duty to promote the success of the company, and so long as directors have made good faith business judgements with reasonable care, skill and diligence they are unlikely to be in breach of this duty (see HL Rep, Hansard HL 681, 9/5/06, cols 845–846). In Committee Stage in the House of Commons, David Howarth made the important additional observation that the class of potential litigants is limited, and that it will also often be difficult to identify any loss. For these reasons, the risk of litigation is minimal. The class of potential litigants is limited to the board, a majority of members, a minority of members under Pt 11 and liquidators acting on behalf of an insolvent company. It is only during a takeover that a board or a majority of members is likely to bring an action against a director; in most cases there are far better remedies available against directors, for example removal of the director. Further, a derivative action under Pt 11 is extremely difficult to advance against the wishes of the majority of members. In reality, it is only during takeovers and liquidation proceedings that the section is likely to be utilised. Moreover, an action will only be useful where there is a loss to the company: a breach of the duty to promote the success of the company is unlikely, alone, to give rise to significant calculable financial loss.

(x) A defence rather than duty?

Although the 'enlightened shareholder value' approach was designed to avoid the problems of director accountability inherent in the 'pluralist approach', it is not clear that this ambition is achieved. Subsection (1) sets out proper considerations for director decision-making, but these considerations will allow directors to justify almost any bona fide approach to delivering the success of the company. Where directors have made a good faith business judgement to favour employees' interests[34] over short-term financial gain, for example in order to promote the success of the company for the benefits of its members as a whole, then this legitimate decision cannot be challenged (see *Re Welfab Engineers Ltd* (1990) BCLC 833). Similarly, directors are not compelled to make decisions according to the wider interests of community and the environment, and they are protected from reproach if they choose to do so. *Is* there any decision directors might take which would self-evidently fall outside the requirements of s 172(1)?

(xi) Duty to disclose misconduct?

The controversial finding in *Item Software (UK) Ltd v Fassihi* **[7.16]** at [44], may be embraced by the terms of s 172. *Fassihi* suggests that a director who acts in breach of his fiduciary duty is under a further duty to disclose the breach to the company if disclosure is required by the general equitable duty to act bona fid *e* in what the director considers to be the interests of the company. The analogy with the statutory duty in s 172(1) is obvious. It is difficult to see when it would not be in the company's interest to know of a breach of duty, and on that basis any breach of duty will always involve a further breach in failing to disclose. The further breach may result in loss of employment benefits (eg termination rights, share options, pension bene fits), and may provide justification for summary dismissal (*Tesco Stores Ltd v Pook* [2003] EWHC 823 (Ch); *Fulham Football Club (1987) Ltd v Tigana* [2004] EWHC 2585 (QB)). On the other hand, this aspect of the *Fassihi* decision represents a radical extension of the traditional **(p. 342)** equitable duties owed by directors, and the approach to these statutory rules advocated in s 170 may argue against its acceptance.

Less controversially, a director also has an equitable duty to disclose breaches of duty committed by fellow directors if this is what the director, acting bona fide, considers to be in the best interests of the company (*British Midland Tool Ltd v Midland International Tooling Ltd* [2003] EWHC 466 (Ch), [2003] 2 BCLC 523). Again, the analogy with the statutory duty in s 172(1) is apparent. Also see *Brandeaux Advisers (UK) Ltd v Chadwick* [2010] EWHC 3241 (QB), referred to later.

The duty to act in good faith for the success of the company

Re-read the cases at **[7.05]**–**[7.12]**.

Duty to act in good faith.

[7.14] Regentcrest v Cohen [2001] BCC 494 (Chancery Division)

Liquidators sought damages for a breach of fiduciary duty arising from the second defendant's agreement, in his capacity as a director of the claimant company, R, to waive that company's entitlement to claw back a sum from the vendors of a company, G. The liquidators contended that by his actions, the second defendant had disposed of the clawback asset for negligible consideration and for an improper purpose. The second defendant submitted that he had agreed to the waiver for a valid commercial reason and had honestly believed that he was acting in the best interest of the company and in accordance with his duties as a director.

JONATHAN PARKER J:

96. …[T]he only live claim is a claim against Mr Don Richardson for having agreed to the waiver of the clawback claim. …

101. …[T]he central issue in the case is whether, when he voted in favour of the first resolution [to waive the clawback], Mr Don Richardson honestly believed that he was acting in the best interest of Regentcrest. If he did not honestly hold that belief, then … it follows that he must have breached his fiduciary duty to Regentcrest and must accordingly be liable to Regentcrest for any resulting loss. As to the quantification of that loss, it is common ground that the loss is equal to the value of the clawback claim as at 5 September 1990. Plainly, the value of the clawback claim cannot exceed its face value of £1.5M, but equally clearly it may, depending on a number of factors including the ability of the vendors to satisfy any judgment and the existence of any defences to the claim, be less than its face value. …

120. The duty imposed on directors to act *bona fide* in the interests of the company is a subjective one … The question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the director's state of mind. No doubt, where it is clear that the act or omission under challenge resulted in substantial detriment to the company, the director will have a harder task persuading the court that he honestly believed it to be in the company's interest; but that does not detract from the subjective nature of the test.

121. As Lord Greene put it in *Re Smith and Fawcett, Ltd* **[11.10]**:

> 'The principles to be applied in cases where the articles of a company confer a discretion on directors … are, for present purposes, free from doubt. *They must exercise their discretion 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*.' (Emphasis supplied.)

(p. 343) 122. To similar effect is the following passage from the judgment of Millett LJ in *Bristol & West Building Society v. Mothew* [1998] Ch 1 at 18:

> 'The various obligations of a fiduciary merely reflect different aspects of his core duties of loyalty and fidelity. Breach of fiduciary obligation, therefore, connotes disloyalty or infidelity. Mere incompetence is not enough. A servant who loyally does his incompetent best for his master is not unfaithful and is not guilty of a breach of fiduciary duty.'

123. The position is different where a power conferred on a director is used for a collateral purpose. In such circumstances it matters not whether the director honestly believed that in exercising the power as he did he was acting in the interests of the company; the power having been exercised for an improper purpose, its exercise will be liable to be set aside (see, e.g., *Hogg v. Cramphorn Ltd* **[7.11]**). However, it has not been contended that that principle applies in the instant case. …

146. Three main reasons [for the waiver] were identified by the Richardson brothers in evidence. First, the need to retain the services of Mr Scott and Mr Farley, with the concomitant benefit of their knowledge and

experience in seeking to realise the various properties in the Regentcrest Group's property portfolio, and (in the case of Mr Cohen) the desirability of retaining his services in relation to the Altrincham Site, about which he was thought to have a good deal of useful local knowledge; secondly, the need to preserve a united board in the face of pressure from the banks and other creditors; thirdly, the fact that it was (to put it at its lowest) questionable to what extent the vendors would be able to satisfy any judgment; and fourthly the fact that the vendors had made it clear (through Mr Farley) that they would not submit to judgment on the clawback claim but would defend the claim on whatever grounds might be open to them—in other words, they were not going to go quietly.

147. In assessing the 'commerciality' of the reasons put forward by the Richardson brothers I have to eschew hindsight and to place myself so far as possible in their shoes as at 5 September 1990. …

158. In the result, therefore, I have no hesitation in accepting the evidence of each of the Richardson brothers as to his reasons for agreeing to the waiver of the clawback claim, and I find that in voting in favour of the resolution for waiver each of them honestly believed that he was acting in the best interests of Regentcrest.

159. It follows that the claim of breach of fiduciary duty on the part of Mr Don Richardson fails.

The Damages Issue

160. In the light of my conclusions on the breach of the duty issue, the damages issue does not arise. However, for the sake of completeness I will address it shortly. I do so on the assumption, contrary to the conclusion which I have expressed above, that Mr Don Richardson was in breach of his fiduciary duty to Regentcrest in voting in favour of the resolution for waiver of the clawback claim.

161. It is common ground that the correct measure of damage is the value of the clawback claim as at 5 September 1990, and that that value is to be assessed on an objective basis. Thus, the court is not limited to such knowledge as the Richardson brothers had at that date as to the vendors' means.

162. I turn, then, to the evidence as to the vendors' means. …

174. In the circumstances as disclosed by the evidence (which is admittedly incomplete), I conclude that as at September 1990 (a) there was no sensible prospect of recovering more than 20 per cent at the most of the face value of the clawback claim, (b) there was a real risk, given the vendors' expressed intention to contest the claim so far as possible, that the total sum recovered under a judgment might not cover the costs of obtaining it, and (c) subject to that, it was a matter of speculation how much might be recovered. …

175. Doing the best I can on the basis of the above conclusions, I assess the value of the claw-back claim as at September 1990 at £50,000. …

176. In the result, for the reasons already given, the action must be dismissed.

(p. 344) [7.15] Roberts (Liquidator of Onslow Ditchling Ltd) v Frohlich [2011] EWHC 257 (Ch), [2011] 2 BCLC 625 (Chancery Division)

The facts appear from the judgment.

NORRIS J:

83 The first ground of liability rests upon misfeasance and breach of duty at common law [since the relevant breaches occurred before the enactment of CA 2006]. Mr Frohlich and Mr Spanner [the company's directors] are said to be in breach of their fiduciary duty to act bona fide in the interests of the company and in breach of their common law duty of skill and care because they permitted ODL [the company] to commence a development which they knew or ought to have known was speculative, inadequately funded

and bound to fail.

84 An allegation of breach of fiduciary duty involves consideration of the question whether the director honestly believed that his act was in the interests of the company. If the act undertaken resulted in substantial detriment to the company the director has a harder task to persuade the court that he honestly believed it to be in the company's interest: but the test remains essentially subjective: per Jonathan Parker J. in *Regentcrest Plc (in liq.) v Cohen* **[7.14]** at [120].

85 Some further exposition is required where the company (to whom the director owes his fiduciary duty) is in financial difficulties.

> 'Where a company is insolvent or of doubtful solvency or on the verge of insolvency and it is the creditors' money which is at risk the directors, when carrying out their duties to the company, must consider the interests of the creditors as paramount and take those into account when exercising their discretion. This principle has been recognised by the Court of Appeal in *Liquidator of West Mercia Safetywear Ltd v Dodd* (1988) 4 BCC 30 at p.33 *per* Dillon LJ … It was also applied in the Court of Appeal in *Brady v Brady* **[10.08]** (1987) 3 BCC 535 at p.552 *per* Nourse LJ where he stated that the interests of the company in this context are in reality the interests of the existing creditors alone.'

See the judgment of Mr Leslie Kosmin QC in *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (Ch); [2003] BCC 885 at [74].

…

87 I am satisfied that both Mr Frohlich and Mr Spanner honestly believed that, at the time when the acquisition of the site was completed, it was in the interests of ODL to go through with this transaction: and in my judgment it was beneficial. ODL secured for itself a paper profit of £275,000: a realisation of that by an 'on-sale' of the site would (even allowing for the costs of realisation) have enabled ODL to pay off its existing creditors and make a profit.

88 … In pitching the project to HBoS in order to secure funding offers Mr Spanner certainly misrepresented the true position in saying that ODL had secured a fixed-price building contract and had pre-sold some units … [However] The 'deception' of the bank into making the loan offers … did not of itself make the funding offers precarious …

89 I am [also] not prepared to infer that Mr Frohlich and Mr Spanner did not honestly believe the entry of the letter of intent on June 8, 2004, to be in the best interests of ODL. It is right that on their evidence they seem to have given little thought to its terms: but whilst that might call into question their competence it does not demonstrate a lack of honest belief that the step was in the interests of ODL. …

90 The letter of intent was entered into (as I have found) with the intention that under it orders for structural steel should be placed: and such instruction was given on July 2, 2004. … The effect of this instruction was (at the least) to commit ODL to pay for the steel when delivered. When the order was placed ODL had no funds in hand with which to meet that future liability. That does not demonstrate a lack of honest belief that placing the order was not in the best interests of ODL. The directors were simply taking a risk that when the time for payment came they would have the money to pay the bill. As well as the 'cash flow risk' there was another risk, the 'project risk'. **(p. 345)** Because the order related to the whole of the structural steel it constituted 'speculative building' in relation to the entire development: something which (from the outset) Mr Frohlich and Mr Spanner said they would not do because of the evident risk. In ordering the steel Mr Frohlich and Mr Spanner were effectively using creditors' money as the working capital of ODL for a project they recognised was 'speculative'. The court will therefore readily draw the inference that they cannot have regarded this as in the best interests of ODL, and the directors face a hard task in putting before the court evidence of sufficient quality to displace that inference.

91 In my judgment Mr Frohlich and Mr Spanner have succeeded in doing so. I have found the question a difficult one: but ultimately I am satisfied that I ought not to conclude that Mr Frohlich and Mr Spanner were acting in breach of their fiduciary duty. I consider that at the beginning of July 2004 they honestly believed that that when the time came for payment they would have a good chance that the money would be available to pay the bill. …

94 By the time one gets to the first half of September 2004, however, it seems to me that the position is entirely different. FCL had by then already been instructed to undertake work to the value of £1.6 million (a sum which exceeded the development facility even if fully available). HBoS had demonstrated that it intended to adhere to its funding conditions (and was requiring proof of satisfaction): and Mr Spanner acknowledged (and I find that Mr Frohlich must have known) that HBoS was proceeding on a false premise as to the degree to which those conditions were met. … Attempts to find a co-venturer failed on the basis that the project was not viable. The Easier transaction had petered out: there was no longer the faintest hope of supplementary funding from that source. Those creditors who had been waiting for the takeover to provide a source of funds for payment of their debts would now inevitably begin to press for payment: and they had reached £300,000 (excluding FCL and PJ Brown). The only proper inference to draw is that Mr Frohlich and Mr Spanner cannot honestly have believed that a continuation with the work already ordered and the placing of fresh orders was in the interests of ODL (meaning, because of the parlous state of the company's finances, effectively the paramount interests of ODL's creditors). However irrational the directors' optimism it cannot have survived these reverses save by wilful blindness—a deliberate decision not to enquire or consider lest an unpalatable truth be exposed. The only honest thing to do was to stop the development—at the very least, temporarily whilst a review of existing and intended commitments was undertaken and HBoS appraised of the true position.

95 Mr Spanner said that he was an optimist and believed things could be pulled round: he said there was interest in the project from other banks (and in particular Lloyds Bank at Guildford). (By contrast, Mr Frohlich said he did not think that there had been any formal approaches to any other banks). Mr Frohlich said that [other parties] were behind the project and they could be looked to as a source of funding. Mr Frohlich said that he and Mr Spanner were people of substance (as was evident from the bank accepting a guarantee of £500,000 from them): there was always the possibility that they could make up the shortfall. None of this causes me to doubt my conclusion that from mid-September at the latest Mr Frohlich and Mr Spanner were not acting bona fide in the best interest of ODL and its creditors. [and he continued, examining the evidence to that effect] …

97 I therefore find and hold that certainly from September 14, 2004, Mr Frohlich and Mr Spanner were in breach of the fiduciary duties which they owed ODL in failing (as those acting bona fide in the interests of ODL would have done) (a) to call a halt—to seek to suspend performance of the unperformed parts of existing contracts and to refuse to authorise the placement of any further orders; and (b) to disclose to FCL the funding status of the project and to disclose to HBoS the contractual status of the project.

➢ Note

These cases, and earlier cases, make it very clear that the test of good faith is subjective. Moreover, the onus of proof of lack of good faith lies on the company (or its liquidator) asserting the claim against its directors. As both Jonathan Parker J and Norris J note, however, the **(p. 346)** greater the detriment to the company from the directors' actions, the harder it will be for the directors to defend themselves against the company's allegations of absence of good faith. If, in the face of the company's assertions, the directors mount a credible rationale for their actions, ones that indicate it is plausible that directors in the circumstances could think the chosen course of action was in good faith in the interests of the company, then they will escape liability. In neither of these two cases are Jonathan Parker J and Norris J applying an objective test of good faith (ie would a reasonable director in the circumstances have thought this action was in the interests of the company?): they are simply *testing the credibility* of *these* directors' assertions of subjective motivations.

➢ Questions

1. Does a subjective rule of good faith catch only those directors whose behaviour is patently fraudulent or grossly negligent? Could, and should, a higher standard be imposed? (See the discussions of subjective/objective tests in the context of the director's duty of care ('The subjective/objective test', pp 355ff) and 'dishonest assistance' by third parties in a director's breach of duty ('Required knowledge for secondary liability', pp 451ff).

2. See *Charterbridge Corpn Ltd v Lloyds Bank Ltd* **[3.03]**. There, the directors of a company within a corporate group did not expressly consider the benefits to their company of a proposed course of action, as distinct from the benefits to the corporate group. When, if ever, could such directors be found guilty of breach of the duty in CA 2006 s 172? Does a subjective test of good faith mean that the directors must give explicit consideration to the issue of whether their actions are in good faith in the interests of the company?

3. The *Frohlich* case **[7.15]** shows that particular facts can generate claims for breach of the duty to promote the success of the company (s 172), the duty to act with reasonable care, skill and diligence (s 174) and the wrongful trading provisions in IA 1986 s 214 (and also note IA 1986 s 212). Who can pursue each of these claims, and how do the specific duties and their related remedies differ under each of these options?

The duty to act bona fide in the interests of the company includes the duty to disclose misconduct by the director to the company.

[7.16] Item Software (UK) Ltd v Fassihi [2004] EWCA Civ 1244, [2005] 2 BCLC 91 (Court of Appeal)

Fassihi was both a director and employee of Item Software (IS), a distributor of products for Isograph. In November 1998, the company tried to renegotiate its distribution agreement with Isograph on more favourable terms. During negotiations, Fassihi approached Isograph with the idea of establishing a new company to take over the distribution agreement. On the other hand, he also encouraged IS to take an aggressive stance with respect to the negotiations with Isograph. Negotiations between IS and Isograph broke down because Isograph refused to accept IS's terms. Isograph terminated the distribution agreement with IS and entered into a new agreement with Fassihi's own company. IS dismissed Fassihi when it learned of this and commenced proceedings against Fassihi, alleging that his actions amounted to a breach of his duty as both a director and an employee to act bona fide in the interests of the company (ie IS). It was also alleged that this duty was breached by Fassihi's failure to disclose his misconduct to the company.

> ARDEN LJ: … [I]t seems to me that the logical place to start in relation to the disclosure issue is to consider the position of Mr Fassihi as a director since the duties of a director are in general higher than those imposed by law on an employee. This is because a director is not simply a senior **(p. 347)** manager of [a] company. He is a fiduciary and with his fellow directors he is responsible for the success of the company's business.
>
> Merely to call a person a fiduciary is only the beginning of the analysis. It is necessary to identify the respects in which he is a fiduciary and the duties which follow. …
>
> For my part, I do not consider that it is correct to infer from the cases to which I have referred that a fiduciary owes a separate and independent duty to disclose his own misconduct to his principal or more generally information of relevance and concern to it. So to hold would lead to a proliferation of duties and arguments about their breadth. I prefer to base my conclusion in this case on the fundamental duty to which a director is subject, that is the duty to act in what he in good faith considers to be the best interests of his company. This duty of loyalty is the 'time-honoured' rule: per Goulding J in *Mutual Life Insurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11, 21. The duty is expressed in these very general terms, but that is one of its strengths: it focuses on principle not on the particular words which judges or the legislature have used in any particular case or context. It is dynamic and capable of application in cases where it has

not previously been applied but the principle or rationale of the rule applies. It reflects the flexible quality of the doctrines of equity. As Lord Templeman once put it 'Equity is not a computer. Equity operates on conscience …' (*Winkworth v Edward Baron Development Co Ltd* [1986] 1 WLR 1512, 1516.)

Professor Robert C Clark *Corporate Law* (1986), pp 34 and 141, has described the fundamental nature of the duty of the loyalty in these terms:

> 'The most general formulation of corporate law's attempted solution to the problem of managerial accountability is the *fiduciary duty of loyalty*: the corporation's directors … owe a duty of undivided loyalty to their corporations, and they may not so use corporate assets, or deal with the corporation, as to benefit themselves at the expense of the corporation and its shareholders. *The overwhelming majority of particular rules, doctrines, and cases in corporate law are simply an explication of this duty or of the procedural rules and institutional arrangements involved in implementing it*. The history of corporate law is largely the history of the development of operational content for the duty of loyalty. Even many cases that appear to be about dull formalities or rules of the road in fact involve disputes arising out of alleged managerial disloyalty … Most importantly, this general fiduciary duty of loyalty is a residual concept that can include factual situations that no one has foreseen and categorised. The general duty permits, and in fact has led to, a continuous evolution in corporate law.'

Although Professor Clark was writing about the duty of loyalty in the United States, his observations seem to me to express qualities of the duty of loyalty applying equally to the law of England and Wales.

The only reason that I can see that it could be said that the duty of loyalty does not require a fiduciary to disclose his own misconduct is that it has never been applied to this situation before. As I have explained, that is not a good objection to the application of the fiduciary principle. …

… Furthermore, on the facts of this case, there is no basis on which Mr Fassihi could reasonably have come to the conclusion that it was not in the interests of Item to know of his breach of duty. In my judgment, he could not fulfil his duty of loyalty in this case except by telling Item about his setting up of RAMS, and his plan to acquire the Isograph contract for himself. …

Both counsel have addressed the court on the policy reasons for holding that Mr Fassihi was in breach of his duty of loyalty in this case. These are relevant questions. If the approach of the law were overly intrusive, legitimate entrepreneurial activity would be discouraged and this would not be a beneficial outcome. But that is not in my judgment the result of holding that a duty of loyalty applies in the present case. This is because, on well established principles of law, Mr Fassihi's setting up of a new company to which the business of Item would be diverted was not a legitimate entrepreneurial activity. In addition, the effect of my decision in this case (if the majority of the court is of the same opinion) is not to make any substantive extension of the duties of directors, such as would be involved for example if the courts held that a director of one company could not accept a directorship of another company. …

(p. 348) A conclusion that a director owes no obligation to disclose his improper actions would be also inefficient in economic terms. It would mean that the company has to expend resources in investigating his conduct and that the enforcement of a liability to compensate the company for misconduct depends on the happenchance of the company finding out about the impropriety. To this it may be said that the law ought not to hold that the duty of loyalty involves a positive duty to disclose because it is unlikely that the consciously misbehaving director will comply with it: this indeed is the rationale for the fraud exception (in *Re Hampshire Land Co*[35]) referred to above.

My answer to that is two wrongs do not make a right: the fact that a director is unlikely to comply with a duty is not a logically sustainable reason for not imposing it if it is otherwise appropriate. As the facts of this case demonstrate, the consequence of non-disclosure may be that the company makes erroneous business decisions because it lacks essential information. A legal rule which condones this, in my judgment, condones inefficient outcomes. Moreover, there is a constant dilemma in company law as to the manner in which the shareholders of a company can monitor those who manage its business on their behalf. The duty upheld above helps to ameliorate these problems (often called agency problems) by encouraging the provision of information on which proper decision-making can take place. In many companies, an agency problem exists not only between shareholders and directors but between the board and executive or managing directors. There is an oversight duty owed by the board in respect of executives by virtue of their duty of care. (The precise extent of the duty depends on the facts of the case: *Re Barings plc (No.5)* **[6.12]**.) The duty of loyalty as applied by me above supports the board in the performance of this duty and is thus efficient for that reason also. Accordingly, in so far as my conclusion on this issue involves a new application of the duty of loyalty, it is supported for policy reasons. For all these reasons, in my judgment, the appeal against the judge's judgment on the disclosure issue must be dismissed.

HOLMAN J delivered a concurring judgment.

MUMMERY LJ concurred.

Also see *Industrial Development Consultants Ltd v Cooley* in *Bhullar v Bhullar* **[7.25]**.

➤ Note

At first instance, [2003] EWHC 3116 (Ch), N Strauss QC Deputy Judge came to the same conclusion that Mr Fassihi's misconduct gave rise to a 'super added' duty of disclosure. However, the learned judge came to the conclusion not as a matter of fiduciary duty, but on a contractual basis:

> 52 … there was a separate and independent aspect of his duties which required him to disclose the facts. He was involved in the negotiations between Item and Isograph and his contractual obligations of fidelity and care required him to disclose important information known to him which was relevant to those negotiations. If he had learned that a rival distributor had been trying to sabotage the negotiations with Isograph, it would have been his duty to tell Mr. Dehghani; the fact that it was himself cannot relieve him of the duty. That it would have been in Item's interest to know of the misconduct in order to deal with Mr. Fassihi would not have justified the imposition of a duty; what justifies it is its relevance to the ongoing negotiations with Isograph. This therefore seems to me to be a case in which a duty of disclosure was owed.

Citing this part of the first instance judgment, Jack J in *Brandeaux Advisers (UK) Ltd v Chadwick* [2010] EWHC 3241 (QB) expressed the view that 'it might be said that it was unnecessary in *Item Software* for the Court of Appeal to have developed the law as it did' [47]. Nevertheless, since *Item Software* was binding on him, he held that a breach had been committed: the director had taken her company's confidential information and, had there been **(p. 349)** proper disclosure, she would have been dismissed by the company. He then held, however, that no loss had been shown by the company: 'the company had the benefit of her work, and I should take its value as the salary the company had agreed to pay' [56].

Where it is deemed to be in the interests of the company, the duty to disclose may include the disclosure of information other than misconduct, and may entail disclosing such information to individuals other than the board, for example the shareholders.

[7.17] GHLM Trading Ltd v Maroo [2012] EWHC 61 (Chancery Division)

GHLM Trading Ltd sued its former directors, Mr and Mrs Maroo, for breach of directors' duties, and also alleged that the directors had committed a further breach by failing to disclose their misconduct. This latter allegation was not upheld, since it had not been pleaded or proved adequately, so Newey J's comments on the law are by way of*dicta* only.

NEWEY J:

192 Recent authority establishes that it can be incumbent on a director to reveal his own wrong-doing. The leading case is *Item Software (UK) Ltd v Fassihi* **[7.16]**. In*Item Software (UK) Ltd v Fassihi*, Arden LJ (with whom Mummery LJ and Holman J expressed agreement) said that a fiduciary does not owe a separate and independent duty to disclose misconduct (paragraph 41). She concluded, however, that a director's 'fundamental' duty 'to act in what he in good faith considers to be the best interests of his company' could mean that a director has to disclose misconduct on his part (paragraphs 41 and 44). On the facts, Arden LJ considered that the director in question 'could not fulfil his duty of loyalty' except by telling his company of steps he had taken to divert business to himself (paragraph 44).

193 As was mentioned in *Brandeaux Advisers (UK) Ltd v Chadwick* [2010] EWHC 3241 (QB) (at paragraph 47), *Item Software (UK) Ltd v Fassihi* is a somewhat controversial decision. Arguably, it breaks new ground in treating a fiduciary duty as prescriptive rather than merely proscriptive. Its result can perhaps now be justified also by reference to section 172 of the Companies Act 2006, which came into force on 1 October 2007. The duty to promote the success of a company which that provision imposes can be said to be expressed in prescriptive terms (a director '*must* act in the way he considers, in good faith, would be most likely to promote the success of the company …'—emphasis added). Be that as it may, *Item Software (UK) Ltd v Fassihi* is clearly binding on me. I therefore proceed on the basis that a director's duty of good faith can potentially require him to disclose misconduct.

194 Two points of relevance seem to me to flow from the Court of Appeal's analysis in *Item Software (UK) Ltd v Fassihi*. The first derives from the fact that the duty of good faith focuses on a fiduciary's subjective intentions. Thus, in *Regentcrest plc v Cohen* **[7.14]** Jonathan Parker J explained … [at [120], see **[7.14]**] …

Accordingly, a company complaining of a director's failure to disclose a matter must, I think, establish that the fiduciary subjectively concluded that disclosure was in his company's interests or, at least, that the director would have so concluded had he been acting in good faith.

195 The second point is that it can be incumbent on a fiduciary to disclose matters other than wrongdoing. The 'single and overriding touchstone' being the duty of a director to act in what he considers in good faith to be in the best interests of the company (to quote from Etherton J in *Shepherds Investments Ltd v Walters* [2006] EWHC 836 (Ch), [2007] 2 BCLC 202, at paragraph 132), there is no reason to restrict the disclosure that can be necessary to misconduct. Were a director subjectively to consider that it was in the company's interests for something other than misconduct to be disclosed, he would, it appears, commit a breach of his duty of good faith if he failed to do so. …

198 [Turning to the question of the person to whom disclosure should be made.] Since the 'touchstone' is the duty of a director to act in what he considers in good faith to be in the best interests of the company, the focus must be on what the relevant director in fact believed to be in **(p. 350)** the company's interests or would have believed to be in the company's interests had he been acting in good faith. If a director subjectively concluded that it was in the company's interests for a matter to be disclosed to a person who was not a member of the board (or if he would have so concluded had he been acting in good faith), it would, it appears, be incumbent on him to ensure that such disclosure was made.

199 On the other hand, a director's duty of good faith is owed to his company, not to shareholders. The question is therefore as to what the director thought (or would have thought) was in the *company's* interests. That disclosure might have been in a *shareholder's* interests will not matter as such.

200 It is perhaps also relevant in this context that [GHLM's articles provide] that, subject to exceptions, 'the business of the company shall be managed by the directors'. In a normal case, therefore, disclosure to the board should suffice. [Counsel] pointed out that, where the two members of a board are involved in wrongdoing [as here], disclosure by one director to the other would not be likely to achieve anything. However, I do not think a director in such a case would necessarily be bound to inform shareholders. Supposing that he had a change of heart and was acting in good faith in the company's interests, he could potentially conclude that what the company's interests required was a change of course by the board or, if

the wrongdoing were in the past, that nothing need be done. There could even be cases in which directors could legitimately take the view that it would be contrary to their companies' interests for shareholders to be given information. It is necessary, I think, to look at the particular facts of individual cases.

➢ Questions

1. Is there any indication in the cases of how the necessary balancing of different interests of stakeholders or constituencies is to be carried out?

2. Perhaps the real issue in *Fassihi* **[7.16]** is one of remedies. A director's contract may provide that he or she is to be dismissed for any breach of duty, and may add further options in favour of the company. This is not in issue. But in *Fassihi* the company was not seeking the traditional remedy of an account of *profits* from Fassihi for the profits he had made from his own new company (under the conflicts of interest rule, see 'Duty to avoid conflicts of interest: CA 2006 s 175', pp 361ff). It was seeking compensation for the *losses* it had suffered in losing its own contract. (And on recovery of losses, see 'Proving causative loss in negligence cases', p 361 and 'Equitable compensation', p 435.) Were these losses caused by a failure to 'act in good faith in the interests of the company'? If so, what does a 'failure to disclose' add? What losses are caused by a failure to disclose?

Duty to exercise independent judgement: CA 2006 s 173

Directors must exercise independent judgement (traditionally expressed as 'directors must not fetter their discretion'). The modern formulation is more illuminating than its traditional expression. This duty to exercise independent judgement is not breached if the director merely takes advice, or acts in accordance with an agreement duly entered into by the company (even one that restricts the future exercise of discretion by its directors: see CA 2006 s 173(2)(a) and **[7.18]**), or acts in a way permitted by the company's constitution. And, even though this is not made explicit in s 173, nor does the duty prevent directors from delegating their functions, provided the exercise of any power to delegate is in accordance with the company's constitution.

The duty applies equally to nominee directors, who cannot blindly follow the judgement of those who appointed them (this allegation is perhaps the most common complaint under **(p. 351)** this head of duty), although they may rely on their advice provided they make the judgement their own: *Scottish Co-operative Wholesale Society Ltd v Meyer***[13.24]**; *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* **[7.45]**.

Also see *Weavering Macro Fixed Income Fund Ltd (In Liquidation) v Peterson* FSD 113 of 2010 (Grand Court of the Cayman Islands).

Legitimate fetters on directors' discretion through contracts with outsiders.

[7.18] Fulham Football Club Ltd v Cabra Estates plc [1994] 1 BCLC 363 (Court of Appeal)

In return for a substantial payment, Fulham Football Club (FFC) and its directors contracted with the landlords of the football ground which they held on lease that they would not oppose any future application to the planning authorities which the landlords might make for the development of the ground. The directors later wished to go back on this undertaking, and pleaded (amongst other things) that it was an unlawful fetter on their ability to act in the best interests of the company at any relevant time in the future, and was therefore void. The Court of Appeal rejected the argument.

The judgment of the court (NEILL, BALCOMBE and STEYN LJJ) was delivered by NEILL LJ: It is trite law that directors are under a duty to act bona fide in the interests of their company. However, it does not follow from that proposition that directors can never make a contract by which they bind themselves to the future exercise of their powers in a particular manner, even though the contract taken as a whole is manifestly for the benefit of the company. Such a rule could well prevent companies from entering into contracts which were commercially beneficial to them.

The true rule was stated by the High Court of Australia in *Thorby v Goldberg* (1964) 112 CLR 597. … [Kitto J dealt with the argument that any fetter on a director's exercise of discretion is void for illegality in the following terms, at pp 605–606:]

> 'The argument for illegality postulates that since the discretionary powers of directors are fiduciary, in the sense that every exercise of them is required to be in good faith for the benefit of the company as a whole, an agreement is contrary to the policy of the law and void if thereby the directors of a company purport to fetter their discretions in advance … There may be more answers than one to the argument, but I content myself with one. There are many kinds of transactions 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. A sale of land is a familiar example. Where all the members of a company desire to enter as a group into a transaction such as that in the present case, the transaction being one which requires action by the board of directors for its effectuation, it seems to me that the proper time for the directors to decide whether their proposed action will be in the interests of the company as a whole is the time when the transaction is being entered into, and not the time when their action under it is required. If at the former time they are bona fide of opinion that it is in the interests of the company that the transaction should be entered into and carried into effect, I see no reason in law why they should not bind themselves to do whatever under the transaction is to be done by the board. In my opinion the defendants' contention that the agreement is void for illegality should be rejected.'

… In the present case the undertakings given by the directors were part of the contractual arrangements made on 28 January 1990 which conferred substantial benefits on the company. In those circumstances it cannot be said that the directors improperly fettered the future exercise of their discretion, nor is there any scope for the implication of any such term as is suggested by the plaintiffs.

(p. 352) … We were referred to two English cases at first instance where in each the court held that an undertaking by directors to use their best endeavours to ensure that their shareholders should approve a particular deal by the company (in one case a purchase, in the other a sale) was unenforceable. The cases are*Rackham v Peek Foods Ltd* [1990] BCLC 895 and *John Crowther Group plc v Carpets International plc* [1990] BCLC 460. In neither case was *Thorby v Goldberg*cited. It may be that these decisions can be justified on their particular facts, but they should not be read as laying down a general proposition that directors can never bind themselves as to the future exercise of their fiduciary powers. If they could be so read then they would be wrong.

➢ Note

The position of nominee directors is particularly difficult in this context. The nominator clearly expects its appointed director to look after its interests, and yet the director's duties are expressly owed to the whole *company*, not to the specific nominator. In *Scottish Co-operative Wholesale Society Ltd v Meyer* **[13.24]**, the difficult and special position of a 'nominee director' is discussed in detail.[36] That case confirms the view that a nominated director must *not* put the principal's (ie the nominator's) interest above those of the company, and indicates that members of the company may be able to invoke CA 2006 s 994 if this happens.

But in Australia and New Zealand there are cases which suggest that this may be too narrow a view. The whole object of having a director appointed to represent a special interest may have been the furtherance of