Millon, ‘Theories of the Corporation’ (1990) 201 \textit{Duke Law Journal} 208.
\item \textsuperscript{14} \textit{Salomon v A Salomon & Co Ltd} [1897] AC 22.
\item \textsuperscript{15} The development in the understanding of the modern company did not take place in a vacuum, but evolved through the second half of the nineteenth century.
\item \textsuperscript{17} Ibid 120.
\item \textsuperscript{18} Arthur Machen, ‘Corporate Personality’ (1911) 24 \textit{Harvard Law Review} 253.
\end{itemize}
Directors exercise their discretion for what they consider is ‘in the interests of the company’ with the limits of this discretion being imposed by the company’s memorandum and articles of association or constitution and the Companies Act 2014\textsuperscript{19}. The Companies Act 2014 codified directors’ duties in Part Five of the Act\textsuperscript{20} and provides that directors shall act in what they consider to be ‘in the interests of the company’,\textsuperscript{21} yet the changes introduced have left the legal position far from clear with the potential for the further development of the law to be constrained. One of the well-known principles of company law is the duty placed on directors to “act in good faith in what the director considers to be the interests of the company”.\textsuperscript{22} It is a duty which highlights that directors are fiduciaries of the company and are to serve the interests of the company rather than their own or any others. It is a duty which originated in the cases of\textit{Hutton v West Cork Railway}\textsuperscript{23} and \textit{Re Smith & Fawcett}.\textsuperscript{24} However, it is a duty which has proven difficult to define with two primary interpretations in existence. The current interpretation by the judiciary which favours the interests of shareholders leaves no room for the interests of secured lenders and as a result leaves open the potential for such lenders to seek alternative methods to ensure their interests are taken on board by the board of directors of a company.

The different interpretations offer two different paths for the company with either the shareholders\textsuperscript{25} or the company itself\textsuperscript{26} and there is a recognition that the interests of the company, and that of the shareholders may well diverge.\textsuperscript{27} These interpretations can lead to vastly different outcomes in terms of a directors’ decision-making, especially if the interests of a company’s lender does not coincide with the potential long-term aims of the company. The

\begin{footnotesize}
\begin{enumerate}
\item Section 228 (1)(a) of the \textit{Companies Act 2014}.\textsuperscript{19}
\item Section 228 of the \textit{Companies Act 2014} sets out the principal fiduciary duties of directors.\textsuperscript{20}
\item Section 228(1)(a) of the \textit{Companies Act 2014}.\textsuperscript{21}
\item \textit{Ibid.}\textsuperscript{22}
\item \textit{Hutton v West Cork Railway} (1883) 23 Ch D 654.\textsuperscript{23}
\item \textit{Re Smith & Fawcett} (1883) 23 Ch D 654.\textsuperscript{24}
\item \textit{Allen v Gold Reefs of West Africa Ltd} [1900] 1 Ch 656.\textsuperscript{26}
\item This was recognised in \textit{Dawson International Plc v Coats Platon plc} [1989] BCLC 233; \textit{Re Wellifab Engineers} [1990] BCLC 833; \textit{Re BSB Holdings Ltd} [1996] 1 BCLC 155.\textsuperscript{27}
\end{enumerate}
\end{footnotesize}
Irish judiciary, as in England, have equated this duty to mean the interests of the shareholders of the company. With this in mind, this thesis explores the decision making of directors in favour of secured lenders to the company concerned which is a different approach to the shareholder value approach favoured by the judiciary.

(2) Section 228(1)(a) of the Companies Act 2014

Directors’ common law and equitable duties which have been developed by the courts were codified and set out in section 228 of the 2014 Act. Among these duties is the duty to act ‘in the interests of the company’ as a whole. The courts will not interfere with their decisions even though they may be to the detriment of the company. The codification and restatement of directors’ duties make them more accessible to directors and those who deal with them. The Act makes it clear, however, that the statutory duties are to be interpreted and applied in the same way as the common law and equitable principles from which they are derived. It implicitly recognises that two directors can, legitimately, have different opinions as to what is ‘in the interests of the company’. In Hutton, Bown LJ stated, “the law does not say that there shall be no cakes and ale, but there are to be no cakes and ale except as such as are required for the benefit of the company”.

Hutton is frequently held up in support of the proposition that a company should not overspend or dispose of its property except for purposes which may be reasonably considered within the carrying on of its business. The directors acting in the interest of the company. Initially, judicial clarity regarding the duty act ‘in the interests of the company’ emerged in Re Smith and Fawcett Ltd where Lord Greene MR observed that “directors must act, bona fide, in what they consider, not what the court considers, is ‘in the interests of the company’, and not for

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29 Directors’ fiduciary duties now set out in s.228 of the Companies Act 2014.
30 The Companies Act 2014.
31 Section 228(1)(a) of the Companies Act 2014.
32 Clark v Workman [1920] 1 IR 207.
33 Re Gresham Life Assurance Society Limited; Ex parte Penney [1872] LR 8 Ch 446.
34 Section 227 of the Companies Act 2014.
35 Hutton v West Cork Railway (1883) 23 Ch D [654] per Bowen LJ.
36 Re Smith and Fawcett Ltd [1924] Ch 304.
any collateral purpose”. The Iris law judgments relating to a directors’ fiduciary duty to act ‘in the interests of the company’ stem from the cases of Hutton v West Cork Railway and Re Smith & Fawcett.

Although the duty to act in the interest of the company is a well-established fiduciary duty in the common law courts, these cases are often cited in support of shareholder value, the duty to act ‘in the interests of the company’ does not support shareholder value. The courts, by interpreting this duty to mean the interests of the shareholders have imposed a shareholder value approach. In Irish company law, as in English, the company’s interests are viewed as synonymous with shareholders’ interests and the interests of the company have been equated by the courts to mean the interests of shareholders.

(3) The Shareholder Value Approach

While not uniformly embraced, common law jurisdictions have tended to favour a shareholder value approach, which has been perceived to be the dominant principle, particularly in the traditional judicial approaches of England, Wales, and the US. The shareholder value is important as it is due to this approach that directors must act in the interests of the shareholders and cannot take a more entity focused approach to the company. Shareholder value provides that the directors of a company manage the assets of the company

37 Re Smith and Fawcett Ltd [1924] Ch 304 [306] per Greene MR.
39 Hutton v West Cork Railway (1883) 23 Ch D 654.
40 Re Smith and Fawcett Ltd. [1924] Ch 304.
and take decisions with the objective of maximising the shareholders gain.\textsuperscript{48} It is a model which has gained widespread backing from academics\textsuperscript{49} with some claiming there is no serious alternative to the view that corporate law should strive for shareholder value.\textsuperscript{50} In \textit{Dodge v Ford},\textsuperscript{51} which advocates the shareholder value approach, Henry Ford pursued a policy of reducing dividends in order to subsidise the sale price of Ford cars. The aim was to stimulate the market by increasing car sales and thereby ensure the jobs of the company’s employees. The Dodge brothers, shareholders in the company, argued that this approach was at the shareholder’s expense and an improper use of Ford’s power. The court held the policy was not in the interests of the company’s shareholders and stated that “the business corporation is organised and carried on primarily for the profit of stockholders. The powers of directors are to be employed to that end”.\textsuperscript{52}

\textit{Dodge v Ford}\textsuperscript{53} demonstrates the strict interpretation of the doctrine of shareholder value.\textsuperscript{54} Here we see an interpretation that any action which will not directly increase the wealth of the shareholders can amount to improper action by the directors. However, in \textit{Dodge}, an argument could have been put forward that the subsidising of prices in order to increase sales and secure the future of the employees would have benefitted the company in the long-term.\textsuperscript{55} While the judgment in \textit{Dodge} demonstrates that the short-term approach of shareholder value prevailed, a more long term approach may have wielded not only a more successful company but also greater wealth for the shareholders. United Kingdom and Irish law judgments relating to this issue have tended to focus on a directors’ fiduciary duty to act ‘in the interests of the company’. It is a duty which stems from \textit{Hutton v West Cork Railway}\textsuperscript{56} and \textit{Re Smith and Fawcett}.\textsuperscript{57}

\textsuperscript{51} \textit{Dodge v Ford Motor Company} 170 NW 668.
\textsuperscript{52} Ibid 684.
\textsuperscript{53} See also \textit{AP Smith Manufacturing Co v Barlow}, 13 N.J. 145, 98 A.2d 581 (N.J. 1953), which concerns the application of directors’ duties in regard to the balancing of the interests of various stakeholders related to the company.
\textsuperscript{54} A strict interpretation meaning any action which does not directly increase the wealth of the shareholders amounts to an improper action by a director.
\textsuperscript{56} \textit{Hutton v West Cork Railway} (1883) 23 Ch D 654.
\textsuperscript{57} \textit{Re Smith and Fawcett Ltd} [1924] Ch 304.
However, despite such cases being cited in support of the shareholder value approach, the duty to act ‘in the interests of the company’ does not, on its own, support shareholder value.

It is the judiciary, by interpreting the duty to mean the interests of the shareholders, which has imposed a shareholder value approach on company directors. In English company law a company’s interests are synonymous with the shareholders’ interests and the interests of the company has been equated by the judiciary to mean the interests of the shareholders. The same position stands in Ireland. In Greenhalgh v Arderne Cinemas Lord Evershed MR stated “[t]he phrase, the company as a whole does not mean the company as a commercial entity as distinct from the corporators. It means the corporators as a general body”. This quote has been cited on many occasions in support of a shareholder value approach to directors’ duties. Plowman J in Parke v Daily News Ltd further supported a shareholder value approach when he stated the benefit of the company means the benefit of the shareholders as a general body.

“It is not deemed to be easy to determine the interests of the company without factoring in the interests of members. Nourse LJ continued with this approach in Brady v Brady and stated;

“The interests of a company, an artificial person, cannot be distinguished from the interests of the person who are interested in it. Who are those persons? Where a company is both going and solvent, first and foremost come the shareholders present and no doubt future as well”.

Along with these supporting cases, others reasons are present as to why shareholder value has prevailed. Shareholders have power over directors compared to other stakeholder groups. They have the power to appoint and remove directors and to take derivative action against directors,

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58 Section 228(1)(a) of the Companies Act 2014.
62 Greenhalgh v Arden Cinemas Ltd [1950] 2 All ER 1120.
66 Ibid [552] per Nourse LJ.
although such actions are rare. There are also legal and normative arguments in favour of the shareholder value approach. Firstly, there is an argument that shareholders own the company\(^{67}\) and the company should run for their benefit, however, this is not in line with the doctrine of separate legal personality. The ownership of shares does not provide shareholders ownership of the company, they own a corporate security in the form of stock.\(^{68}\) Shareholders have no control over assets\(^{69}\) or the right to declare a dividend\(^{70}\) and in the event of a winding up, lenders have a prior claim ahead of shareholders. Berle was of the opinion that directors are trustees and should act on the behalf of the shareholders. Legally, directors, are fiduciaries to the company and owe their duties solely to the company.

Another legal argument, in line with Berle, is that directors are trustees for shareholders and as such should act on their behalf. However, directors are fiduciaries of the company and as such they owe their duties exclusively to the company, and not the shareholders.\(^{71}\) A further legal argument in support of a shareholder value approach is that the shareholders are residual claimants.\(^{72}\) This is based on the idea that a company is just a set of contracts between shareholders and other stakeholders in the company. The non-shareholder interests being protected by the terms of the contract they enter into. The argument puts forward the claim that because a shareholder has no fixed claim through a contract, they are residual claimants and as residual risk bearers they are entitled to have the company operate for their benefit.\(^{73}\) However, there are a number of issues with this argument such as the only time that a shareholder is actually treated as a residual claimant is during the liquidation of the company.\(^{74}\) While the company in question is maintained as a going concern they are only entitled to a payment when

\(^{67}\) Milton Friedman, ‘The Social Responsibility of Business is to Increase its Profits’ \textit{NY Times Magazine}, September 13, 1970, 32.

\(^{68}\) \textit{Short v Treasury Commissioners} [1948] AC 534.


\(^{70}\) \textit{Re Drogheda Steampacket Co Ltd} [1903] IR 512.


\(^{74}\) Liquidation will have a negative effect on other stakeholders as well as the shareholders of the company. Therefore, it is a mistake to view the shareholders as the only residual claimants at risk in a liquidation.
the directors declare a dividend is to be paid. Stout argues that while a company remains as a going concern, it is inaccurate to describe shareholders as residual claimants.

A normative argument in favour of a shareholder value approach is the view that it is the best way to benefit the constituents of a company, however, some consider a shareholder value approach not to be the proper method to ensure the benefit of all the stakeholders. Stout highlights that shareholder value can be damaging to stakeholders and the company as an entity as it puts shareholder interests above all else. Arguments for a shareholder value approach may be persuasive, but not when they are compared to the view of the company as a separate legal entity. What is ‘in the interests of the company’ is what should guide directors’ decision making. Of course, the shareholder value approach is not short of critics with adherence to it being linked to a short-term focus which can be damaging to stakeholders and the company.

Blair and Stout argue that this short-term approach to shareholder value discourages non-shareholders from investing in the company, investments which can be essential in ensuring the company’s success.

Some jurisdictions have attempted to move away from a shareholder value approach, albeit with mixed results. Legislative requirements may be placed on directors to ensure they consider the interests of others than the shareholders as in England, Wales and many US States. Another alternative would be to impose a two-tiered management structure as is operational in Europe in countries such as Germany. This model consists of a board of management and a

75 Bond v Barrow Haematite Steel Co [1902] 1 Ch 353; Re Drogheda Steampacket Co Ltd [1903] IR 512.
76 Lynn Stout, ‘Bad and Not-So-Bad Arguments for Shareholder Primacy’ (2002) 75 Southern California Law Review 1194. See also Fischer Black & Myron Scholes, ‘The Pricing of Options and Corporate Liabilities’ (1973) 81 Journal of Political Economy. 637, 637, where the foundation for modern options theory was put down. This demonstrates that it is not only misleading to say that dispersed shareholders own the company, but that it is even questionable to say that a single controlling shareholder owns a closely held firm after the firm has issued debt.
supervisory board which is made up of both stakeholders and shareholders. Thirdly, the courts, such as those in Canada, may take the view that a company should be treated as a separate entity distinct from the shareholders. Within the UK, the model applied directors are required to run the company for the benefit of the shareholders, but they must also have regard for other stakeholder interests, such as employees, and the likely consequences of any decision in the long term.

In Europe, jurisdictions have adopted more inclusive non-shareholder first approach to the corporate objective, such as the German codetermination model, which is discussed below. However, while such a model has its merits, attempts to implement it within the European Union have been unsuccessful, primarily due to resistance in the UK and the difficulties which would accompany the implementation of such a model in other countries.

(4) The Irish Approach to the Corporate Objective

The Irish approach to the corporate objective is to equate the interests of the company directly to the shareholders’ interests. This provides that directors attempt to maximise a shareholders' wealth as it is accepted the main interest of a shareholder is to maximise their financial return on their investment. This support for a shareholder value approach with an Irish context stems from Henchy J in G&S Doherty v Doherty who stated “directors are in a fiduciary position, and must exercise their power bona fide for the benefit of the company as a whole, that is to say, the shareholders as a whole” Henchy J used Greenhalgh v Ardene Cinemas Ltd as evidence that a shareholder value approach was relevant, despite Greenhalgh concerning a different context. The shareholder value approach in the Irish judiciary was echoed in Irish Press v

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84 An approach known as Enlightened Shareholder Value.
85 Section 172(1) of the Companies Act 2006.
87 Detlev Vagts, ‘Reforming the “Modern Corporation”: Perspectives from the German’ (1966) 80 Harvard Law Review 76.
88 Deirdre Ahern Directors’ Duties: Law and Practice (Round Hall 2009) 158.
89 G & S Doherty Ltd v Doherty (19 June 1969, unreported) 42.
90 Greenhalgh v Ardene Cinemas Ltd [1950] 2 All ER 1120.
Ingersoll91 where Barron J stated that “acting ‘in the interests of the company’ is no more than acting in the interests of all its shareholders”.92

In the Case of Re Frederick Inns Ltd93 the Supreme Court of Ireland also followed a shareholder value approach. Blaney J cited with approval from Kinsela v Russell Kinsela Pty. Ltd94 in stating “In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise”. 95 More recently in Bloxham (in Liquidation) v The Irish Stock Exchange Ltd96 Charleton J cited with approval the decision in G&S Doherty as proof of the duty to act ‘in the interests of the company’. As discussed, the introduction of the Companies Act 2014 encoded, for the first time, directors’ fiduciary duties97 with s. 228 (1)(a) providing that;

A director of a company shall act in good faith in what the directors considers to be the interests of the company.

However, while such a duty was welcome, section 227(5) provides that fiduciary duties will be interpreted and applied in line with common law rules.98 As a result of this, the common law interpretation of the phrase ‘‘in the interests of the company’ ’ continues to ensure the law outlined in the above cases is continued, namely that the Irish judiciary has adopted a shareholder value approach to the phrase.

Prior to the introduction of the 2014 act,99 the Company Law Review Group did consider alternatives to maintaining the current approach. An Irish codification of directors’ fiduciary duties in a manner similar to the approach undertaken in the UK, which also encoded directors’ fiduciary duties was considered, but the Company Law Review Group opposed the introduction of a similar approach which had introduced an Enlightened Shareholder Value approach.100 While the introduction of an Enlightened Shareholder Value approach has resulted in a

91 Irish Press Plc v Ingersoll Irish Publications Ltd (15 December 1993, unreported) 77.
92 Ibid [77] per Barron J.
93 Re Frederick Inns Ltd [1994] 1 ILRM 387.
95 Ibid [730] per Street CJ.
96 Bloxham (in Liquidation) v The Irish Stock Exchange Ltd [2014] IEHC 93.
97 Section 228 of the Companies Act 2014.
98 Section 227(4) of the Companies Act 2014.
100 Section 172 of the Companies Act 2006.
requirement that there be regard given to non-shareholder interests, such an expansion of directors’ duties was not recommended in Ireland. The Group was not convinced by the English approach and believed it would be susceptible to fossilisation.  

The reform proposal sought to consolidate existing directors’ duties as established in the Irish courts and not the introduction of additional duties. The Group also considered both the draft Fifth Company Law Directive and adopting the German two-tiered board model, which are discussed below, but in the end, declined to recommend such reforms on the grounds that employee involvement in a number of different spheres had improved relations.

It is section 224(1) of the Act which provides the only mention of non-shareholder interests by stating:

The matters to which the directive of a company are to have regard in the performance of their functions shall include the interests of the company’s employees in general, as well as the interests of its members.

Despite this strong wording, Courtney is of the opinion that the section is of little practical benefit in ensuring directors consider the interests of non-shareholders such as employees. One positive which derives from the duty is that it legitimised a director when giving consideration to an employee’s interests and it may protect a director from doing so. However, there is no insurance that a director will have regard for such interests and there is no real means of enforcement of the duty available. Therefore, in line with Courtney, section 224(1) is of little practical benefit.

While criticism can be made of the Enlightened Shareholder Value approach, it requires a director to promote the success of the company for the ‘benefit of its members as a whole’ and in doing so, they must have regard to other stakeholders interests. Since the 2006 Act, there is an explicit legislative requirement to act in the interests of shareholders. This removes any

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103 This re-enacts section 52(1) of the Companies Act 1990.
104 Section 224(1) of the Companies Act 2014.
106 Section 172(1) of the Companies Act 2006.
possibility of a reinterpretation which would move away from the prioritisation of shareholder interests. Alcock notes there is no longer any room for a distinction under the UK Companies Act between the interests of the shareholders and those of the company.\textsuperscript{107} During the UK reform process, the Company Law Review Steering Group rejected the idea of omitting this reference to the members as they believed this would provide too much discretion to directors to determine what is in the best interests of the company.\textsuperscript{108} They disagreed with such an outcome as they believed it would grant directors too much power to set any interest above that of the shareholders whenever their view of what constituted company success required it.\textsuperscript{109}

Seemingly, the Group was against any scenario where a non-shareholder interest could be placed above the shareholders’ interests and Enlightened Shareholder Value, in its current form, ensures that shareholders’ interests take priority over all others.\textsuperscript{110} Prioritising the shareholders’ interests presumably applies even if giving priority to a stakeholder would benefit the company as a separate legal entity. The requirement to prioritise shareholder interests has led to many questioning how ‘enlightened’ Enlightened Shareholder Value really is.\textsuperscript{111} The framing of company success in terms of the members was intended by the Group to be offset by the requirement to take into account the non-shareholder interests. However, this requirement is extremely difficult to actually enforce. Given the legislative position, that directors must promote the company’s success in the overall context for the shareholders’ benefit and the nature of the requirement to consider the non-shareholder interests, Enlightened Shareholder Value is potentially, even more shareholder orientated than the common law.

Given the failure to move away from a shareholder value approach in the UK, the Irish Review Group were correct in their decision not to recommend Enlightened Shareholder Value. Unlike in the UK, the Irish Review Group did recommend that a duty to act ‘in the interests of the company’ be adopted. The issue with this is that the courts are, it is submitted here, giving a flawed interpretation of this duty. Section 228(1)(a) does not provide that a shareholder value

\begin{footnotesize}
\textsuperscript{109} Ibid.
\end{footnotesize}
approach should be undertaken. Such an approach is also not only flawed but it is inferior for the purpose of promoting the company. In a case where the interests of a company and its shareholders diverge, the company should prevail. This would allow a director to take a more stakeholder oriented approach, where it is ‘in the interests of the company’ to do so. In doing so, the interests of a secured lender could potentially be addressed prior to any extension of their involvement in the running of the company. Directors would be in a position to take on board such lenders concerns while making a decision ‘in the interests of the company’ as a whole. While this may not be exactly what the secured lender would like it will at least allow for their interests to be considered and allow for negotiation with the directors of the company concerned. It will provide secured lenders with an opportunity to voice their concerns in the knowledge that the directors can make a decision which may at least take their interests on board.

Such a move would not only allow for a move away from a shareholder value approach but also offer another potential solution to the issue of the corporate objective. However, for this to become a possibility the Irish judiciary would need to reinterpret the meaning of the phrase ‘in the interests of the company’.

(5) Reinterpreting the phrase ‘‘in the interests of the company’’

As discussed above, a fundamental principle of company law is that the company is a legal entity which is distinct from its shareholders.112 This view of the company is more plausible than any other theory of what a company is and explains why shareholders can be members of the company and still bring legal action against the company.113 The case which laid down this principle of separate legal personality was Salomon v A Salomon & Co Ltd where Lord Halsbury LC stated that;

“Once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself, and that the motives of those

who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are".\textsuperscript{114}

In the same case, Lord MacNaughton said that the corporation at law is a different person entirely from the subscribers to the memorandum of the company.\textsuperscript{115}

Since the judgment in \textit{Saloman}, there has been widespread juridical support of this separation between the company and its shareholders.\textsuperscript{116} In \textit{Credit Suisse v Allerdale Borough Council} Hobhouse LJ held that “it is elementary law that shareholders are not to be identified with the corporate entity even if there is only one shareholder".\textsuperscript{117} Similarly Lord Millet in \textit{Johnson v Gore Wood} stated that the company is a legal entity “separate and distinct from its members”.\textsuperscript{118}

The Irish courts have also consistently applied the principle laid down in \textit{Solomon}.\textsuperscript{119} In \textit{Redfern v O’ Mahony} McGovern J stated;

“The legal consequences of incorporating a limited liability company are that the company assumes a separate legal identity as distinct from its owners. This is not a fiction. The rule in \textit{Solomon v Solomon & Co Ltd} is still the law in this jurisdiction. The company and its shareholders are separate legal entities”\textsuperscript{120}

Directors owe their fiduciary duties to the company itself and not to an individual shareholder or group of shareholders.\textsuperscript{121} Their fiduciary responsibilities are owed to the company alone as was the decision in \textit{Crindle Investments}\textsuperscript{122} where the court held that;

\begin{itemize}
\item \textsuperscript{114} \textit{Salomon v A Salomon & Co Ltd} [1897] AC 22, 30.
\item \textsuperscript{115} Ibid [51] per Lord Halsbury LC.
\item \textsuperscript{116} \textit{Macura v Northern Insurance Co Ltd} [1925] AC 619; \textit{Roberts v Coventry Corporation} [1947] 1 All ER 308; \textit{Wallersteiner v Moir (No 2)} [1975] QB 373.
\item \textsuperscript{117} \textit{Credit Suisse v Allerdale Borough Council} [1997] QB 309, 359.
\item \textsuperscript{118} \textit{Johnson v Gore Wood & Co (A Firm)} [2002] 2 AC 1, 61.
\item \textsuperscript{119} See also \textit{Allied Irish Coal Supplies Ltd. v Powell Duffryn International Fuels Ltd} [1998] 2 IR 519.
\item \textsuperscript{120} \textit{Redfern v O’ Mahony and McFeely, Carroll, Tefica Ltd and Aifca Ltd} [2010] IEHC 253, [87] per McGovern J.
\item \textsuperscript{121} \textit{Smith v Cork and Bandon Railway Co} (1870) 5 IR EQ 63; \textit{Percival v Wright} [1902] 2 Ch 421; \textit{Dawson International plc v Coats Platon plc} [1989] BCLC 233.
\item \textsuperscript{122} \textit{Crindle Investments et al v Wymes et al} [1998] 2 ILRM 275.
\end{itemize}
“There can be no doubt that, in general, although the directors of a company occupy a fiduciary position in relation to the company, they do not owe a fiduciary duty, merely by a virtue of their office, to the individual member”.123

In Ireland, Charelton J in Bloxham (in Liquidation) v The Irish Stock Exchange Ltd,124 stated that “It is [also] well established that the director owes the duties arising out of his office to the company itself, the separate person, and to no one else”.125 As the company is a separate legal person, the fact that directors owe their duties to the company means there is no legal basis to equate the interests of the company with the interests of the shareholders. Attenborough argues the traditional common law interpretation of what it means to act ‘in the interests of the company’ is wide of the mark.126 From the point of view of the Irish judiciary, a shareholder value approach is not the only opinion which must be taken. With the recent decision in Bloxham (in Liquidation) in mind, not all cases within the Irish judiciary are synonymous with a shareholder value approach to the corporate objective and there is a precedent for a different interpretation of the phrase ‘in the interests of the company’ to be taken by the Irish courts. It is submitted in this thesis that there is a sufficient legal basis for the Irish courts to reinterpret what it means for a director to act ‘in the interests of the company’.

On examination, the question as to what level of common law supports a shareholder value approach can be asked with many of the cases cited in support of a shareholder value approach being considered in a different context to directors’ duties. In Greenhalgh v Ardene Cinemas,127 Evershed MR commented that the company as a whole simply means the shareholders as a general body.128 The case concerned shareholders and the altering of the articles of the company. Attenborough doubts if Evershed MR intended to lay down a principle of general application at the time.129 In Brady v Brady130 Nourse LJ made a statement in the context of a potential breach of section 151,131 which related to financial assistance and not directors’

123 Ibid 288.
125 Ibid.
127 Greenhalgh v Ardene Cinemas Ltd [1950] 2 All ER 1120.
128 Ibid 1126.
129 Ibid.
130 Brady v Brady [1988] 3 BCC 535.
131 Section 151 of the Companies Act 1985.
duties. While there are cases which advocate a shareholder value approach to directors’ duties, there are also cases which take a wider view of directors’ duties. It would be extremely difficult to run a successful company whilst consistently disregarding the interests of a company’s stakeholders and it is questionable if English common law ever advocated such an approach.

As the Companies Act 2014 maintains the duty to act ‘in the interests of the company’, the debate around the interpretation of this phrase is still very much relevant. What the above discussion highlights is that there are alternatives to taking a shareholder value approach and that there is a strong legal basis for avoiding such an approach. The doctrine of separate legal personality, the nature of directors’ fiduciary duties and several cases from England all support the view that the company is a distinct entity, separate from its shareholders. In Hampton v Price and Hutton v West Cork Railway there was no commitment to a strict adherence to a shareholder value approach. In both cases, it was held that gratuitous payments to company employees were legal if they had the potential to indirectly benefit the company. Further cases have found in favour of treating the company as a distinct legal entity which facilitates a more long-term approach rather than strict adherence to shareholder value. Cases such as Allen v Gold Reefs where it was held that the interests of the company itself should take priority over the interests of the shareholders. Similar to Greenhalgh v Ardene Cinemas this decision was made within the context of the shareholder’s power to alter the articles.

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134 Section 228(1)(a) of the Companies Act 2014.
135 Section 228 of the Companies Act 2014.
136 Hampson v Price’s Patent Candle Co (1876) 45 LJ Ch 436.
137 Hutton v West Cork Railway (1883) L.R. 23 Ch.D 654.
138 Ibid 672 – 673.
140 Deirdre Ahern Directors’ Duties: Law and Practice (Dublin 2009) 153.
141 Allen v Gold Reefs of West Africa Ltd [1900] 1 Ch 656.
142 Greenhalgh v Ardene Cinemas Ltd [1950] 2 All ER 1120.
Despite this, it is the judgment in Greenhalgh which is regularly cited in cases concerning directors’ duties\(^{143}\) and not Allen. In Dawson International Plc v Coats Platon plc,\(^{144}\) which concerned the actions of a director during a takeover bid, Lord Cullen held that directors were agents of the company and not the shareholders. He stated there “was no good reason that director should owe a general duty to shareholders and that directors have but one master, the company”\(^{145}\). This appears to be an acceptance that the interests of the company and its shareholders may well diverge. A similar view was expressed in Re BSB Holdings Ltd\(^{146}\) where the court, in considering a potential conflict between the interests of the company and its shareholders stated “… where the proposed act is required to be done in the interest of the company, the interests of the company prevail”\(^{147}\). This is in line with the wording of section 228(1)(a).\(^{148}\) There is also judicial support for the interests of non-shareholders to be taking into account by the directors such as in Lonhro v Shell Petroleum\(^{149}\) where it was held that the best interests of the company are not exclusively those of the shareholders and may include the lenders. In Fulham Football Club v Cabra Estates\(^{150}\) it was held that a company is more than just its shareholders and includes its employees and lenders.

Decisions such as those above have led to claims that the common law may not have adopted a shareholder value approach fully\(^{151}\) and may never have advocated a strict interpretation of a shareholder value approach. Some even argue that non-shareholder consideration which can lead to the benefit of the company has been acknowledged by the common law courts in the UK for over a century.\(^{152}\) However, despite this, the debate regarding a different interpretation of the phrase ‘in the interests of the company’ in the UK has been made redundant with the Companies Act 2006 and the introduction of an Enlightened Shareholder Value approach. Under this approach, it is clear that the success of a company is framed to include the shareholders and that the shareholders’ interests take priority over all other stakeholders and


\(^{145}\) Ibid 243.

\(^{146}\) Re BSB Holdings Ltd [1996] 1 BCLC 155.

\(^{147}\) Ibid 249.

\(^{148}\) Section 228(1)(a) of the Companies Act 2014.

\(^{149}\) Lonhro v Shell Petroleum [1980] 1 WLR 637 HL 634.


the company itself. In the Irish context, the Companies Act 2014 has maintained the duty to act ‘in the interests of the company’ and with this the debate about its interpretation. What this thesis puts forward is that there are alternatives to a shareholder value approach and that there is a legal basis for doing so.

(6) A Possible Solution

The duty to act ‘in the interests of the company’ should mean the company as a separate legal entity with an example of such an approach being provided by Canadian law where the Canada Business Corporations Act 1985 states that directors have a duty to act “in good faith with a view to the best interests of the corporation”. It is a provision which is similar to the Irish law duty contained in section 228(1)(a) of the Companies Act 2014 and Canada, like Ireland, had a tradition of favouring a shareholder value approach. However, the Canadian courts have drawn a different conclusion to the issue of the corporate objective since the case of Peoples Department Stores Inc. (Trustee of) v Wise. There the Supreme Court held that the duty to act ‘in the interests of the company’ did not simply equate to acting in the interests of the shareholders. The Court of Appeal stated;

“Insofar as the statutory fiduciary duty is concerned, it is clear that the phrase the ‘best interests of the corporation’ should be read not as simply the ‘best interests of the shareholders’. From an economic perspective, the ‘best interests of the corporation’ means the maximisation of the value of the corporation. However, the courts have long recognized that various other factors may be relevant in determining what directors should consider in soundly managing with a view to the best interests of the corporation”.

This acknowledges that for a company to be successful the stakeholders must be taken into account. The decision in BCE Inc v Debentureholders continued the focus on the company as an entity. There, the Supreme Court stated that “There is no principle that one set of interests

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153 Section 122(1) of the Canada Business Corporations Act 1985.
154 Peoples Department Stores Inc. (Trustee of) v Wise [2004] 3 SCR 461.
155 Ibid [481] per Major J.
– for example, the interests of shareholders – should prevail over another set of interests.”

However, both the judgments in *BCE Inc* and *Peoples Department Stores* have received criticism for applying stakeholder theory. Yet, requiring directors to focus on the success of the company would remove the problem of balancing competing interests, which is the primary difficulty with stakeholder theory. However, the Canadian Supreme Court did not advocate taking such an approach and as a result, both decisions have been criticised for viewing the company as a collection of stakeholders instead of a separate legal entity. Keay states there is no suggestion from the Canadian courts that directors are to focus on the success of the entity and argues that the courts seem to look past the entity and view the company as being made up of a group of stakeholders.

It is submitted that despite the courts not expressly stating they were in favour of the entity based approach, their statements fit much better with an entity focused approach as opposed to stakeholder theory. In *Peoples Department Stores* it was stated that “at all times directors … owe their fiduciary duties to the [company]. The interests of the [company] are not to be confused with the interests of the [secured lenders] or those of any other stakeholder”. In *BCE Inc* the court was of the opinion that directors’ duties were owed to the company and not to any of its stakeholders. In *BCE Inc* the court went on to state that that not only are directors entitled to rake into account other stakeholders interests but also that, in some circumstances, where the interests of the company needed it, the directors would be obliged to consider the impact of their decision on the stakeholders.

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157 Ibid [84] per McLachlin J.
162 Ibid.
163 *Peoples Department Stores Inc. (Trustee of) v Wise* [2004] 3 SCR 482.
165 Ibid [39].
166 Ibid [66].
B. The Recognition of Directors’ Duties to Secured Lenders

Directors do owe certain duties to a company’s lenders. The recognition of the duties owed by a director to a company’s lenders has been highlighted in a number of cases. Irish case in this line refer to the New Zealand case of *Kinsela v Russell Kinsela*¹⁶⁷ which gives strong judicial recognition to the fiduciary duty owed by the director of a company to its secured lender. In *Kinsela*, the court held that where a company is in a position of marginal commercial solvency the duty owed by directors to the company as a whole extends not only to the interests of the shareholders of that company, but to the interests of its lenders as lenders as well. Where the directors act in breach of this fiduciary duty, to the detriment of the company's lenders, the shareholders of the company do not have the power or authority to absolve the directors of their breach. Members of the Kinsela family as directors of and shareholders in various family companies carried on a business as funeral directors. These companies were well established, well known and had a reputation of which the family members were proud.

One such company, Russell Kinsela Pty Ltd ('the company') offered, in addition to the provision of funeral services, a form of contributory insurance against the cost of its clients' funerals. Regular payments, of small amounts, were received from contributors in return for which they became entitled to cost-free funerals. The company did not structure the scheme properly, failing to make adequate provision for rising costs and it began to incur regular trading losses and its liabilities exceeded its assists. Following issues over a lease, proceedings were brought to have the company wound up. At first instance Powel J held that while the directors had power to lease company premises under the company's Memorandum of Association, the power had been exercised otherwise than in furtherance of the company's stated objects. The court was bound by a previous decision in *Winkworth v Edward Baron Development Co Ltd*²⁰⁸ where Lord Templeman held that directors owe a fiduciary duty to the company, present, and future, to ensure that its affairs are properly administered and to keep the company’s property inviolate and available for the repayment of its debts.²⁰⁹

On appeal to the Court of Appeal, Street CJ found that at the time of the making of the lease, the company was in severe economic difficulties, bordering upon liquidation. Under these

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¹⁶⁸ *Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512.
¹⁶⁹ See also *Lonhro Ltd v Shell Petroleum Co Ltd* [1980] 1 WLR 627 HL.
circumstances, the directors were under a fiduciary duty to the secured lenders of the company and this duty had been breached by the execution of the lease as its intended effect was to place one of the company's assets beyond the immediate reach of the company's lenders. His Honour therefore concluded that while the lease was not ultra vires and void as exceeding the capacity of the company", it was entered into by the directors in breach of their duty to the company, to the detriment of the company's secured lenders at a time of insolvency and therefore could not be affirmed by the company.

This case provides the first authoritative statement of the existence, extent, and scope of the duty owed to the secured lenders of a company. The Court's finding that in certain circumstances the duty owed by directors of a company extends beyond the interests of the company's shareholders is of interest given the increasing demand for and expectations of greater corporate social responsibility on the behalf of a company. The interests of lenders are extended to the rights of shareholders in relation to breaches of duty by a director, but only in circumstances of insolvency, or near insolvency.

Set against this landscape is the decision in Yukong Line Ltd of Korea v Rendsburg Investment Corporation of Liberia\textsuperscript{170} where the Toulson J held that a director of an insolvent company who, in breach of his duty owed, transferred assets beyond the reach of its lenders owed no equal fiduciary duty to any creditor or lender of the company.\textsuperscript{171} The issue of directors’ duties to secured lenders also emerged in Re Pantone\textsuperscript{172} where Richard Reid QC, sitting as a deputy judge in the High Court, observed “… the human equivalent of the company for the purposes of the directors’ fiduciary duties is the company’s [lenders]…\textsuperscript{173} Further, in Colin Gwyer and Associates\textsuperscript{174} it was held that a resolution of the board of directors passed without proper consideration being given by certain directors to the interests of secured lenders would be open to challenge if the company had been insolvent at the date of the resolution. The directors, when considering the company’s interests, must have regard to the interests of the lenders.

\textsuperscript{170} Yukong Line Ltd of Korea v Rendsburg Investment Corporation of Liberia (No 2) [1998] 2 BCLC 266.
\textsuperscript{171} The appropriate means of redress would be for the liquidator to bring an action for misfeasance under section 212 of the Insolvency Act 1986.
\textsuperscript{172} Re Pantone 485 Ltd [2002] 1 BCLC 266.
\textsuperscript{173} Ibid [298] per Richard Reid QC.
\textsuperscript{174} Colin Gwyer and Associates Ltd v London Wharf (Limehouse) Ltd [2003] 2 BCLC 153.
The first Irish case to consider this matter was *Parkes v Hong Kong & Shanghai Bank Corp*\(^{175}\) where the issue before the court was whether the fact that the company was insolvent meant that the disposition was *ultra vires*. Blayney J approved the principle stated by Street CJ in *Kinsella* and accepted the distinction between solvent and insolvent companies and that the directors of insolvent companies owed duties to the company’s lenders. The landmark Irish case was *Re Fredrick’s Inns*\(^{176}\) where Blayney J held that the directors of a company do owe duties to its lenders when the company is insolvent. Thus, where directors act in breach of their duties to the lenders of an insolvent company their actions will be deemed as being unlawful.\(^{177}\)

While it may be true to say that directors should take into account the interests of secured lenders in considering what is for the benefit of the company as a whole, once a duty to secured lenders is recognised a real possibility exists that the duty may conflict with the duty owed by the directors to the shareholders and others associated with the company. It is not hard to imagine the potential difficulties that would be faced by the courts in attempting to find solutions to the problems caused by these competing and conflicting duties. Although the Court of Appeal did break new ground in the *Kinsela* decision it would be wrong to overstate the implications of a basically conservative judgment. As noted above, the concept that directors of a company owe a duty to company secured lenders, at least in some circumstances, had previously received recognition. Moreover, the circumstances in which the Court stated that such a duty arises have been drawn very narrowly. This with the current position of the judiciary in interpreting the duty to act ‘in the interests of the company’ provides that much reasoning will be required before the interests of secured lenders can be fully accounted for by the directors of a company.

C. Stakeholder Theory

Stakeholder theory argues that the directors of a company should act as mediators between the various stakeholders of the company and share the benefits of the company between them.\(^{178}\)

In doing so it rejects the idea that a director is an agent of the shareholders with the sole purpose

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\(^{175}\) *Parkes v Hong Kong & Shanghai Bank Corp* [1990] 1 ILRM 387.

\(^{176}\) *Re Fredrick’s Inns* [1991] ILRM 582.

\(^{177}\) The test for whether or not a company is solvent was set down in *Re Creation Printing Company Ltd* [1981] IR 353.

\(^{178}\) Margaret Blair and Lynn Stout, ‘Director Accountability and the Mediating Role of the Corporate Board’ (2001) 79 *Washington University Law Quarterly* 403.
of increasing the value of their shares. Edward Freeman’s stakeholder theory holds that a company’s stakeholders include just about anyone affected by the company and its workings. Freeman was the first to discuss soundness of stakeholder theory and in the intervening years he has received much support. Freeman argued that managing companies for shareholder wealth was outdated and that stakeholders should no longer be seen as a method by which shareholder value could be obtained but that they should instead attempt to increase the benefits for stakeholders. The main tenet of the theory is that no one interest group automatically ranks above any other, that all parties involved in the company “work together for a common goal and to obtain shared benefits”.

Stakeholder theory holds that the economic and social purpose of the company is to create and distribute wealth and value to all stakeholder groups without favouring one interest group at the expense of others. In achieving this goal, a director is required to balance all stakeholders’ needs which involves ‘assessing, weighing and addressing the competing claims of those who have a stake in the company in the actions of the organisation’. While the view that the company should be run for the benefit of all stakeholders and society in general, may not be preferable to shareholder value, such a framework would be extremely difficult to implement in practice. Keay is of the opinion that the company should be run for the benefit of all stakeholders, stakeholder theory, however, it is widely accepted as a model which is impossible to practically implement. It is this impracticality of the stakeholder theory model which is one of the most persuasive arguments used in favour of the shareholder value

184 Janice Dean, Directing Public Companies (Cavendish, 2001), 94.
principle.\textsuperscript{188} The problem of having to balance the different competing interests makes decision making extremely difficult for directors.\textsuperscript{189} As Jensen points out ‘it is logically impossible to maximise in more than one dimension at the same time’.\textsuperscript{190} As directors are accountable to no one specific group under stakeholder theory, it greatly increases the potential for agency costs with directors acting in their own interests or shirking responsibility.\textsuperscript{191} Under stakeholder theory, operating a company in the interests of a single stakeholder group is expressly rejected\textsuperscript{192} and balanced benefits for each set of stakeholders must be the definitive objective of the company.\textsuperscript{193}

Stakeholder theory is dedicated to ensuring that all stakeholders share the benefits equally. Further, while stakeholder theory demands that benefits to stakeholders is the objective of directors, as has been discussed above, the Canadian courts are instead focused on maximising the value of the company and considering stakeholder interests to the extent which it benefits the company. The success of the company is the ultimate goal rather than providing benefits to stakeholders. It is submitted that there is sufficient scope available for the Irish courts to follow the Canadian Supreme Court decisions discussed above and apply an entity focused approach to the corporate objective. While it would be difficult to have a situation whereby the directors of a company act as mediators between the various stakeholders of the company and share the benefits of the company between them, the consideration of secured lenders interests, along with all other stakeholders, with a view to benefitting the company as a whole would give the directors of a company a more inclusive objective while making decisions in the interest of the company.

(1) German Codetermination

With the European Union, many jurisdictions have adopted a much more inclusive non-shareholder orientated approach to the corporate objective. Such moves prompted action by the

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Union and during the 1970s and 80s, through the draft fifth directive, the European Union moved to adopt a more stakeholder orientated approach. The first draft of the fifth directive required all public companies to implement the German model of codetermination.194 What this meant was that companies would be required to have a management board and a supervisory board, with the supervisory board made up of up to fifty percent employee representation. Wooldridge outlines that the supervisory board has two primary functions: to appoint directors on to the management board and to supervise the management board.195 They also have other functions such as the power to call shareholders meetings, to examine financial statements, and certain transactions may need supervisory board approval depending on the company’s articles.196

A supervisory board may also inspect a company’s books and records of the time and the management board must inform the supervisory board of its policies for the future conduct of business as well as report to the supervisory board regularly regarding company affairs.197 Initially, the Code did not have the effect accommodate employee interests in the manner hoped for and the supervisory board effectively supervised on behalf of the shareholders.198 This action by the supervisory board caused the merits of the two-tiered system to be viewed for some time with considerable suspicion by stakeholders.199 However, following the introduction of equal representation for employees in 1951200 the method of codetermination began to expand and represent a practical application of stakeholder theory. Following on from the 1951 Act was a series of expansions to the Act such as Betriebsverfassungsgesetz in 1952 which required companies with over 500 employees to establish a supervisory board.201

194 OJ EUR COMM (No C131) 49 (1972).
196 Klaus Hopt The German Two-Tiered Board: A German View on Corporate Governance in Comparative Corporate Governance (De Gruyter 1997) 5.
197 Ibid 6.
199 Ibid 72.
200 Montanmitbestimmungsgesetz, 1951.
201 Betriebsverfassungsgesetz, Para 77.
The enactment of the 1951 statute was followed by that of another in 1956, which applied to iron and steel holding companies. The Works Councils Act set out provisions which gave the works council certain rights of codetermination which were binding on the employers, and which were applicable to companies that were not operating in the coal, iron and steel industries. In its 1952 and 1976 versions, it is required that one third of the members of the supervisory board consist of representatives of the employees. Next occurred the implementation of the Codetermination Act 1976, which had the effect to ensure all companies with over 2,000 employee’s implemented codetermination. This included co-operatives and all companies limited by shares and extended its scope beyond AG and GmbH companies. The supervisory boards appointed under this Act were made up of one half shareholders and the chairman was to be appointed by the shareholders. The chairman would also have the deciding vote and thus tipped the balance in the favour of the shareholders. This power of the deciding vote was upheld after a constitutional challenge in the Federal Constitutional Court of Germany.

The German codetermination model clearly focuses on the interest of employees and shareholders, however, this is what makes its practical implementation by a company possible. As shareholders and employees are represented on the supervisory board there is a requirement for their competing interests to be taken into account and as a result, it is unlikely that there will be any confusion with the objectives of the company. German codetermination is quite different from both a shareholder value approach and stakeholder theory and appears the most likely method by which to achieve the objective of increased benefits for all parties connected to the company. Robilotti is of the opinion that strong employee representation may force a supervisory board to give greater consideration to the social consequences of a company’s action.

202 Montain Montanmitbestimmungsgesetz, 1956
203 Betreibsverfassungsgesetz, 1972.
204 The same situation remains, in those companies which employ at least 500 but not more than 2,000 persons, and are thus subject to the Drittelbeteiligungsgesetz (One Third Participation Act of 2004 as amended). The latter Act has no application to companies whose main purpose is the production of coal and iron or the preparation of these materials and which are subject to the inspection by the mining authorities, and to which a quasi-paritative (or equal) system of codetermination is applicable. A
205 Mitbestimmungsgesetz, 1976.
stakeholder theory, however, implementing such an approach in a common law jurisdiction is sure to be fraught with difficulties.

While companies continue to exercise significant influence over the economy and society as a whole, how the law requires them to act in terms of their objectives and aims is increasingly important. Given the standing a company can hold in society and the power and wealth they can possess, the law which regulates with their running should be broader than simply requiring they are run with the interests of the shareholders at its heart. Taking a company as a separate entity allows for all stakeholders interests to be taken into account and allows the directors to make decisions that are ‘in the interests of the company’. It may provide the potential to eliminate any negatives that may accompany a shareholder value approach such as the possibility of excessive risk taking by the directors of a company to achieve short term success.

It is submitted that many of the positive elements of German codetermination come from the employees being given significant representation within a company and directors’ duties which require the directors of the company to focus on the interests of the company as a whole rather than those of its shareholders. Such focus would provide the directors with the opportunity to take on board the interests of secured lenders when considering the interests of the company. The Companies Act 2014 introduced a statutory duty to act ‘in the interests of the company’, however, the common law interpretation of this duty is likely to continue to be applied. This requires directors to act for the shareholders’ benefit and therefore adopt a shareholder value approach. However, unlike the UK there is room for the Irish courts to reinterpret the duty to act ‘in the interests of the company’ with the company viewed as a separate entity.

With the well-established doctrine of separate legal personality and the nature of directors’ duties in mind, in addition to the case law outlined, this chapter provides the scope for a reinterpretation of the phrase ‘in the interests of the company’ by the Irish courts. If such a reinterpretation was undertaken then directors would be in a position to actively consider the concerns of secured lenders and potentially prevent the possibility of them becoming involved in the management of the company. Further, once secured lenders are in a position whereby

their interests are heard, any action by them which could be deemed as involvement in the running of the company may open the possibility of them being accountable to directors’ fiduciary duties.

D. Conclusion

This chapter highlights that the duty to act ‘in the interests of the company’, meaning the shareholders, is due to the interpretation given by the courts to support such a shareholder value approach. It is a doctrine which can amount to improper action by directors if it is proved they have not adhered to it. It is one which can limit the actions of directors in terms of taking a more entity focused approach to the company and sow the seeds for secured lender influence by leaving directors to make decisions which may be profitable in the short term but open the company to potential long-term problems which would give a secured lender the opportunity to exert their influence over the management of the company. This chapter argues that the current interpretation to the duty is flawed and does not support the company as a whole. This chapter puts forward a case for the potential reinterpretation of the phrase ‘‘in the interests of the company’ ’ and that there is sufficient legal basis or such a reinterpretation. This chapter puts forward a possible solution to the issue based on cases from the Canadian judiciary and develops a more entity focused approach and thus allows directors to make decisions which take into account the needs of all stakeholders including secure lenders before it is the lenders that are making the decisions.
Chapter 3 – Secured Lenders as a Nominee Director

A. Introduction

“The fact that a director of a company has been nominated to the office by a shareholder [or another member] does not, in itself, impose any duty on the director owed to his nominator”.1

In a company, the theoretical starting point is generally that the corporate governance of the company is divided between its members and its directors acting as the board of the company. In line with this, one of the central concepts in company law is the distinction which is drawn between ‘ownership’ and ‘management’.2 The corporate management of a company and those actually responsible for it, the directors, play a crucial role not only in the division of its corporate governance between the members and directors but between the ownership and control of the company. However, while this is the du jure position, how this role is controlled when another director such as a nominee director is considered will determine how the division of control over the company plays out.3 If it is the case that the ownership and nominee director are one in the same then the division of power will prove to be a sham, since those concerned are effectively the same person.

Directors are appointed to manage the company and have their powers delegated to them by the members. If any member were not to delegate the management of the company to the directors and, instead, exercise the power to run the company themselves, then they could be said to occupy the position of director and would, therefore, be accountable under the Act in the same manner as an appointed director. Therefore, it is almost invariable that the board of directors will be the part of the organisation which is in receipt of the delegated power of the members to run the company. What this chapter is concerned with is when a nominee director is placed on the board of a company in order to carry out the bidding of a secured lender of the company. After all, it is the directors who carry the important powers of management when it comes to making decisions in the interest of the company. While formally appointed, a nominee

1 Re Neath Rugby Ltd; Hawkes v Cuddy [2010] BCC 597 [605] per Lewison J.
3 The role of a receiver manager is similar with that of a nominee director in terms of their office. A receiver manager can be appointed as manager of a company during a receivership and once the receiver raises enough finance to repay the company debts, the role of the receiver manager is completed.
director is expected to act in accordance with some understanding or arrangement which creates an obligation or mutual expectation of loyalty to their appointor rather than the company as a whole.\textsuperscript{4}

A distinction should be drawn between a representative and independent nominee director with Redmond being of the opinion that the former acts more explicitly as the guardian of their nominator’s interests.\textsuperscript{5} A representative nominee director may be appointed with the purpose of protecting a parent company’s interest or an individual party in the case of a joint venture between companies.\textsuperscript{6} However, it is the fact that a nominee director is appointed by a shareholder, a stakeholder or for the purposes of this chapter a secured lender of the company, which may put the nominee director on a collision course with the director’s duties they owe to the company of which they are a director. The nominee director stands apart from other directors as they have been nominated to represent the particular interests of their nominator.\textsuperscript{7}

However, such an obligation may leave a nominee director between a rock and a hard place with them being under an obligation to a secured lender and continuing to owe the same duties to the company as all other directors. This chapter sets out the current law in relation to nominee directors of a company in both Ireland and the UK. The duties owed by nominee directors are investigated to determine if a nominee director merely carries out the instructions of their nominator and the potential implications this may have for the company. In order to do so, the directors’ duties of the duty to avoid a conflict of interests,\textsuperscript{8} the duty to exercise judgment independently\textsuperscript{9} and their ability to promote the success of the company will be analysed to determine if there are potential conflicts between these duties and the commercial reality whereby a nominee director is expected to consider the interests of their appointor, who for the purposes of this chapter will be considered as a secured lender.

\textsuperscript{4} See Deirdre Ahern, ‘Nominee Directors’ Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy’ (2011) 127 Law Quarterly Review 118; Peter Kelly, ‘The Nominee Director, His Duties to the Company and to His Appointor and whether they can be Modified by Agreement’ (2010) Current Legal Problems Journal 23.


\textsuperscript{7} Boulting v Association of Cinematograph, Television and Allied Technicians [1963] 2 QB 606.

\textsuperscript{8} Section 228(1)(f) of the Companies Act 2014.

\textsuperscript{9} Section 228(1)(e) of the Companies Act 2014.
(1) Defining a Nominee Director

While the term nominee director does not have a statutory definition, a nominee director owes no lesser duties to the company than any other director and nominee directors have been expressly recognised by the Act with the context of their duties provided for. The section provides:

“Without prejudice to the director's duty under subsection (1)(a) to act in good faith in what the director considers to be the interests of the company, a director of a company may have regard to the interests of a particular member of the company in the following circumstances”.

This section is followed by:

“These circumstances are where the director has been appointed or nominated for appointment by that member, being a member who has an entitlement to so appoint or nominate under the company's constitution or a shareholders' agreement”.

In other words, without prejudicing the duty to act ‘in the interests of the company’, a nominee director was appointed or nominated by a member. They are to represent the interests of a specific interest in the company, such as a secured lender. This provides the link between the nominee director and their nominator who for the focus of this chapter will be assessed on the basis that they occupy the role of a secured lender. While such arrangements may be passed off as not overly significant they can, according to Courtney, “… become a battleground for warring factions, each side scrutinising the running of the company…” This is when the formal arrangements of a director can really come into play. It is possible to appreciate how a nominee director may struggle to fulfil their requirements to act ‘in the interests of the company’, to show independent judgment or to promote the success of the company, when their appointor appoints them with a particular interest which they wish to further. How the directors take this into account while discharging their duty under section 228 is a key

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10 Section 228(3) of the Companies Act 2014.
11 Section 228(3) of the Companies Act 2014.
12 Section 228(4) of the Companies Act 2014.
14 Section 228 of the Companies Act 2014.
question and it is one answered by an analysis of a nominee directors approach to their fiduciary duties.\textsuperscript{15} While the term nominee director\textsuperscript{16} has no technical meaning, it falls within the definition in section 2(1) of the 2014 Act to mean “any person occupying the position of director by whatever name called”.\textsuperscript{17} Commercially, the term is applied to “a person appointed as a director of a company on the understanding that he will represent the interest of some other person or group of persons.”\textsuperscript{18}

In \textit{Levin v Clark},\textsuperscript{19} Jacob J stated;

“It is not uncommon for a director to be appointed to a board of directors in order to represent an interest outside of the company…It may be ‘in the interests of the company’ that there be upon its board of directors one who will represent these other interests and who will be acting solely in the interests of such a third party and who may in that way be properly regarded as acting ‘in the interests of the company’ as a whole.”\textsuperscript{20}

However, despite this, a nominee is subject to the same duties as the rest of the board of directors.\textsuperscript{21} Confirmation of this can be found in Lord Denning’s speech in \textit{Boulting} where his Lordship recognised their distinct commercial position but felt unable to deviate from the usual standard of care applicable to company directors.\textsuperscript{22} Lord Denning stated;

“No stipulation is lawful by which he agrees to carry out his duties in accordance with the instructions of another rather than on his own conscientious judgment…Take a nominee director, that is, a director of a company who is nominated by a [secured lender] to represent his interests. 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

\textsuperscript{15} Section 228 of the \textit{Companies Act 2014}.
\textsuperscript{17} Section 2(1) of the \textit{Companies Act 2014}.
\textsuperscript{19} \textit{Levin v Clark} [1962] NSWR 686.
\textsuperscript{20} Ibid [700] per Jacobs J.
\textsuperscript{21} Directors owe their duties to the company, and not the shareholders or any individual shareholder.
\textsuperscript{22} \textit{Boulting v Association of Cinematograph, Television and Allied Technicians} [1963] 2 QB 606.
bound to act in the affairs of the company in accordance with the directions of the patron, it is beyond doubt unlawful”.23

This would mean that any agreement to exercise his discretion according to his nominator’s wishes would, therefore, be void and enforceable. In line with this, Ahern concludes rightly that, in law, nominee directors do not constitute a separate class of directors.24

The difficulty that arises for a nominee director is that although they are treated as all other directors by the judiciary, there is usually an expectation that they will act with some awareness of their appointor’s interests when on the board of directors of the company. It is an issue which may range from the mere expectation of loyalty to their appointor, although more than their appointment will be required to create such a duty.25 As the primary duty of a nominee director is to act in good faith in the interest of the company,26 and because of the uncertainty as to just what are the range of interests that can be included in this concept, the basic duty of a nominee director has been described as a duty to act in interests of the company, present, and future, on the assumption that the company will continue as a going concern.27 It is a duty that can often pose a problem for nominee directors as, they are, in effect required to favour the interests of the shareholders of the company as a whole. However, in doing so, they may disregard the interests of their nominator and find themselves in a position where their nominator may take steps to remove them from the company.28

The common law system imposes upon the directors of a company a number of rigorous obligations.29 They must exercise their powers and perform their functions with a view to the interest of the company. In doing so they must consider the interests of the shareholders as a general body and not any one particular stakeholder. If a nominee director was to act solely for the benefit of a secured lender as their nominator then it is likely they will be in breach of their

23 Ibid [626] per Lord Denning.
26 Section 228(1)(a) of the Companies Act 2014.
28 Ibid 112.
29 Section 228 of the Companies Act 2014.
duty to act in good faith. 30 Redmond is of the opinion that “… directors’ allegiance is to the collective interests of members and they are obliged to act impartially in interpreting and advancing those interests. 31 Nominee directors are expected to ensure that they avoid any potential actions which may create the possibility of a conflict of interests.

(2) Issues Faced by Nominee Directors

A nominee director is a director32 who is “expected to act in accordance with some understanding or arrangement which creates an obligation or mutual expectation of loyalty to some person or persons other than the company as a whole”.33 Barron J took a commercially focused and sympathetic approach to this plight when considering the position of a nominee director. He stated;

“The position of nominee director can be a difficult one if they disagree with the views of the person or body appointing them. Their duty is to act ‘in the interests of the company’. They have also got a duty to act on the instructions of their nominating party… There is nothing wrong with the appointing body or [a secured lender] having a view as to where the interests of the company lie and ensuring that its nominees follow that direction provided that in so doing they are not seeking to damage anybody else’s interest in the company”.34

However, it must be bore in mind that a nominee director does not automatically owe duties to their nominator. In Re Neath Rugby Ltd35 the UK Court of Appeal stated;

“… the fact that a director of a company has been nominated to that office by a shareholder does not, in itself, impose any duty on the director owed to his nominator. The director may owe duties to his nominator if he is an employee or officer of the nominator, or by reason

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30 Section 228(1)(a) of the Companies Act 2014.
34 Irish Press plc v Ingersoil Irish Publications Ltd (16 December 1993) HC [77] per Barron J.
of a formal or informal agreement with the nominator, but such duties do not arise out of
his nomination, but out of a separate agreement or office.\textsuperscript{36}

Traditionally, the courts have been somewhat loath to acknowledge the commercial reality of
nominee directors and have considered is wrong for them to consider anyone’s interests other
than the company. This was illustrated in the Australian case of \textit{Bennets v Board of Fire
Commissioners of New South Wales}\textsuperscript{37} in which Street J commented:

\begin{quote}
“It is entirely foreign to the purpose for which this or any other board exists to
contemplate a member of the board being representative of a particular group or a
particular body. Once a group has elected a member he assumes office as a member of
the board and becomes subject to the overriding and predominant duty to serve the
interest of the board in preference, on every occasion upon which any conflict might
arise, to serving the interests of the group which appointed him. With this basic position
there can be no room for compromise”.\textsuperscript{38}
\end{quote}

Crutchfield has described this statement as one which imposes a standard that makes the
position of nominee director impossible.\textsuperscript{39} It is understandable to see how Crutchfield came to
this conclusion given that Street J set out that the nominee director owes his duty to the board
on every occasion where a potential conflict might arise. Being a nominee director can be most
difficult when dealing with companies which operate as a joint venture. While it is relatively
common for the parties to provide for the appointment of a nominee director to represent their
interests on the board, Lord Denning pointed out in \textit{Boulting}\textsuperscript{40} a director nominated by a
particular interested party still owes their duties first and foremost to the company.\textsuperscript{41} This
general position was recently confirmed by the Privy Council in \textit{Central Bank of Ecuador v
Conticorp SA & Others}.\textsuperscript{42}

\begin{footnotes}
\item[36] Ibid [605] per Lewison J.
\item[37] \textit{Bennets v Board of Fire Commissioners of New South Wales} (1967) 87 WN (NSW) 307.
\item[38] Ibid [311] per Street J.
\item[40] \textit{Boulting v Association of Cinematograph, Television and Allied Technicians} [1963] 2 QB 606.
\item[41] Ibid [626] per Lord Denning.
\end{footnotes}
In Conticorp SA, a company was based in Ecuador and owned Grupo Financiero Conticorp SA (GFC) and in turn, two banks. Through the banks, Conticorp had invested heavily in Interamerican Asset Management Fund Limited (IAMF), a company based in the Bahamas. IAMF held itself out as an independent investment management fund, with an individual, Mr Taylor, as its sole nominated director. The central point was that the securities received by IAMF turned out to be worth substantially less than the value of the portfolio on offer. It seems a clear case of a transaction orchestrated by lenders – Conticorp – in order to illegally extract value from its failing subsidiaries before the Central Bank exercised its rights as a secured lender to seize the remaining valuable assets. The Central Bank’s claims were dismissed at first instance, and again in the Court of Appeal, but the claims were successful on further appeal to the Privy Council.

In the Privy Council, the claims were distilled down to an analysis of (a) whether, by carrying out instructions given ultimately by Conticorp, without exercising any independent judgement, Mr Taylor had acted in breach of his director’s duties to IAMF; and (b) whether Conticorp was guilty of dishonestly assisting in the breach by Mr Taylor of his duties. Although the Privy Council accepted that only in very limited circumstances should it interfere with findings of pure fact made by a trial judge, in this case, the lower courts had made a number of glaring errors. In particular, the Privy Council held that they had failed to appreciate or address a central aspect of IAMF’s case on dishonesty. Critically, the lower courts had failed to analyse whether the respondents believed, or could honestly have believed, that the value received by IAMF was at least equivalent to the value of the portfolio and, in turn, whether the transactions could honestly have been regarded as in the interests of IAMF.

Accordingly, given such a flawed earlier judgment, the Privy Council reopened the analysis around the probity of the respondents in this case. When appointed, Mr Taylor would have been fully aware of the fact that Conticorp did not want or expect him to question their instructions as to how IAMF was to be run. The Privy Council concluded that “from all the evidence, IAMF at all times acted, and acted only, on and in accordance with the instructions of the respondents”. As Lord Denning in Boulting, stated, which has been quoted in full

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above, there is nothing wrong with a director being nominated to represent interests “…so long as the director is left free to exercise his best judgment ‘in the interests of the company’ which he serves...”45 Based on the principle set out by Ungoed-Thomas J in Selangor United Rubber Estates v Cradock46 that a director who acts without exercising any discretion, at the direction of a stranger to the company is fixed with the stranger’s knowledge of the transaction, Mr Taylor was deemed fixed with the knowledge of Conticorp.

On this basis, the Privy Council had no difficulty in concluding that Mr Taylor had breached his duties to IAMF, in particular, his duty to exercise independent judgement, and his failure to act in what he considered to be in the interests of IAMF. Had he exercised independent judgment and considered what was in the interests of IAMF then, being fixed with the knowledge of Conticorp he would surely have concluded that such transactions were not, and would not have caused the company to enter into them. IAMF made a claim against Conticorp and the other respondents on the basis that they had dishonestly assisted in a breach of fiduciary duty by their nominee, Mr Taylor. Lord Mance summed up this part of the claim by stating:

“Acting as an officer of one company, a person may dishonestly procure or assist a breach of duty by the director of another company, in which case such person may be made liable for dishonest assistance to both himself personally and the company of which he is an officer. Otherwise, individuals acting as officers of a company could never commit any wrong tortious or equitable. What matters in the present context are, in short, the factual questions whether the Respondents procured or assisted Mr Taylor’s breaches of duty, what knowledge they had when giving such assistance, and whether any honest person(s) in their position giving such assistance with that knowledge could have believed that the relevant transaction was in IAMF’s interest.”47

The Privy Council, therefore, found that the transactions were when entered into, not transactions which persons in the respondents’ position could honestly have considered to be in IAMF’s interests, in the light of what they knew. Further, IAMF was regarded as a tool used by the respondents at their behest and for their own purposes, without thought being given to what was in the best interests of IAMF as a separate entity. The respondents were therefore

46 Selangor United Rubber Estates Ltd v Cradock (No. 3) [1968] 2 Lloyd’s Rep 289.
liable for having dishonestly assisted Mr Taylor in his breach of duty and were liable to repay the full face value of the portfolio, amounting to some $192 million.

Similarly, in the Commercial Court Division\(^{48}\) which might be considered to have a more commercially realistic approach to directors' duties, it was held in *Ciban Management Corporation v Citco (BVIHCV 2007/0301)*\(^{49}\) that where the beneficial owner of a company was party to an arrangement where the nominee director was expected to act upon the recommendations of a third party, that same beneficial owner could not subsequently complain about the director doing so. Bannister J indicated that the court would take a more pragmatic approach when assessing the conduct of a nominee director. That case did not involve a joint venture, so the word nominee is used in a different sense from the way Lord Denning used it in *Boulting*. However, while this intuitively feels correct, it is suggested in this chapter that the decision can probably be extrapolated: if two parties agree that one or more directors are expected to discharge their roles with reference to a particular person, they should not subsequently be able to argue that this is inappropriate. Furthermore, if the company is a party to that arrangement, either by express agreement or by acquiescence, it should similarly not be entitled to complain.

The difficulty for a nominee director is always going to be whether they can take into account and act on the interests of their nominator, for the purposes of this chapter a secured lender, while also acting ‘in the interests of the company’. In *Levin v Clark*\(^ {50}\) it was held that a nominee director could act primarily in the interests of his nominator and take steps to enforce his nominator’s security, the reason being that the duty could be modified by the company’s constitutional documents. A decision which accords with the commercial realities of commercial life. However, in *Scottish Cooperative Wholesale Society Ltd v Meyer and Another*\(^ {51}\) Viscount Simonds was of the view that nominee directors were not entitled to remain silent and inactive with full knowledge of their nominator’s intention to strip the company of its assets. It is of interest that Viscount Simonds included the nominator within his comments and stated that it was “incumbent on the [nominator] to behave with scrupulous fairness…and to avoid imposing

\(^{48}\) In the Government of the Virgin Islands.

\(^{49}\) *Ciban Management Corporation v Citco (BVIHCV 2007/0301).*

\(^{50}\) *Levin v Clark* [1962] NSWR 686.

\(^{51}\) *Scottish Cooperative Wholesale Society Ltd v Meyer and Another* [1959] AC 324.
upon the nominee the alternative of disregarding their instructions or betraying the interests of the company”.52

While Viscount Simonds referred to the stripping of the company’s assets, it could not be assumed that every secured lender would have such intention. With this in mind, perhaps the element of intention could be taken into account. If a nominee director can take into account the interests of their nominator, a secured lender, and put these ahead of what could be the interests of the company, then the question of intention may play a role in determining whether they are in breach of the duties owed to the company. If it is the case that the secured lender is attempting to protect their investment and with that the position of the company then perhaps the nominee should be permitted to follow this course of action. What is important is that the nominee director demonstrates that they undertook their actions with a view to the duty they owed the company and that it was the best course of action to undertake.

B. Duties Owed by Nominee Directors

In Re Neath Rugby Ltd53 Staney Burnton LJ stated;

“… an appointed director, without being in breach of his duties to the company, may take the interests of his nominator into account, provided that his decisions, as a director are in what he genuinely considers to be the best interests of the company”.54

It is those duties which are central to a nominee director which this chapter will focus on. Nominee directors are de jure directors of the companies to whose board they have been appointed. They are not a distinct class of director and they owe duties to the company the same as other directors while at the same time, representing, perhaps through loyalty, the interest of their nominator. In doing so, difficulties can arise and the duties most likely to be affected concern a conflict of interests,55 Independent judgment and the duty to promote the success of the company.

52 Ibid [341] per Viscount Simonds.
54 Ibid [614] per Stanley Burnton LJ.
55 Section 228(1)(f) of the Companies Act 2014.
(1) Conflict of Interest

The issue of there being divided loyalty of which a nominee director is tied is a difficult proposition as the nominee director is reliant on their nominator whom appointed them to their position. The duty which is relevance for the nominee director is the duty to avoid a conflict of interests. In *Bray v Ford*[^56] Lord Herschell described the rule against conflicts of interests as;

“… an inflexible rule of the Court of Equity that a person in a fiduciary position, such as the respondent’s, is not, unless otherwise provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty would conflict”.[^57]

It is a rule which may apply with equal measure where a director’s duty to his appointor and the duty to the company in question conflict.[^58] Ahern states “It has the potential to make almost every appointment as a nominee director uncomfortable”.[^59]

The rule against the conflict of interests is of significance as it has the potential to make every appointment of a nominee director potentially problematic. The reason for this is that it would be unlikely that a nominee director would not be subject to some level of expectation or loyalty to their appointor. However, judicial exhortations favour nominee directors and the exact nature of the rule can be framed based on the nature of the relationship between the nominee director and their nominator.[^60] In many situations where the appointment of a nominee director arises, the nominee director in question may be or have been an employee or an officer of the nominating company and for this reason they would be subject to a duty to their nominator. Given the fact that the duty is expressed as a duty to;

“avoid any conflict between the director’s duties to the company and the director’s other (including personal) interest unless the director is released from his or her duty to the

[^56]: *Brady v Ford* [1896] AC 44.
[^57]: Ibid [51] per Lord Herschell.
[^58]: In the UK, section 175 of the *Companies Act 2006* has put this rule on a statutory footing and it provides that 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”.
[^60]: *New Zealand Netherlands Society Oranje v Kuyts* [1973] 1 WLR 1126 PC (NZ).
company in relation to the matter concerned, whether in accordance with provisions of
the company’s constitution in that behalf or by a resolution of it in general meeting”.  

There is an important distinction to be drawn between acting in the company’s interests and
having regard for the interests of others, whether that be the members of the company as a
whole, or a stakeholder such as a secured lender with the right to, or already having, appointed
a nominee director. It is submitted in this thesis that a nominee director can be appointed by a
secured lender of a company in order to ensure their will, as a secured lender, is carried out
regarding the running of the company. The duty can be discharged by the nominee director by
the mere consideration of what is required of them. It does not demand that they are acted upon.

While section 228(1)(f) could be interpreted to mean that the acceptance of a directorship by a
nominee director would give rise to the violation of the duty to avoid a conflict of interest, that
said, the law is not that narrow that it does not allow for nominee directors. Section 231(2)  
provides that the duty is not infringed “… to an interest that cannot reasonably be regarded as
likely to give rise to a conflict of interest”. Even though it is possible that the appointment of a
director may cause the possibility of a conflict of interest there is no such breach of this duty
where an actual conflict is not reasonably likely to occur. Such a situation can arise where the
nominee director is the sole shareholder of the company, a director of a number of companies
and the interests are unlikely to diverge. The duty imposes a positive obligation on directors to
avoid any conflict between their duties to the company and their other interests. It has also been
held in the UK that their similar statutory fiduciary duties is subject to an objective, not
subjective, test and does not depend upon whether the director is aware that what he is doing
is a breach of the duty owed.  

As a general principle, it is not per se a breach of a director’s duty to avoid a conflict of interests
if they are involved in a business which may compete with that of his company. The leading

61 Section 228(1)(f) of the Companies Act 2014.
62 Section 231(2) of the Companies Act 2014.
63 Richmond Pharmacology Ltd v Chester Overseas Ltd et al [2014] EWHC 2693 (Ch).
64 Bell v Lever Brothers Ltd [1932] AC 161.
Irish case is *Moore v M’Glynn* where an executor and trustee was put in charge of the deceased’s shop, which he held in trust and ran for the beneficiaries of the trust. When he set up in business himself, the question was asked whether or not he was in breach of his trust. It was held he was not *per se* in breach of his trust, provided that he did not divert custom from the ‘trust shop’ to his own shop. This principle has been criticised and while there is case law which supports it, a director who has business interests in competition with those of the company of which he is a nominee director undoubtedly skirts a fine line in seeking to avoid a conflict of interests between the director’s duties owed to the company and his other interests. This poses the question, if it is a fine line for a nominee director in those circumstances it must be even more onerous for a nominee director who is an employee of his nominator’s company.

In *Moore*, Chatterton VC stated that he was not prepared to hold that a [nominee director] is guilty of a breach of trust provided that he does not resort to deception or solicitation of custom. Should a nominee director be or have been an employee of their nominator then while it may be expected that there is the potential for a conflict of interests due to their loyalty to their nominator it may be possible to measure a breach of their duty owed to the company by their action and whether or not they carried out their duty in a manner which could be described as deceptive or a solicitation of business overly in favour of their nominator. Ahern states that;

“The duty to act *bona fide* ‘in the interests of the company’ is sometimes loosely conceived of as the pre-eminent duty from which other duties stem or as an aspect of the overarching duty of loyalty which directors owe to their company. The problem for nominee directors is that their loyalty extends beyond the interests of the company as a whole.

There is no excuse for a nominee director who may see that they are heading for a conflict of interests between their duties to the company and their other interests and yet they continue on

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65 *Moore v M’Glynn* [1894] 1 IR 74.
67 The same conclusion was reached by the House of Lords in *Bell v Lever Bros Ltd* [1932] AC 161. For a contrary view, see *Hivac Ltd v Park Royal Scientific Instruments Ltd* [1946] 1 ALL ER 3 50 where it was held that working for a competitor in any situation where a disadvantage might accrue to the company, was not allowable.
69 *Item Software (UK) Ltd v Fasshi* [2005] 2 BCLC 91 CA.
70 In Australia the Companies and Securities Law Committee characterises the issue with nominee directors as being one of having ‘extraneous loyalties’.
this path. The courts have been willing to overlook the fact the duty to avoid the possibility of a conflict of interest and have instead focused on the actions of the director in question. A director is not expected to resign or step aside when a conflict arises between the interests of the appointor and the interests of the company but is, instead, expected to prioritise the interests of the company.

(2) Independent Judgment

Directors with fiduciary duties owed to the company, such as a nominee director, must avoid any breaches of their discretion and they must reach their decisions regarding the company independently. This would mean any prior agreement with the nominee director’s nominator to vote or make a decision in a certain manner would violate this duty. It is not wise for a nominee director to fetter their discretion, their duty to exercise their independent judgment. They must keep an open mind and be unbounded when attending a meeting. Ahern states “… a nominee director would fetter their discretion by pledging to their appointer how they will conduct themselves in the future.” It is clear to see how this duty may cause issues for a nominee director. The interests of their appointor will be known to them and the expectation of loyalty, perhaps combined with a realistic commercial expectation that the nominee may lose their position as a director should they chose to vote against the interests of their nominator. Under such circumstances, it is easy to see how the independence of their judgment could be affected.

Selangor United Rubber Estates v Cradock is an example of the potential for a nominee director to violate their duty to exercise their judgment independently. In this case, two directors acted on the instructions of a controlling shareholder to cause the company to improperly finance his purchase of shares in the company. The directors contended that they had acted on the orders of the shareholder without being aware of the improper nature of the

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72 Section 228 of the Companies Act 2014.
75 Bennett’s Case (1854) 5 De GM & G 284 Ch; applied in Clark v Workman [1920] 1 IR 107.
76 Deirdre Ahern, ‘Nominee Directors’ Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy’ (2011) 127 Law Quarterly Review 118, 125.
transaction. It was held that they had committed a breach of trust in misapplying company funds on the basis of failing to exercise their discretion and acting in utter disregard of their duties as directors.\textsuperscript{78} The court found that this amounted to an abdication of responsibility and the directors could not be said to have exercised their judgment at all, let alone independently. A finding of particular relevance to a nominee director’s duty to exercise independent judgment.

Further, Ahern highlights the relevance of the proper exercise of directorial discretion by a nominee director as per the rule in \textit{Re Hastings-Bass},\textsuperscript{79} a rule which derives from a private trust context but has been extended to other contexts.\textsuperscript{80} Ahern states;

“The principle is to the effect that where directors of a company act pursuant to a discretionary power but the effect of their exercise of discretion differs from what they intended, a court may declare the exercise of discretion void where it is clear that the directors would not have acted in the manner they did if they had not failed to take into account material considerations or took into account factors which they ought not to have considered.”\textsuperscript{81}

The rule in \textit{Re Hastings-Bass} was applied to the directors in \textit{Hunter v Senate Support Services Ltd}.\textsuperscript{82} where it was held that the directors’ decision that the plaintiff’s shares should be forfeited for non-payment was voidable. This was because the directors had proceeded on the mistaken basis that the only course of action open to them following non-payment was forfeiture of the shares. However, the directors had not considered any potential alternative courses of action which ought to have been reasonably taken into account by them. It was held they failed to exercise their discretion as directors.

\textsuperscript{78} See also \textit{Lindgren v L&P Estates Co} [1968] Ch 572 CA, where Harman J. regarded the fact that a director of a subsidiary company was appointed to represent the interests of the holding company as “quite irrelevant” to the question of the director’s liability.

\textsuperscript{79} \textit{Re Hastings-Bass} [1975] Ch 25 CA.


\textsuperscript{81} Deirdre Ahern, ‘Nominee Directors’ Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy’ (2011) 127 \textit{Law Quarterly Review} 118, 125. See also \textit{Sieff v Fox} [2005] EWHC 1312 (Ch); [2005] 1 WLR 3811.

\textsuperscript{82} \textit{Hunter v Senate Support Services Ltd} [2004] EWHC 1085 (Ch); [2005] 1 BCLC 175.
One possible suggestion which may provide protection to nominee directors would be to provide in the article of association of the company that the director may act in accordance with their nominator’s wishes. In the UK, the Companies Act 2006 provided a statutory duty on directors to exercise independent judgment. Section 173(2)(a) provides an exception for a director acting “in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors”. Section 173(2)(b) goes further and provides that the duty to exercise independent judgment is not infringed by the nominee director acting “in a way authorised by the company’s constitution”. However, directors’ duties are accumulative in nature and a nominee director is still subject to other directors’ fiduciary duties such as their duty to promote the success of the company.

(3) Promote the Success of the Company

In *Re Smith & Fawcett* Lord Greene MR stated the directors “must exercise their discretion *bona fide* in what they consider, not what the court may consider, is ‘in the interests of the company’ and not for any collateral purpose”. This is codified in the Act which provides that a director shall “act in good faith in what the director considers to be the interests of the company”. However, this is not a clearly defined concept and the debate as to whether this should mean the success of the company for its members or the company itself is not helpful. At present, the Irish courts have deemed to this mean the interests of the company meaning its members. Even if a potential conflict of interest can be dealt with through authorised action or otherwise and if there is constitutional authorisation for the nominee director to take into account the interests of their nominator, there is still an overarching duty to promote the success of the company, to act in its interest.

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84 Section 173(2)(a) of the Companies Act 2006.
85 Section 173(2)(b) of the Companies Act 2006.
86 *Re Smith & Fawcett* [1942] Ch 304.
87 Ibid [306] per Lord Green MR.
88 The Companies Act 2014.
89 Section 228(1)(a) of the Companies Act 2014.
This is an important duty because a nominee director represents a sectional interest in the company, be it a secured lender, shareholder or another stakeholder and their interest may differ from the interests of the company as a whole. However, a nominee director does have some discretion due to the requirement that they act in good faith and consider that their action promotes the success of the company. The test is, therefore, a subjective one. In *Re Smith & Fawcett* Lord Green MR placed much significance on the part of the test that determined that it was for the directors of the company, not the court, to determine what is ‘in the interests of the company’. However, despite the subjective nature of the test, a director will have failed to carry out his duty if no reasonable director could, in good faith, have considered his decision to promote the success of the company.

C. Taking into Account the Interests of the Nominator

It is clear that the very nature of the appointment of a nominee director raises the potential for a conflict of interests. While such a conflict may be managed, even authorised and the duty to exercise independent judgment can be adjusted via the company’s constitution, the above analysis has also highlighted that the overarching duty to act in the interest of the company remains in place and the interests of the company are those of the shareholders and cannot be equated to a secured lender. Therefore, the question for a nominee director is whether they take into account and further the interests of their nominator, for the purposes of this chapter a secured lender, while making decisions as a director of the company concerned. The traditional or ‘absolutist’ approach has been to acknowledge that a nominee director is a commercial reality and that they are in difficult position but to insist that in exercising their powers they are subject to the same duties as other directors without being able to take into account the interests of their nominator.

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91 Section 228(1)(a) of the *Companies Act 2014*.
92 *In Re Smith & Fawcett* [1942] Ch 304.
93 Section 228(1)(a) of the *Companies Act 2014*.
In *Scottish Co-operative v Meyer*,\(^95\) the majority shareholder of ST&M, appointed the majority of the directors to the board of ST&M. The other directors were the minority shareholders in the company. CWS operated a competing business to ST&M and aimed at destroying ST&M’s viability. The nominee directors did nothing to prevent this. The Court of Session found this to be an example of oppression of the minority and CWS was ordered to purchase the shares of the minority. In the course of the judgment in the House of Lords, which dismissed an appeal, Lord Denning stated “as soon as the interests of the two companies were in conflict, the nominee directors were placed in an impossible position …”\(^96\) It is clear that in prioritising the interest of their nominator the nominee directors had placed themselves in breach of the duty they owed. While Lord Denning recognised that their position was impossible he did not recognise the commercial reality that as nominee directors they would at least consider the interests of their nominator. In line with the law, the interests of the company are to be the sole determining factor in the decision making process of any director.

In *Kuwait Asia Bank v National Mutual Life*\(^97\) the Privy Council confirmed that in exercising their duties as directors as directors of a company nominee directors had to ignore the interests and wishes of their nominator.\(^98\) In *Kuwait Asia Bank* a bank had was beneficially interested in a New Zealand money broker and had appointed two directors who were also its employees. The money broker had gone into liquidation and the depositors, unsecured lenders, claimed against the stakeholders in a claim which was similar to that in *Scottish Co-op*. The claim failed, but the Privy Council repeated the position that nominee directors owed a duty only to the company and could not take into account the interests of their nominator. However, it is an approach which has been criticised for being too strict.\(^99\)

Statements such as “directors have but one master, the company”\(^100\) do not take into account the commercial reality of the nominee director. Further, Lord Denning’s approach, which recognised the commercial reality of being a nominee director and the fact they are bound to take into account their nominator’s interests but did not provide any legal recognition is

\(^{95}\) *Scottish Co-operative v Meyer* [1959] AC 324.  
\(^{96}\) Ibid [366-367] per Lord Denning.  
\(^{98}\) Ibid [222].  
\(^{100}\) *Dawson International plc v Coats Paton Plc (No 1)* [1989] BCLC 233 [243] per Lord Cullen.
unworkable. This does not mean that a nominee director should ignore the interests of their nominator if there is a conflict of interest, but it is extreme to have a position whereby the nominee must always do so. This impracticality of this traditional view has been recognised, to an extent, in more judgments\textsuperscript{101} where the emphasis has been placed on nominee director and there has been recognition of their right to take into account the interests of their nominator as long as they do not prefer the interests of their nominator over the interests of the company if a conflict of interests arise. This approach has been termed the “corporate primacy approach”\textsuperscript{102}

Ultimately, the nominee director will only be able to ensure their nominator’s interests are furthered to an extent that there is a congruence of the goals between the company and the nominator. That said, much will still depend on the director’s subjective assessment of this agreement. Ahern points out, conceptually, the distance between this and the absolutist approach is small.\textsuperscript{103} An example of the corporate primacy approach can be found in \textit{Re Broadcasting Station 2GB}\textsuperscript{104} where the 60% owner of a broadcasting company appointed directors to the board of that company. The nominee directors refused to give any details of negotiations with the broadcasting authority to the other directors.\textsuperscript{105} Jacob J rejected the idea that a nominee director could not take into account the interests of their nominator. Instead, he held, that there would be a violation of the directors’ duties if the nominee director in question acted in accordance with their nominator’s wishes for the company and they were of the view that such actions would be contrary to the interests of the company.

This provide for nominee directors to act in the interests of their nominator where there is no conflict of interest with the company. Jacob J emphasised that this approach denies;

\textsuperscript{101} \textit{Re Broadcasting Station 2 GB} (1964-1965) NSWE 1649.
\textsuperscript{102} Deirdre Ahern, ‘Nominee Directors’ Duty to Promote the Success of the Company: Commercial Pragmatism and Legal Orthodoxy’ [2011] \textit{Law Quarterly Review} 118, 131.
\textsuperscript{103} Ibid
\textsuperscript{104} \textit{Re Broadcasting Station 2 GB} (1964-1965) NSWE 1649.
\textsuperscript{105} As in \textit{Scottish Co-operative v Meyer} [1959] AC 324 where the claim was one of oppression by the minority shareholders against the majority.
“any right in the company as a whole to have each director approach each company problem with a completely open mind, but … to require this of each director is to ignore the realities of the company organisation.”\(^{106}\)

What differs here to the approach put forward by Lord Denning in *Scottish Co-op* is the extent to which a director needs to make up their mind independently and without any influence from their nominator. Jacobs J’s approach provides that the director has to act ‘in the interests of the company’, as is also required in Lord Denning’s approach. What differs however, is Jacob J permits a nominee director to come to the conclusion that they are acting ‘in the interests of the company’ without a “close personal analysis of the issues”.\(^{107}\) Therefore, this gives a nominee director the freedom to consider the interests of their nominator.

In *Molomby v Whitehead*,\(^ {108}\) a director was appointed to the ABC board to represent the staff of the broadcaster, the director sought access to various documents of the corporation without giving any reasons for such access but this access was refused. Beaumont J ordered that the director be given access to the documents as no conflict of interests had been established. Furthermore, in *Whitehouse v Carlton Hotel Pty Ltd*,\(^ {109}\) the High Court took the view that the articles of association of a corporation could vary the burden of fiduciary duties which would normally be imposed upon a director. Following these above cases, New Zealand also adopted this approach in the case of *Berlei Hestia (NZ) Ltd v Fernyhough*\(^ {110}\) where the court held that the right of a director to access to corporate records is necessary for him to perform his duties as a director. There was no evidence that the Australian directors intended to act in breach of their fiduciary towards the company.

The Companies and Securities Law Review Committee reviewed the above authorities and concluded that legislation was needed to clarify the duties of nominee directors by indicating that

“[A]ction of any directors guided by an extraneous loyalty in certain circumstances will not constitute a breach of their duty. That provision should not purport to be exhaustive

\(^{106}\) *Re Broadcasting Station 2 GB* (1964-1965) NSWE 1649 [1648] per Jacob J.
\(^{107}\) Ibid [1663] per Jacob J.
\(^{108}\) *Molomby v Whitehead* [1985] FCA 498; 13 IR 119.
\(^{110}\) *Berlei Hestia (NZ) Ltd v Fernyhough* [1980] 2 NZLR 150.
but should refer to the circumstances which, in the views that have been expressed by the courts, justify a director having regard to extraneous interests."111

In the UK, the judiciary appear to favour this approach over the more traditional approach that the interests of the nominator must have no bearing on the decision making of the nominee director. In *Re Neath Rugby Club*,112 Stanley Burton LJ emphasised that a nominee director could, without being in breach of their duties owed to the company, take into account the interests of their nominator, provided that they genuinely considered this to be ‘in the interests of the company’ . An approach indistinguishable from that of Jacob J in *Re Broadcasting Station*.

However, it must be noted, that while this position is different from that of the traditional approach, it remains evident that while a nominee director can take their nominator’s interest into account they cannot prefer these interests over those of the company if a conflict of interest arises. Further to this, in the UK, cases have arisen whereby the directors’ duties have been amended to take into account the circumstances of the nominee director.113 In *Levin v Clark*114 directors nominated to the board of a company by a mortgagee were held to be entitled to act primarily in the interests of the mortgagee after a default by the mortgagor company. Jacob J held the scope and content of the fiduciary duty to act in the interest of the company depended upon the circumstances of each case. In particular, the question was what the interest of the company was. In circumstances where a mortgagee appointed a director to represent his interest on the board of the company, the interest of the company might be served if the director acts in the interests of the mortgagee in the case of a default.115 In *Re Southern Counties Fresh Food*,116 Warren J emphasised that directors’ duties to the company, including the duty to act in the interest of the company, are capable of being reduced with the unanimous agreement of the shareholders of the company.117 Warren J appears to have attempted to create a gap between UK case law and Australian case law by stating that “the strictness of the no conflict and no

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113 Sections 173(2)(b) and 180(4)(b) of the *Companies Act 2006* allow adjustments to the duties owed to avoid any conflict of interests and to exercise judgment independently through the company’s constitutions.
114 *Levin v Clark* [1962] NSWR 686, referred to in *Re Southern Countries Fresh Food* [2008] EWHC 2810 (Ch) 60.
116 *Re Southern Countries Fresh Food* [2008] EWHC 2810 (Ch) 60.
117 *Re Southern Countries Fresh Food* [2008] EWHC 2810 (Ch) 60 [64].
profit rules are well established in UK law whatever flexibility might be seen in the Australian cases”. 118

It appeared important to Warren J that any relaxation in the fiduciary duties of a nominee director is done so with the agreement of the company. He stated “…absent an express agreement, a compelling case will … need to be made out if any sort of qualification of the duty is found to exist”. 119 Warren J concluded that it was unlikely that a matter of UK law shareholders could agree to release the director from his duty to act ‘in the interests of the company’. Nothing in Warren J’s judgment can be understood to have reversed the subtle shift from the traditional approach to the corporate primacy approach. Warren J did not state that should a nominee director take the interests of their nominator into account would be a violation of their duty to act ‘in the interests of the company’. This is in line with the judgment in Re Neath 120 where it was emphasised that in taking the interests of the nominator into account the nominee director would be compatible with the duty to act ‘in the interests of the company’.

Therefore, it can be concluded that traditional approach, as reflected in Scottish Co-op 121 and Kuwait Asia Bank, 122 has been replaced by a more realistic and commercially real approach to nominee directors. There is a recognition that the conflicts faced by a nominee director and any ‘fetters’ of their independent judgment can be controlled. While it is clear that a nominee director can take into account his nominator’s interests when deciding what action to undertake which he deems to be ‘in the interests of the company’, particularly when the shareholders have agreed to such action. There has not been a shift away from the fundamental principle that a director, nominee or otherwise, has to act in the interest of or promote the success of, the company. While such an undertaking is unlikely to be rescinded even by the shareholders, it is for the directors, not the court, to determine what is in the interest of the company and it may be that the directors decide that it is in the company’s interest to have an outside influence reflected on their decision making.

118 Ibid [65] per Warren J.
119 Re Southern Countries Fresh Food [2008] EWHC 2810 (Ch) 60 [65] per Warren J.
121 Scottish Co-operative v Meyer [1959] AC 324.
D. Nominee Directors in an Insolvency

As is known, when a company enters insolvency, the interests of the lenders have to be taken into account by the directors in the discharge of their duty. In a well-established statement, Street CJ in *Kinsela v Russell Kinsela Pty Ltd (In liq)*\(^{123}\) stated;

“In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the lenders intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company’s assets. It is in a practical sense their assets and not the shareholders’ assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to insolvency, or the imposition of some alternative administration”\(^{124}\)

This was approved by Dillon LJ in *Liquidator of West Mercia Safetywear Ltd v Dodd & Anor*\(^{125}\) where the director of a company was found guilty of breach of duty when he disregarded the interests of the general lenders of his insolvent company.\(^{126}\) Where, however, directions are issued by the nominator which may lead the nominee directors into action which may clash with the law, notwithstanding the nature of the shareholders’ agreement, or any other arrangement, is an area of particular difficulty. It is recommended that the legislation should recognise the special position of nominee directors in companies which were administered under shareholders' agreements.

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\(^{124}\) Ibid [730] per Street CJ.

\(^{125}\) _Liquidator of West Mercia Safetywear Ltd v Dodd & Anor_ (1988) 4 BCC 30, 33.

\(^{126}\) This proposition was recently affirmed in *Colin Gwyer and Associates v London Wharf (Limehouse) Ltd_ [2002] EWHC 2748 (Ch).
E. Conclusion

This chapter has examined the role of nominee directors and their duty to act on behalf of their nominator who for the purposes of this chapter was concerned as a secured lender. It outlines the law in relation to nominee directors and discusses the commercial realities of the position. It highlights that nominee directors are not a separate class of director and it investigates the position of a nominee director should they consider the interests of their nominator while also being constrained by the fiduciary duties which they owe to the company as a director of it. In doing so, this chapter highlights the difficulty which a nominee director would have in attempting to favour the interest of their nominator ahead of those of the company. While a nominee director may be in difficult position, such as during a joint venture, they owe their duty primarily to the company.

This chapter also analyses the main fiduciary duties which can apply to a nominee director. While it highlights the potential for a nominee director to take their nominator’s interests into account, it would be difficult to provide a situation in which they could justify doing so at the expense of the company although this chapter does put forward the possibility of the secured lender’s intention be taken into account when judging the actions of a nominee director. The duty to avoid the potential for a conflict of interests was examined and while it is a positive duty to ensure such a serious issue does not arise, it is submitted in this chapter it does not take into account the commercial realities of the position with which a nominee director is in. It is a duty which this chapter submits encompasses the duty of loyalty and this goes beyond the company in the case of a nominee director.
Chapter 4 – Secured Lenders as a Shadow Director

A. Introduction

“There are those who exert influence on the board of directors and guide the company but in a manner which makes their control invisible. In effect, they are flying under the radar, and act ‘from the shadows’.”

Company law has long recognised that there are those who issue instructions to the directors of a company, and wield “real influence” and that they should bear some of the responsibility for the actions of the company, even though they are not on the board of directors. Often described by judges such as Millet J (as he then was) as a figure who “… lurks in the shadows, sheltering behind others who, he claims, are the only directors of the company to the exclusion of himself”, or as “puppet masters” in control of puppet directors, shadow directors can play a leading role in the decision – making process of a board of directors of a company which has come under their influence. A shadow director is a person who is neither formally appointed, nor necessarily held out as a director, but to whom certain sanctions and regulations, normally reserved for directors, can be applicable. To date, the court have not found a secured lender to be a shadow director.

While secured lenders do not normally have a role within the management of a company this may change if a company begins to experience financial difficulties with a lender seeking to undertake more of a role in the company. If it is a case that a lender does not infringe on a director to the point where they can exercise their own independent judgment then no major issue should arise. However, should it be the case that a secured lender is making decisions for the directors, or the directors are putting the secured lenders interests before the interests of the

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2 Secretary of State for Trade and Industry v Deverell [2001] Ch 340 CA (Civ Div) [33] per Morritt LJ.
6 Section 221 of the Companies Act 2014.
7 Section 228(1)(e) of the Companies Act 2014.
company, then shadow directorship will become a real possibility. Shadow directors in Ireland
are bound by director’s fiduciary duties in the same manner as the directors who have been
formally appointed to the company board. Shadow directors exert control over the board of
directors and guide the company, but in a manner which can make their control invisible. Their
legal recognition is a relatively modern development within Irish company law and
unsurprisingly the exact legal relationship between a shadow director and a company has not
been fully settled. Any directions or instruction they issue must relate to the company and
must be interpreted as dictation of strategy and policy. And yet, a case where a secured lender
has been found to be a shadow director has yet to arise. In Re PFTZM Ltd (In liquidation), the
court considered whether a secured lender had become a shadow director due to the fact
the lender’s representatives had attended weekly management meetings of the company, and
had exercised a veto over which payments the company would make. However, the court
decided the lender had been acting within its role, and not as shadow director.

While it is critical for secured lenders to understand that there are consequences if they are
found to have acted as a shadow director, there is currently a lack of such a ruling. As a
consequence, those who have the potential to have influence over the affairs of the board of a
debtor company do so in the knowledge that currently there is a lack of bite in the legislation
which binds the role of a shadow director to directors’ duties in cases which concern secured
lenders. Given the pivotal role such a director can play in the running of the company, it has
been an important move to ensure such non-formally appointed directors are subject to the
same fiduciary duties as those who are appointed as directors. In doing so within the Companies
Act 2014 the Irish legislature has issued a clear signal that such directors will be duty bound

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8 Section 228 of the Companies Act 2014.
9 Section 27 of the Companies Act 1990. In the UK, legislation accounting for the existence of Shadow Directors is visible since Section 63 of the Companies Act 1980.
10 Re Hydrodam (Corby) Limited [1994] 2 BCLC 180, [1994] BCC 161. Referred to as Hydrodam in the BCLC series, it is referred to as Hydrodan in the BCC series.
11 Secretary of State for Trade and Industry v Aviss [2006] EWHC 1846 (Ch); [2007] BCC 288.
13 Ibid.
14 Section 221(1) of the Companies Act 2014.
16 The current statutory definition originates from section 3 of the Companies (Particulars as to Directors) Act 1917, although it was not then given the epithet “shadow director”.
by the same fiduciary responsibly of formally appointed directors of a company and as such will have to consider their fiduciary duties owed to the company when making decisions. This thesis considers the implications of the impact of this on a secured lender of a company and whether they are influencing the board of management of a debtor company and the reluctance of the courts to find a secured lender as a shadow director.

This chapter sets out the current law in relation to shadow directors and the law relating to them in both Ireland and the UK. The test for shadow directors in cases which concern secured lenders is highlighted and the lack of theoretical justification for their exclusion is discussed. It examines the position of secured lenders within a company and investigates the possibility of a secured lender in the role of a shadow director. It discusses issues which relate to the exclusion of a secured lender being found to be a shadow director. It also contains a comparison with the law in the United States. This chapter argues that the judiciary should be able to find that secured lenders can act in the role of a shadow director.

(1) Defining a Shadow Director

Shadow directors have existed in Ireland long before the passing of the Companies Act 1990, although they were only referenced as such by the 1990 Act, which defined a shadow director as:

“… a person in accordance with whose directions or instructions the directors of a company are accustomed to act … unless the directors are accustomed so to act by reason only that they do so on advice given to him in a professional capacity”.

Since the introduction of the Companies Act 2014 the definition of a shadow director defines such a person as:

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18 Section 27 of the Companies Act 1990.
19 Ibid. Of note, Section 195(12)(a) of the Companies Act 1963, however, required every company to keep a register of formally appointed directors and the persons not then registered, in “accordance with whose directions or instructions the directors of a company are accustomed to act”.

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“a person in accordance with whose directions or instructions the directors of a company are accustomed to act shall be treated for the purposes of [Part 5] as a director of the company unless the directors are accustomed so to act by reason only that they do so on advice given by him or her in a professional capacity”.20

Shadow directors, as so defined, are treated by the Act21 as directors in a number of different contexts, such as, the restriction and disqualification of directors,22 insider dealing and fraudulent and reckless trading,23 transactions involving directors where conflicts of interest arise24 and are subject to directors’ fiduciary duties.25 However, determining exactly who is a shadow director is not straightforward with the interpretation and application of the test for a shadow director changing dependent on the facts of the case. It can range from a flexible interpretation26 in cases which do not involve secured lenders such as bank or financiers, particularly when the issue of disqualification of a secured lender as a shadow director is concerned,27 to a narrow one in cases where they are involved28 with current case law being less than plentiful. While the full suite of directors’ fiduciary duties are covered under the 2014 Act,29 the focus of this thesis in on the interpretation of the phrase “in the interests of the company”30 and the limits it places on the directors of a company.

20 Section 221(1) of the Companies Act 2014. In the United Kingdom this is set out under section 251 of the Companies Act 2006. Further, the UK statutory provisions do deal with directors’ duties are set out in ss. 170 – 177.
21 The Companies Act 2014.
22 Park 14 of the Companies Act 2014.
23 Section 610(1)(a) of the Companies Act 2014.
24 Section 238 of the Companies Act 2014.
25 Section 228 of the Companies Act 2014.
26 Secretary of State for Trade and Industry v Aviss [2006] EWHC 1846 (Ch); [2007] BCC 288.
29 Section 228 of the Companies Act 2014.
30 Section 228(1)(a) of the Companies Act 2014.
B. Shadow Directors

(1) The Position in Ireland & the UK

Unlike in the UK where there is uncertainty to the extent with which directors’ fiduciary duties apply to shadow directors because, according to Witney, the imposition of a fiduciary duty depends on the person regarded as having undertaken or assumed the responsibility of being a director, shadow directors in Ireland are bound by directors fiduciary duties. For one to qualify as a shadow director it will not be satisfactory to show an individual has acted as though they were a director, it must be established as a matter of fact that the individual exercises control and influence over the board of the company in question. The mere holding of a senior management role will not be sufficient. They must be shown to be directly involved in the direction or governance of the company. In *Re Vehicle Imports Ltd (In Liquidation)* Murphy J found that the company’s accountant who had responsibility for maintaining and auditing the company accounts was a shadow director.

In *Re Vehicle Imports Ltd (In Liquidation)*, the company liquidator believed that the accountant had a significant involvement in and control over the management of the company’s business during its short trading life and the accountant had, based on his own evidence, received substantial fees over that period. Murphy J held that the uncontroverted evidence of a director that the director had signed blank cheques to be filled in by the accountant did sit within the definition of a shadow director. Murphy J did stress that the mere fact of acting as an accountant providing services to a company would not in itself signify that a person is someone in accordance with whose directions or instructions the directors of the company are accustomed to act. As Morritt J stated in *Secretary of State for Trade and Industry v Deverell*, the aim is to;

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31 *Ultraframe (UK) Ltd v Fielding & Others* [2005] EWHC 1638 (Ch); [2006] FSR 17.
33 Section 228 of the *Companies Act 2014*.
34 Deirdre Ahern *Directors Duties Law & Practice* (Dublin 2009) 59.
35 *Re National Irish Bank Ltd; Director of Corporate Enforcement v Curran* [2007] IEHC 181.
37 Ibid.
38 *Secretary of State for Trade and Industry v Deverell* [2000] 2 All ER 365.
“…identify those, other than professional advisors, with real influence in the corporate affairs of the company. But it is not necessary that such influence should be exercised over the whole field of its corporate activities.”

In *Deverell*, the court was concerned with the status of Mr Deverell in terms of the management of the company, the fact he was described as its founder in a sales document which he was responsible for and who was one of the signatories to the company’s bank account. He claimed he acted in the capacity of an advisor. The court held he was “concerned at the most senior level and with most aspects of the direction of the company’s affairs”. It is submitted in this thesis that the concept of ‘direction’ and ‘instruction’ do not exclude the concept of ‘advice’. In the leading Irish case on shadow directors, *Re Hocroft Developments Ltd* McKechnie J noted that whereas Morritt J had held that non-professional advice is included, Laffoy J “…was of the view that, for advice to be included, it has to carry the same imperative quality as any other communication”. McKechnie J was inclined to the view that only a communication that amounts to a direction or instruction will apply.

In the UK, there has not been the imposition of clear legislative and judicial signals regarding shadow directors unlike the statutory signals in Ireland. While the definition of a shadow director contained in the 2006 Act is the same as in Ireland and although there are a number of specific company and insolvency law statutory provisions in the UK which apply to shadow directors, the scope of their obligations and liabilities has yet to be fully clarified. Following the decision in *Ultraframe (UK) Ltd v Fielding & Others*, it was not made clear if director’s fiduciary duties to the company could even be owed by a shadow director. It was not until *Vivendi SA Centenary Holding III Ltd v Richards* that the law in the UK was, to a certain extent, corrected. In *Vivendi*, Newey J argued that, if there is a need to show assumption of

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39 Ibid [376] per Morritt J.
40 Ibid [381] per Morritt J.
41 *Hocroft Developments Limited (In Liquidation), Dowall v. Cullen & Ors* [2009] IEHC 580
42 Ibid [66] per McKechnie J.
43 *The Companies Act 2006*.
44 Section 251 of the *Companies Act 2006*.
45 See section 182 of the *Companies Act 2006* and section 214 of the *Insolvency Act 1986*.
47 *Ultraframe (UK) Ltd v Fielding & Others* [2005] EWHC 1638 (Ch); [2006] FSR 17.
responsibility by a shadow director, then such an assumption must imply responsibility. In the case of a potential shadow director, Newey J held that taking account of legislative intent, and importance of the role that a shadow director may have in relation to a company’s affairs, they will as a minimum owe a duty regarding any instructions they issue to the board of management of the company and such a duty would include a duty to act in good faith.

Newey J stated that *Ultraframe (UK) Ltd* “understates the extent to which shadow directors owed fiduciary duties”.\(^49\) From the point of view of the law in the UK the *Vivendi* case showed the courts would take a tougher stance moving forward. Ultimately, the court in *Ultraframe (UK) Ltd* made this issue difficult by doubting the extent to which duties are owed by a shadow director, even when one is held to meet the statutory test. Although the judgment of Newry J in *Vivendi* corrected the situation somewhat, the law in the UK could not be said to be fully satisfactory, albeit there were signs that the courts would be taking a tougher stance than had been evident in the past, the Irish courts would need to tread carefully when considering these judgments.

(2) Test for Shadow Directors in the case of a Secured Lender

At present, the status of shadow directorship have never been successfully invoked against a secured lender\(^50\) and while the number of cases where this issue has been before the judiciary number in the few, as discussed below, they provide the potential that the judiciary view the role of a secured lender as “… acting in defence of their own interests”\(^51\). This may indicate a reluctance on the part of the judiciary to find a secured lender to be a shadow director or given the fact that as a secured lender has the option of simply enforcing their security against the company concerned, a potential plaintiff may simply opt against such action. In *Re a Company (No. 005009 of 1987)*,\(^52\) a company, after losing its major customer, reached its overdraft limit and ran into financial difficulties. From that moment onwards, the secured lender concerned,

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\(^{49}\) *Vivendi SA Centenary Holding III Ltd v Richards & Ors* [2013] EWHC 3006 (Ch); [2013] BCC 771; [2013] Bus. L.R. D63 [143] per Newey J.

\(^{50}\) *Ultraframe (UK) Ltd v Fielding & Others* [2005] EWHC 1638 (Ch), (2006) FSR 17; *Re PFTZM (In Liquidation); Jourdain v Paul* [1995] BCC 280; *Re MC Bacon Ltd* [1990] BCC 78 Ch D; *Re a Company (No. 005009 of 1987)* [1988] 4 BCC 424 Ch D.

\(^{51}\) *Re PFTZM (In Liquidation); Jourdain v Paul* [1995] BCLC 354 [367] per Judge Paul Baker QC.

\(^{52}\) *Re a Company (No. 005009 of 1987)* [1988] 4 BCC 424 Ch D.
in this case a bank, took an active role in the affairs of the company. It made suggestions on various management issues and ensured that these were acted upon.

Further to this the lender demanded security be provided for an overdraft and this was granted within a month. The claim was made that the secured lender concerned was a shadow director of the company. On the application by the secured lender to have the claim struck out on the grounds there was no reasonable cause of action, Knox J refused to do so. However, Hadjinestoros makes the point that any further “… hopes of a flexible approach regarding [secured lenders] soon faded away…” In a further hearing of the case, Millett J stated that “the charge would have failed anyway”. This inflexible approach was also evidenced in Re PFTZM Ltd, where the company, after going into liquidation, obtained refinancing from its major lender to renovate its country club. The new club was opened but it proved to be unprofitable. After discussions, the lender and the company agreed that the major shareholder and managing director would stop drawing a salary until the project became profitable. Further, “weekly management meetings would be held concerning the trading of the business” and would be attended by a director and manager from the secured lender. They were able to veto any withdrawals or payments out of the bank account while approval was also required from the secured lender. Similar approval was also required for the company’s financial strategy and for staff changes. Judge Paul Baker QC dismissed the liquidator’s allegations, and held that the secured lender was not a shadow director of PFTZM. In addressing the term ‘shadow director’, Judge Paul Baker QC stated;

“This definition is directed to the case where the nominees are put up but in fact behind them their strings are being pulled by some other persons who do not put themselves forward as appointed directors. In this case, the involvement of the applicants here was thrust upon them by the insolvency of the company. They were not accustomed to give directions. The actions they took, as I see it, were simply directed to trying to rescue

54 Re MC Bacon Ltd [1990] BCLC 607.
57 Ibid 284.
what they could out of the company using their undoubted rights as [secured lenders]".  

Of concern here is the central point made in the judgment which was that the officers of the lender “were acting in defence of their own interests” and the directors of PFTZM had the discretion regarding the loan in that they could “to the offer or leave it”. This is a difficult finding as it places a far more restrictive interpretation on the test for shadow directorship than is applied in cases where the potential shadow director is not a secured lender. While in theory, there should be no reason why a secured lender should not be capable of being held a shadow director, the courts have proven to be extremely reluctant to make such a finding. Therefore, it is unsurprising that some, such as Hadjinestoros, argue that “[a] judicially made exception … concerning [secured lenders] has therefore been formed”. Based on the above decisions, it is clear from the judicial interpretation of s.221 that a high degree of control of a company’s business is going to be necessary for a person to be adjudged a shadow director. As of yet, it is a level which, in the eyes of the court, has not been reached.

This restrictive approach regarding secured lenders as shadow directors came to the fore again in the case of Ultraframe v Fielding where Lewison J accepted that a secured lender has every right “to keep a close eye on what is done with his money” and whether the directors of the company concerned have no other choice but to “accede to his requests, is irrelevant”. Of concern is the fact Lewison J, in his judgment, has gone further than PFTZM by not taking into consideration the issue of director’s discretion. What the judgments in Ultraframe UK (Ltd) and PFTZM share is there is a reluctance by the courts to hold a secured lender to be a shadow director. In both cases it was stated that a secured lender in the form of a bank cannot be a shadow director as it is acting in defence of its own interests. This gives weight to the

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59 Ibid.
60 Ibid 292 per Judge Paul Baker QC.
64 Ibid [1268] per Lewison J.
65 Ibid.
suggestion that a judicially made exception to shadow directorship in the case of a secured lender has therefore been formed.

(3) The Lack of Theoretical Justification for not holding a Secured Lender as a Shadow Director

The cases of PFTZM and Ultraframe UK (Ltd) have a substantial assertion, namely that secured lenders may not be considered as a shadow directors of a company. However, such an assertion is flawed in that it lacks any theoretical justification and it is contrary to the Court of Appeal decision in Deverell. In Deverell, Morritt LJ indicated that the definition of a shadow director should not be strictly construed. This is also in line with the commentary that a strict interpretation would be “more appropriate in a criminal or quasi – criminal provision”. In PFTZM the emphasis was placed on the discretion of the company directors. The directors were deemed to have the discretion to act and therefore it was irrespective whether they followed they followed the “directions or instructions” they were issued with as their discretion was deemed to be the decisive factor in constituting that the secured lender concerned was not a shadow director. While there may be an element of correctness to this decision on point, the level of discretion available to a company director must be quantified.

It has been suggested that even the minimum amount of discretion on the part of the directors, such as having the option "to put the company into lender’s voluntary liquidation or administration", is enough not to constitute another a shadow director. Judge Paul Baker QC in PFTZM was of the view that “[C]reditor made terms for the continuation of credit in the light of a threatened default. The directors of the company were quite free to take the offer or leave it …” This would suggest that Judge Paul Baker QC was of the view that even a minimum amount of discretion on the part of the directors would be sufficient to show that a secured lender would not be a shadow director. However, in Deverell, it was held by the court

68 See also Secretary of State for Trade and Industry v Laing [1996] BCLC 324 Ch D.
69 Section 221(1) of the Companies Act 2014.
that it is not necessary for the lender to exercise its influence “…over the whole field of [the company’s] corporate activities”. The court went on the find that “Even if the board retains some control [the secured lender may still be liable to be a shadow director] without proof of a controlling influence”.

Basically, it is not necessary for the directors of a company to relinquish their discretion, because, as Lewison J stated in *Ultraframe (UK) Ltd*, “Such a requirement would be to put a gloss on the statutory requirement that the board are ‘accustomed to act’ in accordance with ‘such directions or instruction’.” While this judgment see at odds with that of the judgment in *Tasbian*, where similar factors of control were taken into account to find that Mr Nixon was a shadow director, in *PFTZM* it was deemed that there was not enough shown to make a finding that the lender concerned was a shadow director of the company. O’ Donovan suggests that the involvement of a lender should not have been disregarded by the court. And yet, there is a reluctance to find a secured lender a shadow director as evidenced by the case of *PFTZM*. Such lenders have been distinguished from other stakeholders with Lewison J stating that a “lender is entitled to keep a close eye on what is done with his money, and to impose conditions on his support for the company”. He would go on to state;

“[W]here the alleged shadow director is also a [secured lender] of the company, he is entitled to protect his own interests without necessarily becoming a shadow director in the course of doing so”.

However, this leaves the question as to why one should differentiate between a secured lenders and any other stakeholders in a company unanswered. From the facts of the cases discussed, the differentiation appears to have been made due to the fact that the secured lender’s involvement in the company has been thrust upon him following the making of the loan and

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74 Ibid [1267] per Morritt LJ.
75 Ibid.
77 James O’ Donovan *Lender Liability* (Thomson Reuters Australia 2000) 584.
78 *Ultraframe (UK) Ltd v Northstar Systems Ltd (In Liq)* [2005] EWHC 1638 (Ch) [1268] per Lewison J.
79 Ibid.
therefore the lender is entitled to protect his interests. This does not make the case for the differentiation between lender and other stakeholders appear any more sound. Would any other stakeholder consider themselves to have the same right or duty to be involved in the affairs of the company in order to protect their interests? A good illustration is the case Re Augustus Barnett,\(^8\) where the liquidator of a subsidiary company, Augustus, sought to impose liability on the parent company, Rumasa, for the debts incurred by the subsidiary. Rumasa had provided Augustus with finance and reassured suppliers. While no liability was imposed on Rumasa, no distinction was drawn between Rumasa acting as a secured lender or as another stakeholder.

However, it is put forward here that there should be no differentiation made between secured lenders and any other stakeholder. Secured lenders should not be granted a judicial exception to being a shadow director in the same manner in which anyone else undertaking such a role, who is not such a lender, would not be granted. While a shareholding, albeit a significant one, will create an element of control in a company, a loan of funding will create a debt. In *Ultraframe (UK) Ltd*,\(^8\) Lewison J accepted,\(^8\) the following submission of counsel for the claimant:

“A lender is entitled to keep a close eye on what is done with his money and to impose conditions on his support for the company. This does not mean he is running the company or is emasculating the powers of directors, even if [given their situation] the directors feel they have little practical choice but to accede to his [the lender] requests. Similarly with customers who may, because of their buying power, be able effectively to dictate conditions to their suppliers [Or the other way round]. In other words a position of influence [even a position of strong influence] is not necessarily a fiduciary position. To find otherwise would place a wholly unfair an unnatural burden on men of business.”\(^8\)

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\(^8\) Re Augustus Barnett & Son Ltd [1986] BCLC 170 Ch D.

\(^8\) Ultraframe (UK) Ltd v Northstar Systems Ltd (in liq) [2005] EWHC 1638.

\(^8\) Lewison J took a similar view in Triodos Bank NV v Dobbs [2004] EWHC (Ch) 222. In that case he stated that “[t]he protection by the bank of its own interests is consistent with it not having become a director of [the borrower company]. The bank was the funder of [a] project”.

\(^8\) Ultraframe (UK) Ltd v Fielding & Others [2005] EWHC 1638 Ch 1268.
While this statement, by itself, appears unobjectionable and accords with such a situation in reality and suggests that since the secured lender in question has his involvement in the company almost thrust upon him and therefore has to protect his interests it does not address why a differentiation should be made between a lender and the shareholders or other interested parties in a company. In *Re Augustus Barnett*,\(^8^4\) a liquidator of a subsidiary company, Augustus, sought to impose liability on the parent company, Rumasa, for the debts of the subsidiary. Rumasa had provided\(^8^5\) Augustus with finance and provided a letter of comfort for suppliers to assure them it would continue to support the subsidiary. It failed to do so and the subsidiary went into liquidation. The courts being unprepared to lift the veil and find the parent company responsible for its subsidiary corporation. While no liability was imposed on the parent company, no distinction was made between Rumasa in terms of acting as a financier or as a shareholder.\(^8^6\)

It was irrelevant in terms of liability in what capacity the lender was acting, no differentiation should be made when determining secured lenders from other interested parties and yet the courts are not prepared to forego the current judicial exception which is in place when financial institutions are considered to have acted as shadow directors. However, there is no substantive reason as to why a secured lender who is influencing the decision making of company should be treated differently. It is accepted that when a company nears a position of insolvency the relevant financial institution without doubt “takes a more active role in the company”.\(^8^7\) A significant way that a bank as a secured lender may become involved in the affairs of a company is when it uses its bargaining position to negotiate with the directors of the company to obtain a significant level of control over the affairs of the company. However, when a bank as a company’s lender becomes involved in business decisions and in matters normally determined by an executive director or the board, it may risk being found liable as a shadow director.

\(^8^4\) *Re Augustus Barnett & Son Ltd* [1986] BCLC 170 Ch D.

\(^8^5\) Section 221 (2) of the *Companies Act 2014* provides a body corporate is not to be regarded as a shadow director of any of its subsidiaries.

\(^8^6\) It should be noted that the case came before the enactment of wrongful trading where liability may have been imposed for being a shadow director, and it is not clear what the outcome would have been had the relevant section been in force.

\(^8^7\) David Kershaw *Company Law in Context* (Oxford University Press 2009) 296.
A lender can do the above-mentioned acts by virtue of the terms and conditions and covenants which exist in a loan agreement or which they may impose in order to continue to support the struggling company. In cases of possible insolvency, the lender may seek to exercise a form of control over a company by operating a blocked account and exercising control over the use of the overdraft; for example by requiring "prior approval of each payment". Turing suggests that "to allow [a lender] to veto each payment is to allow them to decide how the business should be run". Further, the appointment of a person by a lender as director of the company may impose on that person shadow directorship status since "company directors are legitimate targets for shadow directorship claims". The issue for a shadow director to whom directors’ duties will apply is exacerbated by the fact that their role cannot be equated with that of a de jure director or a de facto director because they assume to act or claim and purport to be a director. There are important differences between these directors and a shadow director which should have a bearing on their legal duties. It is set out that a person does not have to be involved with aspects of a company’s business in order to be found to be a shadow director. In Secretary of State for Trade and Industry v Deverell, Morritt J stated;

"The purpose of the legislation is to identify those, other than professional advisers, with real influence in the corporate affairs of the company. But it is not necessary that such influence should be exercised over the whole field of its corporate activities."

Therefore, it is likely that a shadow director may not be involved in a range of matters which one might expect the board of the company to oversee and they may not seek to act beyond a certain role. Further, the test used to determine whether someone is a shadow director is an objective one, and the shadow director’s actions might subsequently be characterised as ‘directions or instructions’ even if that is not what they are intended to be, or understood as such by the person giving them. Campbell has suggested that should it be the case that a lender becomes involved in the survival planning of the borrower, it will take on the role of a shadow

88 David Turing, ‘Lender Liability, Shadow Directors and the Case of Re Hydrodan (Corby) Ltd’ (1994) 9(6) Journal of International Banking Law 244.
89 Ibid 246.
92 Section 228(1)(f) of the Companies Act 2014.
93 Re Hydrodam (Corby) Ltd [1994] 2 BCLC 180 [183] per Millet J.
95 Ibid [33] per Morritt J. See also Re Kaytech International Plc [1999] BCC 390 CA (Civ Div) [402] where similar comments were made by Robert Walker LJ.
director.\textsuperscript{96} It is in such cases that the courts should be astute to hold banks as shadow directors unless the lender aims is to take measures to protect their investment in the company. The case of \textit{Standard Chartered Bank of Australia Ltd v Antico}, \textsuperscript{97} which was before the Supreme Court of New South Wales offers an insight into how a financial institution as a secured lender may be deemed to fall within the scope of shadow directorship.

In that case, the holding company (Pioneer) owned 42 per cent of its subsidiary (Giant) and had three directors appointed to the board of Giant. Giant had entered into a number of financial agreements with Standard Chartered, particularly the provision of a discount and bill acceptance facility of $30, the payment of which was extended on a number of occasions. When Giant was wound up, Standard Chartered commenced proceedings against Pioneer under the insolvent trading provisions, claiming the Pioneer was a director of Giant and was liable for the insolvent trading of Giant. Have reviewed all the relevant issues, Hodgson J concluded Pioneer was a shadow director of Giant and was liable for the debts of Giant under the insolvent trading provision. His Honour stated;

\begin{quote}
“In my view, the conditions imposed following the decision to fund Giant in March 1989 show a willingness and ability to exercise control and an actuality of control, over the management and financial affairs of Giant.”\textsuperscript{98}
\end{quote}

The fact that plaintiff controlled the financial position, its authorisation was required for any payments to be made and that it gave directions to the appointed directors on company business did, in the opinion of the court, make it a shadow director. \textit{Antico} would suggest that when deciding if a lender is a shadow director, it is not a question of capacity but a question of involvement. By becoming involved in the overall management of a company a secured lender gains the ability to control a company and therefore could be classed as a shadow director. However, it would be rare for banks to "continue to put resources into intensive care after the point when liquidation has become inevitable". It would seem at present as far as the courts are concerned that when a bank as a secured lender becomes involved in a company which needs financial assistance, mostly likely to survive, the secured lender is fully entitled to take any

\textsuperscript{96} Niall R. Campbell, ‘Liability as a Shadow Director’ (1994) \textit{Journal of Business Law} 609.
\textsuperscript{97} \textit{Standard Chartered Bank of Australia Ltd v Antico} (1995) 38 NSWLR 290.
\textsuperscript{98} Ibid [327-328] per Hodgson J.
action it deems necessary to ensure it will receive its funding back.

From that point of view, the lender will take any necessary steps to ensure it has control over the company. It is submitted here that it is from this moment that shadow directorship comes into being on the lender’s behalf on the basis that there is no probability that the company will avoid liquidation.

(4) The Extent of Duties Owed by a Secured Lender

Along with laying down that it would be unlikely that a secured lender is unlikely to be found to be a shadow director, the court in *Ultraframe UK (Ltd)* threw some doubt on the extent with which directors’ duties will be owed by a shadow director, even when the statutory test is met. Lewison J,99 replying on the principles of equity, was of the opinion that there must be evidence of a direct relationship of trust and confidence between the shadow director and the company to ensure the fiduciary obligations can be imposed.100 Lewison J, in citing trust law cases, such as *Bristol & West BS v Mothew*101 and *Arklow Investments Ltd v Maclean*,102 and in quoting from Snell’s Equity,103 stated;

> “not persuaded that the mere fact that a person falls within the statutory definition of ‘shadow director’ is [not] enough to impose upon him the same fiduciary duties to the relevant company as are owed by a de jure or de facto or de facto director.”104

Lewison J stated that the one case which held that a shadow director did owe fiduciary duties, *Yukong Line v Rendsberg*,105 the director in question was more akin to a de facto director. In 1995, the plaintiffs, Yukong Line, who were the owners of the vessels in question, chartered the vessel Rialto to the first defendants, Rendsburg, for a three year period. The second and

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100 *Ultraframe (UK) Ltd v Fielding & Others* [2005] EWHC 1638 (Ch), [2006] FSR 17, 1286.
101 *Bristol & West BS v Mothew* [1998] Ch 1 CA (Civ Div).
102 *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594 PC (New Zealand).
104 *Ultraframe (UK) Ltd v Fielding & Others* [2005] EWHC 1638 (Ch), [2006] FSR 17 [1284] per Lewison J.
105 *YuKong Line Ltd of Korea v Rendsburg Investments Corp of Liberia (No 2)* [1998] 1 WLR 294 QBD.
third defendants, Ladidi Corporation and Mr Dimitrios Yamvrais, acted as undisclosed principals of Rendsburg. However, in January of 1996, Rendsburg, informed Yukong that it was no longer in a position to perform the charterparty as agree due to a deterioration of its financial position. Yukong brought an action against Rendsburg for damages for wrongful repudiation. Lewison J asserted that an assumption of an obligation of loyalty to the company would be required which was not present in the case before him. By making such a judgment, Lewison J place a demanding requirement by requiring a need for the assumption of responsibility to be shown on the part of the shadow director.

Newey J in *Vivendi v Richards* moved away from this requirement by holding that the acceptance and use of corporate powers implies such an assumption of responsibility. While Newey J accepted the proposition that fiduciary duties stem from undertakings or the assumption of responsibility, he asserted that the test of whether there had been such an undertaking or assumption was an objective one, and one which was not based on what the alleged fiduciary intended to apply. Newey J argued that the taking on of a role or position must be capable of implying an undertaking or an assumption of responsibility so that a person who becomes a trustee will also be taken to have agreed to accept the duties which will accompany the position. Newry J conducted an analysis of the duties of a shadow director and in doing so, he highlighted developments since the recognition given by Toulson J in *Yukong* of the principle that a shadow director owes fiduciary duties. Newry J stated that “… shadow directors commonly owe fiduciary duties to at least some degree [to the company]”. He went on to state

"… I consider that a shadow director will normally owe the duty of good faith (or loyalty) … when giving ... directions or instructions. A shadow director can, I think, reasonably be expected to act in the company's interests rather than his own separate interests when giving such directions and instructions."

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107 Ibid, para 142.
108 Ibid, para 143.
When this is considered within the context of a shadow director, Newey J was of the opinion that *Ultraframe UK (Ltd)* had understated the extent to which shadow directors owe fiduciary duties to a company. While this does not settle the legal position relating to secured lenders as shadow directors it did give signs that moving forward, UK law would no longer fully allow for secured lenders to be completely free from the role of a shadow director. It is down to the courts in the future to create binding precedent. In the UK, one aspect of the decision of Lewison J in *Ultraframe UK (Ltd)*,109 which put forward that fiduciary duties could not be imposed on a secured lender without a deliberate assumption of responsibility. However, as Witney points out,110 that instead of building on the law set out by Newey J in *Vivendi*, it is moving further towards the automatic application of a directors general duties to shadow directors. In Ireland, while the 2014 Act111 has extended directors’ duties to include shadow directors, the unwillingness of the judiciary,112 albeit within the context of a dearth of suitable cases in which to consider the matter, to date, to find a secured lender as a shadow director continues to leave a void to be exploited by financial institutions as secured lenders.

(5) Instrumentality Theory

While Ireland and the UK may be lacking an established test or criteria to determine if a secured Lender is a shadow director, in the United States the “instrumentality theory” has been employed to determine the level of control a lender may have over a company. This theory suggests that if a secured lender totally controls another company113 making it its “mere instrument”, then the dominant force becomes liable for those debts of the subservient company that are deemed to be attributable to the abuse of that control. Under this theory, a secured lender, by virtue of the loan agreement they enter into with the debtor company concerned, may exercise a high level of influence or control over the company’s affairs but they may risk being potentially liable for the debtor company’s debts. An early US case to consider the extent

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111 The Companies Act 2014.
113 See Krivo Industrial Supply Co v National Distillers and Chemical Corp 483 F. 2d 1098 (5th Cir. 1973), modified 490 F. 2d 916 (1974); Riquelme Valdes v Leisure Resources Group Inc 810 F. 2d 1345 (5th Cir. 1987).
of control by a secured lender necessary for the imposition of liability on that lender is *Harris Trust & Savings Bank v Keig (In Re Prima Co).*

Here certain banks which had lent large sums to the Prima Company became dissatisfied with the management of company who had operated the company in an unprofitable way. On the suggestion of one of the banks, Prima Company reluctantly employed an outsider to manage the company and contractually granted him complete control over the company. It transpired that his decision making was subject to one criterion, the approval of the lender which was the bank. The court held that the banks controlled and directed the debtor company via the manager and therefore the banks were liable for the losses sustained by the Prima Company during the time in which the recommended manager had operated control over the company. In the end, the decision was overturned on appeal, with the Court of Appeals for the Seventh Circuit finding there was “not sufficient domination of [the debtor’s] will.” Lundgren is of the opinion that:

“It appears central to the decision of the court was the absence of any factual basis demonstrating the bank, as [a secured lender] of the company, had made any specific threats to induce the company to enter into the contract with the new manager.”

The decision in *Harris* was considered by the Court of Appeals for the Second Circuit in *Ford v CE Wilson & Co* where the court approved strong measures taken by a lender to protect the loan it had given. Relying on *Prima*, the held “What was done here was entirely insufficient to render a [lender] co-principal or partner”. The notion that there is pressure on the debtor company from its lender which results in the weakening of control of the board of directors of the debtor company may very well prove to be a key factor in determining such actions, but as

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114 *Harris Trust & Savings Bank v Keig (In Re Prima Co)* 98 F.2d 952 (7th Cir. 1938), cert. denied, 305 U.S. 658 (1939).
115 *Harris Trust & Savings Bank v Keig (In Re Prima Co)* 98 F.2d 961.
116 Ibid 956.
117 Ibid 965.
119 *Ford v CE Wilson & Co* 129 F.2d 614 (2d Cir. 1942).
120 Ibid.
*Harris* highlights without concomitant conduct by the secured lender in the form of being wrongful or excessively overbearing it will be insufficient on this ground to find a secured lender has been exercising control over the running of the company. If control by a secured lender can be established in this form, it must be done so as to highlight their involvement in the day-to-day business of the company. It may be possible to do this by establishing the link between a newly appointed manager and the secured lenders, even where such a manager have apparently been independently appointed.

While establishing control is a necessary step and the seeking of the type of wrongful conduct as discussed above, so far these have proved inadequate in establishing a secured lender’s control over a company. As is obvious, if a secured lender is not deemed to in control they cannot be a shadow director. It is not that such a theory will justify the imposition of directors’ duties on a secured lender, nonetheless, it is a distinct theory which, even though it resembles the test of shadow directorship, provides an example of how the United States deals with lenders controlling their borrowings and is one which the Irish courts should take note of in determining the necessary steps which are required to establish a test in relation to a lender acting in the role of shadow directors.

(6) Insolvency a Just Reason for a Secured Lender’s Influence

Should a situation arise whereby a company has a serious chance of defaulting, a significant way in which a secured lender may become involved in the affairs of the company is by using its bargaining position to negotiate with the directors of the company to ensure that going forward the affairs of the company are managed in a way which the secured lender approves. However, if it becomes involved in the business decision making of the company and in matters normally determined by an executive director or the board,121 the secured lender should run the risk of being liable of being a shadow director. Secured lenders can exercise influence over matters such as the operation of bank accounts and ensure that “prior approval of each payment”122 is required. Turing views such processes which would allow a secured lender

122 David Turing, ‘Lender Liability, Shadow Directors and the Case of Re Hydrodam (Corby) Ltd’ (1994) 9(6) *Journal of International Banking Law* 244, 246.
control or veto payments as “... allowing the [secured lender] to decide how the business should be run”.\textsuperscript{123}

Perhaps the question which should be asked when judging whether a secured lender has become a shadow director of a company is a question of involvement. If the lender has become involved in the affairs of the company then the lender should be classed as a shadow director. One indicator of a secured lender’s involvement may be Fletcher’s “moment of truth” test.\textsuperscript{124} To satisfy such a test, it must be proved that the secured lender “knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation”.\textsuperscript{125} There is some merit in this test and there are two factors which make such a test somewhat feasible, firstly, as Finch suggests, it would be rare for a lender to “continue to put resources into [a company] after the point when liquidation has become inevitable”.\textsuperscript{126} Secondly, a secured lender must be a shadow director of the company concerned at a time when the lender would know or ought to have known that there is little probability that the company would avoid becoming insolvent.\textsuperscript{127}

The point at which a secured lender will exercise sufficient influence over a company to be classed as a shadow director will, except in exceptional circumstances, be after the moment of truth for a company is reached. Once a company is in such a situation a secured lender will be in a position to take the necessary steps of control. In real terms, this is when a secured lender’s shadow directorship will begin.

\textsuperscript{123} Ibid 246.
\textsuperscript{125} Section 722 of the Companies Act 2014. See for UK Section 214(2)(b) of the Insolvency Act 1986.
\textsuperscript{126} Vanessa Finch Corporate Insolvency Law (Cambridge University Press 2002) 303.
\textsuperscript{127} Section 214(2)(c) of the Insolvency Act 1986.
C. Secured Lenders

(1) Lenders

If a secured lender is found to be a shadow director of a company then they will be subject to directors duties\(^{128}\) and, as such, the standard of care expected of directors of a company is outlined in the legislation\(^{129}\) and any person, other than a professional adviser, in whose directions or instructions the directors of a company are accustomed to act, is a shadow director.\(^{130}\) They, as a director of the company, are to act in what is considered to be “… ‘in the interests of the company’ ”.\(^{131}\) A shadow director will be treated as a director of the company.\(^{132}\) They will bear fiduciary duties\(^{133}\) and therefore, they exercise control in a manner which would be invisible to anyone looking into the company’s books or structure from the outside. In a sense, they could be thought of as lurking in the shadows, hence the phrase, although there is no actual requirement that they actually attempt to remain concealed. They have a duty to disclose any interest in a contract they may have with the company whether directly or indirectly, by writing to the directors to inform them.\(^{134}\)

In *Re PFTZM Ltd*,\(^ {135}\) the company, after going into liquidation, obtained refinancing from its major lender to renovate its country club. The new club was opened but it proved to be unprofitable. After discussions, the lender and the company agreed that the major shareholder and managing director would stop drawing a salary until the project became profitable. Further to this, weekly meeting were held regarding profitability and were attended by the director and manager of the lender. They were also in a position to veto any withdrawals or payments from the bank account of the company, without prior approval of the lender. Such approval was also required for the company’s financial strategy and for staff changes. Judge Paul Baker QC dismissed the liquidator’s allegations, and held that the directors of the lender were not shadow directors of PFTZM. Central to his judgment were the points that the director and manager of the lender were acting in the interests of the lender and that the directors of PFTZM had the

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\(^{128}\) Section 221(1) of the *Companies Act 2014*.

\(^{129}\) Section 228(1) of the *Companies Act 2014*.

\(^{130}\) Section 221(1) of the *Companies Act 2014*.

\(^{131}\) Section 228(1)(a) of the *Companies Act 2014*.

\(^{132}\) Part Five of the *Companies Act 2014*.

\(^{133}\) *Yukong Line Ltd v Rendsburg Investments Corporation of Liberia (No 2)* (1978) 311.

\(^{134}\) Section 231 of the *Companies Act 2014*.

\(^{135}\) Section 231 of the *Companies Act 2014*. 
discretion to decide whether to accept or decline the funding available from the lender. After all, a lender is entitled to keep a close eye on what is done with its money, and to impose conditions on its support for the company.136

This does not mean that a lender is running the company or emasculating the powers of the directors, even if the directors have little choice to accede to the lenders requests.137 If it is the case that a lender requires the borrower to provide warranties detailing its present circumstances or covenants as to the conduct of its affairs and decides to impose certain conditions before the funding is provided, and thereafter monitors its compliance, it is simply in line with the terms and conditions to its continued financial support. One thing is clear in deciding if a shadow director has been influencing a board of directors, their directions and instructions must relate to the company138 and must amount to the dictation of the company’s strategy and policy.139 However, whether a secured lender fits within the definition of a shadow director should be a factual and legal question which should be answered by the facts of the case. Despite this, there are various methods which a secured lender can employ over a debtor company to exert control over it, such as, it may demand a reduction of its overdraft,140 request the replacement of senior management,141 or take an active role in the corporate governance of the company.142

While there are certain persons who will not be classed as a shadow director, such as solicitors or accountants, with s. 221(1) including the following sentence “… unless the directors are accustomed so to act by reason only that they do so on advice given by him or her in a professional capacity.”143 Be that as it may, it is doubtful according to Breslin “… that such an [exclusion] would extend to secured lenders.”144 A secured lender which consistently intervenes in the affairs of a company or give continuous advice to a company, perhaps in a near insolvent position, would be possibly acting in its own interests and its actions would not

136 Ultraframe v Fielding [2005] EWHC 1638 [1268]. This was a submission by Counsel accepted ‘in broad terms’ by Lewison J.
137 Ibid.
139 Secretary of State for Trade and Industry v Aviss [2006] EWHC 1846 (Ch); [2007] BCC 288.
141 Ibid 99.
143 Section 221(1) of the Companies Act 2014.
be deemed to have the impartiality of a professional’s actions and therefore the protection set out in Section 221(1)\textsuperscript{145} of the Act may not extend to secured lenders. It is also unlikely to cover commercial advice provided by a secured lender because such advice would not be given in a professional advisory capacity, but in the interests of the lender.

The meaning of the “advice” exclusion was given detailed consideration in \textit{Fyffes v DCC Plc,}\textsuperscript{146} where Laffoy J noted the “apparent oddity” that the legislature deemed it necessary to exclude advice which was given in a professional capacity.\textsuperscript{147} Laffoy J did hold that for a communication of any type to constitute a direction or instruction, it must have an imperative quality.\textsuperscript{148} The potential for a secured lender in the form of a bank to be a shadow director was examined in detail by Clarke J in \textit{Moorview Developments v First Active Plc,}\textsuperscript{149} Clarke J, citing with approval the dictum of Millett J in \textit{Re Hydrodam (Corby) Ltd}\textsuperscript{150} and stated:

“A shadow director, by contrast, [to a de facto director] does not claim to or purport to act as a director… He lurks in the shadows, sheltering behind others who, he claims, are the only directors of the company to the exclusion of himself. He is not held out as a director of the company… What is needed is first, a board of directors claiming and purporting to act as such; and secondly, a pattern of behaviour in which the board did not exercise any discretion or judgment of its own, but acted in accordance with the directions of others.”\textsuperscript{151}

Further to citing the above, Clarke J noted, also with approval, the decision of the English Court of Appeal in \textit{Re Tasbian Ltd (No 2)},\textsuperscript{152} which concerned a “company doctor” who was appointed and paid by the company, who had negotiated a moratorium with lenders, monitored trading and assisted the board of directors, and engaged in negotiations with the Revenue and others, had become a signatory to the company’s bank account and advised on the transfer of

\begin{itemize}
\item \textsuperscript{145} Section 221(1) of the \textit{Companies Act 2014}.
\item \textsuperscript{146} \textit{Fyffes v DCC Plc} [2005] IEHC 477.
\item \textsuperscript{147} Laffoy J did note that advice is not the same as “directions or instructions”.
\item \textsuperscript{148} In contrast, in \textit{Re Hocroft Developments Ltd} [2009] IEHC 580 McKechnie J took a slightly different view and considered that a communication could only come within the ambit of the provision if it could properly be described as a “direction or instruction”.
\item \textsuperscript{149} \textit{Moorview Developments v First Active Plc} [2009] IEHC 214.
\item \textsuperscript{150} \textit{Re Hydrodam (Corby) Ltd} [1994] 2 BCLC 180.
\item \textsuperscript{151} \textit{Ibid} [183] per Millett J.
\item \textsuperscript{152} \textit{Re Tasbian Ltd (No 2)} [1993] BCLC 297.
\end{itemize}
the company’s workforce. The court held that he had overstepped the line and became a shadow director of the company. In contrast to this decision, in Re PFTZM Ltd (In Liquidation), it was held that the attendance of officers of a financial institution at weekly meetings of the company so as to protect the commercial interests of the secured lender, which was a financial institution, in circumstances where the board still retained the power to accept or reject the lender’s terms for further funding did not render the lender a shadow director of the company. Accordingly, in Moorview Developments, the following factors were held to fall short of establishing a secured lender as a shadow director. Factors such as the monitoring of cash flow in circumstances where the company was entirely dependent on the lender for its funding or the imposition of a precondition to further funding that a particular asset be sold. In the case of Re Devona Ltd (In Liquidation) Dunne J addressed the issue of shadow directorship, albeit, not in the context of a secured lender. In Re Devona the liquidator based his case primarily on the assertion that an individual alleged to have been a shadow director of the company has a central role in directing the financial dealings of the company and as such directed the directors in this regard.

The individual concerned was in fact the company’s book-keeper and therefore it is not surprising that he had a role in the company’s financial affairs and, equally, Dunne J held, that, without more evidence, this was insufficient to satisfy the statutory test. In accordance with the decision of McKechnie J in Re Hocroft Developments the question as to whether a person was a shadow director was purely a question of statutory interpretation. By deciding Moorview in a comparable way to PTZM, Clarke J highlighted the reluctance of the Irish courts to hold a secured lender as having acted as a shadow director. Further to this, the decision in Ultraframe (UK) Ltd reached even further and almost declared a lender cannot be a shadow director with Lewison J’s statement that a lender is entitled “to keep a close eye on what is done with his money” clearly distinguishing lenders from all other stakeholders in the company, whether they be employees or shareholders.

154 Re Devona Ltd (In Liquidation) [2012] 2 ILRM 430.
156 Lewison J in Ultraframe (UK) Ltd v Fielding & Others [2005] EWHC 1638 (Ch); [2006] FSR 17 1268.
While there is no doubt that a secured lender could be a shadow director,\(^{157}\) with liability being triggered by the action of the company’s directors for being accustomed to acting in accordance with the instructions of the lender.\(^ {158}\)

(2) Factors Which May Constitute a Secured Lender as a Shadow Director

While this chapter has highlighted the difficulty which exists with a secured lender being identified as a shadow director, it will now outline factors which support the proposition that a secured lender may constitute being a shadow director. If a secured lender appoints the majority of the directors on the board of a company, with the effect that it directs and instructs the company through them, then the secured lender may be found to be a shadow director.\(^ {159}\) It is submitted in this thesis that the same measure should apply in situations where a secured lender appoints the directors of the board of a borrower and those directors act within their powers. This is by extrapolation from the test laid down by Millett J. in \textit{Re Hydrodan}\(^ {160}\) for parent companies, where his Lordship stated that;

"If all they [the directors] have done is to act in their capacity as directors for the ultimate holding company, in passing resolutions at board meetings, then in my judgment the holding company is the shadow director of the subsidiary, and they are not."\(^ {161}\)

However, while Farrar stated;

"[W]here the instructions have come from the appropriate organ of the parent company, this would constitute the parent company but not the individual directors as shadow directors of the subsidiary."\(^ {162}\)

Unlike countries such as Germany and Japan, where relationship management is more frequent,

\(^{157}\) \textit{Re MC Bacon} [1990] BCLC 324. While the case was abandoned halfway through proceedings so definitive judicial pronouncement was not given; although the judge in the case (Millet LJ) stated extra-judicially that the circumstances in which a lender could be a shadow director must be rare.

\(^{158}\) Section 221 of the \textit{Companies Act 2014}.


\(^{161}\) Ibid [164] per Millet J.

in common law jurisdictions and the United States secured lenders, to date, rarely engage in "the business decisions of their borrowers". Where a secured lender appoints the minority of the board it will not be a shadow director unless the minority acts as a hub between the lender and borrower. Even when a single director, acting on instructions from a secured lender, makes decisions for the company which favour the secured lender and are not ‘in the interests of the company’, this may lead to imposition of liability on the secured lender. Otherwise, for a secured lender to be liable for instructions or advice given to its directors, they must be given in bad faith or they must be seen to have been acting in bad faith.

If a secured lender is sued vicariously for breach of the directors’ fiduciary duties, it will not be enough to prove that the appointed directors acted on instructions from the lender. It must also be proven that the directors acted as "… the persona or alter ego of the [secured lender]". Given that a director has a duty to exercise discretion, it will almost invariably be the case that when he acts as a persona of a secured lender, the lender may be in breach of that duty. Moreover, for the purposes of a potential insolvency, should a secured lender appoint a single director to the board of the company concerned, the lender may be classed as an associate of the company and as such, be a connected person to the company and may be more vulnerable to being classed a shadow director. If a situation should arise whereby an employee of a secured lender, who the lender appointed to a company as a director, is found to be a shadow director and the employee an agent of the secured lender, then the lender may be classed as a shadow director.

This applies to company doctors appointed by the secured lender. A secured lender should, for that reason, train its personnel so as to avoid getting actively involved in the management or in

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167 Kuwait Asia Bank EC v National Mutual Life Nominees Ltd [1991] 1 AC 187 PC (New Zealand) [223] per Lowry J.
168 Ibid [195] per Lowry J.
169 Scottish Co-operative Wholesale Society Ltd v Meyer [1959] AC 324 HL.
170 David Pollard, ‘Who is ‘Connected’ or ‘Associated’ Within the Meaning of Insolvency’ (2009) 22(3) Insolvency Intelligence 33, 38.
the corporate governance of the company. A secured lender should be liable as a shadow director if the lender controls a number of matters which are usually in the discretion of the directors of the company. Further to these situations, there are also other potential actions which a secure lender may possibly undertake in order to exercise their influence over the board of a company, other than the appointment of directors to the board. There is the potential to undertake the monitoring of the board of directors to in affect reduce the scope of managerial opportunism which may be open to the board. It is likely that secured lenders do not like to be uninformed, and it would appear that the monitoring of a board of directors is concerned a logical action for secured lenders to undertake while not been seen to influence their decision making. However, while this may rarely amount to control, unless it "shades into actually telling companies how to run their affairs …" if it is done in a manner which undermines or reduces the scope for directors to operate then it should be classed as a level of interference in the management of the company.

Smith and Warner have classed monitoring as an expensive activity which is difficult to carry out and there is opinion that a secured lender would generally therefore prefer to diversify the potential risk they may face by dealing with numerous companies, rather than becoming actively involved in the affairs of the board of directors one of them. It is submitted in this thesis that monitoring will in most cases be carried out when a company is financially troubled for the reasons outlined above. In such a situation a secured lender is more likely to monitor in a more intrusive manner and put the company concerned into an intensive care period or within another appropriately named corporate rescue phase which is designed to “… monitor [the company’s] corporate troubles and to step in and assist when the [secured lender] deems this necessary”. While monitoring may increase in the future, it in itself may not be sufficient to constitute a secured lender as a shadow director though it appears as evidence of the expectation of the bank to influence the firm’s behaviour.

178 Ibid
In this regard, the distinction made by Hirschman between "exit" and "voice" is relevant.\(^{179}\) If a secured lender has threatened to exit a company by warning the borrower of their intention to discontinue the supply of their credit or the termination of their relationship, this in itself may not be sufficient a condition to render the secured lender a shadow director of the company. This is because there are no directions or instructions amounting to control. On the contrary, exit is the time that the potential control ceases. Voice, on the other hand, which is "a deliberate attempt to correct, rather than escape from, an objectionable state of affairs",\(^ {180}\) has the potential to be regarded as control. While this does not mean that voice cannot constitute advice; however, it may range "from advice and exhortation to exclusive control over the firm’s decisions".\(^ {181}\) It should be noted that monitoring can also be exercised through the use of monitoring covenants. These require the borrower company to disclose relevant financial or other information relating to itself for a given financial period.\(^ {182}\)

However, provided the covenants exist for monitoring and reporting purposes, then there is likely to be insufficient control. This is unless they are used in conjunction with other intrusive strategies. Covenants are undertakings by the borrower which give influence to the secured lender in the way that "the business is managed".\(^ {183}\) They depend on a number of factors\(^ {184}\) and can be demanding in the sense that they dictate a course of conduct to the company. Even when they are used so as to exercise leverage over the borrower, through threats of exercising rights under them, then this should lead to the same inference.\(^ {185}\) An example is a covenant requiring the borrower to use specific accounting techniques. A further example is the "negative-pledge" clause which is a promise by a borrower that it will not grant security to a third party.\(^ {186}\) Other covenants may exist which enlist conditions that should be satisfied by the company such as a specific level of dividend, borrowing, working capital or even requiring a specific level of investment in a particular project.


\(^{181}\) Ibid 1101.


\(^{185}\) Ian Ramsay *Company Directors’ Liability for Insolvent Trading* (2000 University of Melbourne) 31.

Such covenants may be established at values which materially restrict management’s discretion to act. If this is the case, then it is suggested that they are akin to directions or instructions within the meaning of shadow directorship and should bring the secured lender concerned within the scope of such a director. In a study conducted by Taylor and Day, it was found that highly restrictive covenants were used only in cases "where a bank recognized a particular need for tight control".187 It is submitted in this thesis that such need will only be found in financially distressed companies where restructuring of the business is required. It is in such cases that secured lenders may control the company concerned through highly restrictive covenants. In cases where the secured lender is a shadow director, the mere existence of restrictive covenants will constitute an outright breach of the duty to exercise discretion.188 This is because restrictive covenants, as the name suggests, may restrict the discretion of the directors to make decision for the company. Working in this dual capacity therefore, as a secured lender and as shadow director, the secured lender, acting in the capacity of director, albeit a shadow director, will be precluded to exercise their discretion since they will have to abide to the covenants which have been given in its capacity as a secured lender.189 Further, a secured lender may also be in breach of the duty to promote the success of the company since,190 by exercising its rights under the covenants, it will be looking to promote its interests as a secured lender. In its capacity as director, it will therefore be in breach, unless the covenants indirectly contribute to the success of the company.

When it comes to the giving of advice,191 a secured lender can only do so if it is in a professional capacity. In differentiating between a professional capacity or not, the courts would need to determine if such advice was given in return for consideration.192 Consideration may indicate professionalism, for no professional in a business context will offer his services for free. Further, professional advice is impartial. A secured lender in a case where it is alleged to be a shadow director will lack the impartiality of a professional’s action.193 The next question

188 Section 228(1)(e) of the Companies Act 2014.
189 Section 228(1)(f) of the Companies Act 2014.
190 Section 228 of the Companies Act 2014.
191 Section 221(1) of the Companies Act 2014.
therefore is whether non-professional advice can constitute directions or instructions. In Deverell,\(^{194}\) it was held that the words "… advice, directions and instructions all share the common feature of guidance"\(^{195}\) and can therefore be used interchangeably. It is conceptually difficult, however, to square the concept of advice with directions. Directions and instructions carry with them an element of compulsion or command.\(^{196}\) In other words, advice can be rejected, while directions cannot. A concession must be made to mere suggestions made by a secured lender, unless they were to imply a threat.

(3) Issues Relating to the Exclusion of Secured Lenders as a Shadow Director

A question which was not addressed by the courts though is why such a differentiation should occur and what level of influence a lender should have over the board of a debtor company before it, if possible, crosses the line and becomes a shadow director. One possible reason for the differentiation between a secured lender and the other stakeholders in the company is perhaps the level of financial commitment which a lender accepts in order for the company to continue and the fact it must provide a level of protection to its interest. Although, many other stakeholders, such as shareholders, may undertake such financial commitments, but they do not have nor reserve the right to influence the direction of the company which a shadow director can.

In the Australian case of Buzzle Operations Pty Ltd,\(^ {197}\) the court considered whether a lender of a debtor company could be a shadow director. Here it was alleged that Apple Computer Australia and its finance director were shadow directors of Buzzle Operations Pty Ltd, as the directors of Buzzle were accustomed to acting in accordance with their instructions. Buzzle was a retailer which sold Apple manufactured products with a large proportion of this stock being held on credit from Apple which held a charge over Buzzle’s assets. In a five-month period after Buzzle became insolvent, the company continued to trade and incurred significant additional debts. Following the appointment of a liquidator, it was claimed Apple and its

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\(^{194}\) Secretary of State for Trade & Industry v Deverell [2001] Ch 340 CA (Civ Div).

\(^{195}\) Ibid [35] per Morritt J.


\(^{197}\) Buzzle Operations Pty Ltd (In Liq) v Apple Computer Australia Pty Ltd (2011) 81 NSWLR 47.
finance director were personally liable for the debt incurred during the insolvent period.\textsuperscript{198} While White J agreed that Apple had the capacity to significantly affect Buzzle’s financial standing he held that this was insufficient to make Apple a shadow director in Buzzle.

Essentially this means that while a shadow director does have the capacity to significantly alter a company’s financial standing within their management of the company, such as, for example, a finance manager who is not an appointed director of the company, this does not extend to a third party which has the capacity to affect a company’s financial standing, if they are deemed to have no involvement in the management of the company as Apple were. White J considered Apple’s instruction to Buzzle in relation to debt repayments as being part of a commercial negotiation at arm’s length. He stated;

“[u]nless something more intrudes, the directors are free and would be expected to exercise their own judgment as to whether it is ‘in the interests of the company’ to comply with the terms upon which the party insists”.\textsuperscript{199}

At present, \textit{Buzzle Operations Pty Ltd} remains the leading Australian authority\textsuperscript{200} and it was considered by the Irish courts in \textit{Re Devona Limited; Pyne v Van Deventer}.\textsuperscript{201} The High Court held that the former secretary of an insolvent company was not a shadow director. Here the applicant, the official liquidator of D & K Partnership, sought a restriction order pursuant to s.150 of the \textit{Companies Act 1990}\textsuperscript{202} against three directors of the company and its former secretary. The liquidator submitted that the company secretary was a shadow director as he played a central role in directing the financial dealings of the company and effectively instructed the directors. In finding against the liquidator, Dunne J referred to the judgment of Hodgson J in \textit{Buzzle Operations Ltd} who stated;

\begin{flushleft}
\textsuperscript{198} During its period of insolvency, Buzzle incurred additional debts of $18 million to Apple and its other creditors and made payments of $12 million to Apple.  \\
\textsuperscript{199} \textit{Buzzle Operations Pty Ltd (In Liq) v Apple Computer Australia Pty Ltd} [2010] NSWSC 243.  \\
\textsuperscript{200} \textit{Emanuel Management Pty Limited v Foster’s Brewing Group Limited} [2003] QSC 205 also concerned a bank as a shadow director. On the facts of the case, it was found that the board of the company in question did not take their instructions from the bank.  \\
\textsuperscript{201} \textit{Re Devona Ltd: Pyne v Vandeventer, Kruis and Schoenmakers} [2012] IEHC 263.  \\
\textsuperscript{202} Now Section 819 of the \textit{Companies Act 2014}.  \\
\end{flushleft}
“What needs to be shown is that the governing majority of the directors must act in accordance with the third party's wishes or instructions if there is to be a finding that the third person is a shadow director. ‘Directors’ does not necessarily mean all of the directors, a governing majority suffices and it is not necessary that the influence extends over the whole field of corporate activities [As nominees]. However, the influence must be in what would be within the field of a director, not just a manager.”\textsuperscript{203}

By approving the decision in \textit{Buzzle Operations Ltd}, Dunne J has given significant comfort to secured lenders who exercise a degree of control over the activities of a debtor company.\textsuperscript{204} Where a secured lender is acting in its own interests it is unlikely it will be deemed a shadow director. This means that the line between unsuitable pressure by such a lender over the directorial decisions of a company and the role of a shadow director remains a fine one, albeit one tipped in favour of the secured lender.

However, to state what the limits of a secured lenders influence over a company is at present is not a relatively easy task with the case law concerned with this issue being limited and the judgments available from the lower courts. Currently, the judiciary has not devised a test for establishing whether a secured lender is a shadow director. What would could the boundaries be? At present, remedies exist for secured lenders to take action.\textsuperscript{205} Where a secured lender goes unpaid by a debtor company that secured lender may, under the debenture, appoint a receiver over the charged property. If the secured lender does not have the security required to enforce such a charge then another option would be to seek the liquidation of the company. If the debtor company has easily identifiable assets, it may be more advantageous for the lender to enforce their claim against those assets. While these highlight options which are available to a secured lender to ensure the recovery of the funding it provides, where then does the situation change from a lender keeping an eye on its investment to the actual running of the company.

\textsuperscript{203} \textit{Buzzle Operations Pty Ltd (In Liq) v Apple Computer Australia Pty Ltd} (2011) 81 NSWLR 47 [237].
\textsuperscript{204} See also comments of Hart J in \textit{Lord Sinai Securities Ltd} [2004] EWHC 1764 (Ch), [2004] BCC 986; and Harman J in \textit{Re Unisoft Group Ltd} (No. 3) [1994] 1 BCLC 609 Ch D 620, both of which were cited with approval by Lewison J in \textit{Ultraframe (UK) Lid v Fielding & Others} [2005] EWHC 1638 (Ch), [2006] FSR 17.
\textsuperscript{205} These can include the detention of chattels and choses in action and freezing/mareva injunctions.
When a secured lender in the form of a bank is in a position where it can appoint the majority of the directors on the board of a company, with the effect that it directs and instructs the company through them, then the bank may be found to be a shadow director.\(^{206}\) It may be possible that the same should apply in cases where a lender appoints its own directors onto the board of a debtor company and those directors act within the powers granted to them. This is applicable to comments made by Millet J in *Re Hydrodan*,\(^{207}\) for parent companies, where his Lordship stated;

“If all they [the directors] have done is to act in their capacity as directors for the ultimate holding company, in passing resolutions at board meetings, then in my judgment the holding company is the shadow director, and they are not”.\(^{208}\)

This is an argument which could be put forward and applied to secured lenders. If the directors of a company, either those already present or appointed, are deemed to be following instructions from the lender then there is a case to be made for the secured lender to be held a shadow director. The imposition of any potential barriers to a secured lender as a shadow director are difficult to determine with actions to date including lender’s attending weekly management meetings,\(^{209}\) exercising a veto over the company account\(^{210}\) and all in a manner which suggests that whether the directors of the company concerned like or not, is irrelevant.\(^{211}\) Determining if a secured lender of a company has become a shadow director is not a simple process. Although there is a reluctance on the part of the judiciary to hold a secured lender of a company has a shadow director, in determining criteria to make such a judgment, the issues of involvement and control should be considered. Imposing shadow directorship status on a secured lender will depend on many factors, but this may develop to be the case when those factors amount to a significant degree of control exercised by the secured lender over the company in question. These factors, as were outlined above, include control over the


\(^{207}\) *Re Hydrodan* [1994] BCC 161.

\(^{208}\) Ibid [164] per Millett J.

\(^{209}\) *Re PFTZM (In Liquidation); Jourdain v Paul* [1995] BCC 280.

\(^{210}\) Ibid.

\(^{211}\) *Ultraframe (UK) Ltd v Fielding & Others* [2005] EWHC 1638 (Ch), (2006) FSR 17.
processing of payments and debts on behalf of the company, the appointment of directors and the overall decision making of the company.

The possibility of shadow directorship should not be overstated. Even though a secured lender may deal with a company for a number of years and as a general rule does not want to be seen as taking part in the decision-making process of a company, the reality of this position may be altered if the company is in financial difficulty and even then it is usually after the company renegotiates its terms of lending that a lender will impose highly restrictive conditions, which can, as this thesis discusses, lead to a secured lender playing a role in the decision making of the company moving forward. Deverell has not been conceived as a threat of increasing the number of cases which may be brought against secured lenders. However, the issue with the judiciary making such a decision remains with Milman commenting "Proving the existence of a shadow directorship in a claim for wrongful trading, for example, will still remain a speculative venture for any liquidator."\(^{212}\) This chapter argues that the same flexible interpretation\(^ {213}\) should be applied to the possibility of a secured lender as a shadow director.

D. Conclusion

This chapter has examined the law in relation to the position of secured lenders as shadow directors and the lack of judicial willingness to make such a finding. It has highlighted that the interpretation of a shadow director as provided in the Act\(^ {214}\) has been interpreted in a more restrictive manner when a case concerns a secured lender and consequently those who undertake such an action do so in the knowledge that their actions will go unpunished. It argues that this is a flawed position and the same flexible interpretation as applied generally to shadow directorship should also be applied in cases concerning secured lenders. Theoretically, there is no reason why such a lender should be distinguished from another potential shadow director. What is lacking is a judicially laid down test by the higher courts which may begin to define the position relating to secured lender. One possible example for the judiciary to examine would be the instrumentality theory as discussed in this chapter and the possibility that if a secured lender becomes directly involved in the running of a company and as a result makes


\(^{213}\) Secretary of State for Trade & Industry v Aviss [2006] EWHC 1846 (Ch); [2007] BCC 288.

\(^{214}\) Section 221 of the Companies Act 2014.
the directors of that company its mere instrument of management, then the lender can become liable for the debts incurred by the company from that point onwards.

While such a theory may not justify the imposition of directors’ duties on a secured lender, it is a distinct theory which the judiciary could consider when outlining a stronger position. However, for the moment the test for shadow directorship concerning secured lenders remains the same and as a result these lenders can rest assured.
Chapter 5 – Conclusion

“Every creditor is entitled to get and to hold the best security the law allows him to take”.

A. Resolution of Central Research Question

The research question of this thesis was to examine the potential for secured lenders to exercise influence over the board of debtor companies and to investigate the potential for directors’ duties to be extended to such lenders. There is good reason for attempting to understand such a situation given the increased level of influence companies have over the economy, company stakeholders and society in general. The law should require more from companies than simply increasing the wealth of their shareholders. The law should also require more from those in the background, those who can pull the strings, secured lenders. By simply following a shareholder value approach to the corporate objective, companies are risking the potential for long-term economic success for short-term gains in favour of its shareholders. As such, they are potentially sowing the seeds for possible secured lender action, should the company endure a difficult financial situation.

It is submitted that it is possible, with a reinterpretation by the Irish courts of what it means to act ‘in the interests of the company’, to provide for directors to take a more entity focused approach to the corporate objective. It is submitted that should a secured lender be involved in the management of a company by directing their nominee director to take certain action, even to the detriment of the company, then directors’ fiduciary duties should be expanded to include the secured lender. It is also submitted that the courts should begin to invoke the test for shadow directorship fully when dealing with a situation in which a secured lender has been involved in the management of a company and make them accountable to directors’ fiduciary duties as set out in the Companies Act 2014.

1 Salomon v A. Salomon & Co Ltd [1897] AC 22 [52] per Lord Macnaghten.
2 Greenhalgh v Arderne Cinemas Ltd [1950] All ER 1120.
(1) Reasons for Advocating the Extension of Fiduciary Duties to Secured Lenders

The first reason for advocating the extension of directors’ duties to secured lenders should they exercise their influence over the board of a debtor company is that it would assist with the argument that an entity focused approach to the corporate objective would reflect the reality that the company is a distinct entity separate from the various constituents and interested parties. A company is, as Farar described, “A legal concept which, through the conferment of separate legal personality, provides legal recognition of bodies of persons as distinctive holders of rights under a collective name, having distinct legal consequences. This is not simply a matter of form and fiction”. The company entity is an organisation that is separate from any of those with an association with it, including the shareholders. Therefore equating the interests of the company with that of the shareholders and applying a shareholder value approach does not represent the legal reality of the company. By treating the company separately, it allows the directors to have the unique ability to consider and promote the many different types of interests a company’s stakeholders will have and it offers the best method for the maximisation for all constituents.

Secondly, the law continues to balance between with the reality of the nominee director any their requirement to take into account the interests of their nominator alongside the fiduciary duties which directors owe to their company, particularly the duty to act ‘in the interests of the company’ and to do so with independent judgment and without conflicts of interest. While the recognition that directors’ fiduciary duties can be amended by a beneficiary, most likely a shareholder, has further assisted the position of nominee director, the courts have not considered the possibility of extending directors’ fiduciary duties to secured lenders as the nominator of a nominee director in situations where the nominee carries out the will of the secured lender, regardless of whether or not their actions are actually ‘in the interests of the company’.

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6 Section 228(1)(a) of the Companies Act 2014.
Thirdly, when considering the issue of a secured lender acting as a shadow director, the cases of PFTZM\(^7\) and Ultraframe\(^8\) made a blunt assertion, namely that secured lenders could not be considered to be shadow directors of companies. The limitation of directors’ fiduciary duties relating to shadow directors in cases which concern secured lenders is an unpractical status which allows secured lenders to be shadow directors of a company and directly become involved in the management of the company without concern for any other interests or fiduciary duties which should apply. By permitting such a situation to continue, the judiciary is facilitating the actions of the secured lender. Secured lenders who act as shadow directors should be able to inherit directors’ duties where it is just and equitable for them to apply. It is not practical that the standard expected of a shadow director who is a secured lender is different from one who is not.

Chapter four demonstrated the potential for a secured lender to act as a shadow director. What is also highlighted was the reluctance of the courts to make such a finding. The chapter argued that this was a flawed position and the same flexible interpretation as is applied generally to shadow directorship should also be applied in cases concerning secured lenders. However, this approach has not been adopted by the courts who have determined that secured lenders are entitled to undertake such action in the course of protecting the investment. Arguments were discussed relating to the issue of shadow directorship not extending to secured lenders, however, such assertions are flawed because it is contrary to the Court of Appeal decision in Deverell\(^9\) and it lacks theoretical justification.

It is also submitted there is a sufficient legal basis for Ireland the courts to make such a reinterpretation based on the doctrine of separate legal personality and cases from the UK prior to the enactment of the UK Companies Act 2006. In taking a more entity focused approach, directors would be in position to take into account, if needed, the interests of secured lenders to the company and do so at a time which could prevent the possibility of a secured lender becoming actively involved in the management of the company. By providing for such a situation the reasoning behind secured lenders undertaking direct involvement in the management of the a company, that a “lender is entitled to keep a close eye on what is done

\(^7\) Re PFTZM Ltd [1995] BCC 280.
with his money, and to impose conditions on his support for the company”, 10 would have the potential to be open to review and this could include the possibility of directors’ fiduciary duties being extended to secured lenders who exercise influence on the management of a company.

In practical terms, secured lenders who exercise influence over the board of directors of a company and become involved in the management of the company would have the potential to be deemed a director of the company and be subject to the fiduciary duties owed to the company.

(2) The Future

How the courts continue to interpret directors’ fiduciary duties as per the Companies Act 2014 when considering if they should apply to a secure lender will have a big impact on the function of the company. This thesis has argued for a reinterpretation of what it means to act ‘in the interests of the company’ and that there is sufficient legal basis for such a reinterpretation based on the doctrine of separate legal personality and from case law. Such an approach can be applied in Ireland if the courts interpreted the duty to act ‘in the interests of the company’ as a duty to act ‘in the interests of the company’ as an entity rather than a duty to promote the shareholders’ interests. 11 This would provide directors with an opportunity to run the company with a view of what is best for it and not what is best for the shareholders. While such a determination would require a judgment in a new case law there is reason to believe the courts may take a different view of the duty in the future as, in more recent years, Ireland has seen an increased focus on directors’ duties serving a public interest function. 12

This thesis has argued that if such a change were undertaken then the path to considering the full extent with which directors’ duties could apply to a secured lender could be examined. If it is the case that a secured lender instructs a nominee director to undertake a particular action or imposes excessive conditions on a board of directors to the point whereby they become a

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10 Ultraframe (UK) Ltd v Northstar Systems Ltd (In Liq) [2005] EWHC 1638 (Ch) [1268] per Lewison J.
11 The cases which equate a duty to act in the interests of company with a duty to act in the interests of the shareholders are more than twenty years old. See & S Doherty Ltd v Doherty (19 June 1969, unreported) HC, 22; Irish Press Plc v Ingersoll Irish Publications Ltd (15 December 1993, unreported) HC, 77; Re Frederick Inns Ltd. [1994] I IRLM 387, 396.
shadow director then the directors’ duties which apply should extend to them. The Companies Act 2014 codified, for the first time, directors’ fiduciary duties and in doing so it introduced the duty to act honestly and responsibly\(^\text{13}\) which suggests that directors’ duties encompass more than simply a duty to maximise the wealth of the shareholders. However, despite the changes advocated for in this thesis, the law in Ireland is still in favour of the secured lender while they extend their influence over a company and it is only by the development of new case law which will ultimately change this.

\(^{13}\) Section 228(1)(b) of the *Companies Act 2014.*
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