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PRINCIPLES OF MODERN COMPANY LAW

ELEVENTH EDITION

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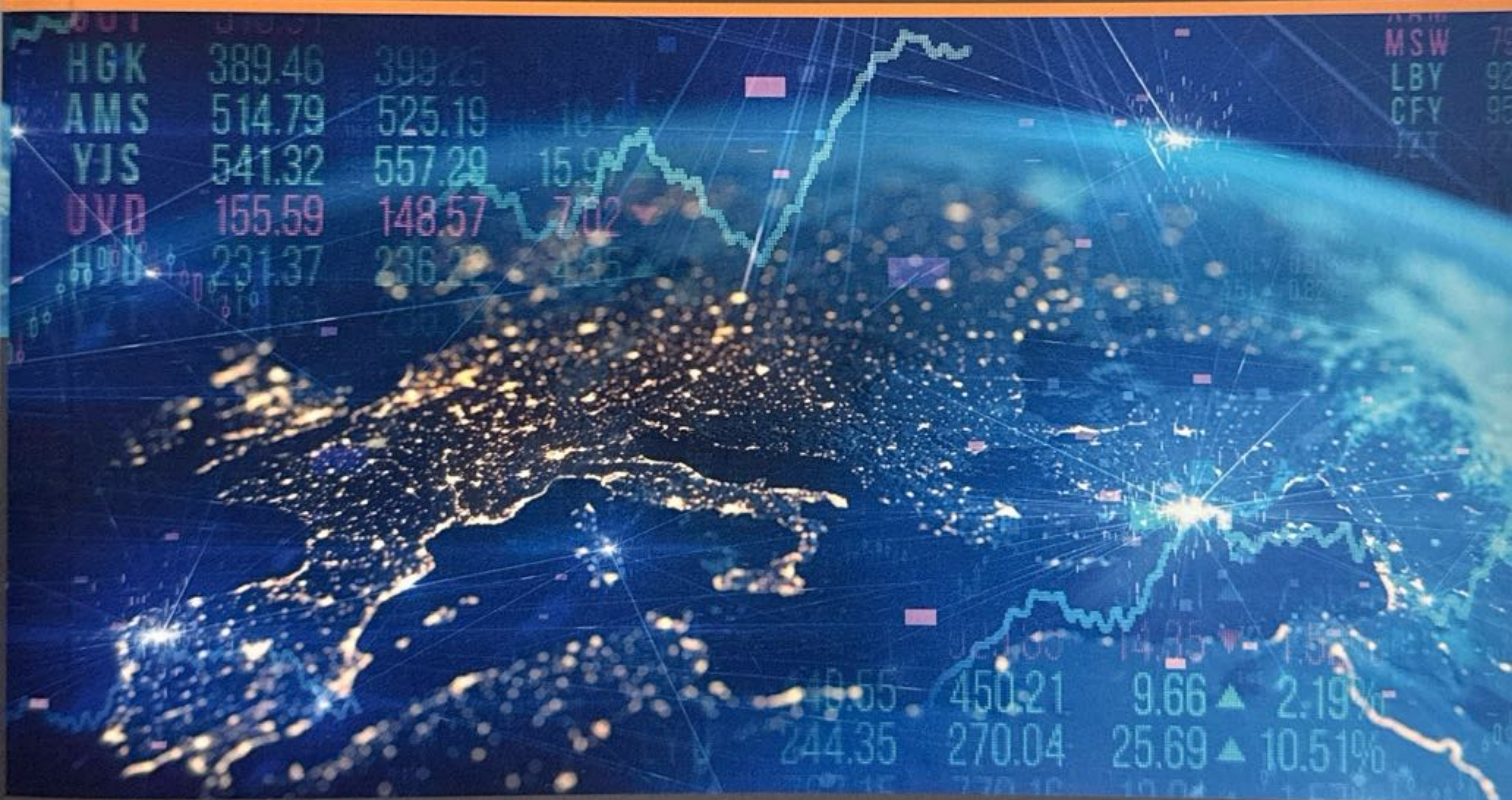

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PIE	Public Interest Entity
RINGA	Relevant Information not Generally Available
RIS	Regulated Information Service
RS	Reporting Standard or Statement
RSB	Recognised Statutory Body
SBEEA 2015	Small Business, Enterprise and Employment Act 2015
SCE	European Cooperative Society
SE	Societas Europaea or European Company
SME	Small or Medium-sized Enterprise
SNB	Special Negotiating Body (of employee representatives)
SO	Supervisory Organ (of an SE)
SPV	Special Purpose Vehicle
SR	Strategic Report
SS	Secretary of State
SSAP	Statement of Standard Accounting Practice
TD	Transparency Directive (Directive 2004/109)
UCITS	Undertakings for Collective Investment in Transferable Securities
UCTA	Unfair Contract Terms Act
USR	Uncertificated Securities Regulations
UKLA	United Kingdom Listing Authority

Documents from the Company Law Review and the Government Response to it

Completing	CLR, *Completing the Structure* (November 2000), URN 00/1335
Developing	CLR, *Developing the Framework* (March 2000), URN 00/656
Final Report	CLR, *Final Report*, 2 vols (July 2001), URN 01/943
Formation	CLR, *Company Formation and Capital Maintenance* (October 1999), URN 99/1145
Maintenance	CLR, *Capital Maintenance: Other Issues* (June 2000), URN 00/880
Modernising	*Modernising Company Law*, 2 vols (July 2002), Cm.5553
Overseas Companies	CLR, *Reforming the Law Concerning Oversea Companies* (October 1999), URN 99/1146
Strategic	CLR, *The Strategic Framework* (February 1999), URN 99/654

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of these factors? The answers to these questions seem inextricably linked to the "improper purposes" issues discussed earlier (s.171(b)); the older common law rule similarly juxtaposed the two requirements.[144]

On the first question, a proper reading of the section does suggest that a failure by directors to have regard to each item on the list of factors would constitute a breach of duty and render the directors' decision challengeable. This principle was already established at common law, although perhaps in a more limited form: although much was left to the directors' discretion (as described below) in determining what was in the interests of the company, the directors might breach that duty where they failed to direct their minds at all to the question of whether a transaction was in the interests of the company, even though a board which had considered the question might well have acted in the same way. A good illustration of the principle is afforded by *Re W&M Roith Ltd*.[145] There the controlling shareholder and director wished to make provision for his widow. On advice, he entered into a service agreement with the company whereby on his death she was to be entitled to a pension for life. On being satisfied that no thought had been given to the question whether the arrangement was for the benefit of the company and that, indeed, the sole object was to make provision for the widow, the court held that the transaction was not binding on the company.[146]

In this case it might be said that the straightforward financial success of the company was clearly compromised by the decision, since the widow was unlikely to provide the company with any corresponding corporate benefit. In such circumstances, the directors needed to be able to demonstrate that their decision was based on due consideration of the corporate benefit, and this they could not do.[147] However, had they been able to do that, the court would have been unlikely to second-guess their conclusions even if the court itself might not have reached the same decision.

10–031 But this strict approach might be thought impractical. By contrast, in *Charterbridge Corp v Lloyds Bank*,[148] the directors of a company forming part of a corporate group had considered the benefit of the group as a whole, but without giving separate consideration to that of the company alone, when they caused the subsidiary company of which they were directors to give security for a debt owed by the parent company to a bank. It was held, perhaps surprisingly given the accepted common law formulation of the requirement on directors, that "the proper test in the absence of actual separate consideration must be whether an intelligent and honest man in the position of a director of the company concerned could have reasonably believed that the transactions were for the benefit of the company". Here the collapse of the parent company would have been "a disaster"

[144] *Re Smith and Fawcett Ltd* [1942] Ch. 304 at 306 (Lord Greene MR).
[145] *Re W&M Roith Ltd* [1967] 1 W.L.R. 432 Ch D.
[146] Following *Re Lee, Behrens & Co Ltd* [1932] 2 Ch. 46 Ch D; but cf. *Lindgren v L&P Estates Ltd* [1968] Ch. 572 CA, where it was held that there had been no failure on the part of the directors to consider the commercial merits.
[147] Similarly, see *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] A.C. 324 HL.
[148] *Charterbridge Corp v Lloyds Bank* [1970] Ch. 62 Ch D. A similar approach has been adopted in the area of unfair prejudice. See *Nicholas v Soundcraft Electronics Ltd* [1993] 1 B.C.L.C. 360 CA.

for the subsidiary.[149] The decision perhaps suggests that although directors must act in ways *they* consider would be most likely to promote the interests (or the success) of the company, it is also true that where, objectively, on balance, their decision can be seen to do that, it will not be overturned; the directors will not be held to be in breach of their duty at common law to act in the interests of the company (or, under the statute, their duty to promote the success of the company) merely because they did not give explicit thought to the question, at least in the absence of proven detriment.[150]

On the other hand, and despite the *Charterbridge* decision, it must be said that the core duty of good faith does not recognise a duty "to the group" or to other companies in the group. It insists that the main focus of directors must be on the interests of their subsidiary, even if it accepts that the interests of the subsidiary are in many cases intimately related to the continuing existence of the group.[151] Directors in corporate groups must guard against their inevitable inclination to promote the interests of the group as a whole (or some part of it).

10–032 These cases all concern the common law duty. Their analysis is in principle equally applicable to breaches of the statutory provisions, and indeed finding a breach of the core statutory duty of good faith on the ground that not all the required interests have been taken into account is perhaps more likely under the ESV approach because the statute is so much clearer about the precise range of matters to which directors must have regard in the discharge of their duty to promote the success of the company for the benefit of its members. To that extent, the retreat from the strict approach in *Re W & M Roith Ltd*[152] is welcome. Moreover, since the statutory list of factors is non-exhaustive, it would follow that a director would be in breach of duty in failing to take account of any matter which he or she considered relevant to the decision in question. However, in truth the statutory formulation largely makes explicit what was already implicit in the earlier common law, so it does not require boards to approach decision-making, or to document their decisions, in a totally novel fashion. Of course, to the extent that boards might previously have ignored potential adverse impacts on

[149] cf. *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 B.C.L.C. 598, accepting the law as stated in the *Charterbridge* case, but coming to a different conclusion on the facts because (a) the directors of the subsidiary never considered whether the survival of the parent was crucial to the subsidiary; and (b) no reasonable director would have concluded that the steps taken by the directors would lead to the survival of the parent.
[150] *Re HLC Environmental Projects Ltd (In Liquidation)* [2014] B.C.C. 337 at [92]–[93] (John Randall QC); *Green v El Tai* [2015] B.P.I.R. 24 Ch D at [110] (Registrar Jones); *Madoff Securities International Ltd v Raven* [2013] EWHC 3147 (Comm) at [194].
[151] See also *Lindgren v L & P Estates Co Ltd* [1968] Ch. 572 at 595, per Harman LJ (no duty owed by director of holding company to subsidiary); and *Bell v Lever* [1932] A.C. 161 at 229, per Lord Atkin (no duty owed by director of subsidiary to the parent company). The statutory qualification to the definition of a "shadow director" in s.251(3) (para.10–011), excluding a company in relation to its subsidiaries, supports this approach. The cases do not distinguish between wholly-owned subsidiaries and those with outside minority shareholders. Only in the latter case does the imposition of a group policy potentially have an adverse effect on the interests of the shareholders, for which the unfair prejudice provisions may now provide a remedy (see Ch.14). It should also be noted that it is apparently legitimate for the company's articles to permit or require the directors to take into account the interests of other companies in the group, because in that way it could be said that the articles have defined what is to be regarded as "success" for the company in question.
[152] *Re W & M Roith Ltd* [1967] 1 W.L.R. 432.

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shareholders' interests by failing to analyse the impact of a proposed decision on non-shareholders, the section is likely to have produced a change of practice.

On the second question, of whether the directors have not simply taken account of the listed factors but have taken *appropriate* account of them, the earlier common law cases suggest that the courts will generally resist any request to second-guess the directors' judgement of how best to act in the interests of the company.[153] The only exception is perhaps when, in the court's view, no reasonable director could have considered the chosen course of action to be in the company's interests (by analogy with the public law "*Wednesbury* unreasonableness" test). Such facts as raise this concern are often seen to go to the question of whether the court believes that the director did in fact consider the relevant matters at all (and so is part of the analysis of the first question just considered), but to the extent that the court's determination is not simply evidential, but judgemental, the resulting judicial oversight of directors' management decisions has remained very restrained, and in any event is limited to overturning the impugned decision, not substituting the courts' decision (except to the extent that this is implicit in the courts' unravelling of what has been done). Indeed, it is notable that the architect of the public law *Wednesbury* principle, Lord Greene MR, was also the judge who in *Re Smith & Fawcett* (quoted earlier) was concerned to stress the freedom of directors from control by the courts in the exercise of their good faith judgement, while also adding a "proper purposes" limitation analogous to the public law principle and to the statutory principle now found in s.171(b).

The most authoritative statement of this approach to judicial review is that of Lord Woolf in *Equitable Life Assurance Society v Hyman*,[154] although his approach was not part of the arguments of the other two judges in that case (or in the House of Lords on appeal). The complaint in this case was between groups of corporate creditors each complaining about the effect of the directors' decision; in other cases where the *Wednesbury* principle has been invoked, the disputes have typically been among members of the company about their rights and interests as shareholders rather than disagreements about the setting of the company's business strategy.[155] It might be thought, therefore, that the inclusion in subs.(1)(f) of "the need to act fairly as between the members of the company" as one of the factors of which the directors need to have regard could turn out to be significant, although the shareholders typically have more amenable avenues for complaint than reliance on a duty the directors owe to the company.

On the other hand, it might be better, analytically, to see this type of objective judicial review, where relevant, as situated entirely under s.171(b), with s.172 merely providing an explicit list of proper considerations required to be taken

153 See para.10-029; and *Edge v Pensions Ombudsman* [2000] Ch. 602 CA at 627E–630G; *Equitable Life Assurance Society v Hyman* [2002] 1 A.C. 408 at [17]–[21].

154 *Equitable Life Assurance Society v Hyman* [2000] 2 All E.R. 331 CA (Civ Div) at [17]–[21] (per Lord Woolf). In the House of Lords ([2002] 1 A.C. 408) Lord Steyn dealt with the case as a matter of an implied term in a contract, whilst Lord Cooke, dealing with it as a matter of the exercise of a discretion for a proper purpose, did not cite the *Wednesbury* principle but confined himself to mention of the *Howard Smith v Ampol* case (see fn.71). See also *Hunter v Senate Support Services Ltd* [2005] 1 B.C.L.C. 175 at [165]–[232].

155 See the previous note and the cases referred to therein. However, it should also be noted that *Re Smith & Fawcett Ltd* was itself an intra-member dispute.

into account in directors' decision-making. Such an approach would effectively align s.171(b) "improper purposes" with the mandatory considerations listed in s.172, but would remind complainants of the inherent limitations in the claim being advanced. And, in a different direction, to the extent that unfair treatment of minorities by controlling persons is the chief mischief to be dealt with, a remedy can often be provided under the unfair prejudice provisions discussed in Ch.14.

A duty to disclose wrongdoing

10-033 This has become an increasingly troubling area of directors' duties. In what is still a controversial decision, the Court of Appeal in *Item Software (UK) Ltd v Fassihi*[156] held that a director was under a duty to disclose his own breaches of fiduciary duty. This obligation was recognised as novel, but seen as derived from, i.e. being an aspect of, the core duty of good faith and loyalty, not a "separate and independent" self-standing duty.[157] Quite what this means is not clear, since in *Item Software* itself the finding of a distinct duty to disclose was seen as essential to delivering the remedy awarded. The director had pursued a corporate opportunity (the relevant breach of duty is discussed below) by setting up a competing business and attempting to persuade a client of the company to engage with his new business rather than renew its existing contract with the company. The director had also suggested that the company should take a tough stance in negotiations with the client, hoping, it seems, to further encourage the client in his direction. In the end, however, the client renewed the contract with neither the company nor the director's new business. This meant that the company could not sue its director for an account of the profits he had made from stealing the client for his own business, as he had made none. Moreover, the trial judge had found as a fact that the director's endeavours to encourage a tough negotiating stance had made no difference to the company's approach to the client. It followed that the company could not sue the director for the loss caused by his failure to act in good faith for the benefit of the company, at least in respect of this intervention, since that breach had caused no loss. In short, the facts appeared to suggest that there could be no account of profits and no compensation for loss, and yet the director had clearly behaved in an underhand way in breach of his duties of loyalty. In the face of this seemingly unacceptable result, the trial judge also found, as a fact, that, had the company known of the director's activities, it would have modified its negotiating tactics and accepted the client's best offer to renew, the one which it had in fact rejected as too low. Thus, it was said, *if*—but only if—it could be shown that the director had a *duty* to disclose this information about his wrongdoing to the company, then the director would have committed a breach of that duty and the company would have a remedy, the remedy being

156 *Item Software (UK) Ltd v Fassihi* [2004] B.C.C. 994. Also see *GHLM Trading Ltd v Maroo* [2012] EWHC 61 (Ch); *IT Human Resources Plc v Land* [2014] EWHC 3812 (Ch).

157 *Item Software (UK) Ltd v Fassihi* [2004] B.C.C. 994 at [40]–[41] and [44]. Also see *Stupples v Stupples & Co (High Sycombe) Ltd* [2012] EWHC 1226 (Ch) at [59] (HHJ David Cooke); *First Subsea Ltd v Balltec Ltd* [2014] EWHC 866 (Ch) at [191]: Norris J emphasised that the duty to "self-report" is "not a discrete and free-standing duty. It is one aspect of a bundle of interrelated obligations which together constitute 'good faith' and 'loyalty'." Contrast *Shepherds Investments Ltd v Walters* [2006] EWHC 836 (Ch) at [132] (Etherton J).

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recovery of the loss it had suffered because it failed to obtain the benefit of the (admittedly less attractive) contract with the client.

Such a duty to disclose the director's wrongdoing was novel,[158] and indeed there were authorities against such a duty in the context of employees.[159] Whether this was the only route to a remedy is doubted, especially when establishing the requisite novel duty was far from straightforward.[160] Moreover, holding that there is such a duty has consequences that are potentially unattractive.[161] Consider, for example, a director who fails to disclose a wrongdoing for which he might have been dismissed by his company: should the company automatically be able to recover the salary paid in the intervening period? The accepted answer is no[162]: if losses are to be recovered, they must be for proven failings in the period before dismissal.[163]

More importantly, the duty would seem to be surplus to needs. The court should have been able to rely simply on the fact that the core duty of good faith and loyalty requires a director to protect the company from harm, bringing to the attention of the company threats to its business of which the director becomes aware.[164] The twist in this case was that the duty was imposed even though the threat arose out of the director's own wrongdoing, but it would be odd if the director's wrongdoing could relieve him or her from a course of action which

[158] *Item Software (UK) Ltd v Fassihi* [2004] B.C.C. 994 at [44].

[159] *Bell v Lever* [1932] A.C. 161, a case which has caused endless difficulties. It is perhaps best seen as a case which (i) confirms that when a company is negotiating a contract (or varying or terminating that contract) with its employee, or indeed with a director, then the employee or director owes no duty to the company to disclose its own wrongdoing: the parties are clearly in an adversarial position, each acting in their own self-interests, and it cannot be said that the company in that context is relying, or entitled to rely, on the employee or director owing the company any duty to look after the company's interests or to assist the company in looking after its own interests; (ii) advances the more questionable and quite general proposition that an employee's duty to act in good faith and in the interests of his employer does not require the employee to disclose his own misconduct when it was committed; and (iii) confirms that a company that has negotiated an agreement with its employee (or, on the same basis, a director) may be able to set that agreement aside on the grounds of mistake, although the general law makes plain that the nature of the mistake is crucial.

[160] As set out in *Item Software (UK) Ltd v Fassihi* [2004] B.C.C. 994, it seemed to require a series of steps that linked two separate directors' duties, directed at different ends, and out of one of them (the conflicts duty) derived a duty to disclose wrongdoing (see [39], even though the function of disclosure had before only been seen as the means whereby the director sought to whitewash/seek approval to pursue the conflict), adding that this duty to disclose assisted in delivering accounting remedies in the conflicts/account of profits context (see [66]), and then simply asserting that this same duty must obviously be seen as an inherent aspect of the good faith duty, and could be used in that different context to deliver compensation for loss (see [40]–[41])—and so was of assistance on the facts in the instant case.

[161] See the extended discussions in *Bell v Lever* [1932] A.C. 161; *Balston Ltd v Headline Filters Ltd* [1990] F.S.R. 385 Ch D; *British Midland Tool Ltd v Midland International Tooling Ltd* [2003] EWHC 466 (Ch), all resisting the conclusion that someone might owe a specific duty to disclose their own wrongdoing.

[162] See *Bell v Lever* [1932] AC 161 at 228, 230–31; cited in *Balston Ltd v Headline Filters Ltd* [1990] F.S.R. 385 at 408; *Item Software (UK) Ltd v Fassihi* [2004] B.C.C. 994 at [51].

[163] See, e.g. *HPOR Servicos de Concultoria Ltda v Dryships Inc* [2018] EWHC 3451 (Comm); *Ali Education Plc v Atkins* [2016] EWHC 1663 (Ch).

[164] *British Midland Tool Ltd v Midland International Tooling Ltd* [2003] EWHC 466 (Ch).

would otherwise need to be taken.[165] Liability thus arises straightforwardly from the failure to act in good faith to protect the company[166]: there was no need for a super-added duty to disclose.[167]

10-034 The harder question, then, is whether there are any circumstances where a director would *not* be liable for his failure to disclose that his own activity posed risks of harm to the company. The decision of the House of Lords in *Bell v Lever Brothers Ltd*[168] (although a case concerning employees) suggests an example. The court in *Item Software v Fassihi* was content with the outcome in that case, even as it might apply to directors, but confined the conclusion to situations where directors were negotiating an improvement in the terms of their employment or compensation for the termination of their services with the company, on the grounds that disclosure in such a case would be contrary to the expectations of the parties.[169] More importantly, it would be contrary to the entitlements of the parties. In those circumstances the parties are clearly in an adversarial position, each acting in their own self-interests, and it cannot be said that the company in that context is relying, or is entitled to rely, on the director owing the company any duty to look after the company's interests or to assist the company in looking after its own interests. Because there is no duty to protect the company, there is no liability for failing to protect. But outside that context, directors owe a duty to act in good faith for the benefit of the company—there is a duty to protect—and liability for failing to do so.

In *Item Software v Fassihi* this novel duty to disclose was used to justify a finding that the company was entitled to compensation for the loss caused by its director's failure to disclose his own wrongdoing (or, as seems preferable, his failure to act in good faith to protect the company), where, had he done so, the negotiating outcome would have been better for the company. Can the same duty to disclose be employed to advantage when the company seeks an account of the profits made by the director from his wrongdoing, not compensation for loss suffered by the company? In another difficult decision, *Parr v Keystone Healthcare Ltd*,[170] the Court of Appeal suggests this is possible, welding together the good faith duty (with, according to *Item Software*, its associated duty to disclose) with the different duty not to engage in activities which involve a

[165] See *Shepherds Investments Ltd v Walters* [2006] EWHC 836 (Ch) at [132] (Etherton J) for the preferable approach. The possibility that the duty to act in good faith for the benefit of the company might, in some circumstances (but not as a general rule), require the directors to disclose the wrongdoing of others, or suffer the resulting liability for failing to do so, has long been settled: see *British Midland Tool Ltd v. Midland International Tooling Ltd* [2003] EWHC 466 (Ch), especially at [86] and also [89].

[166] As effectively conceded in *Item Software (UK) Ltd v Fassihi* [2004] B.C.C. 994 at [44].

[167] See the pithy comment of Lord Aitken in *Bell v Lever* [1932] A.C. 161 at 228: "The servant owes a duty not to steal, but, having stolen, is there superadded a duty to confess that he has stolen? I am satisfied that to imply such a duty would be a departure from the well established usage of mankind and would be to create obligations entirely outside the normal contemplation of the parties concerned."

[168] *Bell v Lever* [1932] A.C. 161. See fn.159.

[169] *Item Software (UK) Ltd v Fassihi* [2004] B.C.C. 994 at [51]–[58].

[170] *Parr v Keystone Healthcare Ltd* [2019] EWCA Civ 1246. See the discussion at para.10-109 especially.

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conflict of duty and interest. We look at this case later, but the potential developments surrounding the "duty to disclose" should be noted in the present discussion.

The problem of "short-termism"

10–035 The common law focus on shareholders led to a widespread but, it is submitted, erroneous view that the law required directors acting in the interests of shareholders to prioritise their short-term interests. The better view, it is suggested, is that the directors were not bound to any particular timeframe; on the contrary, they must take into account both the long- and the short-term interests of the shareholders and strike a balance between them.[171] The CLR proposed in its draft statement of directors' duties to specify an obligation on the directors to take into account "the likely consequences (short and long term) of the actions open to the director".[172] As we have seen, s.172 refers merely to "the likely consequences of any decision in the long term". If anything, the omission of reference to short-term interests in the non-exhaustive list emphasises the importance of long-term consequences. That bias is repeated in the UK Corporate Governance Code.[173]

Corporate groups

10–036 We have already considered the potential problem faced by directors within corporate groups, where their instinct may be to look to the overall success of the group, whereas their duty of good faith and loyalty is owed only to their appointing company.[174]

Employees

10–037 Among the factors to which a director of a company must have regard under s.172(1) are "the interests of the company's employees". This is as one would expect: any comprehensive list of stakeholder interests will necessarily include the employees. But the practical impact of this on employees is limited. Indeed, it was said of the predecessor provision[175] that its real impact was to dilute directors' accountability to shareholders rather than strengthen accountability to employees. This is because employees cannot use the section offensively, whilst

[171] See Counsel's Opinion quoted in the Report by Mr Milner Holland of an investigation under s.165(b) of the CA 1948 into the affairs of the Savoy Hotel Ltd and the Berkeley Hotel Company Ltd, Board of Trade, 1954. This somewhat obscure source has long been regarded as the *locus classicus* on this point. See also *Gaiman v National Association for Mental Health* [1971] Ch. at 330: "both present and future members".

[172] CLR, Final Report I, p.345 (Principle 2, Note (1)).

[173] CGC, Provision 1. See too BIS, *A Long-Term Focus for Corporate Britain: A Call for Evidence* (2010). Responses were published, but then nothing more was done: see *https://www.gov.uk/government/consultations/a-long-term-focus-for-corporate-britain-a-call-for-evidence* [Accessed 8 December 2020].

[174] See para.10–036.

[175] CA 1985 s.309, although expressed in different terms to s.172(1)(b).

directors can use it defensively when sued by shareholders, by arguing that a decision apparently unfavourable to the shareholders is unchallengeable because it was taken in the interests of the employees.[176] Writ large, this illustrates the argument against the pluralist approach to this core duty of good faith. So long as the duty is perceived subjectively, increasing the number of equal-status groups whose interests the directors must promote makes proof of breach difficult, almost to the point of impossibility. Correcting that defect by making the duty objective, however, paves the way for excessive judicial intervention in the taking of board-level decisions, thus inducing caution on the part of those who ought to be risk-takers. The best view is probably that any broadly-formulated pluralist provision could not by itself operate so as to alter the decision-making processes of a board unless coupled with further changes in company law, such as board-level representation for the relevant stakeholder groups.

There is, however, one particular and limited derogation from the core duty which is made in favour of employees. This is to be found in s.247, involving the power to make gratuitous payments to employees on the cessation of the company's business.

Creditors

10–038 There is one surprising omission from the statutory list of matters to which the directors must have regard, namely, the interests of the creditors, except to the extent it is embraced by subs.172(1)(c). Of course, so long as the company's business is flourishing, the creditors' position is not prejudiced by such an omission. Their contractual rights against the company plus the company's desire to preserve its reputation and thus access to future credit will act so as to protect the creditors. However, once the company's fortunes begin to decline, conflict between the interests of the shareholders and the creditors may emerge in a strong form; the directors have an incentive to take excessive risks to protect their own and the shareholders' position, knowing that, if the company is in the vicinity of insolvency, the downside risk will fall wholly on the creditors, whilst the upside benefit will get the company out of trouble. We will see in Ch.19 how this problem is dealt with, both by statutory insolvency laws operating in the lead up to insolvency, and by common law rules operating still earlier.[177] All these rules are embraced by the simple strategy of providing, expressly, in s.172(3), that the duty imposed under that 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".

[176] cf. *Re Saul D. Harrison & Sons Plc* [1995] 1 B.C.L.C. 14 CA at 25, where resort was had to the CA 1985 s.309 to undermine the shareholder petitioning under s.459 against the board/majority shareholders of the company.

[177] See especially the discussion at para.19–013. Also see A. Keay, "Financially distressed companies, preferential payments and the director's duty to take account of creditors' interests" (2020) 136 L.Q.R. 52.

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Donations

10–039 In the abstract, a decision on the part of the directors to give the company's assets away would appear to be a *clear* example of a decision not taken in good faith to promote the success of the company for the benefit of its members. On the other hand, companies are always being approached to support various causes, and do in fact make donations of various sorts. Company law has sought to distinguish between donations which promote the company's business (legitimate) and those which do not (illegitimate). Traditionally, that distinction was drawn by the law relating to ultra vires, but now the focus is on directors' powers: in the absence of an express provision in the articles or elsewhere conferring upon directors the authority to make donations, is there an implied power to do so in order to further the company's business?[178] And if there is such a power, has it been exercised appropriately?[179] This second question has various strands. Thus, in *Re Lee, Behrens and Co Ltd*,[180] where the company's constitution conferred an express power on the directors to make the gift in question, Eve J identified the relevant tests as follows: "(i.) Is the transaction reasonably incidental to the carrying on of the company's business? (ii.) Is it a bona fide transaction? and (iii.) Is it done for the benefit and to promote the prosperity of the company?".

In practice, the courts have tended not to examine very closely the link between the donation and the company's business when it seemed to them that the donation was in the public interest, so that a substantial donation by a large chemical company to promote scientific tertiary education was upheld even though the gift might not be used to promote the study of chemistry in particular and the company had no greater claim on the graduating students than any of its rivals.[181] It seems unlikely that this approach will change in the future, in the light of pressures on companies to be "good citizens" in their communities and of the recognition that companies may secure "reputational" advantages from supporting activities which seem remote from their businesses, for example, a bank sponsoring an opera production (presumably thus enhancing its reputation among wealthy potential customers).[182] By contrast, donations which shift assets away from shareholders in the direction of other stakeholders in the company have traditionally been treated with suspicion, but that attitude may also be undergoing a change and, in any event, it is normally possible to present such apparent gifts as part of an exchange where the company is a going concern.[183]

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[178] The courts are likely to give a positive answer to this question.

[179] Thus, in *Evans v Brunner, Mond & Co Ltd* [1921] 1 Ch. 359 Ch D, where the question was whether a shareholders' resolution expressly conferring power on the directors to make a certain class of donation was ultra vires, Eve J said obiter of the authority conferred by the resolution that it "is certainly impressed with this implied obligation on those to whom it is given, that they shall exercise the discretion vested in them bona fide in the interests of the company whose agents they are".

[180] *Re Lee, Behrens and Co Ltd* [1932] 2 Ch. 46. Also see *MSL Group Holdings Ltd v Clearwell International Ltd* [2012] EWHC 3707 (QB) (Sir Raymond Jack) at [41]–[42], [45].

[181] *Evans v Brunner, Mond & Co Ltd* [1921] 1 Ch. 359.

[182] The donation can then be presented as a contract: a payment in exchange for exposure of the company's name before a valued target audience, in fact a form of advertising, although this will have tax consequences for both sides.

[183] Thus, in *Parke v Daily News Ltd* [1962] Ch. 927 Ch D the payments to the employees failed because it could not be argued that a company about to enter liquidation any longer had a

The upshot of the law in this area is that directors probably have some leeway to steer donations or other similar arrangements (such as sponsorship) in the direction of their favourite charities or pastimes, without serious threat of legal challenge, provided such donations are not of excessive size and provided there is some link with the company's business.

However, in one area, that of corporate political donations, such leeway is arguably constitutionally objectionable. Consequently, in that area, as we shall see, the law has required shareholder approval of donations since reforms made in 2000.[184]

DUTY TO EXERCISE INDEPENDENT JUDGMENT: S.173

10–040 At common law, this issue is typically described as a duty not to fetter the exercise of discretion. In s.173, this is put in positive terms, as a duty to exercise independent judgment. At the level of principle the requirement is uncontroversial. However, there are five points relating to the practical working of this principle which need to be considered.

Taking advice and delegating authority

10–041 First, and perhaps most obviously, the principle does not prevent directors seeking and acting on advice from others. Indeed, the board might well infringe its duty to take reasonable care if it proceeded to a decision without appropriate advice from outsiders (investment bankers, lawyers, valuers). What the board cannot do is treat the advice as an instruction, although in complex technical areas the advice may leave the board with little freedom for manoeuvre, for example, where lawyers advise that the board's preferred course of action would be unlawful. The individual directors on the board must regard themselves as taking responsibility for the decision reached,[185] probing the issues for themselves after taking appropriate advice.[186]

Secondly, just as the duty of care does not prevent a board from delegating its functions to non-board employees (provided it has in place appropriate internal controls—see above), so the duty to exercise independent judgment does not prohibit such delegation.[187] However, it seems that s.173 was not intended to

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(shareholder) interest in fostering good relations with its employees. The specific decision in that case was reversed, within limits, by what is now s.247, which confers a power on the company, if it would otherwise not have it, to make provisions for the benefit of employees on the cessation or transfer of its business, which power is exercisable "notwithstanding the general duty imposed by s.172 (duty to promote the success of the company)".

[184] See para.10–100. Also see para.15–021.

[185] *Dickinson v NAL Realisations (Staffordshire) Ltd* [2017] EWHC 28 (Ch) at [158]–[159] (wife (who was a director) and second director could not simply leave decisions to the third director—in the absence of a proper delegation and the implementation of appropriate monitoring, the third director's views could not simply be adopted as the final decision); *Madoff Securities International Ltd v Raven* [2013] EWHC 3147 (Comm) at [191]–[192] (Popplewell J).

[186] *Raithatha v Baig* [2017] EWHC 2059 (Ch) at [36].

[187] See *Madoff Securities International Ltd v Raven* [2013] EWHC 3147 (Comm) at [191] (Popplewell J).

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overrule the common law rule that *delegatus non potest delegare*, i.e. that a person to whom powers are delegated (as powers are to directors under the articles) cannot further delegate the exercise of those powers, *unless* the instrument of delegation itself authorises further delegation.[188] In practice, wide powers of further delegation are conferred on the directors by the articles, and it is indeed difficult to see how the board of a large company could otherwise effectively exercise its powers of management of the company. However, this rule means that the articles may effectively prevent further delegation beyond the board by simply not providing for this.

Exercise of future discretion

10–042 Thirdly, it was debated at common law whether the non-fettering rule prevented a director from contracting with a third party as to the future exercise of his or her discretion. The answer ultimately arrived at was that this was permissible in appropriate cases. The starting point at common law, despite the paucity of reported cases on the point,[189] seems to be that directors cannot validly contract (either with one another or with third parties) as to how they shall vote at future board meetings or otherwise conduct themselves in the future.[190] This is so even though there is no improper motive or purpose and no personal advantage reaped by the directors under the agreement. This, however, does not mean that if, in the bona fide exercise of their discretion, the directors have entered into a contract on behalf of the company, they cannot in that contract validly agree to take such further action at board meetings or otherwise as is necessary to carry out that contract. As was said in a judgment of the Australian High Court[191]:

> "There are many kinds of transaction in which the proper time for the exercise of the directors' discretion is the time of the negotiation of a contract and not the time at which the contract is to be performed ... If at the former time they are bona fide of opinion that it is in the best interests of the company that the transaction should be entered into and carried into effect, I can see no reason in law why they should not bind themselves to do whatever under the transaction is to be done by the board."

[188] *Re Cartmells' Case* (1873–74) L.R. 9 Ch. App. 691 CA of Chancery.

[189] But see *Clark v Workman* [1920] 1 Ir.R. 107; and an unreported decision of Morton J in the *Arderne Cinema* litigation (see paras 13–011 onwards); and the Scottish decision in *Dawson International Plc v Coats Paton Plc*, 1989 S.L.T. 655 (1st Div.) where it was accepted that an agreement by the directors would be subject to an implied term that it did not derogate from their duty to give advice to the shareholders which reflected the situation at the time the advice was given.

[190] Contrast the position of shareholders who may freely enter into such voting agreements: paras 13–029 to 13–032. What if the directors and the members enter into an agreement which fetters the directors' discretion? This was discussed, but not clearly settled, by the Canadian Supreme Court in *Ringuet v Bergeron* [1960] S.C.R. 672, where the majority held the voting agreement valid because, in their view, it related only to voting at general meetings. The minority held that it extended also to directors' meetings and was void, but they conceded that the position might have been different had all the members originally been parties to the agreement: see ibid., at 677. But cf. *Fulham Football Club Ltd v Cabra Estates Plc* [1994] 1 B.C.L.C. 363 CA at 393.

[191] *Thorby v Goldberg* (1964) 112 C.L.R. 597 Aust. HC, per Kitto J at 601–606.

The principle in *Thorby v Goldberg* was applied by the English Court of Appeal in *Cabra Estates Plc v Fulham Football Club*,[192] so as to uphold an elaborate contract which the directors had entered into on behalf of the company for the redevelopment of the football ground and under which, inter alia, the club was entitled to some £11 million and the directors agreed to support any planning application the developers might make during the coming seven years. This is surely correct: if individuals may contract as to their future behaviour in these matters, it is desirable that companies should be able to do so too. The application of the "no fettering" rule would make companies unreliable contracting parties and perhaps deprive them of the opportunity to enter into long-term contracts which would be to their commercial benefit.

Section 173(2)(a) now provides that the duty to exercise independent judgment is not infringed by a director acting "in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors", including presumably the rider that the agreement must be one entered into by the directors in the bona fide opinion that it is in the best interests of the company to do so (i.e. "duly" entered into). Section 173(2)(b) goes on to state that no breach of the independent judgment rule arises if the director acts "in a way authorised by the company's constitution". Thus, the articles may authorise restrictions on the exercise of independent judgment, which might be a useful facility in private companies.

However, s.173(2)(a) protects the directors only from the argument that they have failed to exercise independent judgment by entering into the agreement which restricts their future freedom of action. Can the subsequent exercise of their powers as the contract demands be said to be a breach of their core duty of loyalty, if at that time they no longer believe it to be in accordance with their core duty to act in accordance with the contract? There are a number of cases in which, where shareholder consent has been required for a disposal of assets or for a takeover, the courts have been reluctant to construe agreements on the part of the directors not to co-operate with rival suitors or to recommend a rival offer to the shareholders as binding the directors, if they come to the view that the later offer is preferable from the shareholders' point of view.[193] This line of cases might be justified on the basis that shareholders are peculiarly dependent upon the advice of their directors and that they might find themselves in a poor position to take the decision which had been put in their hands, if they were given advice by the directors which did not reflect the situation as the directors saw it at the time it fell to the shareholders to take their decision. The continuing validity of the no fettering rule in this context could be reconciled with the provisions of s.173 on the basis that that section deals only with the fiduciary duties owed by the director to the company (see s.170(1)), whereas the situation just mentioned

[192] *Cabra Estates Plc v Fulham Football Club* [1994] 1 B.C.L.C. 363; noted by Griffiths, [1993] J.B.L. 576.

[193] *John Crowther Group Plc v Carpets International* [1990] B.C.L.C. 460; *Rackham v Peek Foods Ltd* [1990] B.C.L.C. 895; *Dawson International Plc v Coats Paton Plc*, 1989 S.L.T. 655. The correctness of these decisions was left open by the Court of Appeal in *Cabra Estates*. Even here it must be accepted that the shareholders may in consequence lose a commercial opportunity which would otherwise be open to them. See the discussion at para.28–035.

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triggers the duty owed by directors to the shareholders to give them advice in the shareholders' best interest, if they choose to give them advice at all.[194]

Duties of strenuously dissenting directors

10–043 Fourthly, there are limits to the duty to act independently. In particular, a director cannot rely on this duty as providing an excuse for his efforts to destabilise the company while still remaining as a board member. *Stobart Group Ltd v Tinkler*[195] illustrates the problem. After Tinkler had been dismissed as the company's CEO but remained a director, he sought to mobilise shareholder support to remove the sitting chairman. The Court held that the duty to exercise independent judgment exists only in order to support the *board's* management of the company's business in an efficient and competent manner[196]: it does not entitle an individual director to act outside the boardroom independently of the board. In particular, if there is conflict between board members about specific issues, then the dissenting director should confine himself to raising the matter at board level and ensuring that any continuing opposition is minuted; or, if the issues are serious, raising the matter at a general meeting with the other directors present, not acting solo and not engaging with shareholders individually; or, finally, if neither of those defin[…] satisfaction, resigning.

Nominee directors

10–044 Finally, the independent judgment principle could cause difficulties for "nominee" directors, i.e. directors not elected by the shareholders generally but appointed by a particular class of security holder or creditor to protect their interests. English law solves such problems by requiring nominee directors to ignore the interests of the nominator,[197] though it may be doubted how far this injunction is obeyed in practice. The Ghana Companies Code 2019 s.190(4)[198] adopted what might be regarded as the more realistic line by permitting nominee directors to "give special, but not exclusive, consideration to the interests" of the nominator, but even this formulation would not permit the "mandating" of directors and thus the creation of a fettering problem.

[194] See para.10–006.
[195] *Stobart Group Ltd v William Andrew Tinkler* [2019] EWHC 258 (Comm).
[196] *Stobart Group Ltd v William Andrew Tinkler* [2019] EWHC 258 (Comm) at [414], and more generally see [413]–[415].
[197] *Boulting v ACTT* [1963] 2 Q.B. 606 CA at 626 per Lord Denning MR; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 A.C. 187 PC. The latter case shows that this principle has the advantage of not making the nominator liable for any breaches of duty to the company by the nominee director. Also see *Thompson v The Renwick Group Plc* [2014] EWCA Civ 635, where the Court rejected the view that a parent assumes a duty of care to employees of its subsidiary in health and safety matters by virtue of that parent company having appointed an individual as director of the subsidiary company with responsibility for health and safety matters.
[198] The provision appears in the equivalent of CA 2006 s.172, not s.173.

DIRECTORS' DUTIES OF SKILL, CARE AND DILIGENCE: S.174

Historical development

10–045 Before the statutory enactment of directors' duties, the long-debated issue in this area was the appropriate standard of care to be required of directors. Historically, the common law was based upon a very low standard of care, because it was subjectively formulated. The traditional view is to be found in a stream of largely nineteenth-century cases which culminated in the decision in 1925 in *Re City Equitable Fire Insurance Co*.[199] Those cases seem to have framed the directors' duties of skill and care with non-executive rather than executive directors in mind and, moreover, on the basis of a view that the non-executive director had no serious role to play within the company but was simply a piece of window-dressing aimed at promoting the company's image.[200] The result was a conceptualisation of the duty in highly subjective terms. The proposition was famously formulated by Romer J in the *City Equitable* case that "a director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of *his* knowledge and experience".[201] The courts were also influenced by a model of corporate decision-making which gave the shareholders effective control over the choice of directors. If the shareholders chose incompetent directors, that was their fault and the remedy lay in their hands. As we shall see,[202] that is no longer an accurate picture of the degree of control exercised by shareholders in most medium and large companies. Furthermore, the proposition formulated by Romer J was highly inappropriate for executive directors, appointed to their positions and paid large, sometimes very large, sums of money for the expertise which they assert they can bring to the business. The implicit view of the role of the non-executive director also became anachronistic after the development of the corporate governance codes in the 1990s, which allocated a major role to the non-executive directors in the monitoring of the executive directors.[203]

Even before the enactment of the CA 2006 this was an area of the law that was changing. The courts were influenced by the development of more demanding and objective statutory standards for directors whose companies were facing

[199] *Re City Equitable Fire Insurance Co* [1925] Ch. 407 CA, a decision of the Court of Appeal but always quoted for the judgment of Romer J at first instance, because the appeal concerned only the liability of the auditors.
[200] The most famous example of this is perhaps *Re Cardiff Savings Bank* [1892] 2 Ch. 100 Ch D, where the Marquis of Bute, whose family, despite its Scottish antecedents, owned, and indeed had largely rebuilt, Cardiff Castle, was appointed president of the Bank at the age of six months and attended only one meeting of the board in his whole life. He was held not liable for any negligence in the management of the Bank.
[201] *Re City Equitable Fire Insurance Co* [1925] Ch. 407 at 427 (emphasis added). This test also contains an objective element, because the director could be held liable for failing to live up to the standard which a person of the director's skill is reasonably capable of reaching, but that leaves the strong subjective element that the director can never be required to achieve a standard higher than he or she is personally capable of reaching.
[202] See Ch.11.
[203] See para.9–018.

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