

... Those [secondary] proceedings are likely to be more effective 'in ensuring payment in full' if the [claimant] can establish a proprietary interest in the commission. [In these cases] the argument ... is really about following and tracing.

4. In Australia, where the imposition of a remedial constructive trust is a discretionary remedy, *Sinclair v Versailles* has not been followed:<sup>76</sup> *Grimaldi v Chameleon Mining NL (No 2)* (p. 435) [2012] FCAFC 6. In the Full Court of the Federal Court of Australia, Finn J refused to follow *Sinclair*, but nevertheless did not award a constructive trust notwithstanding that this was a case where the claimant's funds had been diverted in part-payment (an exceptionally tiny part) of the purchase price of a mining venture. According to Finn J at [584]:

... First, to accept that money bribes can be captured by a constructive trust does not mean that they necessarily will be in all circumstances. As is well accepted, a constructive trust ought not to be imposed if there are other orders capable of doing full justice ... Such could be the case, for example, where a bribed fiduciary, having profitably invested the bribe, is then bankrupted and, apart from the investment, is hopelessly insolvent. In such a case a lien on that property may well be sufficient to achieve 'practical justice' in the circumstances. This said, a constructive trust is likely to be awarded as of course where the bribe still exists in its original, or in a traceable, form, and no third party issue arises.

#### ➤ Question

Pill LJ in *FHR European Venture LLP*, see Note 3, said, at [64]: 'At bottom, this is a question of public policy. There would be a case for deciding that whenever, as in the present case, the agent payee is a wrongdoer, the law, applying equitable principles, should grant a proprietary remedy to the principal. A principal shall stand in his agent's shoes.' If the principal can stand in the agent's shoes, will every disgorgement remedy invariably be proprietary, provided the property to be disgorged is still identifiable? What, if anything, is the flaw in that logic?

## Further issues on remedies

### Extent of liability for profits

See *Regal (Hastings) Ltd v Gulliver* [7.23]; *Ultraframe (UK) Ltd v Fielding* [7.44] (director only liable for profits made personally, not for profits made by others, unless the claim can be brought under some other head of liability, eg knowing receipt, dishonest assistance, partnership law).

### Equitable allowance granted to the director

For cases taking a restrictive approach, see: *Murad v Al-Saraj* [7.35]; *Guinness plc v Saunders*

[5.01]; for a more lenient approach, see: *Warman International Ltd v Dwyer* (cited extensively in *Murad* [7.35]); *Boardman v Phipps* (see the Note following *Peso Silver Mines Ltd (NPL) v Cropper* [7.32], p 404).

### Rescission

See *Cook v Deeks* [7.22] explaining the incidence of rescission. Also see the Note following *Aberdeen Rly Co v Blaikie Bros* [7.34], p 412.

### Equitable compensation

The orthodox view is that equitable compensation is not available for breach of the equitable no conflict and no

profit rules, except to compensate for losses caused by breach of the equitable duty of care (if this duty exists distinct from the common law duty) and the equitable duties to exercise powers independently, bona fide, within the authority granted, and for proper purposes (ie the equitable equivalents of ss 171–174). Note that misuse of the company's property may involve a conflict of duty and interest (for which profits are recoverable) *and* a breach of the duty to act bona fide, within the authority granted, and for proper purposes (for which equitable compensation is recoverable, even if the director has not made a profit from the misuse (*Gwembe Valley Development Co Ltd v Koshy (No 3)* [7.37], in which (p. 436) Mummery LJ raises but does not answer the question whether compensation is available if the *only* breach is of the no conflict or no profit rules).

If equitable compensation is available, the loss is measured at the time of the trial and must be causally related to the breach (*Target Holdings Ltd v Redferns* [1996] 1 AC 421, a case concerning fiduciary obligations of solicitors, not directors).

## Limitation periods

The normal limitation period for breach of equitable fiduciary duties is six years, unless the Limitation Act 1980 s 21(1) applies, in which case there is no limitation (eg *JJ Harrison (Properties) Ltd v Harrison* [7.36]; *Gwembe Valley Development Co Ltd v Koshy (No 3)* [7.37]) (this case contains a long and informative analysis of limitation periods).

## Relief from liability

Directors may be relieved from liability for a breach of duty to the company in three ways:

- (i) consent, approval or authorisation by the members: CA 2006 s 180;
- (ii) ratification by the company: CA 2006 s 239; or
- (iii) by the court: CA 2006 s 1157.

It is clear that any attempt to contract out of liability will be void: CA 2006 ss 232–238.

## Consent, approval or authorisation by members: CA 2006 s 180

Section 180 deals with the ways in which directors can avoid liability for breaches of their general statutory duties by making the appropriate declaration or obtaining the appropriate consent, approval or authorisation from either the directors or the members.

Recall that a director may already have exemptions from liability because he or she has board of directors' authorisation for dealings with outsiders (s 175) or has made a declaration to the directors about dealings with the company (s 177). Section 180(1) indicates that these mechanisms replace the equitable rule which requires the members, not the directors, to authorise these types of breaches of duty. This is subject to any contrary enactment (eg CA 2006 Pt 10, Ch 4), or any provision in the company's constitution imposing additional demands.

Section 180(4) is the crucial subsection. It retains the equitable and common law rules which allow *companies* to authorise (in *advance*—note the wording of s 180(4)(a)) what would otherwise be a breach of duty by the directors, and to make provision in their articles for dealing with conflicts of interest in specific ways.

### Equitable rules for authorisation by the company

The equitable rules indicate that authorisation must be given by the members, not the directors (*Furs Ltd v Tomkies* (1936) 54 CLR 583, 590, 599), unless perhaps the members and directors are the same persons (*Queensland Mines Ltd v Hudson* (1978) 18 ALR 1, PC, see Note 2 following *Multinational Gas* [7.39], p 440).

Consent is effective only if it is proper and fully informed (*Kaye v Croydon Tramways Co* [1898] 1 Ch 358; *Knight v Frost* [1999] 1 BCLC 364). This means that the decision of the (p. 437) members must not be a fraud on the creditors (*Re Halt Garage (1964) Ltd* [5.03]) or (it seems) a fraud on the minority or an abuse of power (*North West*

*Transportation Co Ltd v Beatty* [4.33]. This last aspect is controversial (*Burland v Earle* [1902] AC 83, PC; *Cook v Deeks* [7.22]; *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [13.21]; and *Smith v Croft (No 2)* [13.17]). It is sometimes alleged that authorisation or ratification of negligence is more controversial, but arguably the same rules apply—companies, like other individuals, can waive the duty of care and forgive past acts of negligence. However, see *Pavrides v Jensen* [1956] Ch 565; *Daniels v Daniels* [1978] Ch 406 (for both these cases, see Notes 2 and 3 following *Franbar Holdings Ltd v Patel* [13.12], p 661); *Re Horsley and Weight Ltd* [4.30]; and *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [7.39]).

## Ratification of acts of directors: CA 2006 s 239

This important provision settles new minimum requirements for effective ratification. The provision draws on existing equitable rules, but imposes more stringent demands. In addition, to the extent (if any) that the statutory version may still be more lenient than the equitable rules, the latter rules—and rules in any other enactment—remain effective to supplement or enhance the statutory requirements (s 239(7)).

Section 239(1) makes it clear that the provision is designed to afford a mechanism for the company, via its members, to forgive a defaulting director for conduct amounting to negligence, default, breach of duty or breach of trust in relation to the company (ie the provision includes all the wrongs which are the subject of Pt 10, including negligence, and not simply fiduciary wrongs).

Section 239(2) insists that the ratification must be by resolution of the members of the company. This minimum requirement will apply regardless of any more lenient alternative provided by the company's articles, or by existing general law. And s 239(3) and (4) indicate that ratification is effective only if the resolution is passed *without* votes in favour of the resolution by the defaulting director (if a member of the company) and any member connected with him.

This changes the law as expressed in *North-West Transportation Co Ltd v Beatty* [4.33]; *Burland v Earle* [1902] AC 83, PC; and *Pavrides v Jensen* [1956] Ch 565 (see Note 3 following *Franbar Holdings Ltd v Patel* [13.12], p 661). Instead, it adopts the approach advocated in *Atwool v Merryweather* (1867) LR 5 Eq 464n; *Cook v Deeks* [7.22]; *Hogg v Cramphorn* [7.11]; *Bamford v Bamford* [4.32]; *Howard Smith Ltd v Ampol Petroleum Ltd* [7.12]; *Daniels v Daniels* [1978] Ch 406 (see Note 2 following *Franbar Holdings Ltd v Patel* [13.12], p 661); *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [13.21]; and *Smith v Croft (No 2)* [13.17].

### ► Notes and Questions

1. Does CA 2006 s 239 create difficulties for smaller companies? If the majority of shares in a company are held by directors (which is the norm for smaller family-type companies), then their votes will be disregarded for ratification purposes, giving much more power to small shareholders (or, in an insolvency, to a liquidator), who will then have leverage over the owners, which will not necessarily serve the best interests of the company. What if the minority shareholders own, say, only 1% of the company? Should they still have a veto over ratification? What if there are no independent shareholders? On the other hand, it is difficult to see why wrongdoers should be able to vote to forgive themselves.

2. Section 239(6) makes clear that nothing in this clause changes the law on unanimous consent, so the restrictions imposed by this clause as to who may vote on a ratification resolution (p. 438) will not apply when every member votes (informally or otherwise) in favour of the resolution. On unanimous consent, see: *Re Duomatic Ltd* [4.15] (need the agreement of every member entitled to vote); *Re D'Jan of London Ltd* [7.20] (confirming that all members must actually apply their minds to the question and decide in favour of the proposal).

3. Section 239(6) also makes clear that nothing in the section removes any power of the directors to 'agree not to sue, or to settle or release a claim made by them on behalf of the company'. Does this abrogate the

entire section, allowing the directors to override the tough members' ratification rule, and agree themselves to ratify (ie forgive, and agree not to sue) any wrongdoing director? In making such decisions, however, directors would of course continue to be bound by their normal duties, for example to promote the success of the company.

### ***Approval or ratification by the shareholders.***

#### **[7.39] Multinational Gas and Petrochemical Co Ltd v Multinational Gas and Petrochemical Services Ltd [1983] Ch 258 (Court of Appeal)**

Three international oil companies established a joint venture to deal in liquefied gas. They set up the plaintiff company to carry on the business, and the defendant company 'Services' to manage it and to provide advisory services. The three oil companies were the sole shareholders in both companies and appointed their directors. The plaintiff company went into liquidation owing approximately £114 million, and its liquidator sued its directors and also the defendant company, alleging that they had all been negligent. The Court of Appeal held that the action was not founded on any tort committed within the jurisdiction and so refused leave to serve the proceedings on those defendants who were abroad. But Lawton and Dillon LJ also accepted an argument that there could be no complaint about commercial decisions, alleged to be negligent, which had been made by the directors with the approval of the three oil companies as shareholders.

LAWTON LJ: No allegation had been made that the plaintiff's directors had acted ultra vires or in bad faith. What was alleged was that when making the decisions which were alleged to have caused the plaintiff loss and giving instructions to Services to put them into effect they had acted in accordance with the directions and behest of the three oil companies. These oil companies were the only shareholders. All the acts complained of became the plaintiff's acts. The plaintiff, although it had a separate existence from its oil company shareholders, existed for the benefit of those shareholders, who, provided they acted intra vires and in good faith, could manage the plaintiff's affairs as they wished. If they wanted to take business risks through the plaintiff which no prudent businessman would take they could lawfully do so. Just as an individual can act like a fool provided he keeps within the law so could the plaintiff, but in its case it was for the shareholders to decide whether the plaintiff should act foolishly. As shareholders they owed no duty to those with whom the plaintiff did business. It was for such persons to assess the hazards of doing business with them. It follows, so it was submitted, that the plaintiff, as a matter of law, cannot now complain about what they did at their shareholders' behest.

This submission was based on ... a long line of cases starting with *Salomon v A Salomon & Co Ltd* [2.01] and ending with the decision of this court in *Re Horsley & Weight Ltd* [4.30]. In my judgment these cases establish the following relevant principles of law: first, that the plaintiff was at law a different legal person from the subscribing oil company shareholders and was not their agent (see *Salomon v A Salomon & Co Ltd*). Secondly, that the oil companies as shareholders were not liable to anyone except to the extent and the manner provided by the Companies Act 1948 (see *Salomon v A Salomon & Co Ltd*). Thirdly, that when the oil companies acting together required the plaintiff's directors to make decisions or approve what had already been done, what they did or approved became the plaintiff's acts and were binding on it: see by way of examples *A-G for Canada (p. 439) v Standard Trust Co of New York*,<sup>77</sup> *Re Express Engineering Works Ltd*<sup>78</sup> and *Re Horsley & Weight Ltd*. When approving whatever their nominee directors had done, the oil companies were not, as the plaintiff submitted, relinquishing any causes of action which the plaintiff may have had against its directors. When the oil companies, as shareholders, approved what the plaintiff's directors had done there was no cause of action because at that time there was no damage. What the oil companies were doing was adopting the directors' acts and as shareholders, in agreement with each other, making those acts the plaintiff's acts.

It follows that the plaintiff cannot now complain about what in law were its own acts. Further, I can see no grounds for adjudging that the oil companies as shareholders were under any duty of care to the plaintiff.

DILLON LJ: It is not alleged that the joint venturers or the directors of the plaintiff acted fraudulently or in bad

faith in any way or were guilty of fraudulent trading. What is alleged is that they all acted negligently in that they made five speculative decisions in relation to the ships, when they knew or ought to have known that they did not have sufficient information to make sensible business decisions. The decisions which they took in good faith went, it is said, outside the range of reasonable commercial judgment.

The heart of the matter is therefore that certain commercial decisions which were not ultra vires the plaintiff were made honestly, not merely by the directors but by all the shareholders of the plaintiff at a time when the plaintiff was solvent. I do not see how there can be any complaint of that.

An individual trader who is solvent is free to make stupid, but honest, commercial decisions in the conduct of his own business. He owes no duty of care to future creditors. The same applies to a partnership of individuals.

A company, as it seems to me, likewise owes no duty of care to future creditors. The directors indeed stand in a fiduciary relationship to the company, as they are appointed to manage the affairs of the company and they owe fiduciary duties to the company though not to the creditors, present or future,<sup>[79]</sup> or to individual shareholders. The duties owed by a director include a duty of care, as was recognised by Romer J in *Re City Equitable Fire Insurance Co Ltd* [7.19], though as he pointed out the nature and extent of the duty may depend on the nature of the business of the company and on the particular knowledge and experience of the individual director.

The shareholders, however, owe no duty to the company. Indeed, so long as the company is solvent the shareholders are in substance the company ...

The well known passage in the speech of Lord Davey in *Salomon v A Salomon & Co Ltd* that the company is bound in a matter intra vires by the unanimous agreement of its members is, in my judgment, apt to cover the present case whether or not Lord Davey had circumstances such as the present case in mind.

If the company is bound by what was done when it was a going concern, then the liquidator is in no better position. He cannot sue the members because they owed no duty to the company as a separate entity and he cannot sue the directors because the decision which he seeks to impugn were made by, and with the full assent of, the members.

MAY LJ (dissenting): It is well established by such authorities as *Salomon v A Salomon & Co Ltd* and the many authorities to like effect to which we were referred that a company is bound, in a matter which is intra vires and not fraudulent, by the unanimous agreement of its members or by an ordinary resolution of a majority of its members. However, I do not think that this line of authority establishes anything more than that a company is bound by the legal results of a transaction so entered into: that is to say, for instance, by the terms of contract which is so approved; or that (p. 440) neither it nor for that matter its liquidator can challenge the legal consequences, such as a transfer of title, of a transaction to which its members have agreed to the extent that I have mentioned.

This, however, is very different from saying that where all the acts of the directors of a company, for instance, Services, have been carried out by them as nominees for, at the behest and with the knowledge of all the members of the company, namely the joint venturers, then forever the company as a separate legal entity is precluded from complaining of the quality of those acts in the absence of fraud or unless they were ultra vires. If we assume for the purposes of this argument that the directors of the plaintiff did commit breaches of the duty of care that they owed that company, as a result of which it suffered damage, then I agree with the submission made by counsel for the plaintiff that the company thereby acquired a cause of action against those directors in negligence. The fact that all the members of the company knew of the acts constituting such breaches, and indeed knew that those acts were in breach of that duty, does not of itself in my opinion prevent them from constituting the tort of negligence against the company or by itself release the directors from liability for it. Of course, in the circumstances of the present case, whilst the joint venturers retained effective control of the company they would be extremely unlikely to complain of the negligence of their nominees. But such restraint on their part could not and did not in my opinion amount to any release by the company of the cause of action which ex hypothesi had become vested in it against its

directors. *Salomon's* case and the subsequent authorities make it clear that a limited company is a person separate and distinct from its members, even though a majority of the latter have the power to control its activities so long as it is not put into liquidation and whilst they remain members and a majority. Once, however, the joint venturers ceased to be able to call the tune, either because the company went into liquidation or indeed, though it is not this case, because others took over their interest as members of the company, then I can see no legal reason why the liquidator or the company itself could not sue in respect of the cause of action still vested in it. I agree with counsel's submission that that cause of action was an asset of the company which could not be gratuitously released ...

## ► Notes

1. All three members of the Court of Appeal in this case referred to the doubts expressed *obiter dicta* by Templeman and Cumming-Bruce LJ in *Re Horsley & Weight Ltd* [4.30] whether directors holding a majority of shares were competent to ratify their own making of a corporate gift. This is now outlawed by CA 2006 s 239(3) and (4). CA 2006 therefore abrogates the rule in *North West Transportation Co Ltd v Beatty* (1887) 12 App Cas 589, PC, which held that a contract between the director and his company, which was voidable because of the director's undisclosed interest in it, could be ratified by the company in general meeting; and that the interested director could vote as a member in such a meeting, even though he held the majority of votes.
2. In *Queensland Mines Ltd v Hudson* (1978) 18 ALR 1, 52 ALJR 399, PC, the plaintiff company was set up as a joint venture by A Ltd, a company controlled by Hudson, and F Ltd, a company controlled by Korman. Hudson, as managing director of Queensland Mines, was involved in negotiations with the Tasmanian government for licences to mine iron ore. Just before the licences were issued, Korman and his company F Ltd ran into financial difficulties and Korman told Hudson that he had not the financial resources to proceed with the venture. Hudson took the licence in his own name. He later resigned as managing director of Queensland Mines and formed his own new company, which, at considerable risk and expense, exploited the licences and earned profits. The Privy Council held (i) that the opportunity to make the profits had come to Hudson through his position as managing director of Queensland Mines, but (ii) that since the board of that company had known of Hudson's interest at all times (and had resolved a year after the issues of the licences that Queensland Mines 'should not pursue the matter [ie the licences] any further'), Hudson was not accountable for his profit.

## (p. 441) ► Questions

1. What were the members in the *Multinational Gas* case purporting to do: exercise management decision-making power themselves; or authorise the directors in advance of the directors' action in order to enable the directors to pursue activities that would otherwise be in breach of duty; or ratify, after the event, thereby indicating that the company would not sue the defaulting directors for their breaches?
2. If the members were ratifying the wrongdoing (see *Murad v Al-Saraj* [7.35]), would their decision bind a liquidator who was subsequently appointed to the company and inclined to sue the wrongdoers?
3. If the alleged acts of negligence were committed by the directors with the *prior authorisation* of the members, do you consider the reasoning of Lawton LJ or that of May LJ more appropriate?
4. If the alleged acts of negligence were committed by the directors on their own initiative and later approved by the members, do you consider the reasoning of Lawton LJ or that of May LJ more appropriate?
5. In *Queensland Mines*, how could a decision of the board have this effect? Was the board the legitimate organ of the company to make arrangements with Hudson in advance of any breach? Or was the board of

directors really also the 'general meeting' in all but name, representing all the corporate joint venturer members, and so able to count in effect as a members' vote at a members' meeting?

***Approval or ratification by shareholders is not effective unless the decision is honest, bona fide and in the best interests of the company, including but not limited to instances of prejudice to creditors.***

**[7.40] Madoff Securities International Ltd v Raven [2011] EWHC 3102 (QBD Commercial Court)**

This case was part of the Madoff litigation. L was the liquidator of a US company (B) which had been used for a massive Ponzi scheme fraud orchestrated by Madoff (M). Investors in the scheme had lost about US\$19.5 billion. C was an English company in which 99% of the shares were held by M and 1% by his brother who acted in accordance with his instructions. C was used to launder money and to make payments of stolen money. B and C paid almost \$50 million to K, an Austrian national who introduced investors to M. B put C in funds to make the relevant payments. K described the payments as commission. C's case was that the payments were illegitimate and that the invoices were shams, although C's directors said that the payments were made on M's instructions in respect of research provided by K and they did not know or believe that the payments were by way of commission. C brought proceedings against the directors alleging breach of contract and fiduciary duty in relation to the payments and against K and her companies alleging knowing receipt and constructive trust. In response, it was suggested (amongst other matters) that there was no serious issue to be tried between C and the directors because C had suffered no loss since the money to make the payments was provided by B and/or because their acts had been either requested or approved by the shareholders, in the person of M, so that there was no breach of fiduciary duty or any breach had been ratified. The court disagreed.

FLAUX J:

94 Mr Mowschenson's [counsel for the defendants] second reason for saying there is no serious issue to be tried is a more formidable one. He submits that, where the acts of directors of a (p. 442) company have been either requested or approved by the shareholders, those acts are the acts of the company and that, as a matter of company law, the company cannot contend that the directors have acted in breach of fiduciary duty. Either there was no breach or any breach has been ratified. Mr Mowschenson contends that the only exception to this principle is if the transaction carried out by the directors at the request of or with the approval of the shareholders is one which is likely to jeopardise the solvency of the company or cause loss to its creditors.

95 The general principle that, where the conduct of the directors has been approved or authorised by the shareholders, the company cannot bring a claim for breach of duty against the directors, because the acts of the shareholders are the acts of the company, is recognised in a number of cases. A summary of the relevant principles of law is set out in ... *Multinational Gas v Multinational Services* [7.39] ...

97 The existence of an exception to that principle, where the transaction authorised by the shareholders is one which jeopardises the company's solvency or causes loss to its creditors ... can be traced to dicta of Cumming-Bruce and Templeman LJ in *Re Horsley & Weight Ltd* [4.30] ... [He continued, citing other cases referred to at 'Directors' "duties" to creditors', p 325 on duties to creditors.]

103 Mr Mowschenson submitted that this exception, that the transaction authorised must not be likely to jeopardise the company's solvency or cause loss to the creditors, was the limit of any exception to the general principle. In particular, he submitted that there was not some wider exception that the directors' breach of fiduciary duty could not be ratified where the transaction in question was not bona fides or honest.

104 He made the point that, in the present case, at the time that the payments were made to [K], [C] was completely solvent (and the contrary is not contended by the claimants). Furthermore, since the payments made all derived from the subventions from [B], the creditors of [C] could not be said to have suffered a loss, even if the company had been doubtfully solvent. In those circumstances, it was nothing to the point that Mr Madoff, the 99% shareholder of [C], was a fraudster or that the payments to [K] were the proceeds of that

fraud ... It is equally irrelevant that the true nature of the payments was disguised by Mr Madoff ... The directors' actions in making the payments had been requested or approved by Mr Madoff, so [C] was bound by his consent and could not be heard to complain of breach of fiduciary duty by the directors.

105 Mr Saini [counsel for the claimant] challenged that conclusion. He submitted that there was a wider exception based on grounds of public policy, that the general principle would not apply where the shareholders, in ratifying the directors' acts, were acting dishonestly or using the company as a vehicle for fraud or wrongdoing. That was the case here, since Mr Madoff was using [C] as a money laundering vehicle to disguise and distribute the proceeds of his fraud, including by way of the payments to [K].

106 In support of the submission that the 'doubtful solvency or loss to creditors' exception is not the only exception or is, at least, part of a wider exception, Mr Saini relies upon the judgment of the Vice-Chancellor in *Bowthorpe Holdings* [[2003] 1 BCLC 226]. In that case, one of the questions was whether the sale of shares in another company by the directors of that company was an improper exercise by them of their powers, because it was effected otherwise than in the interests of the company and at a substantial undervalue. It was submitted that, even on that assumption the claim must fail because the sale was authorised by all the shareholders of that company.

107 Having stated the general principle that a company is bound by the unanimous agreement of its shareholders, Sir Andrew Morritt V-C said this at [50]–[51]:

'But subsequent decisions show that there are exceptions to such a principle. First, the transaction must be bona fide or honest. This, in my view, is demonstrated by the qualification of Viscount Haldane in *A-G for Canada v Standard Trust* [1911] AC 498, 505 that "the case was not ... a cloak under which a conspiracy to defraud was concealed", by Younger LJ in *Re: Express Engineering Works* [1920] 1 Ch 466, 471 that "no fraud is alleged in respect of this transaction", and by Lawton LJ in *Multinational Gas v Multinational Services* [7.39], 268 that the members must act in good faith. Thus, in *Re Duomatic* [4.15], 372 Buckley J cited with approval the view (p. 443) of Astbury J in *Parker and Cooper Ltd v Reading* [1926] Ch 975, 984 that the transaction must be both *intra vires* and honest.

51. The second exception, which may be merely an exemplification of the first, is that the transaction so authorised must not be likely to jeopardise the company's solvency or cause loss to its creditors.'

108 Mr Mowschenson sought to suggest that even this 'wider' exception was limited to cases where the directors' acts, albeit approved by the shareholders, have caused prejudice to the creditors of the company ...

109 He questioned the juridical basis of a wider interpretation of the first exception. If the shareholders and directors acted dishonestly, but not in a manner which prejudiced the creditors, then their acts were still those of the company and bound the company, so that the company could not complain. No question of public policy arises in such a situation. It is all simply a question of the internal management of the company. Accordingly, if the Vice-Chancellor was stating some wider exception based on public policy, he was wrong.

110 Although I see the force of Mr Mowschenson's submissions, I am unable to accept them [at least here, on a strike-out action].

111 In my judgment, the wider first exception stated by Sir Andrew Morritt V-C was not intended to be limited to cases where there is prejudice to the creditors. ...

112 ... *Bowthorpe Holdings* stands as an authority of a court of concurrent jurisdiction to this court in support of the wider exception for which Mr Saini contends. ... [and]

113 ... that decision does not stand alone. Whilst I accept that the authorities on this wider exception, both



before and after *Bowthorpe Holdings*, are limited, those to which the Vice-Chancellor refers do not suggest that the earlier courts were limiting the exception to instances of prejudice to creditors. Rather, although none of the cases contains full reasoning, the exception recognised seems a much more general one, applicable where the transaction is one which would be a fraud on the company ... [He referred again to Lawton LJ in the *Multinational Gas* case [7.39].] ...

122 Mr Saini also relies upon the decision of John Powell QC, sitting as a Deputy High Court Judge of the Chancery Division in *Cox v Cox* [2006] EWHC 1077 (Ch). The facts of that case do not matter for present purposes, but it is another case where the court recognised the existence of the two exceptions to which the Vice-Chancellor referred in *Bowthorpe Holdings*. At [58], the learned Deputy Judge said:

‘It was submitted that, notwithstanding the liability of Mr and Mrs Cox as directors and Mrs Cox as constructive trustee, to make good to the Company the excess salary payments to Mrs Cox as a consequence of the Company’s contravention of section 151, it is open to the Company, if it so wishes, to release them from liability. I was referred to passages in Chapter 17 of Gore-Browne on Companies (45th ed.) and to the judgment of Sir Andrew Morritt V-C in *Bowthorpe Holdings Ltd v Hills* ..., especially at 241–2 ... I accept that it is open to a company, by its shareholders acting unanimously, to release a director from liability for breach of duty, provided that the release does not jeopardise the solvency of the company or cause loss to creditors and that there is no sufficient public policy objection to the [grant] of such release.’

123 Mr Mowschenson submitted that the learned Deputy Judge was wrong about there being a public policy exception in circumstances where, as he submitted, ratification of any breach of duty by the directors of a company is an internal matter. However, as I have already indicated, it does seem to me that not only *Bowthorpe Holdings* itself, but a number of other cases, including *Cox v Cox*, recognise the existence of a wider exception to the effect that a transaction can be impugned by the company if it is not honest, bona fide and in the best interests of the company. One explanation of that exception may be that public policy demands that a transaction which is not honest, bona fide and in the best interests of the company is not binding on the company. However, whatever the precise juridical basis of the wider exception, I consider that the claimants can show a serious issue to be tried that that exception applies here ...

#### **(p. 444) Relief from liability granted by the court: CA 2006 s 1157**

The court has a discretion to grant relief to directors and other officers from liability for breach of duty, similar to that which exists in relation to trustees, if they have ‘acted honestly and reasonably and ... ought fairly to be excused’: CA 2006 s 1157 (replacing CA 1985 s 727).

The court in *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749 held that the section could apply to a liability to account for profits, as well as to a liability to pay damages to the company. The discretion was exercised in *Re D’Jan of London Ltd* [7.20], but refused, in a number of well-known cases, for example *Dorchester Finance Co Ltd v Stebbing* (Note 3 at “‘Reasonable’ directors: keeping informed and delegating responsibilities”, p 358), *Guinness plc v Saunders* [5.01], and *Clark v Cutland* [2003] EWCA Civ 810, CA. (Note that in *Re Produce Marketing Consortium Ltd* [1989] 1 WLR 745, Knox J ruled that, as a matter of principle, relief under CA 1985 s 727 could not be granted in favour of a director who is held liable to pay compensation for wrongful trading under IA 1986 s 214: see *Re Produce Marketing Consortium Ltd (No 2)* [16.16].) It is clear that the economic realities of the case are relevant to the court’s exercise of its CA 2006 s 1157 discretion.<sup>80</sup>

Two recent Court of Appeal decisions (both of which refused to grant the relief) further illustrate the court’s approach under s 1157. In *Towers v Premier Waste Management Ltd* [7.24], the failure to make disclosure was found to be a breach of the director’s fiduciary duties; the regurgitation of arguments used to show that there had not been a breach proved similarly ineffective in seeking relief under s 1157. Given the limited additional arguments under this head, the Court of Appeal commended the brevity of the lower court’s treatment of this part of the case.

T had owed fiduciary duties to P and had acted in breach of those duties in circumstances where there was no mitigating factor and no evidence of injustice or hardship which might be relevant to granting relief in his favour. Just as the absence of any finding of bad faith or actual conflict, the reasonableness of T's reliance on R and the lack of direct contact between T and F, and the absence of quantifiable loss by P or the negligible profit to T, did not justify a finding that there was no breach of duty, so too they did not justify relieving him from the consequences of his breach of duty.

In *Smith v Butler* [2012] EWCA Civ 314, CA, having clarified the ambit of a managing director's powers, and thus finding that the managing director had no authority to exclude the chairman from the company, it was then held that the manager director had no power to cause the company to support his actions by resisting the chairman's applications. As the managing director had already proposed to resist the applications, the company could have avoided any significant expenditure if it had simply filed a defence to the effect that it would abide by any court orders arising from those proceedings. It was this feature of the case which led to Arden LJ's conclusion that no relief under s 1157 should be granted.

## **Contracting out of liability: CA 2006 ss 232–238**

Under CA 2006 s 232, 'Any provision that purports to exempt a director of a company (to any extent) from any liability that would otherwise attach to him in connection with any negligence, default, breach of duty or breach of trust in relation to the company is void.' The rule (p. 445) covers provisions in the articles and in separate contracts (s 232(3)). The early predecessors to this section were introduced as a knee-jerk reaction to the decision in *Re City Equitable Fire Insurance Co Ltd* [7.19].

Specific exceptions are allowed by way of providing the director with insurance, qualifying third party indemnity provisions or qualifying pension scheme indemnity provisions (s 232(2)). A further exception is provided in s 205 (exception for expenditure on defending proceedings etc).

Section 232 retains the unresolved difficulty of its predecessors, however, since s 232(4) provides: 'nothing in the section is to be taken as preventing the company's articles from making such provision as had previously been lawful for dealing with conflicts of interest.' Such provisions in the articles are common, permitting certain activities by directors that would otherwise constitute breaches of the no conflict rule. How these provisions could be regarded as legitimate in the face of the predecessor to s 232 (CA 1985 ss 309A–309C) was troubling.

In *Movitex Ltd v Bulfield* [1988] BCLC 104, Vinelott J attempted to resolve the issue by holding that the rule against self-dealing by a trustee or a director is properly seen as a *disability* or restriction on the conduct of a fiduciary and not a *duty*: articles which exclude or modify the application of this rule did not, therefore, infringe CA 1985 ss 309A–310. It did not help matters much, and the analysis was described in *Gwembe Valley Development Co Ltd v Koshy (No 3)* [7.37] as a 'needless complication'. In any event, all this rather unsatisfying mental gymnastics is no longer possible now that the codified rules expressly regard all the rules as 'duties'. Also see R Nicholson, 'Authorising Multiple Directorships in Unrelated Companies: Table A to the Rescue?' (2011) 9 *Journal of International Banking and Finance Law* 534.

## **Special rules on notice requirements and members' approval for certain transactions: CA 2006 ss 182–231**

### **Declarations of interest in existing transactions or arrangements: ss 182–187**

Section 182 provides that if a director enters into a transaction or arrangement with the company without declaring his interest under s 177 (duty to declare interest in proposed transaction or arrangement), he will be under an immediate obligation to declare that interest and failure to do so will constitute a criminal offence (see s 183 (offence of failure to declare interest)). Even in these circumstances, however, it seems that the director is given a reasonable amount of time in which to comply with the duty in s 182 (see subs (4)). (This provision replaces CA 1985 s 317 with regard to existing transactions and arrangements.)

Unlike s 177, s 182(2) makes it clear that directors must use one of the three prescribed methods of declaration. Sections 184–187 elaborate on these, and in particular provide rules for sole directors of companies that ought to have two or more directors, and for shadow directors. Presumably a failure to make a declaration in the prescribed manner will render the declaration either a nullity or incomplete, and a further declaration will be required (s 182(3)); how this requirement will be reconciled with s 182(6)(b), indicating that the duty does not apply if the other directors are already aware of the interest, or ought to be aware of the interest, is unclear. As with s 177, certain interests do not have to be declared.

Unlike the duty to declare an interest in a *proposed* transaction or arrangement (s 177), it is a criminal offence not to comply with the duty to declare an interest in an *existing* transaction (p. 446) or arrangement. The Attorney General, Lord Goldsmith, in Grand Committee explained the rationale behind this:

because one is here concerned with an existing transaction or arrangement, the failure to declare cannot affect the validity of the transaction or give rise to any other civil consequences. That is to be contrasted with the position where there is a failure to disclose an interest in relation to a proposed transaction where the law can say that as a result of the failure to disclose that interest—and the company then enters into the transaction in ignorance of that—consequences follow. The transaction may be voidable, to be set aside. The company may wish to claim financial redress in one form or another as a result of what has taken place. But, as I say, that is different from a failure to declare an interest in an existing transaction where those considerations probably cannot arise. That is why a criminal offence is created. (HL GC Day 4, Hansard HL 678, 9/2/06, col 338)

This does not appear to be an accurate description of the differences between these two provisions. If a director *complies* with s 177, then the company can decide on a fully informed basis whether to proceed with the proposed transaction or arrangement. Section 180 indicates that this declaration replaces the need for the approval of the company's members under the equitable rules, although any additional requirements imposed by the articles will still have to be met. Assuming these additional requirements (if any) have also been met, the transaction cannot be impugned for breach of s 177 or for breach of the no conflict and no profit rules in relation to transactions with the company. However, note that the deal might nevertheless be a breach of some other general statutory duty, and give rise to an action for a remedy under some other head. The availability of the relevant remedies in those particular circumstances will then need to be assessed in the usual way.

On the other hand, if s 177 is *not* complied with, and the company nevertheless enters into the proposed transaction or arrangement, then the director will be in breach of s 177 and, if the breach continues, will also be in breach of s 182. The equitable remedies for breach of the general statutory duty can be pursued against the defaulting director (and, again, an assessment will have to be made about the availability of various remedies—eg rescission will not be available against a bona fide third party purchaser, but will be available against other parties not protected by this equitable rule, including the director). In addition, the director will also be liable for the criminal offence described in s 183. Put this way, there is no logical divide between the remedies available for breach of ss 177 and 182; indeed, if s 177 is breached, and the proposed arrangement is pursued, s 182 will also be breached so long as the director fails to declare the interest. Section 177 is therefore not a provision designed to *impose* liability on directors, but a provision designed to afford protection to those who comply with it.

In this sense, there is the same relationship between ss 183 and 178 (as influenced by s 180) as there is between CA 1985 s 317 and the equitable consequences of breach of the no conflict and no profit rules (as influenced by any relevant consents given by the members or given in the way allowed by the articles). See *Guinness plc v Saunders* [1990] 2 AC 663, 697 (Lord Goff) [5.01]; *Coleman Taymar Ltd v Oakes* [2001] 2 BCLC 749.

## Transactions with directors requiring the approval of members

Certain transactions between the company and its directors are deemed sufficiently 'risky' to require members' approval for their validity, rather than the simpler procedure of board approval set out in s 177. The details of the statutory provisions are not addressed here, but the sections repay careful reading. Several categories of transactions are affected: