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Directors' Duties:
Old Principles, New Perspectives

Deirdre Ahern

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Thesis submitted to University of Dublin
for the Degree of Doctor of Philosophy
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Summary

In managing a company on behalf of the shareholders, directors are possessed of significant freedom. This freedom is constrained by the duties owed by directors to the company, duties which were initially developed by the courts in the nineteenth century by analogy with the duties of trustees. These duties are:

(i) the duty to exercise due care, skill and diligence in the performance of their duties;
(ii) the duty to act *bona fide* in the best interests of the company as a whole and for proper purposes; and
(iii) the duty to avoid secret profits and conflicts of interest.

This thesis assesses the extent to which these duties, and the principles which underpin them, have stood the test of time. As such it is a study of the application, durability and adaptability of the traditional non-statutory duties of directors. Of particular significance to this assessment is the Company Law Review Group's recommendation that directors' duties be placed on a statutory footing within a new unified company law legislative scheme. This resulted in the publication of a *General Scheme of the Company Law Consolidation and Reform Bill* in May 2007, Part A5 of which is designed to move directors' duties to a statutory footing. One of the major concerns with a codification of directors' duties is the potential loss of flexibility.

In terms of methodology, the foundation of this thesis is built upon a detailed evaluation of the relevant duties, based on a wide-ranging review of case law and literature. This informed the provision of a critical narrative tailored to the specific Irish legal and commercial framework which focuses on judicial evolution and adaptation of principles over time to reflect new circumstances and changing perspectives. This groundwork enabled an assessment to be made of the status quo and also provided a platform from which to examine the likely future direction of the duties. Working from this central axis, the proposals to place directors' duties on a legislative footing are set in context. Comparative analysis of other jurisdictions with a similar colonial history, common law and statutory heritage including the United Kingdom,

Australia, New Zealand, Canada, South Africa and Malaysia permitted an informed prognosis to be put forward concerning matters such as the concept of codification and the interpretation and effect of the detailed clauses of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill*. The thesis concludes with a discussion of the importance of questions concerning enforcement, liability and remedies for breaches of directors' duties entering the policy equation in order to reflect the reality that the duties do not exist in a vacuum but arise in a practical context.

Following the outlined methodology enabled a number of key findings to be made concerning the judicial heritage and the future for directors' duties. The survey of judicial application of directors' duties in this thesis has demonstrated the survival into the twenty-first century of the fundamental principles underlying directors' non-statutory duties, albeit with some refinements in their application to reflect new scenarios and changing societal expectations. In relation to the detailed application of the duties, it is concluded that, reflecting their equitable origins, the courts have been ready to intervene in directorial decision-making where fraud or dishonesty is at play but far less inclined to make subjective value judgments about the merits of corporate policy decisions. The courts have also been astute enough to realise the economic dangers inherent in directors becoming risk-averse should too heavy-handed a judicial approach be taken to judging with hindsight. This is manifested in the development of a sense of perspective through application of a business judgment rule.

Looking to the future, this thesis concludes that the manner in which it is proposed to legislatively state the duties in Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* ensures that they will not be fossilised and that the courts will continue to have a central role in relation to the interpretation and evolution of directors' duties. While the general approach taken to statutory drafting is satisfactory, areas of concern have been identified which it is hoped will be addressed in the drafting process. Finally, broadening the focus of concern beyond the content of the duties showed that the likely benefits of clarifying duties are to some extent militated against by the policy failure to date to widen the lens to address the impact of matters of enforcement, liability and remedy.

Acknowledgments

First and foremost, I would like to express my appreciation to my supervisor Dr Eoin O'Dell for his constructive insights and guidance during the writing of this thesis and for his good-humoured support and encouragement.

I would also like to thank my colleagues in the Law School, Trinity College Dublin for their support, particularly Professor Hilary Delany, Ms Patricia Brazil and Mr Des Ryan.

I am also grateful to the Dean of Graduate Studies for acceding to my request for an extension to the word count.

Finally, I would like to acknowledge my deep appreciation to my husband Andreas and to my parents, family and friends, for their understanding and support during the process, with special thanks to my mother.

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CHAPTER 1:

DIRECTORS' DUTIES IN CONTEXT

A. INTRODUCTION

Directors have been emotively described as "... the beating heart of corporate functionality."[1] Managing the company on behalf of the shareholders, the board of directors has a key role to play in corporate policy-making and wealth generation. In the unique interplay between the artificial entity that is the company, its shareholders and the directors, the directors act as "the directing mind and will of the company".[2] The tension between the accepted need for directors to be given freedom to innovate and take risks in order to further company goals and the competing need for controls to guard against this freedom being abused lies at the heart of this thesis.

The director class is a far from homogeneous grouping. Within it some individuals may prove highly effective at discharging their duties while others may prove woefully incompetent and ignorant of what is required of their office. On occasion directors may act without regard to the fact that their stewardship of the company requires them to act in the company's best interests and for proper purposes. Furthermore, as is a hazard of any agency relationship, directors may be tempted to use their position for personal benefit when the opportunity presents itself. Therefore the significant freedom afforded to directors in carrying out their responsibilities is balanced by judicial imposition of controls in the form of duties owed by directors to the company.

On their assumption of office, directors will engage common law and equitable duties owed to the company. These broadly-based non-statutory duties were largely formulated by the courts

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[1] B Clark and A Benstock "UK Company Law Reform and Directors' Exploitation of 'Corporate Opportunities'" (2006) 17 ICCLR 231 at 231.

[2] *HL Bolton Engineering Co Ltd v TJ Graham & Sons Ltd* [1956] 3 All ER 624, 630 CA *per* Denning LJ.

in the nineteenth century by analogy with those of trustees and refined over time. A Redmond succinctly observes,

> "Protection against management self-dealing is afforded by fiduciary duties loyalty which impose obligations of good faith and conflict avoidance upo directors .... Duties of care and diligence are directed towards the problem shirking."[3]

The duties which are at the kernel of this thesis are:

(i) the duty to exercise due care, skill and diligence in the performance of the duties;

(ii) the duty to act *bona fide* in the best interests of the company as a whole and f proper purposes; and

(iii) the duty to avoid secret profits and conflicts of interest.

Directors' duties are sometimes ordered differently in the case law and literature. The variations generally reflect a more specific approach to categorisation rather than a change the content of the underlying duties. For example, Ireland's Company Law Review Group s out the duties of directors under the following more specific headings: duty of loyalty, duty obedience to the company's constitution, duty of avoidance of secret profits, duty independence of judgment, duty to avoid conflicts of interest, duties of care, skill a diligence, duty to consider interests of third parties and duty of fairness.[4] The approach tak in this thesis has been to use the above-mentioned more general categorisation into thr composite duties while recognising the distinct constituent elements of each composite duty.

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[3] P Redmond "The Reform of Directors' Duties" (1992) 15 UNSWLJ 86 at 90. See generally AA Berle and Means *The Modern Corporation and Private Property* (original ed The Macmillan Company New York 1932) ed reprint Harcourt, Brace & World, Inc New York 1968 at 166 ff.

[4] Company Law Review Group *First Report (2000-2001)* (2002) at 11.3.7.

B. SOME CENTRAL CONCERNS AND THEMES

This thesis explores judicial application of the traditional non-statutory duties of directors identified above and asks whether, viewed from a twenty-first century vantage point, the duties and the principles which underlie them can be said to have stood the test of time. As befits the nature of these duties as living and evolving over time rather than being static in nature, a comprehensive resolution of the question posed dictates that this thesis must look not just to the past and to the present but also to the future. An evaluation of the judicial heritage will inform an assessment of both the status quo and the future direction of the duties. To further this assessment, a picture of the practical impact of directors' duties is also obtained through consideration of some issues of liability, enforcement and remedy. These strands are developed further in sub-Parts (1)-(3) below.

This discussion is timely as Ireland is on the cusp of placing the duties of directors on a statutory footing with a view to improving their transparency. The break from a wholly precedent-based approach inherent in the transfer of directors' duties to a legislative scheme will undoubtedly constitute a significant landmark in the evolutionary history of the duties. In 2002 the Company Law Review Group ("CLRG") recommended that the non-statutory duties of directors be encapsulated in a statutory statement within the context of the enactment of a single reforming and consolidating piece of companies legislation.[5] The work of the CLRG led to the publication of a *General Scheme of the Companies Consolidation and Reform Bill*[6] and its presentation to the Minister for Enterprise, Trade and Employment in May 2007. The next stage will be the formal drafting of a Companies Consolidation and Reform Bill by the Office of the Parliamentary Counsel, a process which is expected to be completed by late 2008.[7] To facilitate an informed assessment, a review of the likely impact of this legislative

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[5] *Ibid* at 11.36-11.37.

[6] *General Scheme of Companies Consolidation and Reform Bill* (2007) available on www.clrg.org (Part A5 is reproduced in Appendix II of this thesis). See also the CLRG's accompanying report: Company Law Review Group *Company Law for the 21st Century: Report on General Scheme of Companies Consolidation and Reform Bill* (2007) available on www.clrg.org.

[7] Department of Enterprise, Trade and Employment *Companies Report 2006* (2007) at 9 and Government Legislative Programme (September 2007) published on www.taoiseach.gov.ie.

development is preceded in this thesis by an in-depth analysis of the development of existing legal and equitable non-statutory duties.

What contribution can this doctoral thesis hope to make? The existing global literature on directors' duties is undoubtedly vast but individual contributions often focus on a particular angle rather than providing a broader systematic or big picture contextual approach. Moreover, outside the necessarily general context of discussion in company law textbooks, existing academic discussion of the non-statutory duties of directors in Ireland is limited. This discursive gap is evident in the very succinct approach adopted by the CLRG in its reports on company law reform which focused on presenting the conclusions of the Group rather than opening up the underlying policy choices. It is also notable that there has not been a lively academic or commercial debate in relation to the CLRG's recommendations concerning the codification of directors' duties.

Against this background, the contribution which this thesis makes is predicated on carrying out a detailed analysis of the duties based on a wide-ranging review of the case law and literature and on the provision of a critical narrative tailored to the specific Irish juridical and socio-economic landscape. Furthermore, with the aid of comparative analysis, this work provides an understanding of the implications of the proposed codification of directors' duties in Ireland and a guide to the interpretation of the draft legislative duties. This is a worthwhile contribution as these developments have yet to be subjected to rigorous academic analysis in this jurisdiction.

Chapters 2 to 4 of this thesis are devoted to the equitable and common law duties of directors. Chapter 2 examines the common law and equitable duty on directors to exercise care, skill and diligence in the performance of their functions; Chapter 3, the equitable duty to act in good faith in the interests of the company and for proper purpose; and Chapter 4, the equitable duty to avoid unauthorised conflicts of interest and secret profits. These chapters provide an analysis of the judicial development of the individual duties which ultimately leads to an insight into their current application. Chapter 5 uses this analysis of the status quo as a springboard from which to examine the CLRG's proposals to transfer the duties to a legislative setting as part of an overhaul of company law. With the aid of comparative research on developments in other jurisdictions, this involves making an assessment of the

likely impact of such a step in general terms as well as dissecting the finer drafting details of legislative duties presented in the draft Bill. Chapter 6 unifies the foregoing analysis by highlighting the importance of evaluating directors' duties through a broader lens which encompasses accountability considerations. This reflects the reality that duties do not exist in a vacuum but arise in a practical context. This is seen through an examination of selected aspects of the practical import of directors' duties in relation to enforcement, liability and remedy. While each of these chapters closes with its own set of conclusions, Chapter 7 presents the overall findings of this thesis.

Companies vary enormously in profile from the single member company, the small private company and the quasi-partnership taking the benefits on offer from limited liability, to the large listed public company with a widely dispersed ownership and a heavyweight professional board. The legislative corporate landscape in Ireland is shifting to recognise that the private company is by far the most prevalent corporate vehicle and that it is appropriate to separately house their obligations.[8] This legislative realignment away from the default public company model in evident in the *Companies Act 1963* reflects typically distinct control structures as the separation of ownership and control of public companies is usually inverted in the private limited company, replaced by a convergence of ownership and control.[9] Reflecting the reality that within the Irish corporate landscape the private company model is by far the dominant corporate structure,[10] the primary focus in this thesis is on the private company model.

Some of the main themes explored in the body of this thesis are introduced below.

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[8] This realisation has informed the Company Law Review Group in its approach of "thinking small first" with a view to moving away from the skewed focus in the Principal Act, the *Companies Act 1963*, of treating the public company as the default model: Company Law Review Group n 4 above 3.2.8. See also Company Law Review Group n 6 above at 3.

[9] See further Part E(1) below.

[10] It is estimated that 90% of the companies incorporated in Ireland are private companies limited by shares: Department of Enterprise, Trade and Employment n 7 above at 9. In the future the private company will be replaced by the company limited by shares (CLS). See further Company Law Review Group n 4 above at 3.6-3.7; TB Courtney *The Law of Private Companies* 2nd ed LexisNexis Butterworths Dublin 2002 at [1.001].

(1) Judicial Evolution of Core Principles

Tracing the historical evolution of the duties over time to the present day can provide mu food for thought. Have directors' duties aged well and proved adaptable to mod commercial contexts far removed from the Victorian conception of gentlemen directors decent fellows who should be left well enough alone provided that they are not intent defrauding the company? To address the central concerns of this thesis requires that t application of the broad judicial statements of individual duty be laid bare. In many ca aspects of the duties have proven complex and, unsurprisingly, given the intersection betwe law and the thrust of business, have given rise to both interesting theoretical perspectives a practical issues. Therefore, in order to make an assessment of the durability of directo duties, the groundwork in this thesis involves identifying and carrying out a detailed criti analysis of the main non-statutory duties recognised by the courts. This occurs in Chapters 4 in which there is a thematic presentation of the nuances of directors' duties in terms of th interpretation, their application and their future potential. The evolution and adaptation principles over time to reflect new circumstances and changing perspectives is focused throughout this thesis.

(2) The Impact of the Proposed Codification of Directors' Duties

While many new academic and judicial perspectives have emerged on the specific applicati of well-trodden duties, the newest fledgling perspectives concern the likely impact of t proposed codification of directors' duties derived from the recommendations of the CLRG The publication of the *General Scheme of the Company Law Consolidation and Reform Bill* a highly significant departure whose significance is probed generally and in relation to t individual duties presented. Through critical analysis of the proposed reforms with the aid comparative perspectives, this thesis seeks to provide credible answers to the question of t likely implications of the proposed statutory statement of directors' duties in terms of th development, application and interpretation.

[11] Company Law Review Group n 4 above at Chapter 11.

Almost a century ago Lord Macnaghten expressed the following sentiments:

> "I do not think it desirable for any tribunal to do that which Parliament has abstained from doing – that is, to formulate precise rules for the guidance or embarrassment of business men in the conduct of business affairs. There never has been, and I think there will never be, much difficulty with any particular case on its own facts and circumstances; and speaking for myself, I rather doubt the wisdom of attempting to do more."[12]

The *laissez-faire* nature of Lord Macnaghten's comments quoted above have an additional resonance today in a climate where the publication of the *General Scheme of the Companies Consolidation and Reform Bill* contemplates that the hitherto judicially developed directors' duties will form the subject of a statutory statement. This development will see the Oireachtas stepping in where historically the judiciary feared to tread. What is to come is a transition from a purely judicially crafted set of directors' duties to a new legislative model whereby the core equitable and common law duties will no longer stand apart from existing legislative embellishments on their duties and responsibilities but will be integrated within the architecture of an ambitious single companies legislative code. This gives rise to the question of whether the zeitgeist articulated by Lord Macnaghten has changed and whether a further adjustment of judicial and directorial attitude is likely to be warranted by the advent of parliamentary intervention.

(3) Enforcement of Directors' Duties

The study of directors' duties tends to concentrate its focus on the content and application of the duties. However, no assessment of directors' duties would be complete without some consideration of the impact of the law relating to enforcement, liability and remedies. Breaches of directors' duties involve a vast terrain which would lend itself to a thesis in its own right so their handling here is necessarily restricted in scope. Treatment in Chapter 6 is confined to highlighting key aspects of the enforcement, liability and remedies for directors' duties which feed into the resolution of issues of relevance to the central focus of this thesis

[12] *Dovey v Cory* [1911] 1 Ch 425, 437 *per* Lord Macnaghten.

concerning how well directors' duties have adapted and endured into the modern commerc context.

A rather insistent question which transcends the purely academic to the acutely practical whether the judge-made duties become empty platitudes which have by and large fallen by wayside, crippled by the lack of practical means of enforcement and edged to one side by pervasive application of the statutory restriction and disqualification regime.[13] If so, wha the likely prognosis for their proposed statutory progeny? These issues will be conside against the background of the current reform proposals.

Having now set out the research questions for evaluation in this thesis and the methodology be employed, the remainder of this chapter serves as a contextual backdrop for the detai consideration of the duties of directors which forms the axis of this thesis. The objective is set the scene for the debate through examining the director class and providing an insight i the context in which the relevant duties were developed. Part C of this chapter examines h the role of the company director has evolved over time, a theme which is taken up in Chap 3 on the duty to exercise care, skill and diligence. Also in this Part, the diverse range individuals behind the director moniker is examined and policy issues in relation to appointment of directors are also considered. Part D provides an insight into the histori judicial development of directors' non-statutory duties and outlines the other hard and soft l constraints on directors' conduct. Part E concludes this introductory chapter with a discuss of theoretical considerations which may be used to justify the existence of regulatory contr in the form of generally applicable directors' duties in place of leaving such control to mar forces and contractual negotiation.

[13] Section 150 and section 160 of the *Companies Act 1990*.

C. THE ROLE OF COMPANY DIRECTOR

(1) The Development of Directors as Corporate Managers

Compared to the corporation, the company director has a relatively short pedigree. The genesis of the concept of a corporation can be traced back as far as the Code of Hammurabi in 2000 BC.[14] However, its modern birth was in the nineteenth century where the need for establishment by royal charter or statute gave way to ready incorporation of registered companies.[15] A major landmark was the enactment of the *Joint Stock Companies Act 1844* which moved on from the earlier focus on incorporation by royal charter to provide for incorporation by registration of a deed of settlement. The joint stock company was defined in section 2 as "Every Partnership whereof the Capital is divided or agreed to be divided into shares ...."[16] The *Limited Liability Act 1855* introduced the concept of limited liability. Later refinements simplified the registration process[17] culminating in the consolidating *Companies Act 1862*. At this juncture many of the familiar features of modern corporate governance gained a foothold including the development of an accepted understanding of the interplay between the directors and the shareholders in general meeting. By the end of the nineteenth century, the courts had developed the doctrine of separate legal personality.[18] The private company was formally introduced by section 37 of the *Companies Act 1907*.[19]

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[14] See R VerSteeg "Early Mesopotamian Commercial Law" (1998-1999) 30 U Tol L Rev 183 at 204.

[15] For a good account of the historical development see LW Hein "The British Business Company: Its Origins and Its Control" (1963) 15 UTLJ 134. See also Company Law Review Group n 4 above at 3.5.2; R Keane *Company Law* 4th ed Tottel Publishing Haywards Heath 2007 at Chapter 2.

[16] The original joint stock company had marked similarities to a partnership rather than being the separate legal entity of companies today: LCB Gower "Some Contrasts Between British and American Corporation Law" (1955-1956) 69 Harv L Rev 1369 at 1371-1372; BS Butcher *Directors' Duties: A New Millennium, A New Approach* Kluwer Law International London 2000 at 12-13.

[17] The *Joint Stock Companies Act 1856* abolished the deed of settlement and introduced the memorandum and articles of association as the constitutional documents of the company.

[18] *Salomon v Salomon & Co Ltd* [1897] AC 22.

[19] Prior to this the term was commonly used to denote a company which did not issue shares to the public: see further *Corporate Affairs Commission v Drysdale* [1978-79] 141 CLR 236, 248-249 *per* Aickin J.

The *Companies (Consolidation) Act 1908* was replaced in this jurisdiction by what is kn as 'the Principal Act', the *Companies Act 1963*.[20] In the tradition of its predecessors, the 1 Act continued to treat the public company as the predominant model.[21] However, as adve to earlier in the chapter, it is now recognised that there is a need to separate out the relating to public companies and private companies as very different forms of busi organisation although the core duties applicable to directors remain the same.[22]

The registered company was designed to provide a mechanism whereby people could in their money in a business without having responsibility for its management.[23] The need human agency for the company to act was quickly assimilated by the courts who establis that this human intervention was to be the preserve of the directors rather than shareholders. Directors were given the role of managing the company on their behalf. Thu *Ferguson v Wilson* Cairns LJ was able to assert that a company could not act for itself, through its directors.[24] This led to a legal conception of the board of directors as "the situ essentially all of the corporate power and the responsibility for corporate actions."[25]

The power divide between directors and shareholders is central to any consideration director accountability. Implicit in company law is the understanding that on registration power to exercise all company functions rests in the hands of the members.[26] Howeve practice the general day to day management powers are delegated to the directors.[27] effect of including model regulation 80 in the articles of association is that the members or delegate the powers of management of the company to the directors save insofar as pow

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[20] This was based in part on the deliberations of the Cox Committee: *Report of the Company Law Re Committee* (1958).

[21] R Keane n 15 above at [4.03].

[22] See n 10 above.

[23] S Mayson, D French and C Ryan *Mayson French & Ryan on Company Law* 23rd ed Oxford University P 2006 at 497.

[24] "A company cannot act in its own person, for it has no person" *Ferguson v Wilson* (1866) LR 2 Ch App 77 90 *per* Cairns LJ. See also *Ernest v Nicholls* (1857) 6 HL Cas 401, 423 *per* Lord Wensleydale.

[25] CS Axworthy "Corporate Directors – Who Needs Them?" (1988) 51 MLR 273 at 278.

[26] Section 18(2) of the *Companies Act 1963*.

[27] Model regulation 80 of Table A, Schedule I of the *Companies Act* 1963.

are expressly reserved to the shareholders and subject to the *Companies Acts*.[28] Consequently, directors are invariably at the kernel of corporate governance.

A downstream consequence of the non-prescriptive, contractual approach in the company law of Ireland and the UK to functional delegation to directors is that there has been no legislative attempt to define the powers and functions which must be vested in the directors.[29] As Easterbrook and Fischel point out, "... the corporate contract makes managers the agents of the equity investors but does not specify the agents' duties."[30] While the management role undertaken by directors is that ceded from the shareholders, the agency relationship is unique in that, reflecting the concept of separate legal personality, the directors are regarded as agents of the company. The freedom of action thereby afforded to directors is tempered by constitutional, legislative and contractual restraints as well as the judicial imposition of duties on directors considered in this thesis.

(2) Accession to the Director Class

When it comes to regulation, a very light regulatory touch is in evidence in relation to the *ex ante* controls regulating accession to the office of director. This contrasts acutely with the very significant degree of *ex post* regulation applicable to the director class. Irish company law treats the method of appointment of directors as primarily a matter for the shareholders in general meeting for which contractual provision is made in a company's memorandum and articles of association. Although there is a predominantly *laissez-faire* approach to matters relating to appointment, some threshold public policy criteria are laid down in the *Companies Acts 1963 to 2006.*

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[28] Residual powers reside with the shareholders which may be activated in certain circumstances: see further TB Courtney n 10 above at [8.08]-[8.018].

[29] On this theme see ML Mace "Directors: Myth and Reality" in T Clarke (ed) *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance* Routledge London 2004.

[30] FH Easterbrook and DR Fischel *The Economic Structure of Corporate Law* Harvard University Press 1991 at 91.

Every company registered in Ireland is currently required to have a minimum of 2 directors. Until relatively recently, there was little done to redress the position that minors were bei appointed as directors.[32] There are some negative restrictions on public policy grounds respect of certain individuals who have shown themselves to be unsuitable for the office. Nevertheless, although some changes of policy have occurred in recent years with a view preventing the abuse of the privilege of limited liability, when one considers the onero duties and liabilities which go hand in hand with being a director, it is surprising how fe formal requirements there are for an individual to satisfy. No positive qualifications oth than age have been deemed necessary. The lack of any substantive qualification requiremer reflects the traditional *laissez-faire* approach to regulation of directors. This matter is return to in Chapter 2 on the duty to exercise care, skill and diligence.

(3) The Status of Director

The result of the emphasis placed in statutory company law and memoranda and articles association focusing on procedural issues concerning the appointment and removal directors has been a failure to define the status of director.[34] Initially, modern compa legislation did not define the term "director."[35] The first definition was set out in broad ter in section 30 of the *Companies Act 1900*[36] and has endured into the present definition. This

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[31] Section 174 of the *Companies Act 1963*. The Company Law Review Group has, however, recommen permitting single director companies for the proposed successor of the private company: the company limited shares (CLS): Company Law Review Group n 4 above at 11.8.1; Head 2 of Part A4 of the *General Scheme of Companies Consolidation and Reform Bill* (2007).

[32] In relation to the recommendation that there should be a statutory requirement that persons under the age eighteen should not be permitted to act as a director see Company Law Review Group n 4 above at 11.9; Hea of Part A4 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[33] Thus there is a policy that a person who is an undischarged bankrupt cannot become a director (section 183 the *Companies Act 1963*) and the restriction and disqualification regimes under sections 150 and 160 of *Companies Act 1990* (see further Chapters 2 and 6 below) also serve to restrict access to the office of director.

[34] RR Pennington *Directors' Personal Liability* Professional Books London 1987 at 3.

[35] See *Joint Stock Companies Act 1856*, the *Joint Companies Act 1857* and the *Companies Act 1862*.

[36] See further *Corporate Affairs Commission v Drysdale* [1978-79] 141 CLR 236.

seen in section 2(1) of the *Companies Act 1963* which provides that a director includes "any person occupying the position of director by whatever name called."[37]

As will be seen Chapter 2, the courts are beginning to be conscious that they need to find a coherent manner to accommodate the differing responsibilities expected of different directors when assessing possible breaches of duty. In business, legally appointed directors break down into two broad categories, executive directors and non-executive directors. Although well-ingrained in practice, the separation of the board of directors into executive and non-executive directors is not expressly recognised in the *Companies Acts*.[38] While not a legal term, the term 'executive director' is generally understood to refer to a director who is involved on a full-time basis in the management of the company's affairs.[39] Non-executive directors are often appointed because of their experience and skill-set and the independent judgment which they can bring to the table.[40] Rather than devoting themselves full-time to the management of the company, their role is often limited to attendance at board meetings and general participation in major policy decisions.[41] The *Combined Code on Corporate Governance* envisages a role for non-executive directors in bringing independence to the board and ensuring that no one individual or group dominates the board.[42]

Apart from formally appointed *de jure* directors, other persons may also fall within the definition of a director. Reflecting trends in the UK, the courts and the Oireachtas have recognised some sub-categories of director based on an understanding that certain conduct will mean that a person should be treated in law as occupying the office of director. This has led to

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[37] This definition is followed through in Head 1 of Part A4 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[38] See generally J de Lacy "The Concept of a Company Director: Time for a New Expanded and Unified Statutory Concept" [2006] JBL 267. On the continuation of this policy see Company Law Review Group n 4 above at 11.5.

[39] See further R Keane note 15 above at [27.03].

[40] M Arden "Reforming the Companies Acts – The Way Ahead" [2002] JBL 579 at 579.

[41] R Reed "Company Directors – Collective or Functional Responsibility" (2006) 27 Co Law 170 at 176.

[42] Financial Reporting Council (UK) *The Combined Code on Corporate Governance* (2006) principle A3 "Board balance and independence"; Schedule B "Guidance on liability of non-executive directors: skill, care and diligence".

the recognition of shadow directors[43] and *de facto* directors.[44] There have been mixed vie on whether shadow directors are subject to the equitable and common law duties of directo In the context of English company law, Professor Pennington has contended that a shad director is only subject to specific statutory rules and is not subject to the non-statutory du of directors.[45] The position was left open by the UK *Companies Act 2006* and there has b no judicial guidance on the point in this jurisdiction. However, it is notable that in the d legislative scheme in circulation, Part A5 "Duties of Directors" is expressed to apply, w certain modifications, to shadow directors[46] and *de facto* directors.[47]

Some important consequences can be identified as flowing from the continuation of largely non-prescriptive legislative approach to the definition of a director and to responsibilities of the office. First, in the absence of statutory controls, in the ninetee century the courts developed rules governing directors' conduct by analogy with th governing other categories of person who act in a representative capacity such as agents trustees.[48] Secondly, the broad definition of the office of director, coupled with lack qualitative barriers to entry has meant that directors are a non-homogeneous grouping whom homogeneous principles have been applied by both the legislature and the courts.[49] will be seen, this has had a lasting effect on the texture of the duties. Thirdly, in the abse of positive statutory guidance in relation to the nature of the office of director, the trend statutory company law has been to define the concept of a director somewhat by ellipsis, setting out a raft of statutory obligations and restrictions on directors which complement t duties in equity and at common law.[50] As Masse observes:

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[43] See section 27 of the *Companies Act 1990* which recognised and defined the shadow director; *Secretar State for Trade and Industry v Deverell* [2000] BCLC 1057; *Re Worldport (Ireland) Ltd (in liq)* [2005] IEHC *Fyffes plc v DCC plc* [2005] IEHC 477.

[44] *Re CB Readymix (in liq), Cahill v Grimes* [2002] 1 IR 372, 381 *per* Murphy J, *nem diss*; *Re Lynro Enterprises Ltd* [2002] IEHC 90; *Re First Class Toy Traders Ltd, Gray v McLoughlin* [2004] IEHC *Shepherds Investments Ltd v Walters* [2007] 2 BCLC 202.

[45] RR Pennington n 34 above at 29.

[46] Head 3 of Part A4 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[47] *Ibid* at Head 4. This includes a statutory definition of the *de facto* director for the first time.

[48] RR Pennington n 34 above at 3.

[49] See further S Griffin "Problems in the Identification of a Company Director" (2003) 54 NILQ 43.

[50] A good example of this is the *Companies Act 1990*.

"The law relating to the duties and corresponding liability of directors springs from multiple sources with roots deep in our common law traditions and is a blend of legal, equitable and statutory rules that are intertwined with one informing the development of the others over time."[51]

D. THE EVOLUTION OF DIRECTORS' DUTIES

(1) Judicial Fashioning of Duties Applicable to Directors

The judicial development of distinct duties owed by directors to their company owes a large evolutionary debt to the body of duties and principles developed by the Court of Chancery to apply to trustees holding property on behalf of beneficiaries.[52] Professor Pennington describes these duties as designed "to ensure that persons who hold assets or exercise functions in a representative capacity for the benefit of other people act in good faith and conscientiously protect the interests of those they represent."[53] This meant imposing a duty on trustees to comply with the express terms of the trust. If they failed to do so, they were obliged to make good the assets wrongly applied. If a breach of trust resulted in profit they were obliged to account for such profit to the beneficiary.[54] Furthermore, equity required trustees to account for any personal benefits obtained through their position as trustee.[55] From the late eighteenth and early nineteenth century on, equity required trustees to exercise the standard of care in the performance of their functions that they could be expected to show in dealing with their own private affairs and if they failed to do so the Chancery Court required them to compensate the trust funds for any loss caused by their failure in this regard.[56]

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[51] DG Masse "Directors' liability and the 2001 reform of the Canada Business Corporations Act: A uniquely Canadian journey" paper delivered at the Annual Conference of the Canadian Society of Corporate Secretaries on 20 September 2001 at [14].

[52] For a detailed discussion of the duties of trustees see H Delany *Equity and the Law of Trusts in Ireland* 3rd ed Thomson Round Hall Dublin 2007 Chapter 12.

[53] RR Pennington n 34 above at 32.

[54] *Keech v Sandford* (1726) [1558-1774] All ER Rep 23.

[55] *Armstrong v Armstrong* (1880) 7 LR Ir 207.

[56] *Speight v Gaunt* (1883) 22 Ch D 727; *Re Whiteley* (1886) 33 Ch D 347; RR Pennington n 34 above at 34.

In the early nineteenth century the fiduciary duties which the Chancery Court imposed trustees were extended to agents[57] and company promoters.[58] The trustee's position al served as the inspiration for judicial developments concerning directors.[59] In *Re Lan Allotment Co* Lindley LJ stated "[a]lthough directors are not properly speaking trustees, they have always been considered and treated as trustees of money which comes into th hands or which is under their control."[60] Thus the underlying assumption beneath many of t directors' duties is that a director will act honestly.[61]

The traditional conception of the stewardship role for directors has been described as akin the "eighteenth or nineteenth-century steward or land-agent managing an estate for temporarily absent landlord who might be expected to return to retake control."[62] The uniq position of directors has often led those seeking to understand them to draw analogies, some which give a misleading view of the nature of the role in law. Directors have on occasi been variously likened to "paid servant[s] of the company",[63] "managing partners"[64] a "managing agents".[65] While such analogies provide a useful insight, they are limited. T was recognised by Lord Russell in *Regal (Hastings) Ltd v Gulliver* where he stated:

> "Directors of a limited company are the creature of statute and occupy a position pecul to themselves. In some respects they resemble trustees, in others they do not. In so

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[57] See generally FMB Reynolds (ed) *Bowstead and Reynolds on Agency* 18th ed Sweet & Maxwell London 2 at 6-032 ff.

[58] *Erlanger v New Sombrero Phosphate Co* (1878) 3 App Ca 1218, 1236 *per* Lord Cairns. See further R Kea 15 above at Chapter 7.

[59] For an American perspective on this development see M Szto "Limited Liability Morality: Fiduciary Duti Historical Context" (2004) 23 QLR 61.

[60] [1894] 1 Ch 616, 631.

[61] See *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392; *Dovey v Corey* [1901] AC 477; *Prefontai Grenier* [1907] AC 101; *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407, 427 *per* Romer J.

[62] S Mayson, D French and C Ryan n 23 above at 501.

[63] *Smith v Anderson* (1880) 15 Ch D 247, 276 *per* James LJ.

[64] *Re Forest of Dean Coal Mining Co* (1878) 10 Ch D 450, 452 *per* Jessel MR; *London Financial Associati Kelk* (1884) 26 Ch D 107, 143 *per* Bacon VC; *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cunningh* [1906] 2 Ch 34, 45 CA *per* Cozens-Hardy LJ.

[65] *Re Lands Allotment Co* [1894] 1 Ch 616, 637 CA *per* Kay LJ.

respects they resemble agents, in others they do not. In some respects they resemble managing partners, in others they do not."[66]

The Chancery Court made it clear that while an analogy with trustees could be drawn in applying duties to additional categories of persons acting in a representative capacity, this did not mean that in law they were trustees. This point was well made by Bowen LJ in *Imperial Hydropathic Hotel Co., Blackpool v Hampson* where he stated:

> "... when persons who are directors of a company are from time to time spoken of by judges as agents, trustees, or managing partners of the company, it is essential to recollect that such expressions are used not as exhaustive of the powers or responsibilities of those persons, but only as indicating useful points of view from which they may for the moment and for the particular purpose be considered – points of view at which they seem for the moment to be either cutting the circle or falling within the category of the suggested kind. It is not meant that they belong to the category, but that it is useful for the purpose of the moment to observe that they fall *pro tanto* within the principles which govern that particular class."[67]

The significance of the trustee analogy being purely a metaphor was that it allowed the courts the freedom to adapt and, where necessary, to modify the application of the fiduciary duties applicable to trustees proper to the context of directors. It is important that this analogy is not overstated as it is an imperfect one. The role of the directors acting on the basis of delegated duty from the company in general meeting in managing the company and its assets is distinct from that of trustees, not least because while a trustee's duty is to the beneficiaries, in general, a director's duty is not owed to the shareholders but to the separate legal entity which is the company.[68] Furthermore, the risk-taking and innovation role given to directors to foster entrepreneurship differs from the duty of trustees to act conservatively to safeguard the trust property.[69] In particular, cognisance must be taken of the unique role of the directors in

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[66] [1942] 1 All ER 378, 387.

[67] (1882) 23 Ch D 1, 12. See also *Re Forest of Dean Coal Mining Co* (1878) 10 Ch D 450, 451-2 *per* Jessel MR; *Re City Equitable Fire Insurance Co Ltd* [[1925] Ch 407, 426 *per* Romer J.

[68] *Percival v Wright* [1902] 2 Ch 421; *Dawson International plc v Coats Paton plc* [1989] BCLC 233.

[69] R Keane n 15 above at [27.02]-[27.03].

corporate wealth generation. Redmond captures this inherent balancing exercise in th following passage:

> "A particular difficulty in formulating the terms of legal duties is to strike a appropriate balance between the disciplinary function of the rules and the reality th (unlike, for example, trustees) the directors' mandate requires them to make busine judgments involving commercial risk taking, sometimes in circumstances of limite information and constrained opportunity for deliberation. The prescription standards, accordingly, needs to protect directors' business judgments from hindsig review by risk averse tribunals. Striking a balance between manageme accountability and initiative lies at the core of the corporate law enterprise."[70]

Writing extra-judicially, the Chief Justice of the Supreme Court of Western Australia, Dav Malcolm identified three general principles which guide the courts in their approach corporate law: a "non-interference principle" (business decisions a matter for directors a shareholders not courts), a "commercial reality principle" (the need for the courts decisions reflect commercial realities) and a "non-prescriptive principle" whereby flexibility must maintained to allow for adaptability to a range of circumstances.[71] These considerations ha also influenced policy-making concerning corporate law reforms. The manner in which t courts have struck a balance will be examined in Chapters 2 to 4.

When the limitations of the trust analogy are borne in mind it elucidates the type of princip which are consequent upon taking up a directorial role. However, it would appear that in mo recent times the courts have been less likely to draw express analogies with the duties trustees precisely because there now exists a well-developed body of case law direc addressing the duties of directors in their own right.[72] However, a direct consequence of t trustee analogy and the origins of directors' duties in principles applicable to trustees has be a proliferation of crude judicial classification of directors as 'fiduciaries" and their duties

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[70] P Redmond n 3 above at 94.

[71] Chief Justice Malcolm "Directors' Duties: The Governing Principles" in IM Ramsay (ed) *Corpor Governance and the Duties of Company Directors* Centre for Corporate Law and Securities Regulat University of Melbourne 1997.

[72] R Pennington n 34 above at 36.

'fiduciary duties.'[73] Both such labels are open to objection as lacking precision and not appropriate in all circumstances. A common over-simplification is to recite that directors are fiduciaries and to move on to describe all duties applicable to them as fiduciary duties.[74] The judiciary has had the unfortunate habit of peppering judgments concerning directors with references to "fiduciary duties" where this is unwarranted.[75]

Disposing of the fiduciary misnomer by stripping away the layers of confusion in the case law and the literature is important, as the distinction between equitable and fiduciary duties is not simply a question of semantics. Intellectual slovenliness in this case can have consequences which go beyond semantics as the distinction resonates both in terms of available remedies and public perception.[76] An appreciation of the distinction between fiduciary and non-fiduciary aspects was apparent in the following statement of Finlay Geoghegan J in *Kavanagh v Delaney*:

> "At common law, directors owe duties to the company which are normally divided into duties of loyalty based on fiduciary principles developed initially by the courts of equity and duties of skill and care developed initially by the common law courts from the principles of the law of negligence."[77]

We can conclude that while terms such as "fiduciary" and "trustee" are important to understanding the evolution of directors' duties, they should be used with caution so as not to distort the legal understanding of what is expected of directors. This matter is returned to in relation to each individual duty in Chapters 2, 3 and 4.

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[73] See BS Butcher n 16 above at 32; S Worthington "Corporate Governance: Remedying and Ratifying Directors' Breaches" (2001) 116 LQR 638 at 640.

[74] *Ibid.*

[75] See *eg South Australia v Clark* [1996] ACSR 606, [171] *per* Perry J. In the Canadian case of *Girardet v Crease & Co* (1987) 11 BCLR (2d) 361, 362 (SC), Southin J condemned the fact that "[t]he word 'fiduciary' is flung around now as if it applied to all breaches of duty by solicitors, directors of company and so forth."

[76] An allegation of breach of fiduciary duty carries with it "the stench of dishonesty – if not of deceit, then of constructive fraud." *Girardet v Crease & Co* (1987) 11 BCLR (2d) 361, 362 (SC) *per* Southin J. See also *LAC Minerals v International Corona Resources* (1989) 61 DLR (4th) 14, 28 *per* La Forest J; *Nocton v Lord Ashburton* [1914] AC 392.

[77] [2005] 1 ILRM 34, 41. See also *Re SPH Ltd; Fennell v Shanahan* [2005] IEHC 152.

(2) Other Constraints on Directors

Apart from the equitable and common law duties developed by the courts, there are a numbe of other sources of restrictions on directors' exercise of their powers. As Davies points ou "directors' duties are part of a broader system (or, at least, patchwork) of rules of one type another which together seek to provide an optimum framework of accountability an control."[78] These additional restrictions fall outside the focus of this thesis but are highlighte from time to time to show the juridical landscape within which the equitable and common la duties fit. In particular, it is aimed to give a flavour of the nature of such intervention a regards how other forces can be said to interact with and complement the underlying no statutory duties.

(a) The Memorandum and Articles of Association

As agents of the company, directors must not exceed the powers delegated to them. Th must not procure the company to act outside its capacity as governed by its memorandum association.[79] They are obliged to comply with any restrictions and procedural obligatio specified in the articles of association.[80] The same principles apply where a director has be delegated specific powers by the board of directors or by the company in general meeti There is some consideration of this aspect in Chapter 3 concerning the duty on directors to for proper purpose.

(b) The Companies Acts

Directors must not enter into transactions or act in a manner which is prohibited by *Companies Acts 1963 to 2006.* In the last couple of decades there has been a marked incre

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[78] PL Davies *Gower and Davies' Principles of Modern Company Law* 7th ed Thomson Sweet & Maxwell Lon 2003 at 442.

[79] If the directors cause the company to act in an *ultra vires* manner, this gives rise to a liability to compensat company for any loss suffered: *Evans v Coventry* (1857) 8 de G M & G 835; *Land Credit Co. of Ireland v Fermoy* (1869) KR 8; Eq 7.

[80] Model regulation 80 of Table A, Schedule I of the *Companies Act* 1963.

in legislative intervention in relation to the responsibilities of directors[81] and the methods of enforcing such responsibilities. In many instances it is directors' non-statutory duties which inspired the more specific statutory duties tailored to particular fact scenarios.[82] Indeed, one of the themes which emerges in this thesis is that the effect of statutory intervention has been to render the pre-existing duties an under-utilised resource. This perhaps reflects a preference for the precision of statutory duties over the vague malleability of the non-statutory duties, but it also reflects the considerable hurdles which lie in the path of enforcing the non-statutory duties.[83] A further theme in this thesis is the cross-fertilisation effect of such statutory grafting on the judicial mindset in applying the traditional duties. The restriction and disqualification regime can be credited with helping to quell the revolving door or Phoenix syndrome whereby directors take the privilege of limited liability, run up debts and incorporate a new company to start afresh. It is in this context that much of the modern judicial consideration of directorial conduct has arisen.

(c) Service Contracts and Shareholders' Agreements

Outside a situation where the company structure comprises shareholder-directors, it is common for managing directors and other executive directors to be required to enter into service contracts with the company.[84] This is not a requirement under company law – if there is no service contract, a director's terms of office are governed by the company's articles of association as may be amended from time to time.[85] Rights and obligations under service contracts are enforceable as contractual rights by the company and the director. The same applies to shareholders' agreements which may impinge on a shareholder-director's rights and obligations.

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[81] See generally Company Law Review Group n 4 above at 11.1.

[82] See further I Lynch Fannon "Enforcement and Compliance in Irish Company Law: All Law and No Enforcement or the Dawn of a New Era?" (2002) Insolv L 14.

[83] See further Chapter 6 below.

[84] Service contracts are less common in the case of non-executive directors.

[85] *Shuttleworth v Cox Brothers & Co (Maidenhead) Ltd* [1927] 2 KB 9.

(d) The General Law

Directors must comply with the requirements of the general law in relation to the stewardship of the company *eg* health and safety requirements. This has meant that liabili has increasingly been laid at the door of directors.[86]

(e) Corporate Governance Codes

Over the last decade a number of corporate governance initiatives have been taken with a vie to improving standards in listed companies.[87] 'Corporate governance' has become a bywo for improved corporate and directorial standards, standards demanded by society and therefo the business community to retain and enhance reputation, respect and ultimately profit.[88] T *Combined Code on Corporate Governance*[89] sets out standards of good practice in relation matters such as board composition, remuneration, accountability and audit and relations wi shareholders. All UK incorporated listed companies on the Main Market of the London Sto Exchange are required under the Listing Rules to report on how they have applied t Combined Code in their annual report and accounts. In 1999, the provisions of the Combin Code were adopted by the Irish Stock Exchange by means of annexing the Code to its Listi Requirements. Consequently Irish listed companies are required to use their annual reports 'comply or explain'. Although these codes of best practice were drafted specifically for list companies, many of the principles contained therein can equally be applied to non-list

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[86] See *eg* the *Safety, Health and Welfare at Work Act 1989.* See further Law Reform Commission *Report Corporate Killing* (LRC 77-2005).

[87] *Report of the Committee on the Financial Aspects of Corporate Governance* ("the Cadbury report") Lond (1992); *Final Report of the Committee on Corporate Governance* ("the Hampel report") London (199 Financial Reporting Council (UK) *Combined Code: Principles of Good Governance and Code of Best Prac* (1999); Financial Reporting Council (UK) *The Combined Code on Corporate Governance* (2003); Financ Reporting Council (UK) 'revised Turnbull Guidance': *Internal Control: Revised Guidance for Directors on Combined Code* (2005); Financial Reporting Council (UK) *The Combined Code on Corporate Governa* (2006); Financial Reporting Council (UK) *Review of the Impact of the Combined Code* (2007).

[88] On the growing importance of corporate governance frameworks see BR Cheffins "History and the Gl Convergence Revolution: The UK Perspective" in T Clarke (ed) *Corporate Governance: Critical Perspectives Business and Management* Vol I Routledge London 2005.

[89] Financial Reporting Council (UK) *The Combined Code on Corporate Governance* (2006).

companies as best practice standards. Some companies have therefore opted to adopt principles from the code *eg* those pertaining to non-executive directors, audit committees, internal control and internal audit.

E. THE NEED FOR REGULATORY CONTROLS ON DIRECTORS

Having outlined the historical development of the duties on directors by analogy with those imposed on trustees, this Part discusses the interlocking concepts of ownership and control and some of the theoretical justifications which have been advanced for imposing duties on directors, using first principles and drawing on the work of observers in the fields of law and economics, regulatory theory and corporate governance.

(1) Ownership and Control and the Irish Corporate Landscape

The implications of the separation of ownership and control have long been a concern in corporate governance debate.[90] As Clarke writes:

> "On a practical level, it is obvious that the separation of ownership and control provides management with the opportunities and the powers to engage in forms of behaviour which may not be in the shareholders' best interests. Managers may mismanage the company intentionally through lack of effort or unintentionally through errors of judgment or incompetence. Managers may also be guilty of unfair dealing in areas where conflicts of interest arise."[91]

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[90] The classic work on the separation of ownership and control is AA Berle and GC Means *The Modern Corporation and Private Property* (1932 the Macmillan Company) 4th ed reprint Harcourt, Brace & World, Inc New York 1968. On the enduring relevance of their analysis see WW Bratton "Berle and Means Reconsidered at the Century's Turn" in T Clarke (ed) *Corporate Governance: Critical Perspectives on Business and Management* Vol I Routledge London 2005.

[91] B Clarke "Corporate Responsibility in Light of the Separation of Ownership and Control" (1997) 19 DULJ (ns) 50 at 51. See also B Clarke "Regulating Poison Pill Devices" (2004) 4 JCLS 51 at 54.

A separation of ownership and control is particularly marked in public listed companies whe ownership is widely dispersed. As Professor Dine observes, "[o]ne of the most diffic results of the separation of ownership and control has been the control of the controllers." Where there is little overlap between shareholders and directors, the separation of ownersh and control will heighten the role of directors as representatives of the shareholders a custodians of their investment.[93]

Conversely, where the directors and shareholders are one and the same the usual safegua may be relaxed in practice although not in law. For Irish companies the separation of pow is often illusory given the common position whereby the shareholders and the directors are o and the same.[94] The reality is that a vast number of private limited companies are closely-h companies, small businesses where the directors and shareholders are one and the same. T convergence of ownership and control marks out the Irish corporate landscape as differ from that prevailing in the United Kingdom and the United States.[95] This slant is eviden judicial recognition of the concept of a quasi-partnership where there is a relationship mutual trust and confidence arising out of a personal relationship in which the shareholo and the directors are the same,[96] thereby negating the separation of ownership and control. effect the quasi-partnership concept involves a recognition that despite incorporation ther no separation between ownership and control.

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[92] J Dine "Implementation of European Initiatives in the UK: The Role of Fiduciary Duties" (1999) 3 CfiLr at 218.

[93] CS Axworthy n 25 above.

[94] See R Keane n 15 above at [27.01]. At the end of 2006 there were 170,719 companies on the Regi *Companies Registration Office Report 2006* (2007) at 7. Of these 87.06% were private limited companies 0.91% were public limited companies. The remainder were unlimited companies, companies limite guarantee and external companies. 60 companies are listed on the Irish Stock Exchange: Irish Stock Exch *Annual Statistical Review 2006* (2007) (this figure comprises domestic and foreign companies on the Official and the Irish Enterprise Exchange).

[95] On the affinities between the UK and US corporate landscape see BR Cheffins n 88 above.

[96] See *Irish Press plc v Ingersoll* High Court (Barron J) 15 December 1993 unrep.; *Re Murph's Restaura* [1979] ILRM 141; *Crindle Investments v Wymes* [1998] 4 IR 567 (H Ct), [1998] 4 IR 578 (S Ct); *Re A Cleaning Services Ltd* [1999] BCC 786; *Re Legal Costs Negotiators Ltd* [1999] BCC 59; M Twomey *Partne Law* Butterworths Dublin 2000 at [8.68] ff.

Midway through the twentieth century, Professor Gower noted the separate needs of small private companies and large public companies:

> "The public corporation needs centralized management distinguished from the owners. In the private or close corporation this may not be needed or desired, since often the same persons are both managers and shareholders, with no clear differentiation separating one capacity from the other. The idea that they must act as fiduciary directors for the benefit of themselves as passive beneficial owners will strike them as legalistic nonsense."[97]

Law and economics theorists provide a positive economic analysis which seeks to explain legal rules in terms of the economic principles which can be said to underlie them.[98] They acknowledge that an economic analysis of the corporate rules concerning managers differs in the case of closely held corporations from that of public corporations precisely because there is not the same separation of risk-bearing.[99] As a consequence, "[b]ecause the few participants both manage and bear the cost of their actions, each is more likely to find that what is good for him is also good for the firm...."[100] This is borne out by the tendency in family companies to regard company assets as available for personal benefit.[101] Thus the concentration of power in companies where there is a convergence of ownership and control can often lead to a failure to appreciate and observe the separate interplay of shareholders, directors and the company and hence to the loss of a concept of fiduciary responsibility on the part of director. This is in spite of the fact that, as a strict legal principle, "[e]very director must be deemed to know and appreciate the distinction between the Company and themselves as individuals."[102]

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[97] LCB Gower "Some Contrasts Between British and American Corporation Law" (1955-56) 69 Harv L Rev 1369 at 1376.

[98] See S Deakin and A Hughes "Economic Efficiency and the Proceduralisation of Company Law" (1999) CfiLR 169 at 170.

[99] FH Easterbrook and DR Fischel n 30 above at Chapter 3. See also ML Mace n 29 above at 101.

[100] FH Easterbrook and DR Fischel n 30 above at 229.

[101] ML Mace n 29 above at 106.

[102] *Stafford v Higgins* [2004] IEHC 180 at p 10 of the unreported judgment *per* Finlay Geoghegan J.

(2) Regulatory Models

Directors' duties arise by operation of law rather than as a matter of contract.[103] The ai the concise discussion which follows concerning some models of corporate regulation w have been variously propounded is not to arrive at a conclusion as to which theory consti the most appropriate representation of the rationale behind the imposition of direc duties.[104] Rather than purporting to provide an exhaustive analysis of the competing overlapping theories, the purpose is to highlight some of the theories advanced which plausibly be adapted to explain intervention in the company-director relationship through imposition of duty-based controls on directors. This will set the scene for the focus of thesis which is on the substantive legal constraints on directors in the form of their core du

Corporate legislation is often viewed as essentially enabling in nature, allowing companie carry on business and to develop their own systems of corporate governance.[105] Neverthe regulatory theorists acknowledge that some form of control is needed to keep the condu directors in check. What they differ on is the appropriate regulatory model to be employed

In some instances the market itself will supply some control features. With companies w shares are publicly traded, there is competition for directorial appointments and accordi the market itself may impose some constraints on managerial conduct,[106] for example, bon and remuneration linked to personal and corporate performance.[107] External controls ca seen as insufficient, requiring extensive and costly monitoring.[108] Moreover, market con

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[103] J Howard "Fiduciary Relations in Corporate Law" (1991) 19 CBLJ 1 at 14.

[104] In any case the theories may more accurately be represented as different perspectives which have more o relevance in any given fact scenario, rather than as alternatives.

[105] See *eg* FH Easterbrook and DR Fischel n 30 above at 2. However, Eisenberg cautions against ignorin mandatory thread of corporate rules: MA Eisenberg "The Structure of Corporation Law" (1989) 89 Colum L 1461 at 1486.

[106] See E Ferran "Corporate Law, Codes and Social Norms – Finding the Right Regulatory Combinatio Institutional Structure" (2001) 1 JCLS 381 at 387.

[107] See further FH Easterbrook and DR Fischel n 30 above at 91.

[108] *Ibid at* 91-92. See also Eisenberg's criticisms of market regulation: MA Eisenberg n 105 above at 1488 f

are likely to be less relevant in relation to private companies where there is typically a convergence of ownership and control.

A feature of an agency relationship noted by Easterbrook and Fischel is that "[w]hen one person exercises authority that affects another's wealth, interests may diverge."[109] Agency theory tells us that, based on the concept of man as a rational actor, the tendency of agents to pursue their own interests at the expense of their principal will be held in check by imposing controls on the agent.[110] This economic view is evident in the following statement of the Australian Treasury:

> "As with other agency relationships, the separation of ownership and control in the corporation introduces agency problems. The imposition of directors' duties addresses a concern that market forces may not provide sufficient incentives for company officers to act in a manner that best promotes the interests of the company (and indirectly its members). Unless this higher standard of conduct was required of directors and company officers, an inefficiently low level of capital would be made available to fund corporate activity."[111]

This ties in with the managerialist conception of the corporation as a hierarchal system whose actors need legal control measures to ensure their accountability[112] and with expectations theory which regards the rule against management self-dealing as reflecting the expectations of shareholders.[113]

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[109] FH Easterbrook and DR Fischel n 30 above at 91. A good summary of academic literature on the agency theory of corporations based on the divergence of principal and agent's interests is contained in JH Davis, FD Schoorman and L Donaldson "Towards a Stewardship Theory of Management" in T Clarke (ed) *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance* Routledge London 2004.

[110] See further JH Davis, FD Schoorman and L Donaldson n 109 above and literature cited therein.

[111] The Treasury (Australia) *Review of Sanctions in Corporate Law* (2007) at para 1.22.

[112] For a good discussion of managerialist theory see WW Bratton "The New Economic Theory of the Firm: Critical Perspectives from History" (1989) 41 Stan L Rev 1471.

[113] See further ME Eisenberg "Self-Interested Transactions in Corporate Law" (1988) 13 J Corp L 997.

The alternative contractual theory views the participants as engaged in consensual contract relations.[114] This perspective relies on contractual forces to influence and regulate ma behaviour so as to ensure that the interests of the shareholders are served. A controver example of the contractarian approach can be seen in Delaware's adoption of a legisla provision permitting contracting out of the directors' duty of care.[115]

In answer to the question of why corporate law is not replaced by freedom to contract whatever terms the actors see fit, commentators often raise transaction cost savi Easterbrook and Fischel say that standard corporate law restraints save the cost of indivi contracting because "[c]orporate law – and in particular the fiduciary principles enforced the courts – fills in the blanks and oversights with the terms that people would have bargai for had they anticipated the problems and been able to transact costlessly in advance." Furthermore, contractual restrictions are seen as insufficient, requiring future contingencie be correctly anticipated and involving cost, monitoring and enforcement.[117] However, i usually accepted that directors should not be permitted to negotiate or vary fiduciary duties As Eisenberg notes, "*ex ante* contracting" is not ideally suited for dealing with the "poten for *ex post* contracting."[119] This means that it is not sensible for companies to agree negotiate an up-front contractual dilution of constraints on directorial conflicts of interests profiting from position. Thus although contracts may be good at setting expectations relation to care, skill and diligence, the rigidity of contractual provisions, and the possibilit contractual negotiation leading to provisions which suit a director's interests rather than th

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[114] See further RH Coase "The Nature of the Firm" (1937) 4 *Economia* 386; EM Fama "Agency Problems the Theory of the Firm" (1980) 88 *Journal of Political Economy* 288; MC Jensen and WH Meckling "Theor the Firm: Managerial Behaviour, Agency Costs, and Ownership Structure" (1976) 3 *Journal of Finan Economics* 305; BR Cheffins "Law, Economics and Morality: Contracting Out of Corporate Fiduciary Dut (1991) 19 CBLJ 28.

[115] Del. Code Ann. tit. 6, section 18-1101(c). See further LD Soderquist "The Proper Standard for Direct Negligence Liability" (1990-1991) 66 Notre Dame L Rev 37; MT Steele "Judicial Scrutiny of Fiduciary Dutie Delaware Limited Partnerships and Limited Liability Companies" (2007) 32 Del J Corp L 1.

[116] FH Easterbrook and DR Fischel n 30 above at 34.

[117] *Ibid* at 92.

[118] MA Eisenberg n 105 above at 1462.

[119] *Ibid* at 1465.

of the company, means that contractual outcomes may provide a limited aid to curbing future undesirable behaviour.

In Ireland it is clear that the corpus of corporate law gives strong imprimatur to freedom of contract. The director's relationship with his or her company is primarily a contractual one based on the memorandum and articles of association and other relevant contractual agreements such as service contracts and shareholders' agreements. However, reflecting a policy decision that contractual concerns are not enough, juxtaposed against the freedom provided by the customary broad powers delegated to directors to enable them to manage the company's day to day affairs is the law's circumscription of this freedom by means of the general law, the *Companies Acts 1963-2006* and the broad expressions of duty moulded and evolved by the courts. Indeed, in *Base Metal Trading Ltd v Shannon* Arden LJ emphasised that the duties of directors arise as a matter of law and "do not depend on the content of any agreement between the company on the one hand and the director on the other hand."[120]

The case for legally imposed directors' duties is presented by Easterbrook and Fischel as follows in their formative work:

> "The fiduciary principle is an alternative to elaborate promises and extra monitoring. It replaces prior supervision with deterrence, much as criminal law uses penalties for bank robbery rather than pat-down searches of everyone entering banks. Socially optimal fiduciary rules approximate the bargain that investors and managers would have reached if they could have bargained (and enforced their agreements) at no cost. Such rules preserve the gains resulting from the separation of management from risk bearing while limiting the ability of managers to give priority to their own interests over those of investors."[121]

The need for legal regulation of directors can also be explained in companies where there is a separation of ownership and control by the asymmetry of information between the directors

[120] [2004] EWCA Civ 1316, [76].

[121] See further FH Easterbrook and DR Fischel n 30 above at 92.

and the shareholders.[122] Legal control measures can also be powerfully linked to a pub interest objective of corporate law.[123] Cheffins notes that in their discussion of fiduci obligations the courts emphasise "communitarian concepts".[124] As Butcher observes, "[t] modern corporate sector ... has a profound effect on everyday life. It is crucial to the creat of national wealth. Accordingly, where a company is fraudulently, or even negligen operated, the potential for economic and social harm is tremendous."[125] A particu responsibility goes with public listed companies in which the public can invest:

> "Society has constantly to balance the demands of efficiency and fairness in corporate law. Efficiency is predicated because companies operate in various mark in an increasingly competitive international environment and fairness is predica because of the public interest in the goals of investor and creditor protection and integrity of the capital markets."[126]

It has been contended that an economic analysis fails to reflect adequately the mo component of fiduciary duties – on this view fiduciary duties are the imposition of morality the courts to restrict the abuse by directors of their discretionary powers.[127] A moral view characterise corporate law's solution to director accountability as centred around a broad conceived duty of loyalty.[128]

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[122] See E Ferran n 106 above at 387.

[123] See H Hansmann and R Kraakman "What is Corporate Law?" in R Kraakman *et al The Anatomy of Corpo Law: A Comparative and Functional Approach* Oxford University Press 2004 at 18.

[124] BR Cheffins "Law, Economics and Morality: Contracting Out of Corporate Fiduciary Duties" (1991 *Canadian Business Law Journal* 28 at 29.

[125] BS Butcher "Directors' Duties in the Twenty-First Century: A New Beginning?" (2000) ICCLJ 197 at (footnote omitted).

[126] JH Farrar "The Duty of Care of Company Directors in Australia and New Zealand" in IM Ramsay *Corporate Governance and the Duties of Company Directors* Centre for Corporate Law and Secur Regulation, University of Melbourne 1997 at 85.

[127] J Howard "Fiduciary Relations in Corporate Law" (1991) 19 CBLJ 1. See also BR Cheffins n 124 abo 29.

[128] RC Clark *Corporate Law* Little Brown Boston 1986 at 34 and 141.

While these theories can, to varying degrees, provide plausible justifications for the existence of directors' duties, when it comes to their application, it is relevant that debate on corporate law policy frequently focuses on ensuring the competitiveness of the economy and its attractiveness for inward investment.[129] Indeed, to avoid the problem of 'liability chill', the possibility of a negative impact on society based on reduced risk-taking and investment must be considered.[130] As Professor Sealy has pointed out, the role of directors "is to live with risk, not to avoid it."[131] This was recognised by the Working Group on Company Law Compliance when they said: "[o]f its nature limited liability acknowledges the inevitability of some commercial failures in an enterprising society."[132] This dictates the need for a sophisticated judicial and legislative approach. As will be seen, the courts' awareness of this is borne out in their handling of the duty to exercise care, skill and diligence and the duty to act in the best interests of the company and for proper purposes.

This chapter set out the central research question and themes of this thesis in relation to the adaptability of directors' duties and traced the development of the corporation and the role of the director and judicial evolution of the duties owed by directors to the company. Some putative theoretical justification relating to the imposition of regulatory controls on directors were also considered. Having set the subject matter of this thesis in context, the chapters which follow examine each of the directors' substantive duties in turn, beginning with the duty to exercise care, skill and diligence.

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[129] For an Irish perspective see Company Law Review Group *Directors' Compliance Statement* (2005) at 10.

[130] T Telfer "Risk taking and Insolvent Trading" in R Grantham and C Rickett *Corporate Personality in the 20th Century* Hart Publishing Oxford 1998 at 135; RJ Daniels "Must Boards Go Overboard? An Economic Analysis of the Effects of Burgeoning Statutory Liability on the Role of Directors in Corporate Governance" in JS Ziegel (ed) *Current Developments in International and Comparative Corporate Insolvency Law* Clarendon Press Oxford 1994; Edmunds R and Lowry J "The No Conflict-No Profit Rules and the Corporate Fiduciary: Challenging the Orthodoxy of Absolutism" [2000] JBL 122 at 142.

[131] LS Sealy "Corporate Governance and Directors' Duties" (1995) 1 NZBLQ 92, 99.

[132] *Report of the Working Group on Company Law Compliance* ("the McDowell Report") Pn 6697 Stationery Office (1998) at para 1.12.

CHAPTER 2:
JUDICIAL DEVELOPMENT OF THE DUTY TO EXERCISE, CARE, SKILL AND DILIGENCE

A. INTRODUCTION

Traditionally the law in facilitating business has not based the standard for directors' care, skill and diligence on lofty ideals. Rather, what the law in this area has sought to achieve is to set down broad requirements which can be applied in a manner which complies with societal expectations of directors. These expectations have shifted over time.

It might be considered that the role of the law is not to intervene in the affairs of companies by paternalistically second-guessing difficult decisions made by directors in relation to the running of a company, decisions which inevitably involve some element of risk.[1] However, such an argument presupposes that the directors know what they are doing - something which could not be taken for granted in the nineteenth century and early twentieth century when, in many cases, being a director was regarded as a hobby of gentlemen. The courts' traditional *laissez-faire* approach to directors arose against the backdrop of non-intervention in that the law did not lay down any substantive qualifications or require evidence of business acumen as a prerequisite to becoming a director. It is contended in this chapter that the failure to impose this type of *ex ante* controls has influenced the *ex post* controls on directors in terms of the standards expected of them compared to professionals such as doctors and solicitors subject to common entry barriers in terms of education and training. However, while traditionally the law has not been very prescriptive in relation to what is expected of directors, nevertheless

[1] As Professor Sealy remarks, "[a] duty of care and a liberty to embrace risk are incompatible bedfellows.": LS Sealy "Directors' 'Wider' Responsibilities – Problems Conceptual, Practical and Procedural" (1987) 13 Mon LR 164 at 176.

there were always limits to what the law would allow directors to get away with. This involved making policy decisions about the role of the law and the courts in relation directorial standards.

In 1933 Rugg CJ in the Supreme Court of Massachusetts pragmatically grappled with appropriate role of the law in this area as follows:

> "Law in its sanctions is not coextensive with morality. It cannot undertake to put parties to every contract on an equality as to knowledge, experience, skill shrewdness. It cannot undertake to relieve against hard bargains made between competent parties without fraud. On the other hand, directors cannot rightly allowed to indulge with impunity in practices which do violence to prevailing standards of upright businessmen."[2]

The benchmark which the courts have envisaged as the appropriate standard to which directors should conform in this area is a standard which has never been entirely objective or entirely subjective in nature.[3] Instead, the courts have attempted to walk the tightrope of interpreting the duty on directors to exercise care, skill and diligence in a manner which seeks to ensure that directors uphold the prevailing standards expected by society of "upright businessmen" while taking into account the reality that each director's knowledge and experience, role in company setting is different. Whereas the traditional approach favoured a mostly subjective assessment based on the actual level of skill and competence of the individual director, in the last decade there has been a marked swing towards expecting directors to meet objective standards, an approach which reflects a changing corporate climate and changing social expectations.

An examination of the case law shows that the key principles have remained constant but there has been a perceptible change in how those principles are applied, based on changing conceptions of the role of directors and of the standards they should meet. What this

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[2] *Goodwin v Agassiz* (1933) 186 NE 659, 661 *per* Rugg CJ (Massachusetts Supreme Court).

[3] Mackenzie characterises it as "partly objective ... though more strikingly subjective....": AL Mackenzie "Company Director's Obligations of Care and Skill" [1982] JBL 460 at 461.

meant is that, beginning in the late 1970s and progressing with speed since the 1990s, there has been a discernible shift in approach by the courts in Ireland, England and Wales, and other jurisdictions towards the inclusion of greater objectivity in the standard of care which directors must meet. This in turn reflects an increasingly heightened focus on corporate governance where the need for more specific codes of conduct and statutory refinements of this duty is a live issue.

This chapter seeks to explore judicial development of the duty to exercise care, skill and diligence from the formative decisions of the latter half of the nineteenth century to the paradigm shifts of the present day. Part B begins by examining the sources of the duty and Part C considers what may be termed the formative, traditional approach to care, skill and diligence. Part D looks at development of the modern judicial approach and, in particular, the discernible shift in attitudes evidencing a new 'modern', objective approach to the duty. Part E examines the transition in judicial approach in relation to the discrete areas which can be regarded as emerging distinct sub-duties. Part F reflects on some aspects of the modern approach. The chapter concludes with Part G which endeavours to draw some conclusions from the chapter's analysis of the duty to exercise care, skill and diligence.

B. SOURCES OF THE DUTY

(1) A Composite Duty

When examining this particular duty, it is perhaps tempting to oversimplify matters by stating that duties in relation to care, skill and diligence all come back to one common theme *viz* the potential liability of directors for negligence. In one sense this is an accurate summation. However, it glosses over the intricacies of aspect and legal origin which lie beneath the surface and which need to be drawn together in any coherent analysis of the duty at hand.

The recognition of the duty to exercise care, skill and diligence as a composite duty stems most lucidly from Romer J's authoritative approach in the seminal *Re City Equitable Fire*

Insurance Co Ltd.[4] In this case, drawing together existing authorities, Romer J formulate number of key propositions which evidenced that the standard of care owed by direct comprised distinct aspects in relation to skill, diligence and reasonable reliance on oth However, ubiquitous judicial conjunctive references to "care, skill and diligence" mask fact that care, skill and diligence are distinct aspects which arguably merit sepa examination.[5] Despite judicial tendency towards conflation of the various aspects, which i part explicable by the growing congruence and distillation at judicial level, there nevertheless some judicial windows of insight into the distinct (but frequently intersecti limbs of the duty. For example, in *Re D'Jan of London Ltd*[6] Hoffmann LJ separat formulated a standard of care and a standard of skill. Hicks correctly comments that the t standards are "conceptually separate though difficult to segregate, as the appropriate leve care may depend on the required level of skill."[7]

In the result, given the lack of watertight divisions between the sub-duties, and the reality t judicial consideration frequently involves a conflated analysis, it is no mean task for the l scholar to untangle the ball of wool in order to coherently assess the impact of the whole its discrete aspects. The duty to exercise due care, skill and diligence is perhaps best regar as a composite one with stand-alone but frequently overlapping aspects. In this chapter, i sought to pay heed to the separate limbs of care, skill and diligence while acknowledging t the overlapping analysis which invariably occurs at judicial level makes this task at ti impractical.

(2) Law, Equity and the Fiduciary Misnomer

While the jurisprudence concerning the composite duty to exercise due care, skill diligence is relatively clear as to the applicable principles, far less clarity emerges from judicial attempts to grapple with the preliminary issue of identifying the source of the d Case law and literature in this area have identified a number of disparate originating sou

[4] [1925] Ch 407. The case is discussed in more detail later in this chapter.

[5] See A Hicks "Directors' Liability for Management Errors" (1994) 110 LQR 390 at 393.

[6] [1993] BCC 646.

[7] A Hicks n 5 above at 391. For another discussion of the distinction between care and skill see AL MacKen 3 above at 461.

for the duty to exercise care, skill and diligence.[8] For instance, it has been variously suggested that it arises from fiduciary obligations,[9] contract,[10] and principles concerning the duty of care in tort to 'neighbours'.[11]

It is a rule of equity that, in the management of the business of a trust, a trustee should exercise the same care and skill as an ordinary prudent man of business would exercise in conducting that business if it were his own.[12] It has sometimes been said that the duties of directors are analogous to those of trustees,[13] with the implication that the duty of directors to exercise care and skill is essentially the same as that of trustees. However, while other duties relating to directors are based on a direct analogy with the duties on trustees,[14] in the present context the trust analogy has the unwarranted effect of muddying the waters in relation to the source of the composite duty to exercise care, skill and diligence.[15] Putting such analogies firmly to one side, it is submitted that a fiduciary analysis is fundamentally flawed on the basis that the duty of care, skill and diligence is not connected with fiduciary duties. As Butcher notes:

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[8] See further CA Riley "The Company Director's Duty of Care and Skill: the Case for an Onerous but Subjective Standard" (1999) 62 MLR 697 at 700; BS Butcher *Directors' Duties: A New Millennium, A New Approach?* Kluwer Law International London 2000 at 31.

[9] See RR Pennington *Directors' Personal Liability* BSP Professional Books London 1987 at 81.

[10] *Lister v Romford Ice and Cold Storage Co Ltd* [1957] AC 555; *Hospital Products Ltd v United States Surgical Corporation* (1984-1985) 156 CLR 41, 97 *per* Mason J; *Day v Mead* [1987] 2 NZLR; *Bairstow v Queen's Moat Houses Plc (No. 2)* [2005] 1 BCLC 136; JC Shepherd "Towards a Unified Concept of Fiduciary Relationships" (1981) 97 LQR 51 at 66.

[11] See *Donoghue v Stevenson* [1932] AC 562; *Daniels v Andersen* (1995) 13 ACLC 614, 663 *per* Clarke and Sheller JJA; BS Butcher n 88 above at 31.

[12] See *eg Speight v Gaunt* (1883) 9 App Cas 1; *Re Whiteley* [1886] 33 Ch D 347, 355 *per* Lindley LJ; *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515, 531 *per* Brightman J; *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260; *Stacey v Branch* [1995] 2 ILRM 136.

[13] *AG v Belfast Corporation* (1855) 4 Ir Ch Rep 119, 160 *per* Maziere Brady LC; *Great Eastern Railway Co v Turner* (1872-3) 8 Lr Ch App 149.

[14] Most clearly, the fiduciary duty to avoid conflicts of interest and not to make secret profits. See further Chapter 4 below.

[15] It is notable that in *Re City Equitable Fire Insurance* [1925] Ch 407, 426 the *locus classicus* on the duty, Romer J firmly brushed aside the trustee analogy as unhelpful.

"Fiduciary obligations are imposed to preclude the fiduciary from being influenc personal considerations, or from actually misusing his or her position for pers advantage; considerations which have no application whatsoever to ... a breach o directors' duty to exercise care and diligence."[16]

Thus fiduciary accountability is accurately characterised as being "... concerned exclusi with controlling opportunism on the part of those with limited access [and not with] defi substantive performance standards ...."[17] Nevertheless, courts applying the duty have b slow to address this misconception. In a landmark decision of the Supreme Court of Wes Australia in *Permanent Building Society (in liq) v Wheeler,*[18] the court grasped the nettle clearly pronounced that a director's duty to exercise reasonable care, though equitable (as as legal) is not a fiduciary obligation.[19] In a judgment which extensively considered the na of this duty, Ipp J concisely stated:

"The director's duty to exercise care and skill has nothing to do with any positio disadvantage or vulnerability on the part of the company. It is not a duty that st from the requirements of trust and confidence imposed on a fiduciary. In my opin that duty is not a fiduciary duty although it is a duty actionable in the equit jurisdiction of this court."[20]

This position was confirmed in England in *Bristol & West Building Society v Mothew* wh Millett LJ said that breach of fiduciary obligation "... connotes disloyalty or infidelity. M incompetence is not enough. A servant who loyally does his incompetent best for his ma is not unfaithful and is not guilty of breach of fiduciary duty."[21]

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[16] BS Butcher n 8 above at 33 (footnotes omitted).

[17] R Flannigan "Fiduciary Duties of Shareholders and Directors" [2004] JBL 277 at 279.

[18] *Permanent Building Society (in liq) v Wheeler* Supreme Court Western Australia 28 July 1994 at 87-88 *per* J.

[19] On the nature of fiduciary obligations see also *McMullen v McGinley* [2005] IESC 10.

[20] *Permanent Building Society (in liq) v Wheeler* Supreme Court Western Australia 28 July 1994 at 87-88 *per* J.

[21] [1998] Ch 1, 18. In *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 it was contempl that where gross incompetence is exhibited this may, however, give rise to a claim for breach of duty in to contract. For an example of such a case see *Swan v Sandhu* [2005] EWHC 274 (Ch) where the respondents

It is apparent that the duty of a director to exercise care, skill and diligence is a duty which is owed both in equity[22] and at common law utilising principles developed under the tort of negligence.[23] Therefore a director's equitable duty of care may be paralleled by a tortious duty of care.[24] It is significant that the formative case on this duty, *Re City Equitable Fire Insurance Co Ltd*[25] was decided when the law of negligence was undeveloped, the seminal case of *Donoghue v Stevenson*[26] following some years later. It is only since then that a focus on common law negligence has really begun[27] and this parallel aspect remains nascent in the context of a directorial standard of care. Nevertheless, the co-existence of equitable and tortious duties of care is supported by various beacons in the case law[28] culminating in the decision of the Supreme Court of Western Australia in *Permanent Building Society (in liq) v Wheeler.*[29] In *Base Metal Trading Ltd v Shamurin*[30] Tuckey LJ clearly stated that "[t]here is no doubt that a director owes an equitable as well as a common law duty of care".[31] This was also recognised in *Kavanagh v Delaney,*[32] where Finlay Geoghegan J referred to "duties of skill and care, developed initially by the courts of equity and duties of skill and care developed by the common law courts from the principles in the law of negligence."[33] Given the development of the equitable duty long before Lord Atkin enunciated the neighbour principle

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not considered to be materially motivated and therefore not in breach of fiduciary duty but in breach of a duty of care.

[22] As discussed above, the existence of an equitable duty ought not to be confused with a fiduciary duty.

[23] Some commentators regard the common law duty as having taken all but overtaken the equitable duty: A Walters "Directors' Duties: The Impact of the Company Directors Disqualification Act 1986" (2000) 21 Co Law 110, 112.

[24] *Permanent Building Society (in liq) v Wheeler* (1994) ACSR 109, 156 *per* Ipp J.

[25] [1925] Ch 407.

[26] [1932] AC 562.

[27] A Walters n 23 above at 112.

[28] *Lagunas Nitrate Company v Lagunas Syndicate* [1899] 2 Ch 392, 435; *Kimberley Mineral Ltd v Triguboff* [1978] 3 ACLR 624, 628 *per* Needham J; *Bennett v Minister of Community Welfare* (1992) 176 CLR 408, 411.

[29] *Permanent Building Society (in liq) v Wheeler* Supreme Court Western Australia 28 July 1994 at 82 *per* Ipp J. See also *Mothew v Bristol & West Building Society* [1998] Ch 1.

[30] [2005] 1 All ER (Comm) 17.

[31] *Ibid* at [19].

[32] [2005] 1 ILRM 34. See also *Re SPH Ltd; Fennell v Shanahan* [2005] IEHC 152.

[33] [2005] 1 ILRM 34, 41.

in *Donoghue v Stevenson*[34], Finch argues that it is unlikely that a broadly-based tortious will be developed.[35] So far this prophecy has been borne out.[36]

Although the available remedies have traditionally differed,[37] in practice, the co-existence duty to exercise care and skill in equity and in law does not involve the application different test. This can be traced back to *Lagunas Nitrate Company v Lagunas Syndic* where Lindley MR regarded both legal and equitable duties as being met if directors: " ... with such care as is reasonably to be expected from them, having regard to their knowl and experience....". This common test and reference to "reasonable care" has perhaps responsible for a widespread tendency to refer to liability for negligence in connection this duty, a tendency which obscures the co-existing equitable duty. It is notable tha *Permanent Building Society (in liq) v Wheeler*[39] Ipp J stated that irrespective of whether claim against a director for failure to exercise care in the discharge of his duties is one base equity for restitutionary compensation or whether the claim lies in damages at law, the tes determining whether there has been a breach of duty of a director is one and the same.[40]

It might also have been anticipated that judicial development of the duty to exercise care, and diligence would begin to occur in rulings on contractual duties of care arising u directors' service contracts. Writing in 1987, Professor Pennington regarded this as provi an opportunity for the courts to impose heavier duties of skill and care on directors negligence than the rules of equity have done in the past.[41] As the courts have had difficulty in finding an implied term in a contract of employment that an employee exercise reasonable skill in the performance of his duties,[42] it is open to them to draw a sim

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[34] [1932] AC 562.

[35] V Finch "Company Directors: Who Cares About Skill and Care?" (1992) 55 MLR 179 at 205.

[36] On one view the risk-taking nature of corporate activity is incompatible with any so-called duty of care: se Sealy n 1 above at 176.

[37] See Chapter 6 below.

[38] [1899] 2 Ch 392, 435.

[39] *Permanent Building Society (in liq) v Wheeler* Supreme Court Western Australia 28 July 1994.

[40] *Ibid* at 89 *per* Ipp J.

[41] See RR Pennington n 9 above at 91.

[42] *Eagle Trust plc v SBC Securities Ltd (No. 2)* [1996] 1 BCLC 121 (financial adviser held to owe du exercise reasonable skill and care).

conclusion in respect of an employed director.[43] Indeed, liability in negligence may occur where a person holds himself out as competent to undertake a particular job or to have a particular level of skill relevant to its performance.[44] A greater focus on this added dimension is facilitated by judicial rulings that duties of care in contract and tort can co-exist.[45] *Bairstow v Queen's Moat Houses Plc*[46] is authority for the proposition that where there is a service contract between a director and his or her company pursuant to which he or she is obliged to carry out certain tasks based on his or her expertise, knowledge and experience, the director will be required to meet an objective standard of skill. However, this has not been a central conduit through which judicial moulding of the care, skill and diligence duty has occurred.

C. THE TRADITIONAL APPROACH

(1) The Historical Context

Three factors are key to the traditional failure to impose minimum standards on directors other than honesty. The first such factor which permeated the formative cases on directors' duties was the view of the shareholders as responsible for choosing and controlling directors. Secondly, a *laissez-faire* judicial approach to directors' conduct stemmed from the Victorian conception of a gentleman's place in society. Thirdly, the judiciary did not see themselves as appropriately qualified to interfere with decisions made by men of business.

(a) The Laissez-Faire View of Director Selection and Control

In the early days, shareholders were more likely to have personal involvement in business policy in the company in which they held shares and to belong to a privileged class of 'professional investors' than is the case today. In the early days of corporate activity company shareholders were people of considerable means akin to a class of professional investors.[47]

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[43] See *Jackson v Invicta Plastics Ltd* [1987] BCLC 329.

[44] *Esso Petroleum Co Ltd v Mardon* [1976] 2 All ER 5.

[45] See RR Pennington n 9 above at 91; *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145.

[46] [2005] 1 BCLC 136.

[47] See comments of Else-Mitchell J quoted in D Menzies "Company Directors" (1959) 33 ALJ 156, 171.

Given the context of the professional investor, it is therefore perhaps not altogether surpri that a hands-off approach was evident in the formative stages of judicial development application of this duty. Writing in 1969, Trebilcock remarked that "English law consistently adopted the attitude that directors need have no special qualifications at al office."[48] This is understandable in the historical context where the question of appointm of directors was regarded as a matter for the shareholders. Then, as now, members company had at their disposal, the ability to ratify the unauthorised actions of directors an remove unsuitable directors. In such circumstances a *laissez-faire* approach by the judic was not surprising.

This is illustrated by *Turquand v Marshall*[49] where a loan was made by the board to a dire who did not repay the loan and died insolvent. In the absence of evidence of fraudulent int Lord Hatherley LC let the loss for directors' lack of care lie with the shareholders, stating "however ridiculous and absurd [the directors'] conduct might seem, it was the misfortun the company that they chose such unwise directors".[50] This evidences the early judi conception of shareholders as savvy investors who should know better than to appoint p candidates as directors. A similar view is echoed in Lindley MR's pithy statement in *Lagu Nitrate Co v Lagunas Syndicate:*

> "No one need join a company unless he likes, and if a person knows that if he beco a member he will find as directors persons who, in his opinion, ought not to directors, he should not join the company."[51]

This pervasive view is again evident in Chitty J's statement in *Grimwade v Mutual Soc* that "[d]irectors are not bound to be wiser than those who have appointed them."[52] Th cases reveal a now outmoded view that it was the task of the shareholders to choose suit candidates to act as directors; as a matter of policy, in the event that they failed to do so, the absence of fraud), the loss should lie where it fell.

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[48] MJ Trebilcock "The Liability of Company Directors for Negligence" (1969) MLR 499 at 502.

[49] (1869) LR 4 Ch App 376.

[50] *Ibid* at 386.

[51] [1899] 2 Ch 392, 426.

[52] (1885) 52 LT 409, 416.

(b) The Director Gentleman as 'Amiable Lunatic'[53]

Failure to impose minimum standards for directors can also be attributed to the fact that formative cases concerning the quintessentially Victorian gentleman director emphasised the status of the gentleman at the expense of the office of director and therefore downplayed any requirement of skill. In many cases a gentleman director's involvement was simply to lend a certain cachet to the business. Romer J was alert to this in *Re City Equitable Fire Insurance Co Ltd* when he remarked:

> "Cases have not been unknown in which a director has lent his name to a company for what may be called window dressing purposes, and treated himself as having thereby given ample consideration for his remuneration and as being absolved from any further effort towards promoting the welfare of the company."[54]

Butcher hypothesises that a directorship was considered to be "little more than a sinecure in which reasonable competence was a desirable but not a necessary qualification."[55] Thus initially the duty to exercise skill, care and diligence was tested in subjective rather than objective terms redolent of the pre-Victorian and Victorian conception of a gentleman's role in society.[56] This is borne out in cases such as *Re Brazilian Rubber Plantations and Estates Ltd.*[57] The company had lost substantial monies after making a poor investment in rubber plantations in Brazil in circumstances where the two directors had absolutely no business acumen or qualifications. Neville J described one of them in the following terms: "Sir Arthur Alymer was absolutely ignorant of business. He only consented to act because he was told the office would give him a little pleasant employment without his incurring any responsibility."[58] Neville J held neither of the defendants liable for misfeasance. He laid down a purely subjectively-based duty of care for directors:

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[53] See *Palvides v Jensen* [1956] 1 Ch 565, 570 *per* Danckwerts J.

[54] [1925] Ch 407, 444.

[55] BS Butcher n 8 above at 36 (footnotes omitted).

[56] *Ibid* at 33 ff.

[57] [1911] 1 Ch 425.

[58] *Re Brazilian Rubber Plantations & Estates Ltd* [1911] 1 Ch 425, 437.

"A director's duty has been laid down as requiring such care as is reasonably t expected of him, having regard to his knowledge and experience. He is, I think, bound to bring any special qualifications to his office. He may undertake management of a rubber company in complete ignorance of everything connected rubber, without incurring, responsibility for the mistakes which may result from ignorance; while if he is acquainted with the rubber business he must give the com the advantage of his knowledge when transacting the company's business."[59]

Deference to the gentleman director is again evident in *Re Denham & Co.*[60] A director failed to detect the fraud of the chairman of directors in meddling with the accounts so a create a fictitious profit was amiably described by Chitty J as "a country gentlemen and n skilled accountant"[61] and cleared of liability. The director in question had not attended board meetings in four years.[62]

(c) Judicial Reluctance to Meddle in Business Affairs

The third influential factor in relation to the failure of the judiciary to set out minim standards was the fact that many members of the judiciary were simply not as *au fait* w commercial reality as contemporary judges and deferred to those who were involved in the and thrust of business. In *Re Trusts of Leeds City Brewery,*[63] Lord Sterndale MR fra stated " ... I am not a business man ....".[64] In *Burland v Earle*[65] Lord Davey expresse aversion to "interfer[ing] with the internal management of companies acting within t powers."[66] This judicial reluctance to delve into management matters can be traced bac Lord Eldon's oft-quoted statement: "This court is not to be required on every occasion to

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[59] [1911] 1 Ch 425, 437.

[60] (1884) 25 Ch D 752.

[61] *Ibid* at 767.

[62] Interestingly, some moral blame appears to have been ascribed by Chitty J to the director in question thr the rather curious failure to award the director his costs.

[63] [1925] Ch 532.

[64] *Ibid* at 539.

[65] [1902] AC 83.

[66] *Ibid* at 93.

the management of every playhouse and brewery in the Kingdom."[67] In *Dovey v Cory* Lord Macnaghten exemplified judicial thinking which set its face against judicial activism:

> "I do not think it desirable for any tribunal to do that which Parliament has abstained from doing – that is, to formulate precise rules for the guidance or embarrassment of business men in the conduct of business affairs. There never has been, and I think there never will be, much difficulty in dealing with any particular case on its own facts and circumstances; and, speaking for myself, I rather doubt the wisdom of attempting to do more."[68]

(2) The Formative Cases

(a) The Charitable Corporation v Sutton

The earliest identified proclamation of the potential liability of directors for failing to act with due care, skill and diligence in relation to the performance of their duties *qua* director is contained in *The Charitable Corporation v Sutton.*[69] Fifty members of a committee of a charitable corporation were held liable for losses which occurred as a consequence of their failure to supervise adequately a warehouse-keeper who had made loans without ensuring that appropriate security was in place. Lord Hardwicke LC stated that directors "may be guilty of acts of commission or omission, of mal-feasance or non-feasance"[70] and that:

> "[b]y accepting a trust of this sort, a person is obliged to execute it with fidelity and reasonable diligence; and it is no excuse to say that they had no benefit from it, but that it was merely honorary; and therefore, they are within the case of common trustees."[71]

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[67] *Carlen v Drury* (1812) 1 Ves and B 154, 158. See further A Tunc "The Judge and the Businessman" (1986) 102 LQR 549 and cases cited therein.

[68] [1901] AC 477, 488.

[69] (1742) 2 Atk 400

[70] *Ibid* at 405.

[71] *Ibid* at 406.

Despite the encouraging rectitude of *The Charitable Corporation v Sutton,* an examinati cases of the eighteenth and nineteenth century concerning this duty reveals that this was a of judicial activism in this area peaking too soon. Rather than serving as the yardstick ag which all future acts and omissions of directors would be measured, in retrospect, *Charitable Corporation* can be identified as a high watermark in terms of the applicati such a duty in practice.[72] Although continuing to profess the existence of such a duty, relatively recently the courts did not feel impelled to impose sanctions on directors i absence of clear evidence of *mala fides* or dishonesty on their part.[73] It is therefore accurate to state that the true formative cases in this area are those of the latter part o nineteenth and early twentieth century upon which the leading decision in *Re City Equita* was founded. In the nineteenth century and early twentieth century, the principle be established that a director would not be liable for 'mere negligence' or 'mere' erro judgment.[75] These early cases formulated what has come to be known as 'the busi judgment rule'.

(b) The Business Judgment Rule

In contrast with other directors' duties, the duty to exercise care, skill and diligence has the most part, been applied in a far less onerous manner than its well-established exist would suggest. As was adverted to earlier, historically, the entrenchment of a jud reluctance to pass judgment on the acts and omissions of directors was in part attributab an aversion to "interfer[ing] with the internal management of companies acting within powers."[76] In the late nineteenth century Lord Hatherley LC set out a business manage rule in *Turquand v Marshall*[77] which set at naught the principles underlying *The Chari*

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[72] See MJ Trebilcock n 48 above at 500.

[73] See further V Finch n 35 above at 179.

[74] *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407. See subsequent discussion of this case in this ch

[75] See *Overend Gurney & Co v Gibb* (1872) LR 5 HL 480, 487 *per* Lord Hatherley LC; *Re Faure El Accumulator Co v Lagunas Syndicate* [1899] 2 Ch 392, 435 *per* Lindley LJ; *Marzetti's Case* (1880) 28 WR 543 *per* Brett LJ; *Re National Bank of Wales Ltd* [1899] 2 Ch 629, 672 *per* Lindley LJ; *Re Brazilian R Plantations & Estates Ltd* [1911] 1 Ch D 425, 436-437 *per* Neville J.

[76] *Burland v Earle* [1902] AC 83, 93 *per* Lord Davey.

[77] (1869) LR 4 Ch App 376.

Corporation more than a century earlier. In *Turquand v Marshall* the directors had authorised a loan to a fellow director who had died without repaying the loan. The Lord Chancellor stated that provided directors acted *bona fide* and within the scope of their authority, they could not be made liable for loss to the company. In other words, as there was no hint of fraud or impropriety, the directors ought not to be held accountable.

A similar approach was evident in Lord Hatherley's judgment in the House of Lords decision in *Overend Gurney & Co v Gibb.*[78] Lord Hatherley LC built upon his approach in *Turquand v Marshall* and enunciated the principle that directors could only be held liable to their company for negligence if they exceeded their powers under the company's memorandum and articles of association or "were cognisant of the circumstances of such a character, so plain, so manifest, and so simple of appreciation, that no men would have entered into such a transaction."[79] The latter instance was characterised by Lord Hatherley LC as "*crassa negligentia*".[80]

This approach carried through in judicial decisions in the decades which followed. In *Lagunas Nitrate Co v Lagunas Syndicate*[81] the directors were not held not to have been negligent in overvaluing a nitrate mining undertaking. Lindley MR, building on the approach taken in cases such as *Turquand v Marshall* and *Overend Gurney & Co*, set out a business judgment rule in the following terms:

> "If directors act within their powers, if they act with such care as is reasonably to be expected of them, having regard to their knowledge and experience, and if they act honestly for the benefit of the company they represent, they discharge both their equitable as well as their legal duty to the company … The amount of care to be taken is difficult to define; but it is plain that directors are not liable for all the mistakes they may make, although if they had taken more care they might have avoided them ….

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[78] (1872) LR 5 HL 480.

[79] *Ibid* at 487.

[80] *Ibid.*

[81] [1899] Ch 392.

Their negligence must not be omission to take all possible care; it must be much blameable than that; *it must be in a business sense culpable and gross*."[82]

(c) The Locus Classicus: Re City Equitable Fire Insurance Co Ltd

The *locus classicus* in relation to the duty of directors to exercise care, skill and diligen connection with their stewardship of the company is found in Romer J's judgment in *Re Equitable Fire Insurance Co Ltd*.[83] The case concerned an action by the Official Receiv misfeasance against the directors of a company for failing to keep the running of the bus under review in circumstances where the fraud of the managing director in misappropri the company assets led to the company's liquidation and his conviction for fraud. Alth the directors successfully relied on an article in the company's articles of association w purported to exclude liability for negligence other than for willful neglect or default, the is seminal in terms of the clarity of approach to this duty.[84] *Re City Equitable* remain leading case in this area albeit honed by recent judicial refinements.[85] In his judgment, R J set down a number of key propositions which formed the stratum of the director's duty with due care, skill and diligence. In doing so he synthesised principles from a numb important earlier cases and further developed them.

The first key aspect to Romer J's judgment in *Re City Equitable* was the proposition tha application of duties to directors would vary according to the factual context in whic company and directors went about their business:

> "...in order ... to ascertain the duties that a person appointed to a board o established company undertakes to perform, it is necessary to consider not only nature of the company's business, but also the manner in which the work o

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[82] *Ibid* at 435 (emphasis added).

[83] [1925] Ch 407. Romer J's judgment builds on principles developed in the earlier cases of *Overend Gur Co v Gibb* (1872) LR 5 HL 480; *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392; *Dovey v Cory* [AC 477; *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425.

[84] On appeal, Romer J's decision was affirmed by the Court of Appeal [1925] Ch 407, 500 ff.

[85] See further Part D below.

company is in fact distributed between the directors and the other officials of the company ...."[86]

The importance of applying the duty in relation to the particular company and the context in which its directors operate has been repeatedly echoed in decisions since then.[87]

Romer J highlighted that it was not sufficient for a director to act honestly, "he must also exercise some degree of skill and diligence".[88] This proposition represented a significant and formative step forward from the earlier authorities which had established that so long as a director acts honestly he could not be made responsible in damages unless guilty of gross or culpable negligence.[89] Romer J went on to formulate a standard of care. He stated that the standard of care owed by a director did not require a director to exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience.[90] This largely (but not entirely) subjective test enshrined the concept that directors are not liable for mere errors of judgment.[91] The standard of reasonable care articulated in *Re City Equitable* has its basis in an extrapolation of dicta of Neville J in *Re Brazilian Rubber Plantations and Estates Ltd*[92] to the effect that reasonable care is the care which an ordinary man might be expected to take in the same circumstances on his own behalf. This was, in principle, far more onerous than the *crassa negligentia* test articulated by Lord Hatherley LC in *Overend Gurney & Co.*[93]

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[86] [1925] Ch 407, 427.

[87] This was cemented by the inclusion of this aspect in Jonathan-Parker J's seminal statement of principle in *Re Barings Bank (No. 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433, endorsed on appeal [2000] 1 BCLC 523, CA. See also *Re National Irish Bank Ltd; Director of Corporate Enforcement v Seymour* [2007] IEHC 102.

[88] [1925] Ch 407, 427.

[89] See *Turquand v Marshall* (1869) LR 4 Ch App 376; *Overend Gurney & Co v Gibb* (1872) LR 5 HL 480; *Lagunas Nitrate Co v Lagunas Syndicate* [1899] Ch 392.

[90] This echoes the tenor of *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392, 435.

[91] See *Turquand v Marshall* (1869) Lr 4 Ch App 376; *Re National Bank of Wales* [1899] 2 Ch 629.

[92] [1911] 1 Ch 425, 438.

[93] *Overend Gurney & Co v Gibb* (1872) LR 5 HL 480.

Romer J also enshrined public acceptance and judicial recognition of the part-time direct stating that a director was not bound to give continuous attention to the affairs of his comp Rather, his duties were characterised as being of an intermittent nature to be perform periodical board meetings. Far from being mandated to attend relevant meetings, attend was characterised as more of an obligation "he ought to attend whenever in the circumsta he is reasonably able to do so".[94] This reflected an era of part-time directors and has now thoroughly superseded by developments in the latter part of the twentieth century.[95] relation to the delegation of duties, Romer J endorsed the propriety of delegation of du stating that where, having regard to the exigencies of business and the articles of associa certain duties may properly be left to some other official, a director is, in the absen grounds of suspicion, justified in trusting that official to perform such duties honestly.[96]

It is unfortunate that in such a ground-breaking case the directors were able to rely o exclusion in the articles of association for loss caused other than by their own 'wilful ne or default'.[97] The result has sometimes obscured the value of the stand-alone principles down by Romer J. As Butcher observes in relation to this case and its anteced "[a]lthough the actual decision in each would not necessarily survive today, the principles can be gleaned and refashioned from them, undoubtedly do."[98] From the vantage point o early twenty-first century, it can be said with certainty, that the central concepts in *Re Equitable* such as the notion that directors were to be judged on their individual level of and experience and were not liable for mere errors of judgment held sway until well int final quarter of the twentieth century. However, it is important to distinguish the intr nature of the *Re City Equitable* principles and the tenor of Romer J's approach from how have been interpreted and applied in practice by the courts in the intervening years. Argu the application of these principles was in many cases less strict than was warranted give

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[94] [1925] Ch 407, 429.

[95] See Parts D and E below.

[96] This was founded on the principles in *Re National Bank of Wales Ltd* [1899] 2 Ch 629 and on appeal *sub* *Dovey v Cory* [1901] AC 477.

[97] Such an exclusion would not be upheld in Irish law today as section 200 of the *Companies Act 1963* re void any clause in a company's articles of association or director's service contract which purports to exem indemnify a director from liability for negligence or breach of trust. See further Chapter 6 below.

[98] BS Butcher n 8 above at 41.

partly objective nature of the *Re City Equitable* principles - what may be termed a predominantly *laissez-faire* approach prevailed in relation to all but the grossest of abuses.

Hicks argues that *Re City Equitable* has been misinterpreted "by writers over-stressing the quaint subjective standard of the 'amiable lunatic'. If the lengthy judgment is examined, substantial objective elements are clearly apparent."[99] This misconception may be attributed to long-entrenched judicial and societal perspectives which were not susceptible to ready alteration and also to the perception-skewing effect of the actual result in *Re City Equitable* which may have been regarded as giving the lie to any real embracing, even of a partial nature, of an objective approach. Indeed as late as 1969, Trebilcock wryly observed: "It is unfortunately the case that the fewer a director's qualifications for office, the less time he devotes to his office, and the greater reliance he places on others, legally the less responsible he is."[100]

Whatever the reason, the application of the duties of care, skill and diligence in a magnanimous manner as far as directors are concerned had the effect of lowering the remedies available to the shareholders against mismanagement and gross incompetence. A review of rare Irish cases touching on care, skill and diligence issues for directors indicates that for much of the twentieth century the Irish courts were just as happy as the English courts to cling to well-trodden paths. Dicta of Kenny J in *PMPA Insurance Co Ltd v New Ireland Assurance Co Ltd*[101] indicate that in 1975 the Irish judiciary had yet to step back from applying the business judgment rule in its most robust form. Having outlined that the management of the company is delegated by the shareholders to the directors, Kenny J went on to state that a decision of the board of directors "would not be interfered with unless it was in breach of the articles of association or was dishonest or grossly incompetent." This reflects the hard line *crassa negligentia* approach of pre-*City Equitable* case law. A similar mindset is evident in *Re Mont Clare Hotels Ltd (in liquidation); Jackson v Mortell.*[102] The directors had failed to obtain security on a loan of IR£20,000 and when repayments were not made by the creditor, one of the directors had insisted falsely to his fellow directors that the loan was a secured loan and

[99] A Hicks n 5 above at 461.

[100] MJ Trebilcock n 48 above at 509.

[101] High Court (Kenny J) *The Irish Times* 23 October 1975 unrep.

[102] (1986) [1963-1999] Ir Co Law Rep 512.

would be repaid. The directors then failed to bring proceedings to recover the amo outstanding. The misfeasance application was not upheld for a number of reasons inclu characterisation of the actions as mere errors of judgment. Costello J's approach to the du care again harked back to the *crassa negligentia* concept of cases at the turn of the twen century.[103] He stated that:

> "It is not every error of judgment that amounts to misfeasance in law and it is not e act of negligence that amounts to misfeasance in law. It seems to me that some more than mere carelessness is required, some act that, perhaps may amount to g negligence in failing to carry out a duty owed by a director to his company."[104]

(3) The Traditional Approach to Diligence

An element of the composite duty with which this chapter is concerned is the duty director to exercise his duties diligently. Undoubtedly the judicial latitude granted t Victorian gentleman director impacted heavily in directors' favour. Courtney describe traditional degree of diligence required of a director as "... dependent upon his abilities a subjectively ascertained."[105] Leaving aside the contractual exigencies of service contract general law did not impose any requirement on directors to devote themselves on any per basis, full-time or otherwise to their duties. The policy considerations behind the accommodating attitude were attested to by Jessel MR in *Re Forest of Dean Coal Mining*

> "One must be very careful in administering the law of joint stock companies n press so hardly on honest directors as to make them liable for these constr defaults, the only effect of which would be to deter all men of any property perhaps all men who have any character to lose, from becoming directors of comp at all. On the one hand, I think the Court should do its utmost to bring frau

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[103] Cf *Overend Gurney & Co v Gibb* (1872) LR 5 HL 480; *Lagunas Nitrate Co v Lagunas Syndicate* [189 392.

[104] [1963-1999] Ir Co Law Rep 512, 516.

[105] TB Courtney *The Law of Private Companies* 2nd ed LexisNexis Butterworths Dublin 2002 at [10.069].

directors to account, and, on the other hand, should also do its best to allow honest men to act reasonably as directors."[106]

Looking at early cases with the benefit of hindsight, it is not clear that the courts always got this balance right. The absence of a fraudulent intent was treated as a panacea for inactivity. In *Re Montrotier Asphalte Co (Perry's Case)*[107] Bacon VC exemplified the judicial *laissez-faire* approach to directors' exercise of their functions in the absence of fraudulent intent in stating that "business or pleasure may call him elsewhere and it would be a most unheard of thing to say that if anything wrong was done at a board meeting he being named among the directors but not present, he is liable for what is done in his absence." One of the most celebrated examples of this is the decision of Stirling J in *Re Cardiff Savings Bank (the Marquis of Bute's Case).*[108] In this case the Marquis of Bute's attendance at only one board meeting in thirty-eight years[109] did not debar him from avoiding liability in respect of his failure to discover irregularities which arose in the bank's lending operation. Significantly, it was held by Stirling J that omission to attend the meetings of the bank was not the same as neglect or omission of the duties which ought to have been performed at those meetings. The evidence was that the Marquis had received circulars inviting him to attend the annual meetings, and copies of reports issued by the bank which referred to the accounts of the actuary (the paid officer of the bank) as having been duly audited and found correct. Stirling J's benevolent view was that any person reading these documents would naturally be led to believe that the affairs of the bank were being conducted in conformity with the rules, and in particular that the accounts were duly audited. In these circumstances it was held that the Marquis was entitled to rely on the trustees and managers who took part in these meetings.

The dividing line drawn by Stirling J in *Re Cardiff Savings Bank* was a clear call to complete inaction on the part of directors since it signaled unequivocally that it was only where a director was actively involved in company affairs that care was required. The earlier Irish case of *Jackson v The Munster Bank Ltd ex parte Dease*[110] did, however, set some boundaries

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[106] (1878-9) 10 Ch D 450, 451.

[107] (1876) 34 LT 716, 717.

[108] [1892] 2 Ch 100.

[109] He had succeeded to the board at the tender age of six months.

[110] (1885) 15 LR Ir 356.

on this. The bank lent money to directors of the defendant bank even though this prohibited by the Articles of Association. The bank had two branches, one in Dublin and in Cork. It was sought to make one of the directors who worked in Dublin liable even th he had not attended the meeting in Cork where the loans were sanctioned. It was hel Chatterton VC that he was not liable because he had not attended this meeting. Howeve he was shown a letter which should have alerted him to the possibility of the misappropria from that point on he was held liable for subsequent loss, actual notice of the relevant being the activating factor for liability. Indeed, in *Re Brazilian Rubber Plantations & Es Ltd*[111] Neville J went so far as to say that a director is not bound to take "any definite part" company's affairs. It was only to the extent that he involved himself that he was requir exercise care.

It is telling that in the late nineteenth century the judiciary felt it necessary to state that w there was no duty to attend, if a director attended a board meeting he had a duty to awake.[112] While this appears absurd in retrospect, Professor Pennington places the preva attitudes in context in pointing out that the key cases on directors' negligence arose prior t First World War when most directors gave their services on a part-time basis and where b meetings did not touch on the day to day running of the company but rather on matte general policy.[113] It would not have taken a great deal of ingenuity on the part of directo regard cases of such ilk as *Re Cardiff Savings Bank, Jackson* and *Re Brazilian Ru Plantations & Estates Ltd* as a call to passivity rather than active participation on the pa directors.

The Charitable Corporation v Sutton[114] stands alone as an early precursor of the contemp focus of good corporate governance, for in this case is one solitary example of failure to at board meetings resulting in directorial liability for breaches of trust by others.[115] *Charitable Corporation* apart, the traditional approach to diligence rings rather hollo

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[111] [1911] 1 Ch 425, 437.

[112] *Land Credit Co of Ireland v Fermoy* (1870) LR 5 Ch App 763, 770 *per* Lord Hatherley LC.

[113] RR Pennington n 9 above at 85.

[114] (1742) 26 ER 642.

[115] *Charitable Corporation v Sutton* (1742) 26 ER 642 has been characterised as "a cry in the wilderness" Trebilcock n 48 above at 506.

corporate life today where the trend is towards the 'professional director' and non-executive directors no longer enjoy a much-lessened burden of responsibility and the indulgence of the judiciary.

(4) The Traditional Approach to Delegation and Reliance on Third Parties

Where specific powers were expressly delegated to directors under the company's articles of association, they were generally not permitted to delegate them.[116] However, traditionally it was understood that directors were permitted to delegate aspects of their general duties.[117] In essence this meant that directors could rely on others subject to the proviso that this reliance was not regarded as amounting to a breach of their duty of care. This reflected a period in which directorships were, in the main, a part-time pursuit so that reliance on others was an essential part of business life. In the late nineteenth and early twentieth century directors were held to be entitled to rely on the advice and information received from others such as executive committees,[118] other directors[119] and others occupying management positions.[120] This judicial satisfaction with reliance went beyond day to day management to embrace reliance on the advice of others in relation to key areas of policy making.[121] Thus directors were considered to be entitled to implicitly rely on the advice of others in relation to matters

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[116] *Re Leeds Banking Co (Howard's Case)* (1866) LR 1 Ch App 561; *Re County Palatine Loan and Discount Co (Cartnell's Case)* (1874) LR 9 Ch App 691.

[117] See further MJ Trebilcock n 48 above at 507.

[118] *Land Credit Company of Ireland v Lord Fermoy* (1869) LR 5 Ch App 763.

[119] *Sheffield & South Yorkshire Building Society v Aizlewood* (1890) 40 Ch D 412; *Re National Bank of Wales* [1899] 2 Ch 629; *sub nom Dovey v Corey* [1901] AC 477; *Re Denham & Co* (1884) 25 Ch D 752; *Lucas v Fitzgerald* (1903) 20 TLR 16; *Re Dominion Trust Co* (1917) 32 DLR 63.

[120] *Re National Bank of Wales* [1899] 2 Ch 629; *Re Kingston Cotton Mill Co Ltd* [1896] 1 Ch 331; *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407.

[121] MJ Trebilcock n 48 above at 508.

such as the declaration of dividends[122] and deciding on new business and investment av for the company.[123]

Just before the turn of the twentieth century, *Re National Bank of Wales Ltd*[124] involv director who had been deceived by the general manager and the managing director o company as to matters within their own particular sphere of activity. Lindley MR posite question: "Was it his duty to test the accuracy or completeness of what he was told b general manager and the managing director?"[125] His view was that:

> "[m]en in responsible positions must be trusted by those above them, as well a those below them, until there is reason to distrust them. We agree that care prudence do not involve distrust; but for a director acting honestly himself to be legally liable for negligence, in trusting the officers under him not to conceal from what they ought to report to him, appears to us to be laying too heavy a burde honest business men."[126]

On appeal to the House of Lords,[127] the Earl of Halsbury explained that if directors were permitted to delegate aspects of their duties this would "render anything like an intelli devolution of labour impossible"[128] and that without delegation "the business of life coul go on if people could not trust those who are put in a position of trust for the express pur of attending to details of management".[129] Indeed, in *Re City Equitable*[130] Romer J's was that the larger the business carried on by the company, the more numerous and the important the matters that must of necessity be left to managers, accountants and other staf

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[122] *Lucas v Fitzgerald* (1903) 20 TLR 16.

[123] *Sheffield & South Yorkshire Building Society v Aislewood* (1890) 44 Ch D 412.

[124] [1899] 2 Ch 629.

[125] *Ibid* at 673.

[126] *Ibid.* This perspective was upheld on appeal to the House of Lords *sub nom Dovey v Corey* [1901] AC see also *Re Barings plc (No.5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433.

[127] *Sub nom Dovey v Cory* [1901] AC 477, 485.

[128] [1901] AC 477, 485.

[129] *Ibid* at 486.

[130] *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407.

Nevertheless where there were obvious dangers inherent in relying on others, the courts were not shy of recognising the possibility of directors being negligent.[131] Thus passing over an uncontrolled power of drawing cheques to someone who was not a director or shareholder was categorised as negligent;[132] as was a director signing blank cheques for another director without further enquiry.[133] In the modern world problems have arisen in larger companies in relation to the delegation by directors of their powers to other persons without supervision. The legal position operating today is that this delegation does not exonerate directors from their responsibilities, but until relatively recent times imposition of liability on directors for excessive reliance was unlikely. At the beginning of the twentieth century, Sir Arthur Wilson stated the position as follows in delivering the Privy Council's decision in *Prefontaine v Grenier*:

> "Attempts have been repeatedly made to render directors personally liable, on the ground that they have trusted the regular authorised officers of the company; that they have failed to detect and been misled by misrepresentation or concealment by such officers when there was no room for doubting their fidelity. But such attempts have not been successful."[134]

As will be seen, it was not until the late twentieth century that the tide turned on excessive delegation and reliance and lack of supervision.

D. TOWARDS AN OBJECTIVE APROACH

Having identified the hallmarks of the traditional subjective judicial approach to the duty to exercise care, skill and diligence in the last part of this chapter, this Part examines the extent to which there has been a modern displacement of it by a more objective approach. In *Re City Equitable Fire Insurance*[135] Romer J enunciated a predominantly subjective test in stating that

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[131] *Ibid.*

[132] *Lucas v Fitzgerald* (1903) 20 TLR 16.

[133] *Northern Trust Co v Butchart* (1917) 35 DLR 169.

[134] [1907] AC 101, 109.

[135] [1925] Ch 407.

"[a] director need not exhibit in the performance of his duties a greater degree of skil may reasonably be expected of a person of his knowledge and experience."[136] It has suggested that the true approach in the leading *Re City Equitable* decision was one of "fl objectivity" rather than subjectivity.[137] What these sort of views illustrate is the need for subtlety of approach rather than a polarised subjective-objective categorisation.

In the early twenty-first century, the contemporary corporate playground is, on the one awash with professional directors of large private and public companies and their adviser on the other, encompasses a plethora of small 'one man companies' or 'quasi-partner whose key players have sought to take the advantages offered by limited liability wi having a clear grasp of the ensuing duties which being a director entails. Paradoxi although the boardroom is far less of a homogeneous playing field than in the Victoria the judicial pendulum has nonetheless begun to swing rather more in the direction objective standard to be observed by directors and away from a purely subjective assess of directors' acts and omissions. This reflects the fact that the standard of care laid dow the courts in corporate governance matters is responsive to the expectations of so expectations which have shifted considerably since the formative cases articulating the d care, skill and diligence in the latter half of the nineteenth century and early twentieth ce discussed in Part C of this chapter.

This shift in approach depended on the judiciary and the legislature recognising chang public opinion and mercantile practice and moving to adapt standards accordingly whe opportunity presented itself. In many cases this change has occurred gradually. At t there has been a pronounced gap before the law has had the opportunity to catch up societal expectations by reformulating long-established concepts to suit contemp realities. It is noteworthy that the gradual development of the law in this area in the dire of recognising objective standards for directors was outpaced by developments in tor concerning professional negligence where it has long been the case that a professio expected to exercise the standard of care which may be expected from a reasonably ca

[136] *Ibid* at 427.

[137] A Walters n 23 above at 111. See also LS Sealy "Directors' Duties Revisited" (2001) 22 Co Law 79.

member of that profession.[138] The fact that the law relating to the standards expected of directors has lagged behind may be explained in part by the lack of homogeneity in relation to directors given the wide range of companies and degree of personal involvement of directors.[139]

Indeed where directors and corporate settings are concerned, the individual circumstances are of far more significance than is the case in making assessments in relation to, for example, professional medical negligence, where uniform practices and procedures exist. The recognition of a more objectively tested concept of the educated director, *au fait* with the business of the company and its affairs and his various duties, belatedly brings a measure of congruence to the law's treatment of company directors and the law on negligence which has long been applied to other professionals such as medical professionals, accountants and lawyers. However, this development in relation to directors has occurred, to a large extent, outside the strict realm of either the equitable or the common law duty and within what may be regarded as the now commonplace context of restriction and disqualification of company directors.[140]

On occasion a rapid, radical transformation of public opinion has arisen from the catalyst of revelations of loss and harm caused in corporate scandals where blame has been increasingly laid at the door of directors.[141] Furthermore, statutory developments such as the introduction

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[138] See *eg* solicitors: *Dutton v Bognor Regis UDC* [1972] 1 QB 373, *Roche v Peilow* [1986] ILRM 189, *Doran v Delaney* [1998] 2 IR 61; doctors: *Dunne v National Maternity Hospital* [1989] IR 91; accountants and auditors: *Caparo v Dickman* [1989] QB 653. See generally B McMahon and W Binchy *The Law of Torts* 3rd ed Butterworths Dublin 2000 Chapter 14; EM Dee "Professional Negligence of Solicitors (2001) 19 ILT 282. For a good discussion in an American context of the failure to develop a professional negligence standard for directors see PC Sorensen "Discretion and its Limits – An Analytical Framework for Understanding and Applying the Duty of Care to Corporate Directors (and Others)" (1988) 66 Wash ULQ 553.

[139] See L MacCann "Directors' Duties of Care, Skill and Diligence" (1991) 9 ILT 56.

[140] See section 150 of the *Companies Act 1990* (restriction) and section 160 of the *Companies Act 1990* (disqualification).

[141] Corporate scandals relating to Barings Bank, Enron, MCI, Parmalat, NIB (amongst others) have undoubtedly focused attention on corporate governance matters. The literature on this is wide-ranging. See *eg* CM Elson and CJ Gyves "The Enron Failure and Corporate Governance Reform" (2003) 38 Wake Forest L Rev 855; JC Coffee "What Caused Enron? A Capsule Social and Economic History of the 1990s" in T Clarke (ed) *Theories of*

of the statutory restriction and disqualification regime and the establishment of the Offi the Director of Corporate Enforcement have been highly significant. In addition, establishment of a directors' compliance statement regime in section 45 of the *Compa (Auditing and Accounting) Act 2003* is a significant, though controversial, development w highlights legislative support for directors to maintain minimum standards.[142] T developments can accurately be accorded watershed status for their role in terms of defi the zeitgeist – the prevailing mindset of the public, directors and the judiciary. *Commonwealth Bank of Australia v Friedrich* Tadgell J considered the mutual interac involved in effecting the shift in mindset, explaining that the increasing complexit commerce had led the community:

> "to expect more than formerly from directors whose task it is to govern the affai companies ... In response the parliament and the courts have found it necessar legislation and litigation to refer to the demands made on directors in more exac terms than formerly; and the standard of capability required of them correspondingly increased."[143]

Examined in sub-Part (1) below is the role which the rise of the professional director, and statutory restriction and disqualification regime have played in the inclusion of a measu objectivism in assessments of directors' compliance with the duty to exercise care, skill diligence. Sub-Part (2) examines the judicial contribution.

Corporate Governance: The Philosophical Foundations of Corporate Governance Vol 1 Routledge Lo 2004; N O'Shea "Governance: How we've got where we are and what's next" (2005) 37 Accountancy Irl Tafara "A Race to the Top" (2006) 25 IFL Rev 12. For a summary of recent the headline scandals see CA M *Corporate Governance* 2nd ed Oxford University Press 2007 at Chapter 1.

[142] For an insight into the appalled reaction of the business community to the proposed introduction of su regime see: Company Law Review Group *Report on Directors' Compliance Statement* (2005); D A "Directors' Compliance Statements under the Microscope" (2006) 13 C L Pract 137.

[143] (1991) 5 ACSR 115, 126.

(1) The Rise of the Professional Director

Ultimately the judiciary's traditional approach to the duty to exercise care, skill and diligence did not keep pace with the changing role and position of directors in the commercial world. This changed world assimilated the casting aside of a clearly-defined class system and involved recognition of enterprise as open to all and the rise of what may be termed the 'professional director'. The transition happened, but slowly.[144] However, it can be stated with some degree of assurance that with the advent of restriction and disqualification orders and increasing emphasis on good corporate governance, the vestiges of a *laissez-faire* judicial approach to 'gentlemen directors' have fallen away.

What can be observed mostly keenly in decisions concerning the restriction of directors and corporate governance developments is that it is reaching the stage where it is no longer legally or culturally sufficient to be an honest director, nowadays one is also expected to be competent.[145] Increasingly directors are being appointed on the basis of possessing a particular skill-set and expertise. As Trebilcock observed, "[t]here is a considerable body of opinion which takes the view that the modern public company director is no longer an amateur but has now acquired, and now asserts, a professional status together with professional skills."[146] With increasing emphasis on corporate governance,[147] there is a corresponding acceptance that the level of professional skill, knowledge and experience to be expected of a director should be determined objectively by reference to that which the director ought to have.[148]

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[144] For criticism of the failure of the law to keep pace with society's expectations see RC Nolan "Maxwell's Improper Purposes" (1994) 15 Co Law 85 at 87.

[145] "[T]he boards of major companies are no longer made up of gentlemen amateurs …": R Reed "Company Directors – Collective or Functional Responsibility" (2006) 27 Co Law 170 at 172.

[146] MJ Trebilcock n 48 above at 509.

[147] See section 45 of the *Companies (Auditing and Accounting Act 2003* (directors' compliance statements); Company Law Review Group *Report on Directors' Compliance Statement* (2005); Financial Reporting Council (UK) *Combined Code on Corporate Governance* (2006) and revised Turnbull Guidance: Financial Reporting Council (UK) *Internal Control: Revised Guidance for Directors on the Combined Code* (2005).

[148] On the requirement to be suitably informed see Part E(2) below.

(2) The Impact of the Statutory Restriction Regime

While judicial non-interference was traditionally rationalised on the basis of shareh autonomy, this classical view which equated the company's interests with thos shareholders has been replaced by legislative and judicial recognition of the nee accommodate a broader spectrum of interests, most notably those of creditors employees.[149] This removes the traditional justification for judicial non-intervention However, the shift from a purely subjective assessment of care, skill and diligence u equitable and common law duties to a more complex assessment which accommo objective standards has occurred in a largely tangential fashion. This is so because changes in judicial mindset in the latter part of the twentieth century, and which have l refined since then have occurred, not in the context of direct judicial consideration of t duties, but rather as a downstream effect of judicial activity within the context of the statu restriction and disqualification system, a system designed to safeguard the public interest, a particular emphasis on the interests of creditors.[150] Hence Hoffmann LJ's presentime *Bishopsgate Investment Management Ltd v Maxwell (No. 2)* that "[t]he law may be evolvi response to changes in public attitudes to corporate governance as shown by the enactme the provisions consolidated in the Company Directors Disqualification Act 1986."[151] Se years later, Walter was able to observe the prophecy's seismic but low-key fulfilment:

> "The law has already accommodated the shift in market and public sentiment. process seems to have largely gone unnoticed because it has occurred outside mainstream of company law in cases decided under the Company Direc Disqualification Act 1986 …."[152]

In this jurisdiction, the enactment of the restriction and disqualification regime in Part V the *Companies Act 1990* was pivotal in facilitating a shift in judicial and popular attitu

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[149] See generally Chapter 3, Parts D and E.

[150] See section 150 of the *Companies Act 1990* (restriction) and section 160 of the *Companies Act* (disqualification) and in the UK, the *Company Directors Disqualification Act 1986.*

[151] [1994] 1 All ER 261, 264.

[152] A Walters n 23 above at 110.

towards the conduct of directors. Section 150 of the *Companies Act 1990*, provides, *inter alia*, that in an insolvent liquidation, the court shall make an order against the directors of the company in liquidation restricting them from involvement in managing the affairs of any company for a period of five years unless the directors can show that they have acted honestly and responsibly in relation to the conduct of the affairs of the company.[153] The dearth of litigation relying on the equitable and common law director's duty to exercise care, skill and diligence[154] contrasts with the plethora of restriction applications before the High Court.[155] Consequently, the restriction and disqualification regime and supporting statutory provisions have contributed significantly to the imposition of an objective standard of skill which directors must meet in relation to the role allocated to them.[156] In these decisions the relevant standard is frequently described as a standard of 'probity and competence', rather than in the traditional terms of care, skill and diligence.[157]

In Ireland, a major aim of the restriction and disqualification procedure was to put a stop to the 'Phoenix Syndrome' whereby directors of an insolvent company simply went on to establish on a new company carrying on the same business.[158] The primary purpose of the restriction and disqualification jurisdiction is to protect the public against the future conduct of companies by persons whose past records as directors of insolvent companies have shown them to be a danger to others, particularly creditors.[159] Undoubtedly such punitive statutory

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[153] See generally: TB Courtney n 105 above Chapter 12; A Brennan "Section 150 of the Companies Act 1990: Restriction of Directors Reviewed" (2002) 9 C L Pract 215; B Kirwan "Section 150 Restriction Applications and the Conduct of Directors" (2005) 12 CL Pract 271.

[154] See generally Chapter 6 below.

[155] The explosion in such applications is directly attributable to the effect of section 56 of the *Company Law Enforcement Act 2001*.

[156] See K Wardman "Directors, Their Duty to Exercise Care and Skill: Do the Provisions of the Company Directors Disqualification Act 1986 Provide a Basis for the Establishment of a More Objective Standard?" (1994) Bus LR 71.

[157] See *eg Re Grayan Building Services Ltd (in liq), Secretary of State for Trade and Industry v Gray* [1995] 1 BCLC 276, 286 and 289 *per* Hoffmann LJ and *per* Neill LJ; *Re Squash (Ireland) Ltd* [2001] 3 IR 35, 40 *per* McGuinness J.

[158] See *Report of the Working Group on Company Law Compliance* ("the McDowell Report") Pn 6696 Stationery Office (1998).

[159] See *Re Lo-Line Motors Ltd* [1988] BCLC 698, 703 *per* Browne-Wilkinson VC; *Re Westmid Packing Services Ltd, Secretary, Secretary of State for Trade and Industry v Griffiths* [1998] 2 All ER 124, 131 per Lord Woolf

regimes also fulfil the wider function of raising standards for directors more generally. In the UK, an acknowledged subsidiary purpose of the disqualification regime is to raise standard of conduct of company directors.[161] As Hoffmann LJ put it in *Re Grayan Building Services Ltd (in liq), Secretary of State for Trade and Industry v Gray*, "Parliament decided that it is occasionally necessary to disqualify a company director to encourage others."[162]

When a restriction application is made, the High Court must make a restriction order unless is satisfied that the person concerned "has acted honestly and responsibly in relation to conduct of the affairs of the company" and that there is "no other reason why it would be and equitable" that a restriction order not be made.[163] In the leading Supreme Court decision on restriction, *Re Squash (Ireland) Ltd*,[164] McGuinness J. stated that, in determining whether director acted responsibly, the court should consider the entire tenure of the director and simply his or her behaviour in the run up to the liquidation. In this case there was no question but that the directors had acted honestly and the only question was whether they had acted responsibly. This illustrates the statutory regime's contribution to the thinking that it is no longer regarded as sufficient to have acted honestly. Furthermore, McGuinness J stated that whether or not one acted responsibly was to be judged by an objective standard. Nevertheless there was a residual element of the business judgment rule lurking in this judgment. McGuinness J acknowledged that, in the case of insolvent companies, it is likely that some criticism can be made of directors but some leeway had to be given to directors on the basis that "[c]ommercial errors may have occurred, misjudgements may well have been made but to categorise conduct as irresponsible I feel that one must go further than this."[165] The Supreme Court held that in order to qualify as irresponsible conduct so as to trigger an order

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MR; *La Moselle Clothing Ltd v Soualhi* [1998] 2 ILRM 345, 352 *per* Shanley J; *Re Squash (Ireland) Ltd* [2000] IR 35, 40 *per* McGuinness J.

[160] This view is endorsed in A Walters n 23 above at 115.

[161] *Re Swift 736 Ltd* [1993] BCLC 896, 899 *per* Nicholls VC; *Secretary of State for Trade and Industry v Gray* [1995] 1 BCLC 276, 284 *per* Hoffmann LJ; *Re Westmid Packing Services Ltd, Secretary of State for Trade and Industry v Griffiths* [1998] 2 All ER 124, 131 *per* Lord Woolf MR.

[162] [1995] 1 BCLC 276, 284.

[163] Section 150(2) of the 1990 Act (as amended by section 41 of the *Company Law Enforcement Act 2001*).

[164] [2001] 3 IR 35. On the residual application of the business judgment rule, see further Part F(3) below.

[165] [2001] 3 IR 35, 39.

under section 150 of the *Companies Act 1990* there must be more than mere commercial misjudgment on the part of the company officer concerned. McGuinness J indicated that factors to be considered in this context include the extent to which a director had complied with his statutory obligations, his general competence and commercial probity and the extent to which the officer was responsible for the insolvency of the company.

The Supreme Court approved Shanley J's formulation in *La Moselle Clothing Limited v Soualhi*[166] of relevant factors to be considered in deciding whether directors have acted responsibly. These factors are:

- The extent to which the director has complied with the obligations imposed by the Companies Acts;[167]
- The extent to which the director's conduct could be regarded as so incompetent as to amount to irresponsibility;
- The extent of the director's responsibility for the insolvency of the company;
- The extent of the director's responsibility for the net deficiency in the assets of the company disclosed at the date of the winding-up or thereafter;
- The extent to which the director displayed a lack of commercial probity or want or proper standards.[168]

While the corpus of restriction and disqualification decisions has undoubtedly influenced the judicial view of traditional duties, it is necessary to keep in mind the pertinent differences between the two. The court must make a restriction order, unless it is satisfied that the person concerned "has acted honestly and responsibly in relation to the conduct of the affairs of the company" and that there is "no other reason why it would be just and equitable" that a restriction order not be made.[169] This puts onus of rebutting on the director unlike the position in a common law or equitable claim for breach of the duty to exercise care, skill and diligence. Furthermore, a finding of breach of duty will not automatically lead to a restriction or disqualification. Equally, the absence of a finding of breach of common law or equitable

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[166] [1998] 2 ILRM 345.

[167] This has since been widened in the context of disqualification to include compliance with all legal obligations: *Re National Irish Bank Ltd; Director of Corporate Enforcement v Seymour* [2007] IEHC 102.

[168] [1998] 2 ILRM 345, 352.

[169] Section 150(2) of the 1990 Act (as amended by section 41 of the *Company Law Enforcement Act 2001*).

duties will not rule out the making of a declaration of restriction. The courts have been
to distinguish restriction and disqualification proceedings from a professional negli
claim. In *Re Barings plc (No. 5), Secretary of State for Trade and Industry v Baker*[17
Court of Appeal in considering an appeal against disqualification emphasised that the
was not whether the appellant was an incompetent operator in the financial produc
derivatives market because it was wrong to equate disqualification proceedings w
professional negligence claim. Furthermore, in considering an application for restrictio
court's review will be confined to the director's role in the company at issue and generall
not extend to a review of his or her conduct as a manager or director of a related company

While it is appropriate to take cognisance of the differing terrain of restriction
disqualification proceedings, a development which is of particular significance is
emergence of a judicial practice in the Irish courts of scrutinising a director's compliance
his or her non-statutory duties when considering whether to make a declaratio
restriction.[172] This new departure originated in *Kavanagh v Delaney*[173] where F
Geoghegan J regarded the "common law duty of skill and care" as relevant to a decisio
whether to impose a declaration of restriction. This was a watershed decision in the la
restriction because it involved the addition of an extra criterion to the *La Moselle Clothin*
v Soualhi[174] factors for determining responsible behaviour. The grafting on of an addit
test in *Kavanagh v Delaney* to the existing judicial test to determine whether a director
responsibly in relation to the extent to which a director has complied with the duties imp
by the common law has yielded renewed consideration of the non-statutory duties of dire
including the duty to exercise care, skill and diligence.[175] This contribution will be exp
in the remainder of this chapter.

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[170] [2000] 1 BCLC 523.

[171] *Kavanagh v Delaney* [2005] 1 ILRM 34; *Grace v Kachkar* [2005] IEHC 63.

[172] Previously it had been judicial practice since *La Moselle Clothing Ltd v Soualhi* [1998] 2 ILRM 3
consider compliance with the Companies Acts but not compliance with non-statutory duties.

[173] [2005] 1 ILRM 34. See also *Grace v Kachkar* [2005] IEHC 63; *Re SPH Ltd; Fennell v Shanahan* [
IEHC 152; *Re Club Tivoli Ltd (in vol liq); Foster v Davis* [2005] IEHC 468.

[174] [1998] 2 ILRM 345.

[175] See *eg Kavanagh v Riedler* [2004] 3 IR 498; *O'Ferral v Coughlan* [2004] 4 IR 266; *Grace v Kackhar* [
IEHC 63; *Martin v Ferris* High Court (Clarke J) 4 March 2005; *Re Cooke's Events Co Ltd, Kavanagh v*
[2006] 1 ILRM 191.

(3) Judicial Milestones in Developing The Modern Approach

It is only in the very late stages of the twentieth century that it can be said that a marked change of approach in judicial approach from the traditional one of the late nineteenth and early twentieth centuries is evident. The traditional subjective approach to care, skill and diligence, once firmly entrenched by the judiciary, has now had large inroads made into its application. The shift in the Irish judicial thinking followed a shift in the English judiciary which in turn trailed developments in Australia where the courts have been more dynamic in adapting the application of directors' duties to the modern world.[176]

(a) Early Warning Signs

Dorchester Finance Co Ltd v Stebbing[177] marked the beginning of English judicial disquiet with 'nominal' directors and the end of the Victorian approach that a failure to perform any of duties protected a director from liability. Two non-executive directors were made liable by Foster J for the debts of the company which arose when a third director, Mr Stebbing, made illegal loans that could not be recovered. The other directors had signed blank cheques at Mr Stebbing's request. They were held to have been negligent on the basis that if the other directors had intervened the loss could have been avoided. It was held that the non-executive directors "not only failed to exhibit the necessary skill and care in the performance of their duties as directors, but also failed to perform any duty at all as directors...."[178] This represented a considerable *volte face* in the intervening century from *Re Brazilian Rubber Plantations & Estates Ltd*[179] where Neville J asserted that a director is not bound to take any

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[176] See BS Butcher n 8 above at 78 ff. For the shift in emphasis and clarification of directors' liability in negligence see *Permanent Building Society (in liq) v Wheeler* [1992] 14 ACSR 109 *Permanent Building Society (in liq) v Wheeler* [1992] 14 ACSR 109; *Daniels v AWA Ltd* [1995] 16 ACSR 607, 608 (support for general requirement that directors exercise reasonable care in the performance of their office in judgments of Clarke and Sheller JAA); *State of South Australia v Clark* [1996] ACSR 606.

[177] [1989] BCLC 498 (Foster J's judgment was delivered in 1977 but remained unreported until 1989).

[178] *Ibid* at 505.

[179] [1911] 1 Ch 425, 437.

definite part in a company's affairs and that it was only to the extent that he involved him that he was required to exercise care.

Of particular relevance in *Dorchester Finance* was the fact that two directors were charte accountants and the third was said to have considerable experience of accountancy. Foste held that if they had exercised the skill they possessed, they would have prevented the l occurring. The decision indicated that if a director had relevant skills or expertise, he w required to exercise them for the good of the company.[180] Foster J's approach in *Dorches Finance* followed a trail which had been started by the Australian judiciary in the decision the Australian Capital Territory Supreme Court in *Re Australasian Venezolana Pty Ltd* where directors had been held negligent in signing cheques without enquiry as to their purp and not taking reasonable steps to acquaint themselves with the company's busine Although *Dorchester Finance* is frequently identified as a turning point in judicial thinking reality, it is more accurate to state that it foreshadowed later judicial commitment to spri cleaning the principles in *Re City Equitable* for application to the modern world.[182]

(b) The Imported 'Insolvency' Test

The change of judicial philosophy evident in *Dorchester Finance* was taken up again in t decisions by Hoffmann J in the English High Court in the early 1990s. While *Dorches Finance* may have been a false dawn in 1977, *Norman v Theodore Goddard*[183] and *Re D'J of London Ltd*[184] heralded a decisive judicial movement into the territory of objecti standards for directors.[185] In *Norman*, Hoffmann J articulated an objective element to the d to exercise skill in stating that a director must have the skill "that may reasonably be expec

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[180] This led to *Dorchester Finance Co Ltd v Stebbing* [1989] 1 BCLC 523 being relied on in support of proposition that if a professional director abdicates responsibility to another, the inert director will be h responsible. See further Part E(1) and (3) below.

[181] (1962) 4 FLR 60.

[182] See AS Sievers "Farewell to the Sleeping Director – The Modern Judicial and Legislative Approach Directors' Duties of Care, Skill and Diligence" (1993) 21 ABLR 111 at 119.

[183] [1991] BCLC 1028.

[184] [1994] 1 BCLC 561.

[185] See A Hicks n 5 above.

from a person undertaking those duties."[186] A few years later in *Re D'Jan*,[187] Hoffmann LJ (sitting as an additional judge of the Chancery Division) made an innovation which went on to be widely embraced. This innovation equated the duty of care owed by a director at common law with the statutory standard required of directors in the UK's wrongful trading provision, section 214(4) of the UK *Insolvency Act 1986*.[188] Although the initial importation of the section 214(4) test in *Re D'Jan* occurred with minimal judicial analysis on the part of Hoffmann LJ, over the course of the last decade or so the courts have used the test in section 214(4) of the *Insolvency Act 1986* to establish a common law standard of care applicable outside the insolvency context.[189] The section 214(4) test therefore gained widespread judicial acceptance as a competence test for directors.

Section 214 of the *Insolvency Act 1986* allows personal liability to be imposed on a director where a company has gone into insolvent liquidation in circumstances where, before the commencement of the winding up, the director knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation.[190] Located in the context of wrongful trading, the duties referred to are owed to the company's creditors rather than the company itself.[191] It has been said that the consequence of importing the standard in section 214(4) of the *Insolvency Act 1986* is to take a test which "applies very

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[186] [1991] 1 BCLC 1028, 1030.

[187] See C Nakajima "Signing Without Reading" (1994) 15 Co Law 123; A Boyle "The Common Law Duty of Care and Enforcement under s. 459" (1996) 17 Co Law 83.

[188] This had been previously advocated by commentators. See JH Farrar *et al Farrar's Company Law* 3rd ed Butterworths London 1991 at 398-400; V Finch n 35 above at 201. See generally RM Goode *Principles of Corporate Insolvency Law* 2nd ed Sweet & Maxwell London 1997 at 458 ff.

[189] See *eg Re Landhurst Leasing plc, Secretary of State for Trade and Industry v Ball* [1999] 1 BCLC 286; *Cohen v Selby* [2001] 1 BCLC 176; *Secretary of State for Trade and Industry v Goldberg* [2004] 1 BCLC 597; *Secretary of State for Trade and Industry v Bairstow* [2004] EWHC 1730 (Ch).

[190] Section 214's innovative objective test had its source in the *Report of the Review Committee on Insolvency Law and Practice* chaired by Sir Kenneth Cork ("the Cork Report") Cmnd 8558 (1982).

[191] See D Arsalidou "The impact of section 214(4) of the Insolvency Act 1986 on directors' duties" (2000) 22 Co Law 19 at 19.

late in the day when insolvency is predictable"[192] and "to demand the same objective stand throughout the life of the company."[193]

Applying section 214(4) of the *Insolvency Act 1986's* requirements involves asking whet the conduct of the director was the conduct of:

> "a reasonably diligent person having both (a) the general knowledge, skill a experience that may reasonably be expected of a person carrying out the sa functions as are carried out by that director in relation to the company, and (b) general knowledge, skill and experience that that director has".[194]

Section 214(4) lays down what can be characterised as a part objective, part subject standard.[195] Thus the first requirement is an objective test while the second looks to the act knowledge, skill and experience of the director in question. The first aspect emphasises t importance of setting the relevant standards in the context of the particular role and functi of the director.[196] This allows for the imposition of a different standard for executive and n executive directors. It also allows any particular responsibilities of the director to be tak into account *eg* that he or she is the finance director of the company.[197] The second asp allows for raising the standard beyond objective standard to reflect the director's own level expertise.[198] Therefore what can be expected of a director of a large public company

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[192] A Hicks n 5 above at 391.

[193] *Ibid.*

[194] [1994] 1 BCLC 561, 563.

[195] See A Hicks n 5 above at 391.

[196] See *Bishopsgate Investment Management Ltd (in liq) v Maxwell (No.2)* [1993] BCLC 1282, 1285 Hoffmann LJ; *Re Barings plc (No. 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 4 endorsed on appeal [2000] 1 BCLC 523, CA.

[197] See *Re Brian D Pierson (Contractors) Ltd* [2001] 1 BCLC 275 (director an accountant).

[198] *Ibid* at 302. By contrast, the Irish deemed reckless trading provision, section 297A(2)(a) of the *Companies 1963* (inserted by section 180(3) of the *Companies Act 1990*), refers to a more objective test of "having regard the general knowledge, skill and experience that may reasonably be expected of a person in his position, he ou to have known that his actions or those of the company would cause loss to the creditors of the company, or a of them."

unlikely to be on a par with what can be expected of a director in a small private company.[199] Thus it is "a flexible, not an absolute, minimum standard".[200] As Chadwick LJ stated in *Cohen v Selby,* section 214 "provides a useful exposition of the standard of care required by a director in relation to what he ought to have known, the conclusions which he ought to have reached and the steps which he ought to have taken."[201]

The section 214(4) test addresses the criticism that a purely subjective test of compliance with care, skill and diligence is open to criticism on the basis that, in excusing an individual director who did not have the skill necessary to prevent a particular loss, it derogates from company law's primary assumption of the collective responsibility of directors.[202]

(c) The Duty Centre-Stage: Re Barings plc (No. 5)

The most decisive judicial shift towards an objective standard came about in the aftermath of the Nick Leeson / Barings Bank scandal. It was the infamous *Barings* litigation[203] which marked the point of no return. The decision of Jonathan Parker J at first instance is the leading contemporary case on the duty of care, skill and diligence.[204] It marked a decisive development in judicial thinking from *Re City Equitable.* Jonathan Parker J's judgment gave flesh to the bones of the test in section 214(4) of the *Insolvency Act 1986* adapted by the judiciary for use in this context. *Barings* was a key turning point in judicial thinking on what society expects of directors from which there has been no return; the case represented the crossing of the Rubicon as far as the swinging of the subjective/objective pendulum was concerned. Since then other corporate scandals such as Enron, Parmalat and MCI Worldcom can only have served to further fuel societal expectations that directors should not be allowed to escape responsibility.[205]

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[199] See *Re Produce Marketing Consortium Ltd (No. 2)* [1989] BCLC 520.

[200] A Walters n 23 above at 113.

[201] [2000] 1 BCLC 176, [21].

[202] R Reed n 145 above at 171. However, arguably, there has been a shift towards a focus on individual collective responsibility: see Part F(1) below.

[203] *Re Barings plc (No. 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433.

[204] Jonathan Parker J's judgment was endorsed on appeal: [2000] 1 BCLC 523 (CA).

[205] See further n 141 above.

The attendant blaze of publicity has the consequence that the factual background to decision is well-known. The unauthorised trading of one Nick Leeson, the general mana and assistant director of Barings Futures (Singapore) Pte Ltd resulted in losses of Stg£82 and, ultimately, to the collapse of the Barings group. Disqualification proceedings taken the Secretary of State for Trade and Industry under section 6 of the *Company Direct Disqualification Act 1986* led to directors of the bank being declared unfit to be a director a disqualified.[206] This occurred in circumstances where, although there was no issue as to directors' honesty and integrity, they had failed to put in place adequate internal procedures monitor the activities of a trader within the investment bank. It emerged that there was segregation of front and back office functions within the Singapore office and no real effo had been made to enforce risk limits on Leeson in relation to his trading. In addition, th had been a failure to ensure that consistent and appropriate settlement procedures were place throughout the group.

Jonathan Parker J's landmark three proposition formulation of a directors' duty to exerc skill, care and diligence both synthesised and developed existing principles. The *Barin* propositions are:

> "(i) Directors have, both collectively and individually, a continuing duty to acqu and maintain a sufficient knowledge and understanding of the compan business to enable them properly to discharge their duties as directors.[207]
>
> (ii) Whilst directors are entitled (subject to the articles of association of t company) to delegate particular functions to those below them in t management chain, and to trust their competence and integrity to a reasonab extent, the exercise of the power of delegation does not absolve a director fr the duty to supervise the discharge of the delegated functions.

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[206] Jonathan Parker J disqualified three senior executive directors for four, five and six years [1999] 1 BCLC 4 Orders ranging from two to five years were made against another seven directors in separate proceedings: further *Re Barings plc (No. 5), Secretary of State for Trade and Industry v Baker* [2000] 1 BCLC 523, [2].

[207] Jonathan Parker J based this on the dictum of Lord Woolf MR in *Re Westmid Packing Services Ltd, Secret of State for Trade and Industry v Griffiths* [1998] 2 All ER 124, 130. This has been applied on numer occasions. See *eg Re Kaytech International plc, Secretary of State for Trade and Industry v Kaczer* [1999 BCLC 351; *Re Landhurst Leasing plc* [1999] 1 BCLC 286

(iii) No rule of universal application can be formulated as to the duty referred to in (ii) above. The extent of the duty, and the question whether it has been discharged, must depend on the facts of each particular case, including the director's role in the management of the company."[208]

Re Barings plc (No.5) showed an identifiable hardening of judicial resolve and the removal of unquestioning judicial deference to business judgment. Although the Irish courts have never had the opportunity to directly consider the merits of the section 214 hybrid test adapted by the English judiciary to update directorial standards of care, the Irish courts have embraced the *Barings* propositions in the context of consideration of restriction applications against directors beginning with *Re Vehicle Imports Ltd.*[209] Contemporary case law from *Re Barings plc (No.5)* on therefore evinces a move towards the establishment of a more generic standard for directors to meet.

Although the standard is more objective, there is a difference in treatment to that of other professionals (for whom the standard required for performing a particular operation may be seen in universal terms) because the duty of care applicable to directors requires its application to be tailored to the particular circumstances such as the size of the company and the type of director and even the remuneration of the director in question.[210] Nevertheless, the duty of directors to actively ensure that they are well-informed in relation to their role and the company's business as enunciated in *Barings* will play its part in moving towards an objective concept of 'the professional director'.[211] The impact of *Barings* is that it is now necessary to look at the particular duties allocated to a director and other factors such as his or her prior experience and qualifications and remuneration, a clear advance on *Re City Equitable.*[212]

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[208] [1999] 1 BCLC 433, 489. Quoted with approval on appeal [2000] 1 BCLC 523, [36].

[209] [2000] IEHC 90. See also *Kavanagh v Delaney* [2005] 1 ILRM 34; *Grace v Kachkar* [2005] IEHC 63; *Re SPH Ltd; Fennell v Shanahan* [2005] IEHC 152; *Re Club Tivoli Ltd (in vol liq; Foster v Davis* [2005] IEHC 468.

[210] *Re Barings plc, Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433.

[211] See Part E(2) below.

[212] *Re City Equitable Fire Insurance* [1925] Ch 407.

E. EMERGING SUB-DUTIES

This Part considers how *Barings* has spawned the emergence of various distinct aspects wit the skill, care and diligence composite. A number of distinct sub-duties can be identified fr the case law: a duty to participate, a duty to be appropriately informed and, where directo duties are delegated, a duty to monitor and supervise. Many of these are closely associa with each other and frequently overlap in their application. Nevertheless each has n assumed an individual significance which merits discrete examination.

(1) The Duty to Participate in Company Affairs

As discussed in Part C above, initially the courts did not impose a positive duty on directors participate in company affairs. However, a change of judicial attitude stemmed fr *Dorchester Finance Co Ltd v Stebbing*[213] where Foster J held that the non-executive direct "not only failed to exhibit the necessary skill and care in the performance of their duties directors, but also failed to perform any duty at all as directors."[214] It is now accepted tha all circumstances a duty of active participation exists[215] although its application in any cas a matter of degree. The extent of a duty to participate in company's management will dep on how the particular company's business is organised and the part which the director co reasonably have been expected to play.[216]

The requirement to participate in company management was put beyond doubt by *Re Bari plc (No.5).*[217] Inherent in the first limb of Jonathan Parker J's enunciation of skill, care a diligence is an implicit recognition that a person who accepts the office of director o

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[213] [1989] BCLC 498.

[214] *Ibid* at 505.

[215] *Re Barings (No. 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433; *Kavanag Delaney* [2005] 1 ILRM 34.

[216] *Bishopsgate Investment Management Ltd (in liq) v Maxwell (No.2)* [1994] 1 All ER 261, 264 *per* Hoffm LJ. The approach to duty to exercise skill, care and diligence in this case has been criticised: see RC Nolan n above.

[216] *Re Barings plc (No. 5), Secretary of State for Trade and Industry v Baker* [2000] 1 BCLC 523, [36].

[217] [1999] 1 BCLC 433, 435.

particular company undertakes the responsibility of ensuring that they understand the nature of the duties a director is called upon to perform including the duty of acting collectively with other directors to manage the company. The *Barings* conception of a duty of active participation has also received the imprimatur of the Irish High Court.[218]

Restriction and disqualification decisions show that nominee directors such as family members who do not take an active role in the company's affairs will fall foul of the duty to participate in the management of the company's affairs (and the allied requirement to be suitably informed as to the company's affairs). It is no longer open to directors to simply occupy the position in name alone in order to fulfill legal requirements. The courts have moved away from the traditional *laissez-faire* approach to enunciating the concept of minimum responsibility. Such minimum responsibilities and functions:

> "are not simply discharged by leaving all management functions and consideration of the company's affairs to another director without question, even in the case of a family company .... One cannot be a 'sleeping' director; the function of 'directing' on its own requires some consideration of the company's affairs to be exercised."[219]

In the context of the reckless and fraudulent trading provisions and the restriction and disqualification regimes for directors under the *Companies Act 1990*, it is clear that the *laissez-faire* approach exemplified by cases such as *Re Brazilian Rubber Plantations and Estates Ltd*[220] has been fully cast aside by the Irish judiciary. This dispelling of the myth of the token director has been a consistent thread in Irish restriction decisions. Therefore little sympathy has been afforded to paper directors such as family members. For example, in *Re Hunting Lodges Ltd*[221] a wife of another director was held liable for fraudulent trading on the basis that "a person who becomes a director takes on responsibilities and duties, particularly

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[218] See *O'Ferral v Coughlan* [2004] 4 IR 266; *Kavanagh v Delaney* [2005] 1 ILRM 34.

[219] *Re Brian D Pierson (Contractors) Ltd* [2001] 1 BCLC 275, 309-310 *per* Hazel Williamson QC. See also *Re Westminster Property Management Ltd, Official Receiver v Stern (No. 2)* [2001] BCC 305 (son in dereliction of duties disqualified).

[220] [1911] 1 Ch 425.

[221] [1985] ILRM 75.

where there are only two."[222] The woman was unable to avoid liability by claiming that was only concerned with minding her house and looking after her children. The court's vi was that if that was the limit of the responsibilities she wanted, she should not have becom director of the company. In *Re Costello Doors Ltd*[223] confirmed that the judicial death kn had sounded for the inert director. Murphy J stated emphatically:

> "I do not accept that anybody who agrees to act as director of a company can excused from acting responsibly merely because he or she is a friend, relative spouse of the proprietor of the company and accepts the office to facilitate proprietor without being prepared to involve himself or herself in any aspect of management of the company."[224]

The requisite involvement in company's affairs would include the keeping of statutory boo and accounts[225] and keeping informed of the company's business and financial position.[226] is clear from restriction cases that a director's failure to take reasonable steps to satisfy hims that proper books and records are maintained is treated as significant.[227] Nor will the cou lightly entertain a claim that exclusion from the affairs of the company prevented the direc carrying out his duties.[228] The duty to participate in company affairs may require a director keep abreast of company affairs and to ask questions where suspicions are raised.[229] Thus *Re Park House Properties Ltd*[230] a wife and teenage children who knew nothing of t husband/father's misappropriation of company assets were disqualified for failing to take a

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[222] *Ibid* at 85. See also *Re Vehicle Imports Ltd* [2000] IEHC 90.

[223] High Court (Murphy J) 21 July 1995 unrep.

[224] *Ibid* at p 3-4 of the unreported judgment.

[225] See *Re Produce Marketing Consortium Ltd (No. 2)* [1989] BCLC 520, 550.

[226] See *Re Kaytech International plc, Secretary of State for Trade and Industry v Kaczer* [1999] 2 BCLC 351; *Landhurst Leasing plc, Secretary of State for Trade and Industry v Ball* [1999] 1 BCLC 286.

[227] *Martin v Ferris* High Court (Clarke J) 4 March 2005 unrep.

[228] *Ibid.*

[229] A Walters n 23 above at 116. See further the discussion on the monitoring function below.

[230] [1997] 2 BCLC 530. See also *Re Gaelforce Pleating Co Ltd* [1999] 2 BCLC 704 (spouse director disqualifi who had a negligible involvement in the company's affairs); *Re Westminster Property Management Ltd (No. Official Receiver v Stern (No. 2)* [2001] BCC 305.

part in the company's affairs. In this regard *Re Lynrowan Enterprises Ltd*[231] is somewhat of an aberration in that the High Court rather dubiously refused to make a declaration of restriction against a director who took no part whatsoever in the company's affairs.

In *O'Ferral v Coughlan*[232] a restriction order was made in respect of a director of a wholly-owned Irish subsidiary within a worldwide group who was regarded as not having participated in any substantive decision in relation to the operation of the company. The decision indicates that even where decision-making discretion is small, this would not absolve a director from the duty of active participation in decision-making rather than simply taking orders.[233] This has particular significance in the context of multinationals which are often for all intents and purposes controlled from global headquarters leaving little scope for autonomous decision-making.[234]

In *Kavanagh v Delaney,*[235] Finlay Geoghegan J approved Jonathan Parker J's statement in *Re Barings plc. (No. 5)* that each individual director owes duties to the company to inform himself about its affairs and to join with his co-directors in supervising and controlling them. She also approved dicta from *Daniels v Andersen*[236] concerning the duty to participate which requires directors to "take reasonable steps to place themselves in a position to guide and monitor the management of the Company."[237] Finlay Geoghegan J went on to state that it would be difficult for a director to establish that he had acted responsibly within the meaning of section 150 (2) of the *Companies Act 1990*, "if during a significant period he or she either failed to inform himself or herself about its affairs or if he or she did not take steps to join with

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[231] [2002] IEHC 90.

[232] [2004] 4 IR 266.

[233] See also *Grace v Kackhar* [2005] IEHC 63.

[234] Ireland's statutory corporate landscape has no equivalent of Australia's section 187 of the *Corporations Act 2001* and New Zealand's section 131(2) of the *Companies Act 1993* which in the case of a wholly owned subsidiary permit a company's constitution to authorise the subsidiary company's directors to act in the parent company's best interests. See further RP Austin, HAJ Ford and IM Ramsay *Company Directors: Principles of Law and Corporate Governance* LexisNexis Butterworths Australia 2005 at para 7.15.

[235] [2005] 1 ILRM 34. See also *Kavanagh v Riedler* [2004] 3 IR 498; *Re SPH Ltd; Fennell v Shanahan* [2005] IEHC 152.

[236] (1995) 16 ACSR 607.

[237] (1995) 37 NSWLR 438, 501.

his or her co-directors in supervising and controlling the affairs of the company at least in th sense of taking reasonable steps to guide and monitor the management of the company."[238] I that case, the holding of regular board meetings was regarded as the primary means o ensuring that the directors could collectively seek to discharge their duties of supervision an control.[239] Indeed, in Australia, the judicial view has been articulated that the moder expectation would be that a director would attend all board meetings unless exceptiona circumstances prevented this.[240]

(2) Competence and the Duty to be Appropriately Informed

The traditional approach of the law was not to impose substantive qualification requirement in respect of holding the position of director. This has not been altered a great deal by moder company legislation. There have been limited statutory incursions into the lack of any pre conditions as to who might act as a director. The current position is that although there are n formal qualifications to be satisfied in relation to becoming a director, as a matter of policy bodies corporate[241] and certain individuals[242] are excluded by their conduct from becoming director. However, while special qualifications may not be required, there is a growin impetus worldwide in the direction of director education and qualification. The courts hav fashioned a duty on directors, once appointed, to take steps to assume a certain level o competence and to ensure that they are appropriately informed about the company's affairs s as to participate in decision-making in a meaningful way. It has been noted that in the lack o a requirement for directors to have any particular qualification, regulation occurs not o company formation but after a company has been incorporated.[243] In effect, the judiciar

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[238] [2005] 1 ILRM 34, 45.

[239] On the importance of holding formal board meetings see *Stafford v Beggs* [2006] IEHC 88.

[240] *Vrisakis v ASC* (1993) 11 ACSR 162, 170 *per* Malcolm CJ. Qualifying circumstances were seen as illness or absence from the State.

[241] Section 176 of the *Companies Act 1963*.

[242] Undischarged bankrupts are prohibited from becoming directors: section 183 of the *Companies Act 196* persons who are the subject of a declaration of restriction may only become a director of a company with certai minimum level of capitalisation while disqualified persons may not so act: Part VII of the *Companies Act 1990*.

[243] M Arden "Reforming the Companies Acts – The Way Ahead" [2002] JBL 579, 580.

stepped in where the legislature failed to tread by placing the onus on directors to acquire the level of competence required to properly discharge their functions and duties.

In *Norman v Theodore Goddard*[244] Hoffmann J endorsed an objective understanding of competence in stating that a director must have the skill that may reasonably be expected from a person undertaking those duties.[245] Thus the competence required is to be set in the appropriate factual context. This is apparent from his assertion that a director who undertakes the management of the company's properties would be expected to have reasonable skill in property management, but not in offshore tax avoidance.[246]

In *La Moselle Clothing Ltd v Soualhi,*[247] Shanley J set out as a factor in determining a restriction application, "the extent to which [the director's] conduct could be regarded as so incompetent as to amount to irresponsibility."[248] The self-education imperative springs most cogently from *Re Barings plc (No.5)*[249] where Jonathan Parker J held that directors had, both collectively and individually, "a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them to properly discharge their duties as directors."[250] Once endorsed by the Court of Appeal, this was the point of no return for judicial indulgence concerning ignorant directors. In the disqualification proceedings against senior directors of the bank, their failure adequately to supervise the rogue trader's activities was linked to a lack of understanding of trading activities. The deputy group chairman, had not informed himself by seeking to gain an understanding of the 'switching' business engaged in by Leeson. This ignorance of the business meant that he was oblivious to warning signs that something was amiss and meant that he could be fobbed off with implausible explanations.

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[244] [1991] BCLC 1028.

[245] *Ibid* at 1030.

[246] *Ibid.*

[247] [1998] 2 ILRM 345.

[248] *Ibid* at 352. Adopted by the Supreme Court in *Re Squash (Ireland) Ltd* [2001] 3 IR 35, 40.

[249] [1999] 1 BCLC 433. This was approved by the High Court in *Kavanagh v Delaney* [2005] 1 ILRM 34.

[250] [1999] 1 BCLC 433, 489.

The first limb in Jonathan Parker J's test re-fashioned what had been a somewhat ineffect duty of skill, care and diligence by adding an active self-education requirement into the m This overrode Romer J's tenet in *Re City Equitable Fire Insurance* that a director need exhibit in the performance of his duties a greater degree of skill than can reasonably expected from a person of his knowledge and experience. While the standard of competer was referred to in *Barings* as "a universal standard",[251] the courts continue to emphasise t the standard has to be applied to the facts of each particular case. In the context of judic application of the statutory rules on restriction and disqualification, what has been terme "lowest common denominator" approach to proving competence has been rejected.[252] Thus *Re Barings plc (No. 5),*[253] it was no defence to a charge of unfitness based on incompeter for a director to contend that he had or could competently carry out a management role another company.[254]

Judicial recognition of the need for directors to up-skill parallels other developments in t sphere. The Combined Code recommends that directors, both executive and non-executi should receive appropriate training on the occasion of their first appointment to a list company.[255] In the UK the Institute of Directors has introduced a chartered direc qualification and a code of conduct to be complied with by chartered directors.

On occasion there has been judicial recognition of an educative function of a managi director. In the Australian case, *The State of South Australia v Clark,*[256] the court viewed t managing director and chief executive officer of the State bank as having an educational r on the basis the board of directors looked to him and relied upon him to provide to the boa with full and accurate information as to all of the matters which it was proper for the board

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[251] *Re Barings plc (No. 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433, 484.

[252] *Ibid.*

[253] *Re Barings (No. 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433.

[254] This perhaps reflects the confined nature of the statutory regime and similar restrictions would not apply relation to the equitable and common law duties.

[255] Financial Reporting Council (UK) *Combined Code for Corporate Governance* (2006) Principle A.5.

[256] [1996] SASC 5499.

consider.[257] In *Re Barings plc (No.5)*[258] the information dissemination role of executive directors and the managing director was elucidated as follows:

> "... where board meetings are regularly held it is normally an executive director (often a managing director or chief executive officer or financial controller or financial director) who brings to the board of directors the relevant information in relation to the affairs of the company. That information should in the normal course, be such as to permit all directors, both non-executive and executive, to inform themselves about the affairs of the company and exercise their collective duties and functions of supervising and controlling the affairs of the company."[259]

Similarly, in *Kavanagh v Delaney*[260] Finlay Geoghegan J referred to the role of executive directors and, in particular, a managing director or chief executive officer, in bringing information on the company's affairs to the board including non-executive directors. In *Re Club Tivoli Ltd (in vol liq); Foster v Davis*[261] Mac Menamin J characterised the director's conduct in failing to appreciate the seriousness of the company's financial position as a breach of his duty to inform himself as to the company's affairs.[262]

A number of cases have dealt with the duty of directors of an Irish subsidiary of a global group. In *O'Ferral v Coughlan*[263] a restriction order was made in respect of a director who had not participated in any substantive decision in relation to the operation of the company and who executed documents without making proper efforts to appreciate their significance. Finlay Geoghegan J elucidated the application of the duty to be appropriately informed in holding that the directors of a wholly owned Irish subsidiary company were required not only to appreciate group policies but to apprise themselves in relation to the affairs of the Irish subsidiary company. This obligation applies even where the decision-making discretion afforded to directors of an Irish subsidiary company is highly limited.

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[257] *Ibid* at [157] *per* Perry J.

[258] [1999] 1 BCLC 433.

[259] *Ibid* at 435.

[260] [2005] 1 ILRM 34, 42.

[261] [2005] IEHC 468.

[262] See also *Roache v Culloo* [2005] IEHC 448.

[263] [2004] 4 IR 266.

There are instances of a judicial inclination to place brakes on the potential breadth o director's duty to be educated about their company's business. These indicate that the level education required is not to be equated with specialist expertise. In this respect, the case l indicates that the duty to be appropriately informed and the duty to monitor and supervise closely linked. Accordingly, Professor Hannigan notes that the courts do not expect " detailed knowledge of the minutiae of the particular business but rather knowledge compati with the need to supervise and monitor the conduct of the company's business."[264] This illustrated by *Re Continental Assurance Co of London plc*[265] which concerned the collapse an insurance company. The liquidators sought contributions from the directors to t company's assets from liquidators on the basis of wrongful trading and misfeasance. T liquidators contended that if the directors had ensured that appropriate accounting practic were utilised by the company, the company's difficulties would have been apparent at earlier stage and they could have taken steps to prevent it trading while insolvent. Park rejected the liquidators' attempts to impose a very high standard of education and knowled on the directors. It was held that that non-executive directors of an insurance company shou not be expected to have specialist knowledge of the accounting requirements for su companies but would be expected to have a general grasp of the general issues:

> "... In my view, [the directors] would have been expected to be intelligent layma They would need to have a knowledge of what basic accounting principles for insurance company were .... They would be expected to be able to look at t company's accounts and, with the guidance which they could reasonably expect to available to them from the finance director and the auditors, to understand them. What I do not accept is that they could have been expected to show the sort of intrica appreciation of recondite accounting details possessed by a specialist in the fi ...."[266]

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[264] B Hannigan *Company Law* LexisNexis UK London 2003 at 305.

[265] [2001] All ER (D) 229 Apr (Ch D).

[266] *Ibid* at [258].

Accordingly, the judge found that the directors had acted responsibly and liability was not imposed on either ground. The Irish courts have given credence to the importance of seeking professional or legal advice to redress lack of personal expertise.[267]

(3) Reliance, Delegation and the Emerging Duty to Monitor and Supervise

Subject to the confines of the company's articles of association, it is open to directors to delegate certain of their functions to others.[268] As a matter of policy, there is a clear public interest in this so that a company's business can be managed efficiently and indeed delegation has often been viewed as an intrinsic attribute of management.[269] In contemporary business life, while delegation is common, the emergence of the executive director as a full-time professional dedicated to furthering the company's interests has altered the picture. Judicial development in this area reflects both the changing role of the director and the impact of corporate scandals. Nevertheless, it is only in the last two decades or so that a revamped modern approach has gradually crept into judicial pronouncements. This shift in mindset has been aided in no small part by legislative initiatives which have changed the prevailing mindset. In Ireland, the change of approach can be traced back to the hard-hitting legislative machinery provided for the judiciary in Part VII the *Companies Act 1990*.[270] Furthermore, some judicial revisionism concerning delegation has occurred in the wake of scandals highlighting directors' failure to monitor or supervise those to whom responsibility has been delegated.

The central tenet of cases laying down the modern understanding of delegation is that delegation is not to be equated with wholesale abdication of responsibility. In the Australian

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[267] See *eg Re Squash (Ireland) Ltd* [2001] 3 IR 35.

[268] *Re National Bank of Wales Ltd* [1899] 2 Ch 392; *Dovey v Corey* [1901] AC 477; *Re City Equitable Fire Insurance Co* [1925] Ch 407; *Re Barings plc (No.5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433; *Re Vehicle Imports Ltd* [2000] IEHC 90.

[269] See *Schoonejongen v Curtiss-Wright Corp* 143 F. 3d 120, 127 (3d Cir Apr. 29 1998).

[270] This provided for the restriction and disqualification regimes.

case of *The State of South Australia v Clark,*[271] it was emphasised that while the c executive and managing director of a large bank was entitled to delegate responsibility for operation of different functions of the bank, he remained responsible for overall control operations at the bank.[272] A theme running through the modern case law is that delegation monitoring go hand in hand. This monitoring can be characterised as part of the dilige aspect under the composite rubric of skill, care and diligence. In *Re Westmid Packag Services Ltd, Secretary of State for Trade and Industry v Griffiths,*[273] a disqualificat application, two directors were held to have failed to keep themselves aware of the compan true financial position and to monitor adequately the activities of the dominant director w was availing of unsecured, interest-free loans from the company. Lord Woolf MR, deliver the judgment of the Court of Appeal, stated:

> "A proper degree of delegation and division of responsibility is of course permissib and often necessary, but not total abrogation of responsibility. A board of direct must not permit one individual to dominate them and use them ...."[274]

This emphasises each director's role as a watchdog. In *Landhurst Leasing plc, Secretary State for Trade and Industry v Ball*[275] Hart J endorsed reliance by a director relying on his her co-directors in circumstances where this reflected their area of responsibility within t company, provided there was no reason to suspect that it would be wrong to do so.

It is apparent that the monitoring requirement is closely connected to the director's duty participate. *Re Barings plc (No.5), Secretary of State for Trade and Industry*[276] uncovered t Mr Leeson was given unfettered and unsupervised control of the dealing and settlem

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[271] [1996] SASC 5499.

[272] The court also stressed that, given this position, it was appropriate for other directors to rely on him to ens that the implementation of the board's decisions did not expose the bank to any unnecessary risk. Ot Australian decisions on delegation and failure to monitor include *Cashflow Finance Pty Ltd v Westpac Bank Corp* [1999] NSWSC 671; *Australian Securities and Investments Commission, Re QLS Superannuation Pty L Parker* (2003) 21 ACLC 888; *Adler v ASIC* (2003) 46 ACSR 504

[273] [1998] 2 All ER 124.

[274] *Ibid* at 130.

[275] [1999] 1 BCLC 286.

[276] [1999] 1 BCLC 433.

functions where proper practice would suggest a segregation of these functions. raised the bar for monitoring and supervisory functions. Jonathan Parker J raised the bar for monitoring and supervisory responsibilities in holding that although directors were entitled to delegate their functions, the board of directors (and the individual director) retained responsibility for the delegated function and retained a residual duty of supervision and control the nature of which would depend on the individual circumstances.[277] The court rejected a submission that the group vice-chairman was entitled to act solely as a "leader" and "rainmaker" through the total delegation of his management role. Accordingly his role in the Barings debacle was assessed against the benchmark of the active participation in management which could reasonably be expected of the chairman of a major bank. As counsel for the DTI had said in opening the case, it was not enough for him, like a ship's captain, having given his orders, to sit back and admire the view![278] Jonathan Parker J emphasised that where delegation has taken place, the board (and the individual directors) remain responsible for the delegated function or functions and retain a residual duty of supervision and control. This was endorsed on appeal.

Barings represented a considerable advance on Romer J's approach in *Re City Equitable Fire Insurance Co Ltd*[279] whereby general reliance on others to perform their duties honestly was justified "in the absence of grounds for suspicion".[280] Indeed, the amplification of a duty on directors to supervise persons to whom duties have been delegated places in sharp relief the Earl of Halsbury's assertion (almost a century earlier) that "I cannot think that it can be expected of a director that he should be watching the inferior officers of the bank or verifying the calculations of the auditors himself."[281] High profile collapses such as HIH insurance[282] and Enron also focused on issues of delegation and monitoring.[283]

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[277] Jonathan Parker J applied the dictum of Lord Woolf MR in *Re Westmid Packing Services Ltd, Secretary of State for Trade and Industry v Griffiths* [1998] 2 BCLC 646, 653. See also *Cohen v Selby* [2001] 1 BCLC 176.

[278] See R Reed n 202 above at 175.

[279] [1925] Ch 407.

[280] *Ibid* at 429.

[281] *Dovey v Cory* [1901] AC 477, 486.

[282] See HIH Royal Commission *The Failure of HIH Insurance* (Australia) (2003).

[283] On the increased requirement for internal controls imposed by Sarbanes-Oxley see DC Langevoort "Internal Controls After Sarbanes-Oxley: Revisiting Corporate Law's Duty of Care as Responsibility for Systems" (2005-2006) 31 J Corp Law 949.

The decisive shift in English judicial thinking which followed *Barings* was mirrored in t jurisdiction. In *Re Vehicle Imports Ltd*[284] Murphy J approved the *Barings* proposition to effect that whilst directors were entitled (subject to the articles of association of the compa to delegate particular functions to those below them in the management chain, and to t their competence and integrity to a reasonable extent, the exercise of the power of delegat did not absolve a director from the duty to supervise the discharge of the delegated functi The distinction between the reality of delegation and monitoring in a small company versu large company was recognised by MacMenamin J in *Kavanagh v Cooke*:

> " ... issues such as delegation which may have a significant bearing in the defence the activities of directors in larger enterprises can hardly be seen in the same light this small company where the managing director either knew, must have known, ought to have known, any relevant matter regarding the conduct of the compan affairs and its overall solvency."[285]

It would appear that it may be perfectly appropriate for directors to rely on the advice a actions of professional advisers provided that it is not blind reliance.[286] The practical effect this is that risk-management blinkers may lead directors to waste needlessly company fun on professional advice in respect of every decision.[287] On the other hand, over-reliance advisers ought to be kept in check on the basis that a complete abdication of perso responsibility by a director will no longer be countenanced by the courts. Thus in *Bradcrown Ltd, Official Receiver v Ireland*[288] a director was disqualified for two years w had relied on professional advisers to an unreasonable degree in a transaction which involv the transfer of the company's principal assets for no consideration. The court regard reliance on professional advisers as a question of degree. In this case, the director should ha made some enquiries of his professional advisers rather than placing inordinate reliance

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[284] [2000] IEHC 90.

[285] [2006] 1 ILRM 191, 208.

[286] See further B Hannigan n 264 above at 309; *Norman v Theodore Goddard* [1991] BCLC 1028 (reliance solicitor); *Re Stevenson Cobbold Ltd, Secretary of State for Trade and Industry v Stephenson* [2000] 2 BCLC 6 (reliance on auditors); *Re Continental Assurance Co of London plc* [2001] All ER (D) 229 (Apr) Ch D.

[287] See B Hannigan n 264 above at 309.

[288] [2001] 1 BCLC 547.

them and failing to take any responsibility. In *Re Queens Moat Houses plc (No. 2),*[289] Rattee J (sitting as a judge of the High Court) held that a director was not entitled to deny responsibility for misleading accounting statements issued by the company by simply claiming reliance on other directors to whom the preparation of such statements had been delegated. Nor was it possible to simply rely on the auditors' certificate. Rather, having regard to the fact that the director had wide business experience, but no accountancy qualification, he would be expected to query matters which would be apparent to a person with his experience and knowledge. Therefore, he should have been aware that profit and loss figures were misleading. On the other hand, directors have been found to be entitled to have relied on the erroneous advice of a solicitor that a scheme did not contravene section 60 of the *Companies Act 1963.*[290]

F. ASPECTS OF THE MODERN APPROACH

(1) The Rise of Individual Responsibility

The classical understanding of the management role of the board directors, exercised under delegated authority from the members of the company, is one of collective decision-making and, consequently, collective responsibility. However, there is a discernible contemporary judicial penchant for focusing attention on individual directorial liability rather than collective board responsibility. Reed explains this on the basis of functional responsibility which has its roots in the common law principle of a duty of care arising from a relationship of proximity predicated on an assumption of responsibility.[291] Therefore, where a company director undertakes a specialist function, "[i]mplicit in the director's assumption of responsibility is the notion that he has held himself out as having the special knowledge, skill or experience necessary or appropriate to the particular responsibility being assumed."[292] The judicial focus on individual responsibility is undoubtedly linked to the enactment of the *Company Directors Disqualification Act 1986* in the UK and the Irish restriction and disqualification regime under

[289] [2005] 1 BCLC 136.

[290] *Coyle v Callanan* [2006] 1 IR 447 (restriction application refused).

[291] R Reed n 202 above.

[292] *Ibid* at 175.

Part VII of the *Companies Act 1990* all of which focus on the role and involvement individual directors in order to determine their individual level of culpability.[293] Th legislative initiatives clearly necessitate a judicial focus which is more at micro-level than t macro-level focus of the classical conception of collective directorial responsibility. T accommodation is evident in Lord Woolf MR's statement in *Re Westmid Packaging Servi Ltd, Secretary of State for Trade and Industry v Griffiths* that:

> "[The] collegiate or collective responsibility of the board of directors of a compan of fundamental importance to corporate governance under English company law. T collegiate or collective responsibility must however be based on individ responsibility …." [294]

It is therefore not surprising that the courts have shown themselves ready to consider t allocation of responsibility within a company and have readily accepted the commercial rea of delegation and reliance within the boardroom. That being said, to date the courts have clearly articulated a clear, principled bifurcation between individual and collect responsibility. Reed is adamant that functional responsibility cannot be allowed to erode t continuing existence of collective responsibility, stating that "[e]ven if functio responsibility is preferred as the basis for considering the duties of specialist directors, th will still be circumstances in which the assumption of collective responsibility rema appropriate."[295] The counter-argument is that companies must have the ability to appo specialist directors without exposing them to the risk of liabilities "arising from so collective responsibility for group failures pursuant to some general duty of oversight."[296]

One would suppose that some core responsibilities which should not be delegated call out a collective responsibility response *eg* the maintenance of statutory books and accounts a filing obligations.[297] The judicial view taken has, however, not been so predictable. In

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[293] See K Wardman n 156 above.

[294] [1998] 2 All ER 124, 130.

[295] R Reed n 202 above at 175.

[296] *Ibid.*

[297] The importance of holding board meetings to facilitate directors in collectively discharging their duties w underlined in *Kavanagh v Delaney* [2005] 1 ILRM 34.

Polly Peck International (No.2)[298] Lindley J referred to the confusion as to what duties were properly to be regarded as those of the board as a whole, and those for which directors bore individual responsibility. The court accepted that directors who were not individually responsible for putting in place financial control systems, were not, without more, responsible for the absence of such controls.[299] He rationalised this as follows:

> "An individual director who has not been individually charged by a board with the task of (for example) instituting adequate financial controls, might or might not be in breach of a duty to the company to use his best endeavours to procure their institution but not, without more, with their absence. Were that not so, a director who had striven manfully to introduce them would be as much in breach as one who had resisted them."[300]

This pre-*Barings* perspective jars against the now commercially accepted understanding of collective responsibility for internal financial controls.[301] The approach taken in *Barings*[302] was more subtle. There Jonathan Parker J highlighted the collective duty of directors to manage the company while also acknowledging the responsibility of individual directors. An attempt was made by Hart J in *Landhurst Leasing plc, Secretary of State for Trade and Industry v Ball*[303] to draw a line in the sand between obligations of a director which may be delegated to other directors and those which could be classed as the collective responsibility of the board. He intimated that it would not be appropriate to rely on other directors' involvement in relation to matters for which the board as a whole had a collective responsibility *eg* the duty of the board of directors to approve the annual accounts of the company. The joint and several liability of directors has also frequently been emphasised by

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[298] [1994] 1 BCLC 574.

[299] Professor Hannigan regards this case as exemplifying the confusion as to what ought to be considered collective responsibility and what ought to be an individual directorial responsibility: B Hannigan n 264 above at 307.

[300] [1994] 1 BCLC 574, 594.

[301] See Financial Reporting Council (UK) *Combined Code for Corporate Governance* (2006) Principle C.2.

[302] *Re Barings plc (No. 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433.

[303] [1999] 1 BCLC 286.

the Irish judiciary. For example, in *Re Vehicle Imports Ltd*[304] Murphy J emphasised that obligation to keep proper books of account was not limited to one director but was a joint separate liability on each of the directors. This ties in with the concept that directors can completely abrogate responsibility for the affairs of a company.

It is fair to say that the line between individual and collective responsibility is not alw clear. In this climate of uncertainty, the Combined Code and revised Turnbull Guida applicable to listed companies are making a contribution to thinking and accepted practic this area.[305] In a listed company, the board of directors is collectively responsible for company.[306] The Combined Code gives guidance as to the collective responsibilities directors in relation to, for example, the preparation of accounts presenting a balanced understandable assessment of the company's position[307] and maintaining a sound system internal controls to safeguard shareholders' investment and the company's assets.[308] It can concluded that Reed's viewpoint that "[t]he starting point has shifted to one of indivi functional responsibility, but with limited areas of residual collective responsibility" represents an accurate summation of the legacy of statutory restriction and disqualificat regime.

(2) Non-Executive Directors

There has been a great deal of interest at policy level of late in the role of the non-execut director.[310] Arguably, the function of the non-executive director is altogether different fr that of the executive director:

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[304] [2000] IEHC 90.

[305] See Financial Reporting Council (UK) *The Combined Code on Corporate Governance* (2006); Finan Reporting Council (UK) 'revised Turnbull Guidance': *Internal Control: Revised Guidance for Directors on Combined Code* (2005).

[306] Financial Reporting Council (UK) *Combined Code on Corporate Governance* (2006), Principle A.1.

[307] *Ibid* Principle C.1.

[308] *Ibid* Principle C.2.

[309] R Reed n 202 above at 178.

[310] See D Higgs *Review of the Role and Effectiveness of Non-Executive Directors* (20 www.dti.gov.uk/nonexecreview; European Commission Recommendation of 15 February 2005 on the rol

"The prime function of non-executive directors is (1) to provide a resource to management who wish to bring their skill, knowledge and experience to bear on particular issues, and (2) to provide a degree of independent and detached oversight on all issues."[311]

One of the key issues for the modern approach is the extent of leeway to be given to non-executive directors. The *Companies Acts 1963 to 2006* draw no distinction between executive and non-executive directors. However, the judicial approach to non-executive directors is in transition. What is emerging is that the content of the duty to exercise care, skill and diligence is no different in the case of a non-executive director; rather its application is "fact sensitive",[312] tailored to the role undertaken by a non-executive director. In *Equitable Life v Bowley*[313] Langley LJ commented that:

"[t]here is a considerable measure of agreement about the duty owed in law by a non-executive director to a company. In expression it does not differ from the duty owed by an executive director but in application it may and usually will do so."[314]

This approach is supported by Reed who argues that:

"... [non-executive directors] can only consider and oversee the issues and information which are presented to them, which arise out of that information, or which arise out of documents or information which they ought to have requested on being put on inquiry by the information given them. If this limited function of non-executive directors, by reference to information and documents reasonably available to them, is accepted then

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non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (2005/162); Financial Reporting Council (UK) *Combined Code on Corporate Governance* (2006), Schedule B; M Sweeney Baird "The Role of the Non-Executive Director in Modern Corporate Governance" (2006) 27 Co Law 67.

[311] R Reed n 202 above at 176.

[312] *Equitable Life v Bowley* [2004] 1 BCLC 180, [41] *per* Langley LJ. See further L Roach "An Equitable Solution for Non-Executive Directors?" (2006) 17 ICCLR 117. See also the comments of Tadgell J in *Commonwealth Bank v Friedrich* (1991) 9 ACLC 946, 1011.

[313] [2004] 1 BCLC 180.

[314] *Ibid* at [35].

there is no reason for any special standard of skill or care applying specifically them."[315]

The courts are beginning to realise that they need to find a coherent manner to accommod the differing responsibilities expected of different directors when assessing possible breac of duty. In recent times the English and Irish courts have adverted to the need to t cognisance of the extent of involvement of a non-executive director – the application standards will depend on the particular circumstances. Indeed in *Re Continental Assura Co of London Plc (In Liq)*[316] Park J made the *obiter* observation that if the liquidators' atte to visit multi-million pound liability on the non-executive directors had been successful would be difficult to imagine any person wishing to take up an appointment as a n executive director.

Schedule B to the *Combined Code on Corporate Governance*[317] sets out guidance on c skill and diligence for non-executive directors of listed companies. Paragraph 1 states:

> "Although non-executive directors and executive directors have as board members same legal duties and objectives, the time devoted to the company's affairs is likely be significantly less for a non-executive director than for an executive director and detailed knowledge and experience of a company's affairs that could reasonably expected of a non-executive director will generally be less than for an execut director. These matters may be relevant in assessing the knowledge, skill a experience which may reasonable be expected of a non-executive director a therefore the care, skill and diligence that a non-executive director may be expected exercise."

The courts have yet to comprehensively treat of the application of care, skill and diligence non-executive directors but foundational principles are beginning to emerge. In *Dorches Finance Co Ltd v Stebbing*,[318] Foster J expressed alarm that a chartered accountant and

[315] R Reed n 145 above at 176.

[316] [2001] BPIR 733.

[317] Financial Reporting Council (UK) *Combined Code on Corporate Governance* (2006).

[318] [1989] BCLC 498.

experienced accountant would put forward the proposition that that a non-executive director has no duties to perform.[319] The Court of Appeal of New South Wales in *Daniels v Anderson*[320] formulated the requirement that they take reasonable steps to place themselves in a position to guide and monitor the management of the company. Applying this test, the Court of Appeal held that the company's chief executive officer was negligent in respect of his failure to manage its forex operations but none of the three non-executive directors was held liable as their knowledge was limited by management concealment. In doing so they rejected the approach of Rogers CJ at first instance where he had suggested a lesser standard which conceived of non-executive directors as a class apart with duties of an intermittent nature.[321] The seminal *Barings* decision[322] left non-executive directors out of the reckoning but Jonathan Parker J indicated that, in assessing fitness under the UK's statutory director disqualification regime, one factor to be taken into account was the level of remuneration received by the director.

The Irish courts have had a number of opportunities to consider the position of the non-executive director, often in the context of a nominal director taking no active part in company affairs. In *Re Hunting Lodges Ltd*[323] Carroll J held that there was no doubt that directors' duties apply equally to non-executive directors as to executive directors. This blunt approach in the earlier inert spouse-director cases has been refined in later cases and has given way to a more complex analysis reflecting the range of fact scenarios sheltering under the 'non-executive director' moniker. In *Kavanagh v Delaney* Finlay Geoghegan J acknowledged the appointment of non-executive directors to act alongside executive directors as "a fact of commercial life".[324] However, she did not regard existing authority as satisfactorily addressing the potentially differing responsibilities of executive and non-executive directors even though it was "... a matter of common sense that the duties and responsibilities of each

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[319] *Ibid* at 505.

[320] [1995] ACSR 607. This case was referred to in *Re Barings (No. 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433, 488.

[321] (1992) 7 ACSR 463.

[322] *Re Barings (No. 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 488.

[323] [1985] ILRM 75. See also *Re Vehicle Imports Ltd* [2000] IEHC 90; *Re Costello Doors Ltd* High Court (Murphy J) 21 July 1995 unrep.

[324] [2005] 1 ILRM 34, 42. See also *Kavanagh v Riedler* [2004] 3 IR 498.

may differ."[325] Finlay Geoghegan J emphasised that a non-executive director must ta reasonable steps to place himself in a position to guide and monitor the management of t company.[326] The case indicates that a non-executive director will not satisfy the duty to ke informed by simply obtaining the company's financial statements without seeking out oth relevant information concerning the company.

In *Kavanagh v Riedler*[327] Finlay Geoghegan J recognised that despite the failure of t *Companies Acts* to draw an express distinction between executive and non-executive directo there was a well-established distinction between them in commercial life. In this case declaration of restriction was not imposed on a non-executive director who was experienced businessman. This was on the basis that he had acted honestly, had kept himse informed of company affairs and took active steps to assist the company's position. Finl Geoghegan J stated:

> "In considering whether a person has acted responsibly whilst a director of t company, it appears to me that this court must recognise the distinction betwe executive and non-executive directors. A person may, from time to time, be appointe as a non-executive director to bring a particular expertise to a board of directo Where this is done it appears appropriate to consider such person's conduct as director *inter alia* in relation to any such particular agreement or purpose. Howeve every person who agrees to become a director of a company, whether executive o non-executive or for the purpose of bringing a particular skill to the board of directo must discharge the general duty of a director which has been summarised by Jonath Parker J in [*Barings*]...."[328]

This blurs traditional black and white thinking on the differing responsibilities of executiv and non-executive directors. Finlay Geoghegan J's view was that, in general, a non-executiv director is entitled both to rely upon information provided by his fellow executive directo

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[325] [2005] 1 ILRM 34, 42.

[326] *Ibid* at 51, applying the judgment of the Court of Appeal of New South Wales in *Daniels v Andersen* [199 16 ACSR 607.

[327] [2004] 3 IR 498.

[328] [2004] 3 IR 498, 503.

and to rely upon the executive directors carrying out what might be considered to be normal executive or management functions. However, she cautioned that there may be factual circumstances which will put a non-executive director on notice that he should not continue to rely either upon information provided or upon executive duties being properly performed.

In *Kavanagh v Cooke*,[329] an application for a declaration of restriction, MacMenamin J laid emphasis on the fact that that it was clearly understood that a non-executive director would not be taking an active role in the day to day management of the business. Applying the test set out by Finlay Geoghegan J in *Kavanagh v Delaney*[330] it was held that there was no evidence that she had failed to inform herself about the affairs of the company. She had received monthly management accounts for the business which gave the impression that appropriate returns were being made to the Revenue Commissioners. A similar approach was taken in *Re Stephenson Cobbold Ltd*[331] where it was held that, in a company with professional accountants preparing management accounts, it was not incumbent on a non-executive director acting as a cheque signatory to exercise the degree of financial scrutiny more usually associated with the role of finance director.

In *Equitable Life v Bowley*[332] where Langley LJ acknowledged that " ... [i]t is plainly arguable ... that a company may reasonably at least look to non-executive directors for independence of judgment and supervision of the executive management."[333] Though a feature of corporate governance codes, this aspect remains to be developed at judicial level. In *Stafford v Beggs*[334] O'Leary J chastised the non-executive directors of a company for their failure to insist on cash-flow projections but did not consider this failure sufficient to ground a declaration of restriction. However, some indication of a demarcation of responsibility is evident in the fact that he also held that responsibility for the improper operation of a company bank account and defective invoicing procedures could not be laid at the door of the non-executive directors. In this case the absence of formal board meetings had facilitated reckless trading on the part of

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[329] [2006] 1 ILRM 191.

[330] [2005] 1 ILRM 34.

[331] [2000] 2 BCLC 614.

[332] [2004] 1 BCLC 180.

[333] *Ibid* at [41].

[334] [2006] IEHC 88.

the executive directors. However, a declaration of restriction was not made as the condu complained of, though reprehensible did not meet the standard of incompetence amounting irresponsibility as required by *Re Squash (Ireland)*. A different result may have been yield had O'Leary J had recourse to the approach pioneered by Finlay Geoghegan J of requiri regard also to be had to compliance with common law duties of skill and care.

The Company Law Review Group considered whether there were grounds for varying t legal position of non-executive directors so that their duties as directors might be recognised law as being different from those of executive directors.[335] The Group decided that that t status was not sufficient reason to vary the duties to which they were subject. The Group view was that the proposed statutory statement of directors' duties would "recognise that ea director brings his particular abilities to the board table and, to that extent only, there would validly expected differences in competence expected."[336]

(3) The Residual Survival of the Business Judgment Rule

It is understandable that some leeway has to be given to directors in terms of errors judgment. As we have seen, the courts have always been reluctant to second guess t business decisions of directors.[337] As Easterbrook and Fischel remark, "[o]ne rationale for t business judgment rule is that managers who make errors (and even those who engage in sel dealing) are penalized by market forces while judges who make errors are not."[338] Howeve in recent times there has been a move to examine the quality or grossness of the error judgment. This can be seen as a response to changing societal expectations evidenced in t exasperation expressed by legal commentators concerning undue judicial deference towar business people's decisions. It was a frequent cry of commentators that, through str adherence to *Re City Equitable Fire Insurance,*[339] the law had become fossilised and h

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[335] Company Law Review Group *First Report (2000 – 2001)* (2002) at 11.5.

[336] *Ibid* at 11.5.2.

[337] This contrasts with the position under French law. See A Tunc n 67 above at 555 ff.

[338] FH Easterbrook and DR Fischel *The Economic Structure of Corporate Law* Harvard University Press 1991 243.

[339] [1925] Ch 407.

failed to keep pace with society's expectations.[340] Tunc regarded the business judgment rule in its raw form as encompassing "a kind of business prerogative" which operated to place the businessman above the law.[341]

In the Australian case of *The State of South Australia v Clark*[342] the managing director and chief executive officer of the State Bank was sued by the bank and the State of South Australia for damages arising out of the share purchase by the bank of a life assurance company at a grossly inflated price[343] in circumstances where, *inter alia*, no proper valuation was obtained by the bank prior to the purchase. The defendant was held to be negligent and to have breached his duties to the company. Damages of $81 million were awarded. On this side of the Atlantic, the refinement in judicial thinking is most closely identified with the *Barings* watershed. *Barings plc (No. 5)*, *Secretary of State for Trade and Industry v Baker*[344] showed that a disqualification order indicating that a director was unfit to be involved in the management of a company could be made even where the incompetence is founded not on negligent mistakes but on errors of judgment which did not amount to misfeasance or breach of duty. This is on the basis that it was possible for a director to have been so completely lacking in judgment as to justify a finding of unfitness. This was a significant development in judicial thinking and a blow to the business judgment rule. The Court of Appeal[345] held that whether a director met the required standard of competence for a director was a question of law and only in exceptional circumstances would expert evidence be admitted. Therefore in the context of the UK statutory disqualification regime for directors under section 6 of the *Company Directors Disqualification Act 1986*, errors of judgment no longer receive the accommodating judicial reception evident in early cases on the business judgment rule.

Commentators have warned of the dangers of swinging the balance too far, however. Butcher cautions that "[t]hose circumstances in which directors ought to be held accountable need to be carefully considered lest the scales tilt too far against the interests of commerce and snuff

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[340] See A Tunc n 67 above at 552; BS Butcher n 8 above at 29.

[341] A Tunc n 67 above at 549.

[342] [1996] SASC 5499.

[343] $59 million when the real value was estimated to be $17.2 - $21 million.

[344] [1999] 1 BCLC 433.

[345] [2000] 1 BCLC 523.

out the entrepreneurial flame."[346] Indeed, the Irish judiciary has shown itself to be sensitive these concerns and, rather than embracing Jonathan Parker J's approach to commercial erro has proved more sympathetic to the position of directors. Indeed, despite the rise of objective standard, the continued existence of a residual subjective element will still colo any decision which makes the particular facts and circumstances crucial in any restricti decision. This is supported by the fact that it remains the case that there are no qualificatio required for becoming a director.

In the context of restriction applications, the Irish courts have frequently emphasised that th must be very careful not to judge decisions made by directors with the benefit of hindsight. In contrast with *Barings,* in *Re Colm O'Neill Engineering Services Ltd*[348] Finlay Geoghega emphasised that bad commercial judgment would not in itself be considered by the courts amount to a lack of responsibility by a director in the context of a restriction application. S cautioned against the tendency to judge acts and omissions of directors too harshly with t benefit of hindsight in the context of a liquidation. This reflects the approach taken by t Supreme Court in *Re Squash (Ireland)*[349] where McGuinness J stated:

> "In the case of all companies which become insolvent it is likely that some criticism of the directors may be made. Commercial errors may have occurred; misjudgmen may well have been made; but to categorise conduct as irresponsible I feel that on must go further than this."[350]

In *Re USIT World plc (in liq)*[351] in declining to make declarations of restriction against t directors, Peart J restated the business judgment rule with renewed vigour. Commerci pragmatism was evident in the following statement:

> "If an entrepreneur were to be obliged, on pain of being found to be irresponsible an of being restricted under the section, to avoid taking any decision which

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[346] BS Butcher n 8 above at 49.

[347] See *Grace v Kachkar* [2005] IEHC 63.

[348] High Court (Finlay Geoghegan J) *ex tempore* judgment 13 February 2004.

[349] [2001] 3 IR 35.

[350] *Ibid* at 39. See also *La Moselle Clothing Ltd v Soualhi* [1998] 2 ILRM 345.

[351] [2005] IEHC 285.

some date in the future might be found to have risk attached to it, the business life and a large component of the economic driver of the economy of the State would stultify. I do not believe that this is what the legislature had in mind when enacting section 150."[352]

He went on to draw a distinction between taking a calculated risk and a rash or reckless risk:

"Risks can differ in character. Something can be characterised as a risk simply because the outcome cannot be known with certainty, whereas those with responsibility to see it through and with the knowledge base from which to assess and weigh the magnitude or reasonableness of the risk may see the risk of failure as being far less than the likelihood of success."[353]

It was stressed that the greater the amount of money involved in the risk, the greater the obligation to ensure that appropriate care is taken in all aspects of its planning to guard against a poor outcome.

Despite hearty avowals of the business judgment rule which hark back to its early enunciation, albeit in a very different business climate, the signs are that directors are in danger of becoming 'risk-averse'. Perhaps not unjustifiably, some commentators feel that the current focus on risk management and compliance is at the expense of entrepreneurship.[354] Fears of this nature led to a scale back of the controversial directors' compliance regime in section 45 of the *Companies (Auditing and Accounting) Act 2003*.[355] In relation to the judiciary, whose pronouncements have mainly arisen in the context of restriction applications, the delicate task is to improve standards of behaviour by example without killing the golden goose of corporate

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[352] *Ibid* at p 80 of the unreported judgment.

[353] *Ibid* at p 79.

[354] Editorial "Regulation Makes Directors Too Cautious Says Eversheds Survey" (2006) 27 Co Law 92.

[355] Head 7 of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007) involves amendments to the controversial and never commenced section 205E of the *Companies Act 1990* (inserted by section 45 of the *Companies (Auditing and Accounting) Act 2003*). See further Company Law Review Group *Report on Directors Compliance Statement* (2005); D Ahern "Directors' Compliance Statements under the Microscope" (2006) 13 C L Pract 137.

entrepreneurship by judging too harshly with the benefit of hindsight. To get the bala wrong is to risk the pitfalls of corporate activity outweighing the perceived advantages limited liability.

G. CONCLUSIONS

Of all the duties examined in this thesis, it is the duty to exercise care, skill and diligen which has undergone the most marked transformation. In the Introduction to this chapter was said that the courts have attempted to walk the tightrope of interpreting the duty exercise care, skill and diligence in a manner which seeks to uphold the prevailing standa expected by society of those in business. It was suggested in this chapter that this has be successfully negotiated by the judiciary over the years by adapting to societal and corpora shifts while respecting that a degree of risk-taking is inevitable and indeed desirable to ensu that innovation and entrepreneurship is not stifled by liability chill. This judicial perspicaci is particularly evident in the path forged by Finlay Geoghegan J in recent restriction decisio illustrating the important contribution to thinking that this statutory addition has made. T evolving judicial understanding of the duty while respecting the accepted parameters directorial discretion is one of the most apparent successes in the history of judicial applicati of directors' duties (although some would say that it was a long time coming).

The case law development in both the Irish and the English courts shows that Romer J precepts in *Re City Equitable*[356] remain relevant today albeit tempered by the influenti adjustments made by Jonathan Parker J in *Barings*.[357] Arguably, the now favoured objectiv subjective hybrid test is appropriate because it meets the gap between a professional executi director of a listed company and the director of the archetypal one man company whose h incorporated his small business on the advice of his accountant to benefit from limited liabili and for tax planning objectives. While this chapter has focused on the duty of care, skill a diligence owed by directors to the company, developments in this area need to be place within the context of the developing statutory and judicial understanding of duties being ow to persons other than the company. In this context, creditors, in particular, can be viewed

[356] *Re City Equitable Fire Insurance* [1925] Ch 407.

[357] *Re Barings plc (No. 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433.

"external controllers" of the duties of skill, care and diligence.[358] Professor Sealy aptly comments:

> "If directors are to be required to have a concern for ... employees and creditors ... surely such an objective yardstick ought to be used to measure directors' standards of care and skill, since these new beneficiaries of that care and skill had [unlike shareholders] no say in choosing them."[359]

This perspective is reflected in the objective statutory test applied by the Irish courts to test whether a director has acted responsibly for the purposes of determining a restriction application.[360] These matters will be returned to in Chapter 5 in the context of analysis of legislative proposals to formulate a statutory version of the duty of care, skill and diligence.

Perhaps the greatest change charted in this chapter is in the area of participation, delegation and reliance where earlier decisions now seem very far removed from the hands-on approach required of directors today. Reflecting the demise of the gentleman director and the rise of the MBA-clad professional director, the traditional legislative and judicial *laissez-faire* view of director control has vanished at the post-appointment stage. There is room for greater *ex ante* controls at the pre-appointment stage, perhaps through making first-time appointment as a director conditional on attendance at a director education course. This would help to raise standards at the bottom. It would seem that in the future the diligence aspect is likely to received increased focus within the statutory context of directors' compliance statements. It is also suggested that it is likely that more clearly defined rules will begin to emerge on what is to be expected of non-executive directors, reflecting the increased focus on this issue in the context of listed companies. It is to be hoped that greater clarity will also be brought to the distinction between collective and individual responsibility.

While the key principles and their application have had a smooth transition, the same cannot be said of the confusion and awkwardness which continues to surround the underlying

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[358] This proposition was put forward by Finch: V Finch n 35 above at 189-195.

[359] LS Sealy n 1 above at 173.

[360] *Re Squash (Ireland) Ltd* [2001] 3 IR 35.

theoretical basis for the directors' duty to exercise care, skill and diligence. Inappropri judicial fiduciary references persist and the nature of the duty as both equitable and legal not received comprehensive doctrinal exposition at judicial level. It has been shown t modern judicial exploration of directorial care, skill and diligence has not followed what mi have been the expected path of mirroring developments in professional negligence ca where the standard of care is more onerous. However, the advent of the statutory restricti and disqualification regime has led to a pigeonholing of cases within this framework with result that common law negligence actions and enforcement of contractual duties in t respect against directors have, in this part of the world, remained underdeveloped.

What this chapter also endeavoured to highlight is that the central contemporary judicial foc on directorial care, skill and diligence through the blinkers of restriction and disqualificati contrasts with a corresponding lack of direct judicial consideration of the equitable and leg non-statutory duties.[361] This underlines the role of the statutory restriction and disqualificati regimes in re-working societal and judicial attitudes. However, as Walters remarked in 200 "... the profundity of the impact at the doctrinal level is perhaps not yet fully appreciated."[362] While recent developments have occurred within the medium of restriction a disqualification, the indications are that what is being heralded is a compliance era – a increased focus on compliance and good corporate governance in the form of widespre adoption of codes of best practice such as the Combined Code[363] and the Revised Turnbu Guidance.[364]

In these circumstances it is hardly surprising that there is a school of thought which perceiv the equitable rules as outdated and under-utilised, replaced by resort to restriction an disqualification. In 2001, Professor Sealy was less than sanguine about the future prospec for the equitable concepts of care, skill and diligence. His view was that for practical purpos

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[361] The reasons for the lack of direct private enforcement are examined in Chapter 6 below.

[362] A Walters n 23 above at 113.

[363] Financial Reporting Council (UK) *The Combined Code on Corporate Governance* (2006).

[364] Financial Reporting Council (UK) *Internal Control: Revised Guidance for Directors on the Combined Co* (2005) (revised Turnbull Guidance).

the traditional equitable rules could be characterised as "yesterday's law".[365] He went on to make the following indictment of their continuing relevance:

> "Today's law on directors' duties is being shaped, on the one hand (as regards our large companies) by the non-legal codes of good practice which are obligatory for listed companies and on the other hand (mostly concerning companies at the other end of the scale) by the myriad of disqualification and section 459 cases."[366]

The same could equally be said of developments in Ireland. However, as we have seen, recent restriction decisions in Ireland dating from the pioneering approach of Finlay Geoghegan J *Kavanagh v Delaney*[367] have opened the door to a new lease of life for the equitable and legal duties. Therefore, one of the most significant findings in this chapter in relation to Irish development of the composite duty of care, skill and diligence (and indeed the other duties) is that this new departure indicates that the duty to exercise care, skill and diligence cannot be ignored and, if no longer free-standing in operation, then the duty has an assurance of a continuing parasitic existence. To borrow a phrase, "Equity's place in the law of commerce, long resisted by commercial lawyers, can no longer be denied."[368]

Having excavated issues of competence and the limits to risk-taking behaviour by directors which may harm the company in this chapter, the focus moves on neatly in the next chapter to an examination of the limits imposed on the type of decision-making which is within the discretion of directors as a result of judicial development of the duty to act *bona fide* and for the benefit of the company as a whole and the duty to act for proper purposes. With this change of focus from one duty to the next comes a judicial move away from an examination of the quality of directorial decision-making which is replaced by a preoccupation with the underlying motivation for directorial decision-making.

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[365] LS Sealy n 137 above at 80.

[366] *Ibid.*

[367] [2005] 1 ILRM 34.

[368] PJ Millett "Equity's Place in the Law of Commerce" (1998) 114 LQR 214 at 214.

CHAPTER 3:
THE DUTY TO ACT BONA FIDE IN THE INTERESTS OF THE COMPANY AS A WHOLE AND FOR PROPER PURPOSES

A. INTRODUCTION

Save insofar as powers are expressly reserved to the members, the directors have delegated decision-making powers to manage a company's business on a day to day basis.[1] Although this amounts to the delegation of broad, discretionary decision-making powers, the law imposes some limitations on their exercise. The exercise of directorial powers is subject to limitations laid down in the memorandum and articles of association and to the *Companies Acts*. Furthermore, in the words of Lord Greene MR in *Re Smith and Fawcett Ltd*,[2] the directors of a company are obliged to act "... *bona fide* in what they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose."[3] It is this part-positive and part-negative expression of duty carved out by the courts to limit directorial excesses which forms the subject matter of this chapter. Reflecting the widespread acceptance of the 'proper powers' doctrine as distinct from best interest considerations, this chapter considers separately how the courts have grappled with each discrete element.

At the core of each aspect is an understanding that directors will use their powers as intended and not to benefit themselves or third parties. These concerns are also key to the rationale

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[1] This is the effect of including model regulation 80, Table A, Schedule I to the *Companies Act 1963* in a company's articles of association.

[2] [1942] Ch 304.

[3] *Ibid* at 306. For the origins of this principle see Lord Northington's judgment in *Aleyn v Belchier* (1758) 1 Eden 132, 138 where he stated "[n]o point is better established than that, a person having a power, must execute it *bona fide* for the end designed, otherwise it is corrupt and void." See also *Fraser v Whalley* (1864) 2 Hem & M 10.

behind the negative limitations on the exercise of exercise of directorial powers inherent in th duty to avoid conflicts of interest and the duty not to make secret profits. However, althoug the proper purposes limb is an embargo on exercising directorial powers for purposes oth than those for which they were conferred, the obligation to act *bona fide* in the best interests o the company is positive in nature.

It is contended in this chapter that, looking beyond the application of the rules on corpora capacity, directorial authority and the self-dealing rule, despite some breakthrough thinking i judicial circles, the courts have been consistent in adhering to traditional reluctance to secon guess the judgment of directors. In 1812 Lord Eldon famously declared that "[t]his court i not to be required to take the management of every playhouse and brewhouse in th Kingdom."[4] This classic statement of judicial reticence to make value judgments on director decision-making continues to resonate. This chapter will show that behind seemingly robu judicial statements, deference to business judgment continues to exert a limiting influence o judicial readiness to review directorial decision-making. Nevertheless a broader spectrum i emerging in the burgeoning jurisprudence on the need for directors to take third party interest into account in corporate policy-making. Plotting the future direction of the duties discusse in this chapter requires account to be taken of the changing corporate landscape where it i contemplated that the impact of the *ultra vires* doctrine will be hugely truncated. It i suggested that this is likely to require a greater focus on the control mechanisms of bes interests and proper purpose.[5]

In these days with the ever-increasing emphasis on ethics and environmental and socia responsibility, we are in the midst of a post-Enron shift in how the roles of the corporation an its director puppeteers are envisaged. This means viewing the corporation as a socia construct as well as a legal construct to serve commercial ends. In academic circles this ha yielded a more sophisticated understanding of stakeholders' interests and embracement of th wider concept of corporate social responsibility which is beginning to trickle through at polic

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[4] *Carlen v Drury* (1812) 1 Ves. and B. 154, 158.

[5] See RC Nolan "The Proper Purpose Doctrine and Company Directors" in BAK Rider (ed) *The Realm o Company Law: A Collection of Papers in Honour of Professor Leonard Sealy* Kluwer Law International Londo 1998 at 35.

level. Whether this is likely to lead in the long term to a major policy shift or simply a nominal semantic shift is not yet apparent.

Part B of this chapter begins with a consideration of some taxonomical questions concerning whether what is at issue here is a composite duty or separate duties and whether a fiduciary analysis is merited. Part C considers the judicial approach to the requirement that directors act *bona fide* in the interests of the company as a whole. Part D discusses the controversial subject of whose interests the directors must serve. This is developed in Part E which examines statutory intervention to protect stakeholders. Part F examines the proper purpose doctrine which has been described as "the least discussed and the least well understood of the fiduciary obligations affecting a director."[6] Finally, some concluding observations are drawn together in Part G.

B. SOME ISSUES OF CLASSIFICATION

The duty to act *bona fide* in the best interests of the company is sometimes loosely conceived of as the pre-eminent duty out of which other duties stem.[7] An alternative perspective which is sometimes canvassed views the duty to act in good faith in the best interests of the company as an aspect of an overarching duty of loyalty which directors owe to their company.[8] A more immediately pressing debate which should precede any substantive analysis is whether the requirement that directors act *bona fide* in the best interests of the company and the requirement to act for proper purposes should be regarded as separate or complementary aspects of the one duty.[9] This is considered below.

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[6] RC Nolan n 5 above at 1.

[7] J Dine *Company Law* 4th ed Palgrave Basingstoke 2001 at 217.

[8] See *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91, [41] *per* Arden LJ; B Hannigan *Company Law* LexisNexis UK London 2003 Ch 9; Law Commission and the Scottish Law Commission *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties* LC CP No 153 SLC Discussion Paper No 105 (1998) at para 11.5; R Grantham "The Content of the Director's Duty of Loyalty" [1993] JBL 149.

[9] See LS Sealy "'Bona Fides' and 'Proper Purposes' in Corporate Decisions" (1989) 15 Mon LR 265 at 267; LS Sealy "Company Directors' Unconstitutional Acts" (1992) 51 CLJ 229; BS Butcher *Directors' Duties: A New Millennium, A New Approach* Kluwer Law International London 2000 at 103.

(1) One Duty or Two?

As is the case with other directors' duties,[10] judicial development in this sphere has not be characterised by clean dividing lines but rather by a blurring of adjacent concepts. So clarity has begun to emerge chiefly from decisions on the exercise of directorial powers allot shares. On its face, Lord Greene MR's formative statement of principle in *Re Smith a Fawcett Ltd*[11] (quoted in the Introduction to this chapter) appeared to adopt a convergen approach whereby the two aspects are regarded as two sides of the coin. However, in *Hogg Cramphorn Ltd*[12] Buckley J interpreted Lord Greene MR's statement of principle envisaging a requirement not to act for an improper purpose which would not be satisfied simply complying with the separate duty to act *bona fide* in the best interests of the compan The decision made it clear that the fact that the directors consider that a proposed allotment shares will be in the company's interests is immaterial if the allotment is not being carried o for one of the purposes for which the power to allot is permitted to be exercised under t company's constitution. As such it involved a clear appreciation of the autonomous nature the proper purposes doctrine with a separate test for proper purpose, distinct from that f acting *bona fide* in the best interests of the company.[13]

To the contrary, the existence of dual duties was negated by the British Columbia Supre Court in *Teck Corporation Ltd v Millar*[14] where Berger J stated that there would not be improper purpose if the directors honestly believed that they were acting in the best interes of the company and there were reasonable grounds for such a belief. In effect this truncat what could have been considered to be two separate tests into one of whether the directo

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[10] The duty to avoid conflicts of interest and secret profits and the duty to exercise care, skill and diligence.

[11] [1942] Ch 304.

[12] [1967] Ch 254.

[13] The appropriateness of such a distinction was accepted by Professor Finn: PD Finn *Fiduciary Obligations* T Law Book Company Ltd Sydney 1977 at para 83. See also MC Ling "Re-thinking Directors' Duties: A Analysis of the Proper Purpose Doctrine" (2002) 14 SAcLJ 387.

[14] (1972) 33 DLR (3d) 288.

acted *bona fide* in the interests of the company.[15] The single duty approach of *Teck Corporation Ltd v Millar* was, however, decisively rejected by the Privy Council in *Howard Smith Ltd v Ampol Petroleum Ltd*[16] where it was made clear that, rather than adopting such a broad-brush approach, once it was found that the directors were acting *bona fide* in the interests of the company it was necessary to enquire whether, objectively tested, the purpose in question was proper or improper.[17]

The Irish courts have also accepted a composite duty analysis which accommodates an independent recognition of the proper purposes doctrine. The stand-alone nature of the proper purposes doctrine was embraced in *Nash v Lancegaye Safety Glass (Ireland) Ltd*[18] where Dixon J refused to accept that the mere fact that the directors may have had the object of benefiting the company, in addition to other improper purposes, could justify the course of action taken. In this respect the Irish courts were ahead of their time. This perspective is also implicit in more recent case law. In *G & S Doherty Ltd v Doherty*[19] Henchy J stated that since the directors had used the power to issue shares with a view to benefiting themselves to the detriment of other shareholders, "... it cannot be said that the issue of shares is *bona fide* or for the benefit of the company as a whole."[20] The same perspective is evident in Laffoy J's judgment in *Banfi Ltd v Moran*[21] concerning a refusal to register a share transfer where Lord Greene MR's pronouncements in *Re Smith and Fawcett Ltd* were cited with approval.

It can be concluded that while the courts have often blurred the lines between the two by setting out composite statements, the case law on proper purpose shows an acceptance of the duty to use directorial powers only for proper purposes as standing in its own right.[22]

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[15] See BV Slutsky "Canadian Rejection of the *Hogg v Cramphorn* 'Improper Purposes' Principle – A Step Forward?" (1974) 37 MLR 457; JS Ziegel "Directors' Powers and the Proper Purposes" [1974] JBL 85. See also *Olson v Phoenix Industrial Supply Ltd* (1984) 9 DLR (4th) 451.

[16] [1974] AC 821. See also *Bamford v Bamford* [1970] Ch 212; *Re a Company* (No 00370 of 1987); *Ex p Glossop* [1988] BCLC 570; *Re BSB Holdings Ltd (No 2)* [1996] 1 BCLC 155.

[17] See further JR Birds "Proper Purposes as a Head of Directors' Duties" (1974) 37 MLR 580.

[18] (1958) 92 ILTR 11.

[19] High Court (Henchy J) 19 June 1969 unrep.

[20] *Ibid* at p 22 of the unreported judgment.

[21] [2006] IEHC 257.

[22] As will be seen in Chapter 5 below, this is borne out in the proposals for legislative statement of the duty.

Accordingly, the two distinct aspects for consideration are: whether the directors acted in go faith in what they considered to be the interests of the company as whole, and whether t power in question was exercised for the purpose for which it was given or for some oth improper purpose.

(2) A Fiduciary Analysis?

While there is a well-leavened acceptance of the best interests and proper purposes duties a fiduciary, there is a strong counter-argument that these are not inherently fiduciary duties. Th ill-judged judicial practice of readily attaching the "fiduciary" label to directors in the exerci of their duties has already been highlighted in Chapters 1 and 2. In the present conte careless judicial pronouncements have blurred the nineteenth century understanding of t character of fiduciary duty such that terms such as 'fiduciary power', 'best interest' a 'proper purpose' are regularly juxtaposed alongside each other by the courts to form mongr expressions of principle.

Nolan's description of fiduciary obligations as duties which "... do not tell any fiduciary ho he should act, but rather define acts from which a particular fiduciary must abstain whi discharging his undertaking..."[23] is apt. As the best interests duty is a positively-framed du it should not attract a fiduciary characterisation.[24] Fiduciary accountability is unconcern with the merits of how directorial discretion is exercised and therefore the duty to act in t best interests of the company arises under the law of agency as does the proper purpos doctrine as a manifestation of the requirement not to exceed their authority. On this analysis, breach of fiduciary duty will not occur where what is at issue is simply a case of a po business decision, it will only arise where a failure to act in the company's interests intertwined with self-interested conduct on the part of a director.[25] This analysis is al appropriate in relation to the duty to act for proper purpose since acting for an impro

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[23] RC Nolan n 5 above at 12.

[24] See also L Ho and P Lee "A Director's Duty to Confess: A Matter of Good Faith? (2007) 66 CLJ 348 at 35 360 and the authorities cited therein.

[25] For an example of such a case see *Banfi Ltd v Moran* [2006] IEHC 257. See also R Flannigan "T Adulteration of Fiduciary Doctrine in Corporate Law" (2006) 122 LQR 449 at 467-468.

purpose does not imply any underhand intention on the part of the directors. On the same basis, wrongful exercise of powers will not amount to a fiduciary breach where the improper purpose is not tainted by self-interest.

An emerging judicial appreciation of the correct approach of viewing the factual circumstances to which the duty is applied as determining the appropriate characterisation as fiduciary or non-fiduciary is apparent in *Extrasure Travel Insurances Ltd v Scattergood.*[26] Jonathan Crow QC (sitting as a deputy judge of the High Court) highlighted that a claim of breach of fiduciary duty for failure to act in the best interests of the company would only be appropriate where it could be shown that the director did not honestly believe that his action was in the best interests of the company. Therefore where a director acts on the basis of an honest but unreasonable mistaken belief that he is acting in the company's best interests, this would not involve a breach of fiduciary duty.

C. THE DUTY TO ACT BONA FIDE IN THE BEST INTERESTS OF THE COMPANY

(1) Bona Fide versus Best Interests

While the debate on the stand-alone aspects of proper purpose and best interests is largely settled, a further issue of sub-categorisation arises in relation to the formulation of a requirement to act *bona fide* in the best interests of the company. This concerns whether the requirement to act *bona fide* is correctly regarded as simply an expression of a duty to act in the best interests of the company or whether it can operate as a stand alone obligation in its own right.[27] There are instances of courts referring to the requirement to act *bona fide* but not to a duty to act in the best interests of the company,[28] and *vice versa.*[29] Equally, many

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[26] [2003] 1 BCLC 598.

[27] See JD Heydon "Directors' Duties and the Company's Interests" in PD Finn (ed) *Equity and Commercial Relationships* The Law Book Co Ltd Sydney 1987.

[28] See *eg Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392.

[29] See *eg Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 where there was no mention of the *bona fide* criterion.

decisions refer to a composite duty to act *bona fide* (or in good faith), in the best interests the company.[30] Professor Sealy believes that the judicial act of singling out the *bona fi* aspect gives rise to the lamentable impression that a subjective honesty of purpose is all tha required.[31] That a requirement to act *bona fide* is not the only consideration to which direct must have regard was highlighted by Hutton LJ in *Hutton v West Cork Railway Co*[32] where noted that otherwise a "lunatic" could legitimately act *bona fide* but wholly irrationally.

The approach taken in this chapter prefers the composite approach as, in spite of varyi judicial statements on the matter, there are insufficient grounds to merit according the *bo fide* limb separate standing.[33]

This gives rise to the question of what role the interjection of the term "*bona fide*" has in composite formula requiring directors to act *bona fide*, in the best interests of the compan The meaning of the use of the term "*bona fide*" is not without difficulty.[34] The courts oft use the phrase "*bona fide*" interchangeably with references to a requirement to act honestly a requirement to act in good faith.[35] In some cases the concept is envisaged as an absence bad faith or fraud.[36] Professor Sealy's view is that *bona fide* approximates better to "genuin rather than to "honest".[37] This is supported by the decision in *Re Halt Garage (1964) Ltd* where Oliver J impugned the payment of substantial sums to a seriously ill, hospitalis director on the basis that the payments were not genuinely paid as remuneration. This sam

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[30] See *eg Hirsche v Sims* [1894] AC 654; *Re Dublin North City Milling Co* [1909] 1 IR 179; *Allen v Gold Re Co of Africa* [1909] 1 Ch 311; *Clemens v Clemens Bros Ltd* [1976] 2 All ER 268; *Mutual Life Assurance Co New York v Rank Organisation Ltd* [1985] BCLC 11; *Bishopsgate Investment Management Ltd v Maxwell (No* [1994] 1 All ER 261.

[31] LS Sealy "'Bona Fides" and 'Proper Purposes' in Corporate Decisions" (1989) 15 Mon LR 265 at 269.

[32] (1883) Ch D 654, 751.

[33] Support for this may now be derived from legislative initiatives in the UK and reform proposals in th jurisdiction: see further Chapter 5 below.

[34] See further LS Sealy n 31 above at 269.

[35] On the planned legislative preference for the phrase "act in good faith" see further Chapter 5 below.

[36] See *eg Hirsche v Sims* [1894] AC 654.

[37] LS Sealy n 31 above at 269.

[38] [1982] 3 All ER 1016, 1040.

approach is evident in *Brady v Brady*[39] where Lord Oliver stated that good faith required a "genuine belief that it is being done in the company's interests".[40]

A further consideration of interest to legal scholars concerns the occasional judicial couching of the duty in terms of a requirement to act "in the interests of the company" rather than in terms of a duty to act in the *best* interests of the company.[41] While *prima facie* it may be considered that there is a world of difference between a requirement to act in the interests of the company and a requirement to act in its best interests, Mayson, French & Ryan plausibly attribute English judicial failure to consider whether the qualifying adjective 'best' forms part of the duty as in large part due to the fact that the job of the court is not to evaluate directorial business decisions but to determine whether such decisions were taken *bona fide*.[42] Therefore, as a consequence of the judiciary's stand-back approach to directorial decision-making, the issue is not of as great significance as it might first appear.

An additional consequence of judicial reluctance to review the outcome of directors' decisions is that, beneath the veneer of judicial exhortations about the duty of directors to act in the company's best interests, the requirement to act *bona fide* has consistently assumed pre-eminence as the judicial acid test for the composite duty. This reflects Professor Finn's observation that "[i]t is one thing to oblige a fiduciary to act honestly in what he believes to be the interests of his beneficiaries. It is quite another to attempt to use that formula alone as the criterion on which to base judicial review."[43] What can be concluded is that in spite of superficially broad judicial pronouncements concerning directors' duty to act in the best interests of the company, closer examination reveals that judicial focus has not been on the

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[39] [1989] 1 AC 755.

[40] *Ibid* at 777-778.

[41] See *eg Mutual Life Insurance Co v Rank* [1985] BCLC 11; *Bishopsgate Investment Management Ltd (in liq) v Maxwell (No. 2)* [1994] 1 All ER 261; *JJ Harrison (Properties) Ltd v Harrison* [2002] 1 BCLC 162, [25] *per* Chadwick LJ. Interestingly, the Irish reform proposals envisage an "act in good faith" formula being employed: see further Chapter 5 below.

[42] S Mayson, D French and C Ryan *Mayson, French & Ryan on Company Law* 23rd ed Oxford University Press 2006 at 565.

[43] PD Finn n 13 above at para 27.

quality of decision-making but rather on the genuineness of the belief that they acted in t company's best interests. This analysis is further supported and developed in the next sectio

(2) Best Interests and Judicial Deference

The clearest early enunciation of the obligation to act *bona fide* and in the best interests of t company was made in relation to shareholders in *Allen v Gold Reefs of West Africa Ltd*[44] b has since been judicially quoted many times as equally apt in relation to directors. In th case, in the context of the power to alter the company's articles of association, Lindley M explained the duty as follows:

> "... the power ... must, like all other powers, be exercised subject to those gener principles of law and equity which are applicable to all powers conferred on majoriti and enabling them to bind minorities. It must be exercised, not only in the mann required by law, but also *bona fide* for the benefit of the company as a whole, and must not be exceeded."[45]

While stylised judicial pronouncements of this type abound, the case law reveals that th judiciary is not interested in elucidating what would constitute best practice, rather i engagement is limited to a primarily subjective assessment of whether the directors considere that they were acting predominantly in the interests of the company. This involves tw aspects – the judicial choice of a subjective assessment over an objective assessment and th further dilution effected by the subjective belief test being satisfied by an intention to a *predominantly* in the company's interests. This solidifies into a reality where there is a larg gulf between the underlying duty and how compliance is judicially tested. As Worthingto correctly identifies, the duty is proscriptive, not prescriptive.[46]

The judicial approach has its origins in the nineteenth century *laissez-faire* conception o directors where, absent wilful fraud, the courts were extremely reluctant to take it upo

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[44] [1900] Ch 656.

[45] [1900] Ch 656, 671.

[46] S Worthington "Reforming Directors' Duties" (2001) 64 MLR 439 at 447.

themselves to pronounce upon the internal affairs of companies.[47] The twentieth century follow-through is seen in the leading case of *Re Smith and Fawcett Ltd*[48] where Lord Greene MR stated that directors "... must exercise their discretion *bona fide* in what they consider – not what a court may consider – to be in the interests of the company...."[49] This statement received the imprimatur of the High Court in *Banfi Ltd v Moran.*[50] Accordingly objective assessments of what would be in the best interests of the company have no place in this judicial review model; provided that the directors act in good faith in what they believe to be the company's interests, it is irrelevant that their decision also has the effect of promoting their own interests.[51]

The baseline for directors is that they act *bona fide* believing their acts to be in the interests of the company. The hands-off judicial approach to directorial policy-making is evident in the fact that where there is no evidence to the contrary, the courts will assume that the directors have acted in a reasonable manner and in good faith.[52] Inevitably the judicial opt-out has not always been well-received. Tunc argues that it would be open to the court to ask directors for their reasons as to why they believed what they did was in the best interests of the company.[53] In practice the judicial approach has been far more reverential. This reflects the fact that what is involved is essentially a negative enquiry of a judicial review nature:[54] was there an honestly and reasonably held belief that what was done was done for the benefit of the company?

In establishing whether directors have exercised their powers in good faith with the aim of benefiting the company, the judicial task is to objectively ascertain their subjective intention based on the evidential circumstances surrounding directors' actions as well as averments by

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[47] See Chapter 2 above.

[48] [1942] 1 All ER 542.

[49] *Ibid* at 543. See also *Shuttleworth v Cox Bros & Co* [1927] 2 KB 9.

[50] [2006] IEHC 257.

[51] *Hirsche v Simms* [1894] AC 654.

[52] *Re Gresham Life Assurance Society, ex parte Penney* (1872) 8 Ch App 446; *Gaiman v National Association for Mental Health* [1971] Ch 317.

[53] A Tunc "The Judge and the Businessman" (1986) 102 LQR 549, 552.

[54] PD Finn n 13 above at para 30.

directors. Judicial deference in this sphere carries through to matters concerning proof o breach of duty. The burden of proof lies on the party alleging that powers have been exercise improperly.[55] Directors are not required to provide explanations for their actions and a inference may not be drawn merely from the failure to do so.[56] This softly, softly approach i exemplified in the following observation of Meredith MR in *Re Dublin North City Milling Co*

> "I dislike mystery, but I think the law is wise in refusing to compel directors t disclose their reasons for accepting or declining a transfer... I am of the opinion tha the law allows directors to hold their tongues. It allows them to say that everythin was done honestly and *bona fide* in the interests of their Company ... and according t my view I have no power to make them say more."[57]

A knock-on consequence of the courts requiring subjective intent compliance with the duty t act in the best interests of the company rather than engaging with the merits of decision-making is that directors are not required to take the optimum decision open to them. Hence Lord Wilberforce's legendary observation in *Howard Smith Ltd v Ampol Petroleum Ltd*[58] t the effect that "[t]here is no appeal on merits from management decisions to courts of law; no will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at."[59] This goes hand in glove with the business judgment rule which continues to exert an influence in relation to the directors' duty of care.[60]

Judicial reticence in relation to the review of business judgment is exemplified in *Facia Footwear Ltd v Hinchliffe*.[61] While Scott VC recognised that directors owed a duty t creditors if the company were in a dangerous financial position, the judge was markedly reluctant to judge matters with hindsight. The administrators of a group of companies had brought misfeasance proceedings against the directors of Facia Footwear who had advanced

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[55] *Re Dublin North City Milling Co* [1909] 1 IR 179; *Banfi Ltd v Moran* [2006] IEHC 257.

[56] *Re Hafner* [1947] IR 426.

[57] [1909] 1 IR 179, 184.

[58] [1974] AC 821.

[59] *Ibid* at 832.

[60] See Chapter 2 above.

[61] [1998] 1 BCLC 218.

short term loans to other group companies at a time when the company's solvency was in doubt to allow them to continue to trade with a view to putting together a refinancing arrangement to rescue the group. Scott VC stated:

> "The benefit of hindsight was not available to the directors at the time. But the boundary between an acceptable risk that an entrepreneur may properly take and an unacceptable risk the taking of which constitutes misfeasance is not always, perhaps not usually, clear cut."[62]

Here the Court interpreted the directors' action as reflecting a realistic understanding that that the interests of the creditors of the group would have been best served by a refinancing scheme that could support a continuation of profitable trading as their only chance of being paid in full.

This perspective was further elucidated by Jonathan Parker J in *Regentcrest plc v Cohen*[63] where he emphasised that the role of the Court was not to look at what it would have done had it been in the position of the director. Rather, the question was whether the director honestly believed that his act was in the interests of the company. Where the action resulted in substantial detriment to the company it was acknowledged that it would be more difficult for the director to prove he acted with honest intent, but that could not detract from the subjective nature of the test. Applying this test, the Court upheld the *bona fides* of the directors in waiving a clawback claim against a company whose board included their fellow directors. This was considered to be motivated by good commercial reasons involving the need to ensure unity at board level during a difficult period for the company involving negotiations with creditors rather than the protection of some of their number from liability.

While it is clear that what is at issue is a predominantly subjective test, the case law suggests that even if the directors acted without separately considering the company's interests, they may nonetheless be considered to have acted *bona fide* in the interests of the company if their acts meet the objective benefit test formulated in *Charterbridge Corporation v Lloyds Bank*

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[62] *Ibid* at 228.

[63] [2001] 2 BCLC 80.

Ltd[64] where it was unsuccessfully contended that a failure to give separate consideration to t benefit to the company could *ipso facto* prove a failure to act in its best interests. Pennycui J stated:

> "The proper test, I think, in the absence of actual separate consideration, must whether an intelligent and honest man in the position of a director of the compa concerned, could, in the whole of the existing circumstances, have reasonably believ that the transactions were for the benefit of the company."[65]

Where this objective test is not met, it is likely that the test of improper purpose will also made out.[66]

Although the above discussion suggests that courts will generally not interfere with the powe and duties of directors in their management of the internal affairs of a company, where th are on notice of an untoward motive they will not necessarily stand by.[67] The courts have n been afraid to question the averred *bona fides* of a director where the circumstances indicate contrary position. Thus in *Cannon v Tusk*[68] Bacon VC was satisfied that directors could b restrained from fixing a particular date for a company's annual general meeting with a view t preventing shareholders from exercising their voting powers. Similar judicial scepticism i seen in *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (No. 2)*[69] where a director in single director company was found to have acted solely in his personal interest in procurin the company to pay him Stg£100,000 on the termination of his service contract. In so findi the Court was influenced by the secretive manner in which this was pursued without regard t the shareholders. Indeed there are indications that a failure to provide other directors with th

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[64] [1970] Ch 62.

[65] *Ibid* at 74. See also *Official Receiver v Stern* [2002] 1 BCLC 119; *Colin Gwyer & Associates Ltd v Lond Wharf (Limehouse) Ltd, Eaton Bray Ltd v Palmer* [2003] 2 BCLC 153, [73] *per* Leslie Kosmin QC; *Extrasu Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598, [138] *per* Jonathan Crowe.

[66] *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598.

[67] Currently the corporate capacity requirement that the act in question is *intra vires* and reasonably incidental the business of the company serves as an additional control: *Hutton v West Cork Railway Co* (1883) 23 Ch 654, 671 *per* Hutton LJ.

[68] (1875) LR 20 Eq 669.

[69] [1995] BCC 1000.

full facts in relation to a personal transaction with the company will mean that the director does not act in the best interests of the company.[70] Furthermore, there are indications that it would be a breach of fiduciary duty for the directors to vote with a view to blocking litigation which constituted a legitimate challenge against a company in which they had an interest.[71]

The courts are prepared to draw inferences of improper motivation from the surrounding circumstances[72] and, in the event that directors volunteer reasons for their decision, these may be reviewed by a court in determining whether they acted *bona fide*. Thus in *Banfi Ltd v Moran*[73] the directors' affidavit evidence outlining why they had refused to register the plaintiff as a member was reviewed by Laffoy J who did not find it convincing when placed against the backdrop of oppression proceedings which had been initiated by the plaintiff and stymied by the directors' refusal to register the shareholding. An order for the rectification of the share register resulted.

In some instances the actions of directors will be such as to raise a *prima facie* inference that they have not acted in the interests of the company. Gratuitous dispositions of company pension fund assets to a company associated with a director have so qualified[74] as have withdrawals by a director from the company's bank account on hearing that the termination of his employment was imminent.[75] In *Re W & M Roith Ltd*[76] the company was held to be entitled to rescind a director's service contract whose terms provided for a life pension for the spouse of an ailing controlling shareholder and director in the event of his death. These decisions can be contrasted with *Re Horsley and Weight Ltd*[77] where it was held that the

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[70] See *JJ Harrison (Properties) Ltd v Harrison* [2001] 1 BCLC 158, affd [2002] 1 BCLC 162 (failure to inform directors of development potential of land sold to director).

[71] *Fusion Interactive Communication Solutions (No. 2)* [2005] 2 BCLC 571; *Banfi Ltd v Moran* [2006] IEHC 257.

[72] *Re Hafner* [1947] IR 426.

[73] [2006] IEHC 257. See also Vinelott J's *obiter* view to this effect in *Tett v Phoenix Property Co Ltd* [1984] BCLC 599.

[74] *Bishopsgate Investment Management Ltd (in liq) v Maxwell (No 2)* [1994] 1 All ER 261.

[75] *Zemco Ltd v Jerrom-Pugh* [1993] BCC 275. See also *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (No 2)* [1995] BCC 1000.

[76] [1967] 1 WLR 432.

[77] [1982] Ch 442.

directors of the company had acted properly and in the best interests of the company purchasing an insurance policy which would make up for the fact that a director who would retiring with many years of service had no entitlement to a pension.

It can be concluded that the trajectory of judicial assessment in the realm of the duty to a *bona fide* in the best interests of the company has been largely preferential to directors. Th objective ascertainment of subjective intention has, however, permitted the judiciary measure of flexibility where it is clear that the motives of directors were self-serving. Th does not detract from the reality that judicial assessment of directorial decision-maki unashamedly favours motive over merit.

It would be pre-emptive to state that there is a distinct positive duty on directors to disclose a material facts to shareholders. But there is evidence of some germinative activity in th respect in various pockets of authority with differing juridical bases. In the context of an offe being made for shares, it has been held that the directors are obliged to make full and hone disclosure of relevant circumstances to the shareholders before they are required to vote on resolution.[78] In addition, recent judicial murmurings loosely sketch a duty on a director t communicate information to the company which he has acquired in his capacity as a directo which is relevant to the company and would be of interest to it.[79] To date this has arisen in th context of conflicts of interest rather than being more generally based and is discussed in mor detail in Chapter 4. Further developments are awaited. Certainly if the prevailing view of th company's interests as being equated with those of the shareholders holds sway this provide the courts with the possibility of treating a duty of disclosure to the shareholder body as a aspect of the duty to act in the company's best interests.[80]

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[78] *John Crowther Group plc v Carpets International plc* [1990] BCLC 460.

[79] *Bhullar v Bhullar* [2003] 2 BCLC 241; *British Midland Tool Ltd v Midland International Tooling Ltd* [2003] BCLC 523; *Item Software (UK) Ltd v Fassihi* [2003] 2 BCLC 1; *Crown Dilmun v Sutton* [2004] 1 BCLC 468.

[80] The possibility of a duty being owed to individual shareholders is considered below.

(3) Fettering the Exercise of Directorial Discretion

An aspect of the duty to act *bona fide* in the best interests of the company is the requirement that directors should not, without the consent of the company, fetter their future discretion as to the exercise of their decision-making powers in relation to the company.[81] This would occur by a director pledging how he or she will conduct themselves in the future *eg* how he or she will vote at a future board meeting. The rationale behind this is that directors should be free to exercise their independent judgment when a decision has to be made in the future. Thus it has been said that in exercising his or her duties a director is a trustee for the company, and must go to a directors' meeting with a free mind and unbound.[82] As Ross J put it in *Clark v Workman,* "[a]n opportunity for deliberation in the full light of the facts and circumstances is impliedly required."[83] The policy behind the need to approach the exercise of discretionary powers in a free manner was captured by Lord Denning MR in his dissenting judgment in *Boulting v Association of Cinematograph, Television and Allied Technicians* where he observed:

> "It seems to me that no one, who has duties of a fiduciary nature to discharge, can be allowed to enter into an engagement by which he binds himself to disregard those duties or to act inconsistently with them. 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; or by which he agrees to subordinate the interests of those whom he must protect to the interests of someone else."[84]

In the leading Irish case of *Clark v Workman*[85] an undertaking by the chairman of a company to ensure that the registration of a transfer of a controlling shareholding in a company would be approved was held to amount to an unlawful fettering of directorial discretion. Ross J examined the perceived intentions of the director concerned and held that directors were

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[81] See TB Courtney "Fettering Director's Discretion" (1995) 16 Co Law 227; PD Finn n 13 above at Chapter 7.

[82] *Bennett's Case* 5 D G M & G 284, applied in *Clark v Workman* [1920] 1 IR 107.

[83] *Clark v Workman* [1920] 1 IR 107, 113.

[84] [1963] 2 QB 606, 626.

[85] [1920] 1 IR 407.

bound to consider the interests of all the shareholders, unfettered by any undertaking promise to any intending purchaser. In the Australian case of *Re NRMA Ltd No 5131 a 5132 of 1990*[86] it was contemplated that in exceptional circumstances, avoiding a breach duty could entail the directors causing the company to act in breach of contractual obligation

While the principle behind this line of cases is well-motivated, the difficulty with formulati any absolute rule that the directors must not fetter their discretion is that it may not sensitive to modern commercial realities. Directors are commonly required to contractua agree as to their future conduct in procuring the company to enter into joint ventu agreements, share sale agreements and shareholder agreements. The application of t principle has not proved problematic because the courts have been incisive enough to gi sufficient rope to directors by limiting its application to situations which involving an *unlaw* fettering of discretion. It is not forbidden for directors merely to fetter their discretion, t crucial aspect is that the fettering must merit it being branded 'unlawful'. This gives cruci leeway to the courts to accommodate the bigger picture. Accordingly there is no hard and fa rule that an agreement to fetter a discretion will invariably constitute a breach of duty. Rath the precept which has gained judicial credence is that it is permissible for directors to bi themselves as to their future conduct provided that they *bona fide* consider that this is in t best interests of the company.[87] In other words, the sub-duty on directors not to fetter the discretion is subject to the overriding duty to act *bona fide* in the best interests of the compan This is supported by judicial recognition that members can release directors from the stri application of the general rule.[88]

A particular refinement of judicial thinking has occurred in relation to the issue of the timi of an exercise of directorial discretion which reinforces the pervasive over-arching flexibili afforded by the courts to directors' decision-making. This development began with t

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[86] (2000) 33 ACSR 595.

[87] *Thorby v Goldberg* (1964) 112 CLR 597; *Fulham Football Club Ltd v Cabra Estates plc* [1994] 1 BCLC 363

[88] This was the view of the majority of the Court of Appeal in *Boulting v Association of Cinematograph Television and Allied Technicians* [1963] 2 QB 606. In Australia the importance of the appropriate compa organs consenting to the fetter has been emphasised: *Davidson v Smith* (1989) 15 ACLR 732.

Australian High Court establishing in *Thorby v Goldberg*[89] that it was necessary to consider in each case when the appropriate time for the exercise of the directors' discretion arose. This yielded an important development in judicial understanding of what amounts to unlawful fettering as opposed to a lawful exercise of discretion. According to Kitto J, in many cases the appropriate time for exercising decision-making discretion would be at the time of the negotiation of the contract rather than at the time at which it was to be subsequently performed. Therefore, if at the time the contract is negotiated the directors believe that it is advantageous for the company to enter the contract, there is no difficulty with them agreeing to take all subsequent steps necessary to implement it.

Similar pragmatism is evident in the decision of the Court of Appeal in *Fulham Football Club Ltd v Cabra Estates plc*[90] which concerned an agreement by the directors of the plaintiff company to support the defendant company's planning applications in return for the redevelopment of the plaintiff club's football ground. Applying *Thorby v Goldberg*, the Court of Appeal drew a distinction between the prohibited fettering of directors' discretion and the permissible exercise of that discretion in a manner which restricts their future actions. O'Neill LJ stated that while directors are under a duty to act *bona fide* in the interests of their company, this did not mean that the could never contractually bind their future conduct where, as here, the contract as a whole was manifestly for the benefit of the company. In cases such as *Fulham Football Club* the crux is whether the fetter conferred a manifest benefit on the company. A refinement is evident in the Australian case of *Talbot v NRMA Ltd*[91] where Hodgson CJ of the New South Wales Supreme Court flagged that in the case of a restriction on future conduct, where circumstances change such that it is no longer in the company's interest to have its discretion bound in a particular manner, directors may be in breach of their duty to the company in following through on it.

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[89] (1964) 112 CLR 597. This was endorsed by the Court of Appeal in *Fulham Football Club Ltd v Cabra Estates plc* [1994] 1 BCLC 363.

[90] [1994] 1 BCLC 363. See A Griffiths "The Best Interests of Fulham FC: Directors' Fiduciary Duties in giving Contractual Undertakings" [1993] JBL 576.

[91] (2000) 34 ACSR 650, 658.

(4) The Ultra Vires / Corporate Benefit Distinction

Directorial conduct being indirectly circumscribed by the rules on corporate capacity, the *ul* *vires* rule acts as an additional curb on directorial excesses. While breach of duty is n coterminous with causing the company to act outside its legal capacity,[92] many of t decisions concerning the well-established *ultra vires* rule[93] contain valuable guidance on t concept of corporate benefit. The seminal *Hutton v West Cork Railway Co*[94] is frequently rel on in support of the proposition that a company cannot spend money or dispose of its prope except for purposes which are reasonably incidental to the carrying on of the business of t company. This has prevented gratuitous dispositions of company assets including corpor philanthropy except where there is some form of resulting corporate benefit.[95] As Bowen LJ p it, "[t]he law does not say that there are to be no cakes and ale, but there are to be no cakes a ale except such as are required for the benefit of the company."[96]

While this legacy is useful, any rigorous analysis should distinguish breaches of the *ultra vir* rule from breaches of duty occasioned by breaching the duty to act in the company's be interests. The distinction has some significance as an *ultra vires* act may not be ratified wh an abuse of power may be.[97] Because acts of the directors in breach of their duty to act what they consider to be the best interests of the company and not for any collateral purpo

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[92] *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch 246, 303 *per* Browne-Wilkins LJ; *Arab Monetary Fund v Hashim* [1993] 1 Lloyd's Rep 543, 567-70 *per* Evans J.

[93] *Ashbury Railway Carriage and Iron Co v Riche* (1875) LR 7 HL 653; *Re The Balgooley Distillery* (1886) LR Ir 239; *Re MJ Cummins Ltd (in vol liq)* [1939] IR 60; *Hennessy v National Agricultural and Industr Development Association* [1947] IR 159; *Northern Bank Corporation Ltd v Quinn* [1979] ILRM 221; *Roper Ward* [1981] ILRM 408; *Re Greendale Developments Ltd (in liq) (No 2)* [1998] 1 IR 8.

[94] (1883) 23 Ch D 653.

[95] *Re Lee Brehens & Co* [1932] 2 Ch 46; *Parke v Daily News Ltd* [1962] Ch 927; *Northern Bank Corporation L v Quinn* [1979] ILRM 221; *Roper v Ward* [1981] ILRM 408; *Re Kill Inn Motel Ltd (in liq)* High Court (Murp J) 16 September 1987 unrep; *Re Greendale Developments Ltd (in liq) (No 2)* [1998] 1 IR 8.

[96] (1883) 23 Ch D 653, 673.

[97] *Buchanan Ltd v McVey* [1954] IR 89; *Rolled Steel Products (Holdings) Ltd v British Steel Corpn* [1982] WLR 715; *Re Greendale Developments Ltd (in liq) (No. 2)* [1998] 1 IR 8. See further J Meade "*Ultra Vires* Directors' Abuses: When Can Shareholders Right a Wrong?" (1999) 6 C L Pract 198.

are ratifiable, they are voidable rather than void.[98] It is possible for a transaction to be *intra vires* but in breach of duty and *vice versa*. A gratuitous disposition which is not calculated to confer any indirect benefit on the company may not be *ultra vires*. On the other hand, if such a disposition is supported by an express provision in the memorandum of association which confers such a power for the furtherance of the company's objects, there may be no difficulty on either count.

Although judicial pronouncements in this area have sometimes failed clearly to separate the *ultra vires* issue from breach of directors' duty there is a growing judicial awareness of the distinction. Cases such as *Charterbridge Corporation Ltd v Lloyds Bank Ltd,*[99] *Re Halt Garage (1964) Ltd,*[100] *Re Horsley & Weight Ltd*[101] and *Rolled Steel Products (Holdings) Ltd v British Steel Corporation*[102] show that determining whether a disposition of corporate property is calculated to confer any direct or indirect benefit on the company is not conclusive of whether it was *ultra vires*.

However, while the English courts are now consistently intellectually dexterous in distinguishing appropriately between *ultra vires* and abuse of directorial powers, the Irish courts have been somewhat reluctant to bite the bullet in order to ensure that the *ultra vires* designation is strictly reserved for matters of corporate capacity.[103] Having regard to the Irish case law on *ultra vires*, it would appear that in situations where issues of both corporate benefit and *ultra vires* have raised their heads, the more rigorous analysis has been reserved for the *ultra vires* angle.[104] For example, the Supreme Court's decision in *Greendale Developments Ltd (in liq) (No 2)*[105] concerned payments made by the company to the benefit of the respondents in circumstances where the company derived no benefit in return. The

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[98] *Spackman v Evans* (1868) LR 3 HL 171; *Bamford v Bamford* [1970] Ch 212; *Winthrop Investments Ltd v Winns Ltd* [1975] 2 NSWLR 666.

[99] [1970] Ch 62.

[100] [1982] 3 All ER 1016.

[101] [1982] Ch 442.

[102] [1982] 3 WLR 715.

[103] See B Murray "Gratuitous Disposition of Company Assets" (1990) 12 DULJ (ns) 26 at 36-39.

[104] An exception is *John C Parkes & Sons Ltd (in Liq) v Hong Kong and Shanghai Banking Corporation* [1990] ILRM 341 where Blayney J was at pains to distinguish between breach of duty and *ultra vires*.

[105] [1998] 1 IR 8.

Supreme Court correctly applied the principle that a company must only spend its funds o matters authorised by the memorandum of association and matters reasonably incidental to th carrying on of business. Nevertheless the classification of the relevant payments as *ultra vire* without a separate consideration of the authorities on corporate benefit was unfortunate.[1 Similarly, in *Re Frederick Inns Ltd (in vol liq)*[107] the Supreme Court held that as th memoranda of association of the companies involved did not give them power to pay the ta debts of an associate company the payments to the Revenue Commissioners on their beha were *ultra vires*. Although the payments were also characterised as in breach of fiduciary dut no detailed analysis was undertaken on the issue. Although a clear pronouncement from th Supreme Court would be welcome, it can at least be said that this failure to give adequat consideration to the interaction between *ultra vires* and the duty to act in the best interests o the company is likely to ultimately assume less significance as the *ultra vires* doctrine recede in importance.[108]

D. IN WHOSE INTERESTS MUST DIRECTORS ACT?

It is a central tenet of company law that directors owe duties to the company alone.[109] Thi can be justified on the basis that a limited company is not a trustee of its own funds but is thei beneficial owner[110] and neither shareholders nor creditors have any proprietary interest in th company's assets. However, on occasion, in the interests of perceived fairness, there has bee both judicial and statutory recognition that in some circumstances directors will be required t take into account the interests of other parties. Indeed the conception of the company as a enterprise with a range of constituent interest groups has come increasingly into favour. I plumbing the depths of this duty it is therefore appropriate to examine who is 'the company' and what are its 'best interests'.

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[106] *Re Kill Inn Motel Ltd (in liq)* High Court (Murphy J) 16 September 1987 unrep also involved an equation of lack of corporate benefit with the concept of *ultra vires*.

[107] [1991] ILRM 582 (H Ct), [1994] 1 ILRM 387 (S Ct).

[108] See Company Law Review Group *First Report (2000 to 2001)* (2002) Chapter 10; Head 20 of Part A2 of th *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[109] *Percival v Wright* [1902] 2 Ch 421; *Crindle Investments v Wymes* [1998] 4 IR 567.

[110] *Belmont Finance v Williams (No 2)* [1980] 1 All ER 393, 405 *per* Buckley LJ.

(1) Acting in the Company's Interests

An examination of case law in this area indicates that that the requirement to act in the interests of the company is sometimes judicially equated with the interests of the separate legal entity which is the company and on other occasions with the interests of the members collectively or of individual members. A perceived focus on shareholders' interests rather than a wider concept of public interest is regarded as having its basis in a private conception of the company and company law which accords shareholders a proprietary interest in the company. Under what is termed 'shareholder primacy',[111] directors are required to act in the interests of the shareholders based on the notion that the shareholders are entitled to the profits of the company. There is, however, no one dominant judicial approach to the concept of in whose interests the directors must act to fulfil their duty to the company. The meaning of the interests of the company will vary according to the context. Some judges have regarded the meaning of "company as a whole" as clear[112] whereas others have been less inclined to view its meaning as obvious. Some competing models are examined below.

(a) The Company as Separate Legal Personality

A number of cases support the view that it is the separate legal personality's interests which take precedence over members' interests. This accords with the accepted understanding of separate legal personality emerging from the ground-breaking *Salomon v Salomon & Co Ltd.*[113]

Mutual Life Insurance Co of New York v Rank Organisation Ltd[114] established that the requirement that directors exercise their powers in a manner which is fair as between different classes of shareholders does not require that they be treated identically. In *Mutual Life* this

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[111] For the genesis of the shareholder primacy doctrine see AA Berle "Corporate Powers as Powers in Trust" (1931) 44 Harv L Rev 1049; JE Parkinson *Corporate Power and Responsibility: Issues in the Theory of Company Law* Clarendon Press Oxford 1993 at 75-76.

[112] In *Mills v Mills* (1938) 60 CLR 150, 188 Dixon J stated that "its meaning admits of little doubt".

[113] [1897] AC 22.

[114] [1985] BCLC 11.

meant that the directors' decision not to make available an issue of shares to shareholders residing in North America in order to avoid burdensome compliance costs to the company was not open to question. The exclusion of the North American shareholders was not regarded as affecting the existence of a shareholder's shares nor the rights attached to them and the directors were held to have exercised their powers *bona fide* in the interests of the company. *Mutual Life* was applied by Carroll J in *Afric Sive Ltd v Oil & Gas Exploration plc*[115] in relation to the timing of a rights issue which resulted in the plaintiffs being excluded. The same line of reasoning was also followed in *Re BSB Holdings Ltd (No. 2)*[116] where Arden J stated, "[t]he law does not require the interests of the company to be sacrificed in the particular interests of a group of shareholders."[117] Rather, the authorities embrace an altogether more limited proposition - that where a matter will affect different classes of shareholders, the directors must exercise their powers fairly in relation to the different classes of shareholders.[118]

Generally, in order to respect the doctrine of separate legal personality, if a company is part of a group, the directors must act in the best interests of the company rather than the group.[119] However, in practice companies often act with the interests of the wider group in mind and there is a strong argument to be made that the law ought to accord with commercial practice.[120] A certain amount of leeway was introduced by Pennycuick J's objective benefit test in *Charterbridge Corporation Ltd v Lloyds Bank Ltd.*[121] On this approach the best interests duty will be complied with where a court is satisfied that although separate consideration was not given to the interests of the actor company, a director of the company taking an objective view in the exclusive interest of the company could reasonably have concluded that the transaction was for the benefit of that company.

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[115] High Court (Carroll J) 30 January 1989 unrep.

[116] [1996] 1 BCLC 155.

[117] *Ibid* at 251.

[118] *Mutual Life Insurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11; *Re BSB Holdings Ltd (No.2)* [1996] 1 BCLC 155. The seemingly abortive plan to encapsulate this in statute is discussed in Chapter 5 below.

[119] *Re Pollypeck International plc (in administration)* [1996] 2 All ER 433, 444 *per* Robert Walker J.

[120] See J Dine n 7 above at 209.

[121] [1970] Ch 62.

In some circumstances the wider interests of a corporate group will have an inevitable impact on the interests of a group company. In *Nicholas v Soundcraft Electronics Ltd*[122] it was held that directors of a subsidiary company did not breach the best interests duty in not seeking to recover a debt from its parent company on the basis that since the parent company was the sole distributor of the subsidiary's products it was in its interests not to risk the parent company going into liquidation.[123] Similar commercial awareness is evident in *Re PMPA Garage (Longmile) Ltd*[124] which showed that the Irish courts can be flexible where it can fairly be said that the best interests of the company are served by ensuring the survival of other group companies, in this case through guaranteeing their loans. *Re PMPA* went further than the English case law with Murphy J putting forward the general proposition that, in discharging his duties to a company within a group, a director is entitled to consider the interests of the group as a whole. This was pragmatic as a rigid insistence on the separate legal personality of group companies in *Re PMPA* would not have accorded with the actuality whereby the business of the various group companies was conducted on a co-operative basis with an eye on the welfare of each company and the group as a whole. The considerable co-operation between the companies meant that one company which had surplus funds might transfer it to another in need. Where necessary, security and guarantees were given from one group company in respect of another group company's debts because it would damage the reputation of the group as a whole if one of the companies got into difficulties. Murphy J accepted this, stating:

> "In the nature of things companies associated with each other as parent and subsidiary or through common shareholders or who share common management and common titles or logos cannot safely ignore the problems of each other. Even the most independently minded director of any such related company would necessarily recognise that he should and perhaps must protect the interests of the group as a whole or else take steps to secure that the particular company disassociates itself from the group."[125]

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[122] [1993] BCLC 360.

[123] See also *Facia Footwear Ltd v Hinchcliffe Ltd* [1998] 1 BCLC 218.

[124] [1992] 1 IR 315.

[125] *Ibid* at 324.

Therefore although the result of giving such a guarantee was ultimately commercial disastrous, it was held to be legally unassailable. The subsequent Supreme Court decision *Re Frederick Inns Ltd*[126] added an important limitation to the breadth of the proposition which *Re PMPA* stands, showing that where a company's solvency is in doubt differe considerations will apply. Thus in *Re Frederick Inns* the payment of tax debts of grou companies was regarded as a breach of duty and *ultra vires*.

(b) The Collective Interests of Members

Although the concept of separate legal personality largely reigns supreme, there are instance of judicial approach reflecting the perspective that it is artificial to entirely separate member interests from those of the company. In *Greenhalgh v Arderne Cinemas Ltd*[127] Evershed M had regard to the interests of the corporators as a general body rather the separate legal entity He said:

> "The phrase, 'the company as a whole', does not (at any rate in such a case as th present) mean the company as a commercial entity as distinct from the corporators: i means the corporators as a general body. That is to say, the case may be taken of a individual hypothetical member and it may be asked whether what is proposed is, i the honest opinion of those who voted in its favour, for that person's benefit."[128]

While the interests of the company are not seen as sectional interests of particular factions o shareholders, there is evidence of the courts regarding the company's interests in terms of th collective interests of the shareholders.[129] For instance, in *G & S Doherty Ltd v Doherty*,[13 speaking in relation to the exercise of the power of allotment, Henchy J intoned that director are obliged to exercise "... their power *bona fide* for the benefit of the company as a whole

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[126] [1994] 1 ILRM 387.

[127] [1951] Ch 286.

[128] *Ibid* at 291.

[129] See also the legislative policy in section 205 of the *Companies Act 1963* (protection of existing members i cases of oppression and unfair disregard of interests). For an example of such a link see *Banfi Ltd v Morr* [2006] IEHC 257.

[130] High Court (Henchy J) 19 June 1969 unrep.

that is to say, the shareholders as whole."[131] Subsequently in *Irish Press plc v Ingersoll Irish Publications Ltd*[132] Barron J unequivocally equated the interests of the company with those of the shareholders in stating that "...acting in the interests of the company is no more than acting in the interests of all its shareholders."[133] However, there has yet to be a ruling from the Irish courts on whether the interests of shareholders encompasses the interests of future members. This broader conception of shareholders interests was accepted in *Gaiman v National Association for Mental Health*[134] where Megarry J accepted that in order to determine what is in the best interests of an artificial legal entity, it is necessary to have regard to the interests of both present and future members.[135]

Having looked at the various different judicial approaches, it becomes clear that a choice between ascribing the relevant interests as either the collective interests of the members or those of the artificial legal entity is significant as it colours the approach which can be taken by directors. Professor Sealy argues that an understanding of the interests of the company as separate from those of the shareholders facilitates the directors in acting in the long term interests of the company rather than simply the short term interests of the members.[136] However, a similar result may be achieved by looking at the collective interests of members if regard is had not only to the interests of current members but also those of prospective members as contemplated in *Gaiman*.

If the interests of the company are regarded as those of the membership, this gives rise to the question of what constitutes acting in the interests of members. It is generally accepted that the main interest of members concerns obtaining the maximum gains from their investment in the company thereby setting a profit maximisation goal for the company.[137] This does not provide an answer to the question of whether a short term or long term corporate strategy

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[131] *Ibid* at p 22 of the unreported judgment.

[132] High Court (Barron J) 15 December 1993 unrep.

[133] *Ibid* at p 77 of the unreported judgment.

[134] [1971] Ch 317.

[135] See also Helsham J's comments to a similar effect in *Provident International Corporation v International Leasing Corp Ltd* [1969] 1 NSWR 424, 440.

[136] LS Sealy n 31 above at 270.

[137] This subject will be returned to in the context of the discussion of the proposed reforms in Chapter 5 below.

ought to be taken.[138] The City Code on Takeovers and Mergers[139] introduced in 1968 requir boards to advise shareholders on the financial merits of a bid. It is widely accepted that consequence of this was to force directors to give too great attention to the short-term surviv through maximising shareholder interests rather than long term strategies favouring the lon term development of the company.[140]

(c) The Company as a Constituency of Stakeholder Interests

While shareholder primacy has long dominated, a broader perspective will focus on th interests of all stakeholders.[141] Stakeholders are regarded as comprising all parties affected b the company's activities including creditors, employees, customers and the environment. A Kiarie explains,

> "Shareholder value views shareholders as the owners of the firm, and thus focuses o profit maximisation as the objective of the firm. Stakeholder value, on the other hand sees the firm as encompassing all those affected by its activities and emphasise sustainability and inclusion."[142]

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[138] See further S Mayson, D French & C Ryan n 42 above at 570-571.

[139] See now the Panel on Takeovers and Mergers (UK) *The City Code on Takeovers and Mergers* 8th ed 2006. I Ireland the Irish Takeover Panel administers the *Takeover Rules and Substantial Acquisition Rules* (2006 ed).

[140] See S Kiarie "At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Valu Which Road Should the United Kingdom Take?" (2006) 17 ICCLR 309; JE Parkinson n 111 above at Chapter On this issue see further discussion in Chapter 5 below.

[141] For the genesis of this see EM Dodd "For Whom are Corporate Managers Trustees?" (1932) 45 Harv L R 1145. The corporate governance literature on stakeholder value and corporate social responsibility is vast and comprehensive overview is outside the substantive focus of this thesis. For a good contemporary discussion s MM Blair "Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century" in C Clarke (ed) *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governan* Routledge London 2004; J Parkinson "Corporate Governance: The Company Law Review and Questions 'Scope' in T Clarke (ed) *Corporate Governance: Critical Perspectives on Business and Management* Vol Routledge London 2005.

[142] S Kiarie n 140 above at 309.

What is important in the context of considering the duty to act in the best interests of the company is to note that a shift is underway away from a mono-focus on the interests of the company as solely equated with shareholder value and towards a broader understanding of the interests of other stakeholders.

While corporate social responsibility ("CSR") is now attracting considerable attention, the recognition of duties owed to persons other than the company is not without difficulties. Mayson, French & Ryan hit a conceptual conundrum on the head in stating:

> "The principal problem with imposing on directors a duty to consider the interests of persons other than the company is whether that duty should be owed directly to those persons or whether the company can be entrusted with enforcing its directors' duty to consider their interests. It may be that if the directors of a company take a decision without considering some interest which they ought to consider then the decision will be unlawful and could be challenged by a member...."[143]

They also note that taking into account third party interests may in itself not be in the best interests of the company. In some cases a direct conflict will arise between members and creditors' interests or within a group. One of the difficulties about recognising the need to take other interests into consideration is the issue of how these various stakeholder interests can be meaningfully accommodated. Although the Canadian Supreme Court stated in *Peoples Department Stores Inc (Trustee of) v Wise*[144] that the directors must attempt act to act in the best interests of the corporation and not to favour the interests of any one body of stakeholders,[145] this does not resolve the uncertainty as to how this should work in practice.[146]

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[143] S Mayson, D French & C Ryan n 42 above at 572.

[144] [2004] 3 SCR 461.

[145] In Canada creditors are uniquely equipped to protect their interests by relying on the oppression remedy in section 241(2) of the *Canada Business Corporations Act* R.S.C. 1985, c. C-44: See D Thomson "Directors, Creditors and Insolvency: A Fiduciary Duty or a Duty Not to Oppress?" (2000) 58 UT Fac L Rev 31. Creditors may also be permitted to bring a derivative action in the name of the corporation under sections 239 and 240 of the CBCA.

[146] See also *Re Welfab Engineers Ltd* [1990] BCC 600; *Re MDA Investment Management Ltd* [2003] EWHC 277; DW McKenzie Skene "The Directors' Duty to the Creditors of a Financially Distressed Company: A Perspective

Judicial and statutory efforts to require directors to consider the interests of some stakeholder are examined in subsequent sections of this chapter and the broader issue of accommodating stakeholder interests is revisited in Chapter 5.

(2) The Interests of Individual Members

(a) No General Duty Owed by Directors to Individual Members

The courts have set their face against a general proposition that directors owe direct duties t shareholders. In *Percival v Wright*[147] Swinfen-Eady J held that directors who purchase shares in their company owed no fiduciary duty to their vendors to disclose the existence o takeover negotiations then in progress. This was subsumed into the company law substratu as a rule that the directors only owe duties to the company and not to individual shareholder The rationale for this was explained by Handley JA in *Brunninghausen v Glavanics* a follows:

> "If fiduciary duties owed by directors to their companies were also owed to th shareholders, directors would be liable to harassing actions brought by minori shareholders. Since in that event each shareholder would have a personal righ directors would also be exposed to a multiplicity of actions. There are therefore goo reasons behind the established rule that in general a director's fiduciary duties ar owed only to the company."[148]

The same considerations are evident in *Peskin v Anderson*[149] where at first instance Neuberg J professed that any general imposition of a direct duty owed to shareholders:

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from Across the Pond" University of Maryland School of Law 4th Annual Business Law Conference *Twilight the Zone of Insolvency: Fiduciary Duty and Creditors of Troubled Companies* 4 November 2005.

[147] [1902] 2 Ch 421.

[148] [1999] NSWCA 199.

[149] [2000] 1 BCLC 1. This decision was upheld by the Court of Appeal [2001] 1 BCLC 372.

"... (a) would involve placing an unfair, unrealistic and uncertain burden on a director and (b) would present him frequently with a position where his two competing duties, namely his undoubted fiduciary duty to the company and his alleged fiduciary duty to shareholders, would be in conflict."[150]

In the Court of Appeal a further justification was presented in Mummery LJ's statement that "... few would doubt that, as a general rule, it is important for the well-being of a company (and of the wider commercial community) that directors are not overexposed to the risk of multiple legal actions by dissenting minority shareholders. As in the affairs of society, so in the affairs of companies, rule by litigation is not to be equated with the rule of law."[151]

Having regard to these considerations, the courts have placed sensible boundaries on the prospect of duties being owed directly to members.

(b) The Exceptional Imposition of Duty

While maintaining the general principle that generally no duty is owed directly to shareholders by directors, both Irish and Commonwealth case law has established that in exceptional circumstances a fiduciary relationship may be found to arise such that a director will owe an individual member or members a duty to consider their interests. This has meant re-evaluating the weight afforded to the first instance judicial pronouncements in *Percival v Wright*[152] to the effect that directors owe a duty to the company alone.

Allen v Hyatt[153] indicated that a director may stand in a fiduciary relationship to shareholders to whom they expressly undertake obligations. The Privy Council's view was that this would be the case if the directors have held themselves out to the individual shareholders as "acting for them on the same footing as they were acting for the company itself, that was, as agents...."[154] Here the directors had made a profit as a result of having induced shareholders

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[150] [2000] 1 BCLC 1, 14.

[151] [2001] 1 BCLC 372, [30].

[152] [1902] 2 Ch 421.

[153] (1914) 30 TLR 444.

[154] *Ibid* at 445.

to grant them purchase options over their shares on the basis that to do so would help the directors to negotiate an amalgamation with another company.[155] The finding of an agency relationship enabled the Court to hold that the directors were in a fiduciary relationship to the shareholders.

Since then a line of cases has focused on the existence of a relationship of mutual trust and confidence typically found in small private companies where there is a family relationship between the directors or quasi-partnerships involving shareholder-directors. Thus in the New Zealand Court of Appeal's influential decision in *Coleman v Myers*[156] a fiduciary relationship was found in the context of a small closely-held family company where the shareholders were accustomed to acting on the advice of the defendant director. This arose in the context of a director with a controlling interest acquiring shares from minority shareholders having withheld information from the shareholders regarding the true value of the shares.

Woodhouse J said that the standard of conduct required of a director would depend on the surrounding circumstances and the responsibility he has assumed towards a shareholder:

> "It is . . . an area of the law where the courts can and should find some practical means of giving effect to sensible and fair principles of commercial morality in the cases that come before them; and while it may not be possible to lay down any general test as to when the fiduciary duty will arise for a company director or to prescribe the exact conduct which will always discharge it when it does, there are nevertheless some factors that will usually have an influence upon a decision one way or the other. They include, I think, dependence upon information and advice, the existence of a relationship of confidence,[157] the significance of some particular transaction for the

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[155] The directors were held liable to account to the shareholders for the profit made on the exercise of the share options.

[156] [1977] 2 NZLR 225.

[157] For an instance of judicial inclination to place the qualifying criteria on a broader footing than trust and confidence see the judgment of the New South Wales Court of Appeal in *Brunninghausen v Glavanics* (1999) 32 ACSR 294.

parties and, of course, the extent of any positive action taken by or on behalf of the director or directors to promote it."[158]

Judicial imprimatur for the *Coleman v Myers* formulation followed suit in the English courts[159] and our Supreme Court weighed in behind *Coleman v Myers* in *Crindle Investments v Wymes*[160] where it was recognised that that while directors do not merely by virtue of their offices, owe a fiduciary duty to individual members, in particular circumstances (such as those pertaining in *Coleman v Myers*) a company director may owe a fiduciary duty to individual shareholders.[161] Such circumstances would include where the directors have assumed some additional obligation to the shareholder.

The courts have shown themselves to be prepared to limit the central proposition for which *Percival v Wright*[162] stands where what is at issue is not the collective interests of the corporate entity but rather the interests of a shareholder *qua* individual. The issue has particularly arisen where shares are being purchased by an external purchaser and a director has neglected to keep shareholders fully informed of pertinent information. An example of this is *Securities Trust Ltd v Associated Properties Ltd*[163] which concerned an attempt to compulsorily acquire minority shares under section 204 of the *Companies Act 1963* as part of a takeover bid. The minority shareholder was not informed by the bidder that the takeover was to be financed by the company itself. McWilliam J held that although a director is not a trustee for the shareholders, directors are to some extent in a fiduciary position and in this situation the shareholders were entitled to be given reasonably full particulars by their directors. This reflects an emerging directors' duty to disclose material facts when members would be directly affected by the director's course of action in question. As Handley JA explained it in *Brunninghausen v Glavanics*:

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[158] [1977] 2 NZLR 225, 325. See also *Thexton v Thexton* [2001] 1 NZLR 237.

[159] *Re Chez Nico (Restaurants) Ltd* [1992] 1 BCLC 192; *Platt v Platt* [1999] 2 BCLC 745.

[160] [1998] 2 ILRM 275.

[161] In *Crindle Investment v Wymes* [1998] 2 ILRM 275 the absence of a relationship of mutual trust and confidence proved a stumbling block. For another instance of such a claim being rejected on the facts see *Keaney v Sullivan* [2007] IEHC 8.

[162] [1902] 2 Ch 421.

[163] High Court (McWilliam J) 19 November 1980 unrep.

"Where a director's fiduciary duties are owed to the company this prevents th recognition of concurrent and identical duties to its shareholders covering the sam subject matter. However this should not preclude the recognition of a fiduciary duty t shareholders in relation to dealings in their shares where this would not compete wit any duty owed to the company."[164]

On the basis of the above review, it is clear that central proposition for which the first instanc decision in *Percival v Wright* is relied on has taken quite a battering.[165]

(c) Nominee Directors and the Interests of Nominating Shareholders

In considering the duty to act in the interests of the company, the question arises as to whethe a nominee director is entitled to take into account the interests of the nominating shareholde The position of the nominee director has been described as "between the devil and the dee blue sea."[166] In the mid-twentieth century decision, *Scottish Co-operative Wholesale Socie Ltd v Meyer*,[167] the House of Lords held that a nominee director must not place the interests o those who nominated him above those of the company. The New Zealand decision of *Berl Hestia (NZ) Ltd v Fernyhough*[168] also evinces judicial recognition of a dual requirement to ac in the interest of the company alongside a special responsibility towards those who nominate the director. A greater degree of commercial pragmatism was exhibited in the Australian cas of *Levin v Clark*.[169] It was held that the company's act of taking of a secured loan on term which required the appointment of the secured creditor's nominee as a director amounted to waiver of the company's right to the undivided loyalty of the director. MacCann' contractarian explanation seems well founded. His view was that if the articles of associatio provide for a right of shareholders to nominate a director, they should be taken to b "constructed with the intent and belief that the institution of a special responsibility towards

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[164] (1999) 32 ACSR 294, [58].

[165] The decision was criticised in the UK by the Jenkins Committee: *Report of the Company Law Committe* HMSO London Cmnd 1749 (1962) at paras 8-89, 99 (b). See also L Loss "The Fiduciary Concept as Applied t Trading by Corporate Insiders in the United States" (1970) 33 MLR 34 at 40-41.

[166] RW Parsons "The Director's Duty of Good Faith" (1965-1967) 5 MULR 395 at 418.

[167] [1959] AC 324.

[168] [1980] 2 NZLR 150.

[169] [1962] NSWR 686. See also *Re Broadcasting Station 2GB Pty Ltd* [1964-65] NSWR 1648.

particular shareholder or class of shareholders was conducive to the interests of the company as a whole".[170]

Although there has yet to be comprehensive judicial consideration of the complexities of the nominee director/nominating shareholder relationship, the Irish courts have also recognised the special position of the nominee director. In *Irish Press plc v Ingersoll Irish Publications Ltd*[171] Barron J exhibited some commercial nous in saying of nominee directors:

> "The position of nominee directors 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. But acting in the interests of the company is no more than acting in the interests of all its shareholders. If what they are asked to do involves seeking to damage one section of the shareholders in favour of another then as a director they have a duty not to do that. However, if what they are required to do is merely something that they themselves personally think is not the way to approach the matter then they must give way. There is nothing wrong with the appointing body or party 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."[172]

The proposed legislative recognition of the special position of nominee directors is considered in Chapter 5 below.

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[170] L MacCann "Directors' Fiduciary Duties" (1991) 9 ILT 104 at 107. See also P Crutchfield "Nominee Director: The Law and Commercial Reality" (1991) 12 Co Law 136; P Lee "Serving Two Masters – The Dual Loyalties of the Nominee Director in Corporate Groups" [2003] JBL 449.

[171] High Court (Barron J) 15 December 1993 unrep.

[172] *Ibid* at p 77 of the unreported judgment.

(3) Employees' Interests

Traditionally, the duty to act in the best interests of the company did not encompa consideration of employee interests.[173] Therefore it has been considered permissible to mak gifts to employees only where they constitute "an inducement to them to exert themselves i the future, or as an act done reasonably for the purpose of getting the greatest profit from th business."[174] The Court of Appeal in *Parke v Daily News Ltd*[175] suggested that directors a not entitled to consider the interests of the employees, divorced from the issue of corporat benefit.[176] In *Sweeney v Duggan* Murphy J stated: "I find it difficult to accept that a directo ... has the necessary relationship with an employee of his company to give rise to any duty o the part of the director/shareholder for the economic welfare of the employee."[177] Subsequen statutory intervention aimed at requiring directors to have regard to the interests of employee will be considered after the examination of judicial consideration of creditors' interests.

(4) Creditors' Interests

(a) No General Duty to Creditors

The doctrine of limited liability is often viewed as a mechanism for shifting risk fro shareholders to creditors.[178] While *Percival v Wright*[179] established that directors owed thei duties to the company as whole and not to individual shareholders, in *Jones v Gunn*[180] McGuinness J noted that the decision did not consider the question of duties being owed t

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[173] BAK Rider "The Conduct of Directors" (1978) 128 NLJ 27; I Lynch Fannon "Employees as Corporat Stakeholders: Theory and Reality in a Transatlantic Context" (2004) 4 JCLS 155.

[174] *Hutton v West Cork Railway Co* (1883) 23 Ch 654, 666 *per* Cotton LJ.

[175] [1962] Ch 927.

[176] Section 719 of the *Companies Act 1985* contains a statutory procedure for companies to obtain approval fo voluntary payments to employees on the cessation or transfer of its business "notwithstanding that [this is] not i the interests of employees". See now section 247 of the *Companies Act 2006* (UK).

[177] [1997] 2 IR 531, 545-546 *nem diss.*

[178] BR Cheffins *Company Law: Theory, Structure and Operation* Clarendon Press Oxford 1997 at 497.

[179] [1902] 2 Ch 421.

[180] [1997] 3 IR 1.

creditors. In general the courts have not regarded directors as owing duties to the creditor body or to individual creditors.[181] While there is no generally applicable duty to creditors, there is a judicial acceptance that in very rare circumstances a duty of care to creditors may arise.[182] In *Kuwait Asia Bank v National Mutual Life Nominees*[183] Lord Lowry observed that although directors are not directly liable a director may by implied agreement accept a special duty to a creditor. Examined below is the broader question of recognition of a duty to consider the interests of creditors.[184]

(b) A Limited Duty to Consider Creditors' Interests

The courts have been content to carve out a duty to consider the interests of creditors when the company is being wound up and sometimes where a company is insolvent or even where insolvency is simply looming on the horizon.[185] Judicial recognition of such a duty is open to criticism for breaching the general principle whereby the courts do not seek to imply duties and obligations in arm's length commercial debtor-creditor relationships on the basis that it is open to the parties to put in place contractual protections[186] and that judicial or legislative

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[181] *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch258, 288 *per* Dillon LJ; *Yukong Lines Ltd of Korea v Rendsburg Investments Corpn of Liberia, The Rialto (No. 2)* [1998] 4 All ER 82, 99 *per* Toulson J; *Re National Irish Bank Ltd; Director of Corporate Enforcement v Seymour* [2007] IEHC 102 (argument that director owed a duty to the Revenue Commissioners rejected).

[182] *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242, 250 *per* Cooke J.

[183] [1991] 1 AC 187.

[184] The literature on this is well developed and recent contributions include DD Prentice "Creditors' Interests and Directors' Duties (1990) 10 OJLS 265; R Grantham "The Judicial Extension of Directors' Duties to Creditors" [1991] JBL 1; A Keay "The Duty of Directors to Take Account of Creditors' Interests: Has it Any Role to Play?" [2002] JBL 379; A Keay "Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors" (2003) 66 MLR 665; A Keay "A Theoretical Analysis of the Director's Duty to Consider Creditor Interests: The Progressive School's Approach" (2004) 4 JCLS 307; JW Callison "Why a Fiduciary Duty Shift to Creditors of Insolvent Business Entities is Incorrect as a Matter of Theory and Practice" and DW McKenzie Skene "The Directors' Duty to the Creditors of a Financially Distressed Company: A Perspective from Across the Pond" University of Maryland School of Law 4th Annual Business Law Conference *Twilight in the Zone of Insolvency: Fiduciary Duty and Creditors of Troubled Companies* 4 November 2005.

[185] See R Grantham "The Judicial Extension of Directors' Duties to Creditors" [1991] JBL 1.

[186] See further BR Cheffins n 178 above at 337-338; T Telfer "Risk and Insolvent Trading" in R Grantham and C Rickett (eds) *Corporate Personality in the 20th Century* Hart Publishing Oxford 1998 at 129-131.

interference displaces the contractual allocation of risk.[187] The implicit view that creditors a a class of unsophisticated actors, in need of special protection over and above that provided b the legislative restrictions on directors when the company's viability is in doubt, seem misguided. Accordingly the idea of a duty to consider creditors' interests remains the subje of some scepticism. Murray advances the view that the provisions of the *Companies Acts* suc as the fraudulent preference rules and the capital maintenance rules already give creditor adequate protection against the wrongful disposition of corporate assets.[188]

Behind such judicial activism lies the insolvency law principle that upon winding up company ceases to be the beneficial owner of its assets.[189] It can therefore be rationalised tha in an insolvency situation, the creditors replace the members as the owners of the compan and it is their interests which must be respected.[190] However, while the case law in this are conceptualises insolvency as involving a redistribution of risk from the shareholders to th creditors, this is a somewhat simplistic interpretation given the varying positions of differen classes of creditor. To date the courts have yet to refine the interests of creditors or to indicat that secured creditors should be treated differently from unsecured creditors.[191]

Judicial activism concerning creditors' interests has its origins in case law in Australia an New Zealand which established that the directors of an insolvent company are required t have regard to the interests of its creditors.[192] In the Australian case of *Kinsela v Russe*

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[187] See further JW Callison "Why a Fiduciary Shift to Creditors of Insolvent Business Entities is Incorrect as Matter of Theory and Practice" University of Maryland School of Law 4th Annual Business Law Conferenc *Twilight in the Zone of Insolvency: Fiduciary Duty and Creditors of Troubled Companies* 4 November 2005.

[188] B Murray n 103 above at 42.

[189] *Ayerst v CK (Construction) Ltd* [1974] 1 All ER 676.

[190] S Mayson, D French & C Ryan n 42 above at 574.

[191] See V Finch "Directors' Duties: Insolvency and the Unsecured Creditor" in A Clarke (ed) *Current Issues i Insolvency Law and Corporate Insolvency Law: Perspectives and Principles* Sweet & Maxwell London 1991.

[192] *Re Day-Nite Carriers* [1975] 1 NZLR 172; *Walker v Wimborne* (1976) 137 CLR 1; *Re Avon Chambers Lt* [1978]; *Ring v Sutton* (1980) 5 ACLR 546; *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242; *Kinsela Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722; *Hilton International Ltd v Hilton* [1989] 1 NZLR 442; *Jeffree National Companies & Securities Commission* (1990) 15 ACLR 217; *Re Dalhoff and King Holdings Ltd* [1991] NZLR 296.

Kinsela Pty Ltd,[193] a company faced with imminent collapse granted a lease to two of its directors of a premises at an undervalue and without a rent review clause, and an option to purchase the premises at any stage during the term of the lease at a price below the market valuation. Shortly after the grant of the lease, the company went into liquidation, and the liquidator sought to have the transaction set aside as a breach of the directors' duty. In the New South Wales Court of Appeal Street CJ held that the purpose of the transaction was to put this asset (the premises) beyond the reach of the creditors. He based the requirement to consider creditors' interests on their prospective entitlements on insolvency:

> "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 creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration."[194]

On this side of the world, Lord Diplock's tentative recognition in *Lonrho Ltd v Shell Petroleum Co Ltd*[195] that that the interests of the company did not only encompass the interests of shareholders but may also include those of creditors was developed in *Winkworth v Edward Baron Development Co*[196] where Lord Templeman acknowledged that a company owed a duty to both present and future creditors "... to ensure that ... [the company's] property is not dissipated or exploited for the benefit of the directors themselves to the prejudice of the creditors."[197] This translated into a duty to the company and to creditors to "keep its property inviolate and available for the repayment of its debts."[198] What this meant in practice has been

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[193] (1986) 4 NSWLR 722.

[194] *Ibid* at 730.

[195] [1980] 1 WLR 627, 634.

[196] [1986] 1 WLR 1512.

[197] *Ibid* at 1516.

[198] *Ibid.*

a matter of some doubt.[199] With *West Mercia Safetywear Ltd v Dodd*[200] a requirement t consider creditors' interests was squarely imported by the Court of Appeal into English law. was held that financial transfers to a subsidiary company at the time of the company being i financial difficulties was a breach of duty as it was in disregard of the interests of the gener creditors of the insolvent company. Dillon LJ approved Street CJ's approach in *Kinsela Russell Kinsela Pty Ltd* and these pronouncements have been treated as authoritative i England and Wales ever since.[201]

The *Kinsela* approach has also received the imprimatur of both the High Court and th Supreme Court.[202] *Re Frederick Inns Ltd*[203] saw the High Court and Supreme Court applyin *Kinsela v Russell Kinsela Pty Ltd.* Murray observes that the apparently blunt instrument o general judicial statements concerning the interests of creditors was developed in *Frederic Inns* into "... the conclusion that the payments in question here 'were in disregard of the right and interest of the general creditors.'"[204] In *John C Parkes & Sons Ltd v Hong Kong Shanghai Banking Corporation*[205] Blayney J had approved the *Kinsela* principle and accepte that the directors of insolvent companies owed duties to that company's creditors. However he laid emphasis on the fact that there was no evidence that the defendant director knew th company was insolvent. Accordingly this has been regarded as establishing a subjective tes concerning the triggering of the duty.[206] Indeed a subsequent judicial marker that the Iris courts will not judge directors too harshly who not unreasonably misjudge the future prospect of their company emerges from *obiter* comments of Clarke J in *Hughes v Hitachi Koki Imaging Solutions Europe* where he stated that:

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[199] LS Sealy "Directors' Duties – An Unnecessary Gloss?" [1988] 47 CLJ 175; R Grantham n 185 above at 11.

[200] [1988] BCLC 250.

[201] See *Re Pantone 485 Ltd* [2002] 1 BCLC 266.

[202] See H Linnane "Directors' Duties to Creditors: the Adoption of *Kinsela* into Irish Law" (1995) 16 Co La 319.

[203] [1991] ILRM 582 (H Ct), [1994] 1 ILRM 387 (S Ct). See B Murray n 103 above; M Fealy "The Role o Equity in the Winding Up of a Company" (1995) 17 DULJ (ns) 18.

[204] B Murray n 103 above at 45.

[205] [1990] 1 ILRM 341. See also *Byrne v Shelbourne FC Ltd* High Court (O'Hanlon J) 8 February 1984 unrep.

[206] TB Courtney *The Law of Private Companies* 2nd ed LexisNexis Butterworths Dublin 2002 at [10.013].

"... the directors of a corporate entity which may appear to be insolvent, are entitled to exercise a reasonable judgment as to the availability of funds to meet liabilities. In much the same way as the directors may be absolved from a charge of reckless trading if they are demonstrated to have acted responsibly in circumstances where there was good reason to believe that further funding, sufficient to allow the company to continue, might be forthcoming, so also would directors be absolved from any breach of [the duty to creditors identified in *Frederick Inns*] where they acted responsibly in circumstances where there was good reason to believe that funds would be available to ensure that no party was left worse off than the position that would obtain in the event of a liquidation."[207]

As will be discussed in the next sub-section, there is also a danger in expressing the duty as a duty owed to creditors rather than as a duty owed to the company to consider the interests of creditors.

(c) When is the Duty Triggered?

The theoretical underpinning of a duty to consider creditors' interests rests on the concept of the transfer of residual risk from the shareholders to the creditors.[208] One of the difficulties is with the meaning of "insolvent".[209] In *Peoples Department Stores Inc (Trustee of) v Wise*[210] the Canadian Supreme Court stated:

"The directors' fiduciary duty does not change when a corporation is in the nebulous 'vicinity of insolvency'. That phrase has not been defined; moreover, it is incapable of definition and has no legal meaning. What it is obviously intended to convey is a deterioration in the corporation's financial stability"[211]

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[207] [2006] 3 IR 457, 467.

[208] See *Production Resources Group, Inc. v NCT Group, Inc.* 863 A.2d 784 (Del. Ch. 1992). For a criticism of this approach see JW Callison n 187 above.

[209] For a good discussion of the various senses in which the term may be employed see *Re Club Tivoli Ltd (in vol liq; Foster v Davis* [2005] IEHC 468.

[210] [2004] 3 SCR 461.

[211] *Ibid* at [46].

It would appear that the duty to consider the interests of creditors will arise not just whe formal insolvency procedures have been activated but also where there is an entitlement initiate them.[212] In *Re Frederick Inns Ltd* Blayney J stated:

> "Where, as here, a company's situation was such that any creditor could have caused to be wound up on the ground of insolvency, I consider that it can equally well be sa that the company had ceased to be the beneficial owner of its assets with the result th the directors would have had no power to use the company's assets to discharge th liabilities of other companies. Once the company clearly had to be wound up and i assets applied *pro tanto* in discharge of its liabilities, the directors had a duty to th creditors to preserve the assets to enable this to be done, or at least not to dissipa them."[213]

This been criticised by Fealy who forcefully argues that this reasoning is not sound.[214] H preferred view is that the beneficial ownership of the company's assets is suspended upon th company going into a winding up and that the Supreme Court's innovation of passing th beneficial ownership to the creditors on the company becoming insolvent ignores the fact tha the granting of an order to wind up a company is a matter of judicial discretion.[215]

Commentators have isolated the difficult problem of discerning what duties may be owed t consider creditors' interests in the twilight zone immediately preceding insolvency.[216] Kea has argued that the duty should be triggered where a director can reasonably expect that course of action taken could result in the company's insolvency.[217] In Australia, the court have held that a duty to take the interests of creditors into account arises not just where th company is insolvent, but where the director is aware that there is a real risk of insolvency.[21

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[212] On this issue see A Keay "The Director's Duty to Take into Account the Interests of Company Creditors When is it Triggered?" (2001) 25 MULR 315.

[213] [1994] 1 ILRM 387, 396.

[214] M Fealy n 203 above at 18.

[215] See section 216 of the *Companies Act 1963*.

[216] A Keay n 212 above; T Ciro "The Twilight Zone Revisited: Assessing the Enforceability of Pre-liquidation Transactions in a Corporate Group Insolvency" (2005) 20 JIBLR 590.

[217] A Keay n 212 above.

[218] *Grove v Flavel* (1986) SASR 410.

This approach was also evident in *Colin Gwyer and Associates Ltd v London Wharf (Limehouse) Ltd*[219] where Leslie Kosmin QC (sitting as a deputy judge of the High Court) regarded the creditor consideration principle as applicable when the company is of doubtful solvency or on the verge of insolvency.[220] In such a situation any act by the directors which purports to move assets from the reach of creditors would constitute a breach of duty.

(d) How Can the Duty Be Discharged?

If a duty to consider creditors' interests is recognised, what is required in order for directors to be said to have taken appropriate account of the interests of creditors? In *McLaughlin v Lannen*[221] a declaration of restriction under section 150 of the *Companies Act 1990* was made against two directors arising out of repayments to investors in one of the companies under a BES scheme, including to one of the directors. The Court considered that it ought to have been clear to the directors that payment in full of the BES investors' entitlement would necessarily leave the companies in a position where they would be unable to repay all of their debts. Clarke J stated:

> "While understanding the pressures which may have been on the directors it does have to be noted that all directors in insolvent circumstances are likely to be subjected to significant pressure. It is their job to resist such pressure and to ensure that the company's assets are properly dealt with. Any significant failure in that regard has to be taken as demonstrating a level of irresponsibility sufficient to warrant [making a declaration of restriction]."[222]

General statements of this nature are all very well but do little to elucidate just what is required in order for directors to be said to have acted with appropriate regard to the interests of creditors. In *Re Welfab Engineers Ltd*[223] Hoffmann J expressed the view that the duty is not to act to the best advantage of creditors but directors should ensure that the company only continues trading if to do so would not leave creditors in a worse position than on

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[219] [2003] 2 BCLC 153.

[220] See also *Re MDA Investment Management Ltd* [2003] EWHC 2748.

[221] [2006] 2 ILRM 217.

[222] *Ibid* at 224.

[223] [1990] BCLC 833.

liquidation.[224] However, where the balance should lie is not always readily evident. As Sc VC remarked in *Facia Footwear Ltd v Hinchliffe*, "... the boundary between an acceptab risk that an entrepreneur may properly take and an unacceptable risk the taking of whi constitutes misfeasance is not always, perhaps not usually, clear-cut."[225] A sympathetic ear evident in Lord Templeman's observation in *Winkworth v Edward Baron Developments L* that:

> "... a company owes a duty to its creditors, present and future. The company is n bound to pay off every debt as soon as it is incurred and the company is not obliged avoid all ventures which involve an element of risk, but the company owes a duty to i creditors to keep property inviolate and available for the repayment of its debts. T conscience of the company is confided to its directors. A duty is owed by the directo to the company and to the creditors of the company to ensure that the affairs of t company are properly managed and that its property is not dissipated or exploited f the benefit of the directors themselves to the prejudice of the creditors."[226]

Re Pantone 485 Ltd[227] indicated that if the directors acted consistently with the interests of t general creditors but inconsistently with the interest of a creditor or section of creditors wi special rights in a winding up, they would not be in breach of duty to the company. In *Peopl Department Stores Inc (Trustee of) v Wise*[228] the Canadian Supreme Court was sympathetic t the difficulties faced by directors, stating:

> "In assessing the actions of directors it is evident that any honest and good fai attempt to redress the corporation's financial problems will, if successful, both reta value for shareholders and improve the position of creditors. If unsuccessful, it wi not qualify as a breach of the statutory fiduciary duty."[229]

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[224] See further R Grantham "Directors' Duties and Insolvent Companies" (1991) 54 MLR 576.

[225] [1988] 1 BCLC 218, 228.

[226] [1986] 1 WLR 1512.

[227] [2002] 1 BCLC 266.

[228] [2004] 3 SCR 461.

[229] *Ibid* at [46]. WD Gray "Peoples v Wise and Dylex: Identifying Stakeholder Interests upon or near Corpor Insolvency – Stasis or Pragmatism?" (2003) 39 CBLJ 242.

(e) A Directly Enforceable Duty?

Loose language in some judicial discussion gave rise to an apprehension that a direct duty might be owed to creditors.[230] However, the orthodox view is that judicial developments in this area have envisaged a duty owed to the company rather than a duty owed directly to creditors in the sense of a duty enforceable directly by them. Grantham contends that "... if one accepts the neo-classical view of the company as being dedicated to the pursuit of maximum profits, and the directors as the agents of this maximisation, a direct duty to creditors cuts across this prime economic function."[231] He persuasively argues that other directors' duties are about ensuring profit maximisation by preventing self-interested acts while a duty to creditors goes against this track. Even more compelling is the argument that since shareholders generally cannot directly enforce directors' duties, it would be novel if creditors were permitted to so do. However, it has been contended that the rule in *Foss v Harbottle* and its exceptions could be equally applied to creditors so that if a company was insolvent and the board blocked an action, creditors could be permitted to bring an action.[232]

In giving the Privy Council's opinion in *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd*[233] Lord Lowry decisively stated that a director's position alone does not give rise to any duty being directly owed to creditors. The possibility of direct enforcement by a creditor was subsequently ruled out by an English first instance court in *Yukong Line Ltd v Rendsburg Investments Corporation (No 2)*[234] where Tulson J said that a director of an insolvent company does not owe a direct fiduciary duty towards an individual creditor, nor is an individual creditor entitled to sue for breach of the fiduciary duty owned by the directors to the company.[235] If this were the case this would open a company to the possibility of a

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[230] See *eg Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512, 1516 *per* Lord Templeman; *Re Joshua Shaw and Sons Ltd* (1988) 5 BCC 188; *Re Frederick Inns* [1994] 1 ILRM 387; *Jones v Gunn* [1997] 3 IR 1; *Hughes v Koki Imaging Solutions Europe* [2006] 3 IR 457.

[231] R Grantham n 185 above at 12 (footnotes omitted).

[232] *Ibid* at 17.

[233] [1991] 1 AC 187, 217.

[234] [1988] 1 WLR 294. This position was confirmed in Australia in *Spies v The Queen* (2000) 201 CLR 603 and *Geneva Finance Ltd (rec and man apptd) v Resource & Industry Ltd* (2002) 29 ACLC 1427.

[235] The decision indicated that the only redress available for creditors in relation to a transfer of assets in disregard of a creditor's interests was via the statutory remedies available in a liquidation.

multiplicity of actions and to the issue of double recovery and the circumvention of the *pa passu* rule.[236] Indeed the Delaware Supreme Court recently ruled that a creditor does not ha the right to bring a direct claim against a director for breach of duty.[237] A more practic enforcement possibility is for the duty to be enforced by a liquidator as this is consistent wi the role of the liquidator to act in the creditors' interests.

Nevertheless the Irish courts have shown themselves to be less circumspect as the tenor o Irish judicial pronouncements goes against accepted thinking elsewhere that a duty o insolvent companies is owed to the company and is not open to direct enforcement b creditors. In his company law text, a former Chief Justice observes the effect of *Re Frederic Inns Ltd*[238] as being that "... in the case of an insolvent company, the duty owed by th directors to the company is effectively transposed into a duty to act in the interests of th company's creditors."[239] This perspective is seen in *Jones v Gunn*[240] where McGuinness stated that "... where a company is clearly insolvent, even if not in liquidation, the director owe a fiduciary duty *to the general creditors* and may not make payments which benefit eith closely connected companies or themselves personally to the detriment of the general an independent creditors."[241] Although it may be contended that this turn of phrase was no intended to signify a directly enforceable duty, in *Hughes v Hitachi Koki Imaging Solution Europe,*[242] Clarke J regarded *Re Frederick Inns* as authority for the proposition that th directors owe a duty to the creditors to preserve the assets so as to enable them to be applied i *pro tanto* discharge of the company's liabilities. He went on to indicate that in appropriat

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[236] See DD Prentice "Creditors' Interests and Directors' Duties (1990) 10 OJLS 265 at 275-276; DD Prentic "Corporate Personality, Limited Liability and the Protection of Creditors" in R Grantham and C Ricke *Corporate Personality in the 20th Century* Hart Publishing Oxford 1998 at 108.

[237] *Northern American Catholic Educational Programming Foundation Inc v Gheewalla* Supreme Court o Delaware 18 May 2007.

[238] [1994] ILRM 387.

[239] R Keane *Company Law* 4th ed Tottel Publishing Haywards Heath 2007 at [27.95]. For a similar perspectiv see *Re Pantone 485 Ltd* [2002] 1 BCLC 266.

[240] [1997] 3 IR 1.

[241] *Ibid* at 22 (emphasis added).

[242] [2006] 3 IR 457. See also *McLaughlin v Lannen* [2006] 2 ILRM 217.

circumstances a mareva injunction may be available to pre-empt such breaches of duty.[243] If a directly enforceable duty is accepted, other than pre-emptive action, what is more likely than direct enforcement is indirect enforcement by a liquidator. Indeed in *Re Swanpool Ltd (in vol liq)*[244] the case law on the duty to act in the interests of creditors was used to lend support to a decision to make a declaration of restriction under section 150 of the *Companies Act 1990*.

E. STATUTORY INTERVENTION TO PROTECT STAKEHOLDERS

There has been quite a lot of protection designed to protect stakeholders, some of it more effective than others. In the area of creditors there are a number of developments designed to guard against the effects of assets being put out of reach in an insolvency context. Employees' and members' interests are less rigorously protected.

(1) Creditor Protection Provisions

It was acknowledged in *Trevor v Whitworth*, that "[p]aid-up capital may be diminished or lost in the course of the company's trading: that is a result which no legislation can prevent...."[245] That perspective is evident in policy underlying legislative intervention in this area. Fraudulent trading and reckless trading provisions are designed to apply only when a large measure of culpability can be attached to directorial acts and omissions. The provisions on reckless trading draw a distinction between misconduct and misfortune which respects the traditional business judgment rule.[246] Keane contends that "... the philosophy that underlies the provisions is that honest and responsible people should not be penalised simply because

[243] On a similar plane, Heydon ponders on the availability of a *quiet timet* injunction should a right of direct enforcement be accepted: JD Heydon n 27 above at 133.

[244] [2006] 2 ILRM 217.

[245] (1887) 12 App Cas 409, 423.

[246] N O'Hanlon "The Corporate Form and Reckless Trading: A Modern Pandora and Epimetheus" (2006) 28 DULJ (ns) 255 at 289.

their businesses have failed, but that the dishonest and irresponsible should not escape liabili for the debts they have run up."[247]

Nevertheless the relevant statutory provisions involve considerable recognition of the interes of creditors when a company is trading in financial difficulty. Section 297 of the *Companie Act 1963* introduced both criminal consequences for fraudulent trading,[248] shadowin provisions which had appeared in UK's *Companies Act 1948*; later, civil sanctions fo fraudulent trading were introduced.[249] The latitude traditionally afforded to directo permeated through to the fraudulent trading provisions with the consequence that it prove extremely difficult to discharge the burden of proving intent to defraud creditors.[250] In the U this led to the enactment of the wrongful trading provisions in section 214 of the *Insolvenc Act 1986*[251] which were paralleled in this jurisdiction by the civil reckless trading provisio introduced in 1990, first in respect of examinership and then quickly extended to a wid remit.[252]

The thrust of the reckless trading provisions in section 297A(1) of the *Companies Act 1963* i to provide for the imposition of personal liability for company debts on a director who wa knowingly a party to carrying on the business of the company in a reckless manner. Thes provisions impose an individual rather than a collective responsibility on directors.[253] Th

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[247] R Keane n 239 above at [33.03].

[248] This implemented recommendations of the Cox Committee: *Report of the Company Law Reform Committ* pl 4523 (1958). A new section 297 was substituted by section 137 of the *Companies Act 1990*.

[249] Section 297A(1)(b) of the *Companies Act* 1963 (inserted by section 138 of the *Companies Act 1990*). Se generally TB Courtney n 206 above at [10.104]-[10.113].

[250] See further N O'Hanlon n 246 above at 257-259; L Flynn "Reckless Trading" (1991) 9 ILT 186.

[251] These had their basis in recommendations contained in the *Report of the Review Committee on Insolvency La and Practice* ("the Cork Report") HMSO London Cmnd 8558 (1982), Chapter 44.

[252] Provisions originally contained in section 33 of the *Companies (Amendment) Act 1990* and restricting reckle trading to the context of an examinership were repealed by section 180(3) of the *Companies Act 1990* an replaced by section 138 of that Act which inserted a new section 297A into the *Companies Act 1963*. See furthe J Kettle "Improper Trading in Britain and Ireland" (1994) 12 ILT (ns) 91.

[253] *Re Hefferon Kearns Ltd (No 2)* [1993] 3 IR 191.

concept of knowing recklessness has been judicially interpreted as incorporating a subjective element. In *Re Hefferon Kearns Ltd (No 2)*[254] Lynch J defined recklessness in terms of:

> "... carrying on the business in a manner which the director knows very well involves an obvious and serous risk of loss or damage to others, and yet ignores that risk, because he does not really care whether such others suffer loss or damage or because his selfish desire to keep his own company alive overrides any concern which he ought to have for others."[255]

The concurrently applicable section 297A(2) of the *Companies Act 1963* provides a more objective standard[256] by providing that a director can be deemed to have been engaged in reckless trading where having regard to "the general knowledge, skill and experience that may reasonably be expected of a person in his position" he should have realised that loss to creditors would result[257] or he was party to the company contracting a debt while not honestly believing on reasonable grounds that the company would be in a position to repay it and the other debts of the company when they fell due.[258] This involves statutorily overriding a director's compliance through acting *bona fide* in the best interests of the company as this is no longer sufficient. This is tempered by the availability of a judicial discretion to relieve a director who has acted honestly and responsibility from personal liability in section 297A(6).[259]

Additional protection for creditors comes in the guise of the fraudulent preference provisions. Borrowing from the precepts of bankruptcy law, the statutory fraudulent preference provisions[260] are designed to ensure that company disposing assets are not disposed of prior to

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[254] [1993] 3 IR 191.

[255] *Ibid* at 222. See further TB Courtney n 206 above at [10.083]-[10.086].

[256] *Re Hefferon Kearns Ltd (No 2)* [1993] 3 IR 191.

[257] Section 297A(2)(a) of the *Companies Act 1963*.

[258] Section 297A(2)(b) of the *Companies Act 1963*.

[259] See *Re Hefferon Kearns Ltd (No 2)* [1993] 3 IR 191.

[260] The provisions first contained in section 286 of the *Companies Act 1963* were substituted by section 135 of the *Companies Act 1990* which made it somewhat easier for a liquidator to discharge the burden of proving that a fraudulent preference had occurred: see R Keane n 239 above at [36.159].

the company being wound up in order to deprive the creditors of their due. What is at issue i the wrongful preference of one creditor over another. Accordingly section 286(1) of th *Companies Act 1963*[261] proscribes and renders invalid the disposition of property by company within 6 months of the commencement of an insolvent winding up.[262] Whil section 286 imposes a limit of six months for fraudulent preferences, the *Companies Act 199* increases that to two years in respect of connected persons. Furthermore, the *Companies Ac 1990* shifts the burden of proof with regard to the connected person and obliges him to prov that the disposition was not a fraudulent preference of one creditor over other creditor Subject to a statutory exception in section 286(4) for *bona fide* purchasers for value witho notice, a fraudulent preference is invalid and the transaction is void *ab initio*.

Proving fraudulent preference requires the liquidator to establish a dominant intention t prefer at the time the payment was made.[263] When juxtaposed alongside the equitable dutie explored in this chapter it is interesting that in *Station Motors Ltd (in vol liq) v AIB*[264] Carroll was satisfied that where there is no direct evidence of intention to prefer, there was nothing t prevent a court from drawing an inference of an intention to prefer.[265] That case also indicate that where the effect of the preference is to reduce the personal exposure of a director a intention to prefer will be more readily found. Significantly it is well established that this wi not be met where the directors have acted as a result of overbearing pressure exerted on the by the preferred creditor.[266]

Other relevant provisions include the supporting fraudulent disposition provisions introduce by section 139 of the *Companies Act 1990* and the invalidation of certain floating charge

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[261] As substituted by section 135 of the *Companies Act 1990*.

[262] *Citroen Sales (Ireland) Ltd (in vol liq) v Ashenhurst Williams & Co* [1993] 2 IR 69.

[263] *Re Olderfleet Shipbuilding & Engineering Co* [1922] 1 IR 26; *Corran Construction Co Ltd v Bank of Irelan Finance Ltd* [1976-77] ILRM 175.

[264] [1985] ILRM 756.

[265] *Re M Kushler Ltd* [1943] 2 All ER 22.

[266] *Assignees of Taylor* (1869-70) IRCL 129; *Re Daly & Co* (1887-8) 19 LR IR 83; *Corran Construction Co Ltd Bank of Ireland Finance Ltd* [1976-77] ILRM 175; *Parkes & Son Ltd v Hong Kong and Shanghai Banki Corporation* [1994] ILRM 341.

created in the run-up to a winding up pursuant to section 288 and 289 of the *Companies Act 1963*.

(2) Protection for Members and Employees

While traditionally, there has not been too warm a judicial welcome for directors' desire to take employees' interests into account in decision-making, section 52 of the *Companies Act 1990* requires directors to consider the interests of the company's employees as well as the interests of members.[267] This provision was a wholesale importation of the UK's section 309 of the *Companies Act 1985*.[268] While it has been contended that the equivalent section 309 is "arguably a statutory declaration of an enlightened shareholder value duty",[269] the practical benefits of these provisions are open to serious doubt. Parkinson argues that the duty to take employees' interests into account is "merely a procedural one, having no substantive content."[270] There is no reason to question his view that once there is a consideration of employees' interests in the decision-making process of directors, the courts will not be concerned to look at the substantive decision reached in anything other than a subjective manner.

Most damning is the fact that section 52 of the *Companies Act 1990* does not create a duty which can be directly enforced by employees and has been branded a "paper tiger".[271] The failure to create a readily enforceable duty militates against a satisfactory remedial solution. It is highly unlikely that directors whose acts are challenged will be receptive to authorising proceedings against themselves in the company's name and, while a member's derivative action is possible in limited circumstances, it is by no means certain that it would be available

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[267] See L MacCann "Directors' Duties: To Whom Are They Owed?" (1991) 9 ILT (ns) 30.

[268] See further *Re London Life Association Ltd* Hoffmann J, Ch D, Companies Court 21 February 1989 unrep; *Fulham Football v Cabra Estates* [1994] 1 BCLC 363; *Re Saul D Harrison* [1995] 1 BCLC 14.

[269] Company Law Review Steering Group *Modern Company Law for a Competitive Economy: the Strategic Framework* URN 99/654 Department of Trade and Industry London (1999) at para 5.1.21.

[270] See further JE Parkinson n 111 above at 85.

[271] M Fealy n 203 above at 22 (n 19).

in these circumstances.[272] Accordingly the provision and its UK equivalent have been the subject of unfavourable comment and condemned as "mere 'window dressing'."[273] As Courtney notes, it is only in exceptional circumstances that a liquidator will vindicate this duty to employees or that the members will have sufficient voting power to ensure that section 52 is enforced.[274]

Section 52 of the *Companies Act 1990* also gives rise to unresolved questions concerning the balancing exercise which is required where there is a conflict between the interests of shareholders and employees for whom profit maximisation is not the major concern.[275] In the result the following assessment of Parkinson seems fair:

> "An ambiguously worded provision, patently lacking adequate means of enforcement may be too slender a ground on which to anticipate that the courts would sanction a derogation from the ownership rights of the shareholders, lying as they do at the foundation of the legal model of the company."[276]

These issues will be returned to in the context of consideration of proposed reforms to directors' duties in Chapter 5.

F. THE PROPER PURPOSES DOCTRINE

The other aspect with which this chapter is concerned is the proper purposes doctrine. While earlier cases referred to the exercise of a power for a purpose other than that for which it was conferred as a fraud on the power,[277] nowadays it is referred to in the literature as an improper, collateral or extraneous purpose. The proper purposes doctrine was neatly summarised by

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[272] See JE Parkinson n 111 above at 83.

[273] J Dine n 7 above at 210. On section 309 of the *Companies Act 1985* (UK) see A Boyle and BJ Mordsley "The Companies Act 1980 (4)" (1980) 1 Co Law 280 at 284-285; PG Xuereb "The Juridification of Industrial Relations through Company Law Reform" (1988) 51 MLR 156.

[274] TB Courtney n 206 above at [10.016].

[275] See further JE Parkinson n 111 above at 82 ff.

[276] *Ibid* at 86.

[277] See *eg Spackman v Evans* (1868) LR 3 HL 171, 190.

Turner LJ in *Re Cameron's Coalbrook Steam Coal, and Swansea and Lougher Railway Co, Bennett's Case* in the following observation:

> "Powers given to [directors] for one purpose cannot, in my opinion, be used by them for another and different purpose. To permit such proceedings on the part of directors of companies would be to sanction not the use but the abuse of their powers. It would be to give effect and validity to an illegal exercise of a legal power."[278]

Grantham contends that the proper purposes doctrine should be classed as in the nature of a rule of interpretation with its base in the company's constitution rather than as a duty.[279] While this theory has its attractions, it ignores the reality that limitations may derive from sources other than the constitution.[280]

Sub-Part (1) considers the nature of the proper purposes doctrine as independent from issues of the corporate capacity doctrine of *ultra vires* and the duty to act *bona fide* in the best interests of the company. Sub-Part (2) examines the role which the doctrine has to play in the separation of constitutional functions within a corporate body. Sub-Part (3) explores the concept of improper purpose and how it has been interpreted by the courts against the yardstick of deference to directorial decision-making. Sub-Part (4) examines the potential for procedural challenges to directorial decision-making.

(1) Proper Purposes as a Stand-Alone Doctrine

Some analogies can be drawn between the proper purposes doctrine and other segments of corporate doctrine. To a certain extent the proper purposes doctrine can be allied to the principles governing the authority of directors as corporate agents.[281] An analogy may be drawn with the concept of corporate capacity but this should not be overstated given the

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[278] (1854) 5 De G M & G 284, 298.

[279] R Grantham "The Power of Company Directors and the Proper Purpose Doctrine" (1994-1995) 5 KCLJ 16 at 17. See further MC Ling n 13 above at 397-400.

[280] MC Ling n 13 above at 399.

[281] See R Flannigan n 25 above. For a contrary view see RC Nolan n 5 above.

judicial imprecision which has arisen concerning the distinction to be drawn between those cases where the directors cause the company to exceed its powers *ie* to act *ultra vires*,[282] and those cases where the directors abuse their powers but the company does not exceed its powers.[283]

As will be apparent from the discussion in this chapter, although both the duty to act in the best interests of the company and the proper purposes doctrine are designed to operate as a curb on directorial excesses, the duty to act for proper purposes imposes restrictions on the exercise of directorial powers which go beyond the scope of the best interests duty and both are approached quite differently by the judiciary. Earlier in this chapter it was concluded that the proper purposes doctrine stands alone from the duty to act *bona fide* in the best interests of the company.[284] While there are instances of the proper purposes doctrine being considered as simply an aspect of the duty to act *bona fide*[285] the preponderance of judicial authority points up that even if directors have acted honestly for what they believe is the benefit of the company, they may nevertheless be liable if they have exercised their powers for a purpose different from that for which the powers were conferred upon them.[286] Inherent in this is a recognition of the autonomous nature of the proper purposes imperative.[287] The separation of the two is also supported by the fact that the assessment of proper or collateral purpose test is more objective in nature than the test of *bona fides* and best interests. Based on this dichotomy, recognition of the proper purposes doctrine in its own right is viewed as enabling a legal attack to be mounted on a directorial decision without requiring any condemnation of

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[282] See *eg Hutton v West Cork Railway Co* (1883) 23 Ch D 654; *Parke v Daily News Ltd* [1962] Ch 927.

[283] See *eg Re European Central Railway Co, Sykes' Case* (1872) LR 13 Eq 255; *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] Ch 246. As to the distinction between breach of duty and *ultra vires* see further Part C(4) above.

[284] The proper purposes doctrine can also be regarded as independent of the duty to avoid conflicts of interest and secret profits and of the duty to exercise care, skill and diligence although on occasion the facts of a case will yield an overlap of duty.

[285] The following cases are often relied on in support of this view: *Re Smith & Fawcett Ltd* [1942] 1 All ER 542; *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286, 291 *per* Lord Evershed MR; *Teck Corporation v Millar* (1972) 33 DLR (3d) 288. See RC Nolan n 5 above at 7.

[286] See *eg Re Smith & Fawcett Ltd* [1942] 1 All ER 542; *Nash v Lancegaye (Ireland) Ltd* (1958) 92 ILTR 11; *G&S Doherty Ltd v Doherty* High Court (Henchy J) 19 June 1969 unrep; *Banfi Ltd v Moran* [2006] IEHC 257.

[287] See RC Nolan n 5 above; JR Birds n 17 above.

underlying motive.[288] This is consistent with the proper purposes angle being more focused and procedural than the comparatively broader lens of best interests.

(2) The Constitutional Division Function

While the duty to act for a proper purpose is designed to counteract self-interested decision-making by directors, it also has an important role to play in upholding the separation of decision-making powers within companies. A significant role of the courts in applying the proper purposes doctrine is in giving effect to the constitutional division of power between the directors and shareholders.[289] Nolan's contention is that if the proper purposes doctrine is viewed as implying restrictions into the articles of association, then the doctrine can be seen as "... a presumptive rule of law, which can, at least to some extent, be displaced by contrary intention manifested in the company's constitution."[290] As the proper purposes doctrine takes its parameters from, *inter alia*, the company's constitution, Nolan's hypothesis seems reasonable provided that the constitution does not purport to contract out of a mandatory limitation on directorial or corporate action imposed by law. Professor Hannigan views the issue from the alternative perspective of conceiving the proper purposes doctrine as an obligation on the board to act in accordance with the constitutional division of power.[291] She regards this as consonant with the duty on directors to obey the company's constitution.[292]

The proper purposes doctrine is protective of corporate governance in that it prevents the directors acting to limit shareholder control through manipulating shareholdings and voting power.[293] Indeed the courts' level of review appears to be greater in cases involving the exercise of power in an internal rather than an external matter.[294] This means that the courts

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[288] LS Sealy "Company Directors' Unconstitutional Acts" [1992] 51 CLJ 229 at 229.

[289] B Hannigan n 8 above at 239-241.

[290] RC Nolan n 5 above at 15.

[291] B Hannigan n 8 above at 241.

[292] *Ibid.* However, the duty to obey the constitution is wider given that it involves the duty not to act *ultra vires*, a matter which is not within the scope of the proper purposes doctrine.

[293] B Clarke "Corporate Responsibility in Light of the Separation of Ownership and Control" (1997) 19 DULJ (ns) 50 at 52.

[294] RC Nolan n 5 above at 22-26.

are more likely to find improper purpose in an exercise of powers affecting control within the company.

Professor Sealy is an advocate of the proper purposes doctrine functioning to uphold the constitutional separation of powers in corporate decision-making in a way which goes beyond direct usurpation of the other organ's powers to encompass acts which have the indirect result of trespassing on the territory of the shareholders' decision-making role.[295] This is exemplified in *Lee Panavision Ltd v Lee Lighting Ltd*[296] which concerned actions taken by the directors which had the indirect result of rendering nugatory the constitutional function of the shareholders in general meeting to appoint directors. The Court of Appeal held that it was unconstitutional and that the existing directors had exceeded their powers in entering into a management agreement which would deprive new directors appointed by the shareholders of all managerial powers. In *Howard Smith Ltd v Ampol Petroleum Ltd*[297] Lord Wilberforce suggested that "[i]t must be unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. To do so is to interfere with that element of the company's constitution which is separate from and set against their powers."[298]

Where a takeover bid is made, members of the company must decide whether to accept the offer and the directors of the company are not free to intervene to suit their own interests. Therefore the proper purposes doctrine performs the function of acting as a buffer of shareholders' interests by invalidating the actions of management which are designed to hinder or deter a hostile bid from being made and, where such a bid has been launched, protective actions taken to ensure the bid is defeated. Parkinson gives this insight:

> "The duty to act for a proper purpose is not concerned on its surface with profit maximization, but has an important, indirect role in securing compliance with that objective in two ways. First, it helps protect the democratic shareholder controls from

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[295] LS Sealy n 31 above at 272. See also LS Sealy n 288 above.

[296] [1993] BCLC 1282. See further LS Sealy n 288 above.

[297] [1974] AC 821.

[298] *Ibid* at 837.

being subverted by management. Second, by safeguarding the shareholders' financial interests in a take-over situation it prevents management for corporate control."[299]

Defensive tactics covered by the proper purposes doctrine would include the disposal of corporate assets to make the company a less attractive target, poison pill agreements *eg* granting an option to a third party to acquire company assets in the event of a takeover bid being made. It is a difficult position for directors to be in since their natural inclination will be to protect their own interests given that a change in control may lead to their removal from office. The proper purposes doctrine therefore has a role to play in protecting the right of the shareholders to liquidise their investment on the best possible terms free from directorial restraints. These functions are explored in the section which follows on the meaning of improper purpose.

(3) The Concept of Improper Purpose

(a) General Principles

Central to the application of the proper purpose doctrine is a determination of whether the purpose for which a power has been exercised is proper or improper. The proper purposes doctrine has been applied by the courts in relation to a range of discretionary powers affecting shares including the directors' exercise of their power to allot shares,[300] the discretion to register share transfers,[301] the power to make calls on shares[302] and the power to order the

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[299] See JE Parkinson n 111 above at 137.

[300] See *Punt v Symons & Co Ltd* [1903] 2 Ch 506 (improper allotment to facilitate passing of a resolution); *Piercy v S Mills & Co Ltd* [1920] 1 Ch 77 (improper allotment to ensure change in voting control); *Hogg v Cramphorn Ltd* [1967] Ch 254 (improper allotment to maintain control within the ranks of the directors and their supporters); *Bamford v Bamford* [1970] Ch 212 (allotment to block takeover bid without regard to interests of the company); *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821.

[301] See *Re Bede Steam Shipping Co Ltd* [1917] 1 Ch 123; *Re Smith & Fawcett Ltd* [1942] Ch 304; *Banfi Ltd v Moran* [2006] IEHC 257.

[302] See *Alexander v Automatic Telegraph Co* [1900] 2 Ch 56; *Galloway v Halle Concerts Society* [1915] 2 Ch 233.

forfeiture of shares.[303] Other common situations concern arrangements to fight off a loomi takeover bid[304] and the disposal of company assets.[305]

In determining whether a power has been exercised for an improper purpose, the first step is t ascertain what the power is and what its proper purpose is.[306] If the purpose of a pow conferred on directors is made clear in the memorandum and articles of association, its use fo any other purpose is an abuse of the proper purpose doctrine.[307] Where the power is expressl set out in the articles, its nature is ascertained from a construction of the words of th articles.[308] The power in question may otherwise have its source in resolutions passed by th company in general meeting or in contract. Yet again the power may derive from th *Companies Acts* and its proper purpose will have to be ascertained from interpreting th provision and the legislative purpose in granting the power.

Once the nature of the power is established, the issue of whether it has been improperl exercised can be entered into. It is well-established that directors cannot use their powers t ensure the continuance in control of themselves or their supporters or to defeat the wishes o the existing majority. This represents an important qualification of the *laissez-faire* judicia approach to directorial activity. In particular, the power to issue shares is identified as bein for the purpose of enabling the company to raise fresh capital for the company's coffers wher required. Where additional capital is not needed the courts have found it to be improper t issue and allot shares with a view to maintaining control in the company.[309] Indeed in th

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[303] See *Re Agriculturalist Cattle Insurance Co, Stanhope's Case* (1866) 1 Ch App 161; *Spackman v Evans* (186 LR 3 HL 171.

[304] See *eg Criterion Properties plc v Stratford UK Properties LLC* [2003] 2 BCLC 129 (affd [2006] 1 BCL 129).

[305] See *Bishopsgate Investment Management Ltd v Maxwell* [1993] BCLC 1282 (disposal of company assets fo no consideration to a family company).

[306] As Professor Finn rightly notes, it will often be impossible to make anything approaching an exhaustive list o the purpose for which a power may be exercised: PD Finn n 13 above at para 84.

[307] See *eg Re Bede Steam Shipping Co Ltd* [1917] 1 Ch 123.

[308] *Moffatt v Farquhar* (1877-78) 7 Ch D 591 approved in *Re Dublin North City Milling Co Ltd* [1909] 1 IR 17 183 *per* Meredith MR. See also *Banfi Ltd v Moran* [2006] IEHC 257.

[309] See *Fraser v Whalley* (1864) 2 Hem & M 10; *Punt v Symons and Co Ltd* [1903] 2 Ch 506; *Piercy v S Mills & Co* [1920] 1 Ch 77; *Hogg v Cramphorn Ltd* [1966] 3 All ER 420; *Nash v Lancegaye Safety Glass (Ireland) Ltd*

mid-nineteenth century it was indicated by Wood VC in *Fraser v Whalley*[310] that while as a general principle the courts will not interfere with the internal management of a company, they would be prepared to grant a *quia timet* injunction to prevent an improper issue of shares for purposes other than the raising of capital. In *Piercy v S Mills & Co Ltd*[311] it was said that the power to allot unissued shares was conferred on directors to enable them to raise capital, not as a means of influencing voting. Indeed in *Re Looe Fish Ltd*[312] a director's allotment of shares to himself with a view to enabling him to block directorial appointments of which he disapproved resulted in him being disqualified for two and half years. It has also been established that where an allotment is made for the dominant purpose of financial benefit accruing to the directors, it will be invalid.[313] A further theme arises in relation to directors improperly favouring one class of shareholders over another in allotting shares with a view to maintaining the balance of power in their own favour.[314]

On occasion the courts have been prepared to countenance the allotment of shares for purposes other than that of raising capital. In *Punt v Symons & Co Ltd*[315] Byrne J acknowledged that although the power to issue shares is primarily to be used to raise capital the power might be lawfully used for other purposes[316] and in *Re Jermyn Street Turkish Baths Ltd*[317] an allotment of shares which resulted in an individual director occupying a controlling position was held to be lawful because it was vital to the survival of the company and therefore in its interests. In consideration of the allotment the director agreed to work full-time for the company and to

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(1958) 92 ILTR 11; *Ashburton Oil NL v Alpha Minerals NL* (1971) 123 CLR 614. For an example of an unsuccessful claim of improper purpose see *CAS (Nominees) Ltd v Nottingham Forest FC plc* [2002] 1 BCLC 613.

[310] [1861-73] All ER Rep Ext 1456.

[311] [1920] 1 Ch 77.

[312] [1993] BCLC 160.

[313] *Ngurli Ltd v McCann* (1953) 90 CLR 425.

[314] See *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821; *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285.

[315] [1903] 2 Ch 506.

[316] In that case the issue of shares in order to achieve the requisite majority to pass a special resolution altering the rights of shareholders did not qualify as a *bona fide* purpose.

[317] [1971] 1 WLR 1042.

lend funds to the company with a view to rescuing it from insolvency. In these circumstance the allotment made for purposes other than raising fresh share capital was upheld as valid.

(b) The Judicial Test of Improper Purpose

It is not possible to categorically determine in advance what will constitute a proper purpose each actual decision must be judged in its specific context. In acting as an arbiter of proper purpose, the courts are in an unenviable position. As Nolan has insightfully remarked, "... it can be difficult to divine, let alone assess, the implicit purpose of any endeavour."[318] A distinction can be drawn between the objective purpose and the subjective purpose of a directorial act.[319] In *Nash v Lancegaye Safety Glass (Ireland) Ltd*[320] it was emphasised that it is the object that is important not the likelihood of achieving it.

Generally where the exercise of directorial power is impugned, the onus of proving misuse of power lies on the person alleging it. In some cases the facts will justify a presumption of improper purpose which the director will be required to rebut. This derives from *Bishopsgate Investment Management Ltd v Maxwell (No 2).*[321] The Court of Appeal found Ian Maxwell to have breached his fiduciary duty to the company by signing a number of share transfers permitting shares to be transferred for no consideration to another company in which his father had an interest. As the gratuitous disposition of corporate assets was viewed as *prima facie* an improper use of directors' powers, the burden of proof was on the defendant to rebut this presumption.

As we have seen, the best interests-proper purposes divide means that it is not necessary to show that the directors acted in bad faith or did not believe themselves to be acting in the best interests of the company – the proper purpose aspect stands alone. The well-worn judicial path for assessing a directorial act is that formulated by Lord Wilberforce in *Howard Smith*

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[318] RC Nolan n 5 above at 2.

[319] See *Peters' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457, 513; *Whitehouse v Carlton Hotel Pty Ltd* (1986) 11 ACLR 715; *Brady v Brady* [1988] 2 WLR 1308; LS Sealy n 31 above.

[320] (1958) 92 ILTR 11.

[321] [1994] 1 All ER 261.

Ltd v Ampol Petroleum Ltd.[322] His view was that it was not appropriate to try to set out rigid limits on the exercise of directorial power which would not lend themselves to ready application in individual circumstances. Rather,

> "... it is necessary to start with a consideration of the power whose exercise is in question .... Having ascertained, on a fair view, the nature of the power, and having defined as can best be done in the light of modern conditions the, or some, limits within which it may be exercised, it is then necessary for the court, if a particular exercise of it is challenged, to examine the substantial purpose for which it was exercised, and to reach a conclusion whether that purpose was proper or not. In doing so it will necessarily give credit to the *bona fide* opinion of the directors, if such is found to exist, and will respect their judgment as to matters of management; having done this, the ultimate conclusion has to be as to the side of a fairly broad line on which the case falls."[323]

This case is authority for a two step approach to determine whether, objectively viewed, on balance, the exercise of the power was a proper one. Once the nature of the power is determined,[324] it is necessary to ask what was the substantial purpose behind the exercise of a particular power having regard to the *bona fide* beliefs of the directors and their judgment in relation to matters of management. This necessarily involves an element of forbearance in relation to the actions of directors despite the underlying objectiveness of the test employed.

Butcher regards the proper purpose test as permitting the courts to challenge directors' decision-making without condemning their individual motives thus permitting "a more robust and interventionist approach" which allows the process not to fall foul of the business judgment rule.[325] Professor Hannigan notes that there are concerns as to whether the application of the proper purposes doctrine "has enabled the courts to do what they consistently say they will not, or do not, do, namely review business decisions reached by the

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[322] [1974] AC 821.

[323] *Ibid* at 835.

[324] A very broad power will be limited by the requirement to exercise it in the interests of the company. See B Hannigan n 8 above at 234; *Re Smith & Fawcett Ltd* [1942] 1 All ER 542, 545 *per* Lord Greene.

[325] BS Butcher n 9 above at 119.

directors."[326] An alternative view is that, given the strait-jacket which *Howard Smith* imposes, judicial analysis in this area does not extend beyond a *pro forma* procedural analysis which does not go to the heart of what is actually the motivation for a director's conduct.

Either way, the test is, however, not without perceived difficulties of application. Commentators have contended that it is well nigh impossible to determine a substantial purpose from an insubstantial one.[327] It has been suggested that this difficulty merits an alternative approach of setting aside any exercise of a power for an improper purpose without the need for the courts to engage in a weighting exercise to determine substantial purpose.[328]

Undoubtedly a conceptual difficulty arises where directors act for more than one purpose, some of which are proper, and some, improper.[329] Following on from *Howard Smith Ltd v Ampol Petroleum Ltd,*[330] judicial examination places emphasis on ascertaining the "substantial" or "dominant" purpose which was at work.[331] A leading case in this area is *Hogg v Cramphorn Ltd.*[332] The directors' decision to issue shares to which special voting rights attached in order to fight off a potential takeover bid for the company raised interesting questions for the court. Buckley J accepted that the directors had acted in the best interests of the company. However, as the primary purpose of the share issue was to ensure that control of the company remained with the directors and their supporters, this was an improper motive and the share sale could be set aside.

There is a line of cases which indicate that the conferral of an incidental benefit on a director will not invalidate an exercise of directors' power where the substantial purpose test is satisfied.[333] An example of this is *Mills v Mills*[334] which concerned the directors' decision to

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[326] B Hannigan n 8 above at 239.

[327] See JR Birds n 17 above; SJ Burridge "Wrongful Rights Issues" (1981) 44 MLR 40.

[328] See further B Hannigan n 8 above at 235.

[329] Birds' answer to this is a more objective approach to ascertaining purpose: JR Birds n 17 above at 584.

[330] [1974] AC 821.

[331] See *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285, 294.

[332] [1967] Ch 254.

[333] *Hirsche v Sims* [1894] AC 654; *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112; *Mills v Mills* (1938) 60 CLR 150; *Ngurli v McCann* (1954) 90 CLR 425.

[334] (1938) 60 CLR 150.

issue bonus shares in preference to declaring a dividend. An incidental consequence was that the voting power of the managing director was strengthened. The court found that the dominant purpose of the capitalisation was to retain profits for the benefit of the company's business and therefore any subsidiary or incidental motive of benefiting the managing director would not invalidate it. Latham CJ stated that a director

> "is not ... required by the law to live in an unreal region of detached altruism and to act in a vague mood of ideal abstraction from obvious facts which must be presented to the mind of any honest and intelligent man when he exercise his powers as a director. It would be setting up an impossible standard ...."[335]

A certain appreciation for the realities of corporate life where there is often a cross-over between directors and shareholders is evident in the following statement of Latham CJ:

> "Very many actions of directors who are shareholders, perhaps all of them, have a direct or indirect relation to their own interests. It would be ignoring realities and creating impossibilities in the administration of companies to require that directors should not advert to or consider in any way the effect of a particular decision upon their own interests as shareholders."[336]

The Irish judicial position is not settled but may be somewhat harsher on directors. There is authority which suggests that even a subsidiary motive may invalidate the exercise of a directorial power. In *Nash v Lancegaye Safety Glass (Ireland) Ltd*[337] Dixon J refused to accept that the mere fact that the directors in making an allotment may have had the object of benefiting the company, in addition to other improper purposes, could justify the course of action taken. The object of benefiting the company was not the sole object, and, in the judgment of Dixon J, even if it did contribute to their decision, it "would not suffice to validate the resolutions if the motives were partly improper"[338] as here where the true motive in making the allotment was to exert control. This can be contrasted with the seemingly less

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[335] *Ibid* at 164.

[336] *Ibid* at 163-164.

[337] (1958) 92 ILTR 11.

[338] *Ibid* at 26.

harsh approach employed in the earlier Irish decision in *Re Hafner*[339] albeit in the separate context of refusal to register a share transfer. There Black J stated that "in order to interfere, the court must not only find that the directors had an invalid motive, but it must also find that they had no valid motive that might be itself sufficient."[340]

How are these differences of approach to be reconciled? Naturally there are concerns that the judiciary may tip the balance too far in favour of directors. A middle way between these extremes was ploughed by the Australian High Court in *Whitehouse v Carlton Hotel Pty Ltd*[341] where the preferred view was that where there are competing proper and improper purposes, even if the improper purpose was not the dominant one, the exercise of the power would be invalid if the improper purpose was causative in the sense that but for its presence, the power would not have been exercised.[342]

(c) The Power to Refuse to Register Share Transfers

One of the areas where judicial deference is felt most keenly is in the area of reviewing the exercise of extremely broad discretionary powers granted to directors to register share transfers. A company's articles of association often give the directors a broad discretionary power of refusal to register a share transfer. If model regulation 3 of Table A[343] is adopted by a company this gives the directors the right to refuse to register a transfer without being obliged to give a reason. This type of untrammelled discretion has been upheld by the courts.[344] However, the courts have shown themselves willing to intervene in limited circumstances. The share transfer cases which turn on articles permitting an absolute discretion do not in themselves reject the wider concept of an objective review of directors'

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[339] [1947] IR 426.

[340] *Ibid* at 441. A less flexible approach was taken by the Supreme Court on appeal once an inference of an improper motive was found: *Re Hafner* [1947] IR 462.

[341] (1987) 5 ACLOC 421, [1997] 1 ACLR 715.

[342] On the issue of separating the reasoning and purpose of different directors see *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483; *Langton v Forsayth Mineral Exploration NL* (1975) 1 ACLR 227; *Re Southern Resources Ltd* (1989) 15 ACLR 770 (affd (1990) 8 ACLC 1151).

[343] The *Companies Act 1963* First Schedule, Regulation 3 of Table A, Part II.

[344] See *Re Smith and Fawcett Ltd* [1942] 1 All ER 542; *Re Hafner* [1947] IR 426; *Banfi Ltd v Moran* [2006] IEHC 157.

powers.[345] Directors will have a duty to refuse to register if the transfer is completed without compliance with the articles *e.g.* concerning pre-emption rights. Any exercise by the directors of their powers in order to secure their position is not acceptable.[346] Thus directors must not approve share transfers which are designed to compromise proceedings against themselves.[347]

Nevertheless *Re Smith and Fawcett Ltd*[348] indicates that there is a heavy onus of proof upon a person who challenges the exercise of a wide discretionary power to refuse to register a share transfer. Lord Greene MR stated that

> "in the present case the article is drafted in the widest possible terms, and I decline to write into that clear language any limitation other than a limitation, which is implicit by law, that a fiduciary power of this kind must be exercised *bona fide* in the interests of the company. Subject to that qualification, an article in this form appears to me to give the directors what it says, namely, absolute and uncontrolled discretion."[349]

In other words the giving of an untrammelled discretion implies that the review in this area can only consider the issue of whether the directors could have been acting *bona fide* in the best interests of the company. In essence, directors are not required to give reasons.[350] However if an invalid reason for declining registration is proved to the court, then this will be taken to be the motive for refusal unless the directors can give some alternative explanation. In *Re Hafner*[351] the applicant, whose transfer was refused, was able to show that the directors had paid themselves "such bloated emoluments" as to "convert the company from a dividend paying concern into a director remunerating enterprise".[352] In this instance the Court, while recognising the principle that directors are entitled to remain mute, interpreted the directors'

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[345] RC Nolan n 5 above at 9.

[346] *Punt v Symons & Co Ltd* [1903] 2 Ch 506; *Piercy v Mills* [1920] 1 Ch 77; *Hogg v Cramphorn Ltd* [1966] 3 All ER 420.

[347] *Bennett's Case* (1854) 5 De GM & G 284; *Re Mitre Assurance Co; Eyre's Case* (1862) 31 Beav 177.

[348] [1942] 1 All ER 542.

[349] *Ibid* at 545. This dictum was approved by the High Court in *Banfi Ltd v Moran* [2006] IEHC 257.

[350] *Dublin North City Milling Co* [1909] 1 IR 179.

[351] [1947] IR 426.

[352] *Ibid* at 443.

continuing silence as evidence of bad faith in the particular circumstances. This was regarded as invalidating their refusal to register.

The mere fact of personal animosity between a proposed transferee and the directors will not mean that the directors will be assumed to have acted *mala fides* and not in the company's best interests if they refuse to register a transfer.[353] However, in the recent High Court case of *Banfi Ltd v Moran*[354] Laffoy J was satisfied that an improper purpose was made out in respect of the directors' refusal to register ownership where this was designed to prevent oppression proceedings under section 205 of the *Companies Act 1963*.

(d) Defensive Tactics and Takeovers

One of the most fruitful areas for the proper purpose doctrine arises in the context of actual or potential takeover bids in respect of public listed companies.[355] Parkinson criticises the effect of looking at subjective intention:

> "Since it will usually be easy to justify measures with control consequences in commercial terms in the absence of a concrete bid, it is unlikely that it will often be demonstrated that the proper purpose duty has been breached in that situation. As a result boards have considerable freedom in practice to entrench their position without the need to seek shareholder consent."[356]

Perhaps this underestimates the astuteness of judges. For example, in *Hogg v Cramphorn Ltd*[357] the directors in establishing a trust fund of previously unissued shares for the benefit of the company's employees were primarily motivated by the desire to prevent a hostile takeover bid. Although Buckley J accepted that the directors had acted *bona fide* in what they

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[353] *Popely v Planarrive Ltd* [1997] 1 BCLC 8.

[354] [2006] IEHC 257.

[355] In a private company context pre-emption rights will generally apply: section 23 of the *Companies (Amendment) Act 1983*.

[356] JE Parkinson n 111 above at 144. For a case in point see *Winthrop Investments Ltd v Winns* (1979) 4 ACLR 1.

[357] [1967] Ch 254.

considered to be the company's best interests and to benefit employees, the allotment was declared invalid on the basis of the primary purpose. In a situation where there are rival takeover bids, the directors must not act in a manner which will impede the members' ability to obtain the best price for their shares.[358] On the other hand, on the basis of the Privy Council's substantial purposes test in *Howard Smith v Ampol,*[359] a course of action by a director or directors which has the effect of thwarting a takeover bid will only fall foul of the proper purposes doctrine where this was the substantial purpose of the action. As Lord Wilberforce explained it, a share issue whose substantial purpose was to raise capital but whose result is to prevent a change in control is not open to challenge. This gives rise to Professor Sealy's worrying but fair conclusion that "the courts are in truth making naked value judgments".[360]

Mayson, French and Ryan contend that when the measures taken are disproportionate to the actual threat posed by a takeover there may be a breach of the proper purpose principle.[361] There is certainly a degree of judicial acceptance that an allotment may be acceptable in order to protect the interests of the company on the basis of consideration of who is taking over and why, such as a takeover which will substantially damage the company. In other jurisdictions, the courts have stated that there is no fundamental principle to the effect that it is always improper for the directors to take steps to prevent a successful takeover bid.[362] The limitation of the proper purposes doctrine in the Canadian *Teck Corporation v Millar*[363] decision has been influential. There Berger J held that "the directors ought to be allowed to consider who is seeking control and why. If they believe that there will be substantial damage to the company's interests if the company is taken over, then the exercise of their powers to defeat those seeking a majority will not necessarily be categorised as improper."[364]

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[358] *Heron International Ltd v Lord Grade* [1983] BCLC 244; *Re a Company* [1986] BCLC 382. See also *Byrne v The Shelbourne Football Club Ltd* High Court (O'Hanlon J) 8 February 1984 unrep.

[359] [1974] AC 821.

[360] LS Sealy n 31 above at 276.

[361] S Mayson, D French and C Ryan n 42 above at 581.

[362] *Darwall v North Sydney Brick and Tile Co Ltd* (1989) 16 NSWLR 260, 335 *per* Clarke JA; *Alberta Ltd v Producers Pipelines Inc* (1991) 80 DLR (4th) 359.

[363] (1973) 33 DLR 288, BC SCt.

[364] *Ibid* at 315.

Also inherent in Berger J's judgment is a rejection of the classical conception of the interests of the company simply being those of the shareholders but also those of the employees and the community. This broader definition allows the directors to weigh up the various interests in considering the effect of a takeover. Berger J was conscious of the potential misuse of his words and therefore he required that directors believe that the takeover would substantially damage the company's business and that they had reasonable grounds for such a belief. Nevertheless the decision suggested that the directors may reasonably consider who is seeking control and for what purpose. The decision is also interesting for its acknowledgement of stakeholder interests. This is doctrinally significant because, as Parkinson remarks:

> "[t]he objective of the [proper purposes] rule is to protect the shareholders' right to decide whether or not to sell, and the degree of potential damage to the business if they do not sell is not the issue. It can only become the issue where a break with the exclusivity of shareholder interests is made."[365]

Therefore his view is that recognition of stakeholder interests would provide "a conceptual basis for the permissibility of protective measures."[366]

If the directors state that they believe there will be substantial damage to the company's interests then there must be reasonable grounds for that belief. If there are not, that will justify a finding that the directors were actuated by an improper purpose. Concerns arise in relation to the threat of control being given to those who may engage in asset stripping and, perhaps, to a lesser extent, those whose incompetence may harm the company's interests. In *Cayne v Global National Resources plc*[367] Megarry VC pondered the issue of asset stripping and remarked *obiter* that using the power to issue shares to prevent a takeover which would result in the company being run into the ground could be a proper purpose where the object is not to retain control, but rather to prevent the company being reduced to "impotence and beggary". However, he was careful to note that this was "quite different from directors seeking to retain control because they think they are better directors than their rivals would be." This is more

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[365] JE Parkinson n 111 above at 154 (footnote omitted).

[366] *Ibid* at 155.

[367] Ch D (Megarry VC) 12 August 1982 unrep. Affd [1984] 1 All ER 225.

reined in than the breadth of *Teck* and does not involve a wholesale rejection of the proper purposes duty. However, it still involves the courts having to make a value judgment.

The decision of Hart J at first instance in *Criterion Properties Plc v Stratford UK Properties LLC*[368] suggested that where the terms of a poison pill agreement were "... motivated not by a desire to advance or protect the commercial interests of Criterion but from a desire contingently to cripple those interests so as to deter an unwanted predator"[369] it would be unlikely that directors would be considered to be acting properly where the consequences of so doing would be more damaging than the change in control. On appeal the Court of Appeal declined to make a ruling in these terms. However, Carnwath LJ's view was that, even if one accepted the lawfulness of defensive tactics, in the particular circumstances, the mechanisms utilised could not be regarded as a reasonable exercise of power in the interests of the company.[370] This proportionality requirement suggests a healthy degree of judicial scepticism when presented with defensive tactics.

An example of what has been judged disproportionate emerges from the decision of the Supreme Court of Delaware in *Revlon Inc v MacAndrews*[371] where it was found that the directors had acted improperly as their conduct had resulted in the termination of bidding activity in a situation where the sale of the company was inevitable. The Court envisaged that in such circumstances defensive tactics were no longer justifiable and "[t]he directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[372]

Some legislative assistance has put brakes on the breadth of application of the proper purpose doctrine in the form of the specific rules governing takeovers which restrict defensive action by the board of directors of a target company.[373] Indeed, the duties imposed on directors of

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[368] [2002] 2 BCLC 151.

[369] *Ibid* at [38].

[370] See further B Clarke "Regulating Poison Pill Devices" (2004) 4 JCLS 51 at 64-67.

[371] (1986) 506 A 2d 173.

[372] *Ibid* at 182.

[373] See general principles in the Schedule to the *Irish Takeover Panel Act 1997* and the Takeover Rules and Substantial Acquisition Rules (as amended) and Article 9 of the *European Communities (Take-over Bids)*

offeree companies by the City Code[374] to limit frustrating actions have been viewed as clarifying the duty to act in good faith in the interests of the company.[375]

(4) Procedural Challenges to Directorial Decision-making - a potential new avenue?

It has been said that in reviewing directors' decisions for proper purpose, company law could learn from the principles built up in the body of administrative law case law.[376] However, unlike administrative law, the proper purpose is not concerned with the manner of the exercise of the power but rather with the purposes which the substantive exercise will serve. While directorial decisions can be struck down on the basis that procedures have not been followed such as the appropriate requirements as to quorum, notice and voting, there is a line of discussion as to the extent to which administrative-law style challenges to directorial decision-making can or should be permitted. Professor Sealy favours an objective threshold of reasonableness in relation to decisions of directors so that, as in administrative law, where a result is so objectively unreasonable, it should be unable to stand.[377] However, despite some passing judicial references to decisions not being arbitrary or capricious[378] it seems that there has yet to be a direct authority squarely applying this basis or a reasonableness criterion. There are those who would say that this is rightly so as to do so would stray beyond the realm of fiduciary accountability.[379]

(Directive 2004/25/EC) Regulations 2006 SI No 255/2006 implementing the EU Takeover Bids Directive of 2004). On the Takeover Directive see B Clarke n 370 above.

[374] For Ireland see the sources listed in the preceding footnote.

[375] S Deakin and G Slinger "Hostile Takeovers, Corporate Law and the Theory of the Firm" (1997) 24 J Law & Soc 124, 136.

[376] RC Nolan n 5 above at 17 ff.

[377] LS Sealy n 31 above at 277.

[378] See *eg Re Gresham Life Assurance Society* (1872) 8 Ch App 446, 449 *per* James LJ; *Re Bell Bros Ltd* (1891) 65 LT 245, 245 *per* Chitty J; *Hindle v John Cotton Ltd* (1919) 56 Scot LR 625, 630 *per* Viscount Finlay; *Re Hafner* [1943] IR 426, 439 *per* Black J.

[379] See R Flannigan n 25 above.

A recent decision indirectly suggests the potential for declaring an exercise of directorial powers to be voidable where the directors failed to take into account a material consideration. It was held in *Hunter v Senate Support Services Ltd*[380] that the directors' decision that the claimant's shares should be forfeited for non-payment of the call was voidable because the directors had proceeded on the mistaken basis that the only course available to them on non-payment of the second call was forfeiture of the shares and had not considered alternative courses of action which they ought reasonably to have taken into account. Consequently they were regarded as having had failed to exercise their discretion. It remains to be seen whether this may be used as a springboard for a new departure in judicial review of directors' decision-making or whether it will be confined to its particular context of mistake as to powers. It has been sensibly opined that notwithstanding the decision in *Hunter* it would seem highly unlikely that the courts would wish to be involved in generally reviewing directors' decisions on the basis of failure to take cognisance of a relevant consideration.[381] Indeed, in his seminal work on fiduciary duties, Professor Finn regarded the development of an enforceable general 'duty to consider' as unlikely given the courts' reluctance to trespass on directorial decision-making.[382]

The question arises as to what impact legislative encroachment on directors' duties will have on judicial readiness to accommodate these procedural type challenges. It certainly seems possible that in the UK administrative law style analysis could become more important in the new statutory landscape of the *Companies Act 2006*.. Particular potential for development is evident in section 172 which, in imposing a duty to promote the success of the company for the benefit of the members as a whole, requires directors to have regard (amongst other matters) to:

> "(a) the likely consequences of any decision in the long term,
>
> (b) the interests of the company's employees;
>
> (c) the need to foster the company's business relationships with suppliers, customers and others,

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[380] [2005] 1 BCLC 175.

[381] S Mayson, D French & C Ryan n 42 above at 567.

[382] PD Finn n 13 above at Chapter 8.

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company."[383]

It is therefore conceivable that this could be viewed as imposing a statutory duty to take these relevant matters into consideration, failing which a decision would be treated as void or, more likely, voidable. There are fears, however, that a 'tick the box' mentality may prevail given that stakeholders are not afforded a means of direct enforcement.[384] In this jurisdiction there has not been the same move to spell out relevant considerations[385] so it is far less likely that a successful challenge to a directorial decision will be grounded on the basis of failure to take into account a material consideration.

G. CONCLUSIONS

The analysis in this chapter supports the view that the duty to act *bona fide* in the best interests of the company and the duty to act for proper purpose have different ends in their sight. This is most clearly delineated by the distinct constitutional role forged by the proper purposes doctrine. Consequently it is appropriate to conceive of the duty to act *bona fide* in the best interests of the company and for proper purpose as separate interlocking domains. Indeed while the proper purposes concept may originally have been no more than a rephrasing of the traditional *bona fides* test, it has gone on to prove its utility in its own right. Furthermore, the proper purposes doctrine continues to provide a useful curb on activities which disrupt constitutionally legitimate decision-making within a company. As will be seen in Chapter 5's discussion of the proposed statutory statement of directors' duties, the reform proposals bear out this analysis in providing separately for best interests and proper purposes.

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[383] See further the discussion of this development in Chapter 5 below.

[384] See further the discussion on CSR in Chapter 5 below.

[385] See further Chapter 5 below.

Questions concerning the interrelationship between the two duties as separate but interconnected remain. As Butcher highlights, the courts have not spelled out the circumstances which may attract the application of one of these aspects in preference to the other.[386] It would seem that in any case the application of one or other aspect (or both) is down, not just to the underlying factual circumstances, but also to judicial preferences and the manner in which the case has been argued. It remains to be seen whether the proposed legislative bifurcation will in time lead to judicial development of a transparent and consistently applied rationale concerning the interrelationship between the two limbs.[387] Looking at the wider legal landscape into which directors' duties are slotted, this chapter has noted the unsatisfying lack of judicial clarity concerning the dividing line between the duty to act *bona fide* in the best interests of the company and the application of the *ultra vires* doctrine governing corporate capacity. While there is now a greater judicial appreciation of the dividing line, in the future the focus is likely to be on issues of corporate benefit and proper purpose as a result of the anticipated legislative scale-down of the impact of the *ultra vires* doctrine.

It emerges from the analysis in this chapter that a somewhat greater possibility of value judgment lies in relation to the duty to exercise powers for proper purpose than under the best interests duty although the inconsistency of judicial approach in relation to the impact of a subsidiary improper purpose needs to be worked through. It has been said that the independent recognition of proper purposes has "... caused the judges to venture into what they have traditionally regarded as dangerous ground, since 'proper purposes' looks to the decision itself, rather than the decision-making process, and calls for a more interventionist line, reviewing the business judgments of business men."[388] Writing in 2000, Butcher ventured to suggest that "[w]ith the pre-eminence of the proper purposes doctrine and its current resurgence in popularity with the English and Australian courts, it is considered likely that the judiciary will become more and more involved in reviewing directors' decision-making."[389] This is all the more likely with the planned *ultra vires* reforms.

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[386] BS Butcher n 9 above at 103.

[387] See further Chapter 5 below.

[388] LS Sealy n 288 above at 229.

[389] BS Butcher n 9 above at 97 (footnotes omitted).

Despite their distinct roles, each of the aspects examined in this chapter raises questions about judges' willingness to stand at one remove from the cut and thrust of corporate boardroom life. What is interesting is that both involve a consideration of the power balance between directors and shareholders to ensure that directors do not overstep their mark. In both the case of the best interests duty and the proper purposes doctrine the courts have concerned themselves with subjective intention, objectively ascertained. This involves generally allowing latitude to directors other than when circumstances dictate that they have been disingenuous about their motives. A delicate balance is required between unquestioning judicial acceptance of directors' apparently worthy motives and a failure to recognise the realities of corporate policy-making. In this context this tightrope is most difficult to walk in relation to actions taken in the face of a potential hostile takeover bid. The flexibility evident in judicial decisions relating to behaviour designed to frustrate hostile takeovers has provided a pragmatic escape route for some defensive tactics where it is reasonably contemplated that such a takeover would substantially damage the company. This prevents directors being simply reduced to acting as hostages to fortune but at the same time it is necessary to respect the ordained freedom of shareholders to decide the fate of their company.

Judicial application of the duty to act *bona fide* in the best interests of the company bears out a palpable judicial deference to the decisions made by directors which is associated with the business judgment rule. It remains the case that under this duty directors are not required to take the optimal decision open to them. Rather, reminiscent of old notions of gentlemanly behaviour, misguided action will be countenanced provided it is done with the best of intentions. While this gives crucial breathing space to directors, judicial unwillingness to force directors to give evidence as to the reasons for their decisions seems not just quaint but downright anachronistic in the context of the prevailing zeal for openness and transparency in public and corporate life. Consequently, the courts' reluctance to review decision-making unless bad faith is manifestly evident has understandably been subject to criticism.[390]

The Irish judiciary's willingness to recognise the interests of a subsidiary as having an impact on the wider corporate group demonstrates astuteness in letting commercial attunement take the place of lofty principles even where this involves shying away from a strict construction of

[390] B Clarke n 293 above at 55-56.

the import of separate legal personality. This realism is also apparent in relation current case law on the requirement that directors' should not unlawfully fetter their discretion - rather than treading an unduly pedantic path, the courts have taken an admirably sensible approach which is in line with commercial practice.

While affording a level of flexibility to directors in their decision-making is essential, if the duty to act *bona fide* in the best interests of the company is seen as subject only to subjective assessment and not concerned with the merits of directors' choices, then there seems to be a certain amount of intellectual dishonesty in broad brush statements of this duty in categorical terms when in fact compliance will only be tested by intention rather than result. Parsons persuasively makes the point that:

> "... the principle that a director must act for the benefit of the company can only survive as a basis of judgment if one seeks to distinguish what a director has done from what that director feels he ought to have done. A principle which must be tuned to the wavelength of the directors' conscience may be welcome to a theologian but will be of little significance as a legal control."[391]

The same may be said of other superficially strict statements of directors' duty which on more detailed scrutiny have traditionally received rather less onerous application in practice. The historical judicial attitude to the duty of care, skill and diligence springs readily to mind since in both cases the courts are prepared to stand back from directorial decision-making.

Parkinson argues that as the duty to act in the interests of the company "imposes only a weak control on managerial discretion, since any plausible assertion that a course of action is designed to increase the company's financial well-being will be enough to protect it from attack .... the duty cannot be expected to play a major part in controlling managerialist tendencies."[392] Does the judicial test then emasculate the underlying duty to act in the best interests of the company? A duty is separate from the assessment of compliance but if the

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[391] RW Parsons n 166 above at 417.

[392] See JE Parkinson n 111 above at 96.

judicial standard advanced to demonstrate compliance is not high then inevitably the duty itself must be devalued.

The duty to act in the best interests of the company has been appropriately categorised as a "cant expression in these matters but not yet a shibboleth."[393] What this has meant is that the meaning of "the best interests of the company" has received inadequate consideration. A 'tick the box' judicial mindset attracts the criticism that the principle-based requirement that directors act in good faith in the best interests of the company and for proper purpose provides little guidance on how these principles should be applied in practice.[394] Butcher comments:

> "From the perspective of the practitioner, the academic and/or the businessman, this whole area of law to do with *bona fides* and proper purposes looks unpromising and is in a most unsatisfactory state. As a consequence, it is almost impossible to formulate guidelines of general application so as to delimit impropriety *vis-à-vis* directors' decision-making. Hence each case must, invariably, be considered on its own particular facts."[395]

A development which requires future monitoring concerns judicial review influences creeping into the review of directorial decision-making. This is seen in the emergence in *Hunter v Senate Support Services Ltd*[396] of a judicial willingness to regard a directorial decision as voidable where it has been made without regard to a material consideration. In the UK further development in this area is more likely having regard to the statutory enshrinement of the need for directors to take a variety of different factors into account in their decision-making.[397]

Behind the apparent truism that directors must act in the company's best interests lies the need to question traditional assumptions about the profit maximisation goal of companies and the equation of the company's best interests with those of the shareholder body. The creeping acceptance of the claims of other stakeholders places a dent in the relative impermeability of

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[393] *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112, 138 *per* Rich J.

[394] See further editorial comment (1994) 15 Co Law 34 at 34.

[395] BS Butcher n 9 at 101.

[396] [2005] 1 BCLC 175.

[397] See the discussion in Chapter 5 below concerning Section 172 of the *Companies Act 2006* (UK).

the shareholder primacy model. In terms of duties being owed to shareholders, creditors and employees, the courts are naturally reluctant to open the floodgates to a potential stream of litigation from disgruntled parties not sanctioned by the company in general meeting. To allow this would be to frustrate the workings of corporate life whose wheels are oiled by directors. This debate will be returned to in Chapter 5 which examines the Company Law Review Group's proposed reforms.

While the interests of stakeholders are likely to receive increasing prominence in the future, a particular concern is how best to address the difficult problem presented by competing interests. In relation to the interests of creditors, although a range of legislative measures are in place, aspects of judicial innovation in relation to a duty to consider the interests of creditors remain in a state of flux. Crucial in this regard is the resolution of the question of whether direct enforcement is to be countenanced. The Irish courts have shown themselves to be more predisposed to this than their English counterparts. What can be said is that it would be remarkable if individual creditors were given this right which is generally unavailable to shareholders. The reality may be that the question of direct enforcement may in many cases be more theoretical than real since presumably such an action could only be brought to increase the pool available to the general body of creditors rather than directly resulting in a benefit to a litigant creditor.[398]

Although more sharply circumscribed, some development is also possible in relation to the circumstances in which a duty may be owed to individual members. Particular potential for growth lies in tentative judicial leanings in the direction of an obligation on directors to present shareholders with all relevant information in their possession before they make a decision affecting their interests.

Judicial application of the duties discussed in this chapter undoubtedly evinces commercial sensitivity to the exigencies of corporate management. However, before any snap judgment is made concerning judicial deference, account needs to be taken of the fact that the underlying theoretical framework has become increasingly complex. With the accommodation of

[398] This is why misfeasance proceedings under section 298 of the *Companies Act 1963* are more likely to be taken by a liquidator than by a creditor.

stakeholder interests the courts increasingly expect directors to be remarkably adaptable and chameleon-like in moving seamlessly from their own interests, to those of the company and those of the shareholders. Furthermore, when things get rocky, directors are expected to defy the natural management urge to engage in more risky activity with a view to trading out of difficulties as the law requires creditors' interests to be taken into account. How the conflicting interests of stakeholders can be coherently resolved remains unclear but realistically this is something which will only arise for meaningful consideration when the policy of accommodating stakeholders' interests goes beyond lip service into real impact. Viewed in this light, the delicate task of the legislature and the courts is in its infancy.

It has been aptly commented that the courts have a "myriad of overlapping formulae" available to them in reviewing directors' decisions.[399] While this chapter has looked at positive exhortations to act in the interests of the company, the next chapter builds on this in focusing on the other side of the coin – the negative prohibitions inherent in the equitable duties on directors to avoid conflicts of interest and secret profits. This is the final duty for consideration before turning to examine the legislative proposals prompted by the Company Law Review Group's recommendations.

[399] LS Sealy n 31 above at 278.

CHAPTER 4:
THE DUTY TO AVOID CONFLICTS OF INTERESTS AND THE DUTY TO AVOID SECRET PROFITS

A. INTRODUCTION

In the course of their stewardship of the company, it is more of a probability than a possibility that opportunities for personal profit will cross the path of directors or that some other form of potential conflict of interest will arise. In response to this, the equitable duties on directors to avoid conflicts of interest and secret profits attempt to limit the potential for competing and opportunistic activity by directors. For ease of reference, in this thesis these distinct but closely aligned branches of duty are referred to respectively as the 'no conflict rule' and the 'no profit rule', and collectively as the 'no conflict-no profit rules'.

The policy behind these rules is to ensure that the interests of the company are protected. Each of the duties has at its heart the fiduciary duty of loyalty and the equitable rule that a person subject to fiduciary rules is not permitted to put themselves in a position where their duty and their personal interests conflict. As Lord Herschell outlined in *Bray v Ford*,[1] "[i]t is an inflexible rule of a Court of Equity that a person in a fiduciary position ... is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict."[2] A passage in his judgment contains an illuminating musing on the reasoning behind the principles which captures their normative function in creating standards of best practice, reflected in the fact that an element of moral turpitude is not required in order to trigger their application:

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[1] [1896] AC 44. Although the quoted precepts are very familiar, it is less well known that the case itself concerned an action for libel.

[2] [1896] AC 44, 51. See also *Parker v McKenna* (1874) LR 10 Ch 96.

> "It does not appear to me that this rule is, as has been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary duty being swayed by interest rather than duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to lay down this positive rule. But I am satisfied that it might be departed from in many cases, without any fear of breach of morality, without any wrong being inflicted, and without any consciousness of wrong-doing."[3]

The preventative rather than punitive function underlying the no conflict-no profit rules has the effect of largely removing the relevance of a search for culpability once the behavioural fact pattern triggers their application. The apparent harshness of such an approach has on occasion exemplified the truism that 'hard cases make bad law'.[4] It is not surprising then that the unwavering application of the no conflict-no profit rules to a director who has acted in good faith has proved controversial and given rise to divergent views examined in this chapter.

A pertinent policy question concerns whether modern judicial decisions successfully tread the line between respecting the essence of traditional fiduciary principles while adapting to contemporary norms. A key theme in this chapter is that the basis of these duties in equitable principles governing the role of trustees has led to a correspondingly stringent approach to directors' fiduciary liability which sometimes grates when applied robustly to modern fact scenarios concerning directors. In particular, a major continuing challenge for the courts has been to find a way to approach directorial entrepreneurship in a manner which is both intellectually coherent in the sense of being based on sound legal principles and which is also capable of satisfactorily negotiating a wide spectrum of fact scenarios. This task is added to by the inherent tension between strict fiduciary principles, on the one hand, and public policy against restraint of trade, on the other.

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[3] [1896] AC 44, 51-52.

[4] The most celebrated example in a corporate context being *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378. See subsequent discussion of this case in this chapter.

A further dimension which requires consideration concerns the manner in which the ostensible absoluteness of the no conflict–no profit rules is counteracted by the availability of a consent mechanism providing directors with a crucial method of avoiding the prohibition. As will be seen this addition from the law of agency brings in a relaxation of the rule based on the concept of informed consent.

In order to engage with the above issues, the no conflict-no profit rules are analysed in this chapter from a number of perspectives. An examination of the various ways in which courts and commentators have attempted to categorise or create a dividing line between cases with a common denominator in terms of fact or legal principle is intrinsic to this analysis. Part B of this chapter begins with the development of the no conflict-no profit rules rooted in fiduciary accountability and principles of trust law and goes on to examine key theoretical and taxonomical challenges underlying the no conflict-no profit trajectory. Part C focuses on the biggest doctrinal challenge encountered to date – the ambivalence which has dogged the treatment of directorial entrepreneurship. Part D considers the effect of the availability of consent-based exceptions to the no conflict-no profit rules. Based on this analysis, Part E draws together some concluding observations.

B. DEFINING PRINCIPLES

This Part considers various issues of classification as well as how the no conflict-no profit rules can be seen to fit within the wider context of directors' duties generally and goes on to examines the equitable principles at the heart of the no conflict-no profit rules.

(1) Duty or Disability?

An issue with which courts and legal scholars have grappled is whether the no conflict-no profit rules should be categorised as founded on an equitable disability rather than a duty. In *Tito v Waddell (No. 2)* Megarry VC put forward a disability analysis, stating that "... what equity does is to subject trustees to particular disabilities in cases falling within the self-

dealing and fair-dealing rules".[5] This disability categorisation is used in respect of trustees in Halsbury's Laws of England.[6] In relation to directors, Hirt concludes that it would seem correct to view the rules as a disability or, in the alternative, as a form of negative duty *viz* "a duty not to enter into a transaction involving the exploitation of a business opportunity, without disclosing all relevant facts to the company."[7] This characterisation of the no conflict-no profit rules in terms of a negative duty rather than in terms of a disability would appear consistent with the consequences and remedies which flow from breach of duty.[8]

In recent times some judicial doubt has been cast on the utility of applying Megarry VC's duty/disability analysis to directors. In *Gwembe Valley Development Co Ltd v Koshy (No 3)*,[9] Mummery LJ's perspective was that, whether viewed as duties or disabilities, these rules are simply aspects of a fiduciary's primary obligation of loyalty.[10] Warren J similarly characterised the no conflict rule as an aspect of the fiduciary's duty of loyalty to his beneficiaries in *Wilkinson v West Coast Capital*.[11] The implication is that, as the relevant equitable principles can be viewed as an aspect of the fiduciary duty of loyalty, the duty/disability debate serves no real purpose.[12] In the present analysis, reflecting current judicial practice, the term 'rule' is used in respect of the no conflict-no profit principles. Whatever their legal characterisation, the subtleties of the rules and the consequences of breach are still being explored by the courts.

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[5] [1977] Ch 106, 248. This was cited with approval by Vinelott J in *Movitex Ltd v Bulfield* [1988] BCLC 104, 120.

[6] *Halsburys Laws of England* 4th ed Butterworths London 2000 reissue vol 48 at 540 ff.

[7] HC Hirt "The Law on Corporate Opportunities in the Court of Appeal: Re Bhullar Bros Ltd" [2005] JBL 669 at 678.

[8] In relation to remedies, see further Chapter 6 below.

[9] [2004] 1 BCLC 131.

[10] *Ibid* at [108]. See also *JJ Harrison (Properties) Ltd v Harrison* [2002] 1 BCLC 162, [32]-[33].

[11] [2005] EWHC 3009 (Ch).

[12] The only practical implication would appear to have been in relation to the appropriate statutory limitation period for instituting proceedings. The relevance of the duty/disability distinction in this context was dismissed by the Court of Appeal in *Gwembe Valley Development Ltd v Koshy (No 3)* [2004] 1 BCLC 131.

(2) Relationship to Other Duties

The perception of the no conflict-no profit rules as an aspect of a more generic overarching 'duty of loyalty' owed by a director to his company reflects the fact that a fact scenario involving acting on a conflict of interest frequently throws up the parallel duty to act in good faith and in the best interests of the company.[13] Consequently, judges frequently refer to a basket of standards of loyalty,[14] good faith and avoidance of conflict of duty and self-interest.[15]

Plainly, as a matter of fact, although not as a matter of legal taxonomy, to a large extent the duty to act in the best interests of the company and the duty to avoid conflicts of interest complement each other.[16] In *Imperial Mercantile Credit Association v Coleman,* Malins VC set out the link in unequivocal terms:

> "It is of the highest importance that it should be distinctly understood that it is the duty of directors of companies to use their best exertions for the benefit of those whose interests are committed to their charge, and that they are bound to disregard their own private interests whenever a regard to them conflicts with the proper discharge of such a duty."[17]

Given the close association, it is tempting to view the no conflict-no profit rules as a manifestation of the directors' duty to act in the best interests of the company. However, a more intellectually rigorous approach will distinguish between duties which have their roots in fiduciary duties (the no conflict-no profit rules) and those which do not (the best interests duty). As Flannigan notes,

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[13] See Chapter 3 above.

[14] See *eg Bristol and West Building Society v Mothew* [1998] Ch 1, 18 *per* Millett LJ.

[15] The non-fiduciary equitable and common law duty on directors to exercise their functions with care, skill and diligence discussed in Chapter 2 above has no real interface here.

[16] See *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq HL 461.

[17] (1871) 6 Ch App 558, 563. This was affirmed by HL on appeal: see *Imperial Mercantile Credit Association (liquidators) v Coleman* (1873) LR 6 JL 189.

> "Serving one's own interest is but one way in which directors might fail to act in the best interest of the corporation. The best interest rule also requires directors to evaluate the merits of decisions. Fiduciary accountability is not concerned with the relative merits of decisions. It is concerned only with whether a decision is compromised by conflict."[18]

On this basis, it is not appropriate to categorise the no conflict-no profit rules as simply an aspect of the duty on directors to act in the best interests of the company. This separation may yield differences of approach to the same fact scenario given that the good faith or otherwise of the directors has no purchase with the domain of the no conflict-no profit principles. Clark captures the differences of approach as follows:

> "The strict approach manifest in the conflict of interest proscription may seem counterintuitive against a backdrop of the general good faith duty. The overarching good faith duty can be considered 'soft' in the sense that it is a subjective one predicated on the bona fide belief of directors, whereas the no-conflict principle is a hard-line, objective rule in which ... good faith is not germane."[19]

As Flannigan points out, in the context of the no conflict-no profit rules "[j]udges are prepared, and competent, to check self-interested management."[20] This contrasts with the duty to act in the company's best interests where a deferential approach applies[21] and with the judicial reserve which is traditionally exhibited in relation to the directors' duty of care where the business judgment rule has prevailed.[22]

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[18] R Flannigan "Fiduciary Duties of Shareholders and Directors" [2004] JBL 277, 288.

[19] B Clark "UK Company Law Reform and Directors' Exploitation of Corporate Opportunities" (2006) 17 ICCLR 231 at 234.

[20] *Ibid.*

[21] See Chapter 3 above.

[22] See Chapter 2 above.

(3) Classic Fiduciary Principles Adopted and Adapted

The imposition of liability on directors under the no conflict-no profit rules is substantially based on the fiduciary wrongdoing framework developed to regulate the behaviour of trustees towards their beneficiaries.[23] Fiduciary accountability is said to be concerned with controlling opportunism on the part of those with limited access for a defined purpose to the assets of another.[24] It is this right of limited or restricted access to the company's assets which confers fiduciary responsibility on trustees and also on directors who have access to the company's assets for the purpose of managing its affairs. Accordingly, the relevant equitable principles impose fiduciary standards and consequent accountability for breach of those standards. A fiduciary breach occurs where "... the actions of those with limited access (i.e. fiduciaries) are compromised by self-interest, or a conflict of interest."[25] Therefore the no conflict rule and its natural corollary, the no profit rule, are accurately categorised as fiduciary in origin. The building blocks of these principles are examined below with a view to understanding how they have been assimilated and adapted by the courts to the fiduciary role of directors classically understood to be serving but one master – the company.[26]

The strict application by the courts of no conflict-no profit rules in relation to directors has its origin in the rigid application of such principles in relation to trustees exemplified in the formative trustee case, *Keech v Sandford*.[27] A trustee's personal renewal of a lease (executed, not in order to personally benefit, but because a landlord had refused to renew it in favour of the infant beneficiary), resulted in the lease being deemed to be held in trust for the infant beneficiary along with an account of profits. Lord King LC's approach was one of cautious prudence: "[a]lthough I do not say there is a fraud in this case, yet the trustee should rather

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[23] See R Edmunds and J Lowry "The No Conflict-No Profit Rules and the Corporate Fiduciary: Challenging the Orthodoxy of Absolutism" [2000] JBL 122.

[24] See *Keech v Sandford* [1558-1774] All ER Rep 230; *Gabbett v Lawder* (1883) 11 LR Ir 295. See further JE Martin *Hanbury and Martin Modern Equity* 16th ed Sweet & Maxwell London 2001 at Chapter 21; R Flannigan n 18 above.

[25] R Flannigan n 18 above at 284.

[26] *Dawson International plc v Coats Paton plc* [1989] BCLC 233, 243 *per* Lord Cullen. See further Chapter 3 above.

[27] (1726) [1558-1774] All ER Rep 230.

have let the lease run out, than to have had it to himself."[28] The unbending principle adumbrated by Lord King LC did not require an examination of the trustee's motives and was rationalised by him on the basis of the need to deter fiduciaries from benefiting improperly from their position. The values underlying what was to become known as the rule in *Keech v Sandford* have been consistently applied to trustees ever since[29] including in this jurisdiction.[30] Thus in *Gabbett v Lawder*, Chatterton VC regarded it as well-established that "... no person in a fiduciary capacity shall be allowed to retain any advantage gained by him in his character as trustee".[31] He went on to say of a trustee obtaining the renewal of a lease, "[i]f his position could have caused or even contributed to his obtaining the advantage, it is in my opinion enough; and the Court will not undertake the difficult and often impossible task of investigating the motives of the parties to the transaction."[32]

While the trustee analogy is an imperfect one,[33] the defining principles are the same for directors and trustees *viz* that a fiduciary's duty and interest must not conflict and that a fiduciary must not make an unauthorised profit from his position. Lindley LJ explained the director's position thus in *Re Lands Allotment Co*:

> "Although directors are not properly speaking trustees, yet they have always been considered and treated as trustees of money which comes to their hands or which is actually under their control; and ever since joint stock companies were invented

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[28] *Ibid* at 231.

[29] See *Robinson v Pett* (1734) 24 ER 1049 (executor); *Whelpdale v Cookson* (1747) 27 ER 856 (trustee's purchase of trust lands); *Ex parte Lacey* (1802) 31 ER 1228 (assignee in bankruptcy); *Ex parte James* (1803) 32 ER 385 (solicitor purchasing a bankrupt's estate); *Parker v McKenna* (1874) LR 10 Ch App 97 (directors); *Re Morgan* (1881) 18 Ch D 93 (executor).

[30] Cases where the rule in *Keech v Sandford* arose for consideration include *Gabbett v Lawder* [1883-84] 11 LR Ir 295; *Robinson v Crosse & Blackwell (Manufacturing Co) Ltd* [1940] IR 56; *Coyle v Trust Investment Society Ltd* [1978] ILRM 211; *Harrisrange Ltd v Duncan* [2003] 4 IR 1; *Fyffes plc v DCC plc* [2005] IEHC 477.

[31] [1883-84] 11 LR Ir 295, 299. This was cited with approval by Laffoy J in *Fyffes plc v DCC plc* [2005] IEHC 477.

[32] [1883-84]11 LR Ir 295, 299-300. This reflected statements to similar effect by Lord Eldon in *Ex parte Lacey* (1802) 31 ER 1228.

[33] See Chapter 1 above.

directors have been held liable to make good moneys which they have misapplied upon the same footing as if they were trustees ..."[34]

Therefore in fashioning fiduciary principles for the company director, the courts have used *Keech v Sandford,*[35] the touchstone of fiduciary liability for trustees, as the foundation and have moulded the relevant equitable principles to fit directors. There are a number of justifications which are advanced for so doing. 'Expectations theory' regards the application of fiduciary duties in a corporate context in the form of the no conflict-no profit rules as reflecting the expectations of shareholder beneficiaries.[36] On a related theme, in *Murad v Al-Saraj*, Arden LJ rationalised equity's interest as predicated on the deficiencies of corporate control mechanisms:

> "... equity imposes stringent liability on a fiduciary as a deterrent – *pour encourager les autres*. Trust law recognises what in company law is now sometimes called the 'agency' problem. There is a separation of beneficial ownership and control and the shareholders (who may be numerous and only have small numbers of shares) or beneficial owners cannot easily monitor the actions of those who manage their business or property on a day to day basis. Therefore, in the interests of efficiency and to provide an incentive to fiduciaries to resist the temptation to misconduct themselves, the law imposes exacting standards on fiduciaries and an extensive liability to account."[37]

On this basis, the no conflict-no profit rules can be characterised as rooted in economic efficiency considerations. However, in Ireland the incorporation of businesses in order to obtain the benefits of limited liability has led to a proliferation of closely held private companies where the separation between ownership and control is minimal.[38] In such companies the guiding equitable principles underlying the no conflict-no profit rules have a

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[34] [1894] 1 Ch 616, 631. See also similar comments made by McWilliam J in *Securities Trust Ltd v Associated Properties Ltd* (1980) [1963-1999] Ir Co Law Rep 121, 127.

[35] [1558-1774] All ER Rep 230.

[36] See MA Eisenberg "Self-Interested Transactions in Corporate Law" (1988) 13 J Corp Law 997, 998-999.

[37] [2005] EWCA Civ 959, [74].

[38] See Chapter 1 above.

level of artificiality given the congruence of ownership and control.[39] Therefore the economic trade-off rationale is less persuasive and rather the rationale can be seen as the need to deal with this lack of separation of ownership and control in quasi-partnership-style, small private companies where directors are more likely to blur the line between interest and duty. Moving outside this model to the larger corporate model exemplified by public listed companies, a further basis for the application of the no conflict-no profit rules to directors can be stated in economic terms as based on the need to address the perceived asymmetry of information argument which attributes informational advantages to directors over corporate investors.[40]

These justifications find their mark in the seminal statement of the duty of a director to avoid placing himself in a position where his duty to the company and his personal interests may conflict which derives from the mid-nineteenth century decision of the House of Lords in *Aberdeen Railway Co v Blaikie Bros.*[41] The Aberdeen Railway Company contracted with a partnership for the supply of a large quantity of iron chairs (rail sockets). Since the managing partner was also the chairman of the Aberdeen Railway Company, the railway company successfully contended that that Mr Blaikie's self-dealing rendered the contract voidable at its election.

Lord Cranworth LC situated the relevant principles in the context of a principal-agency relationship and adapted the *Keech v Sandford* lineage to a corporate context:

> "It is true that questions [concerning *Keech v Sandford*] have generally arisen on agreements for purchases of leases of land, and not, as here, on a contract of a mercantile character. But this can make no difference in principle. The inability to contract depends not on the subject-matter of the agreement, but on the fiduciary character of the contracting party, and I cannot entertain a doubt of its being applicable in the case of a party who is acting as manager of a mercantile or trading business for

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[39] TB Courtney *The Law of Private Companies* 2nd ed LexisNexis Butterworths Dublin 2002 at [10.049]. See also S Scott "The Corporate Opportunity Doctrine and Impossibility Arguments" (2003) 66 MLR 852 at 857-858.

[40] See B Clark n 19 above at 234.

[41] [1843-1860] All ER Rep 249. This was a Scottish case but the court was of the view that in this area there was no difference between the law of Scotland and the law of England. See also the earlier case of *York and North Midland Railway Co v Hudson* (1845) 16 Beav 485, 51 ER 866.

the benefit of others no less than to that of an agent or trustee employed in selling land."[42]

In one of the clearest and oft-quoted statements of the no conflict rule applicable to directors, Lord Cranworth LC stated the relevant principles for directors in following terms, rooted in agency principles:

> "The directors are a body to whom is delegated the duty of managing the general affairs of the company. A corporate body can only act by agents, and it is, of course, the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such an agent has duties to discharge of a fiduciary nature towards his principal, and it is a rule of universal application, that no one having such duties to discharge, shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect. So strictly is this principle adhered to, that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into."[43]

Lord Cranworth's adaptation of trust principles for directors in a formulation based on the concept of actual or possible conflict of interest and duty has been recognised as authoritative ever since.[44]

Where undisclosed profits are made by a director, the traditional remedy is an account of profits.[45] The fiduciary duty to account for profits has long been recognised and treated by the courts as a strict principle, carrying through the essentially preventative function of the underlying prohibition on secret profits which sprang from *Keech v Sandford*.[46] The rigid

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[42] [1843-1860] All ER Rep 249, 253.

[43] *Ibid* at 252.

[44] See *eg Broughton v Broughton* (1855) De G & M & G 160; *Bray v Ford* [1896] AC 44; *Cook v Deeks* [1916] 1 AC 554; *Regal (Hastings) v Gulliver* [1942] 1 All ER 378; *Boardman v Phipps* [1967] 2 AC 56; *Guinness plc v Saunders* [1990] 2 AC 663.

[45] See further Chapter 6 below.

[46] [1558-1774] All ER 230.

nature of the account of profits remedy provides an insight into the nature of the underlying duty. Its pedigree is evident in Lord Kames' pronouncement in his 1778 opus, *Principles of Equity* that: "Equity prohibits a trustee from making any profit by his management, directly or indirectly."[47]

The no conflict-no profit fiduciary obligations and the related equitable concept of fiduciary accountability were neatly encapsulated as follows by Deane J in a decision of the High Court of Australia in *Chan v Zacharia*:

> "... the principle of equity is that a person who is under a fiduciary obligation must account to the person to whom the obligation is owed for any benefit or gain (i) which has been obtained or received in circumstances where a conflict or a significant possibility of conflict existed between his fiduciary duty and his personal interest in the pursuit or possible receipt of such a benefit or gain or (ii) which was obtained or received by use or reason of his fiduciary position or of opportunity or knowledge resulting from it. Any such benefit or gain is held by the fiduciary as constructive trustee ...."[48]

This quotation reveals both the dual nature of the duties involved in relation to conflicts of interest and secret profits and the treatment of any such gains made.

To some the perceived austerity and rigidity inherent in the no conflict-no profit rules may seem the product of a more puritanical era which is at quite some remove from the hedonistic society of today and the expectations of the modern business world. Some commentators maintain that in modern day commercial life deterrence needs to be tempered by the realistic demands of the marketplace and modern commercial practice.[49] As Edmunds and Lowry remark, "... the prohibitions are extreme in their absolutism, rigidly embodying equity's

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[47] Lord Kames *Principles of Equity* 3rd ed Edinburgh 1778 vol. 2 at 87.

[48] (1984) 154 CLR 178, 198. This passage was cited with approval by the English Court of Appeal in *Don King Productions Inc v Warren* [2000] 1 BCLC 607, 629 *per* Morritt LJ.

[49] See R Edmunds and J Lowry note 23 above; M Arden "Reforming the Companies Acts – The Way Ahead" [2002] JBL 579.

protectionist instincts."[50] On the other hand, an absolute prohibition on conflicts of interests combined with strict accountability is regarded by others as satisfying "... the deterrent effect that equity requires"[51] and as possessing the merits of simplicity and certainty. These opposing viewpoints are at play in the ambivalence exhibited by the courts in relation to directors taking up business opportunities which they encounter in the course of their directorships. This aspect is explored later in this chapter.

(4) The Conflict-Profit Dichotomy

(a) The Taxonomical Divide

While judicial emphasis on the no profit rule at the expense of the no conflict rule is often fact-driven, judicial failure to distinguish adequately between the no conflict and the no profit limbs may be also be attributable to insufficient appreciation of the ability of each limb to stand alone. Unsurprisingly, it is difficult to locate a case where breach of the no conflict rule by a director is pleaded by a company without an unauthorised profit also being alleged.[52] Consequently, case law in this area has suffered from a lack of separation or a fully reasoned separation of the two aspects.

Early cases dealt somewhat haphazardly with the classification of relevant fiduciary principles, variously voicing a fiduciary requirement to avoid conflicts of interest and to avoid secret profits in language which on occasion implicitly suggested they were distinct concepts, and on others, that they should be viewed in an integrated fashion. This incoherence arose, not from principled differences of approach, but simply because prior to the latter part of the twentieth century judicial decisions did not expressly address the relationship between the two rules. For example, looked at through modern spectacles, the contrasting approaches of Lord

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[50] R Edmunds and J Lowry note 23 above at 122.

[51] HC Hirt "The Company's Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board's Conflict of Interest" [2005] JBL at 672.

[52] See, however, *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704 where the insolvency of the director's competing corporate vehicle made the application of the no profit aspect illusory.

Cairns LC and James LJ in *Parker v McKenna*[53] (which concerned directors profiting from a share issue) raise the issue of whether the no profit rule was regarded as an adjunct of the no conflict rule (the apparent approach of the Lord Chancellor) or whether, having regard to James LJ's sole emphasis on the no profit aspect, the two aspects were regarded as independent of each other.[54]

Writing in 1969, Professor McClean saw fit to remark that the twentieth century had done nothing to alleviate the confusion.[55] In *Re Macadam,*[56] a case concerning remuneration received by trustees who had exercised a power to appoint directors so as to appoint themselves, Cohen J appeared to separate the principle of not making a profit from the position from the duty to avoid conflicts of interest without giving any rationale for so doing. Indeed in the leading case of *Regal (Hastings) Ltd v Gulliver*,[57] the dominant emphasis (other than in the judgment of Viscount Sankey) was on the no profit rule. In that other seminal decision of the House of Lords on conflicts of interest, *Boardman v Phipps*,[58] a variety of approaches were in evidence, with Lord Upjohn regarding the no profit rule as forming part of a wider conflict rule.[59] This conception of the no profit rule is as a sub-set or corollary of the broader duty not to enter into conflicts of interest rather than as a stand-alone rule has been criticised.[60]

However, there is increasing recognition of the separate requirements of each rule such that confusion and conflation of the two elements has given way to a growing consciousness by

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[53] (1874) LR 10 Ch App 96.

[54] See further AJ McClean "The Theoretical Basis of the Trustee's Duty of Loyalty" (1969) 7 Alta L Rev 218 at 221.

[55] *Ibid.*

[56] [1946] Ch 73. See also *Re Gee* [1948] Ch 284.

[57] [1942] 1 All ER 378.

[58] [1967] 2 AC 46.

[59] *Ibid* at 123. This can be traced back to the language used by Lord Herschell in his seminal statement of principle in *Bray v Ford* [1896] AC 44, 51. See also Upjohn LJ's conflated approach in *Boulting v Association of Cinematograph, Television and Allied Technicians* [1963] 2 QB 606, 635-636.

[60] See C Harpum "Fiduciary Obligations and Fiduciary Powers – Where Are We Going?" in P Birks (ed) *Privacy and Loyalty* Clarendon Press Oxford 1997 at 148.

both legal scholars and, increasingly, the judiciary, of the logic of separating out the duty to avoid conflicts of interests and secret profits into two distinct principles.[61]

In the last number of years there has been a developing judicial awareness across the water of how the no conflict-no profit delineation should be carried out. The rationale for a separate analysis was articulated in *Quarter Master UK Ltd (in liq) v Pyke*[62] where Paul Morgan QC (sitting as a deputy judge of the High Court) recognised the existence of an autonomous no conflict rule having its basis in the fiduciary duty of loyalty, allied to, but separate from, the no profit rule. He neatly disposed of the fallacy that conflict and profit always go hand in hand:

> "It is not because he has made a profit from trust property or a profit from his fiduciary position that the director is liable under the conflict rule. Rather, it is because, being in a fiduciary position, he has entered into a transaction, inconsistent with his fiduciary duty of loyalty to the company, which has yielded the profit and he has thereby misused his position. The opportunity to make the profit may not arise from the director's fiduciary position; he might just as well have had the opportunity if he had not been in that position but even so, his liability in respect of the profit arises because of the conflict of interest. In many cases, where the conflict rule applies, the director will also have taken advantage of the property of the company or of his fiduciary position but this will not always be so."[63]

Other recent English cases have pursued this dichotomy.[64] For example, in *Wilkinson v West Coast Capital*[65] Warren J explored the distinction between the 'no conflict' rule and the 'no

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[61] Much to the chagrin of some legal commentators, this refinement did not take place without a good deal of confused judicial analysis which failed to draw the appropriate distinctions: see D Kershaw "Does it Matter How the Law Thinks About Corporate Opportunities?" (2005) 25 LS 533.

[62] [2005] 1 BCLC 245.

[63] *Ibid* at [55].

[64] See *eg Don King Productions Inc v Warren* [2000] Ch 291, [40] *per* Morritt LJ; *In Plus Group Ltd v Pyke* [2002] 2 BCLC 201, [71] *per* Brooke LJ; *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch), [1305]-[1306] *per* Lewison J; *Wilkinson v West Coast Capital* [2005] EWHC 3009 (Ch), [1248] *per* Warren J.

[65] [2005] EWHC 3009 (Ch).

profit' rule in the following passage which also emphasised the fiduciary duty of loyalty analysis:

> "It is important to note that the 'no conflict' rule can apply to a fiduciary in some situations where he neither makes a profit from trust property nor from his fiduciary position. This is because he has a duty to protect those to whom his duties are owed. He cannot prefer his own interests to those of his beneficiaries. His problem arises where he enters into a transaction inconsistent with his duty of loyalty to his beneficiaries."[66]

The conflict-profit divide is clearer in relation to competing activities of former directors.[67] In this case the better view is that it is the no profit rule rather than the no conflict rule which is engaged.[68] As Koh points out, the general policy against restraint of trade is equally relevant to directors as employees and it would be improper to regard a former director as subject to the same duties of loyalty and support as a current director.[69] This is borne out in judicial rationalisation of the non-application of the no conflict rule on termination of directorship as directly linked to the loss of directorial powers, a rationale which is grounded in the purpose of the rule being to prevent the fiduciary "being swayed by personal considerations of his personal interests or competing fiduciary interests in the exercise of the powers exercisable by him in a fiduciary capacity".[70] In *In Plus Group Ltd v Pyke*[71] this reasoning was rather dubiously extended in order to disapply the conflict rule in the case of a director who had effectively been frozen out by the other directors and therefore was regarded as *de facto* having no powers to exercise.

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[66] [2005] EWHC 3009 (Ch), [252].

[67] See further discussion of competing activities in Part C below.

[68] See Warren J in *Wilkinson v West Coast Capital* [2005] EWHC 3009 (Ch), [251] and cases cited therein. *Ultraframe (UK) Ltd v Fielding* [2005] EWHC Civ 1638 (Ch), [1309] *per* Lewison J and *Kingsley IT Consulting Ltd v McIntosh* [2006] EWHC 1288 (Ch), [51] *per* Terence Mowschenson QC.

[69] P Koh "Principle 6 of the Proposed Statement of Directors' Duties" (2003) 66 MLR 894 at 900-901.

[70] *Wilkinson v West Coast Capital* [2005] EWHC 3009 (Ch), [251] *per* Warren J. See also *Ultraframe (UK) Ltd v Fielding* [2005] EWHC Civ 1638 (Ch) [2005] EWHC 1638 (Ch), [1308] *per* Lewison J.

[71] [2002] 2 BCLC 201. See R Grantham "Can Directors Compete with the Company?" (2003) 66 MLR 109.

There is judicial and academic support for the view that the no conflict rule and the no profit rule are not mutually exclusive. Deane J's view in *Chan v Zacharia* was that "... the one 'fundamental rule' embodies two themes ... [which] while overlapping, are distinct. Neither theme fully comprehends the other and a formulation of the principle by reference to only one of them will be incomplete."[72] This passage was cited with approval by the Court of Appeal in *Don King Productions Inc v Warren.*[73] Consistent with this, Austin expresses the view that "[f]or the most part, the rules govern the same ground and a conclusion expressed in terms of one of them can usually be re-stated in terms of the other."[74]

There are few Irish cases where directors' duties in relation to conflict of interest and secret profits have arisen for consideration[75] and the Irish judiciary has yet to articulate its views on the conflict-profit dichotomy. It could be maintained that in *Fyffes plc v DCC plc*[76] Laffoy J's sole focus on the no profit rule to the exclusion of the no conflict rule was an implicit recognition of the separation. However, this is more comfortably attributable to the facts of that case, which concerned an alleged use of confidential information to make a profit on sale of the plaintiff company's shares, and to how the case was pleaded, than to any real conscious judicial choice concerning the separation of the two.

It can be concluded that although it is now fashionable for the courts to pay lip service to the distinction between the conflict and secret profit heads, in practice the relevant distinctions have not been fully worked out. Consequently, while the underlying base-line principles are clear, their putative application to a given situation in practice may be less so. There are continuing instances of judicial confusion as to which head to categorise the impugned

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[72] [1983-84] 154 CLR 154, 198-199.

[73] [2000] Ch 291, [40] *per* Morrit LJ.

[74] RP Austin "Fiduciary Accountability for Business Opportunities" in PD Finn (ed) *Equity and Commercial Relationships* The Law Book Company Ltd Sydney 1987 at 146.

[75] Cases whose facts disclose a conflict/profit concern include *Hopkins v Shannon Transport Systems Ltd* (1972) [1963-1999] Ir Co Law Rep 238; *Irish Microforms Ltd v Browne* (1987) [1963-1999] Ir Co Law Rep 336; *Stafford v Higgins* [2004] IEHC 180; *Fyffes plc v DCC plc* [2005] IEHC 477; *Re Cooke's Events Co Ltd (in liq)* [2006] 1 ILRM 191.

[76] [2005] IEHC 477. The appeal to the Supreme Court [2007] IESC 36 did not deal with equitable principles.

conduct under and also frequent occurrences of judicial failure to distinguish the two aspects.[77] Therefore although the no conflict-no profit divide is now on the judicial radar, the details require some finesse. As will be seen in Chapter 5, this lack of clarity has also permeated the proposed reforms in this area.

(b) The No Conflict Rule: "A Real Sensible Possibility of Conflict"

Stated simply, the no conflict principle applies to situations in which there is a potential for conflict between the duties which a director owes to the company and his personal interests. Key to judicial application of the no-conflict rule is the defining issue of what constitutes the required conflict of interest. Judicial exhortations in favour of common sense, coupled with a recognition that the precise scope of the relevant equitable principles must be moulded according to the nature of the relationship,[78] help to ensure that some restraint is placed on a rule which is capable of producing very harsh results. As Jones astutely observes, "[t]he stringency of a rule which guards against the possibility as well as the actuality of unjust enrichment should persuade the courts to apply it sensitively, not as a sledge-hammer."[79]

A number of aspects of Lord Cranworth LC's formulation of the threshold in *Aberdeen Railway Co v Blaikie Bros*[80] in terms of a personal interest which conflicts with or which possibly may conflict with that of the company have received further judicial elucidation. First, the linking of the rule to a conflict or possible conflict of interest "... excludes the relevance of an inquiry into the actual motives of the fiduciary...."[81] This aspect received some consideration in Part A of this chapter. Secondly, given the potential breadth of the no conflict proposition, the courts have acted to ensure that the principle is applied sensibly so as to rule out its application to situations where the conflict can be characterised as purely theoretical in nature. Therefore it has been clarified that the rule is not designed to come into

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[77] See *Wilkinson v West Coast Capital* [2005] EWHC 3009 (Ch) where Warren J was somewhat critical of the trial judge and Court of Appeal's application of the no conflict rule in preference to the no profit rule in *Bhullar v Bhullar* [2003] 2 BCLC 241.

[78] *New Zealand Netherlands Society 'Orange' Inc v Kuys* [1973] 2 All ER 1222, 1225 *per* Lord Wilberforce.

[79] G Jones "Unjust Enrichment and the Fiduciary's Duty of Loyalty" (1968) 84 LQR 472 at 487.

[80] [1843-1860] All ER Rep 249.

[81] *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 103 *per* Mason J.

play when the interest of the fiduciary is "remote or insubstantial".[82] This limitation was expanded upon in *Boulting v Association of Cinematograph, Television and Allied Technicians* where Upjohn LJ said that the broad rule requiring the avoidance of a conflict of interest and duty had to be applied:

> "... with common sense and with an appreciation of the sort of circumstances in which, over the last two hundred years and more it has been applied and thrived. It must be applied realistically to a state of affairs which discloses a real conflict of duty and interest, and not to some theoretical or rhetorical conflict."[83]

Having been elevated to the House of Lords, Lord Upjohn revisited the issue in his dissenting judgment in *Boardman v Phipps*,[84] introducing an objective test of directorial conflict. He interpreted the phrase "possibly may conflict" in *Aberdeen Railway* as meaning that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was "a real sensible possibility of conflict".[85] This test remains the accepted gold standard against which a possible conflict will be measured.[86] However laudable its design to filter out remote, speculative claims of conflict, applying this test to draw the necessary line in the sand is not an easy task given the use of the term 'possibility' albeit qualified by the words "real sensible".

Warren J amplified how the requisite element of potential conflict might be ascertained in *Wilkinson v West Coast Capital.*[87] His view was that, in applying the 'no conflicts' rule one must have regard, not only to the scope of the directors' duties, but also to the related question of the scope of the company's business. Under his pragmatic approach, although widely

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[82] *Ibid.*

[83] [1963] 1 All ER 716, 730.

[84] [1967] 2 AC 46.

[85] *Ibid* at 124.

[86] See *eg Industrial Development Consultants v Cooley* [1972] 2 All ER 162; *Framlington Group plc v Andersen* [1995] 1 BCLC 475; *Bhullar v Bhullar* [2003] 2 BCLC 241; *Quarter Master (UK) Ltd (in liq) v Pyke* [2005] 1 BCLC 245.

[87] [2005] EWHC 3009 (Ch).

drafted objects clauses would permit all manner of diversification,[88] there would be no real sensible possibility of conflict in a director of a company selling women's fashion clothing taking a stake in a company distributing farm machinery unless the board of the fashion clothing company had been actively considering diversification into the distribution of farm machinery.[89] Although pragmatic, this attempt to determine the limits of corporate interest would be anathema to those who favour the notion of corporations as essentially expansionist in nature. In one of the leading US cases on the corporate opportunity doctrine, *Guth v Loft, Inc*, the court's view was that to deny the expansionist nature of corporations would be "to deny the history of industrial development".[90] Indeed, the application of the no conflict rule to directors' acquisition of a property adjacent to the company's premises in *Bhullar v Bhullar*[91] has been regarded as extending the reach of the no conflict rule from commercial proximity to geographic proximity.[92]

Austin regards the lack of clarity associated with the no conflict rule as problematic:

> "... the conflict rule is not adequate to deal with all cases of profit making by fiduciaries, because it offers no principle for determining the scope of the fiduciary undertaking and the content of the duty with which personal interest may conflict."[93]

It can be concluded that despite robust judicial statements of the central importance of common sense to application of the no conflict rule, subtleties of interpretation remain and judicial understanding is evolving and becoming ever more sophisticated. This was evident in *In Plus Group Ltd v Pyke* where Sedley LJ said of the no conflict principle:

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[88] It should be observed that the proposed company law reforms concerning the *ultra vires* rule will largely remove the need for objects clauses: Company Law Review Group *First Report (2000 to 2001)* (2002) Chapter 10; Head 20 of Part A2 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007). See further D Ahern "Unlimited Corporate Capacity – Plotting the Slow Demise of *Ultra Vires*" (2004) 11 C L Pract 27.

[89] [2005] EWHC 3009 (Ch), [253].

[90] 5 A2d 503, 514 (Del 1939). See also S Scott n 39 above at 858-859.

[91] [2003] 2 BCLC 241.

[92] B Clark n 19 above at 233-234.

[93] RP Austin n 74 above at 149.

> "The proposition can, I think, be amplified in two respects. First, the fiduciary must not only not place himself in such a position: if, even accidentally, he finds himself in such a position he must regularise or abandon it. Secondly, an objectionable position is not only one in which duty conflicts with interest but one in which duty conflicts with duty or interest with interest. Each is objectionable because it is capable of leading to a breach of fiduciary duty."[94]

This succinctly articulates the absence of a base-line requirement that a director has actively sought out a conflicting position. It also provides the basis for the divergent circumstances in which the conflict may be activated including where a director's duties to the company conflict with a duty owed by him to a third party.[95] However, it would be opportune for this aspect to receive further clarification as there is authority to suggest that where a person already has existing contractual relationships on accepting a directorship, he or she may not necessarily be required to abandon those interests.[96]

(c) The No Profit Rule

The traditional thinking is that a director must not make a secret profit through the use of opportunities which arise in the course of his stewardship of the company. At the centre of the no profit rule is the principle of accountability. The traditional approach of the Courts of Equity in considering whether to order an account of profits has not been framed in terms of whether the director improperly acquired an advantage which should or could have been the company's, but rather in terms of whether the director acquired a personal benefit in the course of exercising his functions as a director of the company. In *Parker v McKenna*[97] the court considered an issue of shares in a bank to existing shareholders at a premium. At the request of a shareholder who was not in a position to take up his shares, the directors took the

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[94] [2002] 2 BCLC 201, [86].

[95] See further B Hannigan *Company Law* LexisNexis UK London 2003 at 246; *North-Transportation Co v Beatty* (1887) 12 App Cas 589; *Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co* [1914] 2 Ch 488.

[96] *Vyse v Foster* (1874-5) LR 7 HL 318; *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch), [1311] *per* Lewison J.

[97] (1874) 10 Ch App 96.

shares at a larger premium. They were held accountable for the resulting profit gained. Lord Cairns LC stated:

> "The court will not enquire and is not in a position to ascertain, whether the bank has lost or has not lost by the acts of the directors. All the court has to do is to examine whether a profit has been made by an agent without the knowledge of his principal, in the course and execution of his agency ...."[98]

This epitomises the simplicity of the no profit rule. Once engaged and liability is established, the principle of accountability is activated. As Austin describes it, "[t]he profit rule tells us that a fiduciary is accountable for profits made in connection with his fiduciary office. It directly addresses the problem of profit taking and makes liability depend on a test of connection or causality."[99]

In *Regal (Hastings) Ltd v Gulliver*, Lord Russell described the no profit rule in the terms of it being a "... rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit...."[100] This encapsulates the close nexus between underlying principle, breach and remedy. Given this connection, an account of profits remedy is predicated, not on loss or damage to the company, but rather on a *per se* breach of principle.[101] This is not simply because duty, breach and remedy go hand in hand but because in this instance perception of the consequences of breach has coloured attitudes to the underlying test of liability. This is seen in *Fyffes plc v DCC plc*[102] where Laffoy J was satisfied *obiter* that the authorities supported the following propositions:

> "First, the liability to disgorge a profit made from acting in breach of a fiduciary duty arises irrespective of whether the company itself has suffered a loss. Secondly,

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[98] *Ibid* at 118.

[99] RP Austin n 74 above.

[100] [1942] 1 All ER 378, 386.

[101] See the more detailed discussion of the account of profits remedy in Chapter 6 below.

[102] [2005] IEHC 477.

liability arises irrespective of whether the company itself could have made a profit. Thirdly, the liability is triggered irrespective of considerations of fraud or bad faith."[103]

Accordingly, Jones appropriately classifies the account of profits remedy as "prophylactic" rather than restitutionary in nature.[104] This aspect manifests itself in both a judicial disinterest in inquiring into whether the company could have exploited the opportunity and in the failure to inquire into whether its exploitation by the director has in fact harmed the company. This was historically justified on the basis of the underlying rationale which is to create a deterrent against directors putting themselves in a position where their duty to act in the best interests of the company and their personal interests may conflict. Thus, the aim of imposing an account of profits remedy is not to compensate the company but to ensure that the director who is subject to fiduciary obligations does not profit from breaching them.[105]

(d) The Internal Aspect

Apart from the conflict-profit divide, a further analytical division occurs in the separation between acts of directors which are internal dealings with the company and those acts which are undertaken by directors independently of the company with external third parties.

The internal aspect of the no conflict-no profit rules requires that directors should not have a personal interest in transactions with the company. This interest may arise through a director contracting with the company or a company or other form of business entity in which he has an interest *eg* through a shareholding, directorship or partnership. The rule is closely linked to the self-dealing rule applicable to trustees which operates to prevent a trustee from contracting with himself.[106] Although widely utilised, any reference to a 'self-dealing rule' is technically a misnomer in a directorial context since directors do not hold title to their company's

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[103] *Ibid* at p 346-347 of the unreported judgment.

[104] G Jones n 79 above at 474.

[105] *United Pan-European Communications NV v Deutsche Bank AG* [2000] 2 BCLC 461, 483 *per* Morritt LJ.

[106] *Keech v Sandford* [1558-1774] All ER Rep 230. See the description of the self-dealing rule given by Megarry VC in *Tito v Waddell (No 2)* [1977] 3 All ER 129, 228; *Newgate Stud Co v Penfold* [2003] EWHC 2993, [230] *per* David Richards J.

assets.[107] Rather, the fundamental rationale may be more correctly identified as being an objection to a conflict of interest and duty in the context of any transaction between the company and a director which is founded on the quasi-agency role of directors.

In cases of internal transactions between a director and his company in breach of the no conflict-no profit rules, the contract is voidable at the instance of the company.[108] Significantly, the rule and the associated right of rescission do not require an enquiry into the fairness or otherwise of the terms contracted on. Therefore the fact that the terms would not have been more favourable in arm's length dealing will not save a transaction from being voidable at the company's election. It has been argued by Gower and Davies that this is justifiable on two grounds.[109] First the rule is a "prophylactic" one whose aim is to discourage directors from placing themselves in conflicting situations. Secondly, it is contended that the courts are not well equipped to assess the fairness of a transaction and it is preferable that their enquiry is limited to whether the principle has application and if so whether any approval-based exception applies.

The courts have shed light on the circumstances in which the internal rule is likely to be engaged. A number of decisions concerning internal conflicts have highlighted the conflict which arises when a third party makes a commission payment to directors in respect of contracts entered into on behalf of the company.[110] Early cases also established rules prohibiting the allotment of shares to a director at an issue price below market value.[111] To ensure that the spirit of the internal aspect is maintained, the courts have taken a purposive approach in holding that that it is irrelevant that the director is not the sole person contracting with the company.[112] The internal application has been regarded by the courts as extending to

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[107] *Newgate Stud Co v Penfold* [2004] EWHC 2993, [230].

[108] *Hopkins v Shannon Transport Systems Ltd* (1972) [1963-1999] Ir Co Law Rep 238.

[109] PL Davies *Gower and Davies' Principles of Modern Company Law* 7th ed Thomson Sweet & Maxwell London 2003 at 393-394.

[110] *Imperial Mercantile Credit Association v Coleman* (1871) 6 Ch App 558; *Boston Deep Sea Fishing and Ice Co v Ansell* (1883) 39 Ch D 339; *Cockburn v Newbridge Sanitary Steam Laundry Co Ltd* [1915] 1 IR 249.

[111] See *Parker v McKenna* (1874) 10 Ch App 96; *Shaw v Holland* [1900] 2 Ch 305; *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 387, 386.

[112] *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461 (contract with a partnership). See also *Newgate Stud Co v Penfold* [2004] EWHC 2993 (Ch) (contract with partnership).

transactions entered into by the company with another company in which the director has a personal interest by virtue of being a shareholder of the other company or of having fiduciary obligations towards it. Nor is a conflicting interest which belongs to the director beneficially or as trustee for others beyond the scope of the prohibition.[113] There is authority which further extends the reach of the internal no conflict-no profit rules to cover a situation where the director acts only as an agent for others.[114]

There has been a certain amount of statutory grafting onto the internal application of the no conflict-no profit rules. Statutory intervention on internal conflicts of interest by directors has included the concept of connected persons[115] to further broaden the remit of the rules reflecting the fact that the non-statutory rules did not traditionally extend their remit much beyond the director or a business vehicle in which he was interested. This statutory extension has been mirrored in relation to the equitable rules where it has been held that in cases where a director does not have a personal interest in a transaction but the facts disclose a real risk of conflict between duty and personal loyalties, the burden may fall on the director to demonstrate that the transaction was in the best interest of the company. This development has highlighted the interface between the two duties. In *Newgate Stud Co v Penfold*[116] the sale by a company of three thoroughbred horses to the father of a director's girlfriend was treated as placing the burden on the director to show that the transaction was demonstrably in the best interests of the company.[117] In such circumstances, a focus on the duty to act in the best interests of the company is preferable to any tortuous attempt to extend the no conflict rules to third parties since this would be inconsistent with the fiduciary basis for such rules.

The fiduciary nature of the relationship between directors and their companies is at the heart of statutory regulation of transactions and arrangements between directors and their companies. However, the policy justification for statutory intervention is the perceived shortcomings of the equitable rules. Courtney observes that "[t]he legislature has ordained

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[113] *Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co* [1914] 2 Ch 488.

[114] *Ex parte Bennett* 10 Ves 381; *Ex Parte Moore* (1881) 30 WR 123.

[115] Defined in section 26(1) of the *Companies Act 1990* (as substituted by section 76(a) of the *Company Law Enforcement Act 2001*).

[116] [2004] EWHC 2993 (Ch), [242].

[117] The Court regarded the facts as raising the application of the fair dealing rule rather than the self-dealing rule.

that common law fiduciary duties are not a sufficient protection of companies' assets when it comes to transactions involving directors and their companies."[118] These deficiencies arise in particular where the shareholders and directors are one and the same with the result that the checks and balances function of the shareholders is missing and also in relation to the failure of the equitable rules to extend their scope broadly enough to other parties connected with directors. However, statutory regulation has a part to play in the reality that judicial decisions involving internal conflicts crop up on a far less regular basis than those involving external conflicts.

The enactment of the *Companies Act 1990* coincided with a legislative attempt to tighten the regulation of directors. Part III of the Act was designed "to deal with recognisable situations where a company director might be tempted to put his personal interests before that of the company."[119] Unlike the equitable rules, it extended its remit to the concept of "connected persons".[120] Section 29 of the *Companies Act 1990* put in place an additional bulwark in respect of substantial internal property transactions between a company and its director or directors or qualifying connected persons.[121] Mayson, French and Ryan aptly remark of similar statutory developments in the UK that "[i]t would appear that in relation to substantial property transactions, the statutory provisions have superseded the general equitable principles."[122]

Section 29 requires an ordinary resolution of the company in general meeting to approve substantial property transactions between a company and its director or a connected person. Failure to comply with the authorisation requirement gives rise to a requirement to account to

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[118] TB Courtney n 39 above at [11.001].

[119] See the explanatory memorandum to the *Companies Bill 1987.*

[120] Defined in section 26(1) of the *Companies Act 1990* (as substituted by section 76(a) of the *Company Law Enforcement Act 2001*) to include, *inter alia*, parents, spouse, children, siblings and business partners as well as connected bodies corporate: section 26(2)) By virtue of section 26(6) of the *Companies Act 1990* (as substituted by section 76(c) of the *Company Law Enforcement Act 2001*), there is a rebuttable presumption that the shareholder in a single member company is a connected person.

[121] See TB Courtney "Substantial Property Transactions between Directors and Companies: Section 29 of the Companies Act, 1990" (1997) 4 C L Pract 142.

[122] S Mayson, D French and C Ryan *Company Law* 23rd ed Oxford University Press 2006 at 590.

the company for any gains received and to indemnify the company for any loss suffered.[123] One might question what this adds to the equitable position apart from the additional visibility of a legislative provision and the familiar ground of breach of statutory duty. Certainly there is no real additional protection against directorial abuse involved where the directors and shareholders substantially overlap.[124]

The other major statutory incursion came in the shape of section 31 of the *Companies Act 1990* (as amended by Part 9 of the *Company Law Enforcement Act 2001*). Section 31 regulates loans and related transactions (quasi-loans, credit transactions, guarantees and the provision of security) by companies to directors and connected persons and in the case of guarantees and security requires that a validation procedure involving the passing of a special resolution be followed which is designed to protect the interests of members and creditors. As with section 29, where section 31 is breached, any errant director will be required to account for any gains received and to indemnify the company for any loss suffered.[125] With section 31, the *Oireachtas* saw fit to add the weight of the criminal law to the consequences of breach.[126]

One area where the interface of the equitable rules and statutory regulation has yet to be satisfactorily worked out is that of insider dealing. Directors who posses insider information are in a unique position to benefit from its effect on the company's shares. Insider dealing in quoted securities on the basis of non-publicly available price sensitive information was regulated first by Part V of the *Companies Act 1990* which provided for both criminal and civil liability. The Part V regime has now largely been replaced by the *Market Abuse (Directive 2003/6/EC) Regulations 2005*[127] and Part 4 of the *Investment Funds, Companies and Miscellaneous Provisions Act 2005*. In *Fyffes plc v DCC plc*[128] Laffoy J recognised *obiter* that a director who uses confidential corporate information to make a profit from dealing in

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[123] Section 29(4) of the *Companies Act 1990*.

[124] See further TB Courtney n 39 above at [11.023].

[125] Section 38(2) of the *Companies Act 1990*.

[126] Section 40 of the *Companies Act 1990*.

[127] SI No 342 of 2005.

[128] [2005] IEHC 477.

the company's securities could be liable to account for such profit.[129] She also adverted to the difficulty in such a case of ensuring that the "equitable remedy sat comfortably with the statutory remedies."[130] Unfortunately, the Supreme Court appeal[131] focused only on the statutory insider dealing angle so there was no opportunity to consider the inter-relationship with the equitable rules.

The existence of the statutory disclosure duty in section 194 of the *Companies Act 1963* which requires directors to disclose their interests in contracts with the company has also had a part to play in edging out the equitable rules.[132] *Stafford v Higgins*[133] is a typical example of a case where the opportunity to pronounce on the internal aspect of the no conflict rule was regrettably overshadowed by a judicial focus on section 194. In this case the two executive directors of the company who were also the sole shareholders in the company purchased premises to lease back to the company involving, *inter alia*, complex financing arrangements involving substantial loans from the company without formally seeking the approval of the board. In making a declaration of restriction against the executive directors, Finlay Geoghegan J held that directors could not be regarded as acting responsibly in entering into significant financial transactions with the company without "either bringing those matters to the attention of their fellow directors or obtaining formal board approval."[134]

The court's reasoning in this case was framed in terms of a statutory breach of section 194 of the *Companies Act 1963* (the statutory duty on a director to disclose his interest in a contract with the company) and as displaying a lack of commercial probity and did not consider the issue of breach of fiduciary duty. The failure to also single out the application of the fiduciary no conflict rule and indeed the no profit rule is disappointing not just because of the failure to

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[129] See also *Diamond v Oreamuno* (1969) 248 NE 2d 910; *Walsh v Deloitte and Touche Inc* [2001] UKPC 58.

[130] [2005] IEHC 477 at p 367 of the unreported judgment. On how the statutory insider dealing issue was dealt with in *Fyffes* see S Dowling "*Fyffes v DCC* – Analysis and Implications" (2006) 13 C L Pract 27; NM Mulholland "The High Court goes Bananas: An Overview of the Law on Insider Trading in Light of *Fyffes v DCC*" (2006) 6 UCDLR 48.

[131] [2007] IESC 36.

[132] See further Part D below.

[133] [2004] IEHC 180.

[134] *Ibid* at p 10 of the unreported judgment.

apply the relevant principles and to expand the relevant jurisprudence in Ireland but also because of the detrimental effect which the judiciary and legal profession's concentration on statutory exposition of directorial duties is having in failing to ensure that the well-worn equitable rules remain living and breathing through judicial application of them to modern fact scenarios. It is, however, some comfort to know that if *Stafford v Higgins* came to be heard today, a different approach would be called for on the basis of Finlay Geoghegan J's later requirement in *Kavanagh v Delaney*[135] that all restriction applications be assessed, not just on the basis of statutory principles, but also based on a consideration of compliance with directors' non-statutory duties.[136]

(e) The External Aspect

The other side of the no conflict-no profit rules is the external aspect which relates to a director using his position for personal advantage in his dealings with third parties. As Professor Pennington puts it:

> "A director must not only employ his company's assets exclusively for its benefit and not for his own. He must also pursue and exploit for the company's benefit all business opportunities available to it in the area of commercial activity in which it is legitimately engaged, and must not appropriate such opportunities for himself."[137]

This external aspect has tended to receive greater prominence than the internal aspect. Very often a far greater threat to the company presents itself (or is so perceived) when a former director externally competes with the company rather than where a current director is transacting with the company (whose incumbent status may cushion the response of the organs of the company to internal directorial transactions).

The leading decision on external aspects of the no conflict-no profit rules is that of the House of Lords in *Regal (Hastings) Ltd. v Gulliver*.[138] This case set the tone for a strict judicial

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[135] [2005] 1 ILRM 34.

[136] See further Chapter 2 above.

[137] RR Pennington *Directors' Personal Liability* BSP Professional Books London 1987 at 46.

[138] [1942] 1 All ER 378.

approach by imposing liability to account on directors in circumstances where the company was not in a position to exploit the business opportunity in question and where what was done was unquestionably done for the benefit of the company. The act of four of the directors in subscribing for shares in the company so as to ensure that the capitalisation requirements needed for the company to acquire two cinemas were met resulted in a windfall profit to the directors on the sale of the company by way of share acquisition. An action by the newly acquired company seeking an account of profits was successful against the directors despite the absence of any suggestion of *mala fides* on their part - the company could not afford to put up more than £2,000 and the only way in which a benefit could have been secured for the company was by the directors finding additional capital themselves.

The House of Lords held that the directors had made their profit "by reason, and only by reason of the fact that they were directors of Regal, and in the course of the execution of that office."[139] Since they had not taken the step of obtaining the approval of the company in general meeting, the directors were held accountable for the profits which they had made. Following the tenor of *Keech v Sandford*,[140] the House of Lords held that duty on directors to account for profit was not dependant on fraud or lack of *bona fides*. Lord Russell stated:

> "The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud or absence of fraud, or absence of *bona fides*; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account."[141]

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[139] *Ibid* at 387 *per* Lord Russell.

[140] *Keech v Sandford* [1558-1774] All ER Rep 230, 231.

[141] [1942] 1 All ER 378, 386.

The rule promulgated was a strict one to the effect that where directors have obtained a benefit only by reason of the fact that they were directors and in the course of the execution of their office, they are accountable for any profits which they have made. *Regal (Hastings)* is accepted authority for the proposition that directors of a company are in a fiduciary position and their liability to account does not depend on proof of bad faith and arises irrespective of whether the company could itself have taken up the opportunity in question and irrespective of whether the company in fact benefited from the director taking up the business opportunity.

There has been measured disquiet in relation to this decision of the House of Lords. This has focused on the seeming inequity of the decision given that the directors' activities benefited the company and that the result of the House of Lords' decision was in effect to return the agreed price and provide a windfall profit.[142] Indeed it has been argued that given that the profit made by the directors on the sale of their shares was derived from the persons who thereby acquired control of the company they could therefore be regarded as having impliedly consented to the profit made by the directors.[143] This failure to weigh other factors in the balance has been criticised.[144] Perceived fairness aside, as a strict application of well-established equitable principle, the decision in *Regal (Hastings) Ltd v Gulliver* is not open to reproach. The decision was cited with approval in the Irish courts in *Hopkins v Shannon Transport Systems Ltd*[145] and *Fyffes plc v DCC plc.*[146]

The competing considerations which were thrown into sharp relief by the House of Lords' decision in *Regal (Hastings) Ltd v Gulliver* are revisited in Part C below which reopens the external aspect of the no conflict rules in the context of extra-corporate directorial enterprise.

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[142] See PL Davies n 109 at 418 where it is concluded that the decision "may well be thought to be carrying equitable principles to an inequitable conclusion." See also PH Pettitt *Equity and the Law of Trust* 10th ed Oxford University Press 2006 at 145; *Canadian Aero Service Ltd v O'Malley* [1974] SCR 592, 608-609.

[143] RR Pennington n 137 above at 45.

[144] G Jones n 79 above.

[145] (1972) [1963-1999] Ir Co Law Rep 238.

[146] [2005] IEHC 477.

C. DIRECTORIAL ENTREPRENEURSHIP

One of the bugbears for purist equity lawyers concerning the no conflict-no profits rules is the constant invitation to make accommodations to well-established principles for directors based not on principle, but on pragmatism and the need to facilitate entrepreneurship. Traditionally the courts and legislature have tried to encourage business endeavour, adopting a *laissez-faire* approach where possible.[147] However, the interface of business endeavour with fiduciary responsibilities is not always an easy one.

The courts have looked differently at competing activities commenced while continuing as a director to those commenced after resignation. The starting point of any analysis is that a director is free to resign his directorship at any time (notwithstanding the damage that the resignation may itself cause the company).[148] The courts have taken the position that *prima facie* the 'no conflict' rule ceases on a director ceasing to be a director.[149] However, the position is less cut and dried in relation to the 'no profit' rule.

Of particular significance in terms of doctrinal development is the class of cases dealing with what has been described as a "maturing business opportunity" where courts and commentators alike have agonised over the circumstances in which directors will owe fiduciary obligations to the company in relation to business opportunities which present themselves while they continue to serve as a director and which they resign to pursue.[150] The applicability of traditional equitable precepts to this category of cases has proved most taxing and divisive.

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[147] See further Chapter 2 above.

[148] *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704, [95].

[149] See *Attorney General v Blake (Jonathan Cape Ltd)* [1998] 1 All ER 833, 841 (former employee owes no duty of loyalty); *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704, [95] *per* Lawrence Collins J; *Foster Bryant Surveying Ltd v Bryant* [2007] IRLR 425, [69] *per* Rix LJ.

[150] See *Canadian Aero Services Ltd v O'Malley* (1973) 40 DLR (3d) 371; *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704.

(1) The Corporate Opportunity Debate

Traditionally judges have expressed themselves to be unwilling to go behind a directorial profit in order to determine the level of culpability based on the surrounding circumstances including whether the company would have a real potential to exploit the opportunity in question. This strict approach to pursuing opportunities is characterised as a capacity or status approach since it focuses merely on the opportunity arising *qua* director.[151] Such an approach was exemplified in the decision of the House of Lords in *Regal (Hastings) Ltd v Gulliver.*[152] Consequently, in looking at instances of what may be termed 'directorial entrepreneurship', an obstacle for judges wishing to move outside the strait-jacket of a capacity analysis is the pervasive influence of that House of Lords decision.[153]

A straightforward application of *Regal (Hastings)* prevents the court giving weight to factors such as the *bona fides* of the director in all the circumstances and, more pertinently, to whether or not the opportunity which the director pursued was something which the company would have optimally pursued, having regard to its line of business, and would in fact be in a realistic position to pursue. The main impetus behind a more flexible analysis than that afforded by the capacity approach is a line of Canadian and American cases. This line of authority which has had an impact on judicial thinking on this side of the Atlantic places greater emphasis on ascertaining whether a director had exploited an opportunity which in equity's eyes rightfully belonged to the company than on a *per se* analysis in relation to profits made by directors from other enterprises with which they have become involved. In essence this involves making a value judgment as to whether taking up an opportunity represents an unacceptable diversion of a corporate opportunity as opposed to healthy entrepreneurship.

The US corporate opportunity doctrine prohibits a director from personally pursuing an opportunity which is in the line of business of the corporation in which he holds a

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[151] See R Edmunds and J Lowry n 23 above at 132; HC Hirt n 7 above at 670.

[152] [1942] 1 All ER 378.

[153] *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378.

directorship.[154] Scott regards the doctrine as recognising that corporations are typically expansionist in nature.[155] The corporate opportunity doctrine was described by the Delaware Supreme Court in the following terms:

> " ... when there is presented to a corporate officer a business opportunity which the corporation is financially able to undertake, and which, by its nature, falls into the line of the corporation's business and is of practical advantage to it, or is an opportunity in which the corporation has an actual or expectant interest, the officer is prohibited from permitting his self-interest to be brought into conflict with the corporation's interest and may not take the opportunity for himself."[156]

The corporate opportunity doctrine as enunciated by the Delaware Supreme Court involves examination of a range of factors which would include the nature of the business opportunity in question, the capability of the company to exploit it and the *bona fides* of the director with a view to determining whether it was right for the director to exploit the opportunity in question.[157] It has been characterised as "a more pragmatic and fact intensive approach" than the capacity approach.[158] Proponents of the corporate opportunity approach find in it an appealing fairness – it need not apply where the opportunity comes to the director otherwise

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[154] See the seminal case of *Guth v Loth* Del Supr 5 A2d 503 (1939). For further discussion of the corporate opportunity doctrine see SM Beck "The Saga of Peso Silver Mines: Corporate Opportunity Reconsidered" (1971) 49 Can B Rev 80; PK Chew "Competing Interests in the Corporate Opportunity Doctrine" (1989) 67 NCL Rev 435; E Talley "Turning Servile Opportunities to Gold: A Strategic Analysis of the Corporate Opportunities Doctrine (1998) 108 Yale LJ 277; D DeMott "The Figure in the Landscape: A Comparative Sketch of Directors' Self-dealing Transactions" (1999) 62 Law & Contemp Problems 243, 244; EG Orlinski "Corporate Opportunity Doctrine and Interested Director Transactions: A Framework for Analysis in an Attempt to Restore Predictability" (1999) 24 Del J Corp L 451; R Edmunds and J Lowry n 23 above.

[155] S Scott n 39 above at 858-859.

[156] *Equity Corp v Milton* 221 A2d 494, 497 (Del 1966).

[157] See further DD Prentice "The Corporate Opportunity Doctrine" (1974) 37 MLR 464; J Lowry and R Edmunds n 23 above; S Scott n 39 above.

[158] HC Hirt n n 7 above at 670.

than in the course of his duties as director[159] or because the company is not in a position for financial reasons or otherwise to take up the opportunity in question.[160]

Edmunds and Lowry have argued for a similar approach to be taken by the English courts in preference to the overly strict application of equitable principles.[161] Their position is that "... while the current regime protects the company irrespective of whether it has been injured or suffered any loss, it needlessly inhibits the development of directorial opportunities by the entrepreneurial-minded director."[162]

Some commentators favour the courts utilising a 'maturing business opportunity' analysis which would require judges to delve into the surrounding circumstances with a view to seeking out whether or not the director acted in a *bona fide* fashion. Proponents of this approach regard the *Keech v Sanford / Regal (Hastings)* line as an outdated application of equitable rules formulated in relation to no longer prevailing socio-economic conditions of the eighteenth century.[163] However, given the difficulty involved in making an *ex post facto* assessment of directorial motivation and knowledge, Lowry and Edmunds's assertion that a judicial assessment should be made by having regard to the director's then prevailing state of knowledge seems unrealistic.[164] As Courtney states "... the principal difficulty with a more lenient approach is that it is dependent upon the court being able to satisfy itself that the board acted bona fide in rejecting the contract."[165]

The Privy Council's opinion in *Cook v Deeks* contained a strongly articulated policy against the diversion of corporate opportunities on the basis that "men who assume the complete

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[159] See *eg* the decision of the Supreme Court of Delaware in *Broz v Cellular Information Systems Inc* Del Supr 637 A2d 148 (1996).

[160] In *Guth v Loth* Del Supr 5 A2d 503, 510 (1939) the Supreme Court of Delaware intoned: "The occasions for the determination of honesty, good faith and loyal conduct are many and varied, and no hard and fast rule can be formulated. The standard of loyalty is measured by no fixed scale."

[161] R Edmunds and J Lowry n 23 above.

[162] *Ibid* at 123-124.

[163] J Lowry and R Edmunds "The Corporate Opportunity Doctrine: The Shifting Boundaries of the Duty and its Remedies" (1998) 61 MLR 515, 521.

[164] *Ibid* at 524.

[165] TB Courtney n 39 above at [10.054].

control of a company's business must remember that they are not at liberty to sacrifice th interests which they are bound to protect, and, while ostensibly acting for the company, diver in their own favour business which should properly belong to the company they represent."[16 The first real indication of a potentially less hard-line judicial approach to directoria entrepreneurship came in the House of Lords in *Boardman v Phipps*[167] where it was held tha solicitors acting for a trust would be entitled to pursue an opportunity which would otherwis have been open to the trust if all the beneficiaries rejected the opportunity. *Boardman v Phipps* was an early precursor of developments which were to come concerning directors.

Over the last few decades the English courts have dallied between the pragmatism of th corporate opportunity approach[168] and a strict fiduciary, principle-led analysis.[169] The more expansive, maturing business opportunity analysis of the corporate opportunity doctrine has provided a counterpoint to judicial adoption of the capacity approach which for a time proved attractive to the English courts before the pendulum swung back in favour of a capacity approach. Indeed, while the trend of cases in the 1980s and 1990s was towards embracing a corporate opportunity analysis, recent guidance from the Court of Appeal has thrown a burgeoning maturing business opportunity approach in the English courts off course.

The emergence of a maturing business opportunity analysis in English case law had its origins in the corporate opportunity doctrine as articulated in the Canadian case of *Peso Silver Mines Ltd v Cropper.*[170] In this case the Supreme Court of Canada considered the position of a director who took up a business opportunity to acquire mining claims after the opportunity had been considered and rejected by the company's board of directors due to financial constraints. The Court distinguished *Regal (Hastings)* on the basis that in the instant case the company had

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[166] [1916] 1 AC 554, 563 (the Privy Council's opinion was delivered by Lord Buckmaster LC).

[167] [1967] 2 AC 46.

[168] *Island Export Finance Ltd v Umunna* [1986] BCLC 460; *Balston v Headline Filters Ltd* [1990] FSR 385; *Framlington Group plc v Andersen* [1995] 1 BCLC 475.

[169] *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162; *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734; *Bhullar v Bhullar* [2003] 2 BCLC 241; *Crown Dilmun v Sutton* [2004] 1 BCLC 468; *Quarter Master UK Ltd (in liq) v Pyke* [2005] 1 BCLC 245.

[170] (1966) 58 DLR 1. See I Douglas "Directors' Duties under Bill 125" (1969) 27 U Toronto Fac L Rev 102; SM Beck n 154 above.

rejected the business chance through a decision of the directors acting in good faith, for sound business reasons in the interests of the company.[171] It was relevant that the approach had been made to Mr Cropper by a third party after the company had rejected the opportunity and consequently the opportunity was not regarded as having come to him in his capacity as a director. Consequently it was held he was not liable to account for the profits had made from the business opportunity.[172] *Peso Silver Mines* marks a step forward from the unyielding nature of the fiduciary analysis in *Regal (Hastings)* and is credited with developing an even-handed corporate opportunity approach imbued with the concept of fairness. Professor Pennington regards *Peso Silver Mines* as "... defin[ing] the limits of the company's area of interest, so that the personal exploitation of the opportunity by a director cannot thereafter be a breach of his fiduciary duty."[173]

Another landmark Canadian decision, *Canadian Aero Service Ltd v O'Malley*,[174] was also influential in English judicial analysis. The Supreme Court of Canada articulated a 'maturing business opportunity'[175] test which asked whether the opportunity exploited could be classed as a maturing business opportunity which was being actively pursued by the company. Laskin J set out a dividing line for the application of fiduciary liability which was based on either a director or senior officer:

> "...obtaining for himself, either secretly or without the approval of the company (which would have to be properly manifested on full disclosure of the facts), any property or business advantage either belonging to the company or for which it has been negotiating ... a maturing business opportunity which his company is actively pursuing; he is also precluded from so acting even after his resignation where the resignation may fairly be said to have been prompted or influenced by a wish to acquire for himself the opportunity sought by the company, or where it was his

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[171] The company received 2-3 offers to purchase claims per week.

[172] A similar approach was taken by the Privy Council in *Queensland Mines Ltd v Hudson* (1978) 52 ALJR 399.

[173] RR Pennington n 137 above at 50.

[174] [1974] SCR 592. See DD Prentice n 157 above; SM Beck "*Canadian Aero Services v O'Malley*: The Quickening of Fiduciary Obligation" (1975) 53 Can Bar Rev 771. The decision was followed in a series of New Zealand cases: see *Pacific Shipping Co Ltd v Andersen* (1985) 2 NZCLC 96-040.

[175] [1974] SCR 592, 607.

position with the company rather than a fresh initiative that led him to the opportunity which he later acquired."[176]

Laskin J specifically avoided pronouncing on whether equitable principles were over-zealously applied in *Regal (Hastings) Ltd v Gulliver* but did comment that the relevant principles therein "... grew out of older cases concerned with fiduciaries other than directors or managing officers of a modern corporation ...."[177] He stressed the importance of considering the influence of a range of factors on any given fact scenario. Relevant factors enumerated included the position and functions of the director, the nature of the corporate opportunity, its ripeness, its specificness and the director's relation to it, the amount of knowledge of the opportunity possessed and the circumstances in which it was obtained, the time which elapsed where the alleged breach occurred after termination of the director's relationship with the company, and the circumstances under which the relationship was terminated.[178]

While *Peso Silver Mines* and *Canadian Aero Service* focused on the moral issue of whether the opportunity exploited could be said to rightfully belong to the company, on the other side of the fence is the English first instance decision in *Industrial Development Consultants Limited v Cooley*[179] and cases in this mould. *Cooley* defined the boundaries of the duty on directors not to make secret profits in unrelentingly traditional fiduciary terms under which it is irrelevant whether or not the company could have availed itself of the opportunity.

The facts of *Cooley* are important to an assessment of the Court's approach and are worth setting out in brief. The defendant was the managing director of the plaintiff company who had tried unsuccessfully to secure a contract for the company with the Eastern Gas Board. The Gas Board then approached him seeking to hire him in his personal capacity as an architect with relevant prior experience. He agreed and secured a release from the service of

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[176] *Ibid* at 606-607.

[177] *Ibid* at 608-609.

[178] *Ibid* at 620. The case has been cited with approval in Australasia: see *Green v Bestobell Industries Pty Ltd* [1982] WASR 1; *SSC and B Lintas New Zealand Ltd v Murphy* (1982) 1 NZCLC 98; *Mordecai v Mordecai* (1988) 12 NSWLR 58; *Weldon & Co Services Pty Ltd v Harbinson BC200001837* [2000] NSWSC 272.

[179] [1972] 2 All ER 162.

the company by pretending to be on the verge of a breakdown. On the plaintiff company making a claim for an account of profits, it was countered that the company could not have obtained the contract. Indeed, on this basis, *Cooley* could have been decided in a parallel fashion to *Peso Silver Mines*. Instead Roskill J opted for the orthodox *Regal (Hastings)* approach and held that the defendant had breached his fiduciary duty to the company by using information he received as a director for his own ends.[180] Roskill J's rationale was that it was the duty of the managing director to pass on information to the company which came to him in that capacity which was of concern and relevance to the company.[181] He was therefore obliged to account to the company for the benefit which he had received. The fact that the company would not have obtained the contract was considered to be irrelevant. Unsurprisingly, *Cooley* has been described as the "zenith" of the traditional approach.[182] However, one cannot but wonder whether the unmeritorious conduct of the director in procuring a release from his contract did not in some measure influence the Court.[183]

The door to a corporate opportunity analysis re-opened a crack with the Privy Council's opinion in *Queensland Mines Ltd v Hudson*[184] which countenanced account being taken of the rejection of an opportunity by the company. This was anathema to the *Regal (Hastings)* analysis and difficult to square with it. The challenge to the strict capacity approach continued post-*Cooley* as an alternative line of English High Court decisions flirted with a maturing business opportunity test, directly influenced by the Canadian corporate opportunity approach which thereby gained a foothold in English law, albeit in the lower courts.

Island Export Finance Ltd v Umunna[185] began the trend, going against the tenor of *Cooley* by importing the 'maturing business opportunity' phraseology into English law. Hutchison J

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[180] The decision did not expressly address the no conflict-no profit dichotomy. However, in *Ultraframe (UK) Ltd v Fielding* [2005] EWHC Civ 1638 (Ch), [1336] Lewison J rationalised *Cooley ex post facto* as an application of the no conflict rule even though it is conceptually easier to view it as falling under the rubric of the no profit rule given the fact of resignation.

[181] [1972] 2 All ER 162, 173.

[182] R Edmunds and J Lowry n 23 above at 133.

[183] For a contrary view see RR Pennington n 137 at 49.

[184] [1978] 18 ALR 1.

[185] [1986] BCLC 460.

accepted that a director's fiduciary duty did not necessarily come to an end when he ceased to be a director.[186] To hold otherwise would be to let many an errant director off the hook. He went on to adopt the maturing business opportunity proposition of *Canadian Aero Service Ltd v O'Malley* whereby a director is precluded from diverting to himself any maturing business opportunity which his company is actively pursuing. This was said to apply even after his resignation where the resignation was prompted or influenced by a desire to acquire that opportunity for himself. On the facts its was held that there was no maturing business opportunity in being at the time of the director's resignation since the company was no longer actively pursuing contracts of the type concerned in the relevant market. Significantly the court did not regard the mere hope of obtaining further orders as sufficient to qualify as a maturing business opportunity – active pursuit of the opportunity was required. It was also emphasised that in this case the pursuit of the opportunity had followed resignation and exploitation of this line of business was not the director's motive for resigning.

Island Export showed a clear preference for the corporate opportunity reasoning in *Canadian Aero Service* over the dogmatic fiduciary analysis of the House of Lords in *Regal (Hastings)*. Moreover, in preferring the *Canadian Aero Service* approach to that in *Cooley,* the judge appeared to be influenced by the doctrine of restraint of trade. This approach requires an analysis into the reason for resigning. The requirement that the company be actively seeking business in the relevant area is far less onerous than the classic fiduciary doctrine and perhaps strays even beyond the bounds of the corporate opportunity doctrine of the US[187] with its focus on the corporation's 'line of business'. Indeed, however seemingly far-seeing Hutchison J's innovation appears rather ill-founded having regard to the clear message in *Regal (Hastings)* and *Cooley* and the requirements of *stare decisis*. This did not prevent a number of other first instance decisions following a similar path.[188]

The maturing business opportunity approach developed in *Island Export Finance Ltd v Umunna* was short-lived and later decisions have shown a return to strict fiduciary principles

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[186] In support of this proposition, Hutchison J relied on *Ex p James* (1803) 8 Vest Jun 337, a case concerning a solicitor's fiduciary obligations.

[187] See further R Edmunds and J Lowry n 23 above at 137.

[188] See *eg Balston v Headline Filters Ltd* [1990] FSR 385; *Framlington Group plc v Andersen* [1995] 1 BCLC 475.

The retrenchment began with Rimer J's first instance decision in *Gencor ACP Ltd v Dalby*[189] which bucked the *Island Export* trend and returned to a traditional capacity analysis with additional emphasis on the importance of disclosure. Relying on *Regal (Hastings)*, and not considering the corporate opportunity cases, Rimer J regarded the relevant principles as well-established and saw no reason to depart from a strict application of them. Therefore the fact that the company would not or could not have taken up a business opportunity did not remove a director's strict liability to account for a benefit or gain obtained or received as a result of using for his own benefit a business opportunity that arose for the company. As a first instance decision it was out of kilter with the bolder analyses at first instance in other decisions of the English High Court.[190] *Gencor* suggested that the tide was turning for the corporate opportunity approach. Nevertheless, references to the concept of a "maturing business opportunity" persisted in *CMS Dolphin Ltd v Simonet*[191] where Lawrence Collins J displayed a hybrid approach.

Following these discordant decisions at first instance, clarification came from the Court of Appeal, courtesy of an unmistakeable return to traditional fiduciary principles in *Bhullar v Bhullar*.[192] The case concerned two directors of a property investment company who acquired a property adjacent to property already owned by the company and which it would have been worthwhile for the company to acquire although the board had previously resolved not to acquire further property investments. The directors laid emphasis on the chance discovery of the opportunity on a day off and legal advice obtained indicating that there was no barrier to them purchasing the property.

The Court of Appeal rejected the notion that a maturing business analysis was the sole conduit through which the matter was to be analysed and went on to apply the more general no conflict rule in the traditional strict manner. Delivering the judgment of the Court, Parker LJ applied Lord Upjohn's test of whether "the reasonable man looking at the relevant facts and

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[189] [2000] 2 BCLC 734.

[190] See *Island v Export Finance Ltd v Umunna* [1986] BCLC 460; *Balston Ltd v Headline Filters Ltd* [1990] FSR 385; *Framlington Group plc v Anderson* [1995] 1 BCLC 475.

[191] [2001] 2 BCLC 704.

[192] [2003] 2 BCLC 241.

circumstances of the particular case would think that there was a real sensible possibility of conflict".[193] He stated:

> "In a case such as the present, where a fiduciary has exploited a commercial opportunity for his own benefit, the relevant question, in my judgment, is not whether the party to whom the duty is owed (the company, in the instant case) had some kind of beneficial interest in the opportunity: in my judgment that would be too formalistic and restrictive an approach. Rather, the question is simply whether the fiduciary's exploitation of the opportunity is such as to attract the application of the rule."[194]

On the facts this test was held to be satisfied since the parties had clearly apprehended that there may have been a conflict[195] in making the decision to consult the company's solicitor. The effect of the conflict of interest was to prohibit the directors from purchasing the property. The two directors were held accountable for profits and were also held liable to procure the transfer of the property to the company.

Although Parker LJ was careful to emphasise the importance of flexible application of the rule, judging each case on its own facts, the decision in *Bhullar v Bhullar* signalled that no specific accommodation is to be made for fact scenarios which disclose directorial entrepreneurship or personal initiative. This has returned matters to the test of real sensible possibility of conflict with no apparent weight being placed on the lack of a maturing business opportunity. The clear judicial view which emerges is that the traditional no conflict-no profit rules can operate on a one size fits all basis and there is no need for a separate or subsidiary test for directorial enterprise. Writing in 1974, Professor Prentice argued that while on one analysis all cases of profit by directors could be determined by utilising a corporate opportunity analysis, it was unnecessary to extend the doctrine to cover situations which fall

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[193] *Boardman v Phipps* [1967] AC 46, 124.

[194] [2003] 2 BCLC 241, [28].

[195] It has been put forward that it is only where "the profit-making opportunity is unconnected with the company's existing or any reasonably anticipated future line of business" that no conflict will arise: RP Austin, HAJ Ford and IM Ramsay *Company Directors: Principles of Law and Corporate Governance* LexisNexis Butterworths Australia 2005 at [9.11].

squarely within the prohibition on a director making unauthorised profits from his position.[196] Rather, he contended that the breadth of the corporate opportunity should be confined to "where a director benefits from the exploitation of an economic opportunity which falls squarely within the general line of business of the company, but knowledge of which he acquires in a capacity other than that of a director."[197] However, as matters have panned out, the result of *Bhullar v Bhullar* would appear to favour a return to subsuming these scenarios within the generic principles derived from *Regal (Hastings)* with no further need for a specific corporate opportunity approach.

Since *Bhullar*, a common sense approach was evident in the Court of Appeal in *Foster Bryant Surveying Ltd v Bryant* where it was emphasised that "although general principle is not in doubt, the extent of a director's duty in particular situations may depend on the circumstances."[198] Other decisions have cemented *Bhullar*'s strict fiduciary analysis, with judicial emphasis being placed on the counterbalancing, mitigating effect of disclosure and approval. Thus in *Quarter Master UK Ltd (in liq) v Pyke,*[199] it was held that a conflict of interest arose even though the company would not have been in a position to take advantage of the business opportunity as it was going into liquidation. Paul Morgan QC (sitting as a deputy judge of the High Court) regarded the ability to retain a profit as predicated on obtaining the informed consent of the company.[200] This was the case

> "whether the fiduciary acted in good or bad faith, whether or not the making of the profit involved skill and risk-taking on his part, even though the profit could not or would not have been obtained by the company itself and even though the company had not been prejudiced by, and might even have benefited from, the transaction entered into by the director."[201]

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[196] DD Prentice n 157 above at 464-465.

[197] *Ibid* at 465.

[198] *Foster Bryant Surveying Ltd v Bryant* [2007] IRLR 425, [65] *per* Rix LJ.

[199] [2005] 1 BCLC 245.

[200] [2005] 1 BCLC 245, [54]. See also *Crown Dilmun v Sutton* [2004] 1 BCLC 468; *Murad v Al-Saraj* [2005] EWCA Civ 959, [59] *per* Arden LJ; *Kinsley IT Consulting Ltd v McIntosh* [2006] EWHC 1228, [55] *per* Terence Mowschenson QC (sitting as a deputy judge).

[201] [2005] 1 BCLC 245, [54].

Inherent in this statement is a firm rejection of the relevance of what is known as 'the impossibility argument'. The factual circumstances behind both *Keech v Sandford*[202] and *Regal (Hastings) Ltd v Gulliver*[203] support a clear rejection of the relevance of an impossibility argument.[204] The failure of the English courts to take account of the impossibility of the company taking up the relevant corporate opportunity (a consideration which informs judicial decisions on the other side of the Atlantic) has attracted divided views. Scott maintains that to take account of a company not being able to take up an opportunity would be inconsistent with the modern expectation that the director's role, especially the executive director's role, is to promote the success of the company.[205]

Scott also convincingly contends that it is difficult for the judiciary to make an assessment of the reality of the situation given that a director may exaggerate the significance of obstacles presented to the company exploiting the opportunity. Rather, he argues the answer is for the director to make full disclosure of the relevant circumstances and seek company approval for taking up the opportunity. This perspective is supported by comments in *Demoulas Super Markets, Inc* where the Supreme Judicial Court of Massachusetts stated:

> "We disagree with [limiting] a fiduciary's duty of disclosure to those enterprises judged by the fiduciary to be within the company's legal, financial, or institutional capabilities. Establishing such a threshold test for defining a corporate opportunity would contradict the principle ... that a fiduciary who is interested in pursuing an opportunity should not make the decision as to whether the venture is also of interest to the company without regard to possible impediments, and material facts must be fully disclosed, so that the company may consider whether and how to address these obstacles .... Without such a rule, the fiduciary's self-interest may cloud his judgment or tempt him to overlook his duties."[206]

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[202] [1558-1774] All ER Rep 230.

[203] [1942] 1 All ER 378.

[204] Cf, however, Lord Macmillan's reference to a "dog-in-the-manger policy" in *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378, 392.

[205] S Scott n 39 above at 867.

[206] 677 NE2d 159 (Mass 1997) at 181.

This perspective is evident in the decision of the Australian High Court in *Furs Ltd v Tomkies*,[207] where the joint judgment of Rich, Dixon and Evatt JJ rationalised the inflexibility of strict accountability:

> ". . . It is no answer to the application of the rule that the profit is of a kind which the company itself could not have obtained, or that no loss is caused to the company by the gain of the director. It is a principle resting upon the impossibility of allowing the conflict of duty and interest which is involved in the pursuit of private advantage in the course of dealing in a fiduciary capacity with the affairs of the company. If, when it is his duty to safeguard and further the interests of the company, he uses the occasion as a means of profit to himself, he raises an opposition between the duty he has undertaken and his own self interest, beyond which it is neither wise nor practicable for the law to look for a criterion of liability. The consequences of such a conflict are not discoverable. Both justice and policy are against their investigation."[208]

Where to from here? Although the tone of the Court of Appeal's judgment in *Bhullar v Bhullar* appeared unrelenting, it is not beyond the bounds of possibility that in appropriate circumstances the House of Lords might be willing to take a step back from its unmitigated harshness by taking account of the surrounding circumstances. Jones has argued that there are grounds for drawing a clearer distinction between a situation where a director has unjustly obtained a benefit and a situation where the benefit was not unjustly obtained in that there was no inherent unfairness at play.[209] This very possibility was adverted to by Arden and Parker LJJ in *Murad v Al-Saraj*,[210] a case which arose in a business, but not a corporate, context and concerned the significance of the non-disclosure of information including a secret commission by a business partner to his two other business partners which may have impacted on the terms of their arrangement to invest in a joint venture to acquire a hotel. Arden LJ stated:

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[207] (1936) 54 CLR 583. This passage was cited with approval by the Court of Appeal in *Gwembe Valley Development v Koshy (No 3)* [2004] 1 BCLC, [44].

[208] (1936) 54 CLR 583 592.

[209] G Jones n 79 above.

[210] [2005] EWCA Civ 959.

> "It may be that the time has come when the court should revisit the operation of the inflexible rule of equity in harsh circumstances, as where the trustee has acted in perfect good faith and without any deception or concealment, and in the belief that he was acting in the best interests of the beneficiary."[211]

She indicated that it would be open to the courts to conclude as a matter of policy that the harshness of the no profits rule should be tempered in some circumstances without losing its deterrent effect. Therefore, should the opportunity present itself, it would be open to the House of Lords to enquire into "whether the beneficiary would not have wanted to exploit the profit himself, or would have wanted the trustee to have acted other than in the way that the trustee in fact did act."[212] Any such review would be designed to address the inflexible nature of the rule "where the result is not compatible with the desire of modern courts to ensure that remedies are proportionate to the justice of the case where this does not conflict with some other overriding policy objective of the rule in question."[213] The equivocation of the English courts in selecting the appropriate model for dealing with contemporary standards for competitive activity by directors has been remarkable. Until the House of Lords has the opportunity to rule again on the issue the somewhat disjointed and uncoordinated approach is likely to continue.

Interestingly, Parker LJ, who in *Bhullar v Bhullar* had delivered what appeared to be a decisive blow to a developing corporate opportunity approach, also opened the door to such a possibility, stating:

> "... there can be little doubt that the inflexibility of the 'no conflict' rule may, depending on the facts of any given case, work harshly so far as the fiduciary is concerned. It may be said with force that that is the inevitable and intended consequence of the deterrent nature of the rule. On the other hand, it may be said that commercial conduct which in 1874 was thought to imperil the safety of mankind may not necessarily be regarded nowadays with the same depth of concern."[214]

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[211] *Ibid* at [82].

[212] *Ibid.*

[213] *Ibid* at [83].

[214] *Ibid* at [121].

Like Arden LJ, he envisaged the possibility that at some time in the future the House of Lords may consider that the time has come to relax the severity of the no conflict rule to some extent in appropriate cases where (unlike in *Murad*) the fiduciary had acted in good faith. It is not at all clear that the courts in this jurisdiction would be ready to be similarly receptive to a possible judicial reinvention of fiduciary doctrine. In *Fyffes plc v DCC*[215] Laffoy J accepted without qualification that liability for breach of fiduciary duty could arise irrespective of whether the company could have made a profit.

Sifting through the cases which have considered the corporate opportunity territory, one gets a sense of unease born of shifting views. Consequently, until some settling has occurred, it is difficult for legal advisers (not to mention savvy directors) to get a handle on the relevant principles which will apply in any particular case. *Murad v Al-Saraj* adds opportune impetus to long-standing calls for reform.[216] Indeed, the quoted dicta of Arden and Parker LJJ are reminiscent of similar statements made two decades earlier by Deane J in *Chan v Zacharia*[217] which were receptive to future accommodation of a more flexible approach which would exclude liability to account where it would be "unconscientious" to assert it.[218] He said that:

> "... one cannot but be conscious of the danger that over-enthusiastic and unnecessary statement of broad general principles of equity in terms of inflexibility may destroy the vigour which it is intended to promote in that it will exclude the ordinary interplay of the doctrines of equity and the adjustment of general principles to particular facts and changing circumstances and convert equity into an instrument of hardship and injustice in individual cases ...."[219]

The other overriding impression is that corporate opportunity debate is permeated by a lack of precision. While to some corporate opportunity connotes the more pro-director maturing business opportunity approach, to others the concept has a far broader reach which encompasses a pseudo-proprietary analysis which seeks to contain within its grasp all

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[215] [2005] IEHC 477.

[216] M McInnes "Account of Profits for Breach of Fiduciary Duty" (2006) 122 LQR 11, 15.

[217] [1983-1984] 154 CLR 178.

[218] *Ibid* at 204.

[219] *Ibid* at 205.

opportunities and information which a director encounters while holding that office.[220] This can be seen as part of a wider judicial trend to favour shaping their pronouncements in the language of an ownership paradigm which focuses on to whom the opportunity rightfully belongs in preference to or as well as in the rubric of the traditional loyalty-based conflict paradigm.[221]

There is a line of cases which utilise a property analysis which regards a director's breach of the no conflict-no profit rules in terms of the misappropriation of company property. An early example is *Cook v Deeks*[222] where the directors' appropriation of a contract they were negotiating on behalf of the company was said to have "belonged in equity to the company and ought to have been dealt with as an asset of the company."[223] In recent years a property analysis is evident in English case law whereby the improper diversion of a corporate opportunity is viewed as a misappropriation of company property.[224] In *Fyffes plc v DCC plc*[225] this trend could be observed in the plaintiff company's attempts to establish a basis for the imposition of non-statutory liability for insider trading on the premise that the information in the possession of the director was a form of company property, the appropriation of which for the benefit of the director personally represented a breach of duty.

In *Ultraframe (UK) Ltd v Fielding* Lewison J regarded the property analysis as a variant on the no profit rule.[226] Loose language may, however, lead to undesired consequences - as he observed, the infiltration of property terminology hints at a possible shift from a focus on personal liability to pay over profits to a proprietary basis for liability. Clark rightly cautions against the inappropriate use of the language of property, particularly "... where the contract has never been put before the company, where the company is not in a position to pursue the contract or where opportunities have been encountered by directors in some kind of private

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[220] See RP Austin n 74 above at 141.

[221] See D Kershaw n 61 above at 533.

[222] [1916] 1 AC 544.

[223] *Ibid* at 564 *per* Lord Buckmaster.

[224] *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704, [96] *per* Lawrence Collins J; *In Plus Group Ltd v Pyke* [2002] 2 BCLC 201, [71] *per* Brooke LJ.

[225] [2005] IEHC 477.

[226] [2005] EWHC 1638 (Ch), [1344].

capacity."[227] It would seem appropriate to confine a property analysis to cases of misuse of corporate information which is subject to an obligation of confidence.

The failure to draw clear distinctions does not make for clear doctrinal development. This lack of intellectual rigour inherent in various manifestations of the corporate opportunity doctrine is not in itself reason alone to ground an unabashed avowal of strict fiduciary principles founded on loyalty, yet it adds weight to the appeal of the simple and clear nature of the no conflict-no profit rules as traditionally understood.

It would be all too simple to say that the flexible nature of the maturing business opportunity approach has appeal. However, the flexible nature of the corporate opportunity approach is also its main sticking point; its boundaries remain unclear. Given the deterrent function which a strict rule combined with a disclosure option provides, any complaints about unnecessary harshness can be countered with the response that prior disclosure and consent will set a director free. In this setting, while the traditional principles may seem harsh, the reality is tempered by the ability to seek authorisation before exploiting any such opportunity. It occurs to one that this does not address the possibility of the unwarranted blocking of directorial entrepreneurship based on an overly expansive notion of the best interests of the company, but that is an inescapable hazard of the judiciary's softly, softly approach to directorial assessments of what is in the best interests of the company.[228]

(2) The Mashonaland Non Sequitur

Apart from the challenges posed to orthodox fiduciary principle by judicial flirtation with the imported corporate opportunity doctrine, the generally unforgiving nature of equity's no conflict-no profit rules is also in tension with a slender line of authority which gives its blessing to competitive activity by directors. This line of authority from the late nineteenth and early twentieth century suggests that, in the absence of an express contractual provision, a director cannot be restrained from a number of forms of participation in competing endeavours. Given the direct conflict which such a broad principle sets up with the no

[227] B Clark n 19 at 232.

[228] See further Chapter 3 above.

conflict-no profit rules, this has proved controversial. Therefore where competing involves the use or appropriation of company property or the exploitation of confidential information, the courts have been willing to place limits on the breadth of the directorial freedom to compete. This section explores the evolving law concerning how a former director may remain liable under the no profit rule if he uses property of the company or information which he has acquired as a director and which is of value to the company for his own benefit.

(a) The Mashonaland Principle

London and Mashonaland Exploration Co v New Mashonaland Exploration Co[229] is regarded as establishing that a director does not breach his fiduciary duty by competing with the company, having an interest in a competing company or being a director of a competing company. The judgment is not without difficulties. Chitty J's sparsely reported[230] *ex tempore* judgment (appearing to be a ruling on interlocutory relief) focused entirely on the absence of an express or implied contractual restriction to that effect.[231] Although the principle for which *Mashonaland* is regarded as authority is consistent with the *laissez-faire* approach taken by the courts at that time with a view to favouring gentlemanly entrepreneurship,[232] it places an emphasis on free trade at the expense of equitable principle. While the *Mashonaland* principle received the *obiter* approval of Lord Blanesburgh in the House of Lords in *Bell v Lever Bros Ltd*,[233] its broadly drawn nature has given rise to concern, not least because it does not dovetail coherently into the no conflict-no profit rules.

(b) The Retrenchment from Mashonaland

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[229] [1891] WN 165.

[230] The Weekly Notes devote a mere two sentences to reporting it.

[231] The only apparent basis for the decision which is evident in the very succinct report is a willingness to regard partners and directors differently.

[232] See further Chapter 2 above.

[233] [1932] AC 161, 195. Other cases where the *Mashonaland* principle was applied include *Waite's Auto Transfer Ltd v Waite* [1928] 3 WWR 649; *Albaster v Aubanel* (1949) 66 RPC 343; *Berlei Hestia (NZ) Ltd v Fernyhough* [1980] 2 NZLR 150; *Mordecai v Mordecai* (1988) 12 NSWLR 58.

It has been said that the status of the rule in *Mashonaland* that a director does not act in breach of duty by competing with the company through directly engaging in a competing business or holding a directorship in a competing company is "a long standing conundrum of company law"[234] and that it "sits rather uncomfortably alongside Lord Cranworth's famous imploration in *Aberdeen Railway Co v Blaikie Bros* that no fiduciary 'shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which may possibly conflict with the interests of those whom he is bound to protect'."[235] Most fundamentally, there is a difficulty in reconciling the expansive approval in *Mashonaland* of competition by directors with the resurgence of judicial emphasis on the fiduciary character of the office of director when applying the no conflict-no profit rules.[236] Notably, in *Re Thomson*[237] (which was not cited in *Bell v Lever Bros)* an injunction was granted restraining a trustee from carrying on a business competing with that managed by the trust.[238] In that case, Clauson J followed the *Aberdeen Railway Co v Blaikie Bros* dynamic in order to state that the trustee "by starting such a business and entering into such engagements, would have been entering into engagements which would conflict, or certainly possibly might conflict with the interest of the beneficiaries under the will."[239]

Consequently, academic commentators have doubted whether the *Mashonaland* principle should be viewed in absolute terms.[240] The *Mashonaland* principle has been regarded as increasingly difficult to support in light of the fact that subordinate employees are not permitted to engage in competing activities on the basis of their duty of loyalty to the employer under the so-called 'double employment rule'.[241] Meanwhile, moving outside the plane of the pure contractual emphasis in *Mashonaland,* logical inconsistencies in the sphere

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[234] R Grantham n 71 above at 109.

[235] R Goddard "Competing Directorships" (2004) 25 Co Law 23 at 23 (footnotes omitted).

[236] See M Christie "The Director's Fiduciary Duty Not to Compete" (1992) 55 MLR 501; R Grantham n 71 above.

[237] [1930] 1 Ch 203.

[238] H Delany *Equity and the Law of Trusts in Ireland* 3rd ed Thomson Round Hall Dublin 2003 at 204.

[239] [1930] 1 Ch 203, 216.

[240] For a good summary see A Berg "The Company Law Review: Legislating Directors' Duties [2000] JBL 472 at 487-488. Pennington regarded it as a *prima facie* rule: RR Pennington *Pennington's Company Law* 8th ed Butterworths London 2001 at 714.

[241] PL Davies n 109 above at 414-415.

of equity and company law have not gone unnoticed. Professor Hannigan epitomised these in saying that "... in practice a director will find it difficult to serve two masters without being in breach of his obligations to one or the other."[242]

This uneasiness has manifested itself in the courts exhibiting a reluctance to allow *Mashonaland* to be used as a springboard for a wider principle than its facts warrant. While the bull has yet to be taken by the horns in the form of a decision that *Mashonaland* was wrongly decided, there have been judicial attempts to limit the proposition in *Mashonaland* that there is nothing objectionable in a director who competes with the company either personally or as a director of another company.[243]

The greatest manifestation of judicial discontent with the *Mashonaland* principle to date occurred in *In Plus Group Ltd v Pyke.*[244] The Court of Appeal held that although there was no rigid rule that a director could not be involved in the business of a competing company, the individual fact scenario would be important in making any determination in an individual case.[245] In that decision the Court of Appeal dealt some serious *obiter* blows to the credibility of the expansive *Mashonaland* principle. Sedley LJ noted[246] that there was no indication in the reported decision in *Mashonaland* that Chitty J considered the relevance of *Keech v Sandford.*[247] Bearing in mind the high standard of probity which equity demands of fiduciaries, and the reliance which shareholders and creditors are entitled to place upon it, Sedley LJ regarded the *Mashonaland* principle as a very limited one and as influenced by its

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[242] B Hannigan n 95 above at 246. See further *Bristol and West Building Society v Mothew* [1998] Ch 1, 18 *per* Millett LJ; *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch), [1312]-1317] *per* Lewison J.

[243] See *Scottish Co-operative Wholesale Society Ltd v Meyer* [1958] 3 All ER 56; *Bristol and West Building Society v Mothew* [1998] Ch 1; *In Plus Group Ltd v Pyke* [2002] 2 BCLC 201.

[244] [2002] 2 BCLC 201. See further R Grantham n 71 above; R Goddard n 235 above.

[245] "The fiduciary duty of a director to his company is uniform and universal. What vary infinitely are the elements of fact and degree which determine whether the duty has been breached." *In Plus Group Ltd v Pyke* [2002] 2 BCLC 201, [80] *per* Sedley LJ. The Court of Appeal reiterated this position in *Foster Bryant Surveying Ltd v Bryant* [2007] IRLR 425.

[246] *In Plus Group Ltd v Pyke* [2002] 2 BCLC 201, [88] *per* Sedley LJ.

[247] [1558-1774] All ER Rep 230.

own facts.[248] Rather than treating *Mashonaland* as establishing an absolute principle, it was viewed as establishing that there is nothing inherently objectionable in competing with the company; in other words the *Mashonaland* principle was consigned to the category of general legal proposition to which exceptions exist.

Ireland has not witnessed the full rigour of the *Mashonaland* principle. There is both contemporaneous and recent Irish authority which evidences a more subtle, if somewhat tangled, approach. In *Moore v M'Glynn* (a case in which neither *Keech v Sandford* nor *Mashonaland* was considered) Chatterton VC stated that a trustee setting up a competing business would not be in breach of fiduciary duty "provided that he does not resort to deception or solicitation of [customers]"[249] from the pre-existing business. *Prima facie,* this statement of principle would appear to roll back on the harshness of *Keech v Sandford* and to be consistent with *Mashonaland.* However, the decision reached on the facts supports a somewhat narrower proposition. The decision concerned property including a shop and post office held on trust pursuant to a will by the testator's son and brother for the benefit of the late testator's wife and children. After acting as postmaster for some years, he set up his own business in the same town including a post office. The issue for the court was whether a constructive trust could be imposed in respect of the new business for the benefit of the testator's estate. Although Chatterton VC's dicta cited above are often quoted, their force is diminished when one refers to the Vice Chancellor's later statement which shows that he did not set out any broad general principle in relation to competing:

> "It is plain that the setting up of a shop in a small town to a certain extent in rivalry with another must tend more or less to injure the business of any similar shop in the locality, and I think there would be an inconsistency between the duties of the defendant ... as trustee and manager of the testator's business, and the necessary personal interest which he must take in his own ... I am of opinion that his new position disqualifies him from remaining any longer a trustee, and it would have been

[248] [2002] 2 BCLC 201, [84]. While Sedley LJ questioned the breadth of the *Mashonaland* principle, Brooke LJ and Jonathan Parker LJ did not think it was an appropriate case to examine the scope and application of the *Mashonaland* principle. See also *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch), [1312]-1317] *per* Lewison J.

[249] [1894] 1 IR 74, 89.

better for him to have procured his removal from the trusteeship before setting up for himself. He should not be continued in a position where his duties and his self interest may conflict."[250]

Essentially, the no conflict principle was applied but, in refusing to order an account of profits, the court chose not to apply the no profit rule to its *ne plus ultra* conclusion. Indeed it can be asked whether the courts today would prefer the more resolute approach taken in *Re Thomson*.[251] While *Moore v M'Glynn* could be seen as a dilution of the *Mashonaland*, a less equivocal stance was taken in *Spring Grove Services (Ireland) Ltd v O'Callaghan*,[252] albeit in an elliptical fashion consequent on its context as a ruling on a discovery motion. Herbert J succinctly stated:

"A Director of a Company owes strict obligations of good faith, fair dealing and honesty to the Company of which he is a Director. Aspects of these obligations commonly referred to as, "Fiduciary duties", include a duty not to compete with the company ...."[253]

Unfortunately this clear statement that a director's duties include a duty not to compete with the company was made without reference to authority. Nevertheless, given the tenor of dicta in these two cases and the fact that *Mashonaland* has never been expressly considered, the better view would be that *Mashonaland* did not take hold in Ireland and that if the matter arose directly for consideration, it is likely that the courts would have regard to the increasing judicial and academic disquiet in recent years concerning the potential breadth of *Mashonaland* principle. The current emphasis on the freeing effect of disclosure and approval would be an answer to the apparently draconian nature of an absolute prohibition on competing interests. In addition, a relevant consideration is that *Mashonaland* still unquestionably supports the validity of contractual limitations being placed on directors' ability to engage in competitive activity. Thus a non-compete restriction inserted in the company's articles of association or in a director's service contract with the company may also

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[250] *Ibid* at 89-90.

[251] [1930] 1 Ch 203.

[252] [2000] IEHC 61.

[253] *Ibid* at [26].

prohibit him or her from acting as a director of a competing company or indeed any other company. This may be a direct express prohibition enforceable by injunction or an indirect requirement phrased as an obligation for the director to devote his attention full time to the company's affairs.[254] It is also notable that legislative policy appears to support the perspective that the holding of a directorship is not in itself objectionable.[255]

(c) Limits on the Freedom to Compete

In the intervening century since the succinct enunciation of a general 'freedom to compete' principle in *Mashonaland*, the courts have preoccupied themselves with formulating the small print which must be complied with to avail of the spirit of *Mashonaland.* This task is further complicated by the need to accommodate the public policy rules against restraint of trade which provide a counterbalance between the breadth of the *Mashonaland* principle on the one hand and the strict no conflict-no profit rules on the other. The courts have begun the task of setting the relevant boundaries.

(i) Preparatory Steps on the Road to Competing

It has been judicially established that the fiduciary duties of a current director do not prevent him forming the intention to set up a competing enterprise after the termination of his directorship.[256] In *Balston Ltd v Headline Filters Ltd*[257] Falconer J held that, having regard to the public policy rules on restraint of trade, it was not in itself a breach of duty for a director to commence competing with his former company after resignation even where the intention to so compete was formed prior to resignation. This was envisaged to be limited to situations where the director was not taking advantage of a maturing business opportunity of the company.

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[254] See RR Pennington note 137 above at 52.

[255] Section 45 of the *Companies (Amendment) (No. 2) Act 1999* permits the holding of up to 25 simultaneous directorships.

[256] *Balston Ltd v Headline Filters Ltd* [1990] FSR 749; *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749.

[257] [1990] FSR 385.

Further refinements have followed. In particular, there has been a good deal of judicial discussion as to just what preparatory steps beyond taking the decision to set up a competing enterprise may be undertaken by a director while still in that role. *Coleman Taymar Ltd v Oakes*[258] indicated that preliminary steps could be taken to investigate or further that intention provided that no competitive activity was undertaken until after the termination of the directorship. Since then a number of cases have grappled with the issue of which preliminary steps are permissible. In *Shepherds Investments Ltd v Walters,*[259] Etherton J's view was that making the decision to set up a competing business and discussing it with friends and family would not in itself conflict with the best interests of the company.[260] While it is clear that the law in this area facilitates a certain amount of scoping-out activity, the precise point at which preparations for the establishment of a competing business by a director become unlawful will turn on the actual facts of any particular case.[261]

The act of investigating the possibility of setting up a business in competition has been treated as not being in breach of fiduciary duty so long as no tangible steps such as competitive tendering or actual trading took place.[262] Therefore preliminary consultations with professional advisers such as accountants and solicitors,[263] and viewing potential premises[264] are generally acceptable whereas attempting to trade or enter into any form of competitive commercial activity including competing with the company for staff is not.[265] Unsurprisingly, active solicitation of customers and carrying on a competing business have been viewed as being at the other end of the spectrum to preliminary steps, therefore constituting a breach of

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[258] [2001] 2 BCLC 749.

[259] [2007] 2 BCLC 202.

[260] A less lenient view was advanced by Hart J in the earlier *British Midland Tool Ltd v Midland International Tooling Ltd* [2003] 2 BCLC 523 where he intimated that a director must resign once he has irrevocably formed the intention to engage in the future in a competing business. However, it would seem that the more generally accepted position is that represented in *Shepherds Investments Ltd v Walters* [2007] 2 BCLC 202.

[261] *Shepherd Investments Ltd v Walters* [2007] 2 BCLC 202, [108].

[262] *Balston Ltd v Headline Filters Ltd* [1990] FSR 385.

[263] *Shepherd Investments Ltd v Walters* [2007] 2 BCLC 202.

[264] *Balston Ltd v Headline Filters Ltd* [1990] FSR 385.

[265] *Ibid*; *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749; *British Midland Tool Ltd v Midland International Tooling Ltd* [2003] 2 BCLC 523.

duty.[266] Between these two ends of the spectrum, the judicial assessment would be fact sensitive.[267]

(ii) Skill and Expertise

Despite diverging views which have emerged in relation to directorial entrepreneurship, the courts have for some time been *ad idem* on the fundamental principles concerning the use of skill and expertise. This reflects the principle that in general a fiduciary duty does not continue after the determination of the underlying relationship which gave rise to the duty.[268] Therefore the courts have readily recognised that the law should not prevent directors using their skills and experience in other businesses following the resignation of their directorship.

In *Island Export Finance Ltd v Umunna* Hutchison J characterised knowledge of a potential market which could be exploited in the Postal Department in the Cameroons as part of the defendant director's own skill and knowledge, "something which the law allowed him to use for his own benefit and in competition with the plaintiff after cessation of his appointment."[269] Hutchison J based this conclusion on an adaptation of the doctrine of restraint of trade applicable to employees:

> "Directors, no less than employees, acquire a general fund of knowledge and expertise in the course of their work, and it is plainly in the public interest that they should be free to exploit it in a new position .... while they may have come by it solely because of their position as directors of the plaintiff company, in truth [it] forms part of their general fund of knowledge and their stock-in-trade."[270]

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[266] *Shepherd Investments Ltd v Walters* [2007] 2 BCLC 202.

[267] *Ibid* at [108] *per* Etherton J.

[268] See further *Attorney General v Blake (Jonathan Cape Ltd)* [1998] 1 All ER 833, 841; *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704, [95].

[269] [1986] BCLC 460, 483.

[270] *Ibid* at 482.

At the other end of the spectrum are cases such as *CMS Dolphin Ltd v Simonet*[271] where the information which the defendant director had about the terms of the contracts with clients and their business plans was treated as going far beyond his fund of know-how and it was held that he misused information relating to matters such as contract periods and fees negotiated to effectively step into the company's shoes on diverting the contracts and the business to himself. The case establishes that while the mere use after the termination of a fiduciary relationship of information acquired during the course is not a breach of fiduciary duty, it may be where the use flows from prior breaches of fiduciary duty.

(iii) Use of Information

If, while in office, a director uses the company's assets for the benefit of a competing business, the director will breach the no conflict and the no conflict rules.[272] This also extends to confidential information. In *Bell v Lever Bros Ltd*[273] Lord Blanesburgh emphasised that a director must not use company property or confidential information which has come to him in his capacity as a director.

Austin notes that the law of confidence is not strictly based on fiduciary principles but as applied to directors it has a fiduciary context.[274] Where a breach of confidence is alleged this can give rise to a number of different layers of legal principle. A breach of confidence may be a fiduciary breach of duty, a breach of an equitable duty of confidence, a breach of contractual duty and, in some instances, a breach of statutory duty.[275] These overlapping layers are relevant because the post-termination survival of an equitable confidentiality obligation while the relevant information remains confidential contrasts with the largely accepted extinguishment of the no-conflict obligation (but not the no-profit obligation) on termination

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[271] [2001] 2 BCLC 704.

[272] See *Bell v Lever Bros Ltd* [1932] AC 161; *Saltman Engineering Co Ltd v Campbell Engineering Co Ltd* (1948) 55 PRC 203; *Horcal Ltd v Gatland* [1984] BCLC 549; *Irish Microforms Ltd v Browne* (1987) [1963-1999] Ir Co Law Rep 336.

[273] [1932] AC 161, 194.

[274] RP Austin note 74 above at 142.

[275] See the decision of the New York Court of Appeals in *Diamond v Oreamuno* (1969) 248 NE 2d 910 cited with approval by the Privy Council in *Walsh v Deloitte & Touche* [2001] UKPC 58 and by the High Court in *Fyffes plc v DCC plc* [2005] IEHC 477.

of a directorship. In *Attorney General v Blake (Jonathan Cape Ltd)* Lord Woolf MR explained the basis for this in the parallel context of the employee's duty of loyalty:

> "A [fiduciary relationship of confidentiality] ... arises whenever information is imparted by one person to another in confidence. It is often, perhaps usually, imparted in the course of another fiduciary relationship, such as that of employer and employee. If so, the duty will survive the termination of that other relationship, for it is not derived from it...."[276]

The clear policy of the courts is that the doctrine of restraint of trade will not come to the avail of a director who has misused confidential company information. Thus in *Dranez Anstalt v Hayek*[277] the Court of Appeal confirmed that while a former director is entitled to make use of knowledge and expertise gained through his directorship, he is not entitled to utilise the trade secrets of his former employer as distinct from knowledge and expertise gained through his directorship.[278] It would appear that a similar position pertains in this jurisdiction. In *Spring Grove Services (Ireland) Ltd v O'Callaghan*[279] the plaintiff company sued a director of the company who had resigned from the company and set up a competing company. It was contended that, by using customer lists, price lists, business practices, business plans, tendering processes, product sourcing procedures and production methods, the defendant had wrongfully used confidential information and trade secrets of the company. Although the decision related solely to a preliminary issue, Herbert J clearly stated that a director's fiduciary duties included a duty not to use confidential information obtained as a director otherwise than for the benefit of the company.[280]

Apart from the general law on confidential information under which parties who the law regards as under a duty to keep confidential qualifying information to which they are privy, a wider category of corporate information is increasingly likely to be treated as property of the

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[276] [1998] 1 All ER 833, 842. See also *Bolkiah (Prince Jefri) v KPMG (a firm)* [1999] 2 AC 22 (survival of solicitor's obligation of confidence after the termination of the solicitor-client relationship).

[277] [2003] 2 BCLC 241.

[278] See also *Shepherd Investments Ltd v Walters* [2007] 2 BCLC 202.

[279] [2000] IEHC 62.

[280] *Ibid* at [26]. See also *Fyffes plc v DCC plc* [2005] IEHC 477.

company and treated in the same way as other company assets.[281] There is a noticeable trend where the courts have been keen to protect information in circumstances in which, although the information is perhaps not strictly subject to an obligation of confidence, commercial probity concerns arise such that equitable considerations are brought to bear. This basis for this can be seen as deriving from the decision of the House of Lords in *Boardman v Phipps*[282] where information held by the solicitors representing a trust in relation certain activities of a company in which the trust held shares was treated as the property of the trust.[283] Judicial willingness to categorise information obtained in fiduciary capacity as trust property is evident in both Lord Hodson and Lord Guest's majority judgments.

Nevertheless, there are instances where the courts have not permitted an overly-broad interpretation of "confidential information" to operate as restraint of trade by the back door. In *Island Export v Umunna*[284] it was contended that the defendant was in possession of confidential information and, since that means any commercially valuable information, he must account for the profits he has made exploiting it. The knowledge which it was contended was capable of constituting confidential information was knowledge of a requirement for up to 30,000 postal caller boxes and the information that there was a manufacturing source in the United Kingdom. However, in the absence of a contractual restriction there was no protection for this information which did not emanate from the company and did not qualify as confidential information.[285] The courts have also required more than circumstantial evidence to ground a claim of misuse of confidential information in a competing business endeavour.[286]

While we can say with certainty that the use of information in breach of an obligation of confidence will not be acceptable in the context of upholding a right to contemplate competitive activity, the judicial view of the outer reaches of this are less clear. Given the alternative broad-brush approach to the concept of corporate property which permeates

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[281] See RR Pennington n 137 above at 53; RR Pennnington n 240 above at 716.

[282] [1967] 2 AC 46.

[283] See also *Exchange Telegraph Co Ltd v Gregory and Co* [1896] 1 QB 147 and *Exchange Telegraph Co Ltd v Central News Ltd* [1897] 2 Ch 48.

[284] [1986] BCLC 460.

[285] See further *Faccenda Chicken Ltd v Fowler* [1986] 1 All ER 617.

[286] *Shepherd Investments Ltd v Walters* [2007] 2 BCLC 202.

judgments in relation to directorial entrepreneurial initiatives, the consequence is that the boundaries between Roskill J's wide view in *Island Exports* of what constitutes a director's general fund of knowledge and that which can be loosely categorised as 'corporate property' remain somewhat unclear as the law is still developing in this area.[287]

(d) Multiple Directorships

The breadth of the competition issue for current directors has yet to be resolved. It has been noted that any reformulation of the rules on directors competing ought to accommodate the reality of non-executive directorships being taken by persons who hold an executive directorship with another company.[288] A company is entitled to the unbiased and independent judgment of each of its directors.[289] Conflicting fiduciary duties may arise where the director is a director of more than one company.[290] This was seen in *Re Cooke's Events Co Ltd (in liq)*[291] where, in the context of imposing a declaration of restriction, MacMenamin J looked askance at a director of a company in a difficult financial position who had not called in a debt from another company of which he was a director and who had, wearing his other hat, disputed the amount of the debt owed with the liquidator.

In this jurisdiction the legislature has set a limit on the number of directorships which may be held simultaneously. Section 45 of the *Companies (Amendment) (No.2) Act 1999* contains a general prohibition[292] on a person holding more than 25 directorships (including shadow directorships).[293] Implicit in this measure is an unconscious legislative approval of the practice of holding an array of directorships up the prescribed maximum. However, it would seem that as a policy decision, section 45 is designed to improve care, skill and diligence; a

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[287] See the comments of Peter Smith J in *Crown Dilmun v Sutton* [2004] 1 BCLC 468, [187].

[288] PL Davies n 109 above at 415. See also *Stafford v Beggs* [2006] IEHC 88 where in ruling on a restriction application O'Leary J declined to entertain a complaint relating to a non-executive director's dual role as a director of another company.

[289] *Imperial Mercantile Credit Association v Coleman* (1871) LR 6 Ch App 558.

[290] *Ford v Andrews* (1916) 21 CLR 317, 322 *per* Griffith CJ.

[291] [2006] 1 ILRM 191.

[292] There are certain exceptions in the case of directorships in holding companies, public companies and banks.

[293] The rather misguided application of the provision to shadow directorships is omitted in the proposed reforms: Head 13 of Part A4 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

crude quantitative measure of this nature is of little assistance in relation to the no conflict rule or the duty to act in the best interests of the company. It certainly does not address the qualitative difference between competing and non-competing directorships and executive and non-executive directorships.

In seeking to address the issue the following passage in the joint judgment of Brennan, Deane, Toohey and Gaudron JJ in the Australian High Court in *R v Byrnes* is relevant:

> "Each of Byrnes and Hopwood was in a position of conflicting fiduciary duties: they were directors of both Magnacrete and Jeffcott. The interests of those companies did not necessarily coincide.... Being a fiduciary, the director of the first company must not exercise his or her powers for the benefit or gain of the second company without clearly disclosing the second company's interests to the first company and obtaining the first company's consent."[294]

This supports the position that, provided a director has the appropriate authority sanctioning his involvement in both companies, the issue is then governed by the duty to act in good faith and fairly and in the interests of each company without intending to prefer the interests of one company over the other.[295] How this precept is to translate into commercial practice is, however, far from clear.

It is fair to say that the issue of competing directorships remains a live, if slumbering, one. The fact that the issue has not received detailed judicial consideration suggests that many companies are more than happy to assume any risks associated with subsuming the industry experience of non-executive directors who hold competing directorships. Wondering at the lack of authorities applying the no conflict-no profit rules to these individuals, Boros plausibly states:

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[294] (1995) 130 ALR 529, 540.

[295] *Bristol and West Building Society v Mothew* [1998] Ch 1, 18 *per* Millet LJ; *Ultraframe(UK) Ltd v Fielding* [2005] EWHC 1638 (Ch).

"One probable explanation is a tacit acknowledgement of the commercial reality that there is a large number of directors in these positions. Further, in the case of nominee directors, it may be a recognition that it may be for the benefit of a company to have the advantage of the views and in many cases the assistance and expertise of the principal. In the case of multiple directors, the explanation may be a reluctance to apply a prophylactic rule where not all directors take an active part in the running of the business and that in those circumstances there may be no real potential for conflict."[296]

In any event, broad judicial statements to the effect that, rather than adopting a one-size fits all approach, any assessment of the no conflict-no profit rules must take place within the context of the particular circumstances of the case[297] augur well for a sophisticated judicial treatment of the issue should the need arise.

(3) An Emerging Duty to Disclose?

In *Quarter Master UK Ltd (in liq) v Pyke*[298] Paul Morgan QC opined that one might think it a simple proposition that a director would be under a duty to alert his fellow board members to a nascent commercial threat to the future prospects of the company, and that the duty would be all the greater (and certainly no less) when he himself was planning to be part of that threat. However, this issue is one which has not lent itself to easy resolution; again the doctrine of restraint of trade operates in tension with both the no conflict-no profit rules and the duty to act in the best interests of the company.

In *Bell v Lever Bros Ltd,*[299] a decision of the House of Lords dealing primarily with the law of mistake, it was held that an employee (who was also a director) was under no duty to disclose his own misconduct. This led to an assumption that the same position applied to directors as

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[296] See E Boros "The Duties of Nominee and Multiple Directors: Part II" (1990) 11 Co Law 6 at 9.

[297] See *eg Kelly v Cooper* [1993] AC 205; *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145; *Wilkinson v West Coast Capital* [2005] EWHC 3009 (Ch), [245] *per* Warren J.

[298] [2005] 1 BCLC 245

[299] [1932] AC 161.

to employees. Subsequent judicial refinements to the breadth of the *Bell v Lever Bros* proposition established that the position was less absolute and more fact sensitive.

It is now clear that a duty to disclose will be upheld where express contractual provision is made for it in a director's service contract.[300] However, a series of authorities have developed a fluid equitable disclosure duty applicable to directors.[301] In *Balston Ltd v Headline Filters Ltd*[302] it was established that there was no duty on a director to disclose his own competitive activity unless he had used his position to further that activity. Falconer J held that an intention by a director to set up business in competition with the company after his directorship had ceased was not to be regarded as an interest which conflicts with his duty to the company. Furthermore, the taking of preliminary steps during the directorship to investigate or forward that intention while a director was also not regarded as problematic provided that there no actual competing activity has taken place. It was also made clear that a director who is taking these types of preliminary steps with a view to resignation and subsequent competitive activity is under no duty to disclose those facts to the company.

The issue was comprehensively revisited in *Item Software (UK) Ltd v Fassihi*,[303] a case which concerned an employee director who, while negotiating a contract on behalf the company, successfully negotiated its diversion to a company established by him for the purpose. The company contended that in not disclosing that he had entered into business on his own account he was in breach of his duty as an employee and his duties as a director to act in good faith and in the company's best interests. The Court of Appeal confined the application of *Bell v Lever Bros* to employees and did not regard it as extending to directors acting as fiduciaries whose duties were consequently higher than those of mere employees. Significantly, Arden LJ recognised an affirmative duty on a director to disclose his own misconduct.[304] The relevant directorial disclosure duty established in *Item Software* was founded on what Arden LJ referred to as "the fundamental duty" on directors to act *bona fide* and in the best interests

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[300] *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91.

[301] See further L Ho and P Lee "A Director's Duty to Confess: A Matter of Good Faith? (2007) 66 CLJ 348.

[302] [1990] FSR 385.

[303] [2003] 2 BCLC 1 (HC), [2005] 2 BCLC 91 (CA).

[304] Arden LJ drew support from a number of first instance decisions including *Tesco Stores Ltd v Pook* [2004] IRLR 618 and *Crown Dilmun v Sutton* [2004] 1 BCLC 468.

of the company.[305] In essence, the duty of a director to disclose his own misconduct was not treated as a separate duty (as it had been by Nicholas Strauss QC at first instance) but conceived of as part of the overall duty of loyalty to act in the best interests of the company.[306]

She regarded the disclosure duty as bolstering the remedies available for secret profits and the diversion of corporate opportunities.[307] Arden LJ also relied on public policy considerations of economic efficiency to support this principle since compliance with a duty of disclosure would save a company from using its resources to investigate the possibility of impropriety. However, this economic efficiency argument seems misplaced given that on a cost-benefit analysis, many a director would be likely to take a risk on being found out rather than disclose.

Recent pronouncements in the Court of Appeal have muddied the waters by apparently extending the breadth of the disclosure beyond the subject-matter of misconduct. Parker LJ's view in *Bhullar v Bhullar*[308] was that a more extensive duty of disclosure could arise in certain cases. In particular, a duty to communicate information to the company would be triggered where a director was aware of the existence of an opportunity which it was "relevant for the company to know".[309] This was applied to the directors' discovery of the availability of a property adjacent to the company's premises. Notably, the duty was not expressed to be limited to situations where the company could or would have taken advantage of the opportunity. On foot of *Bhullar v Bhullar*, commentators have queried the legal foundation for an all-embracing duty to disclose business opportunities to the company.[310] The legal basis for Parker LJ's pronouncements is unclear as they were not supported by authority. The duty could be taken to rest on an expansive interpretation of the duty to act in the best interests of the company since a positive duty of disclosure would go against the grain of the essentially

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[305] [2005] 2 BCLC 91, [41].

[306] Interestingly the reasoning in *Item Software* was regarded as wholly inadequate by Hollingworth J of the Supreme Court of Victoria in *P & V Industries Pty Ltd Anthony Porto* [2006] VSC 131. See also the forcefully argued criticisms in L Ho and P Lee n 301 above.

[307] [2005] 2 BCLC 91, [63].

[308] [2003] BCC 711.

[309] *Ibid* at [41].

[310] HC Hirt n 7 above at 677-678.

negative duty to avoid conflicts of interests[311] and would appear to expand beyond the scope of information which would engage the no conflict rule.

Whatever their legal provenance, of particular concern in relation to the rather off-hand remarks made by Parker LJ in delivering the judgment of the Court is that the breadth of any duty thereby articulated is uncertain. "Relevant for the company to know" is capable of a very broad interpretation. *Bhullar* hints at a broader duty to disclose which applies even in circumstances where the director has no intention of taking any steps to exploit a relevant business opportunity which has come to his attention but which may be attractive to the company. This would go well beyond Hart J's dicta in *British Midland Tool Ltd v Midland International Tooling Ltd* to the effect that a director's duty is to act in the best interests of the company in relation to "any activity, actual or threatened, which damages those interests"[312] as a duty may arise irrespective of whether that activity would in itself constitute a breach of a duty owed to the company.

The latest in this line of cases shows a judicial willingness to place boundaries on the disclosure imperative. In *Shepherds Investments Ltd v Walters*[313] Etherton J applied *British Midland Tool.* Rather than recognising a stand-alone duty of disclosure, Etherton J regarded the obligation to disclose misconduct and matters of concern and relevance to the company as an application of a director's duty to act in good faith and in the best interests of the company:

> "There is no separate and independent duty of disclosure. In the context of the director's own acts to promote a competing business, the breach of fiduciary duty is to carry out the impermissible acts of promotion without first disclosing the intention to do them and obtaining permission to do so. There is a breach because the director's conflict between his personal interest and his duty to the company has not been authorised after full disclosure to, and informed consent by, the company. In the case of the acts of his fellow directors in promoting a rival business, the breach of fiduciary duty of the director is failing to disclose matters which are of relevance and concern to

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[311] *Ibid* at 678-679.

[312] [2003] 2 BCLC 523, [89].

[313] [2007] 2 BCLC 202.

the company and which, if acting in good faith in the best interests of the company, the director would disclose. Those are straightforward applications of ordinary principles of equity concerning fiduciary duties."[314]

This synthesis appears to be a firm rejection both of an independent disclosure obligation or set of such obligations in favour of a less-open-ended disclosure requirement firmly tied into the context of competitive activity in breach of fiduciary duty. In addition, the requirement to disclose matters of concern and relevance to the company arising from the activities of other directors is tied to the duty to act in the best interests of the company while the duty to disclose personal competitive activity is framed in terms of the underlying engagement of the no conflict rule. This is clearly a narrower formulation than the free-flying one advanced by Parker LJ in *Bhullar* which was not specifically nailed to a breach of fiduciary duty and could be read either as a broad duty to tell the company of any which might be commercially advantageous, or more narrowly as a duty to disclose directorial misconduct.

In *Shepherds Investments* the Court did not accept that the investment products offered by the company and the competing company were so different as to not fairly be regarded as competing on the same market. This in itself shows that if a duty to disclose competing directorial activity is accepted then the focus will naturally shift to exactly when activity is to be considered competing. This has two aspects: the permissible preparatory steps which may be taken pre-resignation, and, as here, defining the relevant market for the rival competitive activity and whether it can fairly be regarded as the same market as that of the company. This is the classic stuff of competition law. On the other hand, it is not yet clear that so regimented an approach is likely to be adopted if the courts, influenced by the broad corporate opportunity perspective and property emphasis evident in cases like *Bhullar v Bhullar*, are prepared to answer this question by reference to the existing company's potential to compete as well as its actual competitive activities. Both the trend of recent decisions and the proposed abolition of the *ultra vires* rule lend weight to the latter approach. However, its all-embracing nature would be objectionable both in terms of the certainty which is so crucial in business life and in terms of the potential friction which an overly-expansive approach necessarily sparks when juxtaposed against the restraint of trade doctrine.

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[314] *Ibid* at [132].

A further issue which requires sympathetic resolution concerns the difficulties for holders of competing directorships – *Bhullar*'s requirement to disclose information and concern to the company raises the possibility of simultaneous breaches arising from failure to communicate relevant information. In addition, it has been postulated that to subordinate the interests of either could potentially ground a claim of oppression.[315]

No more than a toe has been dipped into these issues in Ireland. In *Stafford v Higgins* Finlay Geoghegan J regarded the obligation to disclose any potential conflict of interest as "a principle of good governance and sound commercial probity."[316] However, these comments were made from the mindset of compliance with section 194 of the *Companies Act 1963* and no attempt was made to address their relevance in the context of underlying fiduciary obligation.

D. CONSENSUAL RELAXATION OF THE NO CONFLICT-NO PROFIT RULES

It is easy to lose sight of the fact that the no conflict-no profit rules are not rules in the sense of absolute prohibitions but rather general principles which admit the possibility of consensual derogation on the part of the interested parties. Judicial zeal in making sweeping statements concerning the fiduciary role of directors often results in the no conflict rule and the no profit rule being stated in terms which are misleadingly absolute.[317] The true position, as was emphasised by the Court of Appeal in *Gwembe Valley Development Co Ltd v Koshy (No. 3)*,[318] is that the no profit rule does not apply to all profits; it applies to unauthorised profits. The same applies to conflicts of interest. The strict nature of the rules is counteracted by the underlying corporate freedom to provide some insulation for directors.[319]

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[315] See E Boros n 296 above.

[316] [2004] IEHC 82 at p 11 of the unreported judgment.

[317] Furthermore, the possibility of consensual derogation is not always given the prominence it deserves in academic discourse concerning the duties of directors.

[318] [2004] 1 BCLC 131.

[319] *Costa Rica Rail Co Ltd v Forwood* [1901] 1 Ch 746 (directors' duties are governed by the general law as modified by the articles).

There are two means of authorising what would otherwise constitute unauthorised conflicts and profits in breach of duty. The first method is contractual exclusion;[320] the second, approval obtained on an individual basis after full and frank disclosure by the director of the relevant circumstances[321] in the appropriate manner.[322] As MacCann explains:

> "... the principal may if he so wishes, release the agent in advance from what would otherwise be his strict fiduciary duties provided full disclosure has been made by the agent of all material facts. Alternatively, the principal could if he so wished upon full disclosure ratify the agent's act or omission, thus waiving retrospectively the agent's past breaches of duty."[323]

That the making of exceptions is countenanced is explicable on the grounds that the no conflict-no profit rules were created for the benefit of the company as principal. It has been contended that the provision of a consent-based exception is soundly based given that in many cases concerning internal conflicts, failing to enter into the contemplated transaction would in fact run counter to the company's best interests.[324] Bratton suggests that the function of making provision for informed consent is to place the company choosing to waive equitable protection in a position which can be regarded as approximating that of an arm's length

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[320] This possibility was judicially recognised in *Kelly v Cooper* [1993] AC 205; *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145. Cases relating to relaxations contained in the articles of association include *Movitex Ltd v Bulfield* [1988] BCLC 104; *Wilkinson v West Coast Capital* [2005] EWHC 309 (Ch). Contractual exclusions also commonly appear in directors' service contracts and shareholders' agreements.

[321] On the meaning of full and frank disclosure see *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 178; *NZ Netherlands Society Oranje Inc v Kuys* [1973] 3 All ER 1222, 1227 *per* Lord Wilberforce; *JJ Harrison Properties Ltd v Harrison* [2001] 1 BCLC 158, [2002] 1 BCLC 162; *Gwembe Valley Development Co Ltd v Koshy (No. 3)* [2004] 1 BCLC 131; *Crown Dilmun v Sutton* [2004] 1 BCLC 465

[322] In the absence of statutory guidance, there has been some controversy as to whether the appropriate forum for consent is the board of directors or the company in general meeting. The Privy Council decision in *Queensland Mines v Hudson* [1978] 52 AJLR 379 lent support to the board being an appropriate organ, and this has been seized on in practice. See further GR Sullivan "Going it Alone – Queensland Mines v Hudson" (1979) 42 MLR 711; Chapter 6 below.

[323] L MacCann "Director's Fiduciary Duties" (1991) 9 ILT (ns) 80 at 81. On the principal-agent rationale see also TB Courtney n 39 above at [10.049].

[324] PL Davies n 109 above at 392.

contracting party.[325] Viewed in this light, the no conflict-no profit rules are less stringent. This was adverted to by Lord Russell in justification of the decision in *Regal (Hastings) Ltd v Gulliver* when he said that the hapless directors could have protected themselves by obtaining an antecedent or subsequent resolution of the Regal shareholders in general meeting.[326]

As originally conceived, the disclosure in question was disclosure to and approval from the company in general meeting. While this rule initially had legislative backing in section 29 of the formative *Joint Stock Companies Act 1844*, it did not carry through in the *Joint Stock Companies Act 1856* which instead contained a model article requiring a director with an internal conflict of interest to vacate office. This was omitted from the UK's *Companies Act 1948* and made no appearance in Ireland's *Companies Act 1963.* Although the speeches of Lord Russell and Lord Wright in *Regal (Hastings) Ltd v Gulliver*[327] contemplate a director obtaining the consent of the shareholders in the company to his exploiting a contract for his own benefit, there is evidence that the strict formalities of seeking the approval of the company in general meeting are no longer insisted upon. The result is an unfortunate level of confusion as to whether the commercially accepted practice of simply requiring board authorisation can be regarded as legally sound.

The proposition that if the board of directors as a whole wish to take advantage of an opportunity, it must be authorised by the company in general meeting is uncontroversial.[328] If, rather than the whole cohort of directors, it is simply one or more of their number seeking authorisation, the issue as to whether the board of directors can perform this function remains controversial, though commercially embraced.[329] Although now an accepted practice enshrined in companies' articles of association, the practice of seeking board approval can be seen as running counter to the agency rationale behind relaxation. One may postulate that if

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[325] WW Bratton "Game Theory and the Restoration of Honor to Corporate Law's Duty of Loyalty" in LE Mitchell (ed) *Progressive Corporate Law: New Perspectives on Law, Culture and Society* 1995 Westview Press, Inc Boulder 139 at 143.

[326] [1942] 1 All ER 378, 389.

[327] [1942] 1 All ER 378.

[328] PL Davies n 109 above at 421.

[329] It is said that directors are "unwilling to suffer the delay, embarrassment and possible frustration entailed by having to submit all such contracts to the company in general meeting": *ibid* at 395.

consent–based exceptions are seen as the prerogative of the principal under an agency-principal analysis, in the absence of a human incarnation of the legal person that is the company, the company's most close human incarnation is represented by the company in general meeting and not the board of directors who in this context fulfil the agent function (albeit a special form of agency with wide discretionary powers to manage the company in its best interests). It may therefore be maintained that is a constitutional *non sequitur* for the board of directors to be the provider of the authority for one of its members which not even the interjection of an independence requirement could cure.

In Ireland, there has not been a decisive judicial statement on the issue. MacCann is an advocate of the traditional position and has opined that disclosure to the board alone is not sufficient "since fellow fiduciaries cannot release each other from their duties to their collective principal. In the case of a company the waiver can only come from the general meeting which appointed them in the first place."[330] That being said, this is an issue on which principle appears to have yielded to pragmatism. The Privy Council decision in *Queensland Mines Ltd v Hudson*[331] lent support to a functional role for the board in relation to disclosure-based consent by upholding the effectiveness of a decision of the board of directors to renounce the company's interest in an opportunity in favour of one of their number.[332] The decision has understandably been criticised for not holding, at a minimum, that the board meeting should comprise independent directors and exclude any director with a direct or indirect interest in the transaction.[333] More fundamentally, its erosion of the role of the general meeting is considered at odds with existing authorities.[334]

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[330] L MacCann n 323 above at 82.

[331] [1978] 52 AJLR 379.

[332] See also *R v Byrnes* (1995) 183 CLR 517 which recognised the effectiveness of making provision in a company's articles of association for disclosure to the board alone.

[333] For the stricter view see *Cook v Deeks* [1916] 1 AC 554; GR Sullivan "Going it Alone – *Queensland Mines v Hudson*" (1979) 42 MLR 711.

[334] *Benson v Heathorn* (1842) 1 Y & CCC 326, 341-342; *Imperial Credit Association v Coleman* (1871) 6th App 556, 567; *Furs Ltd v Tomkies* (1936) 54 CLR 583, 599; *Canada Safeway v Thompson* (1951) 30 DLR 295, 318; *Regal Hastings Ltd v Gulliver* [1942] 1 All ER 378, 389.

The now common practice of including an exempting provision in the articles relieving directors from the requirement to seek shareholder approval gives rise to the potential for self-interested decision-making by directors. On the strength of *Hopkins v Shannon Transport Systems Ltd*[335] it would seem that in Ireland, where there is a contractual relaxation requiring disclosure to the board of directors, disclosure must be made to an independent board of directors *ie* none of the directors must have an interest in the relevant contract, transaction or arrangement. Regulation 7 of Part II of Table A to the *Companies Act 1963* provides that "a director may vote in respect of any contract, appointment or arrangement in which he is interested, and he shall be counted in the quorum present at the meeting." *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd*[336] suggests that if a director votes in a manner which breaches his fiduciary duty, he will not be counted for the purposes of establishing a quorum. While a resolution of the company in general meeting may not be required, it is clear that a court would require clear evidence that, in making a decision to reject a business opportunity available to a company, the board was in full possession of the relevant facts and that such decision was made in good faith, in the interests of the company, and not merely to accommodate a director who intended to pursue the opportunity in a personal capacity.[337]

There is a school of thought which suggests a more sophisticated approval process than that derived from the simple organic one of board of directors or company in general meeting. Austin suggests that rather the issue should be approached from the perspective of the context of the disclosure.[338] On this analysis, a decision to consider a director's proposed personal entrepreneurial initiative should be handled differently than one to authorise or ratify what would otherwise constitute a breach of duty. The former is a matter of business judgment best suited to the directors, while the latter requires a waiver of rights which suggests that a general meeting is the appropriate forum.

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[335] (1972) [1963-1999] Ir Co Law Rep 238.

[336] [2003] 2 BCLC 153.

[337] RR Pennington n 137 above at 50. The *Peso Silver Mines* rationale is also seen in *Framlington Group plc v Anderson* [1995] 1 BCLC 475 where it was held that a company which had expressed itself not to be interested in directors' negotiations to join a competitor, could not subsequently allege that there had been a breach of fiduciary duty in relation to the outcome of those negotiations.

[338] RP Austin n 74 above at 183.

Beneath the permitted relaxation of equitable principles is the judicial understanding that fiduciary duty is not entirely rigid or unbending in nature but rather is responsive to the circumstances in which it is sought to apply it. This limited flexibility is evident in Mason J's observation in *Hospital Products Ltd v United States Surgical Corporation* that the scope of the fiduciary duty must be moulded to the nature of the relationship in question and that "[t]he rigorous standards appropriate to a trustee should not be applied to a fiduciary who is permitted by contract to pursue his own interests in some respects."[339]

The effect of *ex ante* or *ex post facto* consent is to prospectively or retrospectively remove the no conflict-no profit hurdle provided the relevant procedures are followed.[340] However, to this should be added the caveat that the better view would be that any consensual derogation will not operate in a manner which rules out the application of other restrictions on the company or its directors which may independently apply. Thus a breach of duty entailing a breach of the *ultra vires* rule cannot be the subject of a prospective or retrospective release.[341] This makes eminent sense. It has also been wisely suggested that it does not follow from a contractual exclusion that directors are not obliged to act in the company's best interest in making a decision on whether to engage in conduct which gives rise to a conflict of interest.[342] This respects the autonomous nature of the duties and avoids creating a hierarchy where the application or non-application of one duty will trump that of another.

Statutory intervention has served to curb the extent of such relaxation by ensuring that a base line level of disclosure cannot be contracted out of. The mandatory statutory disclosure of directorial interests pursuant to section 194 of the *Companies Act 1963* requires disclosure of conflicts of interest to the board. Section 194 of the *Companies Act 1963* (as amended by section 47(3) of the *Companies Act 1990*) requires any director (including a shadow director)

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[339] (1984) 156 CLR 41, 102 citing *Phipps v Boardman* [1967] 2 AC 46, 123-125 *per* Lord Upjohn; *New Zealand Netherlands Society 'Oranje' Inc v Kuys* [1973] 2 All ER 1222, 1225 *per* Lord Wilberforce; *Canadian Aero Service Ltd v O'Malley* (1973) 40 DLR (3d) 371, 383, 390 *per* Laskin J.

[340] See further R Flannigan "The Boundaries of Fiduciary Accountability (2004) NZ Law Review 215.

[341] *Re Burke Clancy & Co Ltd* (1974) [1963-1999] Ir Co Law Rep 24; TB Courtney n 39 above at [10.049].

[342] See RR Pennington n 240 above at 728.

who is directly or indirectly interested in a proposed contract, transaction or arrangement[343] with the company to declare the nature of his interest at a directors' meeting. Such declarations are entered in a register of directors' interests which can be inspected by a director, secretary, member or the company auditor. The effect of section 194 is to provide for a minimum disclosure requirement which cannot be waived irrespective of any relaxation of the underlying rules. However, as Davies remarks of the equivalent UK provision, section 317 of the *Companies Act 1985*, "[d]espite the section's importance in qualifying the company's freedom to contract out of the 'no conflict' rule in the articles, the legal relationship between the articles and the section is far from clear."[344]

The axis for the inter-relationship is the provision in section 194(7) of the *Companies Act 1963* which states that "[n]othing in this section shall be taken to prejudice the operation of any rule of law restricting the directors of a company from having any interest in contracts with the company." It would therefore appear that the operation of section 194 has no effect on the operation of the no conflict-no profit rules.[345] This in itself does not provide any answers in respect of the vexed issue of the contractual relaxation of those rules. However, it would seem that compliance with section 194 is likely to be regarded by the courts as a pre-condition to obtaining the benefits of a contractual relaxation of no conflict-no profit rules.[346] *Guinness plc v Saunders*[347] suggested that similar statutory disclosure rules cannot be contracted out of in the company's articles of association and the case implicitly approved the practice of providing for board-centred disclosure and approval. In the Court of Appeal, Fox LJ expressed the view that under the fiduciary no profit rule the consent of the members in general meeting would be required to the retention of the profit. He went on to say:

> "That is inconvenient in relation to the day-to day running of a business. It has, therefore, become the practice to relax the general rule by special provisions in the

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[343] The section also covers loans, quasi-loans and credit transactions made by the company to a director or a person connected with them.

[344] PL Davies n 109 above at 397.

[345] For an example of judicial failure to explore the equitable rules in parallel to section 194 of the *Companies Act 1963* see *Stafford v Higgins* [2004] IEHC 180.

[346] L MacCann n 323 above at 82.

[347] [1988] BCLC 607 (CA), [1990] 2 AC 663 (HL).

articles. The purpose of [the statutory disclosure provisions] is not to destroy the power to relax the general rule by the articles, but to impose a binding safeguard on that power."[348]

How much of a safeguard section 194 actually provides is open to debate. The section's wording suggests that it is the fact of the interest rather than the nature of the interest which is to be disclosed. There is persuasive authority to suggest that for the purposes of compliance with section 194's disclosure requirement, it may be irrelevant whether the contract is approved by the board or not.[349] Furthermore, the only sanction provided for failing to comply with the requirements of section 194 is a fine not exceeding IR£500.[350]

E. CONCLUSIONS

The allied duties of directors to avoid conflicts of interest and not to make secret profits have at their heart well-trodden equitable principles. Although the underlying principles are simple in nature, the case law spawned is rather unwieldy with pockets of authority existing on various aspects which do not readily coalesce into a decisive whole. Given that the foregoing exposition reveals a somewhat tortured judicial treatment of the relatively simple principles underlying the no conflict-no profit rules, it seems rather apt to quote the words of Lord Mansfield in *Vallejo v Wheeler*:

> "in all mercantile transactions the great object should be certainty; and therefore it is of more consequence that a rule be certain, than whether the rule be established one way or the other."[351]

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[348] [1988] BCLC 607, 612.

[349] *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald* [1996] Ch 274.

[350] This provision will be even more of a damp squib in the future given that Head 12 of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007) sets out an amended version of this provision which omits the sanction entirely for the CLS company on the basis that it was the opinion of the Company Law Review Group "that such a declaration was a matter of contract and as such, there was no public interest in having the matter prosecuted" (explanatory note accompanying the draft provision).

[351] (1774) 1 Cowp 143, 153.

A certain amount of intellectual sloppiness is at work. Indeed, Austin advocates judges firming up on equitable principles in preference to the penchant for "broad fiduciary incantations"[352] so that their application is more predictable for directors and their advisors.

Clarity has been militated against in part by the wide range of judicial and academic perspectives concerning the usefulness of maintaining the unyielding nature of the *per se* breach analysis which derives from the formative equitable decisions on fiduciary relationships. At the centre of the debate is the issue of how well these rules as originally enunciated are adapted for modern living. Divergent views have meant that a level of uncertainty continues to prevail as to the no conflict-no profit rules; consequently while the underlying equitable principles are clear, their application to modern fact scenarios remains in a state of flux. In addition, a major challenge to philosophical and practical joined-up thinking has come in the form of the competing demands of the doctrine of restraint of trade, resolution of which has yet to be fully worked out. In the result, both the sheer complexity of analysis required and the unsettled aspects militate against hastily drawn statements of principle concerning the application of the no conflict-no profit rules in any given situation. As will be seen in the next chapter, nor can one be confident that the proposed reforms to the no conflict-no profit rules will contribute to any resolution of uncertainty.

The debate continues as to whether the no conflict-no profit rules operate too harshly. This chapter has focused on the doctrinal thinking underlying the no conflict-no profit rules rather than on the intricacies of the remedies,[353] in particular, that of an account of profits. One criticism is that discussions on reform are often muddy, failing to separate out, not only the no conflict rule and the no profit rule, but even more fundamentally, rule from remedy. As Professor Prentice remarks, liability is imposed on directors "... not to proscribe unjust enrichment (which itself is not a *test* of liability but a conclusion) but to stifle the siren call of temptation." [354] Undoubtedly there is a very close purposive nexus between the two in terms of carrying through a strict-principled *per se* rule through imposing an account of profits but this does not imply that separate analysis is not required. To fail to separate duty from remedy

[352] RP Austin n 74 above at 185.

[353] See further Chapter 6 below.

[354] DD Prentice n 157 above at 468.

is to risk overlooking that, as matters stand, the right to account of profits may be lost through the application of equitable doctrines such as laches and equitable estoppel.

If the distinction between rule and remedy is kept in mind then the deterrent function of the no conflict-no profit rules shines through; and if it is accepted that a deterrent from temptation is needed, then "Equity's uncompromising attitude has much to commend it ...."[355] Lord Buckmaster LC captured these sentiments in *Cook v Deeks* in saying:

> "It is quite right to point out the importance of avoiding the establishment of rules as to directors' duties which would impose upon them burdens so heavy and responsibilities so great that men of good position would hesitate to accept the office. But, on the other hand, men who assume the complete control of a company's business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and while ostensibly acting for the company, direct in their own favour business which should properly belong to the company they represent."[356]

There are nevertheless many who rail against the perceived injustice associated with the application of the no conflict-no profit rules to good faith actors. Professor Delany regards the absoluteness of the rule in *Keech v Sandford*[357] as "difficult to justify in a modern context so far removed from the conditions which gave rise to it..."[358] Proponents of reform would no doubt echo Lord Selborne LC's sentiments in *Barnes v Addy*, where he said that there is "no better mode of undermining the sound doctrines of equity than to make unreasonable and inequitable applications of them".[359]

An economic analysis supports the maintenance of certain rules whose deterrent function reduces the need to incur transactional costs through litigation.[360] This has been thrown most sharply into relief in relation to the corpus of corporate opportunity cases as to which Clark

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[355] *Ibid.*

[356] [1916] 1 AC 554, 563.

[357] [1558-1774] All ER Rep 230.

[358] H Delany n 238 above at 201.

[359] (1874) LR 9 Ch App 244, 251.

[360] See B Clark n 19 above at 233.

remarks that "... any precise delineation of the corporate opportunities rule has remained largely out of reach of legal commentators. One might speculate then that it is a faint hope that company directors will be able to assess their conduct with regard to such matters."[361] The difficulty is that achieving anything approaching a consensus on how best to introduce a more sophisticated analysis which incorporates a moral compass, yet is certain of application, has eluded courts and commentators alike. As will be seen, the current legislative proposals examined in Chapter 5 do not assist.

Some commentators endorse the line of thinking which permeates *Keech v Sandford*[362] and *Regal (Hastings) Ltd v Gulliver*[363] and which was reinvigorated by the Court of Appeal in *Bhullar v Bhullar*,[364] that a director should not be free to exploit an opportunity even where the company is unable to exploit it.[365] Nevertheless, the open-textured remarks in the Court of Appeal in *Murad v Al-Saraj*[366] leave open the future possibility of a more subjective approach focusing on the *bona fides* of the director.

Moving to the specific pockets of principle which lie beneath the generality of the headline no conflict-no profit principles, unresolved tensions remain in relation to the issue of current and former directors engaging in other commercial activities. A number of disparate judicial approaches are in evidence which have yet to be drawn together into a coherent whole. The accommodation of competing policies has yet to be bedded down. Thus when the broad generality of the *Mashonaland*[367] principle in support of freedom to compete is pitted against the equally absolutist approach of cases such as *Aberdeen Railway Co v Blaikie Bros*[368] and

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[361] *Ibid* at 231.

[362] [1558-1774] All ER Rep 230.

[363] [1942] 1 All ER 378.

[364] It was also the preferred approach of the UK's Company Law Review Steering Group in *Modern Company Law for a Competitive Economy, Final Report* DTI Pub URN 01/942 and URN 01/943 (2001) at para 3.22-3.27 and the UK Government White Paper *Modernising Company Law* Cm 5553-I (2002) at para 3.20; White Paper *Modernising Company Law-Draft Clauses* Cm 5553-II (2002) section 19, Schedule 2, para 6. On reforms see further Chapter 5 below.

[365] S Scott n 39 above.

[366] [2005] EWCA Civ 959.

[367] *London and Mashonaland Exploration Co v New Mashonaland Exploration Co* [1891] WN 165.

[368] [1843-1860] All ER Rep 249.

Regal (Hastings) v Gulliver, it is not always easy to find sure doctrinal footing. There is a continuing friction between, the fundamental duty of a director to act in good faith in the best interests of his company, on the one hand, and the restraint of trade line of cases which recognise that a director may lawfully take certain preparatory steps to set up a competing business.[369]

Given the current judicial emphasis on disclosure-based approval, it is likely that the principles governing disclosure-based approval will receive increased judicial and legislative scrutiny and that there will also be a greater emphasis on contractual relaxation of the rigour of the equitable rules. This reflects the fact that freedom of contract can give effect to accepted business norms by modifying the pre-Victorian equitable rules to meet the expectations of the twenty-first century world of business. This is consistent with the traditional function of commercial law of providing fall-back rules to govern business situations and thereby provide certainty where commercial actors have not put in place their own contractual provisions to regulate their business relationships. This freedom of contract is an answer to those who believe that the protectionist application of fiduciary principles to corporate settings is "an exceptional incursion of the moral into the marketplace".[370] It is likely that corporate self-help through the exercise of freedom to contract will come into greater focus in the future – certainly the possibility of consent-based approval has always been a ready riposte to those who argue that the no conflict-no profit rules are unduly strict.

Dogmatic statements of principles have a tendency to obscure the variable nature of the duties owed including the reality of contractual relaxation of the rigorous standard.[371] However, despite the fact that quite a large number of uncertainties still require resolution in relation to various limbs of the duties, at base level the courts have recognised that the application of duty is fact dependent which allows for some measure of flexibility. The requirement to approach each case on its own facts should therefore allow for a sensible realism in relation to the as yet unresolved position of non-executive and nominee directors.

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[369] See *Shepherds Investments Ltd v Walters* [2007] 2 BCLC 202, [99] *per* Etherton J.

[370] See WW Bratton n 325 above at 143.

[371] *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41, 102-103.

The difficulty for directors and their advisers in grappling with the practical application of the no conflict-no profit rules is not assisted in this jurisdiction by the lamentable dearth of modern Irish case law on the no conflict-no profit rules. Ireland's lack of detailed judicial analysis in this area means that judicial pronouncements in other jurisdictions merit close examination. The dearth of Irish authorities posits the question of to what this gap in judicial exposition can be attributed. Beginning with the proposition that the imposition of specific statutory duties on directors does not operate to displace relevant fiduciary and equitable duties[372] would suggest that statutory erosion ought not to be the culprit. Nevertheless, on closer examination, the dearth is in no small part attributable to the fact that in those cases which have come before the Irish courts which reveal conflict of interests and secret profit, the courts have preferred to deal with the matter under the statutory restriction regime[373] or as a breach of a statutory duty *eg* section 194 of the *Companies Act 1963*[374] rather than engaging in a rigorous analysis of fiduciary duty.

The failure to accord the equitable rules their deserved stand-alone status is part of a discernible judicial trend in company law whereby statutory intervention has been treated as superseding apposite non-statutory rules in place of carrying out a dual analysis. A case in point is *Fyffes plc v DCC plc*[375] where it was most unfortunate that the High Court did not seize the golden opportunity presented to set out a coherent and comprehensive statement of fiduciary principles. Laffoy J's rather half-hearted discussion of the non-statutory claim was seemingly influenced by the result already achieved on a much fuller consideration of the statutory rules on insider dealing and her apparent desire to avoid reaching an inconsistent result on the equitable analysis. The reluctance of the Irish judiciary to grasp the nettle and pronounce authoritatively on the no conflict-no profit rules is disappointing. However, of greater significance is the consequent risk of these significant equitable principles falling into abeyance. Indeed, as will be seen in discussion of the proposed reforms, the lack of clarity concerning the subtleties of application has carried through into the reform process.

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[372] *Jones v Gunn* [1997] 3 IR 1.

[373] See *Stafford v Higgins* [2004] IEHC 180.

[374] See *eg Stafford v Higgins* [2004] IEHC 180 (section 194 of the *Companies Act 1963*); *Fyffes plc v DCC plc* [2005] IEHC 477 (unlawful dealing under Part V of the *Companies Act 1990*).

[375] [2005] IEHC 477.

This completes the examination of the duty to exercise care, skill and diligence, the duty to act *bona fide* and in the best interests of the company and for proper purposes, and the duty to avoid conflicts of interests and secret profits. Having now provided an insight into how the judicial application of these robust core non-statutory duties of directors has evolved and adapted over time, the next chapter investigates the implications of the Company Law Review Group's recommendation to place these duties on a statutory footing.

CHAPTER 5:
TOWARDS A LEGISLATIVE STATEMENT OF DIRECTORS' DUTIES

A. INTRODUCTION

Earlier chapters of this thesis analysed how the judge-made duties of directors have evolved and concluded that for the most part the general principles developed in the nineteenth century have endured well and the application of the broad duties has shown that they have adapted well over time to meet new circumstances. However, with the planned encapsulation of directors' duties within a legislative companies code, Ireland is on the brink of a new era for directors' duties from which there will be no going back. This chapter focuses on the work of the Company Law Review Group to systematically legislate for directors' duties and the consequences of moving to a legislative statement of duties. Apart from being informed by developments in other common law jurisdictions, analysis of the text of the draft provisions builds upon the understanding of the judicial legacy set out in earlier chapters.

Directors' responsibilities must be ascertained from what has been described as "a confusing and compendious mass of case law and the occasional statutory measure".[1] The proposed statutory intervention will allow a piecemeal set of legislative provisions and common law principles applicable to directors to be replaced by a comprehensive code which is based largely on a synthesis of existing common law and equitable principles, with some reforms. The central premise underlying this policy shift to a statutory statement of the core duties is not to throw the baby out with the bathwater but to capture the essence of the duties in the hope that a statutory statement of existing duties will lend transparency and facilitate greater understanding among directors as to what they are signing up to when they accept an appointment. However, such a process is fraught with the danger that something will be lost in translation in the attempt to reduce judicial pronouncements in individual cases to pithy

[1] L Roach "The Legal Model of the Company and the Company Law Review" (2005) 4 Co Law 98 at 98.

legislative principles of general application. This includes the prospect that unintended effects will result which were not within the contemplation of the drafters. Such concerns highlight that a supposed statutory clarification of the law risks both offending against the subtleties of the pre-existing common law and equitable heritage and creating, rather than reducing, uncertainty. Successful resolution of these concerns requires a well-executed legislative statement which builds in an appropriate degree of flexibility based on a clear understanding of the standing to be accorded to prior judicial decisions in the new legislative duty environment and of the degree of latitude to be afforded to the courts to develop the law over time. These issues will be explored in this chapter against the backdrop of the recent publication of the heads of a Companies Consolidation and Reform Bill[2] which includes the machinery for setting out directors' duties in statute.

In the first part of this chapter (Parts B-D) the impetus behind the drive towards a legislative statement of directors' duties and issues of methodology are examined. In the latter part (Parts E-K) the various statutory duties of directors proposed by the CLRG, and now the subject of a draft Heads of Bill, are scrutinised against the backdrop of alternative approaches taken in other jurisdictions which have ventured down the statutory path in one form or another. Some concluding observations are set out in Part L.

B. THE DRIVE TOWARDS A STATUTORY STATEMENT

(1) The Corporate Landscape

The current impetus to recast directors' duties should be understood as the culmination of a continuum of domestic and global policy discussion on the subject. In Ireland directors' duties have already been substantially supplemented by statutory rules[3] including the

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[2] *General Scheme of Companies Consolidation and Reform Bill* (2007) available on www.clrg.org (Part A5 is reproduced in Appendix II of this thesis). See also the CLRG's accompanying report: Company Law Review Group *Company Law for the 21st Century: Report on General Scheme of Companies Consolidation and Reform Bill* (2007) available on www.clrg.org.

[3] See further Company Law Review Group *First Report (2000-2001)* (2002) at para 11.1.

introduction of the concept of fraudulent and reckless trading,[4] the enactment of a statutory duty requiring directors to ensure that the company complies with the *Companies Acts*,[5] and to ensure that proper books of account are maintained.[6] Statutory controls also exist in relation to substantial property transactions between a company and its directors[7] and restrictions on loans and credit transactions from a company to a director.[8]

While these milestones have demonstrated that the legislature is not afraid to move ahead with legislating where regulatory and enforcement gaps are identified, the most significant development on the road to the development of a comprehensive statutory statement of directors' duties came about as a result of the establishment of the Company Law Review Group ("CLRG"). The CLRG was established by the Government in February 2000 under the chairmanship of Dr Thomas B Courtney and was placed on a statutory footing as an advisory group by Part 7 of the *Company Law Enforcement Act 2001*.[9] Its reports set out recommendations for modernising, reforming, streamlining and consolidating company law[10] including the enactment of a statutory statement of directors' duties.[11] This led in May 2007 to the publication of the Heads of a Bill,[12] Part A5 of which deals with directors' duties. The

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[4] See Chapter 1 above.

[5] Section 383(3) of the *Companies Act 1963* (as substituted by section 100 of the *Company Law Enforcement Act 2001*).

[6] Section 202 of the *Companies Act 1990*.

[7] Section 29 of the *Companies Act 1990*.

[8] Section 31 of the *Companies Act 1990* (as amended).

[9] Section 68(2) of the *Company Law Enforcement Act 2001* states that "In advising the Minister the Review Group shall seek to promote enterprise, facilitate commerce, simplify the operation of the Companies Acts, enhance corporate governance and encourage commercial probity." This followed a recommendation in the *Report of the Working Group on Company Law Compliance* (the "McDowell Report") Pn 6697 Stationery Office (1998) at 5.29.

[10] Company Law Review Group *First Report* n 3 above; *Report on the Second Work Programme of the Company Law Review Group 2002-2003* (2004); *Report on Directors' Compliance Statement* (2005); *Company Law for the 21st Century: Report on General Scheme of Companies Consolidation and Reform Bill* (2007). The framework of recommendations of the CLRG were approved by the Government on 26 July 2002: Company Law Review Group *Report on Second Work Programme of the Company Law Review Group 2002-2003* (2004) at para 11.5.

[11] Company Law Review Group n 3 above at Chapter 11.

[12] *General Scheme of Companies Consolidation and Reform Bill* (2007) available on www.clrg.org. See further Company Law Review Group n 2 above.

Minister for Enterprise, Trade and Employment has indicated an intention to publish a Bill by the end of 2008.[13]

Before considering the Irish legislative proposals in detail, it is worth setting the reforms in a global context by briefly taking stock of influential legislative developments in some other jurisdictions. A statutory statement of the general duties of directors was recently enacted in the UK as part of the consolidating and reforming *Companies Act 2006*.[14] This was the result of a momentum which had been building for several decades with much wavering along the way. Initial policy reviews did not favour a statutory statement of duties. The Greene Committee concluded that "any attempt by statute to define the duties of directors would be a hopeless task"[15] while the Jenkins Committee recommended that a specific definition of the duties of directors should not be set out in legislation.[16] Later, policy began to swing the other way.[17] Tellingly, Arden LJ who was involved in the UK reform process noted that while the issue of codification had "exercised commentators for over 100 years", the catalyst which put aside previous debate over the difficulty of reflecting the complexity of the law in statute was

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[13] "Minister Martin Publishes 2006 Companies Report" Press Release 2 August 2007 available on www.entemp.ie.

[14] *Companies Act 2006* (UK), Part 10, Chapter 2 "General Duties of Directors". This Part was commenced on 1 October 2007 by Regulation 2(1) of *The Companies Act 2006 (Commencement No. 3, Consequential Amendments, Transitional Provisions and Savings) Order* (SI 2007 No. 2194 (c. 84) (except for sections 175 to 177 dealing with the duty to avoid conflicts of interest, the duty not to accept benefits from third parties and the duty to declare an interest in a proposed transaction or arrangement).

[15] *Report of the Company Law Amendment Committee* ("the Greene Committee Report") HMSO London Cmd 2657 (1926) at para 46.

[16] *Report of the Company Law Committee* ("the Jenkins Committee Report") HMSO London Cmnd 1749 (1962) at para 87.

[17] See further the following aborted legislative initiatives: section 52 of the *Companies Bill 1973*, clauses 44 and 45 of the *Companies Bill 1978*. See also English and Scottish Law Commissions *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* Joint Working Paper LCCP 153, SLC Discussion Paper No. 105 (1998); English and Scottish Law Commission *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* Law Com No 261 Scot Law Com No 173 (1999). See also the publications of the Company Law Review Steering Group culminating in *Modern Company Law for a Competitive Economy: Final Report* URN 01/942 and URN 01/943 (2001).

"the imperative ... to improve corporate governance."[18] Legislative statements of directors' duties have also been enacted in a number of other jurisdictions including Canada,[19] Australia,[20] New Zealand[21] and Malaysia[22] and similar reforms are under consideration in South Africa.[23] By contrast the Delaware corporation statute[24] does not set out standards for directors – they remain the subject of a significant body of case law.

(2) The Company Law Review Group's Reasoning

In answer to the question whether codification is feasible and desirable, Santow wryly states that "[a] useful way of testing this is to attempt it."[25] The spirit of this seems to have been taken on by the CLRG who concluded that, despite the undoubted challenging nature of the task, a legislative statement of directors' duties would be desirable. A primary influencing factor was the carrot of transparency for directors in relation to their obligations as exemplified in the following statement:

> "Following much discussion and analysis, the Review Group has come firmly to the view that inaccessibility and incomprehensibility of the law concerning the duties of directors can be remedied by their being stated in statute law. Such inaccessibility and incomprehensibility can in practice be a disincentive to compliance or a ready excuse to the indolent who have no wish to comply with such duties."[26]

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[18] Rt Hon Lady Justice Arden DBE "Companies Act 2006 (UK): A New Approach to Directors' Duties" (2007) 81 ALJ 162 at 163-164.

[19] *Canada Business Corporations Act* R.S., 1985, c.C-44, Part X.

[20] See now the *Corporations Act 2001* (Australia), Chapter 2 D.

[21] *Companies Act 1993* (New Zealand), Part 8.

[22] *Companies (Amendment) Act 2007* (Malaysia).

[23] See Department of Trade and Industry (South Africa) *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (2004) at 18 and Part B, Chapter 4 of the draft Companies Bill published by the Department of Trade and Industry (South Africa) (February 2007).

[24] The *Delaware General Corporation Law.*

[25] GFK Santow "Codification of Directors' Duties" (1991) 73 ALJ 336 at 337.

[26] Company Law Review Group *First Report (2000-2001)* (2002) at 11.3.1.

The Chairman of the Review Group, Dr Thomas B Courtney regarded it as "... simply unacceptable that the law on directors' duties is only discoverable through consulting legal textbooks which describe the evolution of the Common Law...."[27] The principle of *Ignorantia Juris Neminem Excusat* – Ignorance of the Law is No Defence springs readily to mind.[28] In *Kiriri Cotton Co v Devani* Lord Denning stated:

> "it is not correct to say that everyone is presumed to know the law. The true proposition is that ... no man [may] excuse himself from doing his duty by saying that he did not know the law on the matter."[29]

In *Stafford v Higgins* Finlay Geoghegan J applied the maxim to directors in stating:

> "Every director must be deemed to know and appreciate the distinction between the Company as a separate legal person and themselves as individuals. Further, it appears to me that directors must be deemed to be aware of obligations which they have not only to the Company and its shareholders but also to its creditors and others dealing with the Company. Further directors must be assumed to know, at least in a general way, of their obligations under the Companies Act."[30]

However, the educative role of statute law for the layperson is often idealised, as is apparent in the following assessment:

> "It is important to remember why our statutes should be framed in such a way as to be clearly comprehensible to those affected by them. It is an aspect of the Rule of Law. People who live under the Rule of Law are entitled to claim that the law shall be intelligible. A society whose regulations are incomprehensible lives with the Rule of Lottery, not of Law."[31]

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[27] TB Courtney "The Company Law Review Group – Directors' Compliance Statements and Beyond" paper presented to Audit Committee Institute 24 January 2006 at 5.

[28] See generally F Bennion *Statutory Interpretation: A Code* 4th ed Butterworths London 2002 at 28 ff.

[29] [1960] AC 192, 204.

[30] [2004] IEHC 82 at p 10 of the unreported judgment.

[31] Rt Hon Lord Simon of Glaisdale "The Renton Report – Ten Years On" (1985) Stat LR 133 at 133.

The vision of statute law as opening the law to the man on the street seems particularly optimistic in relation to codification measures. Although it is frequently advocated that placing the general duties of directors on a statutory footing will render directors' duties more accessible, well-known and comprehended,[32] it would be somewhat facile to assume that a statement of general duties can do more than act as a signpost; behind the façade of general principle-based statutory provisions lies a whole wealth of judge-made meaning. In his writings on codification, Professor Hahlo rightly contended that while codification can rejuvenate law where it has become clogged up by the "accumulated silt" of centuries of case law and academic debate, it cannot be expected to make the law comprehensible to the lay person.[33] Indeed, a statement of general duties could have the effect of obscuring the depth of the underlying complexities.

Although the CLRG professed to have "... distilled the leading decisions of the courts into a series of statutory principles",[34] the reality is that it will remain difficult for directors to know how the duties will be interpreted. A general statement of duties will give an indication of what is expected but will not remove the need for directors to seek professional advice as to the detailed application of the duties. This was reflected in the Law Society of England and Wales' view that the UK reforms would not clarify the general duties of directors but rather would create uncertainty and the potential for increased litigation.[35] Nevertheless, in the UK some efforts have been made to assist in interpreting the new statutory duties. Although not endorsed by Parliament, the publication of Explanatory Notes to accompany the 2006 Act is of assistance.[36] Furthermore, the DTI[37] sought to address the comprehension gap by publishing

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[32] See *eg* English and Scottish Law Commissions *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* Joint Working Paper LCCP 153, SLC Discussion Paper No. 105 (1998) at para 14.4.

[33] HR Hahlo "Here Lies the Common Law: Rest in Peace" (1967) 30 MLR 241. See also HR Hahlo "Codifying the Common Law: Protracted Gestation" (1975) 38 MLR 23.

[34] TB Courtney n 27 above at 5.

[35] J Harris "Law Society Issues Criticisms of Company Law Reform Bill at Second Reading" (2006) 27 Co Law 95.

[36] Department of Trade and Industry (UK) *Companies Act 2006: Explanatory Notes* (2006).

[37] Now the Department for Business, Enterprise and Regulatory Reform (UK).

non-statutory guidance in respect of the statutory duties couched in accessible language.[38] Similar guidance from the Office of the Director of Corporate Enforcement would be welcomed in this jurisdiction particularly as Sub-head 5(4) of the draft scheme requires newly appointed directors to sign a statement acknowledging their duties.[39]

C. METHODOLOGY

(1) A Top Down Approach

In relation to the preferred legislative approach to setting out directors' duties in statute, there are important differences of methodology between the UK and Ireland. The methodology employed in the UK was to begin at first principles by choosing appropriate supporting principles to form the foundation behind the legal principles.[40] The most recent policy discussion on company law reform began with 'what should the law be?' rather than 'what is the law?'. Consequently it was sought to draft the statement of duties in a "... in a way which reflects modern business needs and wider expectations of responsible business behaviour."[41] By contrast, the methodology in this jurisdiction was top down rather than bottom up and largely involved identifying the existing principles with a view to codification. In keeping with its general aim of simplifying company law through making structural changes to the legislative architecture,[42] the CLRG expressed itself to be concerned with the consolidation of

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[38] Department of Trade and Industry (UK) *Companies Act 2006: Duties of Company Directors: Ministerial Statements* (2007) URN 07/1147. The Association of General Counsel and Company Secretaries of the FTSE 100 (GC100) published its own guidance on 1 February 2007.

[39] The statement reads "I acknowledge that, as a director, I have legal duties and obligations imposed by the Companies Acts, other statutes and at common law." See further Company Law Review Group n 3 above at 11.3.8.

[40] English and Scottish Law Commissions n 32 above, Part 2 "Guiding Principles for Reform". This replicated the approach which had been taken in relation to shareholder remedies: Law Commission *Shareholder Remedies* Law Com No. 246 Cm 3769 (1997). See also Company Law Review Steering Group (UK) *Modern Company Law for a Competitive Economy: Developing the Framework* URN 00/686 (2000) Chapter 2 and para 3.37. See further Rt Hon Lady Justice Arden DBE n 18 above at 163.

[41] Department of Trade and Industry (UK) *Company Law Reform* Cm 6456 (2005) at 20.

[42] Company Law Review Group n 3 above at Chapter 3.

well-established duties.[43] Therefore, other than in a few select instances, did not purport to engage in expansion of traditional duties such as had been undertaken by the UK Steering Group within the context of a wider agenda encompassing the purpose of company law.

(2) The Codification Concept

A process of codification[44] which involves both statute law and case law is sometimes described as an organic codification whereas one which involves merely statute law is described as a mechanical codification.[45] Lord Thring offered the following alternative view:

> "Codification is the reduction into a systematic form of the whole of the law relating to a given subject, that is to say, of the Common Law, the Case Law, and the Statute Law; while consolidation differs from codification in this alone, that it omits the Common Law and comprises only the Statute Law relating to a subject as illustrated or explained by judicial decisions."[46]

Ireland is no stranger to organic codification.[47] The *Sale of Goods Act 1893* was one of the first codifying Acts and involved a code based on both statute law and case law[48] while today

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[43] *Ibid* at 3.2.6.

[44] For the earliest identified use of the term "codification" by Jeremy Bentham in 1815 see S Conway (ed) *The Correspondence of Jeremy Bentham* Vol 8: January 1809 to December 1916 Clarendon Press Oxford 1988 at 464.

[45] B Hunt *The Irish Statute Book: A Constraint on the Functioning of a True Democracy* Doctoral Thesis University of Dublin (2006) at 436. The Law Reform Commission has been given responsibility for undertaking statutory law restatements: see further Law Reform Commission *Consultation Paper on Statute Law Restatement* (LRC CP 45-2007).

[46] Lord H Thring *Practical Legislation* John Murray London 1902 at 14.

[47] For some discussion of the place of codification in Ireland see JP McCutcheon and K Quinn "Codifying Criminal Law in Ireland" [1998] 19 Stat LR 131; J O'Connor "The Law Reform Commission and the Codification of Irish Law" (1974) 9 Ir Jur (ns) 14.

[48] The *Succession Act 1965* is a more recent example.

a process of organic codification of the criminal law is currently underway.[49] In the case of directors' duties, what is being contemplated in Ireland is a miniature organic codification within a larger legislative restatement of the *Companies Act 1963 to 2006.*[50]

Codification is sometimes identified with increased transaction costs based on the need for legal advice where interpretation is not clear[51] but this may be countered by the need for similar advice where judge-made law is not clear or comprehensive. A codification process may or may not include a reform agenda. In the present context, the opportunity is being used to effect some reforms[52] and to move with the zeitgeist, for example, on the issue of nominee directors.[53] Writing extra-judicially, Arden LJ noted that although codification of directors' duties in the UK was "a new and radical departure... the content of the codified statement does no more than reflect existing good practice."[54] However, this does not take account of the significant reforms which also went hand in hand with restating familiar principles applicable to directors.

In choosing an appropriate approach, the following cautionary words of the English and Scottish Law Commissions are apposite:

> "Fiduciary duties cannot be codified without being either stated in detailed terms in which case there will be a loss of flexibility or in general terms in which case the statute may have to be interpreted by the courts and the result may be that the law is not much more accessible than it is at present."[55]

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[49] The Criminal Law Codification Advisory Group chaired by Professor Finbarr McAuley was established pursuant to Part 14 of the *Criminal Justice Act 2006*. Its work in producing a comprehensive criminal code has been estimated as likely to take 5-10 years.

[50] See generally n 10 above.

[51] Rt Hon Lady Justice Arden DBE n 18 above at 165.

[52] This additional benefit of a statutory statement was adverted to by Rt Hon Lady Justice Arden DBE n 18 above at 165.

[53] See Head 9 of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007) discussed below.

[54] Rt Hon Lady Justice Arden DBE n 18 above at 162.

[55] English and Scottish Law Commissions n 32 above at para 14.4.

The CLRG determined that it had a choice of methods: either a brief general statement of duties or the formulation of an expanded statement of duties as had been favoured by the UK's Company Law Review Group Steering Group. Commenting on comparative approaches to legislating in the field of company law, Cheffins notes the fondness in English law for highly detailed statutory provisions:

> "If those who draw up legislation have faith that the judiciary will use its discretion to apply the enacted measures in a fashion which is consistent with the underlying policy objectives, key matters can be left open for the courts to resolve. Alternatively, the drafters can strive for clarity and seek to achieve this by providing precise instructions to the courts. The usual method involved will be the use of detailed legislative measures. Implicitly, this approach reflects a concern that the courts will have difficulty applying statutory provisions in the desired fashion without the assistance of highly specific signals."[56]

The CLRG was not impressed with the UK approach which was seen as heavy-handed. It was said that "[s]uch a prescriptive approach is susceptible to fossilisation and inappropriate application on particular facts and the Review Group prefers a more general statement which gives the judiciary interpretational latitude."[57] Therefore "... with a view to keeping a light touch", the CLRG recommended that the fiduciary duties of directors to "should be stated in general rather than specific terms, and on the basis that the statement of duties is not exhaustive."[58]

It is contended that the CLRG's chosen path is the right one. While the UK legislative reforms betray a fondness for detail, the Irish approach of setting out broad general principles leaves far more discretion to the courts in terms of the appropriate policy objectives to be pursued. Certainly the use of general principles will not present the reader with a complete picture but the guiding precepts should be susceptible to flexible application. In the UK early drafting attempts incorporated an explanatory note format which provided a fuller explanation

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[56] BR Cheffins *Company Law: Theory, Structure and Operation* Clarendon Press Oxford 1997 at 351.

[57] Company Law Review Group n 3 above at 11.3.6.

[58] *Ibid.*

of the duties set out.[59] This gave way to a more comprehensive statement of the duties themselves.[60] The Irish approach is more general and at present only brief explanatory notes follow each head.

(3) A Self-contained Code?

Will Chapter 2 of Part A5 of the draft scheme headed "General Duties of Directors and Secretaries" operate as a stand alone, exhaustive code? While codification "is not a univocal concept",[61] on one view, a true codification of the law involves leaving behind the pre-existing case law. As Professor Hahlo describes it:

> "A code is an end and a beginning. Unlike a statute, which is superimposed upon the common law like a ship floating on the water, a code supersedes the common law, excluding all reference (except on very special grounds) to any source of law other than itself."[62]

A similar perspective is evident in Lord Scarman's definition of a code as "a species of enacted law which purports so to formulate the law that it becomes within its field an authoritative, comprehensive and exclusive source of that law."[63]

This raises a number of issues relating to the pre-eminence of the code including the appropriate interpretational rules, the role of case law and the potential for judicial innovation.

While Hahlo's conception of codification is in harmony with the Civil Law understanding of a code as fully self-sufficient, Hunt persuasively contends that because of the dualist system involving both case law and statute law "any codification which takes place in Ireland may be

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[59] See Department of Trade and Industry (UK) *Modernising Company Law* Cm 5553 (2002).

[60] Explanatory notes have been published separately: n 36 above.

[61] Expert Group on the Codification of the Criminal Law *Codifying the Criminal Law* Stationery Office (2004) at para 1.02. See also Law Reform Commission n 45 above at para 2.21.

[62] HR Hahlo n 33 above at 243.

[63] Lord Scarman "Codification and Judge-Made Law: A Problem of Coexistence" (1967) 42 Ind L J 355 at 358.

codification in name, but it is not codification in the real sense."[64] Either way, Hahlo correctly identifies that one of the perennial problems with codification is that "[a]lmost as soon as the ink on the code is dry the need for legislative amendments will become manifest."[65] However, given that the Irish penchant for generally worded statements of duty, this may be less likely to be a major hazard if, as is contended in this chapter, the latitude afforded to the courts will permit refinements of principle to cater for individual circumstances which arise.

Head 9(2) of the draft scheme states:

> "The duties set out in Subhead (3)[66] are based on certain common law rules and equitable principles as they apply in relation to the directors of companies and shall have effect in place of those rules and principles as regards the duties owed to a company by a director and the duties in Subhead (3) shall be interpreted and applied in the same way as common law rules or equitable principles and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the duties set out in Subhead (3)."[67]

The application of the draft provisions on enactment will also be coloured by a number of influences including the Constitution,[68] the primacy of European Union law and the requirements of human rights law.[69] It has been suggested that these external influences may result in "a strained interpretation" of statutory directors' duties.[70]

The Irish approach and parallel UK approach will be unravelled below. Before doing so it is worth noting that these kinds of issues have also proved troublesome in other jurisdictions who have taken the step of placing the general duties of directors on a statutory footing. In New Zealand, the *Companies Act 1993* both codified and expanded the common law on

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[64] B Hunt n 45 above at 437.

[65] HR Hahlo n 33 above at 250.

[66] These duties are dissected later in this chapter.

[67] Head 9(2) of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[68] See *eg Hughes v Duffy* [2005] 1 IR 571 (fair procedures and the effect of delay).

[69] Section 2(1) of the *European Convention on Human Rights Act 2003* requires the courts to take judicial notice of relevant ECHR case law.

[70] Rt Hon Lady Justice Arden DBE n 18 above at 167.

directors' duties and shareholders' rights. However, whether the legislation supplements or replaces the common law rules and equitable principles in place at the time of its enactment has been the subject of some uncertainty.[71] By contrast, section 185 of the Australian *Corporations Act 2001* is regarded as a successful example of a twin-track approach whereby common-law rules and codifying statute are combined to marry accessibility with the organic development of legal principle.[72] Section 185 clearly states that the legislative statement of general duties is supplementary to the general law rules. As Purcell and Loftus describe it "... directors' general duties are sourced from both statute ... and the general law without the former in any way 'cutting down' or limiting the application of the various rules that have emerged from judicial decision."[73] The Australian Senate Standing Committee on Legal and Constitutional Affairs made the following observation:

> "To some extent the rules of equity have been reproduced as statutory provisions, but they remain judge-made rules capable of judicial development to meet new situations and changing mores."[74]

Butcher sees the implication as being that "... the ability to lean in one direction rather than in the other, when considered desirable, is preserved."[75]

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[71] See T Keeper "Hard Decisions about Soft Law – or Soft Decisions about Hard Questions: A Discussion of the Laws in New Zealand Regulating in whose (Best) Interest Directors must Act": Corporate Law Teachers Association Conference Brisbane 2006 at 3 citing N Campbell "Editorial: Does the Companies Act Codify Remedies?" (2001) NZBLQ 53; *Manakau City Council v Lawson* (2001) 1 NZLR 599 *per* Morris J in an interim decision, and *obiter* comment in *Benton v Priore* (2003) 1 NALR 546, [46] *per* Heath J. On the Canadian position see I Douglas "Directors' Duties under Bill 125" (1969) 27 Fac L Rev 102 at 105-106.

[72] See further BS Butcher "Directors' Duties in the Twenty-First Century: A New Beginning?" (2000) 2 ICCLR 197. For another such hybrid approach see the planned South African reforms: clause 91(6) of Chapter 4 of Part B of the draft Companies Bill for published by the Department of Trade and Industry (February 2007) (South Africa).

[73] JA Purcell and JA Loftus "Regulatory Developments in Corporate Social Responsibility: Directors' and Officers' Duties and the Role of Reporting" (2006) 5 FFRaG 5.

[74] Senate Standing Committee on Legal and Constitutional Affairs *Social and Fiduciary Duties and Obligations of Company Directors* AGPS Canberra (1989) at 37-38.

[75] BS Butcher *Directors Duties: A New Millennium, A New Approach?* Kluwer Law International London 2000 at 23.

We move now to examine how these issues are dealt with in the Irish draft scheme and in the recent UK reforms.

(a) Non-Codified Duties

Obviously care needs to be taken to ensure that a misleading impression is not given that the statement of general duties is exhaustive *ie* that other duties do not arise for directors under company law or under the general law. This concern is partially reflected in section 172(3) of the UK *Companies Act 2006* which indicates that in some circumstances there may be a duty to consider or act in the interests of creditors.[76] In her writings on the *Companies Act 2006*, Arden LJ acknowledged that where an existing duty has not been included in the statutory statement, this does not necessarily mean that the duty will no longer exist.[77] Such concerns are not expressly addressed in the Irish draft scheme but it would seem that when the CLRG describes the statement of duties as "non-exhaustive",[78] this implicitly acknowledges that other duties will exist which fall outside the scope of the general duties.

(b) Existing Case Law and Construction of the New Duties

A certain amount of confusion is created by Head 9(2)'s signalling that pre-existing common law rules and equitable principles are to be replaced while going on to state that the statutory duties are to be understood and applied in the same manner as they rules and principles they replace.[79]

There was no discussion of such a provision in the CLRG's reports – it was developed at a later drafting stage. Therefore clues as to how it is likely to be interpreted need to be garnered from outside this jurisdiction. The first step to getting a handle on its meaning is to appreciate its derivation. The draft provision is a word for word amalgam of section 170(3) and (4) of

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[76] In the House of Lords debates, Lord Freeman noted that "[t]he codified duties apply generally and are primarily directed to the carrying on of business in solvent and ongoing companies." House of Lords Hansard 6 February 2006 Col. GC249.

[77] Rt Hon Lady Justice Arden DBE n 18 above at 165. She referred, by way of example, to the duty to act fairly as between shareholders.

[78] Company Law Review Group n 3 above at 11.3.6.

[79] See text accompanying n 67 above.

the UK's *Companies Act 2006*. In the UK, there has been much criticism of this approach as being likely to create uncertainty and litigation. This stems in part from its lack of clarity and ambivalence on the nature of the statutory general duties, the role of existing case law principles and the scope for judicial innovation.

Policy discussion in the UK of the nature of the code of directors' duties[80] and its relation with existing and future case law has sparked a series of responses which have not always been consistent. During the Bill's passage Lord Freeman was critical of the confusion likely to be caused by a codification and its relationship to existing rules and principles: "... with codification but still with reliance on interpretation from the common law, in a sense we will have a double complication .... [i]f you are going to codify but still rely in part on common law and equitable principles."[81] The Law Society of England and Wales also strongly contended that this type of hybrid provision would lead to litigation.[82]

There has been some speculation as to when previous case law will continue to be relevant. In the UK it was considered that codification would remove the need to consult a wide range of authorities to discover what relevant legal principles applied. This might be the case in relation to the principles themselves but it is suggested that when it comes to their application to particular factual scenarios, both pre- and post-statutory statement case law will continue to be important. In the debates on the UK Bill, Lord Goldsmith regarded what is now section 170(4) of the *Companies Act 2006*[83] as referring the courts to "the existing interpretation and application of the duties that are now being replaced by the statutory duties in understanding what they mean."[84] Worthington argues that existing authorities will not lose their relevance as illustrative of the practical application of the rules.[85] However, in a most useful insight provided by Arden LJ, writing extra-judicially, the UK's reforms were interpreted as intending a complete replacement of the corresponding equitable and common law rules such that in

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[80] *Companies Act 2006* (UK), Part 10, Chapter 2 "General Duties of Directors".

[81] Lord Freeman, House of Lords Hansard 6 February 2006 Col. GC245.

[82] See further J Harris n 35 above.

[83] This corresponds to sub-head 9(2) of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[84] Lord Goldsmith, House of Lords Hansard 6 February 2006 Col. GC243.

[85] S Worthington "Reforming Directors' Duties" (2001) 64 MLR 439 at 456.

general the courts will not look at previous case law where the import of the relevant statutory provision is clear on its face.[86] This is consonant with the approach envisaged by the English and Scottish Law Commissions whereby the courts should give effect to the meaning of the words used and only in the event of an ambiguity should the courts have regard to the law that it was intended to codify.[87] This reflects the purposive construction which the courts are empowered to adopt in the case of any drafting ambiguity.[88] These attempts to make sense of the codification process are consistent with judicial statements on other codification efforts which have indicated that the proper approach is to regard the natural language of the statute as the only port of call if its meaning is clear and not to begin by looking at the law which it was sought to codify.[89]

It would, however, be facile to assume that a legislative statement of general principles of the type envisaged for Ireland could adequately reflect the rich texture of case law built up over the years. One issue which is not squarely addressed is the question of the survival of duties post-termination. This is an issue which is still at development stage in the case law. In the UK the *Companies Act 2006* makes it clear that certain aspects of the duty to avoid conflicts of interests and the duty not to accept benefits from third parties will continue to be owed by a former director to the company.[90] This seems to go against the accepted understanding that it is only the no profit rule which survives termination.[91]

As Butcher contends, the role which equitable doctrine traditionally has to play in directors' duties should mean that a measure of flexibility will be required in interpreting the duties in

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[86] M Arden "Reforming the Companies Acts – The Way Ahead" [2002] JBL 579 at 588.

[87] English and Scottish Law Commissions *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties* Law Com No 261 Scot Law Com No 173 (1999) at para 4.36.

[88] Section 5 of the *Interpretation Act 2005*.

[89] See Lord Herschell's comments on the *Bills of Exchange Act 1882* in *Vagliano v Bank of England* [1891] AC 107, 145 and Lord Alverstone's comments on the *Sale of Goods Act 1893* in *Wallis v Pratt* [1911] AC 394, 398.

[90] Section 170(2) of the *Companies Act 2006* (UK). See further Department of Trade and Industry (UK) *Explanatory Notes to the Company Law Reform Bill 2005* (2005) at para 308; Department of Trade and Industry (UK) n 60 above at para 307.

[91] See further Chapter 4 above.

their statutory form.[92] This seems tacit in the instruction in Head 9(2) to interpret the duties by reference to "corresponding common law rules or equitable principles.[93] However, some interpretive challenges will arise in relation to duties for which there is no identifiable common law or equitable comparator or material differences exist.[94] This pitfall led the Law Society of England and Wales to be critical of the legal uncertainty which would result from the form of codification contemplated:

> "The code's relationship with the existing common law will become more uncertain because it is unclear how far concepts understood by those familiar with the common law will continue to be relevant to the code with its new concepts and different terminology."[95]

There is no ready solution in the proposed legislative scheme to the interpretive conundrum which is likely to result where the relevant provision involves not merely a consolidation of existing case law but also reform. The problem is more acute again in relation to the proposed new duty to act honestly and responsibly.[96] The Company Law Review Group would appear to have been alert to issues of this nature in making the statement that "[c]odifying existing duties is considerably less prescriptive and more workable than an approach that seeks to impose duties that have never been imposed upon directors by the courts or considered to be common law or equitable duties of company directors."[97] However, in practice this did not deter the CLRG from imposing a new duty for which the application and remedies are unclear.

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[92] BS Butcher *Directors Duties: A New Millennium, A New Approach?* Kluwer Law International London 2000 at 24.

[93] Head 9(2) of Part A4 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[94] See the comments of Lord Freeman on the *Company Law Reform Bill 2005* (UK): House of Lords Hansard 6 February 2006 Col. GC239. See also Lord Razzall, House of Lords Hansard 6 February 2006 Col. GC246.

[95] J Harris n 35 above.

[96] This duty is discussed later in this chapter.

[97] Company Law Review Group n 2 above at 42.

(c) Statutory Interpretation and Judicial Innovation

To what extent is the development of principle likely to be stunted? Does what is contemplated equal a complete codification which sets out what the judges must follow or is it merely a statement of general principles which leaves judicial discretion largely intact? Choosing one approach over the other involves a policy decision as to how much discretion should be appropriately left to the courts. The first approach may be described as a codifying approach while the latter is essentially no more than what may be termed a partial codification which sketches broad principles but leaves plenty of room for judicial development and innovation.

Professor Hahlo contended that a code cannot be completely self-contained in the sense of dealing with all issues and dispensing with the need for judicial interpretation. Rather the most a codification can hope to do is to set out general principles which will require interpretation as to their application in individual cases:

> "The propositions codes enshrine are the kind of general legal principles which are trite in any system of law, codified or not. It is when it comes to their application to concrete cases that the doubts arise, and here a clause in a code is generally of no more use to the lawyer than a statement in a textbook or digest."[98]

This is epitomised in the aphorism that "[c]odification, presupposing infinite knowledge, is a dream."[99] Indeed, as Lord Scarman wisely noted, "... the very first decision interpreting a section of the code would begin the reinstatement of judicial decision as a law-shaping force."[100]

Mayson, French and Ryan note the novelty of the method of interpretation signalled in section 170(3) and (4) of the *Companies Act 2006* (reproduced in Head 9(2) of the draft Irish scheme) and observe that it appears to be trying to have the best of both worlds.[101] Their view is that

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[98] HR Hahlo n 33 above at 247.

[99] RF Clarke *The Science of Lawmaking* New York 1898 at 45.

[100] Lord Scarman n 63 above at 357.

[101] S Mayson, D French and C Ryan *Company Law* 23rd ed Oxford University Press 2006 at 556.

the adaptability of the law based on the system of precedent would suffer when replaced by the fixed wording of legislation and the rules on statutory interpretation.[102] In particular, they contrast the continuing possibility of development in the law concerning negligence and other equitable principles outside their application to directors stating that "[c]odification risks losing this adaptability in exchange for the certainty and accessibility of fixed statutory wording."[103]

While the English and Scottish Law Commissions had envisaged a non-exhaustive set of principles that could be added to by the courts, this creative possibility was subjected to some doubt by the UK Company Law Review.[104] It has been opined that, given the general statement of the rules to allow flexibility, the courts will continue to have a key role in elucidating their application.[105] While the duties articulated in the case law are tailored to a particular fact scenario the general statement of duties aims to be capable of application to a wide variety of circumstances therefore some flexibility must be built in.[106] As Jones put it:

> "The statutory duties have been drafted in such a way as to leave the courts scope to interpret and develop them. It is acknowledged that it is difficult at this stage to foresee every eventuality and that the law must be able to adapt over time."[107]

As no statement of principle can ever be comprehensive enough to cover any situation which may arise there will always be need for some discerning application of judicial thinking. Codification should not remove flexibility and the possibility of responding to changing circumstances.[108] The Law Commissions rejected the concept of a full codification:

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[102] *Ibid.*

[103] *Ibid.*

[104] Company Law Review Steering Group (UK) *Modern Law for a Competitive Economy: Developing the Framework* URN 00/656 (2000) at para 3.82 where the preference was for an exhaustive statement of duties.

[105] S Worthington n 85 above at 456.

[106] Department of Trade and Industry (UK) n 90 above at para 304.

[107] C Jones "Directors' Duties – A Supporting Statement" (2005) 16 ICCLR 364 at 367.

[108] See the comments of the Attorney General, Lord Goldsmith, House of Lords Hansard 6 February 2006 Col. GC242.

"We expect that the law will need to continue to evolve incrementally as circumstances require. The commercial context is constantly changing. It is important that the law retains the capacity to develop.

For this reason we think that a *full codification* of directors' duties would not be desirable. To set out in statute duties that were still developing might restrict their ability to adapt to changing circumstances."[109]

But just how much flexibility will this give judges? Ireland's Criminal Law Codification Group was drawn to FH Lawson's description of a judge using a code as being "like a man who has been told he could walk about more or less as he liked in a room, but could not go outside."[110] In this regard it can be expected that judges will have regard to the reports of the CLRG,[111] Oireachtas debates[112] and the Bill's explanatory memorandum[113] as extrinsic aids to construction which highlight the underlying objectives. It is likely that the courts will have regard to comparative case law on statutory enactments of directors' duties in other jurisdictions.[114] A precedent for this can be found in *DPP v McDonagh*[115] where Costello P in his interpretation paid particular attention to the fact that the *Criminal Law (Rape) Act 1981* was modelled on an existing English statute.

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[109] English and Scottish Law Commissions n 87 above at para 4.27-4.28.

[110] Expert Group on the Codification of the Criminal Law n 61 above at para 1.34 referring to FH Lawson *The Rational Strength of English Law* Stevens & Sons Ltd London 1951 at 21.

[111] A useful precedent can be found in *Whiteley v Minister for Defence* [1997] 2 ILRM 416 (Court obtained guidance from Law Reform Commission report providing a General Scheme of a Bill which was enacted with little amendment).

[112] See generally Law Reform Commission *Report on Statutory Drafting and Interpretation: Plain Language and the Law* (LRC 61-2000) at para 5.36-5.67.

[113] See *Maher v Attorney General* [1973] IR 140; *McLoughlin v Minister for the Public Services* [1985] IR 631. See further Law Reform Commission n 112 above at para 5.23-5.25. On the desirability of explanatory memoranda being amended on an Act's enactment to reflect amendments made during a Bill's passage see *ibid* at para 6.36-6.39.

[114] On comparative material as an aid to statutory construction see further Law Reform Commission n 112 above at para 5.34-5.55.

[115] [1996] 2 ILRM 468.

In the UK, the Attorney-General's view was that flexibility was achieved through putting the duties in broad and general language.[116] In his view the statutory provisions permit "organic development ... to take account of changing circumstances and new situations".[117] This would include the ability of the courts to take account of subsequent case law developments in related spheres such as the rules governing trustees and agents.[118] Indeed, an aspect of purposive construction in statutory interpretation is the principle of updated construction which encompasses taking account of changing social conditions.[119] This will give a certain amount of leeway to judges.

D. THE LEGISLATIVE STATEMENT

(1) Structure and Form

The planned *Companies Consolidation and Reform Bill* will rectify the problem of legislative scatter in relation to company law generally, including the existing statutory provisions relating to directors. This is reflected in the sequencing in Part A5 ("Duties of Directors and other Officers") of the draft Bill. Chapter 2 ("General Duties of Directors and Secretaries") is prefaced in Chapter 1 ("Preliminary and Definitions") by a legislative definition of "director" and related terms and it leads on to other more specific provisions currently situated in sections 186 to 189 of the *Companies Act 1963* and Part II of the *Companies Act 1990* in Chapter 3 ("Particular Transactions Involving Conflicts of Interests"). Chapter 4 is entitled "Disclosure of Interests in Shares and Debentures." The CLRG's view was that "[t]hose existing statutory provisions can be better put in context if their preamble is the statement of the underlying fiduciary duties."[120]

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[116] Lord Goldsmith, House of Lords Hansard 6 February 2006 Col. GC242.

[117] *Ibid* at Col. GC244.

[118] Department of Trade and Industry (UK) n 90106 above at para 304; Lord Goldsmith, House of Lords Hansard 6 February 2006 Col. GC244. See also Rt Hon Lady Justice Arden DBE n 18 above at 167.

[119] See further section 6 of the *Interpretation Act 2005* and Law Reform Commission n 112 above Chapter 3.

[120] Company Law Review Group n 3 above at 11.3.6.

Chapter 2 of Part A5 contains a statement of ten discrete general duties applicable to directors:[121]

- a duty to ensure that the company complies with the *Companies Acts*;[122]
- a duty to have regard to the interests of employees;[123]
- a duty to act in good faith in the interests of the company;[124]
- a duty to act honestly and responsibly in conducting the company's affairs;[125]
- a duty to act in accordance with the company's constitution and to exercise powers only for purposes allowed by law;[126]
- a duty not to make unauthorised use of the company's property, information or opportunities;[127]
- a duty not to restrict the exercise of independent judgment;[128]
- a duty to avoid the unauthorised conflict of duty and interest;[129]
- a duty to exercise care, skill and diligence;[130]
- a duty to have regard to the interests of the company's employees and members.[131]

While an earlier draft of the general scheme[132] separated out the duties into stand-alone provisions with their own heading, this was later dispensed with in favour of a single head.

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[121] See also Head 7 of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007) headed "Director's compliance statement and related statement" for which non-compliance attracts criminal consequences.

[122] Sub-head 5(1) of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007). This reflects section 383 of the *Companies Act 1963* (as substituted by section 100 of the *Company Law Enforcement Act 2001*).

[123] Head 6 of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[124] *Ibid* at sub-head 9(3)(a).

[125] *Ibid* at sub-head 9(3)(b).

[126] *Ibid* at sub-head 9(3)(c).

[127] *Ibid* at sub-head 9(3)(d).

[128] *Ibid* at sub-head 9(3)(e).

[129] *Ibid* at sub-head 9(3)(f).

[130] *Ibid* at sub-head 9(3)(g).

[131] *Ibid* at head 6 and sub-head 9(3)(h).

[132] Made available on www.clrg.org.

Head 9 is entitled "fiduciary duties of directors" with unheaded constituent sub-heads. This heading is somewhat unsatisfactory. While the heading has no legal significance,[133] it appears sloppy given the received wisdom that the duty to exercise care, skill and diligence does not qualify as a fiduciary duty.[134] The duplication of the duty to have regard to the interests of employees and members in Head 6 and sub-head 9(3)(h) appears to be a drafting oversight.

Before considering the duties individually, some general issues merit brief exploration.

(2) The Interface Between the Statutory Duties

Part A5 of the draft Bill does not set out any express hierarchy for the general duties imposed on directors. Although not stated, it would appear implicit that, except whether the draft scheme dictates otherwise, the duties are cumulative so that compliance with one will not excuse non-compliance with another. The *sub silentio* nature of such a rule contrasts with the express statement to this effect in section 179 of the UK *Companies Act 2006*. Nor, it would seem, should a director who complies with the general duties be able to rely on this to excuse a breach of the general law.[135] Notably, this aspect extends to compliance with additional provisions in Chapter 3 concerning particular transactions involving a conflict of interest – compliance with the general duties in Head 9 will not obviate the need to follow procedures set out in other statutory provisions regulating directors' conduct including the need to comply with any additional requirements for prior shareholder approval[136] and *vice versa*.[137] Thus shareholder approval will be required in respect of substantial property transactions,[138] loans, quasi-loans and credit transactions,[139] long service contracts[140] and compensation for loss of office.[141] This mirrors the position in the UK.[142]

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[133] Section 18(g)(ii) of the *Interpretation Act 2005*. This was contrary to the recommendation of the Law Reform Commission that it should be permitted for regard to be had to section headings: Law Reform Commission n 112 above at para 4.11-4.18.

[134] See further Chapter 2 above; Department of Trade and Industry (UK) n 60 above at para 305.

[135] Department of Trade and Industry (UK) n 90 above at para 313.

[136] In the UK this is expressly set out in section 180(1) of the *Companies Act 2006*.

[137] See section 180(2) of the *Companies Act 2006* (UK).

[138] Head 16 of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[139] *Ibid* at Head 19.

(3) Contract Theory Influences

While many of the general duties are expressed as mandatory rules,[143] the CLRG appears to have been influenced to some degree by the contractual theory of corporations. In the context of considering the position of nominee directors the CLRG quoted with approval the following passage of Mahon J's judgment from *Berlei Hestia Ltd (NZ) v Fernyhough*:

> "As a matter of legal theory, as opposed to judicial precedent, it seems not unreasonable for all the corporators to be able to agree upon an adjusted form of fiduciary liability, limited to circumstances where the rights of third parties vis-à-vis the company will not be prejudiced."[144]

In some instances contractual choice is facilitated in Part A5 of the draft Bill by inclusion of an enabling provision providing that the imposition of a less onerous duty is permitted where this is specifically authorised by the company's constitution.[145] Approval of the company in general meeting is seen as curative in relation to the use of company property, information or opportunities.[146] Furthermore, it is expressly envisaged that more onerous rules may be

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[140] *Ibid* at Head 27.

[141] *Ibid* at Head 28.

[142] See section 180(2) of the *Companies Act 2006* (UK); Department of Trade and Industry (UK) n 90 above at para 317.

[143] See *eg* Head 6 (the duty to act in the interests of employees and members); sub-head 9(3)(a) (the duty to act on good faith in the interests of the company); sub-head 9(3)(b) (the duty to act honestly and responsibly in conducting company affairs); sub-head 9(3)(c) (the duty to act in accordance with the company's constitution and for lawful purpose); and sub-head 9(3)(g) (the duty to exercise care, skill and diligence) of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[144] [1980] 2 NZLR 159, 166.

[145] See sub-head 9(3)(d) (use of company property, information and opportunities permitted where authorised by the company in general meeting); sub-head 9(3)(e) (fettering of discretion permitted where provided for in company's constitution); sub-head 9(3)(f) (external conflicts of interest permitted where release obtained from company in general meeting); sub-head 9(3)(f) (regard may be had to interests of nominating member where nomination of director authorised by company's constitution or by shareholders' agreement) of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[146] Head 9(3)(d) of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

imposed by the company's constitution in respect of Head 10 (other interests of directors) and Head 11 (acting in a professional capacity for the company). In the UK it is envisaged that companies can choose to specify more onerous requirements on directors *eg* by requiring shareholder authorisation of the remuneration of the directors).[147]

We move now to examine the individual duties as put forward in the draft scheme.

E. THE DUTY TO EXERCISE CARE, SKILL AND DILIGENCE

(1) The Draft Provision

Sub-head 9(3)(g) of Part A5 of the draft scheme states that every director of a company shall:

> "owe the company a duty to exercise the care, skill and diligence which would be exercised in the same circumstances by a reasonable person having both;
>
> (i) the knowledge and experience that may reasonably be expected of a person in the same position which the director has; and
> (ii) the knowledge and experience which the director has."[148]

(2) Analysis

The draft provision follows the CLRG's recommendation of the inclusion in the statutory statement of the duties of care, skill and diligence in similar terms.[149] Other jurisdictions have

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[147] Department of Trade and Industry (UK) n 90 above at para 315.

[148] In addition, sub-head 8(2) of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007) sets out a new statutory duty on directors to ensure that the company secretary has the appropriate skills needed to maintain the records required by companies legislation.

[149] Company Law Review Group n 3 above at 11.3.7.

also seen fit to represent a duty of care in statute.[150] In Ireland, the question of reformulating the *Re City Equitable Fire Insurance Ltd*[151] standard has not been to the fore in the way in which it was in the UK where the need to reform care, skill and diligence was under discussion at policy level for some decades prior to the enactment of section 174 of the *Companies Act 2006*.[152] In its reports the CLRG did not engage in discussion on the appropriate standard and simply opted to take the lead from Romer J's seminal pronouncements in *Re City Equitable.*

Given the generality of the principles stated in the draft provision, when it comes to individual application, the courts are likely to pay heed to the existing case law explored in Chapter 2 above, particularly that in relation to the emerging sub-duties which have begun to find judicial expression but have yet to find the degree of assurance necessary for statutory endorsement. Thus we will still be watching the courts for changing views on standards of probity, participation and delegation. Any individual assessment will also have to give credence to the division of collective and individual responsibility in the relevant company.

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[150] Section 174 of the *Companies Act 2006* (UK); section 122(1)(b) of the *Business Corporations Act of Canada 1975*; section 137 of the *Companies Act 1993* (New Zealand); section 180 of the *Corporations Act 2001* (Australia).

[151] [1925] Ch 407.

[152] Department of Trade (UK) *The Conduct of Company Directors* Cmnd 7037 (1977); Law Commission *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* HMSO London Cm 4436 (1999) at para 4.48, 5.19-5.20 and 5.38; Company Law Review Steering Group (UK) *Modern Company Law for a Competitive Economy: the Strategic Framework* URN 99/654 Department of Trade and Industry London (1999); Company Law Review Steering Group (UK) *Modern Company Law for a Competitive Economy: Developing the Framework* Department of Trade and Industry London URN 00/656 (2000); Company Law Review Steering Group (UK) *Modern Company Law for a Competitive Economy: Completing the Structure* Department of Trade and Industry London URN 00/1135 (2000); Department of Trade and Industry (UK) *Modernising Company Law* Cm 5553 HMSO London (2002); Company Law Review Steering Group (UK) *Modern Company Law for a Competitive Economy: Final Report* Department of Trade and Industry London URN 01/942 and URN 01/943 (2001); Department of Trade and Industry (UK) *Company Law Reform* Cm 6456 (2005).

(a) Implicit Rejection of a Simple Reasonable Person Marker

Implicit in the adoption of the *Re City Equitable* standard is a failure to take the boldest step possible – that of reforming the law by moving to a purely objective standard. The effect of adopting an objective standard would be to set a reasonable director bar which precludes any special skill or expertise of the director being taken into account. As we saw in Chapter 2, this would align directorial standards with those expected in the law on professional negligence standard.[153]

In Chapter 2, the purely subjective standard's fall from favour was documented. Therefore it is not surprising that the desirability of a solely objective standard of care is occasionally advocated.[154] Rider acknowledged that "[s]uch a standard may well result in those persons who have nothing of consequence to give to a company and who are not prepared to study the information that they are given and perhaps seek more information so as to come to an informed decision, being reluctant to accept non-executive appointments...",[155] but he regarded this as a good thing. Nevertheless, a purely objective test was not ultimately favoured in the UK. An objective standard was rejected by the English and Scottish Law Commissions on the basis that it would be out of alignment with the personal liability test under section 214 of the *Insolvency Act 1986*[156] and would not "produce a coherent and consistent scheme for imposing liability for negligence on directors."[157] Some common law jurisdictions have not, however, been afraid to adopt a single strand objective test: Canada,[158] Australia[159] and New Zealand[160] have adopted a statutory duty of care based on an objective

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[153] See further P Redmond "The Reform of Directors' Duties" (1992) 15 UNSWLJ at 94.

[154] See *eg* BAK Rider "The Conduct of Company Directors" (1978) 128 NLJ 27 at 28; J Cassidy "An Evaluation of Section 232(4) of the Corporations Law and the Directors' Duty of Due Care, Skill and Diligence" (1995) 23 ABLR 184.

[155] BAK Rider n 154 above at 28.

[156] See further Chapter 2 above.

[157] English and Scottish Law Commissions n 32 above at para 15.29.

[158] Section 122(1)(b) of the *Canada Business Corporations Act* (1985) bases its standard on the conduct of a "reasonably prudent person" in comparable circumstances. This has roots in the Dickerson Report: RWV Dickerson, JL Howard and L Getz *Proposals for a New Business Corporations Law for Canada* Vol I Ottawa, Information Canada 1971 at 72; *Peoples Department Stores Inc (Trustee of) v Wise* [2004] 3 SCR 461.

[159] Section 180(1) of the *Corporations Act 2001* (Australia).

standard. It has also been noted that to provide for a standard of the prudent director may herald legal recognition of the professional director class but in itself it "does not answer the question of just what is a reasonably prudent director."[161]

The adoption of a similar test would not appear to have received express consideration in this jurisdiction and it can be surmised that the prevailing view is that an objective test would be likely to act as a weighty deterrent to the acceptance of directorships.[162] However, the controversial directors' compliance regime, requiring directors of large companies to certify that their company has appropriate procedures in place to comply with its legal and tax obligations with non-compliance being a criminal offence, qualifies independently as a decisive move towards setting objective standards aside from those already existing under the general law.[163] As Mackenzie acknowledges, there are problems inherent in adopting either an entirely objective or subjective test.[164]

(b) The Hybrid Test

The effect of the draft provision is to introduce a test which largely mirrors the UK's standard derived from section 214(4) of the *Insolvency Act 1986* which is now enshrined in section 180 of the *Companies Act 2006*. However, it can be deduced from the wording of the draft provision that the starting point in terms of existing law was seen as subtly different from that prevailing in English law. Rather curiously, the CLRG's recommendation was succinctly

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[160] Section 137 of the *Companies Act 1993* (New Zealand).

[161] I Douglas n 71 above at 109. See also AL Mackenzie "A Company Director's Obligations of Care and Skill" [1982] JBL 460 at 474.

[162] In Canada this deterrence argument was viewed by the Dickerson Report as "specious" and did not prevent an objective test being ultimately adopted: RWV Dickerson, JL Howard and L Getz *Proposals for a New Business Corporations Law for Canada* Vol I Ottawa, Information Canada (1971) at 83.

[163] Head 7 of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007) involves amendments to the controversial and never commenced section 205E of the *Companies Act 1990* (inserted by section 45 of the *Companies (Auditing and Accounting) Act 2003*). See further Company Law Review Group *Report on Directors' Compliance Statement* (2005); D Ahern "Directors' Compliance Statements under the Microscope" (2006) 13 C L Pract 137.

[164] AL Mackenzie n 161 above at 470.

expressed to be based on *Re City Equitable Fire Insurance Ltd*[165] with no reference to the shift in judicial thinking brought about by the *Barings* litigation.[166] Nevertheless, the *Re City Equitable* formula employed is malleable enough to allow judicial development and adjustment to suit particular cases and societal changes. In applying the provision, the courts' approach will be informed by judicial cognisance in Irish restriction decisions of the shift in judicial mindset dating from the *Barings* decision.[167] Moreover, judges are likely to regard the provision as broad enough to be interpreted as a living provision and to apply an updating standard reflecting current societal expectations concerning directors' standards as is contemplated by section 6 of the *Interpretation Act 2005*.

The difference between the hybrid draft Irish provision and the Australasian objective tests[168] lies in the direct reference in the Irish test to the attributes of the individual director rather than simply to the decision-making scenario. The hybrid objective-subjective test involves a first limb embodying an objective standard while the second limb adds a subjective element to the mix. This gives considerable flexibility to the courts as to how the balance between the objective and the subjective elements should be determined in any particular case. However, given the trends in case law in this area,[169] it can be expected that an increasing weight will be given to the objective limb. In some cases the education and experience of a director may augment what is required by the objective test.[170]

An Australian commentator said the section 214(4) standard:

> "... leaves open to question whether the objective standard sets the floor and the subjective standard a potentially higher ceiling (the preferred view), or whether the

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[165] [1925] Ch 407.

[166] *Re Barings plc (No. 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433, endorsed on appeal [2000] 1 BCLC 523, CA. See further Chapter 2 above.

[167] *Re Vehicle Imports Ltd* [2000] IEHC 90; *Kavanagh v Delaney* [2005] 1 ILRM 34; *Grace v Kachkar* [2005] IEHC 63; *Re SPH Ltd; Fennell v Shanahan* [2005] IEHC 152.

[168] Section 180(1) of the *Corporations Act 2001* (Australia) and section 137 of the *Companies Act 1993* (New Zealand).

[169] See Chapter 2 above.

[170] See the discussion on section 214(4) of the *Insolvency Act 1986* (UK) in Chapter 2 above.

subjective standard may introduce elements in mitigation of the objective standard, where actual experience and knowledge is very limited. Indeed both raising and lowering of the objective standard might conceivably be possible, depending on whether actual experience and knowledge is higher or lower than what might reasonably be expected."[171]

However, Professor Prentice regards it as "reasonably clear" that section 214(4)(a), corresponding to an objective standard, "sets the floor" while sub-section (b), corresponding to a subjective standard, "sets the ceiling".[172] It seems that each case will have to be approached on its facts and will require an individual assessment of liability so in many ways the influence of the objective limb can only be notional.[173]

It is possible that in applying the hybrid test the courts may be prepared to engage in a type of cost-benefit analysis. In *Vrisakis v The Australian Securities Commission*[174] Ipp J emphasised that the "mere fact that a director participates in conduct that carries with it a foreseeable risk of harm to the interests of the company will not necessarily mean that he has failed to exercise a reasonable degree of care and diligence...."[175] This reflects the business judgment rule. It therefore followed that "... the question whether a director has exercised a reasonable degree of care and diligence can only be answered by balancing the foreseeable risk of harm against the potential benefits that could reasonably have been expected to accrue to the company from the conduct in question."[176] This same cost-benefit analysis is also a thread running through reckless trading and wrongful trading decisions.[177]

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[171] GFK Santow n 25 above at 339. See also English and Scottish Law Commissions n 32 above at n 29 accompanying para 15.21.

[172] D Prentice "Corporate Personality, Limited Liability and the Protection of Creditors" in RB Grantham and CEF Rickett (eds) *Corporate Personality in the 20th Century* 1998 Hart Publishing Oxford at 112.

[173] See comments of Chief Justice Malcolm "Directors' Duties: the Governing Principles" in IM Ramsay (ed) *Corporate Governance and the Duties of Company Directors* Centre for Corporate Law and Securities Regulation University of Melbourne 1997 at 78.

[174] (1993) 11 ACSR 162.

[175] *Ibid* at 212.

[176] *Ibid.*

[177] See further TB Courtney *The Law of Private Companies* 2nd ed LexisNexis Butterworths Dublin 2002 at Chapter 10 (C).

Given developments in the UK to align the standard applicable to directors in a solvency and insolvency context,[178] it is worth noting that the hybrid test which is proposed is at some remove from the more objective test of deemed reckless trading in section 297A(2)(a) of the *Companies Act 1963*[179] which requires regard to be had to "the general knowledge, skill and experience that may reasonably be expected of a person in his position" in order to decide whether a director ought to have known that his actions or those of the company would cause loss to the creditors of the company, or any of them."[180] Clearly this is a more onerous test than that applicable in the UK and may reveal an underlying policy assumption that a more onerous test is justified in circumstances where the prospect of insolvency is looming. A consequence of this divergence is that, while in the UK there is now an equivalent legislative standard in place for directors of companies trading as a going concern and directors of companies who are unable to pay their debts as they fall due, the same cannot be said here. This is of some practical significance having regard to the fact that in restriction applications which liquidators are duty-bound to bring against directors of insolvent companies being wound up,[181] the courts currently routinely have regard to the general duty to exercise skill, care and diligence[182] rather than applying the tougher reckless trading test. This assumes greater significance when it is considered that a by-product of the restriction regime is that applications under the reckless trading provisions are less likely.

(i) The Reasonable Person

The reasonable person test encompassing both objective and subjective elements has its origins in *Re City Equitable.*[183] Interestingly, section 174 of the UK *Companies Act 2006* has a slightly different nuance in referring to the care, skill and diligence "that would be exercised

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[178] See English and Scottish Law Commissions n 87 above at para 5.9.

[179] Inserted by section 180(3) of the *Companies Act 1990.*

[180] This wording is carried through to Head 49(2)(a) of Part A11 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[181] Unless relieved of the obligation by the Director of Corporate Enforcement: section 56 of the *Company Law Enforcement Act 2001.*

[182] See *eg Kavanagh v Delaney* [2005] 1 ILRM 34; *Grace v Kachkar* [2005] IEHC 63; *Re SPH Ltd; Fennell v Shanahan* [2005] IEHC 152.

[183] *Re City Equitable Fire Insurance Ltd* [1925] Ch 407.

by a reasonably diligent person"[184] rather than simply a "reasonable person" as appears in the Irish draft provision. That additional "diligence" reference has its roots in the wrongful trading section 214(4) of the *Insolvency Act 1986* which the English judiciary adopted as the applicable common law standard.[185]

The draft provisions do not contain any specific guidance on delegation and reliance which means that it will have to be judged by reference to the general hybrid test in sub-head 9(3)(g). There was no discussion of this in the CLRG's reports but in the UK the rationale behind a decision not to legislate in this area was that the law in this area was still developing.[186] This contrasts with the position in some jurisdictions where more specific legislative guidance exists on directorial delegation and reliance.[187] New Zealand's *Companies Act 1993* permits monitored delegation and reliance which does not amount to delegation of a director's management function and this is reinforced by an express exclusion from delegation of certain functions such as those relating to the transfer and issue of shares.[188] Express statutory guidance in relation to the circumstances in which it is appropriate for a director to rely on information and advice from third parties including employees and professional advisers is available in both Australia[189] and New Zealand.[190]

(ii) The Omission of a Reference to Skill in the Sub-tests

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[184] A similar formulation is proposed for South Africa: section 91(1)(a) of Chapter 4 of Part B of the draft Companies Bill produced by the Department of Trade and Industry (South Africa) (February 2007).

[185] See further Chapter 2 above.

[186] English and Scottish Law Commissions n 87 above at para. 5.36. See also the Company Law Review Steering Group (UK) *Modern Company Law For a Competitive Economy: Developing the Framework* URN 00/656 (2000) at para 3.71.

[187] On delegation see *eg* section 198D of the *Corporate Law Economic Reform Act 1999* (Cth) (Australia) and section 18-407 of the *Limited Liability Company Act* (Delaware). On reliance see *eg* section 121(a) of the *Canadian Business Corporations Act 1985*.

[188] Section 130 of the *Companies Act 1993* (New Zealand).

[189] Section 189 of the *Corporations Law 2001* (Australia).

[190] Section 138 of the *Companies Act 1993* (New Zealand).

The reckless trading test in 297A(2)(a) of the *Companies Act 1963* includes "skill" in its assessment of "the general knowledge, skill and experience that may reasonably be expected of a person in his position". However, although the draft statutory duty in sub-head 9(3)(g) encompasses skill, neither the objective nor the subjective test in the draft provision contain an express reference to skill. This curiosity brings to mind an earlier abortive reform proposal in the UK some thirty years ago which proposed to codify the duty in terms which also omitted the skill element of the comparison by requiring directors to exercise that degree of care and diligence that a reasonably prudent person would exercise in comparable circumstances and the degree of skill which may reasonably be expected of a person of his knowledge and experience.[191] This proposal was the subject of some criticism for not going far enough. Rider viewed that test as imposing too low a level of responsibility and commented that executive directors as employees "might be expected to exhibit the degree of skill objectively contemplated in their particular job".[192]

As matters stand, this aspect of the draft provision falls between the traditional Australian approach in section 180(1) of the *Corporations Act 2001* which provides for a standard of care and diligence while omitting any reference to skill[193] and that taken in its closest analogue section 174 of the UK *Companies Act 2006*, which contains a reference to "skill" in both the objective and subjective sub-clauses, based on section 214(4) of the *Insolvency Act 1986*, as imported into company law in *Re D'Jan of London Ltd.*[194] At one level this differential can be explained by a process of faithful codification rather than reform - there has never been direct judicial consideration of the need to reformulate the test (as occurred in the UK based on section 214(4) of the *Insolvency Act 1986*)[195] so it is the original *City Equitable* test which is mirrored in this respect. It would, however, be disingenuous to suggest that no reforms have

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[191] UK Department of Trade *The Conduct of Company Directors* Cmnd 7037 (1977) at para 4.

[192] BAK Rider n 154 above at 27-28. He cited *Lister v Romford Ice and Cold Storage Co Ltd* [1957] 1 All ER 125 to support this proposition.

[193] See further GFK Santow n 25 above at 342.

[194] [1994] 1 BCLC 561. See also 122(1)(b) of the *Canada Business Corporations Act 1975* and section 91(1)(a) of Chapter 4 of Part B of the draft Companies Bill produced by the Department of Trade and Industry (South Africa) (February 2007).

[195] The contrary view is that the restriction and disqualification decisions have embraced that shift. See further Chapter 2 above.

been included in the CLRG's draft legislative statement concerning directors' duties. Seen in this light, the failure to go back to the drawing board in relation to care, skill and diligence is all the more surprising.

In any event it is possible that judges will read an imperative to obtain the necessary education and skills into the equation.[196] Judicial willingness to look through an objective lens was focused on in the watershed *Kavanagh v Delaney*[197] decision which saw the High Court placing an onus on directors to take reasonable steps to up-skill so as to ensure that they are in a position to control and supervise the company's affairs. In *Australian Securities Commission v Gallagher*[198] the reasonable person test was interpreted as including an expectation that a director would take reasonable measures to ensure that he was equipped to guide and monitor the company's affairs. Furthermore, in the celebrated American case of *Barnes v Andrews* the clear view was that if a director "... feels that that he has not had sufficient business experience to qualify him to perform the duties of a director, he should acquire the knowledge by inquiry, or refuse to act ...."[199]

(iii) The Objective Standard

As in other jurisdictions, the legislature is now being asked to follow the lead of the courts in responding to changing societal attitudes. The English and Scottish Law Commissions' perspective on the hybrid section 214 test was that it was laudable for involving a general objective standard of care which would have to be met by all directors.[200] The Steering Group of the UK's Company Law Review viewed the objective element as designed "... to ensure proper modern standards of professionalism for the benefit of the community as a whole."[201] In choosing to reflect the section 214 wrongful trading standard, the UK Steering Group opted for a public policy emphasis over a contractarian approach and rejected the argument that companies should be permitted to contract with directors as to where the risk will fall where a

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[196] See the discussion in Chapter 2 above.

[197] [2005] 1 ILRM 34.

[198] (1993) 10 ACSR 43.

[199] 432A 2d 814, 822 (1981) *per* Pollock J.

[200] English and Scottish Law Commissions n 32 above at para 15.2 and n 87 above at para 5.9.

[201] The Company Law Review Steering Group (UK) n 186 above at para 2.19.

director acts beyond his competence. It was not considered desirable that the objective standard should be capable of being relaxed by contract.[202] It has been said that the effect is that "... a director is not excused because he lacks the basic attributes that a director should have."[203]

The first limb refers to "the knowledge and experience that may reasonably be expected of a person in the same position which the director has". This reflects the same emphasis in the case law dating from *Re City Equitable*[204] where, in seeking to assess the appropriate standard, there is considerable judicial emphasis on defining the duties which the director was expected to perform, the nature of the company's business and the internal division of work within the company. This was reinforced in the *Barings*[205] formulation which has been adopted by the Irish judiciary in restriction decisions.[206] Such considerations will continue to be central to the application of the statutory duty in a fact-sensitive manner.[207] This limb is also broad enough to allow the courts to accommodate differing expectations of non-executive directors if they so choose (subject to the appropriateness of the actual degree of delegation and monitoring). Based on the approach taken in the sphere of restriction, it may be hazarded that the courts will adopt a base line objective standard but not an unrealistic one. The likely type of balance is that marked out in the reduction in *Re Squash (Ireland) Ltd*[208] where McGuinness J indicated that irresponsibility would be judged by an objective standard but that qualifying conduct would have to go beyond mere commercial misjudgment.

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[202] *Ibid* at para 3.68. However, one would quibble with the Steering Group's suggestion at para 3.68 that this would amount to aligning the standard with that which prevails in professional negligence claims.

[203] Rt Hon Lady Justice Arden DBE n 18 above at 169.

[204] *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407.

[205] *Re Barings plc (No. 5), Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433, endorsed on appeal [2000] 1 BCLC 523, CA.

[206] *Re Vehicle Imports Ltd* [2000] IEHC 90; *Kavanagh v Delaney* [2005] 1 ILRM 34; *Grace v Kachkar* [2005] IEHC 63; *Re SPH Ltd; Fennell v Shanahan* [2005] IEHC 152.

[207] In the UK the English and Scottish Law Commissions recommended that the statutory statement should make express provision for the need to have regard to the functions of the director and the nature and size of the company: n 87 above at para 5.38. However, this was not included in the *Companies Act 2006* (UK).

[208] [2001] 3 IR 35.

(iv) The Subjective Test

It is usually considered that the superimposition of a subjective test will be relevant where a director had particular skill and expertise which he should have been using.[209] In those circumstances he or she would be judged on the basis of being in possession of that extra expertise and experience. This has the effect that the greater the knowledge, skill and experience, the greater the standard to meet.[210] As discussed above, in the converse scenario of a director who has less than average skills and experience,[211] the most obvious interpretation is that this type of director would still be met with the objective standard. In other words it would appear that the subjective provision is designed to raise the standard not to lower it.[212]

(3) The Business Judgment Rule

While fear that a statutory statement of the business judgment rule could prove inflexible and operate either too harshly or too leniently in a particular case led the UK's Steering Group of the Company Law Review not to recommend statutory intervention,[213] there was no direct consideration of the issue by the CLRG in its reports.[214]

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[209] English and Scottish Law Commissions n 32 above at para 15.21.

[210] See *eg Cummings v Claremount Petroleum* (1992) 9 ACSR 583 (both directors were experienced commercial solicitors and directors); *Re First Class Toy Traders Ltd* [2004] IEHC 289 (two directors were experienced businessmen, a third director had significant accounting and finance experience).

[211] *Re Club Tivoli Ltd (in vol liq); Foster v Davis* [2005] IEHC 468 (respondent director regarded as not having any particular skill concerning the company's business).

[212] Rt Hon Lady Justice Arden DBE n 18 above at 169. Neither the Explanatory Notes prepared by the Department of Trade and Industry (UK) on the *Company Law Reform Bill 2005* (n 36 above) nor those prepared on the *Companies Act 2006* (UK) (n 90 above) provide any guidance on this point.

[213] The Company Law Review Steering Group (UK) n 186 above at para 3.70. See also English and Scottish Law Commissions n 87 above at para 5.21 ff.

[214] N 10 above.

Throughout the US, the business judgment rule is primarily a case law-based doctrine.[215] The *Revised Model Business Corporation Act* does not purport to codify the business judgment rule and the commentary to it notes that "[b]ecause the elements of the business judgement rule and the circumstances for its application are continuing to be developed by the courts, it would not be desirable to freeze the concept in a statute."[216] The Canadian experience is that the courts apply the objective test in a sensible manner which recognises that "[b]usiness decisions must sometimes be made, with high stakes and under considerable pressure, in circumstances in which detailed information is not available."[217] Nor has New Zealand incorporated a business judgment rule.

However, a statutory business judgment rule is contained in section 180(2) of Australia's *Corporations Act 2001*[218] whereby directors are deemed to meet the statutory duty of care and diligence if they make a judgment in good faith and for a proper purpose, do not have a material personal interest in the matter, inform themselves in relation to the matter the subject of the judgment to the extent that they reasonably believe to be appropriate and rationally believe that the judgment they make is in the best interests of the corporation.[219] Although the enactment of the rule was motivated by the fear that directors might otherwise avoid new opportunities involving responsible risk-taking,[220] some commentators have queried the need

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[215] An exception is section 13.1-690A of the *Virginia Stock Corporations Act*. See further JH Farrar "Corporate Governance, Business Judgment and the Professionalism of Directors" (1993) 6 CBLJ 1; MB Hemraj "The Business Judgment Rule in Corporate Law" (2004) 15 ICCLR 192.

[216] American Bar Association *Revised Model Business Corporation Act* 3rd ed 2005 supplement § 8.31 at 8-163.

[217] *Peoples Departments Stores Inc (Trustee of) v Wise* [2004] 3 SCR 461, [64].

[218] The courts also have a common law business judgment rule which applies to judgments made by directors which are outside the scope of the statutory duty of care and diligence *eg* as to whether a matter is in the best interests of the company.

[219] Cases considering the statutory business judgment rule include *Re HIH Insurance Ltd (in prov liq)*; *ASIC v Adler* (2002) 41 ACSR 72; *Adler v ASIC (2003) 46 ACSR* 504. See further Senate Standing Committee of Legal and Constitutional Affairs (Australia) *Company Directors' Duties* (1989) para 3.30 ff; Companies and Securities Law Review Committee *Company Directors and Officers: Indemnification, Relief and Insurance* Report No. 10 1990 para 68-92; RP Austin, HAJ Ford and IM Ramsay *Company Directors: Principles of Law and Corporate Governance* LexisNexis Butterworths Australasia 2005 at 6.8-6.11.

[220] *Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1998* (Australia) at para 6.1-6.10.

for such a statutory provision given the well-established equitable doctrine.[221] It has also been said that the force of argument in favour of a statutory business judgment rule is lost by the fact that statutory provision exists to relieve directors who have acted honestly and reasonably.[222]

While the richness and flexibility of the common law has much to commend it in this sphere, the issue with leaving a business judgment entirely to the courts is how far they will take it. Delaware's case law-based business judgment rule articulates a rebuttable presumption that a director acted having been appropriately informed, in good faith honestly believing that he acted in the best interests of the company.[223] It also sets a standard based on a concept of gross negligence[224] and it is argued that this helps to ensure that this will not deter entrepreneurship. DeMott asserts that the "functional consequence" is judicial deference to the decisions of boards unless they "cannot be attributed to any rational business purpose."[225]

Leaving the matter as a judgment call for a court seems sensible since on the case law evidence examined in Chapter 2 above, the Irish courts have shown themselves to be up to the task. There are in any event statutory provisions enabling the courts to relieve directors from liability.[226] While the Irish courts have shown themselves to be sensitive to the need for risk-taking in business decisions, it is unlikely that they will tip the balance too far in the direction of the old unquestioning acceptance of directors' judgment. Therefore the absence of a

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[221] See *eg* P Redmond "Safe Harbours or Sleepy Hollows: Does Australia Need a Statutory Business Judgment Rule" in IM Ramsay (ed) *Corporate Governance and the Duties of Company Directors* Centre for Corporate Law and Securities Regulation, University of Melbourne 1997; D Botha and R Jooste "A Critique of the Recommendations in the King Report Regarding a Director's Duty of Care and Skill" (1997) 114 S African LJ 65 at 72-76; MB Hemraj n 215 above.

[222] R Baxt "The Duty of Care of Directors – Does it Depend on the Swing of the Pendulum?" in IM Ramsay (ed) *Corporate Governance and the Duties of Company Directors* Centre for Corporate Law and Securities Regulation, University of Melbourne 1997 at 121.

[223] *Aronson v Lewis* 473 A.2d 805 (Del. 1984).

[224] *Ibid*; *Smith v Van Gorkom* 488 A.2d 873 (Del. 1985).

[225] D DeMott "Inside the Corporate Veil: The Character and Consequences of Executives' Duties "(2006) 19 Austn Jnl of Corp Law 251 at 262.

[226] See further Chapter 6 below.

statutory enunciation of the business judgment rule seems unlikely to prove problematic.[227] The point can also be forcefully made that a statutory business judgment rule should not be deemed a priority in a country such as this where obstacles to enforcement make litigation of duties a very unlikely occurrence.[228]

F. THE DUTY TO ACT HONESTLY AND RESPONSIBLY

(1) The Draft Provision

Rather curiously sub-head 9(3)(b) of Part A5 of the draft heads of Bill introduces a new duty to "act honestly and responsibly in relation to the conduct of the affairs of the company".

(2) Analysis

(a) Background

A duty to act honestly and responsibly was not put forward by the CLRG in its reports on reform; this innovation occurred when the heads of bill were being drafted. Consequently, the thinking behind the introduction of such a statutory duty is somewhat unclear. The provision has its roots in the language used in relation to the restriction regime in section 150 of the *Companies Act 1990*.[229] When a restriction application is made, the High Court must make a restriction order unless it is satisfied that the director "has acted honestly and responsibly in relation to the conduct of the affairs of the company" and that there is "no other reason why it would be just and equitable" not to make a declaration of restriction.[230]

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[227] For a similar UK perspective see S Worthington n 85 above at 450.

[228] For an Australian perspective on this point see P Redmond n 153 above at 113. See further Chapter 6 below.

[229] For confirmation of this see Company Law Review Group n 2 above at 42.

[230] See further Chapter 2 above.

(b) Some Theoretical Misgivings

To introduce a positive requirement "to act honestly and responsibly" as a stand alone duty is a very different proposition from usage of the concept as evidence of mitigating circumstances in the event of a restriction application being brought. Unlike the restriction regime, the onus of proof is likely to fall on the person seeking to allege that director has not acted honestly or responsibly. That is a high onus to meet. Furthermore, at base level, a certain level of theoretical incoherence is evident when this draft provision is juxtaposed alongside the statutory provision for relief from liability for breach of duty where a director has acted "honestly and reasonably".[231]

Doubts as to the wisdom of introducing such a duty crystallise on carrying out a comparative assessment, the results of which do not bode well for the success of such a provision in a code motivated by the need for transparency and ease of application. In the UK, the introduction of a statutory duty to act honestly was contemplated on a number of occasions.[232] The proposal was criticised for being narrower than the composite duty to act *bona fide* in the best interests of the company and for proper purposes[233] and came to nothing. It is instructive that the Malaysian Corporate Law Reform Committee recently recommended the abolition of a stand alone duty to act honestly[234] on the basis of the uncertainty as to its application and said that it should be replaced by a statutory statement of a duty to act *bona fide* in the best interest of the company and a duty to exercise powers for a proper purpose.[235]

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[231] See Head 14 "Power of court to grant relief to officers of the company" which corresponds to section 391 of the *Companies Act 1963*. See further Chapter 6 below.

[232] See Clause 52 of the *Companies Bill 1973* (UK) and Clause 44 of the *Companies Bill 1978* (UK); Company Law Review Steering Group (UK) n 186 above at 3.46. This did not appear in the Company Law Review Steering Group's final report: *Modern Company Law for a Competitive Economy: Final Report* Department of Trade and Industry London URN 01/942 and URN 01/943 (2001).

[233] JR Birds "A Code of Directors' Duties?" (1974) 124 NLJ 1163 at 1163.

[234] Section 132(1) of the *Companies Act 1965* (Malaysia).

[235] Corporate Law Reform Committee (Malaysia) *A Consultative Document on Clarifying and Reformulating the Directors' Role and Duties* (2006) at para 4.11-4.17.

(c) Some Issues of Construction

If enacted (and it is hoped that this will not be the case), the ball will be firmly in the judiciary's court as to the provision's interpretation. There is no indication of how honesty and responsibility are to be judged. This may jeopardise any certainty to be expected from what was intended as essentially a restatement rather than a reform of directors' duties.

Immediately the wording of this novel duty presents one with difficult questions concerning the difference between a duty to take reasonable care and one to act responsibly and the duty to act in good faith in the interests of the company and the potentially seemingly more open-ended nature of a duty to act honestly in the conduct of the company's affairs. A further important issue concerns how the proposed care, skill and diligence duty would to interact with the proposed new duty to act honestly and responsibly. While an honesty requirement has never had any bearing on breach of the common law and equitable duty,[236] it has been influential at remedy stage under both the restriction regime and in decisions concerning the granting of relief from beach of duty.[237] Presumably the requirement to act responsibly will not be met simply by satisfying the test for the skill, care and diligence duty since it would seem that the duties stand alone. Therefore it would seem that it would be assessed in its own right on an entirely objective basis. The question arises as to whether this would lead to a usurpation of the proposed statutory duty of care should the courts set the bar for acting responsibly at a higher level than the objective-subjective hybrid which it is intended to enshrine for testing care, skill and diligence.

Some hints as to how the "honesty and responsibility" formula may be interpreted can be gleaned from the restriction context[238] albeit with the caveat that the corpus of restriction decision do not involve the interpretation of a statutory duty but rather concern the availability of a sanction against directors whose conduct fell short of what was expected.

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[236] *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407.

[237] See further Chapter 6 below.

[238] See in particular *La Moselle Clothing Ltd v Soualhi* [1998] 2 ILRM 345 and *Re Squash (Ireland) Ltd* [2001] 3 IR 35 discussed in Chapter 2 above.

The restriction case law indicates that the honesty and responsibility requirements are regarded as stand-alone – breach of one is sufficient.[239] Thus in *Re Squash (Ireland) Ltd*[240] the finding that the director had undoubtedly acted honestly did not rule out a rigorous consideration of whether they had acted responsibly. It is therefore possible that the proposed statutory duty would be viewed as a composite duty with each aspect requiring to be separately met in order to avoid being found to have been in breach of duty. McGuinness J's judgment in that case also indicated that in a restriction context the time frame in which a director's conduct was to be assessed extended beyond the insolvency to his whole tenure in office. In the context of the proposed new duty it is conceivable that the courts would interpret the duty to act honestly and responsibly not just in relation to particular acts or omissions complained of, but as a general assessment of conduct since taking up the directorship.

From this perspective a lack of honesty may be equated to a lack of commercial probity rather than dishonesty in the strict criminal sense.[241] In relation to acting responsibly, in *Re Squash (Ireland) Ltd* the Supreme Court endorsed an objective assessment of whether a director has acted responsibly but indicated that it would require conduct which went beyond mere commercial misjudgment. This indicates that the courts may still be keen to be pragmatic with regard to the risk-taking involved in business life and that vestiges of the business judgment rule will continue to permeate decisions even though there has been no move to tie this down in legislation. In *Business Communications v Baxter*[242] Murphy J regarded acting responsibly as requiring compliance with the *Companies Acts* and the records required to be maintained under them in order to allow the directors to make reasonable commercial decisions. This has been echoed in other decisions[243] and while some slack may be cut for limited non-compliance with tax requirements,[244] prolonged non-compliance is likely to be viewed as irresponsible,[245] particularly where executive directors are concerned.[246]

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[239] See *eg Re Squash (Ireland) Ltd* [2001] 3 IR 35; *Re Club Tivoli Ltd (in vol liq); Foster v Davis* [2005] IEHC 468.

[240] [2001] 3 IR 35.

[241] *Re Squash (Ireland) Ltd* [2001] 3 IR 35.

[242] High Court (Murphy J) 21 July 1995 unrep.

[243] *Re Club Tivoli Ltd (in vol liq); Foster v Davis* [2005] IEHC 468.

[244] *Re Digital Channel Partners Ltd; Kavanagh v Cummins* [2004] 2 ILRM 35.

G. THE DUTY TO ACT IN GOOD FAITH IN THE INTERESTS OF THE COMPANY

Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* contains a number of discrete aspects which will have an impact on the composite duty to act in good faith in the best interests of the company and for proper purpose examined in Chapter 3 of this thesis. The relevant heads are Head 6 "Directors to have regard to the interests of employees", Head 7 "Director's compliance statement and related statement" and sub-heads 9(3)(a), (c), (e) and (h) which deal with codifying the various elements in statutory form.

The draft scheme confirms the separation of best interests from proper purposes. While a composite formulation for good faith and interests of the company is favoured,[247] the separate provision for the proper purposes doctrine[248] indicates an acceptance of the stand alone nature of that doctrine. The clear separation of these aspects should make for greater clarity of judicial analysis.

(1) The Draft Provision

Sub-head 9(3)(a) of Part A5 of the draft scheme requires every director to:

> "act in good faith in what the director considers to be the interests of the company."

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[245] *Re Club Tivoli Ltd (in vol liq); Foster v Davis* [2005] IEHC 468; *Re National Irish Bank Ltd; Director of Corporate Enforcement v Seymour* [2007] IEHC 102.

[246] *Re National Irish Bank Ltd; Director of Corporate Enforcement v Seymour* [2007] IEHC 102 (disqualification order on the basis of failure to resolve tax non-compliance).

[247] Sub-head 9(3)(a) of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[248] *Ibid* at sub-head 9(3)(c).

(2) Analysis

The draft provision reflects the CLRG's recommendation[249] of the inclusion in the statutory statement of a "duty of loyalty"[250] in identical terms based on *Clark v Workman*[251] and *Percival v Wright.*[252] The UK's decision to opt for a reworking of this duty as a duty to promote the success of the company (discussed below) marks a divergence in approach between the two jurisdictions.[253]

(a) A Composite Duty

The substance of the statutory formulation is a composite statement of duty. That the "good faith" requirement is separate from the duty to "act in the interests of the company" is supported by the omission of a conjunctive "and" between the two aspects in the draft provision.

(b) "The Company"

The draft Irish provisions do not give any express guidance on the meaning of "the company" for the purposes of considering its interests. As will be seen later in this chapter, the legislative approach was to deal separately with the interests of employees and members and those of nominating shareholders. New Zealand's *Companies Act 1993* includes a further

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[249] Company Law Review Group n 3 above at 11.3.7.

[250] It is contended that the removal of the "duty of loyalty" label is salutary given the confusion which continues to surround the exact ambit of the term.

[251] [1902] 1 IR 107.

[252] [1902] 2 Ch 421.

[253] Section 172 of the *Companies Act 2006*. This is discussed further later in this chapter.

exception to the best interests rule in section 131 to cover acting in the interests of a parent company.[254]

(c) A Subjective Test

The statement retains the traditional deference to the directors' assessment of the company's interests.[255] While some will regard this as an appropriate manifestation of the business judgment rule, others will view its entirely subjective perspective as an anachronism in today's business world. Comparative analysis indicates that express legislative endorsement of a subjective assessment is not unheard of in legislative enactments of the duty[256] but some legislative treatments remain silent on the test to be employed.[257] However, section 181 of Australia's *Corporations Act 2001* contains an objective test which requires a director to act "in good faith in the best interests of the corporation". This involved the removal of the earlier qualifying words "in what they believe to be" so as to create an objective rather than a subjective test.[258] This development was case law-led – the courts had indicated that the equitable duty would be breached if the directors failed to give adequate consideration to what the court determined to be the interests of the company.[259] In simply opting to encapsulate the status quo, it is unfortunate that no comparative analysis was undertaken by the CLRG in its reports as this would have presented these varying options for consideration.

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[254] See also Australia's relaxation of the best interests rule in the case of wholly-owned subsidiaries in section 187 of the *Corporations Act 2001*.

[255] See Chapter 3 above.

[256] See *eg* section 131(1) of the *Companies Act 1993* (New Zealand) and section 172 of the *Companies Act 2006* (UK). Clause 91(b) of South Africa's draft *Companies Bill 2007* published by the Department of Trade and Industry uses a hybrid formula of "in a manner the director reasonably believes to be in the best interests of, and for the benefit of, the company".

[257] See *eg* section 122(1) of the *Canada Business Corporations Act* RS 1985 c.C-44.

[258] See Companies and Securities Advisory Committee (Australia) *Report to the Minister for Financial Services and Regulation on Sections 181 and 189 of the Corporations Law* (2000).

[259] See further H Ford, R Austin and I Ramsay *An Introduction to the CLERP Act 1999* Butterworths Sydney 2000 at para 2.27.

(d) Acting in the Company's Interests

While the draft Irish provision contains no guidance on whether it is the short term or long term interests which are in issue, section 172(1)(a) of the UK's *Companies Act 2006* reveals that a long term view is to be favoured.[260]

The omission of the word "best" in the context of the legislative formulation of a duty to act in the interests of the company is noteworthy. While this omission is sometimes evident in judicial formulations,[261] there is a marked penchant in discussion of the duty for the inclusion of the qualifying adjective and the "best interests" formulation is also used in statutory encapsulations of the duty.[262] On the other hand, the point may be made that there is no definitive Irish judicial pronouncement on the best interests duty and that in these circumstances a choice of approach was open. Indeed, in his leading text, Courtney expressed the duty in terms of a duty on directors to exercise their powers "bona fide and in the interests of the company".[263] Regrettably the succinct approach of the CLRG to the statement of duties does not shed any light on the thinking here. It is fair to state that the issue is not purely a semantic one: a requirement to act merely in the interests of the company rather than its best interests is a less onerous proposition and, if solidified in a legislative companies code, it would introduce a legislative slant which could not be departed from or manoeuvred around as easily as judicial utterances.

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[260] This was a *volte face* on the position adopted at White Paper stage where the UK Government wished directors to have regard to both short term and long term consequences: Department of Trade and Industry (UK) n 41 above at draft clause B3(3).

[261] See *eg Re Smith and Fawcett Ltd* [1942] Ch 304; *Mutual Life Insurance Co v Rank* [1985] BCLC 11; *Re PMPA Garage (Longmile) Ltd* [1992] 1 IR 315; *Bishopsgate Investment Management Ltd (in liq) v Maxwell (No. 2)* [1994] 1 All ER 261; *JJ Harrison (Properties) Ltd v Harrison* [2002] 1 BCLC 162, [25] *per* Chadwick LJ; *Banfi Ltd v Moran* [2006] IEHC 257. See further Chapter 3 above.

[262] See *eg* section 131 of the *Companies Act 1993* (New Zealand); section 181 of the *Corporations Act 2001* (Australia); section 122(1) of the *Canada Business Corporations Act* RS 1985 c.C-44; Clause 91(b) of South Africa's draft *Companies Bill 2007* published by the Department of Trade and Industry (South Africa).

[263] TB Courtney n 177 above at [10.024].

(3) Employees' and Members' Interests

(a) The Draft Provision

Head 6 of Part A5 of the draft scheme entitled "Directors to have regard to interests of employees" provides:

> "(1) The matters to which the directors 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.
>
> (2) Accordingly, the duty imposed by this head on the directors shall be owed to the company (and the company alone) and shall be enforceable in the same way as any other fiduciary duty owed by a company to its directors."

(b) Analysis

The heading "Directors to have regard to the interests of employees" is misleading as the text also refers to the interests of the members. The CLRG had initially favoured the more apt rubric of a "duty to consider interests of third parties."[264] In any event, Head 6 involves an unvarnished re-enactment of section 52 of the *Companies Act 1990*.[265] It has been asserted that this type of provision requiring regard to be had to the interests of employees and members should not be understood as stating that directors owe a duty to them.[266] Accordingly, the comments made in Chapter 3 concerning its token nature and lack of efficacy retain their force.

Rather curiously, the UK's Company Law Review Steering Group sought the repeal of the equivalent section 309 of the *Companies Act 1985* lest it facilitate the ousting of shareholder

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[264] Company Law Review Group n 3 above at 11.3.7.

[265] See further Chapter 3 above. Sub-head 9(3)(h) of the draft scheme contains an additional requirement for directors "to have regard to the interests of the company's employees in general and to those of its members." This duplication appears to be a drafting oversight.

[266] DJ Bakibinga "Directors' Duty to Act Bona Fide in the Interest of the Company" (1990) 39 ICLQ 451 at 456.

primacy through preferring employees' interests. To prevent such an interpretation, a remodelled provision was recommended which would clarify that directors would only be required to consider employees' interests within the context of acting in shareholders' interests.[267] This development has been regarded as replacing shareholder primacy with the concept of enlightened shareholder value.[268]

The CLRG had also recommended the inclusion in the statutory statement of a duty of fairness requiring directors to "act fairly as between different members"[269] based on *Nash v Lancegaye Safety Glass (Ireland) Ltd.*[270] However, no such duty appears in the draft scheme. The thinking behind this *volte face* has not been laid bare. This is surprising given the clear and consistent *Mutual Life* line of authority emphasising that where a matter will affect different classes of shareholders, the directors must exercise their powers fairly in relation to the different classes of shareholders.[271] In contrast, section 172(1)(f) of the UK's *Companies Act 2006* requires directors to have regard to "the need to act fairly as between members of the company." It has, however, been plausibly suggested that such a principle more properly belongs to that part of companies legislation dealing with shareholders' rights and remedies rather than being expressed as a duty owed to the company.[272]

(4) The Interests of Nominating Shareholders

(a) The Draft Provision

Sub-head 9(4) of Part A5 of the draft scheme states:

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[267] Company Law Review Steering Group *Modern Company Law for a Competitive Economy: the Strategic Framework* URN 99/654 Department of Trade and Industry London (1999) at para 5.1.20-5.1.23.

[268] This development is discussed in more detail below.

[269] Company Law Review Group n 3 above at 11.3.7.

[270] (1958) 92 ILTR 11.

[271] See *Mutual Life Insurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11; *Afric Sive Ltd v Oil & Gas Exploration plc* High Court (Carroll J) 30 January 1989 unrep and other cases discussed in Chapter 3 above.

[272] A Berg "The Company Law Review: Legislating Directors' Duties" [2000] JBL 472 at 489.

"A director appointed or nominated for appointment by a member with an entitlement to so appoint or nominate under the constitution or a shareholders' agreement may have regard to the interests of that member."

(b) Analysis

The CLRG noted that the law was not altogether clear as to whether a company can contract out of its legal entitlement to compel performance by directors of their fiduciary duties.[273] However, the Review Group considered that the continued strict application of principle to nominee directors did not take account of situations where no adverse consequences to third parties arise, for example, where the joint venture is a centre of profit in its own right, with the joint venturers having an investor's financial interest and ancillary trading relationships.[274] In support of this they referred to the New Zealand case of *Berlei Hestia (NZ) Ltd v Fernyhough*.[275]

Accordingly, the Review Group recommended that where a nominee director is appointed pursuant to an entitlement provided to a shareholder in the company's articles or a shareholders' agreement, the director's fiduciary duties to the company are varied to the extent that they may have duties to third parties' interests.[276] The draft provision follows the CLRG's recommendation but the provision appears as a separate sub-head rather than as part of a duty to consider third party's interests as originally contemplated by the CLRG.[277] It would seem that the provision would encompass appointments to a joint venture vehicle or appointments to represent the interests of a lending bank or a major shareholder.

A comparative analysis indicates that the enactment of such a provision would place Ireland somewhat out on a limb. The draft provision contrasts with the position in other jurisdictions

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[273] Company Law Review Group n 3 above at 11.4.5.

[274] *Ibid* at 11.4.4.

[275] [1980] 2 NZLR 150. See further Chapter 3 above.

[276] Company Law Review Group n 3 above at 11.4.6. This reflects Barron J's appreciation of the position of nominee directors in *Irish Press plc v Ingersoll Irish Publications Ltd* High Court (Barron J) 15 December 1993 unrep.

[277] Company Law Review Group n 3 above at 11.3.7.

such as Canada and the UK where there is no express statutory carve-out for nominating shareholders. In Australia, Justice Thomas has argued in favour of making an accommodation for nominee directors in order to reflect the commercial reality that nominee directors are typically appointed with a mandate to promote and protect their appointer's interests.[278] However, no statutory provision has resulted. While such a provision is rare, interestingly, section 131(4) of New Zealand's *Companies Act 1993* goes further in expressly permitting a director of a joint venture company to act in the interests of a shareholder or shareholder even if it is not in the company's interest provided that appropriate provision is made in the company's constitution. By contrast, the draft Irish provision is mandatory rather than enabling in nature. It places the emphasis on the power of nomination being provided for in the constitution or a shareholders' agreement and imposes no requirement that these documents expressly provide for regard to be had to the interests of the nominating member.

The draft provision does not give any flavour of the balancing exercise which may be required between the appointer's interests and those of the company. This may have been a deliberate ploy to give flexibility to the courts but it makes for some uncertainty. It is interesting that the Malaysian Corporate Law Reform Committee recommended against the inclusion of a legislative principle concerning nominee directors on the basis that it would send out the wrong message concerning in whose interests the directors must act.[279] It remains to be seen whether Barron J's understanding of the primacy of the company's interest in *Irish Press plc v Ingersoll Irish Publications Ltd*[280] will be read into the section. A tighter rendering would be preferable. For instance, in Ghana there is an express statutory acknowledgement that a nominee director is entitled to give "special, but not exclusive consideration" to the interests of the nominator.[281] Certainly the expectation would be that any consideration of the appointer's interests would be subject to the overriding duty to act in the best interests of the company.

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[278] Justice EW Thomas "The Role of Nominee Directors and the Liability of Their Appointor" in IM Ramsay (ed) *Corporate Governance and the Duties of Company Directors* Centre for Corporate Law and Securities Regulation, University of Melbourne 1997.

[279] Corporate Law Reform Committee (Malaysia) n 235 above at para 4.29-4.37.

[280] High Court (Barron J) 15 December 1993 unrep. See further Chapter 3 above.

[281] See section 203(3) of the *Ghana Companies Code* (1963).

(5) The Interests of Creditors

The CLRG had recommended that a statutory duty to consider the interests of third parties would contain a reference to a duty being owed to the creditors where a company is insolvent,[282] based on *Re Frederick Inns Ltd.*[283] However, an express reference to the interests of creditors was omitted from the draft scheme published in May 2007. The CLRG has not proffered any explanation as to this change of heart. The omission may reflect thinking to the effect that there would be no need to state the duty given the statutory duties already imposed on directors in an insolvency situation. Or it may reflect the fact that a number of uncertainties continue to surround the precise application of a duty to have regard to creditors' interests as developed by the courts. In the UK this difficulty was dealt with in the final text of section 172(3) of the *Companies Act 2006* (duty to promote the success of the company) by including the following nebulous statement:

> "The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company."

From a comparative perspective, while it is the norm to provide creditor protection in the form of reckless trading provisions and similar safeguards, the provision of an independent duty to have regard to creditors' interests is not.[284] Indeed, the Canadian Supreme Court declined to read such a duty into the *Canada Business Corporations Act* given the wealth of statutory provisions designed with creditor protection in mind.[285]

(6) The Corporate Social Responsibility Debate

In Chapter 3 the burgeoning interest in corporate social responsibility was referred to within the context of a discussion on third parties whose interests might potentially be taken into

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[282] Company Law Review Group n 3 above at 11.3.7.

[283] [1991] ILRM 582 (H Ct); [1994] 1 ILRM 387 (S Ct).

[284] The companies legislation of Australia, New Zealand and Canada does not contain such a duty.

[285] *Peoples Departments Stores Inc v Wise* [2004] 2 SCR 461.

account by directors. Although the concept has been voluntarily embraced by the business community, it is obvious from the preceding discussion in the instant chapter that an active policy level debate on placing CSR and related concepts on a legal footing has not yet taken place in Ireland.

In terms of duties owed to stakeholders, the CLRG did not engage in a review of the status quo. Worthington sagely comments that "[a] sensible discussion of corporate governance cannot take place without adopting a position on the role of companies: what interests should companies, and company law, serve? Only then is it possible to assess which duties ought to be imposed on directors and, after that, how and by whom those duties can best be enforced."[286] This scope issue appears to have received minimal consideration in an Irish context. For its part, the CLRG approached the issue of a statutory statement of directors' duties with an eye to restatement rather than reform. By default this has meant that Ireland has opted not to move with the changing nature of societal expectations of companies by incorporating a wider understanding of the interests of the company as encompassing those of other stakeholders such as suppliers, the community and the environment. This is not necessarily a bad thing as moving beyond idealistic principles to practically workable legal solutions in the sphere of CSR is no mean feat. As Professor Sealy emphasises:

> "[The] issue is not whether any of these 'wider' interests merits recognition and protection but whether this can be satisfactorily achieved within the framework of company law as we know it, through the conceptual and remedial vehicle of directors' duties."[287]

Indeed, in Australia a legislative amendment to reflect an enlightened shareholder model was recently recommended against on the basis that uncertainty would result from an approach

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[286] S Worthington n 85 above at 441.

[287] LS Sealy "Directors' 'Wider' Responsibilities – Problems Conceptual, Practical and Procedural" (1987) 13 Mon LR 164 at 173-174. See also AA Berle "For Whom Corporate Managers are Trustees: A Note" (1932) 45 Harv L Rev 1365.

such as that taken in the UK and that it would lead to formulaic compliance.[288] The New Zealand Law Commission took the view that social obligations should be imposed in subject-specific legislation rather than in companies legislation.[289] This seems sensible.

More than a decade ago Professor Parkinson castigated any strategy which would necessitate the objective balancing of conflicting interests.[290] Nevertheless, the UK's recently enacted *Companies Act 2006* gives explicit recognition in section 172 to the need to consider third party interests.[291] The UK's Company Law Review Steering Group explained the rationale as follows:

> "We believe there is value in inserting a reference to the success of the company, since what is in view is not the individual interests of members, but their interests as members of an association with the purposes and mutual arrangements embodied in the constitution; the objective is to be achieved by the directors successfully managing the complex of relationships and resources which comprise the company's undertaking."[292]

The duty to promote the success of the company "for the benefit of its members as a whole" with its concept of 'enlightened shareholder value' requires the directors to have regard to a number of matters including the long-term consequences of their decision, the interests of the company's employees, relationships with suppliers and customers, the impact on the community and the environment and the desirability of maintaining a reputation for high standards of business conduct. Mayson, French & Ryan comment that this neatly brings in the interests of both the company as a separate person and its members by expressing the duty in

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[288] Joint Parliamentary Committee on Corporations (Australia) *Corporate Responsibility: Managing Risk and Creating Value* (2006). See also the Corporations and Markets Advisory Committee (Australia) *The Social Responsibility of Corporations* (2006) where similar conclusions were reached.

[289] New Zealand Law Commission *Company Law Reform and Restatement* Report No. 9 (1993) at 66. For a similar approach see Corporate Law Reform Committee (Malaysia) n 235 above at para 4.7-4.10.

[290] See JE Parkinson *Corporate Power and Responsibility: Issues in the Theory of Company Law* Clarendon Press Oxford 1993 at 86.

[291] D Attenborough "The Company Law Reform Bill: An Analysis of Directors' Duties and the Objective of the Company" (2006) 27 Co Law 162.

[292] Company Law Review Group Steering Group n 186 at para 3.51.

terms of promoting "the success of the company for the benefit of its members as a whole'".[293] During the Bill's passage the Law Society expressed concern that such a provision would invite the courts to objectively review business decisions taken in good faith with detrimental consequences for the management of companies.[294]

The consideration of these factors within an overall mandate to act for the benefit of the members as a whole is subjectively tested. In essence it would appear that the courts will apply the business judgment rule provided that the directors have acted in good faith. As Arsalidou astutely observes, "[t]he primary beneficiaries remain the company's shareholders."[295] Therefore it remains to be seen whether section 172 will amount to anything other than a convenient reminder for directors or whether it will be given teeth by the courts. As Kiarie notes, the provision "... does not confer on stakeholders any *locus standi*. Any action if brought must be by the company or its shareholders."[296] If, as she suggests, the new section simply requires a consideration of stakeholder interests then it will amount to no more than window dressing and Professor Parkinson's concerns would be unfounded.

In Ireland, despite the lack of an express reference to the interests of stakeholders (other than those of employees and members), it would be possible for the courts if they are so minded to read in a stakeholder-friendly definition of "company" in relation to the duty to act in its interests. In this regard judicial interpretation of section 122(1) of the *Canada Business Corporations Act 2001* is instructive. The section requires directors to "act honestly and in good faith with a view to the best interests of the corporation". In *Peoples Department Stores Inc (Trustee of) v Wise*[297] the Canadian Supreme Court ruled that the statutory duty to act in the "best interests of the corporation" is not to be equated simply with the interests of shareholders. While the Court acknowledged that from an economic perspective the best interests of the corporation were maximising the value of the corporation, it was also

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[293] S Mayson, D French and C Ryan n 101 above at 569.

[294] J Harris n 35 above.

[295] D Arsalidou "Shareholder Primacy in Cl. 173 of the Company Bill 2006" (2007) 28 Co Law 67 at 69.

[296] S Kiarie "At Crossroads: Shareholder Value, Stakeholder Value and Enlightened Shareholder Value: Which Road Should the United Kingdom Take?" (2006) 17 ICCLR 309 at 340.

[297] [2004] 3 SCR 461.

recognised that other factors may be relevant to the determination.[298] Therefore the Supreme Court indicated that in a particular case it may be appropriate for the directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment. It remains to be seen whether such an expansive approach would be influential in this jurisdiction given the legislative intention manifested in the largely perfunctory legislative nod in the direction of employees and members in Head 6 of Part A5 of the draft scheme.

H. THE DUTY TO OBEY THE COMPANY'S CONSTITUTION AND TO ACT FOR PURPOSES PERMITTED BY LAW

(1) The Draft Provision

Sub-head 9(3)(c) of Part A5 of the draft scheme states that every director is under a duty to:

> "act in accordance with the company's constitution and must exercise his powers only for the purposes allowed by law."

(2) Analysis

The concept of a duty to obey the company's constitution is regarded as analogous to the duty of trustees to act in accordance with the terms of the trust instrument.[299] The draft provision reflects the CLRG's recommendation that a duty to obey the company's constitution be included in the statutory statement[300] based on *Punt v Symons*[301] and *Piercy v S Mills & Co.*[302]

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[298] Citing *Teck Corporation v Millar* (1972) 33 DLR (3d) 288 (BCSC) and *Re Olympia & York Enterprises Ltd* (1986) 59 OR 254 (Div Ct).

[299] RP Austin, HAJ Ford, IM Ramsay n 219 above at para 7.17.

[300] Company Law Review Group n 3 above at 11.3.7.

[301] [1903] 2 Ch 506.

[302] [1920] 1 Ch 77.

The draft scheme also contains a separate obligation on directors to ensure compliance by the company with the *Companies Acts*.[303]

The provision mirrors the approach taken in the UK in section 171 of the *Companies Act 2006* headed "Duty to act within powers". By contrast there is no statutory expression of this duty in Australia. An alternative approach would have been to opt for independent duties as occurred in New Zealand where there is a self-contained statutory duty to exercise powers for a proper purpose[304] which is separate from the provision requiring directors to comply with the *Companies Act* and the company's constitution.[305]

(a) Acting in Accordance with the Company's Constitution

With the proposal to scale back the impact of the *ultra vires* rule and the removal of the objects clause in most types of private limited company,[306] what will be most relevant to the proposed statutory duty will be what currently form the articles of association but which in future will form part of the company's "constitution".[307] The draft provision does not reflect the fact that a director's powers can derive from sources other than the company's constitution *eg* contract, but, in any event, any such contract will be subject to the constitution. In the UK a more comprehensive formula proposed by the Steering Group of the Company Law Review (which is not reflected in section 272 of the *Companies Act 2006*) included a reference to "decisions taken under the constitution (or by the company, or any class of members, under any enactment or rule of law as to means of taking company or class decisions)".[308]

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[303] Sub-head 5(1) of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[304] Section 133 of the *Companies Act 1993* (New Zealand).

[305] Section 134 of the *Companies Act 1993* (New Zealand).

[306] See generally Company Law Review Group *First Report* n 3 above at Chapter 10; Head 20 of Part A2 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[307] *Ibid* at Head 3.

[308] Company Law Review Steering Group (UK) *Modern Company Law for a Competitive Economy: Final Report* (2001) URN 01/942 Department of Trade and Industry Vol. 1, Annex C clause 1 of Draft Statement of Directors' Duties.

(b) Exercise of Powers for Purposes Allowed by Law

What is most remarkable is the use of the limitation "purposes allowed by law" in this sub-head. This is infelicitous as it gives a misleading impression that what is at issue is an assessment of legality rather than whether the exercise reflects the purpose for which the power has been conferred which is the current judicial understanding of the proper purposes doctrine as discussed in Chapter 3 above. Undoubtedly the UK formulation of "only exercise powers for the purposes for which they are conferred"[309] sits better with the case law in this area. If this unhappy formulation is retained in the enacted legislation, it is hoped that the employment of a purposive judicial construction which takes cognisance of the well-established concept of proper purpose and collateral purpose will avoid an overly broad interpretation of the provision.

I. THE DUTY NOT TO RESTRICT THE EXERCISE OF INDEPENDENT JUDGMENT

(1) The Draft Provision

Sub-head 9(3)(e) of Part A5 of the draft scheme provides that every director of a company shall:

> "not agree to restrict the director's power to exercise an independent judgment unless this is expressly permitted by the company's constitution and provided that if a director considers in good faith that it is in the interests of the company for a transaction to be entered into and carried into effect, a director may restrict the director's power to exercise an independent judgment in the future by agreeing to act in a particular way to achieve this."

[309] Section 171 of the *Companies Act 2006* (UK).

(2) Analysis

Although there has been relatively little judicial consideration of this duty, the CLRG decided that it should be codified.[310] By contrast, New Zealand and Australia and Canada opted not to legislate in respect of the duty not to fetter discretion. The precise formulation adopted under the rubric of "independent judgment" appears to be inspired closely by section 173 of the UK's *Companies Act 2006* which creates a statutory duty to exercise independent judgment. The UK approach differs from the Irish proposed reforms in that section 173 requires that an agreement be entered into by the company which restricts directorial discretion rather than this simply being an independent judgment call of a director or the directors as is contemplated in the broader sub-head 9(3)(e).

At first blush the nomenclature employed is somewhat misleading. In the UK it has been queried whether the duty to exercise independent judgment could prevent a director from delegating functions to committees of the board[311] but this is not what is in contemplation by section 173 of the UK's *Companies Act 2006* or the draft Irish duty. Rather, sub-head 9(3)(e) equates to the equitable duty on directors not to unlawfully fetter their discretion and the *Thorby v Goldberg*[312] clarification assimilated by the Court of Appeal in *Fulham Football Club*[313] is reflected in the provisions.[314]

The current draft of the provision reflects the addition of a caveat to the text formulated by the CLRG which makes it clear that the company's constitution may permit the restriction of independent judgment. It has been noted that the initial UK formulation (and this applies to the current Irish proposal) was not a duty to exercise independent judgment but simply a duty on directors not to restrict their powers to do so.[315] Interestingly the UK formulation was

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[310] Company Law Review Group n 3 above at 11.3.7. This was based on *Clark v Workman* [1902] 1 IR 107; *Thorby v Goldberg* [1965] 112 CLR 697 and *Fulham Football Club Ltd v Cabra Estates plc* [1994] 1 BCLC 363.

[311] Norton Rose "Companies Acts 2006: the impact on directors" http://www.nortonrose.com/html_pubs/view.asp?id=12624&pp=1 accessed on 14 May 2007.

[312] [1965] 112 CLR 697.

[313] *Fulham Football Club Ltd v Cabra Estates plc* [1994] 1 BCLC 363.

[314] See further Chapter 3 above.

[315] S Worthington n 85 above at 448.

broadened to a duty to exercise independent judgment. Worthington suggests that this type of broader formulation blurs the division with the duty of loyalty and may prove difficult to police separately.[316]

J. THE DUTY TO AVOID UNAUTHORISED CONFLICTS OF INTERESTS AND CONSEQUENT BENEFITS

Of all the draft legislative provisions for directors' duties, it is those relating to the no conflict-no profit rules which display the least intellectual coherence, reflecting the challenging nature of the rules at play. The provisions maintain a separation between the two aspects of the no conflict-no profit limbs which is evident in the underlying principles as discussed in Chapter 4. However, the distinct territory of each rule is not clearly set out and the draft reveals some fudging of the lines of demarcation between unlawful conflicts of interest and unauthorised profits.

(1) The Draft Provision

Sub-head 9(3)(f) of Part A5 of the draft scheme states that a director shall:

> "avoid any conflict between the director's duties to the company and the director's other, including personal, interests and may not retain any benefit derived from any engagement (other than a transaction or arrangement to which the director and the company are party) where there is such a conflict of interests unless the company's members in general meeting release the director from his duty to the company."

(2) Analysis

As discussed below, the current draft provision differs somewhat from that originally envisaged by the CLRG. The CLRG recommended the inclusion in the statutory statement of a duty to avoid conflicts of interests in the following terms:

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[316] *Ibid.*

"Duty to avoid conflicts of interest

If there is a conflict between an interest or duty of a director and an interest of the company in any transaction, he must account to the company for any benefit he receives from the transaction. This applies whether or not the company sets aside the transaction.

However, a director need not account for the benefit if he is allowed to have the interest or duty by the company's memorandum and articles of association or the interest or duty has been disclosed to the members and approved by ordinary resolution."[317]

(a) Blurring of Concepts

The CLRG's original approach quoted above was problematic as its focus on the benefit derived from a conflict of interest indicated an implicit lack of recognition of the existing equitable position whereby a conflict of interest would in itself amount to a breach irrespective of whether a benefit is obtained. In essence, this involved an unwarranted merging of the separate heads of conflict of interest and secret profit. However, in the interim between the CLRG's report and the preparation of the draft heads of a bill, a change of approach manifested itself. The formula utilised in sub-head 9(3)(f) is somewhat different in nuance. It represents an advance on the formula first deployed the CLRG which did not expressly regard a conflict of interest as problematic *per se*. However, the sub-head would benefit from clearer drafting to emphasise that a conflict of interest must be authorised, not simply the taking of a consequent benefit. The approach taken in section 175 of the UK's *Companies Act 2006* headed "Duty to avoid conflicts of interest" is clearer in this respect. Section 175(1) states:

"(1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company."

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[317] Company Law Review Group n 3 above at 11.3.7. This was expressed to be based on *Gabbett v Lawder* (1883) 11 LR Ir 295.

(b) Scope

On the one hand, section 175(1) of the UK's *Companies Act 2006* is on its face more expansive in scope than this sub-head in covering "a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company." On the other hand, a policy decision was made in the UK to restrict the application of the duty to trifling breaches - by virtue of section 175(4)(a) there will be no breach "if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest".[318] There is no such *de minimis* provision in contemplation in this jurisdiction.

Section 176 of the UK's *Companies Act 2006* contains an additional related duty not to accept benefits from third parties by reason of his directorship. There is a qualification that this will not be breached where "the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest."[319] While there was no legal need to include this, it sends a signal to the judiciary that an unduly pedantic approach should not be taken. In this jurisdiction it is likely that such activities would be caught by sub-head 9(3)(f) and possibly by the duty not to restrict independent judgment in sub-head 9(3)(e).

(c) Conflicts between interest and duty, duty and duty and interest and interest

A conflict of interest may be characterised as the possession of an interest which may conflict with a duty to the company while a conflict of duty involves a director owing a duty to a third party which conflicts with a duty owed to the company. In *In Plus Group Ltd v Pyke,* Sedley LJ emphasised that "... an objectionable position is not only one in which duty conflicts with interest but one in which duty conflicts with duty or interest with interest."[320] In both the Irish and UK provisions it is curious that the reference is solely to a conflict with an interest of the company. This seems to be a case of some of the sense being lost in transposition and amendment since the CLRG's original recommendation showed a somewhat broader

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[318] Section 175(4)(a) of the *Companies Act 2006* (UK) could not be invoked in a situation where there is no reasonable possibility of the company exploiting the opportunity since section 175(2) states that it is immaterial whether the company could take advantage of the property, information or opportunity.

[319] Section 176(4) of the *Companies Act 2006* (UK).

[320] [2002] 2 BCLC 201, [86].

understanding of this in its reference to "a conflict between an interest or duty of a director and an interest of the company....".[321] This illustrates the dangers of imperfect drafting in any statute which aims to encapsulate and replace the existing law.

The provision also provides no answer to the uncertainty which exists where a director of two companies has conflicting duties to both.[322] By contrast, section 175(7) of the UK's *Companies Act 2006* makes it clear that the section applies to both a conflict of interest and duty and a conflict of duties.

(d) Internal Conflicts

In its exclusion of the internal application of the no conflict-no profit rules, the draft provision mirrors section 175(3) of the UK's *Companies Act 2006* which provides an exclusion of duty where the conflict of interest arises in relation to "a transaction or arrangement with the company". The requirement that the director be a party to the relevant transaction or arrangement seems rather narrow but it is unclear whether this is the result of a deliberate policy decision to exclude arrangements with business units in which the director is directly or indirectly interested so that approval by ordinary resolution will be required.

In the CLRG's first report it was clearly contemplated that the restated provision would apply to internal transactions.[323] Although the rationale for the change of heart in relaxing the application of the no conflict rules was not laid bare by the CLRG in its final report, this seems to be another instance of inspiration being drawn from the UK reforms.[324] The change would appear to reflect the fact that frequently companies' articles of association permit

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[321] Company Law Review Group n 3 above at para 11.3.7 "Duty to avoid conflicts of interest".

[322] See further Chapter 4 above.

[323] Company Law Review Group n 3 above *First Report* at 11.3.7.

[324] In Australia, a relaxation of the internal rule is permitted by statute but requires a constitutional provision giving effect to this: Section 194 of the *Corporations Act 2001* (Australia). See further RP Austin, HAJ Ford and IM Ramsay n 219 above at para 8.28. See also section 1401(A) of *Companies Act 1993* (New Zealand); section 120 of the *Canada Business Corporations Act.*

internal conflicts provided they are disclosed.[325] Indeed, in the mould of the UK, Head 12 of Part A5 of the *General Scheme of the Companies Reform and Consolidation Bill* contains a stand-alone duty on directors to disclose their direct or indirect interests in contracts entered into by the company to the board. This signifies a move from authorisation to declaration of interest compliance.

Head 12 is headed "Duty of director to disclose his interest in contracts made by the company." The provision continues the parallel disclosure regime which must be complied with in tandem with the other conflict and profit-related duties under section 194 of the *Companies Act 1963*.[326] The effect is that where a director is interested in a contract between him or her and the company, disclosure of "the nature of his interest" to the board is all that is required whereas external conflicts will require both the board disclosure contemplated in this provision and the additional approval of the company in general meeting.[327] While the draft provision is largely an approximation of section 194, non-compliance will no longer be an offence in respect of private companies. Reflecting a contractarian perspective, the CLRG was of the view that in the new private company model (the "CLS") what is at issue is "a matter of contract and as such, there [is] no public interest in having the matter prosecuted".[328]

(e) Authorisation Procedures

Sub-head 9(3)(f) contains a requirement to obtain a release from the company in general meeting.[329] This is in line with the strict view articulated by Malaysia's Corporate Law Reform Committee to the effect that "[a] conflict of interest transaction is not an ordinary commercial transaction which is within the directors' powers to approve or disprove."[330] It

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[325] See Model Regulation 78 of Part I of Table A, First Schedule, *Companies Act 1963*. MacCann and Courtney note that the effect is an apparent reversal of *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378: L MacCann and TB Courtney (eds) *Companies Acts 1963-2006* Tottel Publishing Haywards Heath 2007 at 676.

[326] As amended by section 47(3) of the *Companies Act 1990*. See further Chapter 4 above.

[327] See further Chapter 4 above.

[328] See Company Law Review Group explanatory note to head 12 of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[329] For a criticism of a requirement to obtain the consent of the company in general meeting see S Worthington "Corporate Governance: Remedying and Ratifying Directors' Breaches" (2000) 116 LQR 638.

[330] Corporate Law Reform Committee (Malaysia) n 235 above at para 4.28.

may be said that this approach is not user-friendly in large companies with diffuse membership if, for example, the appointment of a director to the board of another company is required to be put to the company in general meeting rather than simply seeking board authorisation.[331] The requirement to obtain the approval of the company in general meeting rules goes against the tenor of the High Court decision in *Hopkins v Shannon Transport Systems Ltd*[332] which indicated that where there is a contractual relaxation requiring disclosure to the board of directors, disclosure would be fulfilled by it being made to an independent board of directors.[333]

The choice of the general meeting as the appropriate forum for the authorisation regime represents a parting of the ways with the UK. Subject to constitutional restrictions, the *Companies Act 2006* permits authorisation at board level of the exploitation of corporate opportunities but limits participation in the decision to unconflicted directors.[334] The choice of board authorisation reflects the view that unnecessary hurdles should not be placed in the way of directors wishing to start up entrepreneurial activity.[335] The emphasis on disclosure to an independent board is welcomed by those who regard general meeting approval as a time-consuming and cumbersome process.[336]

(f) Additional Provisions Concerning the No Conflict-No Profit Rules

While the core general duties are set out in Head 9 of the draft scheme, subsequent provisions deal with particular situations currently reflected in the *Companies Acts*. A number of these provisions carve out an exception to the general duties concerning conflicts of interest.[337]

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[331] Whether this is necessary may depend on how broadly the concept of a conflict of interest is interpreted.

[332] (1972) [1963-1999] Ir Co Law Rep 238.

[333] For an exposition of the contrary perspective see *Woolworths Ltd v Kelly* (1991) 22 NSWLR 189.

[334] Section 175(5) and (6) of the *Companies Act 2006* (UK).

[335] See Department of Trade and Industry (UK) n 90 above at para 304.

[336] See B Clark "UK Company Law Reform and Directors' Exploitation of Corporate Opportunities" (2006) 17 ICCLR 231 at 238.

[337] In Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (May 2007) see *eg* Head 10 "other interests of directors" which is based on a reworking of Model Regulation 78, Table A, Part I, First Schedule, *Companies Act 1963*; Head 11 (payment for professional services to the company) and Chapter 3

K. THE DUTY NOT TO EXPLOIT COMPANY PROPERTY, INFORMATION AND OPPORTUNITIES WITHOUT AUTHORISATION

(1) The Draft Provision

Sub-head 9(3)(d) of Part A5 states that a director shall

> "not use the company's property, information or opportunities for his own or anyone else's benefit unless he is allowed to by the company's constitution or the use has been approved by a resolution of the company in general meeting."

(2) Analysis

Unlike the position in the UK where there is no stand-alone statement of the no profit rule,[338] the separation is still maintained in the Irish provisions. The draft provision reflects the CLRG's recommendation of a statutory statement in almost identical terms under the rubric of a "duty of avoidance of secret profits".[339] The ambit of the section is broad but this is balanced by the availability of an approval mechanism.

The drafter has chosen to emphasise the company's proprietary interest in its property, information and opportunities. The concept of secret profit is reflected in a broader concept of "benefit". This reflects frequent judicial murmurings viewing corporate information as quasi-property.[340] However, the restriction here to use of company property, information or

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"particular transactions involving conflicts of interest" which continues to make provision for authorisation of substantial property transactions involving directors and loans to directors and connected persons.

[338] See section 175 (duty to avoid conflicts of interest") and section 177 (duty to declare interests in proposed transactions) of the *Companies Act 2006* (UK).

[339] Company Law Review Group n 3 above at 11.3.7. This was expressed to be based on *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378.

[340] See Chapter 4 above.

opportunities contrasts with the use of these as non-exhaustive examples in section 175(2) of the UK's *Companies Act 2006*. It also contrasts with the more expansive approach taken in relation to the just discussed sub-head 9(3)(f) concerning conflicts of interest.

(a) Corporate Opportunities

Given the broad terms in which the duty is stated, a large amount of refinement will be required from the courts concerning its application. For one thing, there is no clarification on the thorny question of when an opportunity will be considered to be that of the company and when it will not be so considered.[341] Nor is there a restriction on the circumstances in which a director becomes aware of an opportunity. Therefore the *Bhullar v Bhullar*[342] debate remains as to whether an opportunity arose in the course of the performance of directorial functions. It is interesting to note that Principle 6(a) in Schedule 2 of the UK Government's White Paper *Modern Company Law*[343] under the heading "Personal use of the company's property, information or opportunity" read:

> "A director or former director of a company must not use for his own or anyone else's benefit any property or information of the company, or any opportunity of the company which he became aware of in the performance of his functions as director....[344]

However, this specification did not appear in the enacted section.

(b) Requirement of Actual Benefit?

The question arises whether in order to be caught by the provision there is a requirement that a benefit be in fact obtained *ie* is unauthorised use sufficient to establish a breach? On a literal

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[341] By contrast, section 175(2) of the *Companies Act 2006* (UK) clarifies that "it is immaterial whether the company could have taken advantage of the property, information or opportunity."

[342] [2003] 2 BCLC 241.

[343] Department of Trade and Industry (UK) *Modernising Company Law* Cm 5553 HMSO London 2002.

[344] It would appear that this may not catch the *Bhullar* scenario. On *Bhullar v Bhullar* [2003] 2 BCLC 241 see Chapter 4 above; HC Hirt "The Law on Corporate Opportunities in the Court of Appeal: Re Bhullar Bros Ltd" [2005] JBL 669, 681.

interpretation, it would seem that the purpose coupled with the unauthorised use is sufficient even if no tangible benefit in fact results. In the somewhat different context of Australia's statutory duty to refrain from making improper use of position,[345] breach of which constitutes an offence, the courts have not regarded actual benefit as necessary provided the conduct is considered to be improper.[346] Therefore it would seem that motivation is considered more important than result.

A further question which arises is whether a mistaken belief by the director that he was acting in furtherance of the company's interests would be to any avail. Is there a case for a subjective aspect to an assessment of events? Generally speaking, it can be said that compliance with one duty will not provide an answer to another. The test of proper purpose has been objective but the determination is not easy where more than one purpose may be ascertained. In *ASC v Matthews*[347] the Full Court of the Supreme Court of Western Australia regarded the test of improper use of position under section 229(4) of the *Companies Code* as primarily an objective test although the subjective belief could be weighed as part of the objective determination of whether the use of a power was improper.[348] Perhaps this type of analysis is misplaced in the present context since the emphasis in the section is on a strict rule balanced by the possibility of authorisation.

(c) Authorisation

As with the proposed duty concerning conflicts of interests, the proposed reforms preserve the ability of the company in general meeting to authorise the obtaining of benefit from the company's property, information or opportunities.

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[345] Section 182(1) of the *Corporations Act 2001* (Australia).

[346] *Chew v R* (1992) 173 CLR 626; *R v Byrnes* (1995) 183 CLR 501.

[347] (1995) 16 ACSR 313.

[348] In the same vein see *R v Byrnes* (1995) 183 CLR 501.

L. CONCLUSIONS

This chapter supports the view that the significance of moving directors' duties to a legislative setting is huge, but if handled sensibly should not be seismic. It is clear from discussion in this chapter that while the reform and consolidation of directors' duties within a new companies code is a mammoth task, in effect, this is only the beginning of the process. Clearly, no statement of principle can ever be comprehensive enough to cover any situation which may arise – there will always be need for some discerning application of judicial thinking. That being said, a consequence of codification is a reduced possibility of judicial activism in the sense of innovation rather than clarification. For the most part the proposed statutory duties are imbued with the spirit of the principles and perspectives carved by the courts over the centuries. Nevertheless, there are plenty of areas explored in the case law which it has not been seen fit to represent in statute such as the duty to act fairly between classes of shareholders. In such circumstances non-codification leaves the courts with flexibility in relation to the development of new perspectives concerning principles which are not yet fully-formed. Much will depend on a sensible approach being taken by judges to filling in the gaps in the proposed scheme and arriving at an interpretation of sometimes obtuse provisions in a manner which will serve the interests of posterity as well as justice in an individual case.

One can empathise with Professor Hahlo's rather pessimistic view that the effect of introducing a code is to create a lengthy period of uncertainty as to its application based on its combination of reformulating old rules and adopting new rules. He colourfully describes the process in the following terms:

> "For each head of controversy that has been cut off, there will arise, hydra-like, one or more new ones. And it will only be decades later, after the codes has become overlain with a thick encrustation of case law, that the old measure of legal certainty (or uncertainty) will be restored."[349]

[349] HR Hahlo n 33 above at 249.

To this it may be countered that areas of the law which have been gathering dust may once again be brought to the forefront and revitalised. Thus while uncertainty may necessarily result it simply replaces one form of uncertainty borne of disuse with another borne of awaiting current interpretations of principles which have been idle for some time.

Certainly, in the short term there will be a period of flux while clarification is awaited on the significance of the duties for directors in practice.[350] It has also been contended in this chapter that realistically it would be a misapprehension to expect the codification of directors' duties to achieve a great deal more than a signposting function and undoubtedly directors will continue to need to have recourse to legal advice concerning compliance with their duties. Based on the current draft it can be seen that there is considerable potential for differing nuances of interpretation although those attributable to poor drafting could be laid to rest before enactment. A lack of congruity with the existing judicial landscape seems most pronounced in relation to the clumsy handling of the no conflict-no profit rules and the ill-judged addition of a duty to act honestly and responsibly.

It has been said that "[u]nknown rules have limited deterrent effects."[351] The same can equally be said of unknown remedies and rules which are subject to considerable obstacles to enforcement. The final chapter explores the question of how issues of enforcement, liability and remedies have impacted on the general duties, and are likely to do in the future. This contextual discussion will provide the final piece in the jigsaw.

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[350] See Norton Rose, Solicitors "Companies Acts 2006: the impact on directors" http://www.nortonrose.com/html_pubs/view.asp?id=12624&pp=1 accessed on 14 May 2007.

[351] C Bradley "Enterprise and Entrepreneurship: The Impact of Director Disqualification" (2001) 1 JCLS 53 at 66.

CHAPTER 6:
BROADENING THE FOCUS OF CONCERN

A. INTRODUCTION

In Chapter 1, a health check on directors' duties was promised with a view to determining how well they are adapted to modern living. Previous chapters traced the individual duties and looked at the likely impact of plans to place them on a statutory footing. There is, however, some further ground which calls for examination before any final prognosis can be made on directors' duties. That ground relates to how easily the duties have lent themselves to practical application. As Sugarman notes, "[a]ccess to justice depends upon both the existence of legal rights and the ability to enforce them."[1]

Scholarship on directors' duties has tended to concentrate disproportionately on the content and application of the duties. This has led to a somewhat blinkered vision of the duties of directors which can obscure practical issues relating to enforcement, liability and remedies from view. The objective of this penultimate chapter is to demonstrate that a broader range of vision is required which situates directors' duties within a wider frame of reference through exploring the inter-relationship between duty, enforcement, liability and remedy. By examining these 'big picture' issues and thus widening scope of analysis to encompass the broader conceptual framework of accountability, a greater contextual appreciation of directors' duties and their place in the legal system can be arrived at. To support this, this chapter examines some theoretical and practical considerations relating to enforcement, liability and remedies which indirectly affect the doctrinal impact of

[1] D Sugarman "Reconceptualising Company Law: Reflections on the Law Commission's Consultation Paper on Shareholder Remedies: Part 2" (1997) 18 Co Law 274 at 276.

directors' duties by circumscribing the environment in which the principles underlying the duties are applied.

Having regard to both the declared objective of this chapter and the potential breadth of the subject matter within its remit, a selective approach has necessarily been employed which focuses on some key policy issues rather than seeking to provide a comprehensive guide to enforcement, liability and remedies for breaches of directors' duties. Part B begins the debate by introducing the connections between duty, breach and enforcement. Part C considers how the legal rules concerning enforcement have influenced the shape of directors' duties and the remedies for breach of such duties by restricting access to the courts as the organ of development. Part D examines the regulatory policy behind the statutory rules pertaining to the courts' discretion to relieve directors from liability for breach of duty and other provisions which enable directors to avoid the consequences of breach. Part E considers the need to take cognisance of the influence of the remedial framework for breaches of directors' duties. Part F contains some concluding observations.

B. THE INTERSECTION BETWEEN DUTY, BREACH AND ENFORCEMENT

The natural connection between duty, breach of duty and enforcement is a strong one. As Redmond highlights, directors' duties "depend for their efficacy upon the mechanisms for their enforcement."[2] When we think of a breach of duty, the availability of an appropriate remedy is presumed. However, the natural connection between breach and remedy may be dislodged if the route to obtaining a remedy is unduly arduous. Before a remedy can be obtained, careful navigation of the law is required in order to determine which actors are entitled to enforce the alleged breach of duty, and in what circumstances. This chapter highlights a number of issues which militate against a judicial remedy being obtained for a breach of directors' duties thus denying the opportunity for remedies to perform as intended.

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[2] P Redmond "The Reform of Directors' Duties" (1992) 15 UNSWLJ 86 at 94.

As will be seen in Part C below, the procedural restrictions contained in the rule in *Foss v Harbottle*[3] and its narrowly circumscribed exceptions have a lot to account for in terms of limiting the scope for judicial rulings on directors' duties in a private actor context. Furthermore, far greater attention at policy level has been focused on public enforcement consequent on the insolvent liquidation of a company than on private enforcement.[4] This enforcement trajectory has contributed to the paucity of judicial decisions concerning directors' duties and remedies for breach arising from the traditional enforcement of directors' duties by a company or a member acting in a representative capacity. Indeed, the difficulties surrounding enforcement of directors' duties can lead to them being branded as educative rather than as a mechanism of control.[5]

Furthermore, remedies for breach of directors' duties have not been subjected to comprehensive judicial or scholarly treatment. Consequently, in appropriate cases there is often a failure to pursue complex remedies or to opt instead for statutory remedies. It will be seen that the dearth of judicial dissection of remedies within the specific context of breach of directors' duties is also attributable in part to the existence of a broad statutory discretion to relieve directors from liability and to other available methods for avoiding the consequences of breach. Statutory carve-outs in relation to the imposition of liability and the ability to cushion directors against the impact of remedies also impinge on the utility of civil remedies. Therefore, in spite of the breadth and diversity of the remedies available, they have not been utilised at all as frequently or imaginatively as one might expect.

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[3] (1843) 2 Hare 461.

[4] Private enforcement is used in this chapter to connote enforcement at the behest of the company or by means of a derivative action. Public enforcement is used to refer to indirect third party enforcement by a liquidator or the Director of Corporate Enforcement.

[5] J Parkinson "Reforming Directors' Duties" Policy Paper No. 12 (1997) Political Economy Research Centre, University of Sheffield.

Taken together, these various elements have conspired to create a morass of underused remedies which, rather than experiencing revitalisation through innovative applications reflecting the commercial world of today, often languish in their nineteenth century origins with no opportunity being afforded for modern updating. As a result, in the small number of cases for breaches of directors' duties which are litigated, the remedies sought and given represent a very small subset of the available remedies.

Having provided a flavour of the nodes of intersection in the directorial accountability framework, this chapter now moves to consider these individual aspects in more detail.

C. ENFORCEMENT OF DIRECTORS' DUTIES

(1) Enforcement as a Benchmark for Assessing the Effectiveness of Duties

While it can be contended that the very existence of a duty serves a function, it is also recognised that duties should be legally enforceable and subject to effective enforcement mechanisms.[6] Consistent with this, Parkinson asserts that in order for duty-based controls to be effective there must be a realistic prospect of enforcement.[7] In the case of directors' duties, as well as being dependent on the initiative of internal corporate actors, enforcement is heavily dependent on an external agency, the courts.[8] One cannot but be struck by the lack of evidence of Irish judicial consideration of directors' duties which is

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[6] E Ferran "Corporate Law, Codes and Social Norms – Finding the Right Regulatory Combination and Institutional Structure" (2001) 1 JCLS 381 at 405.

[7] JE Parkinson *Corporate Power and Responsibility: Issues in the Theory of Company Law* Clarendon Press Oxford 1993 at 73.

[8] *Ibid.* See also J Hill "Changes in the Role of the Shareholder" in R Grantham and C Rickett *Corporate Personality in the 20th Century* Hart Publishing Oxford 1998 at 198.

attributable to private enforcement.[9] Easterbrook and Fischel present the common law system's reliance on cases being brought before it as an economising device.[10] In Ireland this is augmented by inefficient private enforcement mechanisms.

Obviously judicial participation in the enforcement of directors' duties requires appropriate judicial proceedings to be being instituted. If there is little likelihood of judicial enforcement, a number of significant knock-on consequences ensue. The deterrent effect of the duties is reduced and individual breaches may not be remedied. At a jurisprudential level, a loss is also keenly felt because a failure to bring breaches of duty to the bench rules out the opportunity for the courts to consolidate existing precedents and to clarify and adapt the reach of the duties to meet new circumstances.

The ability to enforce a legal duty may be seen as a rudimentary litmus test of its effectiveness. Seen in this light, the rules governing corporate litigation are far-reaching in the sphere of directors' duties, linked as they are to the ability to bring errant directors to account. To appreciate the contribution of enforcement issues to the dearth of case law concerning directors' duties requires an understanding of Ireland's acute public-private divide concerning the enforcement of company law. At the axis of the public-private enforcement divide lies not only the long-standing procedural and practical hurdles to private enforcement, but also the intersecting spur of the public enforcement model. In a country where a convergence of ownership and control is common, both enforcement actions by director-controlled companies and derivative actions by minority shareholders can be expected to be rare, but the rules concerning derivative actions have compounded the situation. The resultant gaps in private enforcement activity have contributed to a cumulative lack of judicial and professional acquaintance with the modern day application of traditional remedies concerning directors' duties. The continuing

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[9] The notable exception being the jurisprudentially disappointing High Court decision in *Fyffes plc v DCC plc* [2005] IEHC 477, considered in Chapter 5 above (the equitable duties aspect did not feature in the Supreme Court appeal [2007] IESC 36).

[10] FH Easterbrook and DR Fischel *The Economic Structure of Corporate Law* Harvard University Press 1991 at 35.

difficulties which the rule in *Foss v Harbottle*[11] and its exceptions present to private enforcement by individual members will be examined below, followed by an overview of action taken in other jurisdictions to reform the derivative action and to present it in a statutory context. Afterwards the effects of the policy concentration in the last decade on public enforcement will be weighed in the balance.

(2) Private Enforcement and the Corporate Power Division

When it comes to private enforcement of directors' duties, the practical hurdles which exist to bringing directors to account are inextricably intertwined with company law's strict demarcation of the power base between directors and shareholders.[12] The basic precept from which all doctrinal development in this area flows is that directors' duties are owed to the company and not to individual shareholders.[13] This is manifested in judicial adherence to the proper plaintiff principle enshrined in *Foss v Harbottle*[14] whereby the harm is done to the company, not the members and accordingly it is the company which must bring any action taken against the directors' for breach of duty. As Parkinson notes, "[w]hether or not a suit is brought mainly depends on the shareholders, but the collective action problem which underlies the separation of ownership and control also militates against shareholder participation in enforcement proceedings."[15]

If the majority of members make the decision that it is in the best interests of the company not to seek a remedy this will generally bind the minority. As Vinelott J

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[11] (1843) 2 Hare 461.

[12] R Gregory "What *is* the rule in *Foss v Harbottle*" (1982) 45 MLR 584; AJ Boyle "The Private Law Enforcement of Directors' Duties" in KJ Hopt and G Teubner (eds) *Corporate Governance and Directors' Liabilities* Walter de Gruyner Berlin 1985.

[13] *Percival v Wright* [1902] 2 Ch 421; *Dawson International plc v Coats Paton plc* [1989] BCLC 233.

[14] (1843) 2 Hare 461; *Edwards v Halliwell* [1950] 2 All ER 1064, 1066 *per* Jenkins LJ; *Balkanbank v Taher* Supreme Court 19 Jan 1995 unrep; *O'Neill v Ryan* [1993] ILRM 557.

[15] JE Parkinson n 7 above at 73-74.

observed in *Taylor v National Union of Mineworkers (Derbyshire Area)*, this may occur for legitimate reasons:

> "The majority of the members of a trading company, for instance, might properly take the view that the publicity, costs and the inevitable loss, let us say, of the services of a managing director, who would be the defendant, would outweigh the benefit to the company of successfully prosecuting an action and might properly decide not to pursue it ...."[16]

This is consistent with law and economic theorists' rationale that in some situations enforcement of duties may not maximise corporate wealth – the costs of enforcement are high and may exceed the benefits.[17] As Easterbrook and Fischel point out, "[i]nvestors, like all of us in our daily lives, accept some unwelcome conduct because the costs of the remedy are even greater."[18] In closely-held companies where the separation of ownership and control is minimal, there will be a large disincentive to acting in the company's interests in pursuing litigation, rather than in the interests of its human agents.[19] It is a fact of commercial life that even disinterested directors and shareholders may prefer to absolve breaches of duty rather than to pursue litigation against the directors which may result in high legal costs, adverse publicity and an uncertain outcome.[20] However, in widely-held public companies there may be market forces which dictate that to preserve the company's reputation it should be seen to litigate possible

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[16] [1985] BCLC 237, 254-255.

[17] BR Cheffins "Law, Economics and Morality: Contracting Out of Corporate Fiduciary Duties" (1991) 19 CBLJ 28 at 31.

[18] FH Easterbrook and DR Fischel n 10 above at 7.

[19] Indeed, even a reform of the derivative action would not be likely to address a conspiracy of silence unless third parties are given the possibility of bringing an action. For some suggestions to resolve conflicts of interest concerning the litigation decision see HC Hirt "The Company's Decision to Litigate Against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest" [2005] JBL 159.

[20] See further BR Cheffins n 17 above at 43; HC Hirt n 19 above at 166.

breaches of duty, particularly fiduciary breaches.[21] The *Fyffes* litigation concerning an allegation of insider dealing is a case in point.[22]

While in principle one may not quibble with majority decision-making by the company in general meeting, when one peels back the layers of the onion, the danger of self-interested decision-making is apparent, particularly where there is an overlap of ownership and control. Therefore, while the proper plaintiff principle is sensible as a general precept, from an enforcement perspective it presents a major stumbling block for disgruntled shareholders should the majority choose not to bring proceedings against an errant director. Indeed, writing extra-judicially, a former Chief Justice has suggested that as the principle of majority rule is subject to the overriding influence of the Constitution, the interests of natural justice may require that the minority be given a fair hearing before a majority decision not to sue is taken.[23] As yet this concept has not been judicially tested and in any event would appear to focus on appropriate procedural formalities being put in place rather than on the merits of a decision as to whether litigation should be initiated against a director or former director.

Leaving aside any potential protection which the Constitution may offer, if members are unhappy with the decision of the board not to bring a claim against an errant director, they are immediately confronted by the impact of the rule in *Foss v Harbottle*.[24] The rule is a bulwark enshrining judicial policy against hearing claims by disgruntled individual members of a company which encompasses the proper plaintiff principle based on the principle of separate legal personality as well as the internal management principle whereby the courts are loath to interfere in matters which are considered to be for internal resolution within a company. As Lord Davey put it in *Burland v Earle*:

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[21] See further BR Cheffins n 17 above at 41.

[22] *Fyffes plc v DCC plc* [2005] IEHC 477, [2007] IESC 30.

[23] R Keane *Company Law* 4th ed Tottel Publishing Haywards Heath 2007 at [26.36] – [26.38].

[24] (1843) 2 Hare 461.

> "It is an elementary principle of the law relating to joint stock companies that the court will not interfere with the internal management of companies acting within their powers and in fact has no jurisdiction to do so.... The cases in which the minority can maintain such an active action are, therefore, confined to those in which the actions complained of are of a fraudulent character or beyond the powers of the company."[25]

A justification for this was presented by O'Flaherty J in *O'Neill v Ryan* where he stated that without the rule in *Foss v Harbottle* "there would be a multiplicity of actions, oppressive litigation and the company would cease to have proper control of its corporate destiny."[26] At the most fundamental level, the rule in *Foss v Harbottle* exemplifies company law's adherence to the policy that the members of a company agree to regulate their affairs according to the principle of majority rule. However, a more controversial perspective would regard the procedural restrictions on minority suits as embodying the judicial preference for staying out of corporate policy-making.[27]

(3) The Position of the Minority Shareholder as Would–Be Litigant

The courts' adherence to the proper plaintiff rule in the complex rule-bound *Foss v Harbottle* environment contributes to the reality that procedural impediments to the enforcement of directors' duties remain well-entrenched.[28] Based on the policy that a shareholder's right is simply a right of participation and that the shareholders bear the

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[25] [1902] AC 83, 93. Cited with approval in *Moylan v Irish Whiting Manufacturers* (1980) [1963-1999] Ir Co Law Rep 280.

[26] [1993] ILRM 557, 559 (Finlay CJ and Egan J concurring).

[27] BR Cheffins *Company Law: Theory, Structure and Operation* Clarendon Press Oxford 1997 at 315.

[28] See Law Commission (UK) *Shareholder Remedies, A Consultation Paper* No. 142 (1996); Law Commission (UK) *Shareholder Remedies* Law Com Report No. 246 Cm 3769 Stationery Office (1997) where it was concluded at para 1.4 that the law relating to the exceptions to the rule in *Foss v Harbottle* was "rigid, old fashioned and unclear".

risk as far as their investment in the company is concerned, generally speaking shareholders may not sue to recover a loss suffered in their personal capacity which is attributable to a breach of directors' duties owed to the company such as a diminution in the value of their shareholding.[29] However, in exceptional circumstances a derivative claim may be brought by a member of the company in a representative capacity to enforce the company's rights in respect of a breach of directors' duties.[30] To date the rules on derivative actions have been expounded by the courts and the Oireachtas has not seen fit to intervene. As will be evident from the discussion which follows, when a company refuses to institute proceedings against a director for breach of duty, the limited accommodation afforded by the exceptions to the rule in *Foss v Harbottle* can by no means be regarded as the answer to an aggrieved shareholder's prayers. The practical significance of the obstacles to mounting a derivative action should not be underestimated.

The representative nature of the action has a number of consequences. The moving shareholder's cipher status gives him all of the pain and none of the gain.[31] As Parsons observes, pursuit of a derivative action is "... mightily discouraged by the fact that the shareholder who brings a derivative suit must assume the risk that in defeat he will have to meet all costs, and must be content to receive only taxed costs in the victory he has

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[29] See *eg Prudential Assurance v Newman Industries (No. 2)* [1982] Ch 204; *Heron International Ltd v Lord Grade* [1983] BCLC 244; *Stein v Blake* [1988] 1 All ER 724; *O'Neill v Ryan* [1993] ILRM 557; *Ellis v Property Leeds (UK) Ltd* [2002] 2 BCLC 175. See generally D Ahern "The Rule Against Shareholders' Recovery of Reflective Loss" (2005) 12 C L Pract 163. It will of course be open to members to sue where there has been a separate breach of a duty owed to them. This may comprise a breach of their rights *qua* member under section 25 of the *Companies Act 1963*. See *MacDougall v Gardiner* (1875) 1 Ch D 13; *Pender v Lushington* [1877] 6 Ch 70; *Edwards v Halliwell* [1950] 2 All ER 1064.

[30] A derivative action is a species of representative action brought on behalf of all shareholders (other than those who are defendants): *Cooke v Cooke* [1997] 2 BCLC 28. D Linehan "Derivative Suits in American, English and Irish Law" (1974) 9 Ir Jur (ns) 265. An action by a minority shareholder may not be permitted if a majority of the minority shareholders are against it: *Smith v Croft (No. 2)* [1987] BCLC 355.

[31] Or at least no more than a residual expectation of uplift based on any gain to the company's coffers since any benefit will accrue to the company rather than the moving shareholder.

won for all shareholders."[32] The English courts have, however, countenanced the company being required to indemnify a shareholder in relation to the costs of derivative proceedings where it can be said that the proceedings were instituted in good faith and to do so was reasonable, prudent and in the interests of the company.[33] This enlightenment is predicated on the understanding that in bringing a derivative claim the member acts as an agent of the company.[34]

The so-called fourth exception expounded by the courts is the most pertinent exception in respect of directors' breaches of duty.[35] Under this exception, in strictly delimited circumstances a derivative action will be permitted where what is at issue can be classified as a 'fraud on the minority'. The minority in question refers to the minority of the members being one or more who wish to sue in the face of majority opposition (or that of the board). There is a requirement that the persons against whom the action is taken must have majority control of the company and have blocked an action being brought in the name of the company.[36] In *Smith v Croft (No. 2)* Knox J put the matter thus:

> "Ultimately the question which has to be answered ... is 'Is the plaintiff being improperly prevented from bringing these proceedings on behalf of the company?' If it is an expression of the corporate will of the company by an

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[32] RW Parsons "The Director's Duty of Good Faith" (1965-1967) 5 MULR 395 at 417, 426.

[33] *Wallersteiner v Moir (No. 2)* [1975] QB 373; *Jaybird Group Ltd v Greenwood* [1986] BCLC 319. For a more restrictive approach see *Smith v Croft* [1986] 1 WLR 580 (suggestion that plaintiff show insufficient funds in order to obtain indemnity).

[34] *Wallersteiner v Moir (No. 2)* [1975] QB 373.

[35] This is sometimes regarded as the only real exception to the rule in *Foss v Harbottle*: JH Farrar *et al* *Farrar's Company Law* 3rd ed Butterworths London 1991 at 449. The other exceptions are *ultra vires* or illegal acts, acts requiring greater than simple majority to ratify and the more nebulous exception based on the justice of the case discussed below.

[36] *Burland v Earle* [1902] AC 83.

appropriate independent organ that is preventing the plaintiff from prosecuting the claim he is not improperly but properly prevented ...."[37]

Prudential Assurance v Newman[38] established that in order to qualify for a derivative action based on a fraud in the minority, the plaintiff must show both wrongdoer control and a good *prima facie* case.[39]

The act or omission in question must also satisfy a qualitative test to constitute 'fraud'. In *Crindle Investments v Wymes*, Keane J, delivering the judgment of the Supreme Court, stated that "[t]o make out such a case it is not, of course, necessary to establish that there was fraudulent conduct in the criminal sense."[40] Rather, regard will be had to the broader equitable understanding of fraud.[41] In a situation where there has been a breach of directors' duties, it is recognised that it would be unseemly to allow the directors to block any consequent action. The requirement of fraud on the minority will be satisfied by a decision not to sue if the wrong is of a fraudulent character or beyond the powers of the company.[42] The ambit of the exception was elucidated by Lord Davey, giving the advice of the Judicial Committee of the Privy Council in *Burland v Earle* in stating that "[a] familiar example is where the majority are endeavouring directly or indirectly to appropriate to themselves money, property, or advantages which belong to the company, or in which the other shareholders are entitled to participate ...."[43] Thus fraudulent acts

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[37] [1988] Ch 114, 186.

[38] [1982] Ch 204. See also *Smith v Croft (No. 3)* [1987] BCLC 355.

[39] These aspects were noted by the Supreme Court in *Crindle Investments v Wymes* [1998] 4 IR 578, 594 *per* Keane J (Hamilton CJ and Barrington J concurring) but it was not required to rule on them.

[40] [1998] 2 ILRM 275, 290.

[41] See *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 WLR 2, 12 *per* Megarry VC.

[42] *Burland v Earle* [1902] AC 83. It has been pointed out that realistically it may be impossible for a court to determine whether a fraud has been committed on the minority until the entire action has been heard: R Keane n 23 above at [26.25]. Thus this may need to be tried as a preliminary issue as was the preference of the Court of Appeal in *Prudential Assurance Co v Newman Industries Ltd* [1982] Ch 209. See also *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 All ER 437.

[43] [1902] AC 83, 93.

by directors are regarded as encompassing personally appropriating money, property or opportunities that belong to the company[44] and other *mala fide* abuses of power.[45]

Further complexity is added by the precept that acts which qualify as ratifiable by the company do not meet the test of being "of a fraudulent character or beyond the powers of the company."[46] Thus the legacy of the rule in *Foss v Harbottle* is that if the wrong in question is capable of ratification by a majority of the company's shareholders in general meeting, the minority is not entitled to being a derivative action in the name of the company and whether or not ratification has in fact occurred is immaterial.[47] Significantly, this ratifiability criterion has the effect of ruling out a derivative action in respect of the *bona fide* exercise of directors' power for a collateral purpose[48] and incidental profit-making of a *bona fide* nature as these would be ratifiable.[49]

How an allegation of breach of the duty of care should be treated has been a matter of some debate.[50] There is doubt as to whether a derivative action will lie under the fraud on the minority exception where what is involved can simply be characterised as a breach of the duty to exercise care, skill and diligence. In the mid-nineteenth century authority, *Palvides v Jensen*,[51] an allegation of negligence (but not fraud) in relation to the directors' purported sale of company property at an undervalue was considered insufficient to warrant a derivative action as there was no suggestion of personal

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[44] *Menier v Hooper's Telegraph Works* (1874) LR 9 Ch App 350; *Burland v Earle* [1902] AC 83.

[45] See *Cook v Deeks* [1916] 1 AC 554. See further B Hannigan *Company Law* LexisNexis UK London 2003 at 460.

[46] *Burland v Earle* [1902] AC 83, 93 *per* Lord Davey.

[47] See *MacDougall v Gardiner* [1875] 1 Ch 13.

[48] On ratification in this instance see *Hogg v Cramphorn Ltd* [1967] Ch 254; *Bamford v Bamford* [1970] 1 Ch 212.

[49] *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378, 389 *per* Lord Russell; B Hannigan n 45 above at 460.

[50] See further V Finch "Company Directors: Who Cares about Skill and Care?" (1992) 55 MLR 179 at 187.

[51] [1956] Ch 565.

benefit.[52] This gave rise to the inference that a derivative action would not lie in respect of an allegation of directorial negligence if there is no element of personal benefit.[53] Professor Hannigan deduces from this that while what she describes as "mere negligence" is ratifiable, where the negligence in question is self-serving, it is not.[54]

Some indirect support for this perspective is to be found in *Daniels v Daniels*[55] where it was indicated that the fraudulent or negligent sale of a company asset by the directors to one of their number at an undervalue would permit a minority shareholder to bring a derivative action. Templeman J stated:

> "If minority shareholders can sue if there is fraud, I see no reason why they cannot sue where the action of the majority and the directors, though without fraud, confers some benefit on those directors and majority shareholders themselves. It would seem to me quite monstrous — particularly as fraud is so hard to plead and difficult to prove — if the confines of the exception to *Foss v. Harbottle* (1843) 2 Hare 461 were drawn so narrowly that directors could make a profit out of their negligence."[56]

Daniels v Daniels is therefore regarded as authority for the proposition that in circumstances where the directors or connected persons personally gain from the negligence of the directors then a minority shareholder would not be prevented from bringing a derivative action. This rules out derivative actions for negligence simpliciter,

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[52] On personal benefit to directors at the expense of the company see *Alexander v Automatic Telephone Co* [1900] 2 Ch 56; *Cook v Deeks* [1916] 1 AC 554; *Daniels v Daniels* [1978] Ch 406.

[53] See *Prudential Assurance Co Ltd v Newman Industries Ltd (No. 2)* [1981] Ch 257, 316 *per* Vinelott J.

[54] B Hannigan n 45 above at 460-461. See also I Lynch Fannon "A Translantic Case: The Derivative Action as a Corporate Governance Tool" (2005) 12 DULJ (ns) 1 at 16-17.

[55] [1978] Ch 406.

[56] *Ibid* at 413-414. *Daniels v Daniels* [1978] Ch 606 was affirmed in *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 All ER 437 where Megarry VC understood fraud in the equitable sense of a fraud upon a power.

allowing them only when some lack of probity can be tagged on.[57] As Finch correctly identifies, "[t]his limitation may reflect the exclusion of unintended causing of harm from equitable fraud but, from the viewpoint of shareholder enforcement of duties of skill and care, is disastrous."[58]

The position on derivative actions in respect of non-self-serving breaches of care, skill and diligence remains unsettled in this jurisdiction. In *Crindle Investments v Wymes*,[59] Keane J, delivering the judgment of the Supreme Court, quoted Templeman J's dicta in *Daniels v Daniels* but did not regard it as necessary to rule on the point in the case at hand. Therefore it remains to be seen whether the *Daniels v Daniels* distinction will be followed so as to permit a derivative action in limited circumstances where allegations of negligence on the part of directors are raised. Obviously, if a derivative action is open to doubt where negligence is concerned, this indirectly channels enforcement and remedies into the realm of the third party enforcement mechanism of the restriction application which will generally only arise in the event that the company has gone into insolvent liquidation.[60]

Apart from the applicability of the fraud on the minority exception, there is the more nebulous possibility of relying on a line of authority which suggests that an exception may be made to *Foss v Harbottle* where the justice of the case demands it.[61] In Ireland this has its roots in *Moylan v Irish Whiting Manufacturers Ltd* where Hamilton J expressed the *obiter* view that, having regard to the provisions of the Constitution, "... an exception to the rule must be made when the justice of the case demands it."[62] Later in

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[57] *Palvides v Jensen* [1956] Ch 565; *Heyting v Dupont* [1964] 1 WLR 843; *Daniels v Daniels* [1978] Ch 406.

[58] V Finch n 50 above at 187.

[59] [1998] 2 ILRM 275.

[60] Misfeasance actions are generally only used to restore misapplied company funds and a misfeasance action will not lie unless pecuniary loss has been occasioned to the company by the breach of duty: *Cavendish-Bentinck v Fenn* [1886-1890] All ER Rep 333.

[61] *Russell v Wakefield Watertanks Ltd* (1878) LR 20 Eq 475; *Heyting v Dupont* [1964] 1 WLR 843.

[62] High Court (Hamilton J) 14 April 1980; [1963-1999] Ir Co Law Rep 280, 287. See further R Keane n 23 above at [26.18].

Prudential Assurance Co Ltd v Newman Industries (No. 2) Vinelott J was happy for a derivative action to be permitted against the directors if " ... the interests of justice ..." required it.[63] However, when the case reached the Court of Appeal the Court did not evince a willingness for such a test to be adopted.[64] The matter was considered but left unresolved by the Supreme Court in *O'Neill v Ryan*[65] but in *Crindle Investments Ltd v Wymes* Keane J made passing *obiter* reference to "the less securely based fifth exception".[66] It remains to be seen whether the Irish courts will grasp the nettle as regards this expansion should an appropriate case present itself.[67]

From the above discussion it is clear that practical and theoretical difficulties have converged to make private enforcement a rarity in cases of breaches of directors' duties. Courtney notes that a derivative action by a member is normally only considered where they cannot bring an oppression claim under section 205 of the *Companies Act 1963*.[68] In the circumstances, Professor Lynch Fannon's conclusion that "... the derivative action as a minority shareholder governance mechanism seems to be almost a dead letter"[69] seems well-rooted.

Sub-part (5) examines the policy failure to review the derivative action in recent company law policy debate. To appreciate the reason for this omission requires first an understanding of the modern policy shift to a public enforcement model within the context of a view of company law in black letter law terms and of compliance as serving a public interest function rather than the interests of the investing shareholders. This is turned to below.

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[63] [1981] Ch 257, 326-327.

[64] [1982] Ch 204.

[65] [1993] ILRM 557.

[66] [1998] 2 ILRM 275, 290.

[67] For a recent attempt to rely on the exception which was judged undeserving of consideration see *Keaney v Sullivan* [2007] IEHC 8.

[68] TB Courtney *The Law of Private Companies* 2nd ed LexisNexis Butterworths Dublin 2002 at [19.097].

[69] I Lynch Fannon n 54 above at 27.

(4) The Public Enforcement Policy Dimension

The recent statutory development of Irish company law (beginning with the *Companies Act 1990* and continuing apace in the *Company Law Enforcement Act 2001*) has noticeably been structured to underpin a view of the default enforcement method for duties and obligations owed to the company as a public enforcement, public interest model, rather than private enforcement at the behest of a company or its minority shareholders.[70] This policy has thrust a watchdog role not only on the Director of Corporate Enforcement, but also, in a remarkable act of cost-effective outsourcing, on liquidators[71] and auditors.[72]

Why is the policy focus so skewed in favour of a public enforcement option? The finding in the McDowell report on enforcement[73] of widespread non-compliance with the Companies Acts' requirements provided the impetus for the establishment of a public law enforcement officer with the aim of enforcing the Companies Acts.[74] The perceived need to address public perceptions in relation to directorial standards was addressed by the establishment of the Office of the Director of Corporate Enforcement under Part 2 of the *Company Law Enforcement Act 2001*.[75] However, this cemented a policy focus on compliance with statutory obligations to the exclusion of the non-statutory duties.

Against this policy background, the fact that well-reasoned modern decisions on the application of remedies for breaches of directors are few and far between is in no small

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[70] This is exemplified in the *Report of the Working Group on Company Law Compliance* (the "McDowell Report") Pn 6697 Stationery Office (1998).

[71] Section 56 of the *Company Law Enforcement Act 2001*.

[72] Section 194(5) of the *Companies Act 1990* (as inserted by section 74 of the *Company Law Enforcement Act 2001*) (duty to report indictable offences).

[73] The McDowell Report n 70 above at para 2.3.

[74] Section 12(1)(a) of the *Company Law Enforcement Act 2001*.

[75] The impetus behind the establishment of the Office of the Director of Corporate Enforcement was the McDowell Report: n 70 above at para 4.53. See Department of Enterprise Trade and Employment "Director of Corporate Enforcement to be Established" press release 15 March 1999.

part attributable to private enforcement with its attendant panoply of remedies having its rightful place usurped by a statutory interloper *viz* the statutory restriction and disqualification regime.[76] A notable milestone in this regard was the enactment of section 56 of the *Company Law Enforcement Act 2001* which requires liquidators to bring restriction applications in respect of the directors of insolvent companies unless exempted by the Director of Corporate Enforcement.[77] Although liquidators were traditionally the persons most likely to uncover directorial breaches and best-placed to bring an action against directors for negligence,[78] this function was tempered by the need for liquidators to ensure the availability of funds to cover their costs. However, in recent years section 56 has effected a transformation in the role of the liquidator as enforcer with the liquidator's former discretion to institute proceedings being replaced by mandation.

The restriction and disqualification mechanisms reflect the truism that where the directors and shareholders are one and the same it is unlikely that they will authorise proceedings against themselves. Thus, while the scope for public enforcement of directorial standards by liquidators has been statutorily enhanced, in contrast, the law relating to private enforcement has been neglected. The result is that the default enforcement of directorial standards generally occurs in the context of insolvent liquidation and is designed with the protection of the public in mind.[79]

As a consequence, the statutory imposition of a general requirement on liquidators of insolvent companies to make a restriction application in respect of their directors has become the prime moving force in relation to directorial misconduct and incompetence. This has helped to push the traditional duties and the cumbersome methods of enforcing them out of the spotlight and off the policy agenda. The explosion in restriction applications by liquidators has meant that judges are within their comfort zone in

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[76] Part VII of the *Companies Act 1990*.

[77] On the mandatory nature of the duty see *Duignan v Carway* High Court (McCracken J) 23 January 2002.

[78] Section 298 of the *Companies Act 1963* (as amended) provides for a misfeasance action to be taken by liquidators against directors for breaches of duty with a view to recovering company property and monies.

[79] *Re La Moselle Clothing Ltd* [1998] 2 ILRM 345, 350-351 *per* Shanley J.

applying the statutory restriction regime. Thus the role of the statutory restriction regime as the heir apparent, leaving behind the traditional duties in the ha'penny place, has played its part in decreasing the currency of equitable and common law remedies.

That being said, some indirect doctrinal gains are attributable to legislative grafting onto the core duties and responsibilities of directors and the provision of public interest enforcement. In recent times the restriction regime (and to a lesser extent, the disqualification regime) has provided an unrivalled conduit to judicial consideration of directors' conduct and the legal constraints imposed under the general law. While corporate actions and derivative actions are few and far between, frequent judicial consideration of directorial conduct does occur within the context of the restriction regime.[80] It can be concluded that indirect enforcement has become a key driver in relation to standard-setting for directors and the corpus of restriction and disqualification decisions have an important role to play in conditioning societal expectations as to what is considered irresponsible directorial behaviour. There has also been an unexpected fillip for directors' duties as it is now common in restriction proceedings for judges to devote some consideration to whether a director had complied with his common law duties to be considered in deciding whether to make a declaration of restriction.[81] However, in some cases this is done in little more than a perfunctory manner.[82]

(5) Enforcement in the Reform Process

Having regard to the considerable difficulties with private enforcement of directors' duties catalogued above, what are the implications for enforcement of the proposed

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[80] B Farren "Restrictions on Directors of Insolvent Companies" (1997) 2 BR 349; H Garvey "Restricting Directors – Recent Case Law on Section 150 of the Companies Act 1990" (1998) 5 C L Pract 289; B Kennedy "Restrictions and Disqualifications of Directors" (2002) 7 BR 241; A Brennan "Section 150 of the Companies Act 1990 – Restriction of Directors Reviewed (Part I) (2002) 9 C L Pract 215.

[81] This stems from *Kavanagh v Delaney* [2005] 1 ILRM 34. See further *Re Cooke's Events Co Ltd; Kavanagh v Cooke* [2006] 1 ILRM 191; *Re Swanpool Ltd* [2006] 2 ILRM 217.

[82] See *eg Kavanagh v Kelly* [2005] IEHC 421.

legislative statement of such duties discussed in Chapter 5? O'Brien provides the following timely insight on policy formation concerning enforcement:

> "Just as important as the capacity to create regulatory instruments is the ability to manage their enforcement. The form that enforcement takes is determined by the relative power of diverse actors within the corporate governance and regulatory equation."[83]

Unfortunately there has been little consideration in this jurisdiction of enforcement and the need to calibrate policy appropriately so as to achieve this balance in the regulatory equation. The CLRG's drive towards a statutory statement of directors' duties was not accompanied by a comprehensive review of how such duties should be enforced. Head 9(1) of the draft scheme[84] deals with enforcement as follows:

> "Without prejudice to the provisions of any enactment (including this Act) a director of a company shall owe the duties set out in Head 3[85] to his company (and the company alone), which shall be enforced in the same way as any other fiduciary duty owed to a company by its directors."[86]

A number of observations may be made about this. Whatever the objective, the wording is less than felicitous and the unsophisticated drafting risks opening a chasm. The formulation employed reveals a lack of appreciation of the distinction between the

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[83] J O'Brien "Governing the Corporation: Regulation and Corporate Governance in an Age of Scandal and Global Markets" in J O'Brien (ed) *Governing the Corporation: Regulation and Corporate Governance in an Age of Scandal and Global Markets* John Wiley & Sons Ltd Chichester 2005 at 2.

[84] Head 9(1) of Part A5 of the *General Scheme of Companies Consolidation and Reform Bill* (2007).

[85] It would seem that this should be a reference to sub-head 3 of Head 9.

[86] This was based on a recommendation of the Company Law Review Group: see *First Report (2000-2001)* (2002) at 11.3.7 which presented this formula with no discussion as to its purported intent.

fiduciary and non-fiduciary duties of directors.[87] What "other fiduciary duties" are owed to a company by its directors? The provision would appear to be designed to clarify that the same methods of enforcement will apply as if the relevant pre-existing common law rule or equitable principle applied. It would seem that these problems in the draft text are a result of unwise importation of the enforcement wording from section 52(2) of the *Companies Act 1990* which concerns a requirement to consider the interests of employees and members.[88] The formulation is also injudiciously used in the enforcement provision of the UK's *Companies Act 2006.*[89] As its stands, the draft provision gives a misleading impression that a class of non-statutory, fiduciary duties owed by directors to their company remains extant. It is to be hoped that the drafting clumsiness will be addressed by the Office of the Parliamentary Counsel, or failing that, during the legislative process.

Drafting issues aside, more fundamentally, the draft Irish provision reveals a lack of fresh thinking on private enforcement by means of derivative litigation against directors. The Company Law Review Group did not consider the subject of private enforcement of company law so it would appear that a significant opportunity to effect reforms has been missed. While it is appreciated that the work involved in producing a companies code is gargantuan in nature, to effect reforms in some areas of underlying duties while failing to devote consideration to the subject of private enforcement does not make for a comprehensive review or a satisfactory legal outcome. A unipolar concentration on facilitating understanding of directors' duties is unfortunate as the simplification and codification of enforcement represent the obverse side of the coin of attempts to make the directors' code more transparent. The failure at policy level to consider the very real issues which surround enforcement is regrettable particularly when juxtaposed alongside

[87] By contrast section 178(2) of the UK's *Companies Act 2006* reveals an appreciation of widespread acceptance of the duty to exercise care, skill and diligence as non-fiduciary in nature.

[88] Company Law Review Group n 86 above at 11.3.7 (n 12 to).

[89] Section 178(2) of the *Companies Act 2006* (UK).

the acute academic awareness of the inherent difficulties in the sphere of private enforcement.[90]

The lack of a policy review of derivative actions by the Company Law Review Group can be contrasted with efforts made in other countries to redress the balance. Many common law jurisdictions have not been afraid of the consequences of forming a view that the traditional rules governing derivative actions are unwieldy and out of step with current expectations. Indeed, as Watson highlights, the underlying premise of the statutory derivative action is a policy admission that the common law has not provided adequate remedies for the minority shareholder "either at law or economically".[91] This is reflected in Canada,[92] Australia,[93] New Zealand, [94] Singapore[95] and the UK[96] opting to create an extended statutory derivative action in order to address the difficulties concerning the private enforcement of directors' duties. Meanwhile South Africa is poised to follow the popular US solution of requiring the appointment of an independent committee to examine the merits of litigation.[97] Behind these reforms is a desire to ensure that directors' duties are not a dead letter because of the lack of accountability engendered by the vagaries of *Foss v Harbottle*. The provision of a statutory derivative

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[90] The literature includes D Linehan n 30 above; BR Cheffins and JM Dine "Shareholder Remedies: Lessons from Canada" (1992) 13 Co Law 89; S Watson "A Matter of Balance: The Statutory Derivative Action in New Zealand" (1998) 19 Co Law 236; I Lynch Fannon n 54 above.

[91] S Watson n 90 above at 236.

[92] Sections 238 to 240 of the *Canada Business Corporations Act*. See further MA Maloney "Whither the Statutory Derivative Action" (1986) 70 Can Bar Rev 29 at 32; BR Cheffins and JM Dine n 90 above.

[93] Sections 236 and 237 of the *Corporations Act 2001* (Australia).

[94] Section 165 to 168 of the *Companies Act 1993* (New Zealand). See further S Watson n 90 above; A Fraser "The Companies Act 1993: Shareholder Remedies" (1992-1995) 7 Auckland U L Rev 739.

[95] Section 216A and 216B of the *Companies Act* (Cap 50). See further P Koh Ming Choo "The Statutory Derivative Action in Singapore: A Critical and Comparative Examination" (2001) 13 Bond LR 3.

[96] Part 11 of the *Companies Act 2006* (UK). See further D Lightman "The Companies Act 2006: a Nutshell Guide to the Changes to the Derivative Claim" (2007) 26 CJQ 37.

[97] Section 166 of the draft Companies Bill 2007 (South Africa) produced by the Department of Trade and Industry and available on http://www.thedti.gov.za.

action is also seen as providing a deterrent against managerial misconduct.[98] This is an important function in itself even if many such actions do not materialise in practice.[99]

It is instructive to refer briefly to the recent experience of our closest neighbour. In the UK calls for a statutory derivative action[100] bore fruit in Part 11 of the reforming *Companies Act 2006* which is designed to simplify the law on derivative claims by creating more flexible criteria in respect of the derivative action.[101] Thus, with the court's consent, a derivative claim is permitted in respect of an actual or proposed breach of directors' duties including one involving negligence.[102] These reforms remove difficulties concerning the meaning of "fraud" and the need to review the circumstances surrounding alleged directorial negligence which derive from *Palvides v Jensen.*[103] Furthermore, the requirement of showing wrongdoer control is dispensed with.[104] The UK's new scheme will require, *inter alia*, a *prima facie* case to be demonstrated in order to obtain judicial consent to a derivative action. This is an important control since the moving shareholders' motives may not be entirely altruistic and there is a need to avoid what can be termed the wrong type of litigation.[105]

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[98] P Koh Ming Choo n 95 above at para 17.

[99] *Ibid* at paras 17, 50.

[100] V Finch n 50 above at 204; Law Commission (UK) *Shareholder Remedies, A Consultation Paper* No. 142 (1996); *Shareholder Remedies* (Report) Law Com No. 246 Cm 37649 Stationery Office (1997) (recommending the replacement of the rule in *Foss v Harbottle* (1843) 2 Hare 461 with a statutory derivative action).

[101] This reflected the Law Commission's recommendations in its report on shareholder remedies *Shareholder Remedies* Law Com No. 246 Cm 3769 Stationery Office (1997).

[102] Section 260(3) of the *Companies Act 2006* (UK). This reflects the approach of both the Law Commission and the Company Law Review: see further Company Law Review Steering Group (UK) *Modern Company Law For a Competitive Economy: Developing the Framework* URN 00/656 (2000) at para 4.112-4.139.

[103] See further S Mayson, D French and C Ryan *Mayson French & Ryan on Company Law* 23rd ed Oxford University Press 2006 at 673.

[104] See Department of Trade and Industry (UK) *Companies Act 2006: Explanatory Notes* (2006) at para 491.

[105] P Koh Ming Choo n 95 above at para 2-6.

It is not unreasonable to suppose that the experience of these jurisdictions, coupled with the accompanying academic and policy debate, could prove instructive in Irish policy-making discussions. The benefits for Ireland of giving consideration to including a statutory derivative action in the proposed *Companies Consolidation and Reform Bill* would be twofold. Not only would such a course of action increase transparency in relation to the institution of proceedings, it would also provide the opportunity to review some of the obstacles which stand in the way of individual shareholder enforcement. There is no reason why judges in this jurisdiction should not be trusted to apply a sensible screening process in any application put before them using a legislative model such as that devised in the UK. However, realistically, having regard to the experience in other jurisdictions which have introduced a statutory derivative action, it is likely than even if Ireland were to take the plunge, in many cases other statutory remedies such as the personal statutory oppression remedy would continue to prove more attractive to the average shareholder in terms of cost, procedure and effectiveness of the remedy afforded.

D. AVOIDING THE CONSEQUENCES OF BREACH

We turn now to examine some of the influences on liability which have militated against liability for breaches of directors' duties being regarded in absolutist terms. The role of ratification is briefly considered before moving on to discuss theoretical issues concerning relief, exemptions from liability and indemnities.

(1) Release and Ratification

While the statement of strong policy rules relating to directors sends a clear message, a feature of the law relating to directors' duties is the less than absolute nature of those rules, particularly having regard to the accepted role of *ex ante* and *ex post* authorisation

by the company in general meeting.[106] Generally the shareholders of a solvent company may unanimously release the directors, either prospectively or retrospectively, from liability for particular actions which would otherwise constitute a breach of fiduciary duty[107] provided their actions are *intra vires* the company,[108] the transaction was honest[109] and full disclosure of the relevant facts has been made.[110] Ratification owes its exercise to the return of members' powers over directors where the directors act in breach of their duties and is regarded as curing the breach and absolving the director in question from liability.[111] As well as operating to remove liability, ratification involves the adoption or approval of the underlying transaction which involved a breach of duty. It is clear that ratification will not be effective where what is at issue amounts to a wrongful appropriation of corporate property.[112] While a full examination of the intricacies of release and ratification is outside the scope of this chapter, what is highlighted here is the important role of these mechanisms in diluting an absolutist view of the consequences of breach as contrary to the interests of the company and leading to enforcement action against the director or directors concerned.

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[106] The appropriate company organ to effect a release from liability has proved controversial: see further PL Davies *Gower and Davies' Principles of Modern Company Law* 7th ed Thomson Sweet & Maxwell London 2003 at 437.

[107] *North-West Transportation Co Ltd v James Hughes Beatty* (1887) 12 App Cas 589; RJC Partridge "Ratification and the Release of Directors from Personal Liability" (1987) 46 CLJ 122; S Worthington "Corporate Governance: Remedying and Ratifying Directors' Breaches" (2000) 116 LQR 638. See also the *obiter* observations of Lord Russell in *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 150.

[108] *Bamford v Bamford* [1970] 1 Ch 212; *Re Greendale Developments* [1988] 1 IR 8. This will assume less significance in future given that the proposed reforms in Ireland will significantly abrogate the impact of the *ultra vires* rule.

[109] This qualification was added by Keane J in *Re Greendale Developments* [1988] 1 IR 8.

[110] Although the term ratification is often used in a broader sense to encompass prospective release, strictly speaking it refers to a removal of liability which occurs after a breach of duty has taken place.

[111] In *Bamford v Bamford* [1970] 1 Ch 212, 238, Harman LJ referred to this process as one of obtaining "absolution and forgiveness for their sins."

[112] This will be relevant where the directors are also shareholders and are engaging in self-interested voting. See further PL Davies n 106 above at 439-440.

(2) Relief from Liability for Breach of Duty

Historically, a provision giving the courts a statutory discretion to relieve a director from liability for breach of duty is a common feature of common law company legislation. However, statutory provision for relief (and indemnification) represents a balancing exercise which may be seen as emasculating the impact of the duties. In the UK the need for such equilibrium was described as follows during the reform process:

> "The law on directors' liability needs to strike a careful balance: on the one hand, the law must be firm and robust to deal fairly with cases where something has gone wrong, as a result of either negligence or of dishonesty; on the other, Britain needs a diverse pool of high-quality individuals willing to assume the role of company director, and a willingness to take informed and rational risks."[113]

Section 391(1) of the *Companies Act 1963*[114] gives a court a statutory discretion to relieve directors from liability for "negligence, default, breach of duty or breach of trust"[115] if the court believes that "he has acted honestly and reasonably, and that, having regard to all the circumstances of the case, including those connected with his appointment, he ought to be excused". Once these conditions are fulfilled, the court must consider whether in all the circumstances the director ought fairly to be excused,[116] and if so it has a discretion to relieve him either absolutely or partly[117] on whatever terms the

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[113] Department of Trade and Industry (UK) *Company Law Reform* Cm 6456 (2005) at 23.

[114] This provision mirrored legislative developments in the UK in section 448 of the *Companies Act 1948* (UK) arising from recommendations in the *Report of the Company Law Amendment Committee* ("the Reid Committee Report") Cmnd 3052 London HMSO (1906) at para 24.

[115] The incongruous use of the phrase "breach of trust" is attributable to the provision's antecedent, section 32 of the *Companies Act 1907*, which was based on the trustee liability provision, section 32 of the *Judicial Trustees Act 1896*: P Koh "An Issue of Absolution – Section 391 of the Companies Act" (2003) 15 SAcLJ 306 at 307; R Edmunds and J Lowry "The Continuing Value of Relief for Directors' Breach of Duty" (2003) 66 MLR 195 at 198-201.

[116] On the concept of fairness see P Koh n 115 above at 317-320.

[117] For an instance of partial relief from liability see *Re D'Jan of London Ltd* [1994] 1 BCLC 561.

court thinks fit.[118] Directors are also granted the right to invoke a similar protection as a preventative strike where they consider that such a claim will be brought against them.[119] Koh is rightly dubious about a policy assumption that otherwise directors would be reluctant to take up office.[120] Given the low chance of enforcement of directors' duties, the failure to provide such a provision would be unlikely in itself to prove a decisive influence.

Indeed, a consequence of the dearth of litigation against directors for breach of duty is that section 391 of the *Companies Act 1963* would not appear to have received judicial scrutiny.[121] This contrasts with the position in the United Kingdom where the equivalent section 727 of the *Companies Act 1985*[122] has received the scrutiny of the courts on many occasions. Although section 727 is rarely a first or sole line of defence,[123] it has been applied to actions for breach of duty giving rise to an account of profits[124] and to negligence claims giving rise to damages.[125]

Inherent in making provision for relief from liability is an acceptance of the judicial role in making a value judgment as to which breaches are acceptable and which are not.[126] That value judgment involves making a decision as to which breaches are trivial or inadvertent and qualifying as lesser on a scale of moral blameworthiness. Similar

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[118] See *National Trustees Co of Australasia Ltd v General Finance Co of Australasia Ltd* [1905] AC 373, 381 (PC); *Re Simmon Box (Diamonds) Ltd* [2000] BCC 275; *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749; *Re Brian D Pierson (Contractors) Ltd* [2001] 1 BCLC 275.

[119] Section 391(2) of the *Companies Act 1963*.

[120] P Koh n 115 above at 309.

[121] TB Courtney n 68 above at [10.077].

[122] This will be superseded by section 232 of the *Companies Act 2006* (UK) in the same terms when commenced.

[123] R Reed "Company Directors – Collective of Functional Responsibility" (2006) 27 Co Law 170 at 170-171.

[124] See *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749.

[125] *Bairstow v Queens Moat Houses* [2001] 2 BCLC 531 (relief from liability for negligence for unlawfully paying dividends when there were insufficient distributable reserves).

[126] For a good discussion of this see P Koh n 115 above at 309 ff.

provisions with the same parentage have been described as "the statutory *nemesis* of directors' duties."[127] Given the inherent value judgment, it is interesting to note that while section 727 was initially regarded as requiring an "essentially subjective approach",[128] the courts now treat proof that a director has acted both subjectively honestly[129] and objectively reasonably[130] as a precondition for the exercise of the court's jurisdiction.[131] While the honesty criterion has been viewed as an intention to act in the company's interests,[132] conversely, it would seem that an absence of honesty has been judicially understood in the equitable sense of moral turpitude rather than in a criminal law sense. Those who find it difficult to reconcile to the excusal of undoubted breaches may find some comfort in the fact that the effect of the combined test has been to ensure that unquestioning judicial deference has not been extended to directors. Thus in *Coleman Taymar Ltd v Oakes*,[133] applying the dual test, it was held that although the defendant had not acted in a subjectively dishonest fashion, it was not objectively reasonable for him to negotiate personal leases with the company's landlords, therefore relief for that breach of duty was not granted.[134] However, since the power of excusal is a discretionary one, the courts can weigh other pertinent factors in the balance including policy considerations.[135]

While it has been opined that it seems most unlikely that a self-serving fiduciary breach would merit relief,[136] the section's application to conflicts of interest cannot be ruled out.

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[127] *Ibid* at 306.

[128] *Re Produce Marketing Consortium Ltd* [1989] BCLC 513, 518 *per* Knox J.

[129] *Re D'Jan of London Ltd* [1994] 1 BCLC 561; *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749; *Whalley v Doney* [2004] EWHC 42 (Ch); *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch).

[130] *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749; *Whalley v Doney* [2004] EWHC 42 (Ch).

[131] *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749, 770.

[132] *Re J Franklin & Son Ltd* [1937] 4 All ER 43.

[133] [2001] 2 BCLC 749.

[134] See also *Extrasure Travel Insurance Co Ltd v Scattergood* [2003] 1 BCLC 598 (defendants not considered to have acted reasonably therefore not excused).

[135] See further R Reed n 123 above at 170-171.

[136] P Koh n 115 above at 321-326.

When it comes to care, skill and diligence, the application of section 391 presents a logical conundrum *viz* how can a director who is found to have acted negligently ever avail of section 391(1) given its prerequisite that he has acted, not only honestly, but reasonably?

Not surprisingly, this aspect has come under the scrutiny of commentators.[137] Reed describes its application as follows: "In so far as I may have acted negligently or in breach of my duties to the company, I at least acted honestly and reasonably, and so I ought fairly to be excused and relieved of all or part of my liability."[138] Finch observes a manifest strain inherent in such a hypothesis.[139] At any rate, it has been judicially conceded that reasonableness for the purpose of section 727 is capable of being satisfied by something less than compliance with the common law standard of care in negligence.[140] As Hoffmann LJ observed in *Re D'Jan of London Ltd*:

> "It may seem odd that a person found to have been guilty of negligence, which involves failing to take reasonable care, can ever satisfy a court that he acted reasonably. Nevertheless, the section clearly contemplates that he may do so and it follows that conduct may be reasonable for the purposes of [the section] despite amounting to lack of care at common law."[141]

It was held in *Barings v Coopers & Lybrand* that negligent acts may have been done reasonably for the purpose of section 727 if the relevant directors "acted in good faith and their negligence was technical or minor in character, and not 'pervasive and compelling'."[142] An example of this is *Re D'Jan* where a director's breach of duty in

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[137] See V Finch n 50 above; P Koh n 115 above; R Reed n 123 above.

[138] R Reed n 123 above at 170.

[139] V Finch n 50 above at 201.

[140] *Re D'Jan of London Ltd* [1994] 1 BCLC 561, 564 *per* Hoffmann LJ.

[141] *Ibid.*

[142] [2003] EWHC 1319 (Ch), [1133] *per* Evans-Lombe J. See also *Re Duomatic Ltd* [1969] 1 All ER 161.

failing to read a form before signing was not considered to be gross, "[i]t was the kind of thing which could happen to any busy man ...."[143]

Despite the lack of judicial application of the provision in this jurisdiction and the undoubted quirks it has in relation to application to breaches of care, skill and diligence, it is proposed to re-enact section 391 of the *Companies Act 1963* without amendment.[144] The failure to review its operation may have stemmed in part from a lack of appreciation of the potential of such a section given the lack of judicial consideration to date. However, this oversight ignores the reality that the difficulties surrounding private action to enforce directors' duties already discussed are responsible for section 391's lack of application rather than any lack of potency within the section itself.

Comparative analysis does not reveal a policy consensus in other common law jurisdictions concerning the continuing need for this type of provision. In Australia, section 1318 of the *Corporations Act 2001* reflects a legislative amendment effected in 1981 which removed the express requirement to find that the defendant acted reasonably.[145] Despite this, the Australian courts have continued to regard whether the director acted reasonably as a pertinent consideration.[146] This has been viewed as involving a broader enquiry than that in relation to a duty of care *eg* did the director seek legal advice where appropriate to do so.[147] In the UK, the Steering Group of the Company Law Review considered that although the relief provision was little used, it was still of value.[148] The Steering Group recorded the doubt surrounding the extent to which relief was available in respect of negligence given the logical obstacle which the requirement that he had acted reasonably presented. It concluded that relief ought to be

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[143] [1994] 1 BCLC 561, 564 *per* Hoffmann LJ.

[144] Head 14 of Part A5 of the *General Scheme of Companies Consolidation and Reform Bill* (2007).

[145] See further RP Austin, HAJ Ford and IM Ramsay *Company Directors: Principles of Law and Corporate Governance* LexisNexis Butterworths Australia 2005 at para 17.18.

[146] *Circle Petroleum (Queensland) Pty Ltd v Greenslade* (1998) 16 ACLC 1577; *Kenna & Brown Pty Ltd (in liq) v Kenna* (1999) 32 ACSR 430.

[147] RP Austin, HAJ Ford and IM Ramsay n 145 above at para 17.18.

[148] The Company Law Review Steering Group (UK) n 102 above at para 3.77.

available where a court believes a director ought fairly to be excused. Accordingly it recommended the deletion of the requirement that the director must have acted reasonably, while retaining the other conditions.[149] However, this did not occur and section 1157 of the *Companies Act 2006* essentially reproduces the antecedent section 727 of the *Companies Act 1985*. This apparent u-turn may have influenced the Irish policy decision to retain section 391 of the *Companies Act 1963* although given the lack of express consideration of section 391 in the CLRG's reports, it is not possible to be more definite in relation to the thinking behind its re-enactment.

It has been said that a section 391-type provision does not help to clarify the conduct that is expected of directors.[150] More accurately, the concepts of breach and liability are clear enough but what section 391 does by offering the discretionary possibility of judicial relief from liability is to create uncertainty as to what a director can ultimately expect to 'get away with'. The existence of section 391 in the *Companies Act 1963* is explicable in terms of historical legacies. Its continued presence in the *General Scheme of the Companies Consolidation and Reform Bill* is consistent with an unarticulated policy choice in favour of leaving considerable judicial discretion in place in cases concerning breaches of directors' duty in order to provide the requisite flexibility for a sensible judicial decision to be arrived at in an individual case.[151]

(3) Exemptions from Liability and Indemnities

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[149] *Ibid* at para 3.75; the Company Law Review Steering Group (UK) *Modern Company Law For a Competitive Economy: Completing the Structure* URN 00/1135 (2000) para 3.29 (n 50 to). For an alternative suggestion that the section should operate using a fairness criterion see R Edmunds and J Lowry n 115 above.

[150] P Koh n 115 above at 332.

[151] The CLRG described it succinctly as "[a] necessary mitigating provision": Company Law Review Group *Company Law for the 21st Century: Report on General Scheme of Companies Consolidation and Reform Bill* (2007) at 43.

Contractarians would argue that the participants in corporate law contracts should be able to contract out of standard form rules where they so desire.[152] In this context, corporate insurance and indemnification against directorial liability can be viewed as a contractual response to liability rules.[153] The extent of policy support for this perspective requires further exploration in order to determine:

(i) whether a company can contractually agree to modify the director's liability through the inclusion of an exemption clause;

(ii) whether a company can take steps to ensure that a director is indemnified against the financial consequences of liability for breach of directors' duties.

Both aspects are addressed in section 200 of the *Companies Act 1963*.

(a) Exemptions from Liability

Originally the courts were willing to uphold provisions in the articles of association exempting directors from liability for negligence provided that the directors were not guilty of fraud or wilful default.[154] However, in the UK the legislature intervened to modify this position based on the Greene Committee's view that such a provision would meet the public expectation that no such escape from liability would be possible.[155] Section 200(1) of the *Companies Act 1963* reflects this in declaring void any provision contained in a company's articles of association or any contractual provision which

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[152] See further BR Cheffins n 17 above at 29.

[153] FH Easterbrook and DR Fischel n 10 above at 105.

[154] *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425; *Re City Equitable Fire Insurance* [1925] Ch 407. PL Davies n 106 above at 396.

[155] See section 129 of the *Companies Act 1929* (UK) which was enacted on foot of a recommendation of the Greene Committee: *Report of the Company Law Amendment Committee* ("The Greene Committee Report") Cmnd 2657 (1926). For similar provisions in other jurisdictions see section 199A(1) of the *Corporations Act 2001* (Australia); section 172(1) of the *Companies Act* (cap 50) (Singapore); section 165 of the *Hong Kong Ordinance*. Canada does not have an express provision prohibiting exempting provisions.

purports to exempt a director or indemnify him against liability "in respect of any negligence, default, breach of duty or breach of trust" in relation to the company.[156]

There has been some uncertainty as to what will fall foul of such a prohibition. On the issue of what constitutes an exemption, the Malaysian Corporate Law Reform Committee noted that uncertainty existed as to whether an act of ratification of a breach of duty by the shareholders would amount to an infringement.[157] It concluded that the equivalent section was enacted "to prevent the director from being exempted in advance of the occurrence of the breach" therefore it should have no application to ratification of a breach.[158] A further issue concerns the frequent insertion of a regulation in the articles of association purporting to allow a director to retain profits arising from a conflict of interest provided appropriate disclosure is made to the board. Davies ventures to suggest that as exemptions from conflict of interest breaches appear in the model articles appended to companies legislation and ruled upon by the courts, they should be taken to be effective.[159]

The issue came up for judicial consideration in *Movitex Ltd v Bulfield*[160] where Vinelott J did not construe this type of provision as an attempt to exempt from liability but rather as laying down conditions which must be followed to ensure a transaction is valid *ie* the model regulation was seen as dealing with the consequences of a breach rather than as effecting a modification of the underlying principle.[161] One may justifiably regard this distinction as being semantic in nature and founded in pragmatism. What is also worth digesting is Vinelott J's *obiter* view that it would not be possible to modify the care and

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[156] See TB Courtney n 68 above at [10.79]; C Passmore "Directors' Indemnities" (1995) 16 Co Law 243; LS Sealy "Company-Directors' 'Duties' and Exempting Articles" [1987] 46 CLJ 217.

[157] Corporate Law Reform Committee (Malaysia) *A Consultative Document on Clarifying and Reformulating the Directors' Role and Duties* (2006) at para 5.6.

[158] Corporate Law Reform Committee (Malaysia) n 157 above at para 5.6.

[159] PL Davies n 106 above at 396.

[160] [1986] 2 BCC 99, 403. See further LS Sealy n 156 above.

[161] LS Sealy n 156 above at 219; C Passmore n 156 above at 244.

skill duty.[162] Furthermore, it has been opined that the articles of association could never effect a release from the over-arching duty to act in the best interests of the company.[163] While these aspects would not appear to have been judicially tested, they show a willingness to draw a line, but it remains to be seen whether the pencilled line will be subject to future adjustment.

(b) Indemnities

There has been some shifting of policy concerning the appropriateness of allowing directors to be indemnified against the costs of defending proceedings issued against them. The rationale behind the original prohibition on indemnifying directors in section 200 of the *Companies Act 1963* was viewed by the CLRG as being that "... the company ought not spend its money in bailing out negligent directors and other officers."[164] This prohibition was softened by a provision permitting the company to indemnify a director against his costs in successfully defended proceedings or in connection with a successful application for relief under section 391 of the *Companies Act 1963*.[165]

For a long time section 200 was out of step with the common commercial practice of obtaining directors' and officers' insurance ("D&O insurance") to help meet the gap which may occur where a director's resources are insufficient to compensate the company for the breach.[166] However, following the CLRG's recommendation that D&O insurance be facilitated,[167] section 200 was amended.[168] The amended provision

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[162] [1986] 2 BCC 99,403 at 99,429-99,430.

[163] See PD Finn *Fiduciary Obligations* The Law Book Company Ltd Sydney 1977 at para 83.

[164] Company Law Review Group n 86 above at 11.6.3.

[165] Section 200(b) of the *Companies Act 1963*.

[166] See Company Law Review Group n 86 above at 11.6.1.

[167] *Ibid* at 11.6.4.

[168] Section 56 of the *Companies (Auditing and Accounting) Act 2003* was commenced on 6 April 2004 pursuant to the *Companies (Auditing and Accounting) Act 2003 (Commencement) Order* (SI No. 132 of 2004).

maintains the general prohibition on liability exemption but expressly permits a company to obtain directors' and officers' insurance.[169]

There is an issue as to the impact of the availability of D&O Insurance on the standards to which directors aspire. The potential for a punitive function is lessened by permitting D&O insurance since this involves shifting the risk for both directors and their companies. The Irish Law Reform Commission had this to say of D&O reforms in the UK:

> "While it is argued that such policies might increase the moral hazard by giving directors the impetus to act with impunity, they have been welcomed, on balance, as being more beneficial than not to all those affected – including those harmed by the wrong."[170]

It would seem that conduct which is dishonest, fraudulent or otherwise illegal will, in any event, generally be excluded from cover on public policy grounds.[171] This in itself mitigates some concerns as to the policy behind D&O insurance allowing directors to escape punishment. Finch presents the view that, in the UK "the debate on skill and care has been placed in a new and uncertain context by the advent of company funded directors' liability insurance."[172] However, in Ireland, given that judicial enforcement of directors' duties is rare, the main beneficiaries of D&O policies are likely to be the insurance companies.

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[169] Head 15 of the *General Scheme of Companies Consolidation and Reform Bill* (2007) restates section 200 of the *Companies Act 1963* (as amended).

[170] Law Reform Commission *Consultation Paper on Corporate Killing* (LRC CP 26-2003) at para 2.25. See also MA Clarke *The Law of Insurance Contracts* 3rd ed Lloyds of London Press 1997 at 681.

[171] V Finch "Personal Accountability and Corporate Control: The Role of Directors' and Officers' Liability Insurance" (1994) 52 MLR 880 at 899.

[172] V Finch n 50 above at 214.

E. REMEDIES, THE POOR RELATION?

Having examined some of the ways in which legislative and judicial policy on enforcement and liability matters influence the application of remedies for breaches of directors' duties, it is worth giving some consideration to remedies in their own right. At the most fundamental level, remedies for breach of equitable and common law duties can be seen to perform a number of different functions. As with breaches of trust, the major aspects of direct liability for breach of directors' duties are enforcement of duties owed, restitution of gain and compensation for loss occasioned by the breach of duty.[173] In addition, as Cheffins acknowledges, "[b]y giving corporations remedies against directors and officers [who breach their duties], fiduciary duties provide an incentive to managers to act consistently with shareholders' interests."[174]

It is contended below that remedies took a back seat in the reform process. In the Company Law Review Group's debate on company law reform and consolidation, equitable remedies for breaches of directors' duties received no more than cursory consideration. To understand why requires consideration of a number of factors. Most obviously, there is a general lack of familiarity with the finer details of the remedial framework which is contributed to by the dearth of case law applying the remedies. The enforcement pattern discussed earlier in this chapter helps to explain this. In addition, the proliferation of black letter company law has led to a downgrading of equitable doctrine and a mono-focus on statutory rights and remedies. In order to appreciate how remedies fared in the recent process, an outline of the existing remedial framework for breaches of directors' duties is first set out below.[175]

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[173] On these goals in a trust context see R Chambers "Liability" in P Birks and A Pretto (eds) *Breach of Trust* Hart Publishing Oxford 2002.

[174] BR Cheffins n 17 above at 31. As will be seen, that deterrent effect may be negated by hurdles to enforcement.

[175] This outline of remedies is set out for illustrative purposes and does not purport to be comprehensive in nature.

(1) The Existing Framework

The remedies which are available for a breach of directors' duties will depend on the circumstances surrounding the underlying breach and its aftermath. The remedies available may be either personal (*in personam*) remedies against a director or proprietary (*in rem*) remedies against property or a combination of both.[176] An injunction may be sought to prevent a continuance of a breach of duty[177] and the courts have indicated that they will act where there is anticipated breach of directors' duties as well as where one has actually occurred.[178]

Personal remedies are exercised against a director in breach of duty and focus on either the gain made or the loss incurred. The normal remedy where a director wrongly profits from his position is to make him account for the profits to the company[179] and it is this remedy which involves the restitution of the unauthorised profit which is perhaps the most widely recognised personal remedy. However, there is a judicial tendency to characterise the personal account of profits remedy as making the director liable as a constructive trustee, thus giving misleading overtones of a proprietary remedy rather than a personal liability to account.[180] An alternative to seeking an account of profits remedy is to seek equitable compensation from the director.[181] While an account of profits

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[176] An analytical division may also be made between common law and equitable remedies.

[177] See *Crindle Investments Ltd v Wymes* [1998] 2 ILRM 275 (claim failed).

[178] *Tito v Waddell (No 2)* [1977] 3 All ER 129; *Pacifica Shipping Co Ltd v Andersen* [1986] 2 NZLR 328; *Movitex Ltd v Bulfield* [1988] BLCC 104 at 119-120 *per* Vinelott J; *CMS Dolphin v Simonet* [2001] 2 BCLC 704, [84] *per* Lawrence Collins J; *In Plus Group Ltd v Pyke* [2002] 2 BCLC 201, [85]- [87] *per* Sedley LJ.

[179] The trust law basis for this can be seen in *Keech v Sandford* [1558-1774] All ER Rep 23 and *Gabbett v Lawder* (1883) 11 LR Ir 295. The classic case in respect of company directors is *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378. For a modern Irish judicial consideration see *Fyffes plc v DCC Plc* [2005] IEHC 477.

[180] See the admonitions of Lewison J in *Ultraframe (UK) Ltd v Fielding* [2005] EWCA 1638 (Ch), [1517].

[181] Less commonly, a common law action for money had and received may be brought: *Moses v Macferlan* (1760) 2 Burr 1005, 1012 *per* Lord Mansfield CJ. It is now recognised that the basis of the common law action for money had and received is not based on implied contract but on unjust enrichment: *Fibrosa*

focuses on gains made, equitable compensation focuses on loss to the company attributable to the breach of equitable duty.[182] The liability to pay equitable compensation is analogous to the personal liability of trustees to restore trust property lost through a breach of trust.[183] The compensation awarded is designed to put the company back into the position it would have been in if the breach had not occurred and the liability to compensate will arise irrespective of whether personal benefit accrued to the director. Where there has been a breach of the common law duty of care, skill and diligence, the common law remedy of damages for negligence may provide a remedy to the company for loss suffered.[184]

A director who acquired assets or other financial benefits in breach of duty can be ordered to make restitution of the assets or the value received. This is the case whether the assets were misappropriated from the company or were obtained in breach of duty from a third party. Thus, subject to certain bars, rescission will be an appropriate remedy where a contract has been entered into which is tainted by a breach of duty.[185]

Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd [1943] AC 32, 63-64 *per* Lord Wright; *Pavey & Mathews Pty Ltd v Paul* (1987) 162 CLR 221, 227, 255; *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548, 578; *Woolwich Equitable Building Society v Inland Revenue Commissioners* [1993] AC 70; *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] AC 669.

[182] See further *Nocton v Lord Ashburton* [1914] AC 932; *Target Holdings Ltd v Redferns* [1995] 3 All ER 785, 798 *per* Lord Browne-Wilkinson; *Swindle v Harrison* [1997] 4 All ER 705 See generally MDG Conaglen "Equitable Compensation for Breach of Fiduciary Dealing Rules" (2003) 119 LQR 246.

[183] *Clough v Bond* (1838) 3 My & Cr 490, 497 *per* Lord Cottenham LC; *Re Land Allotment Co* [1894] 1 Ch 616.

[184] Issues relating to the differing treatment of causation, foreseeability and remoteness in equitable and common law compensation models are outside the scope of the present discussion. On moves towards convergence see *Permanent Building Society v Wheeler* Supreme Court Western Australia 28 July 1994 at 93-95 *per* Ipp J; *Bristol & West Building Society v Mothew* [1996] 4 All ER 698, 719 *per* Staughton LJ. See also PL Davies n 106 above at 425.

[185] *Transvaal Lands Co v New Belgium (Transvaal) Land and Development Co* [1914] 2 Ch 448; *Hely-Hutchinson v Brayhead Ltd* [1967] 3 All ER 98; *Guinness plc v Saunders* [1990] 2 AC 663,

Proprietary remedies focus on property and assert an interest in it which is tied to an underlying breach of duty. As the judicial understanding of proprietary remedies is still in development, it remains the case that personal remedies have been the primary focus in relation to breaches of directors' duties. Where there has been a breach of fiduciary duty any property misappropriated by a trustee or director will in equity belong to the company.[186] Therefore if a director of a company has acquired property in breach of a fiduciary duty owed to the company, the property is held on trust for the company and the director can be ordered to pass it to the company.[187] A proprietary claim will not be available where the director (or a third party) is no longer in possession of the trust property or its traceable proceeds. In such circumstances a personal claim against the director or a personal claim against a third party recipient to account as a constructive trustee under the knowing receipt head will be more appropriate.[188]

In policy terms when it comes to accountability, it is of interest that in any case it may be possible to choose between a range of overlapping remedies.[189] As Butcher points out, it is axiomatic that it is for the plaintiff to choose the remedy preferred.[190] There are a number of different factors influencing the remedies pursued for breach of directors' duties. Some remedies have proved more readily resorted to than others reflecting issues such as ease of application and the identity of the primary mover behind enforcement. To

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[186] *Agip (Africa) Ltd v Jackson* [1990] Ch 265; *AG for Hong Kong v Reid* [1994] 1 All ER 1. See also *Brinks Ltd v Abu-Saleh (No. 3)* The Times 23 October 1996 discussed in R Pearce and J Stevens *The Law of Trusts and Equitable Obligations* 4th ed Oxford University Press 2006 at 781-782; *JJ Harrison (Properties) Ltd v Harrison* [2002] 1 BCLC 162.

[187] *JJ Harrison (Properties) Ltd v Harrison* [2002] 1 BCLC 162, [27]–[30] *per* Chadwick LJ.

[188] See *Belmont Finance Corporation Ltd v Williams Furniture Ltd (No. 2)* [1980] 1 All ER 393; *Baden Delvaux v Société Générale* [1983] BCLC 325; *AG of Hong Kong v Reid* [1994] 1 AC 324; *El Ajou v Dollar Land Holdings* [1994] BCC 143; *Re Frederick Inns Ltd* [1994] 1 ILRM 387; *BCCI Ltd v Akindele* [2000] 4 All ER 221; *Fyffes plc v DCC Plc* [2005] IEHC 477; *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch).

[189] See further RR Pennington *Directors' Personal Liability* BSP Professional Books 1987 at 33.

[190] BS Butcher "Directors' Duties in the Twenty-First Century: A New Beginning?" (2000) 2 ICCLJ 197 at 227-228.

some extent choice of remedy involves a cost-benefit analysis.[191] In some instances the remedy afforded by a court will be down to the approach taken in the pleadings, in others the remedy chosen will be down to a matter of judicial preference based on what is required to do justice between the parties. As with all equitable remedies, a remedy will not be afforded where to do so would be inequitable.

The appropriateness of a particular type of remedy will depend on the individual circumstances. In many situations a personal remedy will be the preferred route, and within this frame, it will often more advantageous to pursue an account of profits rather than equitable compensation. This will be the case, for example, where the actual profits obtained by the director from his entrepreneurship are likely to be greater than the damages which would be awarded for the loss of opportunity suffered by the company such as where the company would not have been able to avail of the opportunity.[192] There are a number of situations in which pursuit of a proprietary remedy will hold particular pragmatic appeal over a personal remedy including where a director is unlikely to prove a good mark for a personal remedy.

The remedy given for a breach of directors' duties will also be influenced by the fact that where the law provides for more than one remedy, remedies which are inconsistent are treated as alternative remedies.[193] An account of profits made in breach of fiduciary duty which is measured by the wrongdoer's gain is regarded as inconsistent with a remedy in damages for loss suffered which is measured in terms of the injured party's loss.[194] Therefore where there is a breach of the secret profit rule, directors can only be made liable for losses or profits, but not both.[195] In *Tan Man Sit v Capacious Investments*

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[191] *Attorney General v Blake* [1998] 1 All ER 833, 841 *per* Lord Woolf MR.

[192] See *Industrial Developments Consultants Ltd v Cooley* [1972] 2 All ER 162.

[193] *Tan Man Sit v Capacious Investments Ltd* [1996] 1 All ER 193.

[194] This policy against double benefit was acknowledged in *Cosmoline Trading Ltd v DH Burke* [2007] IEHC 186 High Court (Finnegan P) 14 June 2007.

[195] *Tang Man Sit v Capacious Investments Ltd* [1996] 1 All ER 193, 197-198. See further *Island Records Ltd v Tring International plc* [1996] 1 WLR 1256, 1258-1259; *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749, [79].

Ltd,[196] having set out the rule against the accumulation of inconsistent remedies, Lord Nicholls went on to state that remedies which are not inconsistent with each other may be cumulatively obtained.[197] Therefore where a contract with a director is set aside for breach of duty, it is also possible to obtain damages.

While the above outline of potential remedies represents the spectrum of directly applicable equitable and common law remedies for breaches of directors' duties, it would be remiss in an assessment of the duties to ignore the impact of company law's busy legislative heritage. Instead of suing directly for breach of duty, a number of other statutory remedies are open to dissatisfied members which will often hold more appeal than the equitable and common law remedies outlined above. In this regard, the complexities of remedies and the procedural rules surrounding litigating directors' duties can be contrasted with the relative ease with which other remedial tools can be deployed.

On the basis of the considerable procedural and financial hurdles to be negotiated in order to bring a derivative action (particularly where non-fiduciary breaches are concerned), it is fair to conclude that it will often make more sense for a disgruntled shareholder to seek the removal of the offending director by ordinary resolution if a simple majority of the general meeting can be procured.[198] Alternatively, in appropriate circumstances a minority shareholder may be able to construct a claim for oppression under section 205 of the *Companies Act 1963*[199] which provides a remedy against directorial conduct which is oppressive towards a shareholder.[200]

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[196] [1996] 1 All ER 193.

[197] *Ibid* at 198-199.

[198] Section 182(1) of the *Companies Act 1963*. See *Feighery v Feighery* High Court (Laffoy J) 25 February 1998; *McGilligan v O'Grady* [1999] 1 IR 346; B Dunleavy "The Power of Shareholders to Remove Directors under Section 182 of the Companies Act, 1963" (1999) 4 *The Bar Review* 265.

[199] See sections 205 and 231(g) of the *Companies Act 1963*. The Company Law Review Group did not recommend any change to the oppression remedy: see Company Law Review Group n 86 above at 6.12.2.

[200] Cases concerning section 205 of the *Companies Act 1963* include *Re Irish Visiting Motorists Bureau Ltd* High Court (Kenny J) 7 February 1972 unrep; *Re Westwinds Holding Co Ltd* High Court (Kenny J) 21 May 1974 unrep; *McCormick v Cameo Investments Ltd* [1978] ILRM 191; *Re Murph's Restaurant Ltd* [1979]

Alternatively, a member may present a petition for the winding up of the company on the basis that this would be just and equitable.[201] However, poor-decision-making ability, inefficiency and carelessness in the performance by directors of their duties will not always be judicially considered to justify a winding up.[202] In reality, petitions frequently disclose conduct amounting to lack of probity on the part of directors[203] but where the courts consider that the directorial wrongdoing could be remedied in another fashion *eg* through the company suing or the bringing of a derivative claim, they have been slow to entertain a petition for winding up on the just and equitable ground.[204] Realistically, if matters have become so far gone as to predict insolvency there will be little point in a shareholder pursuing a remedy on behalf of the company which will ultimately feed the creditors. In those circumstances, the desire for retribution may be satisfied by the possibility of a restriction application being brought by a liquidator pursuant to section 56 of the *Company Law Enforcement Act 2001* should the company go into insolvent liquidation.

Apart from the lure of easily applied statutory remedies, it can also be maintained that scholarly, professional and judicial tentativeness in relation to remedies has contributed to a failure to appreciate and harness the rich diversity of remedies available. There is

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ILRM 141; *Greenore Trading Co Ltd* [1980] ILRM 94; *Colgan v Colgan* High Court (Costello J) 22 July 1993 unrep; *Irish Press Plc v Ingersoll Irish Publications Ltd* High Court (Barron J) 1993 unrep, [1995] 2 IR 175 (S Ct); *Re Murray Consultants Ltd; Horgan v Murray* [1997] 3 IR 23; *Re Forest Mill Investments Ltd; MacAvin v Fleming* Supreme Court 14 July 1998 unrep; *Banfi Ltd v Moran* [2006] IEHC 257.

[201] Section 213(f) of the *Companies Act 1963*. See *eg Re Murph's Restaurant Ltd* [1979] ILRM 141; *Re Murray Consultants Ltd* [1997] 3 IR 23.

[202] *Re Five Minute Car Wash Service Ltd* [1966] 1 WLR 745.

[203] See *Loch v John Blackwood Ltd* [1924] AC 783; *Re Straw Products Pty Ltd* [1942] VLR 272; *Re Concrete Column Clamps Ltd* [1953] 4 DLR 60; *Re Maritime Asphalt Products Ltd* (1965) 52 DLR (2d) 8; *Re Worldhams Park Golf Course Ltd* [1998] 1 BCLC 554.

[204] See *Re Anglo-Greek Steam Co* (1866) LR 2 Eq 1, 5 *per* Lord Romilly MR; *Re Diamond Fuel Co.* (1879) 13 Ch D 400, 408 *per* Baggallay LJ; *Re Thoma Edward Brinsmead & Sons* [1897] 1 CH 45; *Re Kitson and Co. Ltd* [1946] 1 All ER 435, 441 *per* Lord Greene MR; *Re Surrey Garden Village Trust Ltd* [1965] 1 WLR 974, 981 *per* Plowman J.

vast untapped potential in the sphere of equitable remedies. The lack of vibrant judicial development in this sphere can be linked to a perception of the terrain of equitable remedies as an intimidating zone. A failure to grasp the nettle in relation to the range of remedies available is a testament to the fact that company lawyers are somewhat uncomfortable in the realm of equity and restitution, wrestling with nineteenth century principles which are the traditional preserve of the trust lawyer. Their predicament is not aided by the fact that cross-over scholarship between the company law and equity disciplines on the subject of non-statutory remedies for directors' breaches is relatively rare.[205] This is reflected in the fact that in many cases the path of least resistance is trodden in terms of remedies sought and awarded. It can be surmised that this deficit has contributed to shrinking the pool of remedies to which resort is commonly had. This is a self-perpetuating problem since if proceedings involving the wide spectrum of remedies are not instituted and brought to conclusion, then no chance of judicial illumination will arise.

A major challenge lies in ensuring that the courts are not afraid to step up to the plate when it comes to applying equitable principles and remedies in corporate and commercial contexts. While the English and Antipodean courts generally excel at this, on the rare occasions where the opportunity has presented itself the Irish courts have been noticeably more reticent than their English counterparts in relation to the application of complex equitable principles to modern commercial scenarios. This was exemplified in Laffoy J's judgment in *Fyffes plc v DCC plc*[206] which shied away from the equitable angle and focused instead on statutory regulation of insider dealing under Part V of the *Companies Act 1990*.

(2) The Reform Context

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[205] Notable exceptions include S Worthington n 107 above; RC Nolan "Enacting Civil Remedies in Company Law" (2001) 1 JCLS 245; BS Butcher "Breach of Directors' Duties: Are the Remedies Equitable?" (2001) 3 ICCLJ 335.

[206] [2005] IEHC 477. See further Chapter 4 above.

The general lack of confidence in relation to remedies for breaches of directors' duties has permeated through to the Irish company law reform process. The policy behind the planned creation of a statutory statement of the duties of directors was examined in Chapter 5. A transparent statement of duties will be detracted from by a failure to address remedies. However, in the reform context, the array of largely under-utilised remedies for breach of such duties received markedly little scrutiny. In effect, remedies (along with private enforcement) were the elephant in the room which nobody was talking about. Given the proposals to merge the traditional general duties of directors and other existing specific statutory provisions and to site them side by side within a single legislative framework, one wonders at the lack of *de novo* policy consideration of the remedies for breaches of directors' duties.

The question of whether shareholders' remedies should be reformed or legislatively restated is an important one in the context of a review of directors' duties. As the UK's Company Law Review Steering Group stated,

> "Remedies are mainly regarded as 'Lawyers' Law'; but they are the obverse of rights, and what litigants ultimately want, and arguably should be as clear and accessible as the rights they vindicate."[207]

It has been rightly said that "[r]emedies are what gives substance to rights".[208] However, while the role of sanctions is a key area of criminological concern, in a company law context, deep consideration has not been given in this part of the world to the purpose of legal sanctions and the appropriate range of remedies.[209] Thus, for example, when the English Law Commission published a consultation paper and report on shareholders' remedies, it focused solely on the mechanics of enforcement rather than examining the

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[207] Company Law Review Steering Group (UK) *Modern Company Law for a Competitive Economy: Completing the Structure* Department of Trade and Industry London URN 00/1135 (2000) at para 13.73.

[208] RC Nolan n 205 above at 258.

[209] For some discussion see S Worthington n 107 above at 639. On the subject of criminal sanctions see Company Law Review Group n 86 above at Chapter 8.

role and scope of the underlying non-statutory remedies.[210] As Sugarman points out, this approach maintains an artificial separation between procedure and rights.[211]

The *General Scheme of the Companies Consolidation and Reform Bill* does not envisage any major change the existing remedies. No overt consideration was given to a codification of shareholder remedies. This meant that no attempt was made to comprehensively enumerate the available remedies. Regrettably, this head in the sand approach helps to ensure that the vast territory of remedies are likely to remain, in many respects, *terra incognita*. As Worthington noted in the context of the UK company law reform process, given the poor appreciation of the detailed remedial consequences of breaches of directors' duties, if remedies are ignored in a reform of directors' duties, it is "a recipe for inadequate or inefficient law reform."[212] As will be seen, the consequences of the failure to tackle remedies head on are evident in the sloppy manner with which they have been dealt in the draft scheme.

While it may well be concluded that the case for codifying remedies for breaches of directors' duties is not a strong one, that is not an argument against the debate taking place. A comprehensive statement would have the benefit of providing a coherent framework of remedies and allowing existing statutory remedies to be integrated with current non-statutory remedies.[213] It would also provide an opportunity for inconsistencies to be weeded out and improvements made. Worthington contends that a statutory statement of remedies for breach of directors' duties is both desirable and achievable if it is not sought to engage in a comprehensive reform but simply to provide a legislative statement of the existing position.[214] As against this, there are many vagaries

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[210] Law Commission (England) *Shareholders' Remedies, A Consultation Paper* No. 142 (1996); *Shareholders' Remedies* Report No. 246 Cm 3769 Stationery Office (1997). For criticism of this narrow approach see LJ Moran "Missing Links and Missed Opportunities" (1997) 18 Co Law 264 at 265; D Sugarman n 1 above.

[211] D Sugarman n 1 above at 274.

[212] S Worthington n 107 at 638.

[213] For a systematic proposal for the codification of remedies in broad terms see RC Nolan note 205 above.

[214] S Worthington "Reforming Directors' Duties" (2001) 64 MLR 439 at 457.

of remedies which are far from clear and there is a danger of a codification process resulting in an unanticipated loss of judicial flexibility to award the most appropriate remedy in an individual case. In this regard it is notable that an all-embracing restatement of remedies has not been attempted in other common law jurisdictions.[215] That is not to say that the task would be an impossible one, but it does signal the need to reflect on the feasibility of what would undoubtedly involve a highly complex and time-consuming operation particularly given the arcane and unsettled aspects of the application of some remedies in the field of directors' duties. Indeed, there are many areas where the law is in development *eg* the boundaries of the account of profits remedy and the reach of proprietary remedies. Other issues which have yet to be fully resolved relate to questions of causation and remoteness and quantum in relation to equitable compensation and the thorny issue of the requisite level of knowledge in order for liability to be imposed under the knowing receipt head.

In the UK, the Steering Group of the Company Law Review presented the view that the case for codifying civil remedies was less strong than that for codifying the underlying duties.[216] It was argued that it was more important the ordinary user be aware of the rules than of the detailed legal consequences of breach and that as the law on civil remedies was still developing it might be best be left to judicial development rather than being crystallised in legislation. However, it also considered whether there was a case for a more full setting out of civil remedies in legislation.[217] Were this to occur it would have to be done in broad terms. The Group pointed out that many questions of interpretation remained and that the issues involved went beyond the realm of company law to matters such as the rules on tracing and the causation rules.[218] Nevertheless the final view adopted was that consideration should be given to codifying civil remedies for breaches

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[215] Company Law Review Steering Group (UK) n 207 above at para 13.72.

[216] *Ibid* at para 13.71-13.74.

[217] *Ibid.*

[218] *Ibid* at para 13.74.

of directors' duties.[219] As will be seen, the solution adopted in the *Companies Act 2006* (UK) was a far less radical solution.

Based on an examination below of the draft Irish provisions relating to remedies, the dangers of a poorly thought out legislative scheme in the arena of remedies and enforcement are cautioned against. Obviously, where the challenge of codification cannot be satisfactorily met, it will be preferable to leave matters to case by case development.

(3) Remedies for Breach of the Proposed Statutory Duties

This section examines the implications for remedies for breach of directors' duties in the post-legislative statement scene. The approach taken in the UK was to state in section 178(1) of the *Companies Act 2006* that "[t]he consequences of breach (or threatened breach) of sections 171 to 177 are the same as would apply if the corresponding common law rule or equitable principle applied." This neatly avoided the need to list what those remedies were and to work out how to set them out in statute in a satisfactory manner. In the Irish draft scheme no such provision appears. Instead sub-head 13(1) of Part A5 of the draft general scheme[220] states that a breach by a director of his duties under Part A5 will render him liable:

> "(a) to account to the company for any gain which he makes directly or indirectly; and

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[219] The Company Law Review Steering Group (UK) *Modern Law for a Competitive Economy: Final Report* 2001 URN 01/942 at para 15.30. See also the London Stock Exchange's opinion that clear remedies for breach of each duty should be set out in statute: Department of Trade and Industry (UK) *Responses to White Paper (2005 – Modern Company Law)* URN 05/928.

[220] *General Scheme of the Companies Consolidation and Reform Bill* (2007).

(b) to indemnify the company from any loss or damage resulting from that breach of duty."[221]

The explanatory note accompanying the draft provision states that "[t]he head codifies the common law remedies of account and indemnity." The draft provision would appear to apply to all the obligations to be complied with under Part A5 of the draft scheme and not simply to the duties under Head 9 entitled "fiduciary duties of directors". Some confusion is engendered. First and foremost, the draft provision leaves open the question of the survival of the other equitable personal and proprietary remedies for breach of duty. Bennion suggests that where an Act sets out specific remedies there is a presumption that other remedies that could otherwise be regarded as applicable are impliedly excluded. Nevertheless, the courts will strive to avoid an interpretation which produces an absurd result.[222]

Other questions arise as to interpretation of the draft provision. On a literal reading the use of the mandatory phrase "shall be liable" when combined with the use of the conjunctive "and" construction give rise to the impression that the duty to account and the duty to indemnify for loss are cumulative remedies.[223] However, it is likely that the courts would have regard to the existing judicial precedents which indicate that where remedies are inconsistent in nature (as the case with an account of profits and damages for loss) they are treated as alternative rather than cumulative.[224] This ambiguity should nevertheless be addressed before publication of the Bill.[225]

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[221] This is said to be based on the remedies available under Part III of the *Companies Act 1990* for breach of the provisions in respect of transactions involving directors: Company Law Review Group n 151 above at 42. Indeed, the wording closely follows that in section 38(2) of the *Companies Act 1990*.

[222] F Bennion *Bennion on Statute Law* 3rd ed Longman Harlow 1990 at 165-173 citing *Felix v Shiva* [1983] QB 82, 90-91; *Payne v Lord Harris of Greenwich* [1981] 1 WLR 754, 767.

[223] This reflects similar drafting limitations inherent in section 38(2) of the *Companies Act* 1990 whose wording inspired sub-head 13(1). A limitation is, however, built into the draft provision to cover a situation where a court excuses a director from liability for breach of duty under head 14.

[224] *Tan Man Sit v Capacious Investments Ltd* [1996] 1 All ER 193.

[225] The use of the permissive "may" would be preferable to the mandatory "will".

Sub-head 13(3) states that sub-head (1) is "without prejudice to the company's right at common law to claim damages for breach of duty." This appears to be designed to ensure that a claim for damages in negligence may also be available as a parallel source of remedy. The distinction between the common law remedy of damages and equitable remedies remains important because while a common law remedy is given as a matter of right once breach is proven, equitable remedies are discretionary in nature and this may be relevant, for example, where the plaintiff is judged not to have come to court with clean hands. However, the act of singling this out does a disservice to the host of other remedies which could otherwise be available but are not expressly referred to. For example, there is no mention here of the possibility of obtaining a proprietary remedy in appropriate circumstances. It is unclear whether the implication is that such remedies are excluded since it would have been possible to use the same "without prejudice" approach to advert to the possibility of obtaining a proprietary remedy without the need to set out the qualifying circumstances. These issues indicate that it would be preferable to give a clearer signal that the remedies mentioned are not exhaustive.

The draft provision is also clouded in uncertainty as to the appropriate remedies for statutory duties which do not have a directly existing counterpart at common law or in equity. The drafters would do well to heed Nolan's cautionary advice that "[i]t must always be remembered that what is proposed is a *set of remedies* responding to different duties, not a 'one-size-fits-all' list of consequences triggered by any breach of any duty."[226]

All in all, it is fair to conclude that remedies have not been given the consideration they deserve in the reform process.

[226] RC Nolan n 205 above at 250.

F. CONCLUSIONS

It can be concluded from the foregoing analysis that an interactive analysis which takes cognisance of the accountability spectrum through focusing on issues of enforcement, liability and remedy is necessary to achieve a full picture of directors' duties. While earlier chapters in this thesis showed that the broad content of directors' duties has been relatively settled for some time and has not altered significantly in the reform process, this chapter contended that a piecemeal approach to policy questions relating to enforcement, liability and remedies has prevented an integrated, holistic approach.

As Professor Dine has highlighted, a focus on the content of the duties can draw focus away from a debate which should take place concerning when and how it is possible for offending behaviour to be excused.[227] In short, the effectiveness of directors' duties cannot be judged in isolation, divorced from wider enforcement realities. The view advanced in this chapter was that legislative and judicial pronouncements on the scope and content of these duties are devoid of contextual meaning without consideration of the barriers which exist to enforcement, the imposition of liability and ultimately to obtaining a remedy for breach. To achieve this broader vision a policy examination of the purposes of directors' duties within corporate law will be required.

Undoubtedly the enforcement method which is available and chosen will influence the remedy sought and given. Difficulties with direct private actor enforcement of directors' duties mean that in many situations a statutory remedy will be more readily selected for ease of application. Where obstacles of a legal and a practical nature are of significant magnitude there is a threat to the organic development of the law concerning directors' duties. This is seen in this jurisdiction in the development of judicial thinking on directorial standards, not in corporate litigation concerning breaches of duty, but in the adjacent statutory sphere of restriction and disqualification, and in rulings on occasional petitions under section 205 of the *Companies Act 1963*.

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[227] J Dine *Company Law* 4th ed Palgrave Basingstoke 2001 at 217.

The indirect result of mandating liquidator restriction applications in the case of insolvent liquidations is that, as the law stands, directors of insolvent companies in liquidation are judged more harshly than directors of companies who are not insolvent, and are less likely to come under judicial scrutiny. This highlights the need for issues of enforcement, liability and remedy to be considered alongside doctrinal matters so that they all contribute to a workable whole rather than skewing the very policy objective it is sought to achieve.

Given the considerable hurdles which stand in the way of obtaining a remedy for breaches of directors' duties in the courts, it is difficult to avoid the conclusion that directors' duties are in danger of being consigned to the sphere of lofty principles. There has been no attempt in the reform process to address the fundamental obstacles presented by the bulwark of the rule in *Foss v Harbottle*. Furthermore, the need for a clear and widely understood set of remedies is now greater than ever with a statutory statement of directors' duties in the agenda. However, in contrast to the policy focus on the vocalisation of duties, precious little consideration has been given to remedies and issues concerning liability and enforcement of directors' duties. The consequence is that the current overhaul of Irish company law is unlikely to address many of the existing practical and theoretical difficulties.

As drafted, the attempts to selectively legislate for the compensation and account of profits remedies appear clumsy and ill-considered. It can be posited that the very fact that remedies have been an under-utilised and under-appreciated terrain has contributed to the lack of confidence in relation to broaching them in the reform process. Ironically, current uncertainties in relation to issues of enforcement and remedy are likely to be exacerbated rather than clarified based on a lack of systematic attention to these issues in the reform process. This is regrettable. Therefore it is doubtful whether the increased visibility which a statutory statement of directors' duties will bring will result in any change in the balance of enforcement and remedies.

This completes the assessment in this thesis of how the duties of directors have fared from their initial development by the courts in the nineteenth century right up to the present proposals emanating from the work of the Company Law Review Group. The final chapter sets out the conclusions of this thesis.

CHAPTER 7:

DIRECTORS' DUTIES IN PERSPECTIVE

A. INTRODUCTION

The overarching issue presented for discussion in this thesis which was introduced in Chapter 1 concerned whether, viewed from a twenty-first century vantage point, the non-statutory duties of directors formulated by the courts in the nineteenth century can be said to have stood the test of time. In order to resolve this, a journey of discovery was required.

This thesis focused on directors' duties, a currently non-statutory control mechanism in respect of directorial conduct. However, in achieving the goals of such intervention in the marketplace, cognisance should be taken of the wider reality of the interface of different control mechanisms briefly outlined in Chapter 1: the constitutional documents of companies, the *Companies Acts* and other legislation addressed to directors and their companies, contractual provisions in service contracts and shareholders' agreements, and the improvements in standards effected by corporate governance codes. The combined effect of these initiatives is that the expectations of directors are to the fore and are subject to critical review and revision.

In Chapter 1 the role of directors was examined and it was found that their significant freedom in carrying out their duties is tempered by the significant responsibility of stewarding the company and the duties imposed by the law. The rationale for the imposition of such duties was explored both in terms of their historical development by the courts by analogy with the duties applicable to trustees and in terms of the theoretical bases which are commonly deployed in discussions regarding the appropriateness of intervening in the market. In Chapters 2 to 4 the core duties of directors which were developed and refined by the courts were examined in turn: the duty to exercise care, skill and diligence; the duty to act *bona fide* and in the best interests of the company and for proper purposes; and the duty to avoid conflicts of interest and secret profits. These chapters formed the main axis of the thesis and provided an analytical link to an understanding of the evolution of the duties and of judicial attitudes as well as highlighting deficiencies and potential for future development.

Working from this central axis, based on an understanding of how the courts have handled the duties, it was possible in Chapter 5 to set the proposals to place directors' duties on a legislative footing in context. Comparative analysis of other jurisdictions with a similar colonial history, common law and statutory heritage including the United Kingdom, Australia, New Zealand, Canada, South Africa and Malaysia permitted an informed prognosis to be put forward concerning the concept of codification, its particular incarnation in the current proposals, and the effect of the detailed clauses of the *General Scheme of the Companies Consolidation and Reform Bill*. Chapter 6 tied the various strands of old and new together in focusing on issues of enforcement, liability and remedy. This change of focus provided a counterweight to the penchant in discussion of directors' duties to focus on the content of the duties without considering the obverse side of the coin concerning whether the law's handling of enforcement of the duties detracts from or supports the duties.

Having undertaken this journey, what are the conclusions which can be drawn at this final standpoint? In the starkest of terms, this thesis's conclusion is that, on balance, the duties of directors have indeed successfully prospered over the centuries right into the twenty-first century. The subtleties of how that conclusion was arrived at are explained below.

B. THE RATIONALE FOR EXTERNAL REGULATION OF DIRECTORS

Chapter 1 highlighted the unique role of directors as agents of the company possessed of very broad authority and discretion in pursuing the goal of corporate wealth generation. The judicial development of directors' duties by analogy with those applicable to trustees was observed. Moving back a step, the question was asked whether, having regard to today's theoretical law and economics perspectives on corporate governance matters, this intervention in the marketplace could be justified. It was seen that a purely contractarian *laissez-faire* perspective is not an altogether convincing one in this sphere. In a company where there is a widely dispersed ownership, and the gulf between ownership and control is wide, informational asymmetries and a lack of clear monitoring of the controllers may make both market and contractual restraints meaningless in practice. In Ireland, where the prevalent corporate model involves a convergence of ownership and control, this militates against an arm's length bargaining process and displaces the utility of market and contractual restraints

as a complete solution. While a service contract has a role to play in setting out what is expected in terms of directorial competence, this is often not the case in small closely-held companies where the separation of ownership and control is illusory.

Agency theory permits directors to be conceived of as rational actors who may act in their own interests where the opportunity presents itself, provided that operational external constraints on their behaviour are not high. Agency analysis therefore provides a credible rationale for the law's intervention. The role of companies in the economy also feeds into a societal and economic public interest objective in providing external legal controls on directors. Therefore, when modern robust corporate governance theoretical perspectives are applied, the *raison d'être* for the existence of directors' duties is apparent. This allows us to conclude that the continuing existence of directors' duties is vindicated. Having established the modern day relevance of external duty-based controls on directors, the crux of the issue remaining for resolution in this thesis concerned the content and application of these duties.

C. THE ENDURING NATURE OF THE JUDICIALLY APPLIED PRINCIPLES

"... [T]he judicial process involves constant application of principles to ever changing factual settings and circumstances presented by real-world economic forces."[1]

The survey of judicial application of directors' duties in this thesis has shown the remarkably enduring nature of the fundamental principles underlying directors' non-statutory duties. Although fundamentally moulded in the late nineteenth century, directors' duties were not fossilised at that point but rather made the subject of incremental refinements in the course of judicial application. In the application of each of the duties identified, following the principle of *stare decisis*, the purpose and kernel of the duties has remained relatively unscathed in more than a century of judicial application.

The courts can be congratulated for their role as guardian of the duties, formulating the principles underlying directors' duties which have endured admirably and been adapted for use right into the new millennium. Their considerable judicial achievement has been to craft a

[1] Justice JT Walsh "The Fiduciary Foundation of Corporate Law" (2001-2002) J Corp L 333 at 340.

legacy of precedents which are not just erudite and academically sound, but also commercially sound. In the case of the Irish courts, whose experience of applying the duties has been limited, commercial pragmatism has also been evident. However, regrettably, the opportunities for Irish judicial discussion concerning the application of the duties, and the nature of such discussion when it has arisen, have been sparse.

The enduring nature of the principles on which the duties are based can be attributed in part to the inherent wisdom of the judicial approach taken. The courts' interpretation of the duties has been consistently sensitive to the particular environs within which individual companies and individual directors operate. The consequence of this is that, while the principle-based duties are generic in nature, generally they have not been judicially applied on a 'one size fits all' basis, their application has been bespoke. This is consonant with the director class constituting a non-homogeneous grouping. Given the non-prescriptive legislative approach to defining the directorial animal explored in Chapter 1, some judicial ingenuity has been required in order to bring a subtlety of approach to bear which counteracts the legislative blunt instrument in relation to key definitional issues. The bespoke application of the duties is particularly evident in relation to the standards expected of directors in terms of care, skill and diligence, whose precise content has been regarded as dependant on factors such as the nature of the company, the role taken on by the relevant director and his commercial experience. Looking ahead, it can be expected that the courts will continue to follow sound instincts by sensibly locating the application of duty within the broader factual surroundings to take account of the type of company, its organisational structures and the nature of the role undertaken by the director, while at the same time upholding base principles.

In some instances, the judicial approach can be characterised as nascent rather than embedded. For example, although the genesis of a distinction between executive and non-executive directors has begun to emerge in restriction decisions,[2] as yet the lines of demarcation between these two categories of director are far from clear. Rather than specifying different duties for

[2] *Kavanagh v Riedler* [2004] 3 IR 498; *Kavanagh v Delaney* [2005] 1 ILRM 34; *Kavanagh v Cooke* [2006] 1 ILRM 191; *Stafford v Beggs* [2006] IEHC 88.

non-executive directors, early indications are that the judicial preference will be for a fact-sensitive application of the generic duty of care to non-executive directors.[3]

Some reservations are necessary in relation to the judicial role as self-appointed guardian of the duties. In particular, the failure to accord equitable rules their deserved stand-alone status is part of a discernible trend in modern company law whereby concise and easily applied statutory interventions are treated as superseding apposite non-statutory duties when advocates of directors' duties would argue for a dual analysis. This trend has been inimical to the organic development of directors' duties and is mirrored in the dearth of recent judicial consideration of the duties in this jurisdiction.

In recent times Finlay Geoghegan J's innovation in *Kavanagh v Delaney*[4] opened the door to increased consideration of directors' duties albeit in the tangential context of restriction applications. However, in contrast to the closely reasoned decisions of their English counterparts, the impression of Irish judicial treatment of the directors' duties in such decisions is often one of a cap being doffed in a formulaic add-on manner rather than of any deep consideration having been given to the possibility of extending existing principles or creating precedent weight that could be relied on in the future. There is a lack of a big picture view and it remains the case that a more analytical approach is open to judicial pursuit. In a sense the Irish courts have ensured the fire is alight but have not stoked the embers so that they give additional heat. This ruefulness for what might have been especially surrounds the *Fyffes*[5] litigation which qualifies as a major lost opportunity for judicial clarification and synthesis of equitable and fiduciary principles as applied to directors.

D. THE JUDICIAL ANALYTICAL DICHOTOMY

One of the main reasons why the judicial approach to directors' duties has remained so steadfast is that the courts have consistently portrayed a keen instinct concerning when it is appropriate to intervene and when it is not. It has been suggested in this thesis that the courts' widespread reluctance to review directorial decision-making can be attributed to the existence

[3] *Equitable Life v Bowley* [2004] 1 BCLC 180.

[4] [2005] 1 ILRM 34.

[5] *Fyffes plc v DCC plc* [2005] IEHC 477; [2007] IESC 30.

of a judicial comfort zone. A more hands-off approach has certainly prevailed in relation to reviewing what is perceived as well-intentioned directorial decision-making. Indeed, an identifiable analytical dichotomy is evident in judicial decision-making on directors' duties. The courts have always been quick to intervene in directorial decisions where there is a hint of fraud or dishonesty, but less inclined to step in to make subjective judgments about the merits of corporate policy decisions. On the one hand, the courts have been keen to adopt a strong moral tone reflecting the equitable origins of the duties yet, where the moral barometer is not activated, the leeway afforded to directors has been generous.

The following observation of Professor Gower, made a half century ago, remains apposite:

> "English courts tend to be strict when they have a rule of thumb to apply, such as the rule that directors must not take personal advantage of a corporate opportunity. They move with less assurance when they have no fixed standard to guide them."[6]

The courts have drawn a discernible line in the sand. On one side of that line leeway is granted by the courts to directors engaging in well-intentioned entrepreneurial behaviour on behalf of the corporation which results in harm to the company. On the other side of the line the judicial desire to impose controls with a view to constraining mismanagement, abuse of position and divergence from acceptable agency behaviour reverberates. In applying long-established duties there has been a pervasive judicial reluctance to adjudicate on matters of business provided that there is no whiff of unclean hands on the part of the directors concerned in the form of fraudulent or self-serving motives. Accordingly, a key finding of this thesis is that there has been an enduring difference in judicial attitudes between the approach taken to breaches of duty classed as fiduciary breaches and those where moral concerns are not engaged. That this approach is well-entrenched at policy level is evident in the UK Department of Trade and Industry's comment on reforming the law relating to directors' duties:

> "The law on directors' liability needs to strike a careful balance: on the one hand, the law must be firm and robust to deal fairly with cases where something has gone wrong,

[6] LCB Gower "Some Contrasts Between British and American Corporation Law" (1955-56) 69 Harv L Rev 1369 at 1383.

as a result of negligence or of dishonesty; on the other, Britain needs a diverse pool of high quality individuals willing to assume the role of company directors, and a willingness by directors to take informed and rational risks."[7]

A consequence of the bifurcated judicial approach is that while the courts have been willing to modify their interpretation of the duties to reflect societal shifts in sentiment as to what is expected of directors, pre-*Barings*[8] there was a divergence between business and societal norms and expectations in relation to care, skill and diligence and the latitude afforded to risk-taking behaviour. This type of catch-up process is also symptomatic of ongoing judicial grappling to find the appropriate balance as the law adapts to reflect changes in societal mores and this in turn reflects a wider societal process of norm-building and refinement.

The judicial analytical dichotomy described can be seen as having at its base a moral dimension. It is in relation to breaches of the no conflict-no profit rules that this dimension is generally engaged. However, as was evident in Chapter 4, while it has often been easier to get the balance right in relation to blatantly self-serving behaviour where the moral dimension is uncontroversially engaged, a lack of clarity has arisen in some difficult fact scenarios concerning corporate opportunities precisely because of a lack of firm judicial or societal consensus on whether the moral compass has been engaged.

A closer look behind this crude bifurcation into judicial treatment of fiduciary and non-fiduciary breaches reveals greater subtleties behind the treatment of self-interested conduct. In contrast to the simplicity of its deterrent rationale, the duty to avoid unauthorised conflicts of interest and profits qualifies as the most complex duty in terms of application. On the one hand, judges have shown themselves to be up to the task of checking self-interested management. On the other, the preventative function of the rules and their unbending judicial application have given rise to the apprehension of unfairness in relation to their application to

[7] Department of Trade and Industry (UK) *Company Law Reform* Cm 6456 (2005) at 23. The recent *volte face* in Ireland on the scope of the statutory directors' compliance statement regime under section 45 of the *Companies (Auditing and Accounting) Act 2003* involved a recognition that this balance had been misjudged. See further Company Law Review Group *Report on Directors Compliance Statement* (2005); Head 7 of Part A5 of the *General Scheme of the Companies Consolidation and Reform Bill* (2007).

[8] *Re Barings (No. 5) Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433.

individual cases and an apprehension that the pendulum may be swung too far in the name of deterrence.

A criticism which consistently resurfaces in relation to directors' duties is that "... so long as the law ensures that directors' hearts are pure, it may not matter that some directors are incompetent."[9] In general terms a wide margin has been afforded to directors in relation to matters of care, skill and diligence and those involving directorial value judgments as to whether a course of action will serve the company's interests. By contrast, the hint of conflict of interest will not be entertained by a court. However, in recent years a tangible recalibration has occurred through the lens of restriction and disqualification decisions which has showed the courts to be well able to question competence and to link a director's failure to take steps to get on top of the company's affairs with a lack of competence.

While the rationale for the existence of directors' duties is solidly-based, the courts have been sophisticated in their realisation of the value of a softly, softly approach so that directors do not become risk-averse, hence the development of a sense of perspective through application of a business judgment rule. The legacy of the traditional non-prescriptive legislative approach to the office of director, coupled with a judicial willingness to accommodate business, has translated into a flexible approach to the application of directors' duties. It is this flexibility which has ensured the durability of the duties. Judicial decisions have consistently projected an underlying pro-business policy which appreciates the fact that companies are the lifeblood of the economy. Judges are keenly aware that hindsight is a great thing and that it would be folly to make a harsh judgment in relation to a commercial decision of which they have no practical experience or insight other than that provided by the parties. Easterbrook and Fischel's economic explanation for the business judgment rule is that, "[b]ehind the business judgment rules lies recognition that investors' wealth would be lower if managers' decisions were routinely subjected to strict judicial review."[10] Thus the residual survival of the business judgment rule is crucial to ensuring that we avoid killing the golden goose of entrepreneurship. This ability to stand back where required is matched on occasion

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[9] RW Parsons "The Director's Duty of Good Faith" (1965-1967) 5 Melb UL Rev 195 at 395.

[10] FH Easterbrook and DR Fischel *The Economic Structure of Corporate Law* Harvard University Press 1991 at 93.

by a judicial ability to step up to the plate when it matters. As seen in Chapter 3, despite some unsure footing, in general good horse sense is evident in the astute judicial line trodden in relation to defensive actions to ward off hostile takeover bids.

However, to act as devil's advocate, when viewed against the sharp relief provided by the standards of care imposed on other professional actors, the failure to impose a purely objective standard of care on directors may smack to some of something akin to regulatory capture. On the other hand, judicial adoption of the objective-subjective hybrid standard must be related back to the legislative policy of not imposing rigorous *ex ante* controls on accession to the office of director. Undoubtedly this has had an influence on the *ex post* controls imposed. If directors are not required to present themselves for appointment as savvy professional directors unless the market rather than the law demands it, how fair is it for the law to later impose a standard predicated on just such an assumption? At any rate, the failure to take the plunge concerning an objective standard at either judicial or legislative level should not be viewed in black and white terms given that the flexible hybrid test affords the courts considerable leeway as to how it is to be interpreted in any given case, including the possibility of imposing higher standards on the experienced, professional director. Some commentators have maintained that there is no reason to exclude directors from the general duty of care in negligence and that a statutory assimilation of their special position neatly sidesteps discussion of this fundamental issue.[11] That may be so, but the reality is that the enactment of a statutory section with its own *sui generis* hybrid standard for directors, as examined in Chapter 5, is likely to kill off this debate.

E. THE DUTIES AS LIVING DUTIES

As Bull JA observed in *Peso Silver Mines Ltd v Cropper*, "[t]hat the principles, and the strict rules applicable to trustees upon which they are based are salutary cannot be disputed, but care should be taken to interpret them in the light of modern practice and way of life."[12] The dynamic handling of the duties by the courts has meant that the duties have remained relevant. The deftness of the judicial approach to the incremental development of sub-principles carved

[11] S Worthington "Reforming Directors' Duties" (2001) 64 MLR 439 at 449.

[12] (1966) 56 DLR (2d) 117, 155.

from the rock-face of the core duties is commendable. In most respects the broad judicial incantations of principle have shown themselves to be sufficiently flexible so as to be capable of interpretation to meet changing demands. It was famously said by Lord Denning MR that "Equity is not past the age of child-bearing."[13] In the sphere of directors' duties the flexibility of broad, principle-based judge-made rules has facilitated judicial revitalisation of the duties where required to move with the changing world view in relation to corporate standards. It is contended that this has been instrumental in ensuring that the duties retain both credibility and relevance. Age-old principles have proved capable of yielding new applications and new perspectives.

Societal shifts in perspective, both gradual and rapid in response to the catalyst effect of a range of corporate scandals, have influenced judicial attitudes. This is most starkly apparent in relation to the shift in judicial approach to duty of care, skill and diligence where a paradigm shift in judicial mindset took place. In modern commercial life most directors will have a valuable role to play, unlike in the past when directors were often appointed simply for the cachet which their association with the company would provide rather than with any expectation of their participation in company affairs. In many key respects, thanks to the watershed decision of Jonathan Parker J in *Re Barings plc (No. 5)*,[14] the pendulum has now swung in the direction of duty and responsibility and away from *lasissez-faire* freedom. There is now a discernible 'call to arms' for directors which prevents them abdicating their position as was frequently done in the past.

In the process, the courts have moved from tolerance of the passive, 'amiable lunatic' director to placing emphasis on a sub-duty of active participation.[15] The principles concerning delegation have also been significantly modified to ensure that complete abdication of responsibility does not occur. Again, the *Barings* litigation was the main catalyst in this development and Jonathan Parker J's pronouncements on delegation have been assimilated by the Irish courts. Recognition of a self-education imperative has overridden the traditional *Re*

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[13] *Eves v Eves* [1975] 1 WLR 1338, 1341.

[14] [1999] 1 BCLC 433.

[15] *Re Costello Doors Ltd* High Court (Murphy J) 21 July 1995 unrep; *Re Barings (No. 5) Secretary of State for Trade and Industry v Baker* [1999] 1 BCLC 433; *Kavanagh v Delaney* [2005] 1 ILRM 34.

City Equitable[16] approach that a director need not exhibit in his duties a greater degree of skill than can reasonably be expected of a person of his knowledge and experience. Subtlety is evident in the brakes being put on the knowledge which directors are expected to obtain: the courts have limited the knowledge required to that required to monitor and supervise rather than requiring an expert level.

The Irish courts have been smart enough to recognise the influence of the wider group's fortunes rather than treading a pedantic path based on a theoretical separate legal personality bent. This is seen in the commercial pragmatism evident in Murphy J's approach in *Re PMPA Garage (Longmile) Ltd*[17] where he revealed a more streetwise perspective than his English counterparts in recognising that, despite separate legal personality, it is in the interests of a group company to have regard to the fortunes of the wider group. Likewise the Irish courts have been shrewd in recognising the special position of nominee directors[18] and the interests of nominating shareholders are now set to receive statutory clarification.

F. SOME INTRACTABLE ISSUES

Despite the prescience of the judiciary in ensuring the ease of application of old principles to provide answers to new perspectives, in some respects the bank of case law grafting flesh onto the bones of the duties does not yet reflect certain current business realities. The traditional universality of principle or generic approach to directors at policy level jars against the more sophisticated appreciation of divisions within the ranks which is evident in the market's evolving differentiation of the professional director class and its differing expectations of executive and non-executive board members. There has also been a failure to satisfactorily address the division between collective and individual responsibility although the market has developed its own understanding of what is expected. These issues are unlikely to be resolved any time soon. This borne out in the fact that the general functions of the board are not expressly addressed in the *General Scheme of the Companies Consolidation and Reform Bill* and that the duties are expressed as applying to all directors with no separation between individual and collective responsibility.

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[16] *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407.

[17] [1994] 1 ILRM 387.

[18] *Irish Press plc v Ingersoll Irish Publications Ltd* High Court (Barron J) 15 December 1993.

For the truly intractable, one need only turn to the outer reaches of the corporate opportunity doctrine. The courts have yet to discern a universal moral yardstick in relation to some of the more thorny questions which present themselves in relation to corporate opportunities. The boundaries of acceptable steps which can be taken with a view to setting up a rival business are not as clear as they might be. The courts will still have to grapple with the issue identified in *Bhullar*[19] concerning when an opportunity is to be considered that of the company as opposed to an opportunity independently sourced by a director. Furthermore, a duty of disclosure of wrongdoing is in germination which straddles the duty to act in the best interests of the company and the duty to avoid conflicts of interest and secret profits.

The courts have not been on altogether firm ground in bowing to directorial explanations for acts and omissions which do not necessarily represent an obvious means of advancing shareholder welfare. This uncertainty is added to by the perhaps inevitable lack of a uniform corporate or judicial consensus concerning defining corporate goals and how they might be achieved. While the central focus of this thesis has been on the duties owed by directors to their companies, looking to the future, the interests of third party stakeholders are likely to come more and more to the fore in corporate governance debate. Judicial discussion touching on the conception of the purpose of the company is far from presenting a unified or knot-free perspective. There has been a lack of cohesive judicial thinking on the issue of who is the company and whose interests are perceived as its interests. There is also a lack of guidance in relation to whether a long term, medium term or short term approach to achieving corporate goals is expected. The challenge to the traditional profit-maximisation / shareholder primacy model puts a new spin on how directors' duties should be interpreted. However, there has yet to be a comprehensive policy debate in Ireland on whether it is permissible to take into account other stakeholders' interests.

Chapters 2 and 5 revealed that the corporation is increasingly being regarded as a social construct as well as a legal construct to serve commercial ends and that corporate social responsibility has filtered into the corporate agenda as something to be done and to be seen to be doing. There is widespread commercial recognition of the value of the CSR concept of giving something back to the community. Whether this can translate into a useful legal as

[19] *Bhullar v Bhullar* [2003] 2 BCLC 241.

opposed to a social obligation is debatable. It is understandable that the legislature and the courts have been reluctant to set anything down in stone which would not be future-proof and which could hamper corporate enterprise. For the moment no more than legislative lip service has been afforded to the interests of employees and members in this jurisdiction, while in the UK a superficial semantic nod has been given to CSR with little substance underlying it. This may not satisfy idealists but it is a realistic outcome given the complexities of competing rights and the intractable enforcement issues which any real attempt at accommodation of stakeholder interests would unleash.

With the failure to legislate in this area in other than a token manner, the question arises as to whether the courts will expand the milieux in which duties may be owed to individual shareholders, creditors and third parties. The crux for the courts will be to address the issue in a manner which is satisfactory from both a practical and a theoretical perspective. Of particular practical importance is the need to revisit the unsettled issue of when a duty to consider creditors' interests will be triggered and how it is to be enforced. The shroud of uncertainty surrounding the duty to consider creditors' interests is reflected in the policy *volte face* concerning the inclusion of an express duty to consider creditors' interests in the statutory statement.

G. THE IMPACT OF A STATUTORY STATEMENT OF DUTIES

An assessment of the longevity of the duties also requires a projected estimation of their future direction.

In Chapter 1 we noted Lord Macnaghten's views in *Dovey v Cory*:

> "I do not think it desirable for any tribunal to do that which Parliament has abstained from doing – that is, to formulate precise rules for the guidance or embarrassment of business men in the conduct of business affairs. There never has been, and I think there will never be, much difficulty with any particular case on its own facts and

circumstances; and speaking for myself, I rather doubt the wisdom of attempting to do more."[20]

Given the trenchant nature of such comments, Lord Macnaghten would be understandably surprised to learn of the trend towards statutory encapsulation of such duties in the common law world. The publication of the *General Scheme of the Companies Consolidation and Reform Bill* in May 2007 should rightly be viewed as momentous within the historical trajectory of directors' duties. Arguably, legislating for directors' duties represents the most significant doctrinal development in relation to the duties since their formulation in the Court of Chancery. At the same time, it is possible to overstate the practical effect of such a step. As was seen in Chapter 5, the approach taken by the CLRG to transferring directors' duties to a statutory setting has been largely concerned with capturing existing principles rather than effecting reform.

In relation to legislatively stating the duties, it is clear that a broad approach was taken and where principles were in development the general approach has been to leave them undefined in legislation. Thus, for example, although the requirement to be appropriately informed as to the company's affairs has been granted increasing judicial and soft law recognition, it was not seen as meriting legislative statement in its own right. Nor did the CLRG feel inclined to clarify whether any concessions are to be given in relation to the obligations on directors operating in a company which is part of a wider corporate group. Therefore this remains an area for refinement by the courts.

A conceptual theme which is threaded through this thesis is that sporadic consideration of directors' duties has not advanced the bigger picture – the case by case application of principles within the blinkers of the facts at hand has meant that notable gaps in how company law views different classes of directors and companies remain unplugged or at least imperfectly considered. It is contended that the use of broad general principles in the proposed statutory statement of the general duties of directors does not change this as many specific situations will require judicial clarification when an appropriate case arises. Therefore, in considering the effect of codification, we would do well to remember Lord

[20] [1911] 1 Ch 425, 437.

Scarman's advice that in resolving the relationship of a code with judge-made law, "it is not a question of total war involving the destruction of one or the other but a study in coexistence."[21] It is still the case that judges need to guard against judging harshly with the benefit of hindsight. In general we have no reason to fear the disappearance of the rich equitable and common law heritage. If that is to occur it will be down to the lack of cases presented to the court rather than to any statutory strictures imposed on judicial interpretation. It will remain the case, that there will be no ready answers in the general principles themselves to how the principles will be specifically applied. This reflects the fact that it is not a code in the civil law sense which is being proposed but rather a statement of broad principles.

Irish judges, attuned to applying a statutory corporate framework, may feel more at home in looking to a statutory framework of duties rather than being presented with the murky ground of complex legal and equitable principles on which there has been precious little indigenous judicial guidance. They may, however, feel a lot less confident when presented with the uncharted territory of remedies for breaches of these duties.

One of the major issues with a 'codification' of directors' duties is the potential loss of flexibility and the possibility of overly specific rules imposing "an unbearable straitjacket".[22] It is crucial for a statement of duties to allow the law to be responsive to changing needs and changing expectations by allowing incremental development within the spirit of the broad principles set out. It is important that enough wriggle room is left to leave sufficient judicial discretion in place to provide flexibility. This would not appear likely to be a major difficulty given the level of generality at which the draft provisions are pitched.

It has been argued in this thesis that the transparency argument (which is frequently presented as the pre-eminent argument in favour of codification) falls down because in reality professional advice will be needed as to the interpretation of duties and the consequences of non-compliance. In the UK, the Law Society of England and Wales expressed significant concerns in relation to the likelihood of the then reform bill achieving its objectives of

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[21] Lord Scarman "Codification and Judge-made Law: A Problem of Coexistence" (1966-1967) 42 Ind LJ 355 at 358.

[22] GFK Santow "Codification of Directors' Duties" (1991) 73 ALJ 336 at 340.

providing an intelligible framework for directors.[23] There is a strong argument for conceding that the concept of legislation for the layman is a somewhat Utopian one and for concentrating attention and resources on the education of directors as to the practical effect of their duties. Some admirable work is done in this area by the Companies Registration Office, the Office of the Director of Corporate Enforcement and the Institute of Directors in Ireland. A directors' qualification would be a step towards recognising the value of competence-enhancing activities, as has occurred in the UK with the Institute of Directors' development of a professional chartered director qualification.

On the basis of the examination in Chapter 5 of the legislative nuances of the proposed directors' duties, some caution is advised. While the proposed statement of duties in circulation in draft bill form is largely uncontroversial in substance, it is in relation to matters of form and omissions that some difficulties may arise. The need for clear legislative drafting is imperative so that when judges are called to interpret the duties and lawyers are asked to advise on them, their meaning is not obscured by imprecise or ill-thought through drafting. While the general approach taken to statutory drafting is satisfactory, there are areas of concern which it is hoped will be addressed in the drafting process. Certainly, as matters stand, there are instances of infelicitous wording but, on the other hand, the courts will be able to avail of a purposive construction in interpreting the duties.

Whatever we think about how the individual duties have been formulated in the *General Scheme*, it is heartening to see that in general room has been left for organic development by the courts. The manner in which it is proposed to legislatively state the duties ensures that they will not be fossilised and that the courts will still have a central role in relation to the interpretation and evolution of directors' duties. It is this scope for development which is the main advantage of the relatively opaque drafting. The downside is evident in Menzies' observation that "company law is statute law, but nobody could hope to become a company lawyer merely by reading and understanding the words of the statute."[24]

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[23] J Harris "Law Society Issues Criticisms of Company Law Reform Bill at Second Reading" (2006) 27 Co Law 95.

[24] D Menzies "Company Directors" (1959) 33 ALJ 156 at 165.

The major negative at substantive level surely lies in the proposed introduction of a new duty to act honestly and responsibly which is uncertain as to its breadth and application and which lacks a clear rationale. Furthermore, the congruence and inter-relationship between this proposed new duty to act "honestly and responsibly" and the hybrid statutory duty of care is unclear.

The draft provisions confirm the separation of best interests and proper purposes into discrete influences. It remains the case that the duty to act *bona fide*, in the interests of the company is primarily about subjective rather than objective assessment. As discussed above, perhaps it is time for the courts to become more interventionist in relation to best interests and proper purposes; at the very least there needs to be a shift in the direction of mandating directors to explain the reasons for their action or inaction. The significance of proper purpose is likely to grow with the emasculation of the *ultra vires* doctrine. Nevertheless, one has to query whether the proposed wording unintentionally truncates the scope of the proper purposes doctrine by referring to the exercise of powers for purposes "allowed by law". While the proposed separate duty not to restrict the exercise of independent judgment is unobjectionable in principle, some points were raised in Chapter 5 in relation its execution.

Of all the draft provisions, it is the attempt to legislate for the no conflict-no profit rules which displays the least theoretical coherence. The proposed relaxation of the internal application of the no conflict-no profit rules is a significant development. The draft provisions retain a separation between the no conflict and the no profit rules but the demarcation between the two is not terribly clear from the wording employed. Of some concern is the fact that the proposed statutory rules on conflicts of interest give no real guidance on what will qualify as a conflict of interest. As matters stand, the overlapping nature of the rules is unsatisfactory and the draft provisions give rise to considerable interpretative challenges.

H. ENFORCEMENT, LIABILITY AND REMEDIES

Despite the general optimism of the above conclusions concerning judicial handling of directors' duties, it is fair to say that the development and credibility of the rules has been hindered by the barriers to enforcement. There is a symbiotic relationship between duties and enforcement. Therefore, while the existence of directors' duties may have some deterrent

effect, this will be considerably lessened if the prospect of enforcement is remote. Furthermore, efforts to elucidate the meaning of directors' duties will not be effective in an environment where judicial opportunities to pronounce on the detailed application of these duties are few and far between. This is a vicious circle as regards the development of both duties and remedies. Hoping for a comprehensive statutory statement of remedies might be to wish for the moon. However, the economising function performed by the rule in *Foss v Harbottle*[25] of preventing a floodgate of unmeritorious claims could be more fairly performed by arbitrating on the procedural validity of derivative actions by means of a statutorily-based judicial clearing system of the type introduced in other jurisdictions. The impact of the rule in *Foss v Harbottle* should not be overstated in a country where a united boardroom conspiracy of self-interest may prevail in many owner-managed companies, nevertheless its impact needs to be part of the reckoning.

It was contended in Chapter 6 that reforms which propose a statutory statement of directors' duties would be incomplete without addressing the serious shroud of uncertainty surrounding issues of enforcement. A major finding of this thesis is that the benefits which may accrue from placing the duties of directors on a statutory footing are countered by the failure to address policy issues concerning enforcement, liability and remedies. There is something of the emperor's new clothes phenomenon at play in the unveiling of a statutory statement of directors' duties without simultaneously presenting solutions to the emasculating effects of the lack of credible enforcement mechanisms and the deep lack of certainty as to the range of remedies on offer. The gap smacks of a tacit policy assumption that the restriction regime is the key conduit for enforcement. As a result, it remains to be seen whether taking the step of reducing directors' duties to a statutory statement will lead to a revitalisation of duties which are seldom judicially enforced. At a policy level, this short-sightedness is doubly disappointing as it is unclear when an opportunity for such a comprehensive review of the parameters of company law will come around again.

Cynics would note the considerable policy emphasis of late on the need to avoid deterring inward investment.[26] This begs the question as to whether the need for a business-friendly

[25] (1843) 2 Hare 461.

[26] Company Law Review Group *Report on Directors' Compliance Statement* (2005).

regulatory regime has led to the presentation of directors' duties as a form of window-dressing whereby at a practical level the key players – the shareholders and the courts – are not effectively empowered to deal with breaches of those duties. This accountability deficit concerning enforcement calls into question the *raison d'être* of the duties. Of course the duties have an innate declaratory effect. However, it should not be overblown by giving inordinate weight to the duties' educational effect. The ball has been very much left with the company as to private enforcement of directors' duties which raises the real spectre of self-interested decision-making as to the merits of pursuing a claim for breach of duty against one or more directors given the limited circumstances in which a derivative action will be available.

In relation to deterrence, some redemption can be found in the very visible judicial activity on the restriction and disqualification front which lends some tangential credibility to the general duties which might otherwise be considered semi-dormant from the perspective of the rare judicial consideration in the Irish courts. The considerable work done by the Companies Registration Office and the Office of the Director of Corporate Enforcement to raise standards and to make an example of those who transgress the corporate code is also deserving of recognition.

The policy deficit in relation to enforcement, liability and remedies is manifested in the inadequate handling of remedies for breach of the proposed duties in the *General Scheme of the Companies Consolidation and Reform Bill.* As matters stand, the draft provisions concerning enforcement and remedies reveal a raft of interpretative challenges and it is to be hoped that they will be revisited before the Bill is published. The complex interaction between duty, enforcement, liability and remedies may have dropped from the policy radar but in reality an integrated approach which broadens the focus of concern holds the key to the continuing organic evolution of the duties in this millennium.

I. CONCLUDING COMMENT

It is suggested that this thesis provides an addition to existing scholarship on directors' duties, both in the detail of its constituent chapters concerning the individual duties, and in terms of the coherence of the analysis as a whole which provides an understanding of the evolving

inter-relationship between the duties and the relevance of wider contextual issues such as issues of enforcement, liability and remedy. This analysis has been informed by developments on the wider global stage and this has facilitated the provision of an insight into where the duties have been and where they are likely to be going in the future in this jurisdiction.

It is gratifying to conclude that, all in all, the core duties of directors have both endured and adapted organically through the centuries and have indeed stood the test of time, yielding both many new applications and new practical and theoretical perspectives. As Friedman notes in his history of American law, "... what is kept of old law is highly selective. Society in change may be slow, but it is ruthless. Neither evolution nor revolution is sentimental. Old rules of law... stay alive when they still have a purpose – or at least, when they do not interfere with the demands of current life."[27]

With the publication of the *Companies Consolidation and Reform Bill* planned for late 2008, an exciting new chapter in the duties' history is about to unfold. That some issues remain to be resolved signals the potential for new growth. Successful achievement of this legislative goal necessitates an appreciation of the depth of the judicial legacy and an understanding of the need to give the courts sufficient leeway to continue to breathe life into the statutory incarnation of directors' duties while remaining true to the spirit of the legislation. Undoubtedly this legislative step will yield many fruitful new perspectives on the duties of directors and, as this thesis concludes, it simply remains to express the hope that this new departure will herald an era of wider appreciation of the increasingly sophisticated role of directors and what the law requires of them.

[27] LM Friedman *A History of American Law* 2nd ed Simon and Schuster New York 1985 at 18.

APPENDIX I

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APPENDIX II

EXTRACT FROM THE GENERAL SCHEME OF THE COMPANIES CONSOLIDATION AND REFORM BILL (MAY 2007)

Part A5 - Directors and Other Officers

(d) in the case of a guarantee or security, the amount guaranteed or secured;

(e) in the case of an arrangement to which Head17 (2) and (3) of this Part [equivalent of Section 31(2) and Section 31(3) of the Companies Act, 1990] applies the value of the transaction to which the arrangement relates less any amount by which the liabilities under the arrangement or transaction of the person for whom the transaction was made have been reduced.

(5) For the purposes of Subhead (4), the value of a transaction or arrangement which is not capable of being expressed as a specific sum of money (because the amount of any liability arising under the transaction is unascertainable, or for any other reason) shall, whether or not any liability under the transaction has been reduced, be deemed to exceed €65,000.

(6) For the purposes of this Part, a transaction or arrangement is made for a person if—

(a) in the case of a loan or quasi-loan, it is made to him;

(b) in the case of a credit transaction, he is the person to whom goods or services are supplied, or land is sold or otherwise disposed of, under the transaction;

(c) in the case of a guarantee or security, it is entered into or provided in connection with a loan or quasi-loan made to him or a credit transaction made for him;

(d) in the case of an arrangement to which Head 17 (2) and (3) of this Part [equivalent of Sections 31(2) or 31(3) of Companies Act, 1990] applies, the transaction to which the arrangement relates was made for him; and

(e) in the case of any other transaction or arrangement for the supply or transfer of goods, land or services (or any interest therein), he is the person to whom the goods, land or services (or the interest) are supplied or transferred.

(7) This Part, does not apply to arrangements or transactions entered into before the 1st February 1991 but, for the purposes of determining whether an arrangement is one to which Head 17 (2) and (3) of this Part [equivalent of Section 31(2) and Section 31(3) of the Companies Act, 1990] applies, the transaction to which the arrangement relates shall, if it was entered into before the 1st February 1991, be deemed to have been entered into thereafter.

(8) This Part shall have effect in relation to an arrangement or transaction whether governed by the law of the State or of another country.

Explanatory note

This head is a slightly amended re-enactment of Section 25 of the Companies Act, 1990, as amended by Section 75 of the Company Law Enforcement Act, 2001.

The cross-references have been amended in accordance with the new provisions and the amounts specified in Subheads (3)(b) and (5) have been converted from punts to euro and rounded off.

Subsection (7) has been amended insofar as the commencement date of the head is replaced by the specific.

Head 2 Connected persons

(1) For the purposes of this Part, a person is connected with a director of a company if, but only if, the person (not being himself a director of the company) is –

(a) that director's spouse, parent, brother, sister or child;

(b) a person acting in his capacity as the trustee of any trust, the principal beneficiaries of which are the director, his spouse or any of his children or any body corporate which he controls; or

(c) in partnership within the meaning of Section 1(1) of the Partnership Act 1890, with that director.

(2) A body corporate shall also be, for the purposes of this Part, connected with a director of a company if it is controlled by that director.

(3) For the purposes of this head, a director of a company shall be deemed to control a body corporate if, but only if, he is, alone or together with any other director or directors of the company or any person connected with the director or such other director or directors, interested in one-half or more of the equity share capital of that body or entitled to exercise or control the exercise of one-half or more of the voting power at any general meeting of that body.

(4) In Subhead (3)—

(a) "equity share capital" has the same meaning as in Part A1, Head 6(9) [equivalent of Section 155 of Companies Act, 1963]; and

(b) references to voting power exercised by a director shall include references to voting power exercised by another body corporate which that director controls.

(5) The provisions of Head 33 of this Part [equivalent of Section 54 of Companies Act, 1990] shall have effect for the purposes of Subhead (3) with the substitution of the words "one-half or more" for the words "one-third or more" in Subhead (2)(c) [equivalent of Sections 54 (5) and (6) of the Companies Act, 1990] of that head.

(6) It shall be presumed for the purposes of this Part, until the contrary is shown, that the sole member of a single-member private limited company is a person connected with a director of that company.

Explanatory note

This head is a slightly amended re-enactment of Section 26 of the Companies Act, 1990, as amended by Section 76 of the Company Law Enforcement Act, 2001.

Subsection (6) has been amended insofar as the reference to S.I. No.275 of 1994, EC (Single-Member Private Limited Companies) Regulations, 1994, has been deleted in view of the fact that provision for a single member private-company limited by shares is now contained in Pillar A of the Bill.

Head 3 Shadow directors

(1) Subject to Subhead (2), a person in accordance with whose directions or instructions the directors of a company are accustomed to act (in this Bill referred to as "a shadow director") shall be treated for the purposes of this Part 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 in a professional capacity.

(2) A body corporate is not to be regarded as a shadow director of any of its subsidiary companies.

(3) A shadow director shall not be guilty of an offence under Part B10, Head 17(8) [equivalent of Section 44(8) of Companies Act, 1990] by virtue only of Subhead (1).

(4) Part A5, Head 12 [equivalent of Section 194 of Companies Act, 1963] shall apply in relation to a shadow director of a company as it applies in relation to a director of a company, except that the shadow director shall declare his interest, not at a meeting of the directors, but by a notice in writing to the directors which is either:

(a) a specific notice given before the date of the meeting at which, if he had been a director, the declaration would be required by Subhead (2) of that head to be made; or

(b) a notice which under Subhead (3) of that head falls to be treated as a sufficient declaration of that interest or would fall to be so treated apart from the proviso; and Part A4, Heads 33 and 60 [equivalent of Section 145 of Companies Act, 1963] shall have effect as if the declaration had been made at the meeting in question and had accordingly formed part of the proceedings at that meeting.

Explanatory note

This head is a slightly amended re-enactment of Section 27 of the Companies Act, 1990. The cross references have been amended in accordance with the new provisions of the Bill.

Subheaed (2) is new. It follows, in part, Section 230(3) of the UK Company Law Reform Bill. The CLRG is of the view that it is appropriate to separate the law applicable to holding companies from the law applicable to directors as to treat holding companies as shadow directors in any situation is wrong – if there is a mischief to be addressed, it should be addressed head-on by regulating the dealings of holding companies qua holding company and not qua shadow director.

Head 4 De Facto Directors

(1) Subject to Subhead (2), a person who occupies the position of director but who has not been formally appointed as a director (in this Bill referred to as a "de facto director") shall be treated for the purposes of this Part as a director of a company provided that a person shall not be a de facto director by reason only of the fact that he gives advice in a professional capacity.

(2) Head 12 of this Part [equivalent of Section 194 of Companies Act, 1963] shall apply in relation to a de facto director of a company as it applies in relation to a director of a company.

Explanatory note
This head is a new head. The head gives a statutory definition to de facto directors for this Part.

This head extends the High Court decision in Re Lynnrowan Enterprises Ltd. (31st July 2002) in that de facto directors shall now, for all purposes, be treated as directors of the company and not merely for the purposes of restriction orders. Thus, they will be under the same duties as ordinary directors but need not be registered.

A saving provision for those giving professional advice has also been inserted.

Chapter 2
General Duties of Directors and Secretaries

Head 5 Duty of each director

(1) It is the duty of each director of a company to ensure that the Companies Acts are complied with by the company.

(2) For the purpose of any provision of the Companies Acts which provides that an officer of a company who is in default shall be guilty of an offence, an officer who is in default is any officer who authorises or who, in breach of his duty as such officer, permits the default mentioned in the provision.

(3) An officer shall be presumed to have permitted a default by the company unless the officer can establish that he took all reasonable steps to prevent it or that by reason of circumstances beyond his control, was unable to do so.

(4) Upon notification of appointment as a director on the prescribed form, the director's signature should appear below a statement: "I acknowledge that, as a director, I have legal duties and obligations imposed by the Companies Acts, other statutes and at common law.

(5) In this head 'default' includes a refusal or contravention.

Explanatory note
This head is an amended re-enactment of Section 383 of the Companies Act 1963, as substituted by Section 100 of the Company Law Enforcement Act, 2001. As an introductory provision to the Chapter of this Part dealing with the general duties of directors and secretaries, it sets out the overall duty of compliance by directors with the Companies Acts. It must be noted that this head now applies to registered directors, shadow directors and de facto directors equally.

Subheads (1), (2), and (3) are re-enactments of Sections 383(3), (1), and (2), and of the Companies Act, 1963 respectively.

Subhead (4) is new. This subhead implements the recommendation of the First Report of the Company Law Review Group that such an acknowledgement of the existence of directors' duties by the directors upon registration is desirable. This is achieved through requiring them to sign a declaration to that effect.

Subhead (5) re-enacts Section 383 (4) of the Companies Act, 1963.

Head 6 Directors to have regard to interests of employees

(1) The matters to which the directors 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.

(2) Accordingly, the duty imposed by this head on the directors shall be owed by them to the company (and the company alone) and shall be enforceable in the same way as any other fiduciary duty owed to a company by its directors.

Explanatory note
This head re-enacts Section 52 of the Companies Act, 1990.

Head 7 Director's compliance statement and related statement

(1) In this head—

'amount of turnover' and 'balance sheet total' have the same meanings as in Part A6, Head 58 [the equivalent of Section 8 of Companies (Amendment) Act, 1986];

'relevant obligations', in relation to a company, means the company's obligations under—

(a) the Companies Acts, where the failure to comply with any such obligation is a category one offence or a category two offence or a Serious Market Abuse Offence or a Serious Prospectus Offence or a Serious Transparency Offence; and

(b) tax law,

'tax law' means—

(a) the Customs Acts,

(b) the statutes relating to the duties of excise and to the management of those duties,

(c) the Tax Acts,

(d) the Capital Gains Tax Acts,

(e) the Value-Added Tax Act, 1972 and the enactments amending or extending that Act,

(f) the Capital Acquisitions Tax Act, 1976 and the enactments amending or extending that Act,

(g) the statutes relating to stamp duty and to the management of that duty, and

(h) any instruments made under an enactment referred to in any of paragraphs (a) to (g) or made under any other enactment and relating to tax.

(2) The directors of a company to which this head applies shall also include in their report under Part A6, Head 37 [the equivalent of Section 158 of the Companies Act, 1963] a statement—

(a) acknowledging that they are responsible for securing the company's compliance with its relevant obligations; and

(b) confirming that the company has in place a compliance policy statement that is, in the opinion of the directors, appropriate for the company and, if this is not the case, specifying the reasons; and

(c) confirming that the company has in place, appropriate arrangements or structures that are, in the opinion of the directors, designed to secure material compliance with its relevant obligations, which arrangements or structures may (at the discretion of the directors) include the company's reliance upon internal and/ or external advisors who appear to the directors to have the requisite knowledge and experience to advise the company on compliance with its relevant obligations and if this is not the case, specifying the reasons; and

(d) confirming that the company's arrangements or structures referred to in paragraph (c), have been reviewed during the financial year to which the report relates, and if this is not the case, specifying the reasons.

(3) For the purposes of this head, a company's arrangements or structures are considered to be designed to secure material compliance with its relevant obligations if they provide a reasonable assurance of compliance in all material respects with those obligations.

(4) Where the directors of a company to which this head applies fail to comply with Subhead (2), each director to whom the failure is attributable is guilty of a category three offence.

(5) This head does not apply to a company in respect of any financial year of the company if, either—

(a) its balance sheet total for the year does not exceed—

(i) €12,500,000, or

(ii) if an amount is prescribed under Part A14, Head 45 (1)(l) [the equivalent of Section 48(1)(l) of the Companies (Auditing and Accounting) Act, 2003] for the purpose of this provision, the prescribed amount,

or, in the alternative to the provisions in (a),

(b) the amount of its turnover for the year does not exceed—

(i) €25,000,000, or

(ii) if an amount is prescribed under Part A14 Head 45 (1)(l) [the equivalent of Section 48(1)(l) of the Companies (Auditing and Accounting) Act, 2003] for the purpose of this provision, the prescribed amount.

(6) This head does not apply to any company that is of a class exempted under Part A14, Head 45 (1)(l) [equivalent of Section 48(1)(j) of the Companies (Auditing and Accounting) Act, 2003].

Explanatory note

This head is an amended re-enactment of Section 205E of the Companies Act, 1990 as inserted by Section 45 of the Companies (Auditing and Accounting) Act, 2003. The amendments have been made in accordance with the recommendations made by the Company Law Review Group in its 2005 Report on the Directors' Compliance Statement and subsequently adopted by the Minister. The previous Section 45 has not been enacted.

This head does not apply to guarantee companies and unlimited companies under Part B4 and B5 respectively. It has full application to DACs under Part B3 (subject to the exemption provided for in Subhead (5)) and to PLCs in Part B2

Head 8 Duties of secretary

(1) The duties and responsibilities of the secretary of the company shall, without derogating from the secretary's statutory and other legal duties and responsibilities, be such duties and responsibilities as are delegated to the secretary by the board of directors.

(2) The directors shall in their appointment of a secretary, who may be one of their number, have a duty to ensure that the person appointed as secretary has the suitable skills to maintain (or to procure the maintenance of) the records (other than accounting records) required to be kept under the Companies Acts.

(3) Upon notification of appointment as a secretary on the prescribed form, the secretary's signature should appear below a statement: "I/We acknowledge that, as a secretary, I/we have legal duties and obligations imposed by the Companies Act, other statutes and at common law.

Explanatory note

This head is new. The head sets out the duties and responsibilities of the secretary. The head also reflects that the secretary is appointed by and can be removed by the board of directors. The secretary is not responsible for company law compliance since the secretary does not have the authority to cause the company to comply, such being vested in the board of directors.

Subhead (1) sets out and recognises the role of the secretary as the person who, by order of the board of directors, convenes meetings, records their proceedings, is custodian of the registers required by the Companies Acts and the person to whom the directors are permitted and expected to delegate their responsibility to make filings under the Companies Acts. It also reflects that it is the directors who are primarily responsible for the management and direction of the company, and to that extent primarily responsible for compliance with the Companies Acts.

Subhead (2) imposes a duty on the directors to ensure that the secretary has the suitable skills to maintain records required by the Companies Acts. Such a duty is new. However, it is worth noting that a similar duty is imposed upon the directors of a PLC under Section 236 of the Companies Act, 1990.

Subhead (3) implements the recommendation of the First Report of the Company Law Review Group that such an acknowledgement of the existence of a secretary's duties by the secretary upon registration is desirable. This is achieved through requiring the secretary to sign a declaration to that effect. The wording of such a declaration recognises that the secretary may be a corporate body.

Head 9 Fiduciary duties of directors

(1) Without prejudice to the provisions of any enactment (including this Bill) a director of a company shall owe the duties set out in Head 3 to his company (and the company alone), which shall be enforced in the same way as any other fiduciary duty owed to a company by its directors.

(2) The duties set out in Subhead (3) are based on certain common law rules and equitable principles as they apply in relation to the directors of companies and shall have effect in place of those rules and principles as regards the duties owed to a company by a director and the duties in Subhead (3) shall be interpreted and applied in the same way as common law rules or equitable principles and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the duties set out in Subhead (3)

(3) Every director of a company shall—

(a) act in good faith in what the director considers to be the interests of the company;

(b) act honestly and responsibly in relation to the conduct of the affairs of the company;

(c) act in accordance with the company's constitution and must exercise his powers only for the purposes allowed by law;

(d) not use the company's property, information or opportunities for his own or anyone else's benefit unless he is allowed to by the company's constitution or the use has been approved by a resolution of the company in general meeting;

(e) not agree to restrict the director's power to exercise an independent judgment unless this is expressly permitted by the company's constitution and provided that if a director considers in good faith that it is in the interests of the company for a transaction to be entered into and carried into effect, a director may restrict the director's power to exercise an independent judgment in the future by agreeing to act in a particular way to achieve this;

(f) avoid any conflict between the director's duties to the company and the director's other, including personal, interests and may not retain any benefit derived from any engagement (other than a transaction or arrangement to which the director and the company are party) where there is such a conflict of interest unless the company's members in general meeting release the director from his duty to the company;

(g) owe the company a duty to exercise the care, skill and diligence which would be exercised in the same circumstances by a reasonable person having both;

(i) the knowledge and experience that may reasonably be expected of a person in the same position as the director, and

(ii) the knowledge and experience which the director has; and

(h) have regard to the interests of the company's employees in general and to those of its members.

(4) A director appointed or nominated for appointment by a member with an entitlement to so appoint or nominate under the constitution or a shareholders' agreement, may have regard to the interests of that member.

Explanatory note

This head is new and implements the recommendation of the First Report of the Company Law Review Group that the fiduciary duties owed by directors to the company be stated within the new companies code.

The fiduciary duties of the directors have been enunciated, until now, by the Irish courts. The Company Law Review Group recommended that the inaccessibility and incomprehensibility of the common law concerning directors' duties to the layperson should be addressed by their being stated within the body of the companies code. Furthermore, the fiduciary duties are stated in general rather than specific terms and since they are derived from principles established by the courts, they are not intended to be exhaustive.

Head 10 Other interests of directors

Save to the extent that the constitution of a company provides otherwise, a director of a company may be or become a director or other officer of, or otherwise interested in, any company promoted by the company or in which the company may be interested as shareholder or otherwise subject to Head 9 of this Part and no such director shall be accountable to the company for any remuneration or other benefits received by him as a director or officer of, or from his interest in, such other company unless the company otherwise directs.

Explanatory note

This head is new and imports, in a slightly amended manner, Model Regulation 78 of Part I of Table A of the First Schedule to the Companies Act 1963. It is an exception to the fiduciary duties set out in Head 9 of this Part.

Head 11 Power of a director to act in a professional capacity for the company

Save to the extent that the constitution of a company provides otherwise, any director may act by himself or his firm in a professional capacity for the company of which he is a director and he or his firm shall be entitled to remuneration for professional services as if he were not a director, but nothing herein contained shall authorise a director or his firm to act as auditor to the company.

Explanatory note

This head is new and imports Model Regulation 87 of Part I of Table A of the First Schedule to the Companies Act, 1963. The purpose of this head is to elaborate upon the powers of the directors, notwithstanding the fact that the fiduciary duties are set out in this Part.

Head 12 Duty of director to disclose his interest in contracts made by the company

(1) It shall be the duty of a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company, to declare the nature of his interest at a meeting of the directors of the company.

(2) In the case of a proposed contract, the declaration, required by this head to be made by a director, shall be made at the meeting of the directors at which the question of entering into the contract is first taken into consideration, or if the director was not at the date of that meeting interested in the proposed contract, at the next meeting of the directors held after he became so interested and in the case where a director becomes interested in a contract after it is made, the said declaration shall be made at the first meeting of the directors held after the director becomes so interested.

(3) Subject to Subhead (4), for the purposes of this head a general notice given to the directors of a company to the effect that—

(a) he is a member of a specified company or firm and is to be regarded as interested in any contract which may, after the date of the notice, be made with that company or firm; or

(b) he is to be regarded as interested in any contract which may, after the date of the notice, be made with a specified person who is connected with him (within the meaning of Head 2 of this Part [equivalent of Section 26 of Companies Act, 1990]);

shall be deemed to be a sufficient declaration of interest in relation to any such contract.

(4) No such notice as aforesaid shall be of effect unless it is given at the meeting of directors or the director takes reasonable steps to secure that it is brought up and read at the next meeting of the directors after it is given.

(5) A copy of every declaration made and notice given in pursuance of this head shall, within 3 days after the making or giving thereof, be entered into a book for this purpose. Such book shall be open for inspection without any charge by any director, secretary, auditor or member of the company at the registered office of the company and shall be produced at every general meeting of the company and at any meeting of the directors if any director so requests in sufficient time to enable the book to be available at the meeting.

(6) Nothing in this head shall be taken to prejudice the operation of any rule of law restricting directors of a company from having interests in contracts with the company.

(7) Any reference in this head to a contract shall be construed as including a reference to any transaction or arrangement (whether or not constituting a contract) made or entered into on or after the commencement of this Bill.

(8) For the purposes of this head, a transaction or arrangement of a kind described in Head 17, made by a company for a director of the company or a person connected with such a director shall, if it would not otherwise be so treated (and whether or not prohibited by that head), be treated as a transaction or arrangement in which that director is interested.

Explanatory note

This head is an amended re-enactment of Section 194 of the Companies Act, 1963, as amended by Section 47(3) of the Companies Act, 1990.

Sections 194(5)(b) and 194(6) have not been included in Pillar A as private companies limited by shares are our only concern here. Those subsections will be included in Pillar B for companies other than the CLS. The reason for their exclusion from this Part is that since their purpose was to protect the investing public, it carries less weight in relation to the private company limited by shares as the shares cannot be offered to the public.

Furthermore, it was the opinion of the Company Law Review Group that such a declaration was a matter of contract and as such, there was no public interest in having the matter prosecuted.

Subheads (7) and (8) re-enact Sections 47 (1) and (2) of the Companies Act, 1990.

Head 13 Liability to Account and Indemnify

(1) Subject to Head 14 of this Part [equivalent of Section 391 of Companies Act, 1963], where a director acts in breach of his duties under this Part, he shall be liable -

(a) to account to the company for any gain which he makes directly or indirectly; and

(b) to indemnify the company for any loss or damage resulting from that breach of duty.

(2) Subject to Subhead (4), where a company enters into a transaction or arrangement contrary to Head 16 [equivalent of Section 29 of Companies Act, 1990] or Head 17 of this Part [equivalent of Section 31 of Companies Act, 1990] with a director of the company or its holding company or a person connected with him, that director and the person so connected and any other director of the company who authorised the arrangement or any transaction entered into in pursuance of such an arrangement, shall (whether or not the transaction or arrangement has been avoided) be liable -

(a) to account to the company for any gain which he had made directly or indirectly by the arrangement or transaction; and

(b) (jointly and severally with any other person liable under this subhead) to indemnify the company for any loss or damage resulting from the arrangement or transaction.

(3) Subheads (1) and (2) are without prejudice to the company's right at common law to claim damages for breach of duty.

(4) Where an arrangement or transaction is entered into by a company and a person connected with a director of the company or its holding in contravention of Head 16 [equivalent of Section 29 of the Companies Act, 1990] or Head 17 of this Part [equivalent of Section 31 of the Companies Act, 1990], that director shall not be liable under Subhead (2) if he shows that he took all reasonable steps to secure the company's compliance with that head and in any case, a person so connected and any such other officer as is mentioned in the said Subhead (2) shall not be so liable if he shows that at the time the arrangement or transaction was entered into, he did not know the relevant circumstances constituting the contravention.

Explanatory note
This head is new and codifies the common law remedies of account and indemnity.
Subhead (2) replicates Sections 29(4) and 38(2) of the Companies Act, 1990.

Head 14 Power of court to grant relief to officers of the company

(1) If in any proceeding for negligence, default, breach of duty or breach of trust against an officer of a company or a person employed by a company as auditor, it appears to the court hearing the case that that officer or person is or may be liable in respect of the negligence, default, breach of duty or breach of trust but that he has acted honestly and reasonably and that having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for the negligence, default, breach of duty or breach of trust, that court may relieve him either wholly or partly from his liability on such terms as the court may think fit.

(2) Where any such officer or person as aforesaid has reason to apprehend that any claim will or might be made against him in respect of any negligence, default, breach of duty or breach of trust he may apply to the court for relief and the court on any such application shall have the same power to relieve him as under this head it would have had if it had been a court before which proceedings against that person for negligence, default, breach of duty or breach of trust had been brought.

(3) Where any case to which Subhead (1) applies is being tried by a judge with a jury the judge, after hearing the evidence, may if he is satisfied that the defendant ought, in pursuance of that subhead, to be relieved either in whole or in part from the liability sought to be enforced against him, withdraw the case in whole or in part from the jury and direct judgment to be entered for the defendant on such terms as to costs or otherwise as the judge may think proper.

Explanatory note
This head is a re-enactment of Section 391 of the Companies Act, 1963.

Head 15 Avoidance of provisions exempting officers and auditors of the company from liability

(1) Subject as hereinafter provided any provision whether contained in the constitution of a company or in any contract with a company or otherwise for exempting any officer of the company or any person employed by the company as auditor from or indemnifying him against any liability which by virtue of any rule of law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company shall be void so however that—

(a) nothing in this head shall operate to deprive any person of any exemption or right to be indemnified in respect of anything done or omitted to be done by him while any such provision was in force; and

(b) notwithstanding anything in this head a company may in pursuance of any such provision as aforesaid, indemnify any such officer or auditor against any liability incurred by him in defending proceedings whether civil or criminal in which judgment is given in his favour or in which he is acquitted or in connection with any application under Head 14 of this Part [equivalent of Section 391 of Companies Act, 1963] in which relief is granted to him by the court.

(2) Notwithstanding Subhead (1), a company may purchase and maintain for any of its officers or auditors, insurance in respect of any liability referred to in that subhead.

(3) Notwithstanding any provision contained in an enactment, the constitution of a company or otherwise, a director may be counted in the quorum and may vote on any resolution to purchase or maintain any insurance under which the director might benefit.

(4) Any directors' and officers' insurance purchased or maintained by a company before the 6th April 2004 (commencement of Companies (Auditing and Accounting) Act, 2003) is as valid and effective as it would have been if those amendments had been in operation when that insurance was purchased or maintained.

(5) In this head a reference to an officer or auditor includes any former or current officer or auditor of the company, as the case may be.

Explanatory note
This head is a slightly amended re-enactment of Section 200 of the Companies Act, 1963, as amended by para.16 of the First Schedule to the Companies (Amendment) Act, 1983 and Section 56 of the Companies (Auditing and Accounting) Act, 2003.

References to the articles have been replaced by references to the constitution of the company.

Chapter 3

Particular transactions involving conflict of interest

Head 16 Substantial property transactions involving directors, etc

(1) Subject to Subheads (4) and (5), a company shall not enter into an arrangement—

(a) whereby a director of the company or its holding company or a person connected with such a director, acquires or is to acquire, one or more non-cash assets of the requisite value from the company; or

(b) whereby the company acquires or is to acquire, one or more non-cash assets of the requisite value from such a director or a person so connected,

unless the arrangement is first approved by a resolution of the company in general meeting and if the director or connected person is a director of its holding company or a person connected with such a director, by a resolution in general meeting of the holding company.

(2) For the purposes of this head a non-cash asset is of the requisite value if at the time the arrangement in question is entered into, its value is not less than €5,000 but, subject to that, exceeds €75,000 or ten per cent of the amount of the company's relevant assets and for those purposes the amount of a company's relevant assets is—

(a) except in a case falling within paragraph (b), the value of its net assets determined by reference to the entity financial statements prepared in accordance with Head 12 of A6 and laid in accordance with the requirements of Part A6, Head 12 [equivalent of Section 148 of Companies Act, 1963] in respect of the last preceding financial year in respect of which such entity [company] financial statements were so laid;

(b) where no entity [company] financial statements have been prepared and laid under that head before that time, the amount of its called-up share capital.

(3) An arrangement entered into by a company in contravention of this head and any transaction entered into in pursuance of the arrangement (whether by the company or any other person) shall be voidable at the instance of the company unless—

(a) restitution of any money or any other asset which is the subject-matter of the arrangement or transaction is no longer possible or the company has been indemnified in pursuance of Head 13 (2) of this Part [equivalent of Section 29(4)(b) of Companies Act, 1990] by any other person for the loss or damage suffered by it; or

(b) any rights acquired bona fide for value and without actual notice of the contravention by any person who is not a party to the arrangement or transaction would be affected by its avoidance; or

(c) the arrangement is affirmed by a resolution of the company in general meeting and if it is an arrangement for the transfer of an asset to or by a director of its holding company or a person who is connected with such a director, is so affirmed by a resolution of the holding company in general meeting.

(4) Subhead (1) shall not apply in relation to any arrangement for the acquisition of a non-cash asset—

(a) if the non-cash asset in question is or is to be acquired by a holding company from any of its wholly owned subsidiaries or from a holding company by any of its wholly owned subsidiaries or by one wholly owned subsidiary of a holding company from another wholly owned subsidiary of that same holding company; or

(b) if the arrangement is entered into by a company which is being wound up unless the winding-up is a members' voluntary winding-up;

(c) if the arrangement involves the disposal of a company's assets by a receiver.

(5) Subhead (1) (a) shall not apply in relation to any arrangement whereby a person acquires or is to acquire an asset from a company of which he is a member if the arrangement is made with that person in his character as such member.

(6) No approval is required to be given under this head by any body corporate unless it is a company within the meaning of Pillar A or if it is a wholly owned subsidiary of any body corporate.

Explanatory note

This head is an amended re-enactment of Section 29 of the Companies Act, 1990. The relevant recommendations of the First Report of the Company Law Review Group have also been implemented. These include the amendment of Section 29(3) insofar as the "reasonable period" should be subject to ratification taking place at the next AGM and in any event not later than 15 months. It was further recommended that Section 29(7) be amended by the addition of a third exemption regarding the disposal of the company's assets by the receiver.

The amounts specified in Subhead (2) have been converted into euro and rounded.

Section 29(4) of the Companies Act, 1990 has not been included in this head. Instead it is included in Part A5, Head 13 which specifically deals with the liability of directors to account and indemnify where they act in breach of their duties under this Part. Sections 29(5) & 29(6) have been deleted.

Subhead (6) has been newly inserted in accordance with the recommendation of the Review Group. Its aim is to clarify the scope of this provision.

Head 17 Prohibition of loans, etc. to directors and connected persons

(1) Except as provided by Heads 18 to 23 of this Part [equivalent of Sections 32 to 37 of the Companies Act, 1990], a company shall not—

(a) make a loan or a quasi-loan to a director of the company or of its holding company or to a person connected with such a director;

(b) enter into a credit transaction as creditor for such a director or a person so connected;

(c) enter into a guarantee or provide any security in connection with a loan, quasi-loan or credit transaction made by any other person for such a director or a person so connected.

(2) A company shall not arrange for the assignment to it or the assumption by it of any rights, obligations or liabilities under a transaction which, if it had been entered into by the company, would have contravened Subhead (1), but for the purposes of this Part the transaction shall be treated as having been entered into on the date of the arrangement.

(3) A company shall not take part in any arrangement whereby—

(a) another person enters into a transaction which, if it had been entered into by the company, would have contravened Subhead (1) or (2); and

(b) that other person, in pursuance of the arrangement, has obtained or is to obtain any benefit from the company or its holding company or a subsidiary of the company or its holding company.

Explanatory note

This head is a slightly amended re-enactment of Section 31 of the Companies Act, 1990. The cross-references have been amended in accordance with the new provisions of the Bill.

Head 18 Arrangements of certain value

(1) Part A5, Head 17 [equivalent of Section 31 of the Companies Act, 1990] shall not prohibit a company from entering into an arrangement with a director or a person connected with a director if—

(a) the value of the arrangement; and

(b) the total amount outstanding under any other arrangements entered into by the company with any director of the company, or any person connected with a director, together is less than ten per cent of the company's relevant assets.

(2) For the purposes of this head—

(a) a company enters an arrangement with a person if it makes a loan or quasi-loan to or enters into a credit transaction as creditor for that person; and

(b) the amount of a company's relevant assets shall be determined in accordance with Part A5, Head 16 (2) [equivalent of Section 29(2) of Companies Act, 1990].

Explanatory note
This head is a slightly amended re-enactment of Section 32 of the Companies Act, 1990. The cross-references have been amended in accordance with the new provisions of the Bill.

Head 19 Reduction in amount of company's relevant assets

(1) This head applies to a company in respect of which the total amount outstanding under any arrangements referred to in Part A5, Head 18 [equivalent of Section 32 of Companies Act, 1990] comes to exceed 10 per cent of the company's relevant assets for any reason but in particular because the value of those assets has fallen.

(2) Where the directors of a company become aware or ought reasonably to become aware, that there exists a situation referred to in Subhead (1), it shall be the duty of the company, its directors and any persons for whom the arrangements referred to in that subhead were made, to amend, within two months, the terms of the arrangements concerned so that the total amount outstanding under the arrangements again falls within the percentage limit referred to in that subhead.

(3) Where the terms of the arrangements referred to in Subhead (2) are not amended within the period specified in that subhead, the arrangements shall be voidable at the instance of the company unless Part A5, Head 24 (1) (a) or (b) [equivalent of Section 38(1)(a) and (b) of Companies Act, 1990] applies.

Explanatory note
This head is a slightly amended re-enactment of Section 33 of the Companies Act, 1990, as amended by Section 77 of the Company Law Enforcement Act, 2001. The cross-references have been amended in accordance with the new provisions of the Bill.

Head 20 Group exceptions to prohibitions on loans etc

Part A5, Head 17 [equivalent of Section 31 of the Companies Act, 1990] does not prohibit a company from entering into a guarantee or providing any security in connection with a loan, quasi-loan or credit transaction made by any other person for a director of the company or of its holding company or for a person connected with such a director, if the validation procedure in Part A4, Head 71 is followed, and for the purposes of the validation procedure, a guarantee or the provision of security in connection with a loan, quasi-loan or credit transaction is a restricted activity.

Explanatory note
This head is an amended re-enactment of Section 34 of the Companies Act, 1990, as amended by Section 78 of the Company Law Enforcement Act, 2001.

Those subsections of Section 34 of the Companies Act, 1990 relating to the validation of such restricted activities have been deleted in light of the fact that a single general validation procedure is now provided for in Part IV.

This new validation procedure has been introduced in accordance with the recommendations of the Company Law Review Group in its First Report.

Head 21 Transactions with holding company

Part A5, Head 17 [equivalent of Section 31 of the Companies Act, 1990] shall not prohibit a company from—

(a) making a loan or quasi-loan to any company which is its holding company, subsidiary or a subsidiary of its holding company or entering into a guarantee or providing any security in connection with a loan or quasi-loan made by any person to any company which is its holding company, subsidiary or a subsidiary of its holding company;

(b) entering into a credit transaction as creditor for any company which is its holding company, subsidiary or a subsidiary of its holding company or entering into a guarantee or providing any security in connection with any credit transaction made by any other person for any company which is its holding company, subsidiary or a subsidiary of its holding company.

Explanatory note
This head is a slightly amended re-enactment of Section 35 of the Companies Act, 1990, as amended by Section 79 of the Company Law Enforcement Act, 2001. The cross-references have been amended in accordance with the new provisions of the Bill.

Head 22 Directors' expenses

(1) Part A5, Head 17 [equivalent of Section 31 of the Companies Act, 1990] shall not prohibit a company from doing anything to provide any of its directors with funds to meet vouched expenditure properly incurred or to be incurred by him for the purposes of the company or the purpose of enabling him properly to perform his duties as an officer of the company or doing anything to enable any of its directors to avoid incurring such expenditure.

(2) Where a company enters into any transaction pursuant to Subhead (1), any liability falling on any person arising from any such transaction shall be discharged by him within six months from the date on which it was incurred.

Explanatory note

This head is a slightly amended re-enactment of Section 36 of the Companies Act, 1990. The cross-references have been amended in accordance with the new provisions of the Bill.

Head 23 Business transactions

Part A5, Head 17 [equivalent of Section 31 of the Companies Act, 1990] shall not prohibit a company from making any loan or quasi-loan or entering into any credit transaction as creditor for any person if—

(a) the company enters into the transaction concerned in the ordinary course of its business; and

(b) the value of the transaction is not greater, and the terms on which it is entered into are no more favourable, in respect of the person for whom the transaction is made, than that or those which—

(i) the company ordinarily offers, or

(ii) it is reasonable to expect the company to have offered, to or in respect of a person of the same financial standing as that person but unconnected with the company.

Explanatory note

This head is a slightly amended re-enactment of Section 37 of the Companies Act, 1990. The cross-references have been amended in accordance with the new provisions of the Bill.

Head 24 Civil remedies for breach of Part A5, Head 17 [equivalent of Section 31 of the Companies Act, 1990]

Where a company enters into a transaction or arrangement in contravention of Part A5, Head 17 [equivalent of Section 31 of the Companies Act, 1990] the transaction or arrangement shall be voidable at the instance of the company unless—

(a) restitution of any money or any other asset which is the subject matter of the arrangement or transaction is no longer possible, or the company has been indemnified in pursuance of Part A5, Head 13 (2) (b) [equivalent of Section 38(2)(b) of Companies Act, 1990] for the loss or damage suffered by it; or

(b) any rights acquired bona fide for value and without actual notice of the contravention by any person other than the person for whom the transaction or arrangement was made would be affected by its avoidance.

Explanatory note

This head is an amended re-enactment of Section 38 of the Companies Act, 1990. The cross-references have been amended in accordance with the new provisions of the Bill.

Section 38(2) has not been included. The reason for this is that there is now a head which deals with making directors liable where they act in breach of their duties under this Part, to account for any gain made and to indemnify the company in respect of any loss or damage which may result to the company. This is provided for in Part A5, Head 17.

Section 38(3) has also not been included as it is now provided for in Head 10(4) of this Part.

Head 25 Personal liability for company debts in certain cases

(1) If a company is being wound up and is unable to pay its debts and the court considers that any arrangement of a kind described in Part A5, Head 18 (2) (a) [equivalent of Section 32(2)(a) of the Companies Act, 1990] has contributed materially to the company's inability to pay its debts or has substantially impeded the orderly winding-up thereof, the court, on the application of the liquidator or any creditor or contributory of the company, may, if it thinks it proper to do so, declare that any person for whose benefit the arrangement was made shall be personally liable, without any limitation of liability for all or such part as may be specified by the court, of the debts and other liabilities of the company.

(2) In deciding whether to make a declaration under Subhead (1), the court shall have particular regard to whether and to what extent, any outstanding liabilities arising under any arrangement referred to in that subhead were discharged before the commencement of the winding-up.

(3) In deciding the extent of any personal liability under this head, the court shall have particular regard to the extent to which the arrangement in question contributed materially to the company's inability to pay its debts or substantially impeded the orderly winding-up of the company.

Explanatory note
This head is a re-enactment of Section 39 of the Companies Act, 1990. The cross-references have been amended in accordance with the new provisions of the Bill.

Head 26 Criminal penalties for breach of Part A5, Head 17 [equivalent of Section 15 of the Companies (Auditing and Accounting) Act, 2003, formerly Section 31 of the Companies Act, 1990]

(1) An officer of a company who authorises or permits the company to enter into a transaction or arrangement, knowing or having reasonable cause to believe, that the company was thereby contravening Part A5, Head 17 [equivalent of Section 31 of the Companies Act, 1990] shall be guilty of a category 2 offence.

(2) A person who procures a company to enter into a transaction or arrangement knowing or having reasonable cause to believe that the company was thereby contravening Part A5, Head 17 [equivalent of Section 31 of the Companies Act, 1990] shall be guilty of a category two offence.

Explanatory note
This head is a slightly amended re-enactment of Section 40 of the Companies Act, 1990. The cross-references have been amended in accordance with the new provisions of the Bill.

Head 27 Contracts of employment of directors

(1) Subject to Subhead (6), a company shall not incorporate in any agreement, a term to which this head applies, unless the term is first approved by a resolution of the company in general meeting and in the case of a director of a holding company, by a resolution of that company in general meeting.

(2) This head applies to any term by which a director's employment with the company of which he is the director or, where he is the director of a holding company, his employment within the group is to continue, or may be continued, otherwise than at the instance of the company (whether under the original agreement or under a new agreement entered into in pursuance of the original agreement), for a period exceeding five years during which the employment—

(a) cannot be terminated by the company by notice; or

(b) can be so terminated only in specified circumstances.

(3) In any case where—

(a) a person is or is to be employed with a company under an agreement which cannot be terminated by the company by notice or can be so terminated only in specified circumstances; and

(b) more than six months before the expiration of the period for which he is or is to be so employed, the company enters into a further agreement (otherwise than in pursuance of a right conferred by or by virtue of the original agreement on the other party thereto) under which he is to be employed with the company or where he is a director of a holding company within the group,

Subhead (2) shall apply as if to the period for which he is to be employed under that further agreement there were added a further period equal to the unexpired period of the original agreement.

(4) Except in the case of a written resolution, a resolution of a company approving a term to which this head applies shall not be passed at a general meeting of the company unless a written memorandum, setting out the proposed agreement incorporating the term, is available for inspection by members of the company both—

(a) at the registered office of the company for not less than the period of 15 days ending with the date of the meeting; and

(b) at the meeting itself.

(5) In the case of a company replacing a general meeting by written resolution, the written memorandum referred to at Subhead (4) shall be circulated to members with the proposal for a written resolution.

(6) A term incorporated in an agreement in contravention of this head shall, to the extent that it contravenes this head, be void and that agreement and in a case where Subhead (3) applies, the original agreement shall be deemed to contain a term entitling the company to terminate it at any time by the giving of reasonable notice.

(7) In this head—

(a) "employment" includes employment under a contract for services; and

(b) "group", in relation to a director of a holding company, means the group which consists of that company, the holding company and its subsidiaries.

Explanatory note

This head is an amended re-enactment of Section 28 of the Companies Act, 1990.
As Part A5 only applies to a CLS, Section 28(6) has been moved to Pillar B rather than re-enacted in this head.

Subsection (1) has been amended as a result of the proposed implementation of the recommendation of the Company Law Review Group in its First Report that a resolution required to be passed by the company in general meeting can now be passed by written resolution.

Subhead (5) is a new subhead. It has been inserted to provide that, where the CLS replaces the general meeting with a written resolution, that proposed resolution must be circulated to the members.

Head 28 Approval of company necessary for payment by it to director or director's dependants for loss of office

(1) It shall not be lawful for a company to make to any director of the company, any payment by way of compensation for loss of office or as consideration for or in connection with his retirement from office, without particulars relating to the proposed payment (including the amount thereof) being disclosed to the members of the company and the proposal being approved by the company in general meeting.

(2) The directors on behalf of the company may pay a gratuity or pension or allowance on retirement to any director who has held any other salaried office or place of profit with the company or to his widow or dependants and may make contributions to any fund and pay premiums for the purchase or provision of any such gratuity, pension or allowance, subject to particulars relating to the proposed payment being disclosed to the members of the company and the proposal being approved by resolution of the company.

Explanatory note
This head is a new head. Subhead (1) is a re-enactment of Section 186 of the Companies Act, 1963.

Subhead (2) imports Model Regulation 90 of Part I of Table A of the First Schedule to the Companies Act, 1963.

Head 29 Approval of company necessary for payment to director of compensation in connection with transfer of property

(1) It shall not be lawful in connection with the transfer of the whole or any part of the undertaking or property of a company, for any payment to be made to any director of the company by way of compensation for loss of office or as consideration for or in connection with his retirement from office, unless particulars relating to the proposed payment (including the amount thereof) have been disclosed to the members of the company and the proposal approved by resolution of the company

(2) Where a payment which is not lawful pursuant to Subhead (1) is made to a director of the company the amount received shall be deemed to have been received by him in trust for the company.

Explanatory note
This head is a slightly amended re-enactment of Section 187 of the Companies Act, 1963.
Subsection(1) has been amended insofar as "It is hereby declared that it is not lawful..." has been replaced by "It shall not be lawful..."
Subsection (2) has been amended insofar as "Where a payment which is hereby declared to be illegal..." has been replaced by "...which is not lawful pursuant to Subhead (1)..."

Head 30 Duty of director to disclose to company payments to be made to him in connection with transfer of shares in a company

(1) Where, in connection with the transfer to any persons of all or any of the shares in a company being a transfer resulting from—

(a) an offer made to the general body of shareholders; or

(b) an offer made by or on behalf of some other body corporate with a view to the company becoming its subsidiary or a subsidiary of its holding company; or

(c) an offer made by or on behalf of an individual with a view to his obtaining the right to exercise or control the exercise of not less than one-third of the voting power at any general meeting of the company; or

(d) any other offer which is conditional on acceptance to a given extent,

a payment is to be made to a director of the company by way of compensation for loss of office or as a consideration for or in connection with his retirement from office, it shall be the duty of that director to take all reasonable steps to secure that particulars of the proposed payment (including the amount thereof) shall be included in or sent with any notice of the offer made for their shares which is given to any shareholders.

(2) If—

(a) any such director fails to take reasonable steps as aforesaid; or

(b) any person who has been properly required by any such director to include the said particulars in or send them with any such notice as aforesaid fails so to do, he shall be guilty of a category three offence.

(3) Unless—

(a) the requirements of Subhead (1) are complied with in relation to any such payment as is therein mentioned; and

(b) the making of the proposed payment is before the transfer of any shares in pursuance of the offer approved by a meeting summoned for the purpose of the holders of the shares to which the offer relates and of other holders of shares of the same class as any of the said shares,

any sum received by the director on account of the payment shall be deemed to have been received by him in trust for any persons who have sold their shares as a result of the offer made and the expenses incurred by him in distributing that sum amongst those persons shall be borne by him and not retained out of that sum.

(4) Where the shareholders referred to in paragraph (b) of Subhead (3) are not all the members of the company and no provision is made by the constitution for summoning or regulating such a meeting as is mentioned in that paragraph the provisions of this Pillar and of the company's constitution relating to general meetings of the company, shall for that purpose apply to the meeting either without modification or with such modifications as the director on the application of any person concerned may direct for the purpose of adapting them to the circumstances of the meeting.

(5) If at a meeting summoned for the purpose of approving any payment as required by paragraph (b) of Subhead (3), a quorum is not present and after the meeting has been adjourned to a later date a quorum is again not present, the payment shall be deemed for the purposes of that subhead to have been approved.

Explanatory note

This head is a slightly amended re-enactment of Section 188 of the Companies Act, 1963. The reference to being liable to a fine has been changed to guilty of a categorised offence The reference to the articles of the company have been replaced by a reference to the constitution of the company.

Head 31 Other provisions relating to payments to directors

(1) Where in proceedings for the recovery of any payment as having by virtue of Part A5, Head 29 (1) and (2) [equivalent of Section 187 of the Companies Act, 1963] or Part A5, Head 30 (1) and (2) [equivalent of Section 188 of the Companies Act, 1963] been received by any person in trust it is shown that—

(a) the payment was made in pursuance of any arrangement entered into as part of the agreement for the transfer in question or within one year before or 2 years after that agreement or the offer leading thereto; and

(b) the company or any person to whom the transfer was made was privy to that arrangement,

the payment shall be deemed, except in so far as the contrary is shown, to be one to which the subheads apply.

(2) If in connection with any such transfer as is mentioned in Part A5, Head 29 [equivalent of Section 187 of the Companies Act, 1963] or Part A5, Head 30 [equivalent of Section 188 of the Companies Act, 1963]

(a) the price to be paid to a director of the company for any shares in the company held by him is in excess of the price which could at the time have been obtained by other holders of the like shares; or

(b) any valuable consideration is given to any such director,

the excess or the money value of the consideration as the case may be, shall for the purposes of that head, be deemed to have been a payment made to him by way of compensation for loss of office or as consideration for or in connection with his retirement from office.

(3) It is hereby declared that references in Part A5, Head 28 [equivalent of Section 186 of the Companies Act, 1963], Part A5, Head 29 [equivalent of Section 187 of the Companies Act, 1963] and Part A5, Head 30 [equivalent of Section 188 of the Companies Act, 1963] to payments to any director of a company by way of compensation for loss of office or as consideration for or in connection with his retirement from office, include payments to him by way of compensation for loss of office as director of the company or for the loss while director of the company or on or in connection with his ceasing to be a director of the company of any other office in connection with the management of the company's affairs or of any office as director or otherwise in connection with the management of the affairs of any subsidiary company but do not include any bona fide payment by way of damages for breach of contract or by way of pension in respect of past services and for the purposes of this subhead, "pension" includes any superannuation allowance, superannuation gratuity or similar payment.

(4) Nothing in Part A5, Head 28 [equivalent of Section 186 of the Companies Act, 1963] and Part A5, Head 29 [equivalent of Section 187 of the Companies Act, 1963] shall be taken to prejudice the operation of any rule of law requiring disclosure to be made with respect to any such payments as are therein mentioned or with respect to any other like payments made or to be made to the directors of a company or to prejudice the operation of any rule of law in relation to the accountability (if any) of any director for any such payment received by him.

(5) References in Part A5, Head 28 [equivalent of Section 186 of the Companies Act, 1963], Part A5, Head 29 [equivalent of Section 187 of the Companies Act, 1963] and Part A5, Head 30 [equivalent of Section 188 of the Companies Act, 1963] and this head to a director include references to a past director.

Explanatory note

This head is a slightly amended re-enactment of Section 189 of the Companies Act, 1963. The cross-references have been amended in accordance with the new provisions of the Bill.

Head 32 Contracts with sole members

(1) Subject to Subhead (2), where a company enters into a contract with the sole member of the company and the sole member also represents the company in the transaction, whether as a director or otherwise, the company shall, unless the contract is in writing, ensure that the terms of the contract are forthwith set out in a written memorandum or are recorded in the minutes of the first meeting of the directors of the company following the making of the contract.

(2) Subhead (1) shall not apply to contracts entered into in the ordinary course of the company's business.

(3) If a company fails to comply with Subhead (1), the company and every officer of the company who is in default shall be guilty of a category three offence.

(4) Subject to Subhead (5), nothing in this head shall be taken to prejudice the operation of any other enactment or rule of law applying to contracts between a company and a director of that company.

(5) Failure to comply with Subhead (1) with respect to a contract shall not affect the validity of that contract.

Explanatory note

This head is a slightly amended re-enactment of S.I. No.273 of 1993, EC (Single-Member Private Limited Companies) Regulations 1993, Reg.13. All cross-references have been updated in accordance with the structure of the new Bill. Furthermore, Subsection (1) has been amended by replacing the phrase "single-member company" with "company".

Chapter 4

Disclosure of interests in shares and debentures

Head 33 Meaning of "disclosable interest"

(1) "Disclosable interest" in relation to shares or debentures, means subject to the succeeding subheads of this head, any interest of any kind whatsoever in shares or debentures of a company,

(a) there being disregarded any restraints or restrictions to which the exercise of any right attached to the interest is or may be subject;

(b) whether or not the interest is held alone, jointly or in common with any other person; and

(c) whether or not the shares or debentures are identifiable;

(2) A person shall be taken to have a disclosable interest in shares or debentures if—

(a) he enters into a contract for their purchase by him (whether for cash or other consideration); or

(b) not being the registered holder, he is entitled to exercise any right conferred by the holding of those shares or debentures or is entitled to control the exercise of any such right;

(c) a body corporate is interested in them and—

(i) that body corporate or its directors are accustomed to act in accordance with his directions or instructions; or

(ii) he is entitled to exercise or control the exercise of one third or more of the voting power at general meetings of that body corporate;

and, for this purpose:

(I) "voting power" shall not include any power to vote which arises only in specified circumstances;

(II) where a person is entitled to exercise or control the exercise of one third or more of the voting power at general meetings of a body corporate and that body corporate is entitled to exercise or control the exercise of any of the voting power at general meetings of another body corporate (the "relevant voting power"), then, for the purposes of this paragraph the relevant voting power shall be taken to be exercisable by that person;

(d) otherwise than by virtue of having an interest under a trust—

(i) he has a right to call for delivery of the shares or debentures to himself or to his order; or

(ii) he has a right to acquire an interest in shares or debentures, or is under an obligation to take an interest in shares or debentures, whether in any case the right or obligation is conditional or absolute and for this purpose a person shall be taken to be entitled to exercise or control the exercise of any right conferred by the holding of shares or debentures if he has a right (whether subject to conditions or not), the exercise of which would make him so entitled, or is under an obligation (whether so subject or not), the fulfillment of which would make him so entitled;

(e)

(i) the person is a beneficiary of a trust; and

(ii) the property held on trust for that beneficiary includes any interest in shares or debentures; and

(iii) that person, apart from this paragraph, does not have an interest in the shares or debentures.

(3) A person shall, amongst other circumstances, be taken to have ceased to have a disclosable interest in shares or debentures upon—

(a) delivery to a another person's order of shares or debentures in fulfillment of a contract for the purchase thereof by that other person or in satisfaction of a right of his to call for delivery thereof; or

(b) failure by another person to deliver shares or debentures in accordance with the terms of a contract or pursuant to a right to call for delivery thereof; or

(c) the lapse of that person's right to call for delivery of shares or debentures.

(4) The following interests shall not constitute disclosable interests—

(a) where property is held on trust and an interest in shares or debentures is comprised in that property, an interest in reversion or remainder or of a bare trustee and any discretionary interest;

(b) an interest of a person subsisting by virtue of—

(i) his holding units in—

(I) an authorised unit trust scheme within the meaning of Section 3 of the Unit Trusts Act, 1990;

(II) an undertaking for collective investment in transferable securities, within the meaning of the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations, 2003 (S.I. No. 212 of 2003);

(III) an investment company within the meaning of Pillar B, Part 9 [equivalent of Part XIII of Companies Act, 1990];

(ii) a scheme made under Section 46 of the Charities Act, 1961;

(c) an interest for the life of himself or of another person under a settlement in the case of which the property comprised in the settlement consists of or includes shares or debentures, and :

(i) the settlement is irrevocable, and

(ii) the settlor (within the meaning of Section 10 of the Taxes Consolidation Act, 1997) has no interest in any income arising under, or property comprised in, the settlement;

(d) an interest in shares or debentures held by a member of a recognised stock exchange carrying on business as a stock broker which is held by way of security only for the purposes of a transaction entered into by the person or body concerned in the ordinary course of business of such person or body;

(e) any power or discretion vested in a person by virtue only of such person having been duly appointed as or acting as:

(i) an attorney of a person with an interest in shares or debentures;

(ii) a proxy of a member or debenture holder or representative of a body corporate, member or debenture holder of a company;

(f) any interest in shares where the aggregate interest of the director or secretary and spouse and minor children of such director or secretary is in:

(i) shares representing 1per cent or less of the company's share capital of a class carrying rights to vote in all circumstances at general meetings of the company (provided that the temporary suspension of voting rights in respect of shares comprised in issued share capital of a company of any such class shall be disregarded); or

(ii) shares or debentures not carrying the right to vote at general meetings of the company or group company in question, save a right to vote which arises only in specified circumstances;

(g)

(i) An interest in shares arising on the acceptance of an offer subject to the Irish Takeover Panel Act, 1997 or the European Communities (Takeover Bids (Directive 2004/25/EC)) Regulations 2006 which is subject to a threshold acceptance condition which remains unfulfilled;

(ii) For the purposes of subparagraph (i) a threshold acceptance condition is a condition that the offer is conditional as to acceptances unless acceptances of a particular amount or percentage are received or such condition is waived;

(h) such interests, or interests of such a class, as may be prescribed for the purposes of this paragraph by regulations made by the Minister.

Explanatory note

This head is new. The head is comprised of a slightly amended re-enactment of Section 54 and 55 of the Companies Act, 1990.

Subheads (1)(a), (b) and (c) are, in substance, a re-enactment of Sections 54(2), (11) and (12) of the Companies Act, 1990, respectively

Subheads (2)(a) and (b) are a re-enactment of Section 54(4) of the Companies Act, 1990.

Subhead (2)(c) is, in substance, a re-enactment of Section 54(5) and (6) of the Companies Act, 1990.

Subhead (2)(d) is, in substance, a re-enactment of Section 54(7) and (8) of the Companies Act, 1990.

Subhead (2)(e) is a re-enactment of Section 54(3) of the Companies Act, 1990.

Subhead (3) is a re-enactment of Section 54(13) of the Companies Act, 1990.

Subheads (4)(a) – (d) are a slightly amended re-enactment of Section 55(1) of the Companies Act, 1990. The cross-references to the legislation concerning unit trusts have been updated in light of recent changes. In addition, an interest in an investment company has been included as a non-disclosable interest.

Subhead (4)(e) is a new provision stating which powers or discretion vested in a person constitute a non-disclosable interest.
Subhead (4)(e)(i) is new and includes an attorney of a person with an interest in shares or debentures.
Subhead (4)(e)(ii) is, in substance, a re-enactment of Section 54(9) of the Companies Act, 1990.

Subhead (4)(f) is new. It introduces an exception to the requirement of disclosure of shares or interests. This exception applies where the shares held amount to less than 1 per cent of the share capital of the company or where the shares or debentures do not carry a right to vote at general meetings, save for specified circumstances.

Subhead (4)(g) is a re-enactment of Section 55(1)(e) of the Companies Act, 1990.

Head 34 Duty of directors and secretary to disclose disclosable interests in certain shares and debentures

(1) Subject to Part A5, Head 33 [equivalent of Section 54 of Companies Act, 1990], a person who, at the commencement of this Chapter:

(a) is a director or secretary of a company; and

(b) is aware of:

(i) his having, or

(ii) a spouse or minor child of his having,

a disclosable interest in shares in or debentures of, the company or of any group company of the company;

shall notify the company in writing of requisite particulars of the disclosable interest, save where the requisite particulars of the disclosable interest appear in the register kept under Part A5, Head 37 [equivalent of Section 59 of Companies Act, 1990], having been entered in that register within the time specified in this Bill for future notifications under this Chapter of disclosable interests.

(2) Subject to Part A5, Head 33 a person who:

(a)

(i) is a director or secretary of a company; and

(ii) becomes aware of:

(I) his having acquired or having ceased to have; or

(II) a spouse or minor child of such person having acquired or having ceased to have;

a disclosable interest in shares in, or debentures of, the company or any group company of the company; or

(b)

(i) is aware of:

(I) his having; or

(II) a spouse or minor child of his having;

a disclosable interest in shares in or debentures of, the company or of any group company of the company; and

(iii) becomes a director or secretary of the company (not being the secretary of the company at the time of so becoming a director or not being a director at the time of so becoming the secretary of the company)

shall notify the company in writing of requisite particulars of the disclosable interest and as the case may be, its acquisition or disposal.

(3) A director or secretary of a company who is aware of:

(a)

(i) his being granted by another body corporate, being a group company of the company, of a right to subscribe for shares in, or debentures of, that other body corporate;

(ii) his exercise of such a right so granted; and

(b) any of the transactions in paragraph (a) to which the spouse or a minor child of the director or secretary is party,

shall notify the company in writing of:

(I) the occurrence of any of such events;

(II) save where before and after the relevant event the aggregate disclosable interest of the director or secretary, his spouse and minor children before or after such event would be such that Part A5, Head 33 (1) would apply, the number or amount, and class, of shares or debentures involved and the consideration payable.

(4) A director or secretary of a company who is aware of:

(a) his entering a contract to sell shares in or debentures of, the company or of any group company of the company;

(b) his assigning a right granted to him by the company or a group company of the company to subscribe for shares in, or debentures of, the company or such group company; and

(c) any of the transactions in paragraphs (a) or (b) to which the spouse or a minor child of the director or secretary is party;

shall notify the company in writing of:

(i) the occurrence of any of such events;

(ii) save where the aggregate disclosable interest of the director or secretary, his spouse and minor children before such event would be such that Head 33 (4) (f) (i) would apply, the number or amount, and class, of shares or debentures involved and the consideration payable.

(5) This head applies to shadow directors and de facto directors as to directors, but the making of a notification by a person under this head shall not, in itself, be proof that the person making the notification is a shadow director or de facto director.

(6) Nothing in this head shall operate so as to impose an obligation with respect to shares in a body corporate which is the wholly owned subsidiary of another body corporate, and for this purpose a body corporate shall be deemed to be the wholly owned subsidiary of another if it has no members but that other and that other's wholly owned subsidiaries and its or their nominees.

(7) Nothing in this head shall operate to impose an obligation on a director or secretary of a company who is granted an option to subscribe for shares or debentures of that company to make any notification to that company in respect of such grant.

Explanatory note

This head is a new head. It is taken, in substance, from Section 53 of the Companies Act, 1990 insofar as it imposes an obligation on directors and secretaries to notify their interests in shares or debentures of the company held by themselves or by their spouse or minor children. The latter requirement was previously contained in Section 64 of the Companies Act, 1990.

The obligation has also been expressly stated to apply to both de facto directors and shadow directors.

Head 35 Mode of disclosure by directors and secretaries under this Chapter

(1) Where the shares or debentures are acquired or disposed of by the director or secretary, the "requisite particulars" shall, where the director or secretary so chooses, mean—

(a) the instrument of transfer of the shares or debentures, identifying:

(i) the director or secretary by name;

(ii) the shares or debentures in question;

(iii) the purchase or sale price therefor;

(b) delivered to the company within 30 days of the date of the instrument of transfer.

(2) In any case other than those envisaged by Subhead (1) the "requisite particulars" shall mean a statement in writing to the company by or on behalf of the director or secretary:

(a) stating that the director or secretary, or spouse or minor child (as the case may be) has, has acquired or has ceased to have (as the case may be) a disclosable interest in shares or debentures of the company or a group company;

(b) identifying the number of shares or debentures and their class, and the registered holders of the shares or debentures;

(c) in the case of an acquisition or disposal, the consideration payable therefor;

(d) delivered to the company no later than 8 days of the event giving rise to the notification.

(3) The notification required by Part A5, Head 34 (3) and (4) [equivalent of Section 53 of the Companies Act, 1990] must be delivered to the company no later than 8 days after the event giving rise to the notification.

(4) A shadow director or de facto director must, in any notification under this Chapter, identify his address.

Explanatory note

This head is new. The "requisite particulars" have been taken from Section 57(1) of the Companies Act, 1990. They have also been extended in accordance with the Recommendations of the First Report of the Company Law Review Group.

Head 36 Enforcement of the notification obligation

(1) Where a person authorises any other person ("the agent") to acquire or dispose of, on his behalf, interests in, shares in, or debentures of, a company, he shall secure that the agent notifies him immediately of acquisitions or disposals of interests in such shares or debentures effected by the agent which will or may give rise to any obligation on his part to make a notification under this Chapter with respect to his interest in those shares or debentures.

(2) Subject to the succeeding subheads of this head, where a person fails to fulfill, within the proper period, an obligation to which he is subject by virtue of Part A5, Head 34 [equivalent of Section 53 of Companies Act, 1990] no right or interest of any kind whatsoever in respect of the shares or debentures concerned shall be enforceable by him, whether directly or indirectly, by action or legal proceeding.

(3) Where any right or interest is restricted under Subhead (2):

(a) any person in default under that subhead or any other person affected by such restriction may apply to the court for relief against a disability imposed by or arising out of Subhead (2);

(b) the court, on being satisfied that the default was accidental or due to inadvertence or some other sufficient cause or that on other grounds it is just and equitable to grant relief, may grant such relief either generally or as respects any particular right or interest, on such terms and conditions as it sees fit;

(c) where an applicant for relief under this subhead is a person referred to in Subhead (2), the court may not grant such relief if it appears that the default has arisen as a result of any deliberate act or omission on the part of the applicant.

(4) Where—

(a) a person fails to fulfill, within the proper period, an obligation to which he is subject by virtue of Part A5, Head 34 [equivalent of Section 53 of Companies Act, 1990] and;

(b)

(i) the identity of the director or secretary and his holding, acquisition and disposal of the shares or debentures in question and consideration paid or payable therefor has been apparent on the face of the register of members and/ or register of directors and secretaries and / or the register of share and debenture interests of directors and secretaries and /or the documents made available by that company with those registers, from not later than 30 days from when the obligation to notify has arisen; or

(ii) the members by resolution so resolve

then:

(I) all rights and interests of any kind whatsoever in respect of the shares or debentures concerned shall be enforceable by him, whether directly or indirectly, by action or legal proceeding;

(II) upon production of a plain copy of any such special resolution certified by the company secretary for the time being as having been duly passed in compliance with this head, any third party having dealings with the company or the registered holder of the shares or debentures in question shall be entitled to presume without further enquiry that the provisions of this subhead have been complied with and that the registered holder is entitled to deal with the shares or debentures registered in his name,

(III) Subhead (3) shall not apply to an obligation relating to a person ceasing to be interested in shares in, or debentures of, a company.

(5) A person who fails without reasonable excuse to comply with Subhead (1) shall be guilty of a category three offence.

(6) A person who fails to fulfill, within the proper period, an obligation to which he is subject by virtue of Part A5, Head 34 [equivalent of Section 53 of the Companies Act, 1990] shall be guilty of a category three offence.

Explanatory note

This head is new and is taken in substance form Section 58 of the Companies Act, 1990.

Subheads (1) and (2) are re-enactments of Sections 58(1) and (3) of the Companies Act, 1990, respectively.

Subhead (3) is a re-enactment of Sections 58(4) and (5) of the Companies Act, 1990.

Subhead (4) is new. This allows a company's members to cure a breach of the disclosure obligation by passing a resolution or consider there is no breach where the interests are evident from another public register.

Head 37 Register of interests: contents and entries

(1) Every company shall keep a register of directors' and secretaries' interests for the purposes of this Chapter.

(2) Whenever the company receives information from a director or secretary in consequence of the fulfilment of an obligation imposed on him by [that head], the company shall within 3 days of such receipt enter in the register, against the name of that person, that information and the date of the entry.

(3) Every company shall, whenever it grants to a director or secretary a right to subscribe for shares in, or debentures of, the company, enter in the register against his name—

(a) the date on which the right is granted;

(b) the period during which or time at which it is exercisable;

(c) the consideration for the grant (or, if it be the case that there is no consideration, that fact); and

(d) the description of shares or debentures involved and the number or amount thereof, and the price to be paid therefore.

(4) Whenever such a right as is mentioned in Subhead (3) is exercised by a director or secretary, the company shall enter in the register of interests against his name:

(a) that fact (identifying the right);

(b) the number or amount of shares or debentures in respect of which it is exercised; and

(c) if it be the case that they were registered in his name, that fact, and if not, the name or names of the person or persons in whose name or names they were registered, together (if they were registered in the names of two persons or more) with the number or amount thereof registered in the name of each of them.

(5) The register to be kept under Subhead (1) shall be so made up that the entries therein against the several names inscribed therein appear in chronological order.

(6) The nature and extent of an interest recorded in the said register of a director or secretary in any shares or debentures shall, if he so requires, be recorded in the said register.

(7) The company shall not, by virtue of anything done for the purposes of this head, be affected with notice of or put upon inquiry as to, the rights of any person in relation to any shares or debentures.

(8) If default is made in complying with Subheads (1) to (6), the company and every officer in default shall be guilty of a category three offence.

Explanatory note

This head is new. The head is comprised of a re-enactment of various subsections of Sections 59 and 60 of the Companies Act, 1990.

Subheads (1) - (4) are a slightly amended re-enactment of Sections 59(1) – (4) of the Companies Act, 1990.

The 3-day requirement inserted into Subhead (2) has been taken from Section 60(2) of the Companies Act, 1990.

Subhead (5) – (7) are re-enactments of Sections 60(1), (3) and (4) of the Companies Act, 1990.

Head 38 Register of interests: maintenance and inspection

(1) The register provided for in Part A5, Head 37 shall–

(a) if the company's register of members is kept at its registered office, be kept there;

(b) if the company's register of members is not so kept, be kept at the company's registered office or at the place where its register of members is kept,

and shall during business hours (subject to such reasonable restrictions as the company in general meeting may impose so that not less than two hours in each day be allowed for inspection) be open to the inspection of any member of the company without charge and of any other person on payment of 50 cent or such less sum as the company may prescribe for each inspection.

(2) The company shall send notice to the Registrar of the place where the said register is kept and of any change in that place, save in a case in which it has at all times been kept at its registered office.

(3) Unless the said register is in such a form as to constitute in itself an index, the company shall keep an index of the names entered therein which shall—

(a) in respect of each name, contain a sufficient indication to enable the information inscribed against it to be readily found; and

(b) be kept at the same place as the said register,

and the company shall, within 14 days after the date on which a name is entered in the said register, make any necessary alteration in the index.

(4) Any member of the company or other person may require a copy of the said register or of any part thereof, on payment of 20 cent or such less sum as the company may prescribe, for every hundred words or fractional part thereof required to be copied. The company shall cause any copy so required by any person to be sent to that person within the period of 10 days beginning with the day next following that on which the requirement is received by the company.

(5) The said register shall also be and remain open and accessible to any person attending the company's annual general meeting at least one quarter hour before the appointed time for the commencement of the meeting and during the continuance of the meeting.

(6) In the case of a refusal of an inspection, required under this head, of the said register, the court may by order, compel an immediate inspection thereof, and in the case of a failure to send within the proper period a copy required under this head, the court may by order direct that the copy required shall be sent to the person requiring it.

(7) A company may remove an entry against a person's name from the register of interests in shares and debentures kept under Part A5, Head 37 [equivalent of Section 59 of the Companies Act, 1990] if more than 6 years has elapsed since the date of the entry being made, and either—

(a) that entry recorded the fact that the person in question has ceased to have an interest notifiable under this Chapter in shares in or debentures of the company; or

(b) it has been superseded by a later entry made under the said Part A5, Head 37 [equivalent of Section 59 of Companies Act, 1990] against the same person's name;

and in a case within paragraph (a) the company may also remove that person's name from the register.

(8) Where a name is removed from a company's register of interests in shares or debentures in pursuance of Subhead (7), the company shall within 14 days of the date of that removal make any necessary alterations in any associated index.

(9) Entries in a company's register of interests in shares and debentures under this Chapter shall not be deleted except in accordance with Subhead (7) and (8) of this head.

(10) If an entry is deleted from a company's register of interests in shares in contravention of Subhead (1), the company shall restore that entry to the register as soon as is reasonable and practicable.

(11) If default is made in complying with Subheads (3), (4), (5) (8), (9) or (10), the company and every officer of it who is in default shall be guilty of a category 3 offence, and if default is made for 14 days in complying with Subhead (2) the company and every officer in default shall be guilty of a category two offence.

Explanatory note

This head is a new head. The head relates to the maintenance and inspection of the register of interests. The head is a slightly amended re-enactment of various provisions of Section 60, 61 and 62 of the Companies Act, 1990. The cross-references have been amended in light of the new provisions. Fees have also been converted into euro and rounded.