adequate majority of shares and so not proceed with the bid, thus keeping the directors in power (see ***Hogg*** v ***Cramphorn*** [1966] 3 All ER 420). There is, of course, statutory protection in this area in that the directors require the authority of the members to allot shares, and there are also pre-emption rights given to existing shareholders unless the shareholders have disapplied them. Nevertheless, cases such as ***Hogg*** have a continuing relevance since in private companies these rights may be disapplied by the articles. In such a situation, the case law would have to be used to render the allotment of shares to the nominees invalid. A further 'poison pill' device was before the High Court in the following case.

Criterion Properties plc* v *Stratford UK Properties LLC [2002] 2 BCLC 151

The managing director of the claimant company made an agreement with a substantial shareholder that required the company to buy out the shareholder at a high price should there be a change of control or composition of the board of directors of the company. The managing director was later removed from office and the company asked the court to set aside the agreement because it was entered into for an improper purpose. The High Court ruled that the agreement, which was intended to put off an unwelcome bidder, in a predatory takeover, had been made for an improper purpose. The damage that would be caused to the company by making the substantial shareholder buy-out would be greater than any harm likely to be inflicted on it by an acquisition. The agreement was not a proper exercise of a director's powers and could not be enforced against the company.

Comment

A 'poison pill' is North American jargon for a legal device of any form put in place by the management of a company that feels vunerable to predatory acquisition, designed as a defence mechanism to eliminate or reduce that risk. Other expressions such as 'shark repellant' are also used.

See p. 94

Therefore, a director has a duty to exercise the company's powers for the purposes for which they were allocated to him and the Board of Directors (see discussion in Chapter 4). This is reinforced by Turner LJ's statement in ***Re Cameron's Coalbrook Steam Coal, and Swansea and Kougher Railway Co, Bennett's Case*** (1854) 5 De GM & G 284,

> . . . in the exercise of the powers given to them . . . they must, as I conceive, keep within the proper limits. Powers given to them for one purpose cannot, in my opinion, be used by them for another and different purpose. To permit such proceedings on the part of directors of companies would be to sanction not the use but the abuse of their powers. It would be to give effect and validity to an illegal exercise of a legal power.

The question naturally arises as to where the limits of a director's powers end and when an individual starts to overstep what is deemed to be an acceptable use of their powers. In many instances, a common sense approach will suffice as a company's articles should outline the various powers/day-to-day decision-making activities which have been given to the board of directors. However, this will not always be the case and, in those instances, it will be necessary to look at the specific facts of the case and for the court to decide if a power has been exercised for a proper or improper purpose and as to whether the director has acted in accordance with the company's constitution (***Howard Smith Ltd*** v ***Ampol Petroleum Ltd*** [1974] AC 821).

Howard Smith Ltd* v *Ampol Petroleum Ltd [1974] AC 821

Two companies, A and B, held 55 per cent of the issued shares of company M, which required more capital. A made an offer for all the issued shares of M, and another company, H, announced an intention to make a higher offer for those shares. M's directors considered A's offer too low and decided to recommend that the offer be rejected. A and B then stated that they intended to act jointly in the future operations of M and would reject any offer for their shares. H then applied to M for an allotment of 4½ million ordinary shares; M's directors decided by a majority to make the allotment and immediately issued the shares. The effect of that issue was that M had much needed capital; A and B's shareholding was reduced to 36.6 per cent of the issued shares and H was in a position to make an effective takeover offer. A challenged the validity of the issue of the shares to H and sought an order in the Supreme Court for the rectification of the share register by the removal of H as a member of M in respect of the allotted shares. M's directors contended that the primary reason for the issue of the shares to H was to obtain more capital. On Appeal Lord Wilberforce stated:

> To define in advance exact limits beyond which directors must not pass is, in their Lordships' view, impossible. This clearly cannot be done by enumeration, since the variety of situations facing directors of different types of company in different situations cannot be anticipated. No more, in their Lordships' view, can this be done by the use of a phrase – such as 'bona fide in the interest of the company as a whole', or 'for some corporate purpose'. Such phrases, if they do anything more than restate the general principle applicable to fiduciary powers, at best serve, negatively, to exclude from the area of validity cases where the directors are acting sectionally, or partially: i.e. improperly favouring one section of the shareholders against another . . .
>
> In their Lordships' opinion it is necessary to start with a consideration of the power whose exercise is in question, in this case a power to issue shares. Having ascertained, on a fair view, the nature of this power, and having defined as can best be done in the light of modern conditions the, or some, limits within which it may be exercised, it is then necessary for the court, if a particular exercise of it is challenged, to examine the substantial purpose for which it was exercised, and to reach a conclusion whether that purpose was proper or not in doing so it will necessarily give credit to the bona fide opinion of the directors, if such is found to exist, and will respect their judgment as to matters of management; having done this, the ultimate conclusion has to be as to the side of a fairly broad line on which the case falls.

Held – dismissing the appeal, that, although the directors had acted honestly and had power to make the allotment, to alter a majority shareholding was to interfere with that element of the company's constitution which was separate from and set against the directors' powers and, accordingly, it was unconstitutional for the directors to use their fiduciary powers over the shares in the company for the purpose of destroying an existing majority or creating a new majority; and that, since the directors' primary object for the allotment of shares was to alter the majority shareholding, the directors had improperly exercised their powers and the allotment was invalid.

In addition, the state of mind of the directors at the time that an alleged abuse or misuse of powers took place is an important consideration for the courts. In the case of ***Hogg* v *Cramphorn*** [1966] 3 All ER 420, it was acknowledged by the courts that while Colonel Cramphorn had exceeded the true purpose for which the power to allot shares had been conveyed to the company's directors, his intentions were, nevertheless, bona fide in what he considered to be the best interest of the company. However, there may be instances where the rationale behind a director's improper use of a power may be multi-faceted and, in such instances, the courts will seek to identify the 'dominant purpose behind the act'. This issue was considered by Viscount Finlay in ***Hindle* v *John Cotton Ltd*** (1919) 56 SLR 625, when he noted:

> Where the question is one of abuse of powers, the state of mind of those who acted, and the motives on which they acted, are all important, and you may go into the question of what their intention was, collecting from the surrounding circumstances all the materials which genuinely throw light upon that question of the state of mind of the directors so as to show whether they were honestly acting in discharge of their powers in the interests of the company or were acting from some by-motive, possibly of personal advantage, or for any other reason.

This is reinforced by Lord Wilberforce's observation in ***Howard Smith Ltd*** v ***Ampol Petroleum Ltd*** [1974] AC 821 (see above):

> When a dispute arises whether directors of a company made a particular decision for one purpose or for another, or whether, there being more than one purpose, one or another purpose was the substantial or primary purpose, the court, in their Lordship's opinion, is entitled to look at the situation objectively in order to estimate how critical or pressing, or substantial or, per contra, insubstantial an alleged requirement may have been. If it finds that a particular requirement, though real, was not urgent, or critical, at the relevant time, it may have reason to doubt, or discount, the assertions of individuals that they acted solely in order to deal with it, particularly when the action they took was unusual or even extreme.

Duty to promote the success of the company

The statutory duty

Section 172 of the Companies Act 2006 provides that:

1 A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (among other matters) to:
   (a) the likely consequences of any decision in the long term,
   (b) the interests of the company's employees,
   (c) the need to foster the company's business relationships with suppliers, customers and others,
   (d) the impact of the company's operations on the community and the environment,
   (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
   (f) the need to act fairly as between members of the company.

2 Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

3 The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

The decision as to what will promote success and what is success is one for the director's good faith judgment and will be discussed further below in relation to the case law in the area. However, a look at the director's motive and intent will be essential for divining such judgment on a director's part. It is also worth noting that the 'six factors' set forth in s 172 must

find their way into every decision a director makes on behalf of a company and they are only subservient to the duty of directors to promote the success of the company.

The related common law and equitable principles

In many respects, the case law already discussed in relation to a director's duty to act in accordance with the company's constitution and to use the powers available to him for their proper purposes overlaps with this statutory duty. However, it is worth considering some of the case law which relates to the decision-making process and, more importantly, whether the actions of a director will be second-guessed by a court which has the benefit of hindsight.

In ***Re Smith and Fawcett Ltd*** [1942] Ch 304, Lord Greene MR observed that directors must act 'bona fide in what they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose'. Consequently, if this approach is applied to s 172 then a director is expected to behave in a fashion that he himself honestly considers will be most likely to promote the success of the company. The court will not intervene so as to impose what it considers, with the benefit of hindsight and expert evidence, to be the appropriate actions. As Jonathan Parker J observed in ***Regentcrest Plc* v *Cohen*** [2001] 2 BCLC 80,

> 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.

Turning to the concept of 'success of the company', then s 172 includes an important phrase which has, for some time, been the subject of debate; 'for the benefit of its members as a whole'. In other words, the actions of a company's directors must take account of not only the shareholders but also the company as a separate legal entity. This latter aspect, though relatively easy to understand, is nevertheless quite challenging to analyse, especially in terms of posing the question '*What is best for the company as a separate legal entity*?' This in turn usually leads to a consideration of the interests of current and future shareholders, before being extended so as to consider other stakeholders in the company. Section 172 addresses this issue by focusing upon the 'members as a whole' and then, separately, as an additional list of considerations, itemises the company's stakeholders.

The result is that with this new statutory duty, a court may, at least initially, follow the reasoning set out by Goulding J in ***Mutual Life Insurance Co of New York* v *Rank Organisation Ltd*** [1985] BCLC 11, in that the powers outlined in a company's constitution to its directors are subject to two implied considerations: 'First, the time-honoured rule that the director's powers are to be exercised in good faith in the interests of the company, and secondly, that they must be exercised fairly between different shareholders.'

However, while directors do not, in general, owe any contractual or fiduciary duties directly to members of their company (***Percival* v *Wright***, 1902, see below), the situation becomes slightly more complex in situations involving a takeover situation. First of all, there appears to be a duty to shareholders in regard to the advice, if any, given by directors to those shareholders in regard to the acquisition or rejection of a takeover bid. Company legislation does

not deal with this. However, in ***Gething* v *Kilner*** [1972] 1 All ER 1166, it was said that in a takeover the directors of the 'victim' company owe a duty to their shareholders to be honest and not to mislead as by suppressing, for instance, professional advice recommending rejection, and that the court might grant an injunction where this had happened, to prevent the bid going ahead. Where there are competing offers then the directors are not under a positive duty to recommend and facilitate the acceptance of the highest offer (***Dawson International plc* v *Coats Patons plc*** [1988] SLT 854).

Percival* v *Wright [1902] 2 Ch 421

The claimant wished to sell shares in the company and wrote to the secretary asking if he knew of anyone willing to buy. After negotiations, the chairman of the board of directors arranged the purchase of 253 shares, 85 for himself and 84 for each of his fellow directors at a price based on the claimant's valuation of £12 10s per share. The transfers were approved by the board and the transactions completed. The claimant subsequently discovered that prior to and during the negotiations for the sale, a Mr Holden was also negotiating with the board for the purchase of the company for resale to a new company, and was offering various prices for shares, all of which exceeded £12 10s per share. No firm offer was ever made, and the negotiations ultimately proved abortive, and the court was not satisfied that the board ever intended to sell. The claimant brought this action against the directors asking for the sale of his shares to be set aside for non-disclosure.

Held – by Swinfen Eady J – the directors are not trustees for the individual shareholders and may purchase their shares without disclosing pending negotiations for the sale of the company. A contrary view would mean that they could not buy or sell shares without disclosing negotiations, a premature disclosure of which might well be against the best interests of the company. There was no unfair dealing since the shareholders in fact approached the directors and named their own price.

Comment

(i) The Criminal Justice Act 1993 would not seem to affect this decision since it does not apply its insider dealing provisions to private dealings in shares but only to dealings on a recognised stock exchange. In any case, the Act gives no civil claim but merely contains criminal sanctions.

(ii) It should not be assumed that an obligation of trust and good faith may not arise if the circumstances require it. In ***Platt* v *Platt*** [1999] 2 BCLC 745 the High Court ruled that although the relationship between a company director and the shareholders of the company does not of itself give rise to fiduciary duties, special circumstances may require the imposition of such a duty. Three brothers – Colin, Denis and Keith Platt – were shareholders in an Essex company holding a BMW dealership. Keith ran the business and held ordinary shares. Colin and Dennis, the claimants, did not work in the business and held preference shares. The company did badly in the recession of the early 1990s. By 1992 Keith was the only brother in touch with BMW and the only director of the company. Keith misled his brothers by telling them that BMW was about to withdraw the franchise and was urging him to sell. As a result, Colin and Denis transferred their preference shares to Keith for £1. These transfers were said to be necessary to enable the business to be sold. Subsequently profitable trading resumed and the business was not sold. Later BMW terminated the franchise and the business was sold leaving net profits after all expenses of some £770,000. Colin and Denis, who could not participate in those profits, claimed damages for misrepresentation and breach of fiduciary duty by Keith.

In particular, the court accepted the existence of a fiduciary duty in the circumstances. The interpretation of ***Percival* v *Wright*** [1902] 2 Ch 421 as deciding that directors owe no fiduciary duties to shareholders was not followed on the ground that the ***Percival*** case had been interpreted too widely. Such a wide interpretation did not follow from the underlying facts in *Percival*.

(iii) In ***Peskin* v *Anderson*** [2001] 1 BCLC 372 the Court of Appeal affirmed that, in the absence of a special relationship, directors do not owe a duty to individual shareholders to keep them constantly informed of all matters that might affect their position. Mr Peskin claimed damages against the directors of the RAC because he resigned his membership before its demutualisation and failed to get the consequent cash benefit. The directors had not disclosed from the beginning the negotiations about and proposals for the demutualisation and the Court of Appeal ruled that they were not required to do so. They had not been directed by the members to demutualise and were not therefore negotiating on their behalf. This was a sensible decision because in such matters the board must be left to formulate proposals which may at some stage be put to the members but not as soon as the idea occurs and is moved forward.

Secondly, where a listed company is concerned, the Stock Exchange has introduced a code of dealing for directors. The rules which the City Panel has laid down now have the force of law. In addition, the Panel on Takeovers and Mergers may issue and publish a reprimand for insider dealing in the shares of a company prior to its takeover and this could have an adverse effect upon the career, particularly of a professional person (see Chapter 24). The Stock Exchange, in consultation with the CBI, published a Model Code for Securities Transactions, to give guidance as to when it is proper for directors of listed companies to deal in the securities of the company. This Code received widespread acceptance and became part of the Listing Agreement. The main principles of the Code have already been considered (see Chapter 13).

See p. 531

See p. 259

Directors may become agents of the members for a particular transaction, in which case the situation of agency gives rise to fiduciary duties.

Allen* v *Hyatt (1914) 30 TLR 444

In this case the directors induced the shareholders to give them options for the purchase of their shares so that the directors might negotiate a sale of the shares to another company. The directors used the options to purchase the shares themselves and then resold them at a profit to the other company.

Held – by the Privy Council – that the directors had made themselves agents for the shareholders and must consequently account for the profit which they had obtained.

Comment

There are disadvantages in this agency arrangement. It was held by the House of Lords in ***Briess* v *Woolley*** [1954] 1 All ER 909 that where shareholders employ the directors to negotiate a sale of their shares, the shareholders will be vicariously liable in damages to the purchaser if the directors fraudulently misrepresent the state of the company's affairs to the purchaser of the shares.

Interests of the company's employees

Turning now to the list of stakeholders contained in s 172(1), to whom the directors should have regard when making decisions, it is important to emphasise the fact that while, for example, the interests of employees must be considered, the duty is owed not to the employees but directly to the company. (The same situation existed under s 309 of the Companies Act 1985.)

It would, for example, be within the provision for the directors so to arrange the company's business as to save jobs, provided the company's interests were also served in a reasonable

fashion. It would not be within it for the directors to carry on the company's business at a loss and put it at risk of liquidation in order to save jobs. There must be a balance of interests but the interests of the employees must be considered.

The provisions cannot be enforced by employees unless they are also shareholders and even then a shareholder will have to bring himself within one of the exceptions to ***Foss* v *Harbottle*** (see Chapter 15). In normal circumstances a shareholder should be able to do this on the grounds that if the directors are ignoring the employee provisions they are doing an act contrary to law, i.e. an act contrary to the Companies Act 2006. However, unless there is damage to the company the most which a shareholder would be entitled to would be a declaration that the directors had failed to consider the interests of the employees in breach of the Act. While accepting that one cannot predict how the courts will interpret these provisions it does appear to be a declaration of good intent and little more. It is unlikely that the company will take action to enforce the duty.

See p. 289

The CA 2006 also provides that the powers of a company are deemed to include, if they do not otherwise do so, the power to make provisions for its own or a subsidiary's employees or former employees when the company itself or that subsidiary:

(a) ceases to carry on the whole or any part of its undertaking; or
(b) transfers the whole or any part of its undertaking.

The Act specifically states that the exercise of that power need not be in the best interests of the company. This provision therefore reverses the decision in ***Parke* v *Daily News Ltd*** [1962] Ch 927. Briefly, the facts of that case were that the defendant company had sold the major part of its business and proposed to use the proceeds to make payments to employees by way of redundancy pay before such payments were required by law. However, the court held that such payments were not for the benefit of the company, but rather for the benefit of the employees and, therefore, the company had no power to make the payments.

Where a company has power to make provision for its employees only by reason of the CA 2006, then the exercise of the power must normally be approved by an ordinary (or written) resolution. However, this does not apply if the memorandum or the articles contain a provision whereby the power can be exercised by a directors' resolution or require its sanction by a resolution other than an ordinary resolution of the company in general meeting, e.g. a special resolution.

The resolution can be implemented by a liquidator even though it was passed before the winding-up (Insolvency Act 1986, s 187). Furthermore, the power may be exercised by the liquidator if the following conditions are complied with:

(a) the company's liabilities have been fully satisfied;
(b) provision has been set aside for the costs of the winding-up;
(c) the exercise of the power has been approved either by such a resolution of the company as is required by the company's constitution or, if there is no such requirement, by an ordinary (or written) resolution of the members; and
(d) any other relevant requirements of the memorandum or the articles have been complied with.

It should be noted that if any payment is made before the commencement of a winding-up, then it must be made out of profits available for dividend as defined in the Companies Act 2006. In any other situation it must be made out of those assets of the company that are

available to its members on its winding-up. In other words a payment cannot be made in order to prejudice creditors.

In connection with the power of the liquidator to implement the above provisions, it should be noted that s 167 of the Insolvency Act 1986 applies so that in a compulsory winding-up the liquidator exercises this power like all his others subject to the control of the court, and any creditor or contributory of the company may apply to the court with respect to the liquidator's exercise or proposed exercise of these powers if he does not agree with the way in which things are being done. In a voluntary winding-up the liquidator may make an application to the court for directions under s 112 of the 1986 Act if he is in any doubt as to whether he should exercise the above powers.

Since a company employer is bound in any case today to make basic redundancy payments a common application of the above provisions would be where the company intends to make redundancy payments, on a transfer of its business, which are in excess of the basic statutory requirements.

Interests of the company's creditors

In a solvent company the shareholders are entitled, as a general body, to be regarded as 'the company' when questions of the duty of directors arise. However, where a company is insolvent the interests of the creditors intrude. They have power, through insolvency procedures, to control the company's assets which are, in a practical sense, their assets and not the shareholders' assets.

Consequently, s 172(3) of the Companies Act 2006 makes it quite clear that the focus of a director's duties will shift away from the 'members as a whole' to that of the creditors when the company becomes insolvent.

Liquidator of West Mercia Safetywear Ltd* v *Dodd [1988] BCLC 250

Mr A J Dodd was a director of two companies, West Mercia and A J Dodd Ltd. The bank account of West Mercia was in credit while that of A J Dodd Ltd was considerably overdrawn. Both companies eventually went into insolvent liquidation and it then emerged that Mr Dodd had paid away £4,000 of West Mercia's money to discharge a debt which it owed to A J Dodd Ltd at a time when both companies were proceeding towards liquidation and the liquidator had instructed the directors not to operate either bank account. The advantage to Mr Dodd was that he had personally guaranteed the overdraft of A J Dodd Ltd and the payment reduced his liability on the guarantee. The Court of Appeal ordered Mr Dodd personally to repay the money to the liquidator of West Mercia on the basis that he was in breach of his duty to the creditors of West Mercia.

Comment

A further example of a breach of duty to creditors and the company is to be found in the ruling of the Court of Appeal in ***MacPherson* v *European Strategic Bureau Ltd*** (2000) *The Times*, 5 September. In that case three persons were members of the company. The relationship between them broke down and the company was not a success. The director/shareholders made an agreement under which two of them were to leave the company under a contract that repaid money owed to them being loans to finance the company and the profit from certain contracts of the company. All of this was expressed to be for payment of consultancy services to the company. The company later went to court to challenge the validity of the contracts. The Court of Appeal eventually ruled:

- that the contractual arrangement though supported by consideration in terms of the consultancy was not binding on the company because it was not for its benefit. It amounted to an informal distribution of assets as on a winding-up without making provision for all the company's creditors. It was a breach of the directors' duties and outside the powers of the company;
- although the matter did not arise because the contractual arrangements were not binding on the company, they were basically an infringement of the distribution rules of the 1985 Act since they were not distributions of profit alone but also distributions of the company's assets, which was permitted by law only in a winding-up (see s 263(2)(d)), but, being *remuneration* not *dividend*, they were valid;
- although it was not necessary in the circumstances to reach a definitive view, the arrangements appeared to constitute unlawful assistance for the purchase of shares since it was clearly envisaged that the departing shareholders would transfer their shares to the remaining shareholder with a material reduction in the net assets of the company.

Duty to exercise independent judgment

The statutory duty

Section 173 of the Companies Act provides:

1 A director of a company must exercise independent judgment.
2 This duty is not infringed by his acting:
   (a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or
   (b) in a way authorised by the company's constitution.

The related common law and equitable principles

One of the most useful cases with respect to this duty is that of ***Boulting* v *Association of Cinematograph, Television and Allied Technicians*** [1963] 2 QB 606, in which Lord Denning MR noted:

> It seems to me that no one, who has duties of a fiduciary nature to discharge, can be allowed to enter into an engagement by which he binds himself to disregard those duties or to act inconsistently with them. No stipulation is lawful by which he agrees to carry out his duties in accordance with the instructions of another rather than on his own conscientious judgment; or by which he agrees to subordinate the interests of those whom he must protect to the interests of someone else.

Duty to exercise reasonable care, skill and diligence

The statutory duty

Section 174 of the Companies Act 2006 requires a director of a company to exercise reasonable care, skill and diligence. It provides:

1 A director of a company must exercise reasonable care, skill and diligence.
2 This means the care, skill and diligence that would be exercised by a reasonably diligent person with:
   (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
   (b) the general knowledge, skill and experience that the director has.

The related common law and equitable principles

It has been an accepted part of a director's duties to the company that he owes a duty of care to the company at common law not to act negligently in managing its affairs. The standard is that of a reasonable man in looking after his own affairs, and it might fairly be said that the earlier cases show that the duty is not a high one.

Re City Equitable Fire Insurance Co [1925] Ch 407

In this case the chairman of the company committed frauds by purporting to buy Treasury bonds just before the end of the accounting period and selling them just after the audit. By this method a debt due to the company from a firm in which the chairman had an interest was considerably reduced on the balance sheet by increasing the gilt-edged securities shown as assets. With regard to the duty of auditors it was *held* that they might have been negligent in that they had not asked for the production of the Treasury bonds but appeared to have trusted the chairman. However, they were held not liable mainly because this was one item in a very large audit. The case does, however, show a movement towards a situation in which the auditors cannot necessarily implicitly trust the company's officers. The case is also concerned with the duties of directors in that it appeared that the directors of this insurance company had left the management of its affairs almost entirely to the chairman and it was perhaps because of this that he had more easily been able to perpetrate his frauds. In the course of his judgment, Romer J laid down the following duties of care and skill required of directors, and the general view is that these are not unduly burdensome:

> [. . .] (1) A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. A director of a life insurance company, for instance, does not guarantee that he has the skill of an actuary or of a physician [. . .] (2) A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings . . . He is not, however, bound to attend all such meetings though he ought to attend whenever, in the circumstances, he is reasonably able to do so. (3) In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly.

Comment

A classic illustration of the above principles is to be found in the earlier ***Marquis of Bute's Case*** [1892] 2 Ch 100 where the Marquis was made president of the Cardiff Savings Bank at six months old by inheriting the office from his father. He attended one board meeting in 38 years and was held by Stirling J not liable for certain irregularities in the lending operations of the bank.

However, in modern times when the directors of companies are often experts in certain fields, e.g. accounting, finance or engineering, a higher standard of competence may now be expected of them in their own sphere. Certainly directors employed by companies in a

professional capacity, i.e. executive directors, have a higher objective standard of care to comply with (see ***Lister* v *Romford Ice and Cold Storage Co*** [1957] 1 All ER 125), and so have non-executive directors who are qualified or experienced in a relevant discipline.

Dorchester Finance Co Ltd* v *Stebbing [1989] BCLC 498

On 22 July 1977 Foster J dealt, in the Chancery Division, with this case which concerned the duties of skill and care of company directors. The decision was not initially reported, which is unfortunate since it seems to be the first decision in this area of the law since ***Re City Equitable Fire Insurance Co Ltd***. The case concerned a money lending company, Dorchester Finance, which at all material times had three directors. Only one, S, was involved in the affairs of the company on a full-time basis. No board meetings were held and P and H, the other directors, made only rare visits to the company's premises. S and P were qualified accountants and H had considerable accountancy experience, though he was in fact unqualified. It appeared that S caused the company to make loans to other persons and companies with whom he had some connection or dealing, and that he was able to achieve this, in part at least, because P and H signed cheques on the company's account in blank at his request. The loans did not comply with the Moneylenders Acts and adequate securities were not taken so that the loans could not be recovered by the company which then brought an action against the three directors for alleged negligence and misappropriation of the company's property.

Held – by Foster J – that all three directors were liable to damages. S, who was an executive director, was held to have been grossly negligent and P and H were also held to have failed to exhibit the necessary skill and care in the performance of their duties as non-executive directors, even though the evidence showed that they had acted in good faith throughout. The decision is of particular importance in regard to P and H because the judge appears to have applied a higher standard for non-executive directors than that laid down in the ***Re City Equitable*** case. In particular, the judge rejected any defence based upon non-feasance, i.e. the omission of an act which a person is bound by law to do. Contrary to ***Re City Equitable***, therefore, it would seem from this case to be unreasonable for a non-executive director not to attend board meetings or to show any interest in the company's affairs and merely rely on management, or, according to the judge, on the competence and diligence of the company's auditors.

Comment

It is not possible to say with certainty whether this decision affects the liability of non-executive directors who are not qualified or experienced in a discipline relevant to company administration. It was obviously of importance that P and H were experienced accountants and one would have expected a more objective and higher standard to be applied to such persons, even in their capacity as non-executive directors. The matter is really one which should be dealt with by legislation but there is nothing which is relevant to this problem in the Companies Act 1985. However, it is worth noting that Foster J did not make any distinction between executive and non-executive directors, stating that their duties were the same.

See p. 554

The UK standard of care is also being derived from the law relating to wrongful trading by directors. In particular, s 214 of the Insolvency Act 1986 (see further Chapter 25) provides for personal liability for directors in such amount as the court may decide in an insolvent liquidation as a contribution to the company's debts. The section is based on negligence and the standard is objective. The qualified/experienced (or talented) director is judged by the higher standard he ought to have but other directors are required to reach a level of competence to an objective standard. The court will consider current practice.