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HISTORICAL INTRODUCTION TO THE LAW RELATING TO THE DUTIES AND LIABILITIES OF DIRECTORS

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A. Introduction

Directors of a company are identified by their functions, rather than their descriptive title. The Joint Stock Companies Act 1844, the first of the Victorian statutes on company law, defined directors as 'the persons having the direction, conduct, management, or superintendence of the affairs of the company'.¹ The Companies Act 1862 did not provide definitions, but since 1908 the Companies Acts have provided that in those Acts a director 'includes any person occupying the position of director, by whatever name called', so including de facto directors.² Whereas the 1844 Act made it clear that the directors, not the shareholders, had the conduct of the ordinary management of the company, with power to make contracts, execute documents, and hire employees and agents,³ subsequent Companies Acts have imposed duties on directors, but left it to the company's constitution to provide for the directors' functions and powers. **1.01**

¹ 1844 Act, s 3.

² 1908 Act, s 285; 1929 Act, s 380; 1948 Act, s 455; 1985 Act, s 741(1); and 2006 Act, s 250.

³ 1844 Act, s 27.

- 1.02** Directors occupy a central position in the structure of company law, made up of statutory provisions supported by common law rules and equitable principles. The structure reflects three purposes.⁴ The first purpose is that companies are formed and managed by the directors for the benefit of shareholders. This is achieved through the fiduciary obligations of directors and their duties of care, skill, and diligence, remedies at law for their breach, and by the shareholders' powers of dismissal.⁵ That purpose is subject to the second purpose, which is that there should be safeguards for the benefit of actual and potential creditors. This is achieved through directors' duties, insolvency law, and special provisions or rules about, for example, capital maintenance. Finally, as reflected in accounting and disclosure requirements, company law operates for the benefit of the community as a whole, including actual and potential shareholders and creditors.
- 1.03** The following sections of this chapter trace the changing functions and obligations of directors as reflected in the default articles prescribed for companies, identify the common law rules and equitable principles which support the statutory framework, and finally outline the changes in statute law as they have affected the functions, duties, and liabilities of directors. These matters are discussed in more detail in later chapters.

B. Articles of Association Relating to Directors

- 1.04** The Companies Acts of 1862, 1908, 1929, and 1948 prescribed articles of association in the form of Table A, which would stand as the default articles for companies unless excluded or modified, as was frequently the case. Table A for the 1985 Act and the Model Articles for the 2006 Act have been prescribed by statutory instruments.⁶ Under the 2006 Act there are separate Model Articles for private companies limited by shares (pcls), private companies limited by guarantee (plg), and public companies (plc). Many companies, particularly larger ones, adopt bespoke articles which depart to a greater or lesser extent from the Table A model or the 2006 Model Articles.
- 1.05** The 1862 Act, Table A established the essential features of the office of director which, with modifications, were repeated in the 1908, 1929, 1948, and 1985 Tables.⁷ The significant developments have concerned directors with executive functions and conflict of interest. The first directors were appointed by the subscribers and thereafter by the company in general meeting, subject to a power of the board to fill casual vacancies. Directors received remuneration determined by the company in general meeting. There were provisions for directors to retire by rotation, but a director could only be removed by special resolution. The directors managed the business of the company and could exercise all its powers except for those reserved by the Act or the articles to the company in general meeting. They would

⁴ CLR: *The Strategic Framework* at paras 5.1.4–5.1.7.

⁵ This traditional relationship between directors and shareholders is described by Lord Oliver in *Caparo plc v Dickman* [1990] 2 AC 605, 630, HL.

⁶ Companies (Tables A to F) Regulations 1985 (SI 1985/805); Companies (Tables A to F) (Amendment) Regulations 2007 (SI 2007/2541); and Companies (Tables A to F) (Amendment) (No 2) Regulations 2007 (SI 2007/2826) which apply to companies incorporated between 1 October 2007 and 30 September 2009; Companies (Model Articles) Regulations 2008 (SI 2008/3229) which apply to companies incorporated after 1 October 2009.

⁷ 1862 Act, Table A, regs 52–94; 1908 Act, Table A, regs 68–108; 1929 Act, Table A, regs 64–101; 1948 Act, Table A, regs 75–129, 136; 1985 Act, Table A, regs 64–110, 118.

dispatch the business of the company at board meetings, but could delegate their powers to a committee of one or more directors. They could recommend the payment of dividends out of profits subject to the sanction of the company in general meeting. They were responsible for keeping accounts and in each year having them audited and laid before the company in general meeting.

Under the 1862 Act, Table A a director automatically vacated office if 'he holds any other office or place of profit under the company', or 'if he is concerned in or participates in the profits of any contract with the company'; subject to the proviso that he should not vacate office 'by reason of his being a member of any company which has entered into contracts with or done any work for the company of which he is director; nevertheless he shall not vote in respect of such contract or work; and if he does so vote his vote shall not be counted'.⁸ It was not envisaged, therefore, that a director would be a full-time executive, remunerated under a contract of employment; hence references in the cases to the intermittent nature of the office. By the turn of the century this had begun to change and the role of executive directors who devoted the whole or a substantial amount of their time to the company's affairs was recognized in the 1908 Act, Table A. Under it the directors could appoint one or more of their body to the office of managing director or manager on terms and at remuneration fixed by the directors and a director so appointed was not subject to the rotation provisions and did not automatically vacate his office as director.⁹ **1.06**

The 1948 Act, Table A acknowledged the obligations, expenses, and risks of the office of director by providing that in addition to remuneration directors might be paid all expenses properly incurred in attending meetings of directors, committees of directors, or general meetings of the company or in connection with the business of the company and that they were entitled to an indemnity in respect of all liabilities incurred in successfully defending civil or criminal proceedings or applying for relief under the 1948 Act, s 448.¹⁰ Although a director's remuneration was to be determined by the company in general meeting, the directors could determine the terms, including remuneration, on which a director held other offices or places of profit under the company or provided professional services.¹¹ The 1985 Act, Table A for the first time expressly stated that the directors' powers of management were subject to any directions given by special resolution.¹² **1.07**

Under the 1948 Act, Table A conflict of interest was no longer a ground for vacating office. Instead a director who was in any way directly or indirectly interested in a contract or proposed contract with the company was to declare his interest to a meeting of the directors in accordance with the 1948 Act, s 199. With certain exceptions he was not to vote on the contract. The 1985 Act, Table A went further: a director could be directly or indirectly interested in transactions or arrangements with the company or in which the company was interested and was not accountable for benefits, provided that he disclosed the nature and extent of his interest to the directors. **1.08**

⁸ reg 57. He also vacated office if he became bankrupt or insolvent.

⁹ regs 72 and 77, which also provided for a director to vacate office if he 'is found lunatic or becomes of unsound mind'.

¹⁰ 1948 Act, Table A, regs 76 and 136.

¹¹ 1948 Act, Table A, regs 76, 84, 88. Also 1985 Act, Table A, regs 85 and 94. 1985 Act, Table A, reg 87, gave the directors power to provide gratuities and pensions to former executive directors and their families.

¹² 1985 Act, Table A, reg 70.

- 1.09** The 2006 Act Model Articles give directors more powers in relation to appointment and remuneration and more flexibility in decision-making. They are responsible for managing the company's business, subject to directions given by special resolution, and they have full power to delegate to any person or committee.¹³ Directors' decisions are to be taken collectively, either at a meeting or by written resolution.¹⁴ Since the 2006 Act, ss 175, 177, and 182 deal expressly with conflicts of interest and interests in actual and proposed transactions, the Model Articles simply deal with the mechanics of decision-making in cases of conflict.¹⁵ Directors may be appointed by ordinary resolution or by decision of the directors.¹⁶ A director's remuneration for services as director and for any other service undertaken for the company is to be decided by the directors.¹⁷

C. Common Law Rules and Equitable Principles Relating to the Management of Companies

(1) The ultra vires doctrine

- 1.10** The memorandum of association of a company incorporated under the Companies Acts 1862 to 1985 had to state the objects of the company with some degree of particularity.¹⁸ Two consequences, of particular relevance to directors, followed from this. The first was that any transaction outside the scope of the company's objects, or what may fairly be regarded as incidental or consequential upon the stated objects, was void and incapable of ratification by shareholders.¹⁹ A director who caused the company's property to be applied for purposes outside its objects would be personally liable for any loss caused.²⁰ The courts developed the ultra vires rule to protect investors in the company and creditors from loss resulting from the unauthorized use of company funds. A company could avoid the rigours of the rule by including in its memorandum a long list of objects, each of which was stated to be as an independent object, not limited or restricted by any other object.²¹ The second consequence was that since the funds of a company were made by statute applicable only for the specific purposes set out in the memorandum, those funds were impressed with the qualities of a trust fund.²² Directors were therefore considered to be in a position

¹³ Model Articles (pcls, plg, and plc) 3–6.

¹⁴ Model Articles (pcls and plg) 7–13, 15, 16 and Model Articles (plc) 7–15, 17–19.

¹⁵ Model Article (pcls and plg) 14 and Model Article (plc) 16.

¹⁶ Model Article (pcls and plg) 17 and Model Article (plc) 20. Retirement by rotation only applies to directors of public companies (Model Article (plc) 21). Model Article (pcls and plg) 18 and Model Article (plc) 22 deal with automatic vacation of office for disqualification, bankruptcy, etc.

¹⁷ Model Article (pcls and plg) 19 and Model Article (plc) 23. The company may also pay a director's reasonable expenses: Model Article (pcls and plg) 20 and Model Article (plc) 24.

¹⁸ 1985 Act, s 2(1)(c). Also 1862 Act, s 10; 1908 Act, s 3; 1929 Act, s 2; 1948 Act, s 2(1)(c); *Re Crown Bank* (1890) 44 Ch D, 634, 644.

¹⁹ *Eastern Counties Railway v Hawkes* (1855) 5 HLC 331, 346, 348; *The Ashbury Railway Carriage and Iron Co v Riche* (1875) LR 7 HL 653, 672, 673, 679, 689, 694; *A-G v Great Eastern Railway Co* (1880) 5 AC 473, 478, 481, 486.

²⁰ *Joint Stock Discount Co v Brown* (1869) LR 8 Eq 376; *Hardy v Metropolitan Land Co* (1872) 7 Ch App 427; *Great Eastern Railway Co v Turner* (1872) 8 Ch App 149; *Russell v Wakefield Waterworks Co* (1875) LR 20 Eq 474, 479; *Cullerne v London and Suburban Building Society* (1890) 25 QBD 485; *Re George Newman & Co* [1895] 1 Ch 674, CA; *Re Claridge's Patent Asphalt Co Ltd* [1921] 1 Ch 543, CA.

²¹ In *Cotman v Brougham* [1918] AC 514, 523 Lord Wrenbury deprecated the use of 'independent objects' clauses, but acknowledged that they were effective.

²² *Selangor United Rubber Estates v Cradock* (No 3) [1968] 1 WLR 1555, 1575.

comparable to that of a trustee, although account had to be taken of the commercial nature of their engagement.²³

The ultra vires doctrine has now largely disappeared from view as a result of statutory reforms beginning in 1972 by which a company's capacity is no longer limited by the objects stated in its memorandum.²⁴ The 2006 Act, s 39(1) provides that 'the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution'.²⁵ **1.11**

Also, the objects clause has been liberalized. The 2006 Act, s 31(1) reverses the traditional rule that the memorandum must positively state the company's objects. Instead it provides that 'unless a company's articles specifically restrict the objects of the company, its objects are unrestricted'.²⁶ **1.12**

(2) The indoor management rule

*Royal British Bank v Turquand*²⁷ established that, although it was to be assumed that a person dealing with a company had read the company's public documents²⁸ and satisfied himself that the proposed transaction was not inconsistent with them, such a person was not required to inquire whether internal procedures had been duly carried out. The rule is supplemented by the rules of agency that a director or other officer may bind the company if he has ostensible or apparent authority to do so.²⁹ **1.13**

The rule has been superseded by statutory provision now contained in the 2006 Act, s 40(1), which provides that, in favour of a person dealing with a company in good faith, the power of the directors to bind the company, or authorize others to do so, is deemed to be free of any limitation under the company's constitution.³⁰ For this purpose s 40(2) provides that a person dealing with a company, through being a party to any transaction or other act to which the company is a party (i) is not bound to enquire as to any limitation on the powers **1.14**

²³ Para 1.19 below.

²⁴ The reforms began with the European Communities Act 1972, s 9 (giving effect to Article 9 of Council Directive 68/151/EEC), which became 1985 Act, s 35. A new s 35 was inserted into the 1985 Act by 1989 Act, s 108(1) as from 4 February 1991 to remove the limit of the protection in the original s 35, which only applied to third parties acting in good faith and to transactions decided on by the directors. The purpose of the 1972 Act and the directive 'is to enable people to deal with a company in good faith without being adversely affected by any limits on the company's capacity or its rules for internal management'; per Sir Nicholas Browne-Wilkinson V-C in *TCB Ltd v Gray* [1986] Ch 621, 635.

²⁵ There are special rules for charitable companies: 2006 Act, ss 39(2) and 42. 2006 Act s 39 replaced the 1985 Act, s 35(1) and (4) without material change. 1985 Act, s 35(2) and (3), concerning proceedings by members to restrain an act beyond the company's capacity and the duty of directors to observe limitations on their powers flowing from the company's memorandum and ratification were repealed and not replaced.

²⁶ 2006 Act, s 31(1) replaced 1985 Act, s 3A, which provided that where a company's memorandum stated that the object of the company was to carry on business as a general commercial company, then its object was to carry on any trade or business whatsoever, and it had power to do all such things as were incidental or conducive to the carrying on of any trade or business by it. 1985 Act, s 3A had been inserted by 1989 Act, s 110 with effect from 4 February 1991.

²⁷ (1856) 6 El & Bl 327. In *Mabony v East Holyford Mining Co* (1875) LR 7 HL 869, 898 Lord Hatherley used the phrase 'the indoor management' in this context.

²⁸ eg its memorandum of association, articles of association, and special resolutions delivered to the Registrar.

²⁹ *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB, 480, CA.

³⁰ 2006 Act, s 40 replaced without material change 1985 Act, ss 35A and 35B, which had been inserted by 1989 Act, s 108 with effect from 4 February 1991 in place of the original s 35. In their original form these provisions were introduced by European Communities Act 1972, s 9.

of the directors to bind the company or authorize others to do so, (ii) is presumed to have acted in good faith unless the contrary is proved, and (iii) is not to be regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company's constitution. Section 40(5) provides that the section does not affect any liability incurred by the directors, or any other person, by reason of the directors exceeding their powers.

(3) Attribution

- 1.15** In numerous civil and criminal contexts the court may have to determine whether the knowledge, mental state (malice, dishonesty), or intentions of its directors, other officers, or employees are to be attributed to the company. In the leading case of *Lennard's Carrying Company v Asiatic Petroleum Ltd*³¹ the House of Lords attributed the managing director's default to the company on the ground that he was the 'directing mind and will' or alter ego of the company. Where wrongdoing is attributed to the company, the maxim *ex turpi causa* may prevent it from obtaining indemnity from the wrongdoers³² or insurers.³³
- 1.16** In *Meridian Global Funds Management Asia Ltd v Securities Commission*³⁴ Lord Hoffmann reviewed the rules of attribution. The primary rules are generally found in the company's constitution (eg a decision of the directors is a decision of the company) and those primary rules are supported by principles of agency law. If it is apparent that a particular rule of law is intended to apply to companies, but insistence on the primary rules would defeat that intention, it becomes necessary to apply a special rule of attribution. The court's task is to interpret the rule in order to determine whose act, knowledge, or state of mind is to be attributed to the company; that person may be the person entrusted with conduct of the particular matter.

(4) The duties of directors

- 1.17** From the earliest times the duties of directors have been identified by comparing directors with trustees. In 1742, in *The Charitable Corporation v Sutton*,³⁵ Lord Hardwicke LC found that the corporation's affairs were a 'great scene of iniquity' in which its funds, rather than being applied for the relief of the industrious poor, had been misapplied in fraudulent and fictitious loans and other improper transactions, causing loss to the corporation of more than £350,000. The corporation brought proceedings to recover its losses from some 50 committeemen, directors, and other officers on the ground that they 'had been guilty of manifest breaches of trust, or at least of such supine and gross negligence of their duty'. Lord Hardwicke held that the office of director (or committeeman) was in the nature of a private trust, so that such officers were liable to the corporation for 'breaches of trust, either by commissions or omissions, for acts of misfeasance or nonfeasance' and that where 'there is a series of neglects, and breaches of trust are occasioned by their absence, then they are answerable for the misfeasance of others'. Even though the office of director is voluntary, it had to be discharged with 'fidelity, integrity, and diligence'. The five conspirators who had

³¹ [1915] AC 705, HL.

³² *Stones & Rolls v Moore Stephens* [2009] AC 1391, HL; *Safeway Stores Ltd v Twigger* [2011] Bus LR 1629, CA.

³³ *KR v Royal & Sun Alliance plc* [2007] Bus LR 139, CA.

³⁴ [1995] 2 AC 500, 506–12, PC.

³⁵ (1742) 2 Atk 400; 9 Mod Rep 349. There are differences between the two reports and the quotations in this paragraph are taken from both reports.

been directly responsible for the misapplication of the funds were primarily liable to make good the losses, but the other directors could be liable in the second degree if they connived in the affair by signing the false notes under which monies were misapplied, or if they failed to make use of 'the proper power invested in them by the charter, in order to prevent the ill consequences arising from such a confederacy'. Inquiries were ordered to determine the liability of the directors in the second degree. Thus *The Charitable Corporation v Sutton* established that directors owed the company fiduciary duties (fidelity and integrity) and a duty of diligence.

In relation to fiduciary duties the courts have always imposed exacting standards. Directors were liable to restore misapplied company property, whether they were recipients of the property or participants in the misapplication³⁶ and to account for secret profits and bribes.³⁷ A director's fiduciary duty to promote the interests of the company precluded him from entering on behalf of the company into a contract with himself or a firm or company of which he was a member, regardless of the fairness or unfairness of the contract.³⁸ He could only be released from his position of conflict or duty to account by the assent of the members.³⁹ The fiduciary duties of a director were reflected in the 1862 Act, s 165, which gave the court a summary power, where a company was being wound up, to assess damages against a delinquent director or officer who had 'misapplied or retained or become liable or accountable for any moneys or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company'.⁴⁰ **1.18**

The position of a director could not be equated entirely with that of a trustee. In 1878 Jessel MR said: 'Directors have sometimes been called trustees, or commercial trustees, and sometimes they have been called managing partners. It does not matter what you call them so long as you understand what their true position is, which is that they are really commercial men managing a trading concern for the benefit of themselves and all other shareholders in it', and that 'they are so bound to use fair and reasonable diligence in the management of the company's affairs, and to act honestly'.⁴¹ In *City Equitable Fire Insurance Co*⁴² Romer J said that he found the analogy with trustees wholly misleading. Directors stood in a fiduciary relationship to the company, but there was little resemblance between their duties and those of a trustee of a will or marriage settlement. The duties that a director owes to the company are determined by the functions he undertakes to perform, the nature of the company's business, and the way in which work is properly distributed among the directors and other officers. **1.19**

In 1998 the Law Commission, chaired by Arden J, identified six heads of fiduciary duties owed by a director to the company:⁴³ (i) a duty of loyalty (to act in the best interests of the **1.20**

³⁶ *Benson v Heathorn* (1842) 1 Y&CC 326.

³⁷ *The York and North-Midland Railway Co v Hudson* (1853) 16 Beav 485.

³⁸ *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461, HL.

³⁹ *Regal (Hastings) Ltd v Gulliver* (1942) [1967] 2 AC 134n, 150, HL.

⁴⁰ As restated by Companies (Winding Up) Act 1890, s 10. *Palmer's Handbook on Company Law*, 4th edn (1902), pp 170, 172 took the view that breach of trust was generally confined to misapplication of company funds (eg application for an ultra vires purpose), whereas misfeasance covered other breaches of duty (eg the allotment of shares to an infant, taking a bribe, or committing a fraudulent preference).

⁴¹ *Re Forest of Dean Coal Mining Co* (1878) 10 Ch D 450, 451, 452; *Re Lands Allotment Co* [1894] 1 Ch 616, 631, CA, per Lindley LJ.

⁴² [1925] Ch 407, 426–30.

⁴³ Law Commission Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties (Consultation Paper No 153) at paras 11.4–11.20.

company),⁴⁴ (ii) a duty to act for proper purposes (to exercise powers for the purpose for which those powers were conferred),⁴⁵ (iii) a duty not to fetter their discretion,⁴⁶ (iv) the no conflict and no profit rules (under which a director could not keep profits from information, property, or opportunities that belong to the company),⁴⁷ (v) a duty to act in accordance with the company's constitution, and (vi) a duty to act fairly as between different shareholders.⁴⁸

1.21 The amount of diligence expected of a nineteenth-century director was distinctly modest. A director who, by taking no part in the company's affairs and not attending board meetings, was unaware of wrongdoing or breaches of the company's constitution could escape liability to compensate the company for losses suffered.⁴⁹ Since a director could hold office while being largely ignorant of the company's affairs, he was free to take office as a director of a rival company.⁵⁰

1.22 Consistently with the low standard of diligence tolerated by the court, a director could be found liable to compensate the company for breach of a duty of care and skill in relation to business decisions only if a high degree of negligence was shown. The negligence had to amount to *crassa negligentia*,⁵¹ or 'it must be in a business sense culpable and gross'.⁵² The standard of care was essentially subjective and dependent on the director's own capabilities: a director was required to show the degree of skill to be reasonably expected of a person with his knowledge and experience and to take such a care as an ordinary man might be expected to take on his own behalf, but he was not bound to give continuous

⁴⁴ Directors must act in good faith in what they consider to be in the best interests of the company: *Re Smith and Fawcett Ltd* [1942] Ch 304, 306, CA. If they do so, it does not matter that their decision also promotes their own interests: *Hirsche v Sims* [1894] AC 654, 660, 661, PC. The best interests of the company may require account to be taken of the interests of creditors (Ch 12, Section E below) and employees (*Hutton v West Cork Railway Co* (1883) 23 Ch D 654, 672, 673, CA, where Bowen LJ said 'The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company', and 1985 Act, s 309).

⁴⁵ *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, 835, PC; also *Spackman v Evans* (1868) LR 3 HL 171, 186; *Alexander v Automatic Telephone Co* [1890] 2 Ch 233; *Re a Company (No 00370 of 1987)*, *ex p Glossop* [1988] BCLC 570, 577; *Re BSB Holdings Ltd (No 2)* [1996] 1 BCLC 155, 243–6.

⁴⁶ *Fulham Football Club Ltd v Cabra Estates plc* [1994] 1 BCLC 363, 392, CA.

⁴⁷ *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 131n; *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443; *Movitex Ltd v Bullfield* [1988] BCLC 104, where Vinelott J said that the no profit rule imposed a disability not a duty; *Island Export Finance Ltd v Umanna* [1986] BCLC 460.

⁴⁸ *Mutual Life Insurance v Rank Organisation Ltd* [1985] BCLC 11, 21; *Re BSB Holdings Ltd (No 2)* [1996] 1 BCLC 155, 246–9.

⁴⁹ *Re Cardiff Savings Bank, the Marquis of Bute's Case* [1892] 2 Ch 100; *Re Denham* (1883) 25 Ch D 752.

⁵⁰ *Re London and Mashonaland Exploration Co v New Mashonaland Exploration Co* [1891] WN 165; discussed in *In Plus Group Ltd v Pyke* [2002] 2 BCLC 201, CA. In fact the New Mashonaland Exploration Co soon collapsed into insolvent liquidation and the director whose appointment had been in dispute was fortunate to escape liability for misfeasance in making negligent loans of company money: *Re New Mashonaland Exploration Co* [1892] 3 Ch 577.

⁵¹ *Overend, Gurney & Co v Gibb* (1872) LR 5 HL 480, 487, HL; Lord Hatherley explained that directors would be guilty of *crassa negligentia* if 'they were cognisant of circumstances of such a character, so plain, so manifest, and so simple of appreciation, that no men with any ordinary degree of prudence, acting on their own behalf, would have entered into such a transaction as they entered into'.

⁵² *Lagunas Nitrate Co v Lagunas Syndicate* [1899] 2 Ch 392, 435, CA. In *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425 the directors, who somewhat surprisingly were acquitted of negligence and were in any event entitled to rely on an exemption clause in the articles, consisted of a baronet who was 'absolutely ignorant of business', a banker from Bath who was 'seventy-five years of age and very deaf', a rubber broker who understood that his only function was to value the rubber if and when it arrived in England, and a businessman who joined because he considered that the banker and rubber broker were 'good men'.

attention to the affairs of the company and, in the absence of grounds for suspicion, was entitled to trust his fellow officers.⁵³ Therefore shareholders and creditors had to put up with the blunders of foolish and unwise directors⁵⁴ or of a board comprising ‘a set of amiable lunatics’.⁵⁵

Subsequent changes to the Companies Acts, including provisions to enforce fair dealing, to strengthen the duties of directors, to maintain sufficient accounting records, and for the disqualification of unfit directors, have required directors to be more conscientiously involved in a company’s affairs. This has encouraged the court to apply an objective standard of care, skill, and diligence and to adopt the twofold test in the Insolvency Act, s 213(4) (wrongful trading).⁵⁶ **1.23**

Now the general duties of directors are codified by the 2006 Act and these duties are buttressed by provisions requiring directors to disclose interests in existing transactions and to obtain the approval of members for certain transactions in which they are interested.⁵⁷ The statutory statement of directors’ fiduciary duties includes elements of reform in relation to the duty to promote the success of the company and in permitting the independent directors to authorize a matter in which a director has a conflict of interest.⁵⁸ **1.24**

(5) Shareholders’ remedies

Where directors have misapplied company property or otherwise caused it loss, the company can sue to recover its property or to obtain compensation even though it was party to the impugned transaction.⁵⁹ If the wrongdoers are in control of the company, they will be able to prevent it from suing. To prevent this injustice, in *Hichens v Congreve*,⁶⁰ decided in 1828, Lord Lyndhurst LC held that shareholders could sue on behalf of themselves and the other shareholders for the purpose of compelling the directors to refund monies improperly withdrawn by them. The limits of Lord Lyndhurst’s decision were soon exposed by the well-known case of *Foss v Harbottle*,⁶¹ decided in 1843, which established (i) the ‘proper plaintiff’ principle, by which prima facie the corporation is the proper claimant in proceedings in respect of a wrong alleged to have been done to it, and (ii) the ‘majority rule’ principle, by which an individual shareholder will not be allowed to pursue proceedings on behalf of himself and all other shareholders if the alleged wrong was within the powers of the company, since, in those circumstances, the majority of the shareholders might ratify the allegedly wrongful transaction; if they did not, they would be able to put the company in motion to bring the necessary proceedings. **1.25**

The rule in *Foss v Harbottle* did not apply to claims to enforce a shareholder’s personal rights, as distinct from rights belonging to the company. Nor did the rule prevent an individual **1.26**

⁵³ *Re City Equitable Fire Insurance Co* [1925] Ch 407, 428, 429; *Dorchester Finance Co Ltd v Stebbing* (1977) [1989] BCLC 498, 501, 502. As to relying on other officers: *Dovey v Corey* [1901] AC 477, 485, HL.

⁵⁴ *Turquand v Marshall* (1869) LR 4 Ch App 376, 386.

⁵⁵ In argument in *Pavlides v Jensen* [1956] Ch 565, 570.

⁵⁶ *Norman v Theodore Goddard* [1991] BCLC 1028, 1030, 1031, 1037, 1038; *Bishopsgate Investment Management Ltd v Maxwell* [1994] 1 All ER 261, CA; *Re D’Jan of London Ltd* [1994] 1 BCLC 561, 563.

⁵⁷ The general duties of directors are in 2006 Act, ss 170–81 and the supporting disclosure and transparency obligations are in ss 182–231.

⁵⁸ 2006 Act, s 175.

⁵⁹ *AG v Wilson* (1840) Cr & Ph 1, 24.

⁶⁰ (1828) 4 Russ 562.

⁶¹ (1843) 2 Hare 461. Followed in *Mozley v Alston* (1847) 1 Ph 790.

shareholder from bringing proceedings (later called a 'derivative action') in respect of a wrong done by the directors to the company where (i) the transaction in question was beyond the powers of the company or illegal, (ii) there had been a fraud on the minority shareholders and the wrongdoers were in control, or (iii) the act required the sanction of a special majority which could not be obtained.⁶² In relation to the 'fraud on the minority' exception the law was 'complex and obscure'.⁶³ Litigation could become protracted, expensive, and damaging to the company, which could be 'killed by kindness'.⁶⁴ Rules of court were introduced to control the procedure.⁶⁵

- 1.27** In 1980 a new remedy, now contained in the 2006 Act, ss 994–9, was introduced to protect members from unfair prejudice.⁶⁶ The new remedy meant that minority shareholders would seldom need to resort to a derivative action. The 2006 Act has reformed this area of the law in two further ways. First, s 239 prevents the director and those connected with him from voting on a resolution to ratify his own wrong. Secondly, Part 11, ss 260–4, has introduced a new statutory code for derivative actions, which replaces the rule in *Foss v Harbottle* and its exceptions.

(6) Decision-making of members

- 1.28** A company's articles invariably provide that the directors have unfettered powers of management which cannot be interfered with by the members except by altering the articles, giving directions pursuant to a special resolution, or by removing and replacing directors.⁶⁷ The directors may need to obtain a resolution of the members, whether to alter the constitution; to consent to, approve, or authorize some transaction or arrangement; or to ratify acts of directors or for some other purpose. In this connection the courts have developed three rules. First, the notice of the meeting to consider the resolution (or statement accompanying the proposed written resolution) must give 'a fair and candid and reasonable explanation' of the proposed business and must not be misleading or tricky.⁶⁸ If it does not, any resolution purportedly passed will be invalid. This rule remains relevant to the provisions of the 2006 Act, Part 13, about resolutions and meetings.
- 1.29** Secondly, there is an equitable rule that, in order for a resolution to be effective, the voting rights of the members in support of it must be exercised in good faith in the interests of the

⁶² *Burland v Earle* [1902] AC 83, 93, HL, per Lord Davey; *Edwards v Halliwell* [1950] 2 All ER 1064, 1067, CA; *Daniels v Daniels* [1978] Ch 406, 408, 414, where Templeman J said that the minority could sue 'where directors use their powers, intentionally or unintentionally, fraudulently or negligently, in a manner which benefits themselves at the expense of the company'; *Prudential Assurance Co Ltd v Newman Industries Ltd* [1982] Ch 204, 210, CA; *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 WLR 2, 12; *Smith v Croft (No 2)* [1988] Ch 114, 173. The minority have not been allowed to proceed on an allegation of mere negligence without fraud: *Pavlidis v Jensen* [1956] Ch 565; *Heyting v Dupont* [1964] 1 WLR 843, CA.

⁶³ Law Commission Consultation Paper No 142 *Shareholder Remedies* at para 1.6.

⁶⁴ *Prudential Assurance Co Ltd v Newman Industries Ltd* [1982] Ch 204, 221, CA.

⁶⁵ RSC Order 15, rule 12A, replaced by CPR 19.9. In *Barrett v Duckett* [1995] 1 BCLC 243, 249, 250, CA, Peter Gibson LJ stated the general principles governing such actions.

⁶⁶ 1980 Act, s 75, which was replaced by 1985 Act, s 459. On 1 October 2007 the 2006 Act, Part 30, ss 994–9 came into force and replaced 1985 Act, s 459. 1980 Act, s 75 replaced 1948 Act, s 210, which provided the first statutory remedy for oppression, but in terms that were too onerous on the applicant.

⁶⁷ Table A, reg 70; Model Article (pcls) 3 and Model Article (plc) 4.

⁶⁸ *Kaye v Croydon Tramways Co* [1898] 1 Ch 358, 373, CA; *Tiessen v Henderson* [1899] 1 Ch 861; *Baillie v Oriental Telephone and Electric Co Ltd* [1915] 1 Ch 503, CA; *Pacific Coast Coal Mines Ltd v Arbutnot* [1917] AC 607, 618, PC; *Clarkson v Davies* [1923] AC 100, PC.

company as a whole.⁶⁹ The CLR said the rule was rather ‘rather ill-defined’ and limited it to alterations of articles and class right cases,⁷⁰ but in *British America Nickel Corp Ltd v MJ O’Brien Ltd*⁷¹ Lord Haldane referred to ‘a general principle, which is applicable to all authorities conferred on majorities of classes enabling them to bind minorities; namely, that the power given must be exercised for the purpose of benefiting the class as a whole, and not merely individual members only’. In cases where the rule does apply the court would only find that voting rights had been invalidly exercised if it is satisfied that no reasonable person could have considered the resolution to be for the benefit of the company.⁷²

Thirdly, there is a rule that the company is bound by the unanimous agreement of its members entitled to attend and vote on the matter without the need for a formal resolution, whether in writing or at a meeting.⁷³ This rule, which is expressly preserved by the 2006 Act, ss 239(6)(a) and 281(4), is subject to exceptions, the scope of which is not clearly marked out, where a transaction is beyond the powers of the company, such as a gift to directors out of capital,⁷⁴ or where the company is insolvent or nearly so.⁷⁵

1.30

(7) Accounts

Like any other fiduciary a director is liable to account to the company. The 1844 Act stated the obligation of directors to keep books of account, prepare accounts to be laid before the members, and have them audited. The 1862 Act left those matters to Table A,⁷⁶ but the twentieth-century Companies Acts have regulated those obligations and provided for the public filing of accounts. The provisions concerning accounts, reports, and audit are now contained in the 2006 Act, Parts 15 and 16. Any failure of a director to comply with his statutory duties in relation to accounts is to be taken into consideration in determining his fitness to be a director for the purposes of disqualification proceedings.⁷⁷

1.31

⁶⁹ *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656, 671, CA. Also: *Blisset v Daniel* (1853) 10 Har 493 (a partnership case); *Menier v Hooper’s Telegraph Works* (1874) 9 Ch App 350; *Dominion Cotton Mills Co v Amyot* [1912] AC 546, 551–3, PC; *Cook v Deeks* [1916] 1 AC 554, 564, PC; *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286, 291, CA; *Re Holders Investment Trust Ltd* [1971] 1 WLR 583; *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 WLR 2, 16; *Smith v Croft (No 2)* [1988] Ch 114, 186.

⁷⁰ CLR: *Developing the Framework* at para 4.142. In CLR: *Completing the Structure* at paras 5.94–5.101, 5.110 the CLR proposed retaining the rule, but only in relation to changes to the constitution and class rights and cases where the votes of the majority are tainted. The CLR recommended the reforms in 2006 Act, s 239 to deal with this area: CLR: *Final Report* at paras 7.52–7.62.

⁷¹ [1927] AC 369, 371, PC; *Redwood Master Fund Ltd v TD Bank Europe Ltd* [2006] 1 BCLC 149 (both cases concerning the power to modify debentures or loan notes). Briggs J reviewed these authorities in *Assengon Asset Management SA v Irish Bank Resolution Corp Ltd* [2012] EWHC 2090 (Ch) at paras 41–9.

⁷² *Shuttleworth v Cox Bros & Co (Maidenhead) Ltd* [1927] 2 KB 9, 18, 23, CA; *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286, 291, CA; *Citico Banking Corp NV v Pusser’s Ltd* [2007] 2 BCLC 483, PC. In *Standard Chartered Bank v Walker* [1992] 1 WLR 561 Vinelott J invoked the court’s Mareva jurisdiction to restrain a shareholder from causing willful damage to the value of his shares by voting his shares to block a restructuring proposal.

⁷³ *Re Duomatic Ltd* [1969] 2 Ch 365, 373; *Cane v Jones* [1981] 1 WLR 1451. The informal unanimous decision is attributed to the company: *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258, 269, 288–90, CA; *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, 506, PC.

⁷⁴ *Re George Newman & Co* [1895] 1 Ch 674, 686, CA; *Cook v Deeks* [1916] 1 AC 554, 564, PC.

⁷⁵ *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722, 730; approved in *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250, 252, 253, CA.

⁷⁶ 1862 Act, Table A, regs 78–94.

⁷⁷ CDDA, s 9 and Part I of Sch 1.

- 1.32** In addition, if a company becomes subject to insolvency proceedings (administration, administrative receivership, or liquidation) or proposes a voluntary arrangement, directors become subject to additional duties to provide a statement of affairs and provide information to the officeholder or the official receiver.⁷⁸ Furthermore directors may be called to account in a private or public examination.⁷⁹ If in the winding up it is found that directors have failed to keep proper books of account or have falsified or destroyed them, a criminal offence is committed which is punishable by imprisonment.⁸⁰

(8) Maintenance of capital

- 1.33** In their management of the company, directors are bound by the fundamental common law principle of maintenance of capital, breach of which exposes the directors responsible to liability for damages for breach of duty. Since, in most cases the liability of members is limited, the paid up share capital is the fund of last resort available to meet the claims of creditors. The principle of maintenance of capital is therefore a principle for the protection of creditors.⁸¹ Maintenance of capital is now entirely regulated by statute,⁸² but at common law it was manifest in four rules. First, shares could not be issued at a discount: the company must not be entitled to receive less than the nominal amount of the share, par value, in consideration for its allotment.⁸³ Secondly, a person who retained his shares, which he had been induced to take by fraud, could not claim damages, because that would infringe the principle of maintenance of capital. His only remedy was to rescind the contract on the ground of fraud and recover his money, provided he did so before the company went into liquidation.⁸⁴ Now, by the 2006 Act, s 655 holding or having held shares is not a bar to obtaining damages or other compensation from a company.⁸⁵ Thirdly, a company could not return capital to its members except by a reduction of capital in accordance with the provisions of the Companies Acts.⁸⁶ Now the 2006 Act contains detailed provisions for the reduction of capital and the circumstances in which a company may redeem or purchase its own shares.⁸⁷ Fourthly, although the way in which a company distributes its profits is a matter for its constitution, it could not pay dividends or make other distributions out of capital, since that would involve an unlawful

⁷⁸ Statement of affairs: Insolvency Act, ss 47, 99, 131. Sch B1, paras 47 and 48; Insolvency Rules 1.5, 1.56, 2.28–2.32, 3.3–3.7, 4.32–4.42.

⁷⁹ Private examinations are provided for by the Insolvency Act 1986, s 236 and can be traced back to the 1844 Winding Up Act, s 15. Public examination is provided for by the Insolvency Act, s 133 and can be traced back to the Companies (Winding Up) Act 1890, s 8.

⁸⁰ Insolvency Act, ss 206–11.

⁸¹ *Trevor v Whitworth* (1887) 12 App Cas 409, 423, HL; *The Ooregum Gold Mining Company of India Ltd v Roper* [1892] AC 125, 133, HL.

⁸² 2006 Act, Parts 17, 18 and 23.

⁸³ This principle is governed by statutory provision: 2006 Act, ss 580–609, 1150, 1153.

⁸⁴ *Houldsworth v City of Glasgow Bank* (1880) 5 App Cas 317; *Re Addlestone Linoleum Co* (1887) 37 Ch D 191, CA. The principle also applied to claims under Misrepresentation Act 1967, s 2(2). It did not apply to purchases in the after-market: *Soden v British & Commonwealth Holdings plc* [1998] AC 298, HL. Note the departure from the principle taken by the High Court of Australia in *Sons of Gwalia Ltd v Margaretic* [2007] HCA 1 and the subsequent amendment to the Australian Corporations Act, made by the Corporations (Sons of Gwalia) Act 2010.

⁸⁵ On 1 October 2009 this section replaced 1985 Act, s 111A, which was inserted by 1989 Act, s 131.

⁸⁶ *Trevor v Whitworth* (1887) 12 App Cas 409.

⁸⁷ 2006 Act, ss 641–723. Since 1 October 2008 private companies no longer have to obtain court sanction for a reduction of capital.

distribution of capital.⁸⁸ The rules controlling the making of distributions are contained in the 2006 Act, ss 829–53.

D. The Development of Statute Law Affecting Directors before the Companies Act 2006

The Companies Acts provide for the incorporation of companies and lay down the framework for their operation. To an ever-increasing extent, in order to protect members and persons dealing with a company and improve standards of corporate governance, the Companies Acts have imposed restrictions on the management of companies, required public disclosure of information about the company, and imposed sanctions and provided remedies for default. The techniques adopted have included: (i) making certain conduct a criminal offence (eg fraudulent trading and some contraventions of the Companies Acts); (ii) disqualifying bankrupts and fraudulent or unfit persons from being directors or concerned in the management of a company; (iii) making some transactions unlawful (eg financial assistance in the purchase of a company's own shares and formerly tax-free payments to directors and loans to directors); and (iv) to protect the interests of members, making some transactions with directors unlawful unless approved by the members (payments for loss of office and transactions with directors) and providing members with a statutory remedy for unfair prejudice (formerly oppression). **1.34**

Since 1844 winding up has been the process through which directors have been brought to account for their management of the company. Since 1890 the procedures have been strengthened to give creditors more control of the winding up where the company is insolvent, to improve the means of calling directors to account, and to make directors personally liable for fraudulent trading. The procedures have been extensively modernized by the Insolvency Act 1986, which has made directors personally liable for wrongful trading and contravention of the 'phoenix company' provisions. **1.35**

Since the 1856 Act the Board of Trade, or its successor Department, has had power, on the application of a specified proportion of members, to appoint inspectors to examine the affairs of the company. The 1967 Act extended these powers and enabled the Board of Trade to appoint inspectors whenever it had good reason to do so. Now the powers are held by the Secretary of State for the Department of Business, Innovation and Skills (BIS) and the provisions are contained in the 1985 Act, Part XIV, ss 431–7, 439–53, as amended by the 2006 Act, Part 32. **1.36**

(1) Legislation for companies 1844 to 1890

The Joint Stock Companies Act 1844 provided the first general statutory scheme for companies to obtain corporate personality through registration with the Registrar of Companies. It suffered from two serious defects. First, the process of registration was cumbersome and the company could not enjoy the benefits of the Act until it was complete. Secondly, members were personally liable for the debts of the company.⁸⁹ In order to protect the members who **1.37**

⁸⁸ *MacDougall v Jersey Imperial Hotel Co* (1864) 2 Hem & M 528; *Dovey v Corey* [1901] AC 477; *Ammonia Soda Co v Chamberlain* [1918] 1 Ch 266, 292, CA.

⁸⁹ 1844 Act, s 25.

were at risk, their approval was required for the purchase and sale of shares by directors, loans to directors, and contracts with directors outside the ordinary course of business and at least two directors had to sign larger contracts and bills.⁹⁰ Directors were responsible for maintaining the company's books of account and having the accounts confirmed by an auditor.

- 1.38** The 1844 Winding Up Act provided for the winding up of companies unable to meet their debts and was intended 'to make better provision for discovery of the abuses that may have attended the formation or management of the affairs' of companies and 'for ascertaining the causes of their failure'. Members would be the principal beneficiaries of these provisions since they were personally liable for the company's debts. Directors were to produce a balance sheet and provide information on which they would be examined and hand over company property.⁹¹ The court would make a report on the causes of failure which could lead to criminal prosecution.⁹²
- 1.39** The main defect of the 1844 Act, the failure to provide for limited liability, was remedied by the Limited Liability Act 1855, which allowed a company to be incorporated with limited liability if its name included the word 'limited'. The 1855 Act contained a number of provisions to protect persons dealing with the company, including one, which continued to be used in subsequent Companies Acts until repealed by the 2006 Act, making directors personally liable on all bills and other documents on which its correct name did not appear.⁹³
- 1.40** The Joint Stock Companies Act 1856 consolidated and amended the law relating to companies, including winding up. It omitted many of the sanctions in the 1844 and 1855 Acts,⁹⁴ but included, for the first time, provisions for inspectors to examine the affairs of the company, either appointed by the Board of Trade on the application of members or by special resolution of members.⁹⁵
- 1.41** The 1862 Act is generally regarded as the Act that 'laid down the foundation upon which subsequent legislation relating to companies has been built'.⁹⁶ The underlying philosophy was that a company should be free to determine the way in which it would be managed and administered, although default articles in the form of Table A were provided. A director could only be removed by special resolution.⁹⁷ Directors and managers were liable for a fine, along with the company, if they knowingly and willfully authorized or permitted contravention of certain provisions for record-keeping and transparency.⁹⁸
- 1.42** Among the provisions of the 1862 Act for winding up companies were provisions for the court to order officers and others to deliver up monies, books, papers, and other property to which the company is entitled,⁹⁹ for the private examination of, and production of books

⁹⁰ 1844 Act, ss 27, 29, 44–6.

⁹¹ 1844 Winding Up Act, ss 12–15.

⁹² 1844 Winding Up Act, ss 26 and 27.

⁹³ Limited Liability Act 1855, ss 4, 5, 9, 10, 13. The provision referred to last appeared as 1985 Act, s 349, which was repealed on 1 October 2008 by the 2006 Act Commencement Order No 5, Art 8(b) and Sch 3.

⁹⁴ 1856 Act, ss 14 and 31.

⁹⁵ 1856 Act, ss 48–52.

⁹⁶ Report of the Cork Committee at para 75.

⁹⁷ 1862 Act, s 51 and Table A, reg 65. That remained the position until 1948 Act, s 184 gave an overriding power to remove directors by ordinary resolution.

⁹⁸ 1862 Act, ss 25, 27, 32, 34, 43, 44, 46, 53, 54, 58, 60.

⁹⁹ 1862 Act, s 100. This section was the derivation of 1948 Act, s 258 and is the predecessor of Insolvency Act, s 234, which uses broader language.

by, officers and others,¹⁰⁰ and for the court to assess damages against delinquent directors and officers.¹⁰¹ If a director or other person was found to have falsified the company's books he was guilty of an offence, punishable by imprisonment.¹⁰² There were also provisions for the prosecution of a director who had committed an offence in relation to the company, but on terms that the court could order that the costs and expenses of the prosecution could be paid out of the company's assets.¹⁰³

The Companies Act 1867 amended the 1862 Act¹⁰⁴ and included a new provision for the memorandum of a company with limited liability to provide for directors, managers, or managing directors to have unlimited liability and for the memorandum to be altered by special resolution to render unlimited the liability of those officers. Although the provision was seldom, if ever, used, it was retained in the successive Companies Acts until it was repealed on 1 October 2009¹⁰⁵ and it is reflected in the Insolvency Act, s 75. **1.43**

In 1890 there were two major reforming statutes affecting directors. The first was the Companies (Winding Up) Act 1890, which was 'clearly aimed at fraudulent and dishonest company promoters and directors'.¹⁰⁶ It improved the statutory powers for investigating the affairs of the company by requiring directors to make out and submit to the official receiver a statement of affairs and providing machinery for the public examination of promoters, directors, and officers of the company and gave the court somewhat wider powers to assess damages against delinquent directors and promoters than had been contained in the 1862 Act, s 165.¹⁰⁷ The second reforming statute was the Directors' Liability Act 1890, which was a prompt legislative response to the refusal by the House of Lords in *Derry v Peek*¹⁰⁸ to hold that a director could be personally liable for negligent misstatement in a prospectus. Section 3 made directors and others responsible for issuing a prospectus personally liable to subscribers for any false statement unless they could show that the untrue statement was made by an expert on whom they could reasonably rely or by an official person in a public document, or was one that they had reasonable grounds for believing was true.¹⁰⁹ **1.44**

¹⁰⁰ 1862 Act, ss 115–17. These sections were the derivation, subject to amendment by the 1928 Act, of 1948 Act, s 268 and are the predecessors of Insolvency Act, ss 236 and 237.

¹⁰¹ 1862 Act, s 165. See para 1.18 above. This section was replaced by the Companies (Winding Up) Act 1890, s 10, which was the derivation, subject to amendment by the 1893 and 1928 Acts, of 1948 Act, s 333 and is the predecessor of Insolvency Act, s 212, whose provisions are significantly broader.

¹⁰² 1862 Act, s 166. This section was the derivation, subject to amendment by the 1947 Act, of 1948 Act, s 329, and is the predecessor of Insolvency Act, s 209.

¹⁰³ 1862 Act, ss 167 and 168. These sections were the derivation, subject to amendment by the 1928 and 1947 Acts (to remove the provision for the costs and expenses of prosecution to be borne by the company), of 1948 Act, s 334 and are the predecessors of Insolvency Act, ss 218 and 219.

¹⁰⁴ The most significant amendments were provisions enabling a company to reduce its capital. 1867 Act, s 37 re-enacted 1856 Act, s 41 (which had been inadvertently omitted from the 1862 Act) and provided for the ways in which contracts on behalf of the company could be made.

¹⁰⁵ 1985 Act, ss 306 and 307 were repealed by 2006 Act Commencement Order No 8, para 4 and Sch 1.

¹⁰⁶ Cork Report at para 78.

¹⁰⁷ Companies (Winding Up) Act 1890, ss 7, 8, 10.

¹⁰⁸ (1889) 14 App Cas 337. Directors were personally liable for their own deceits: *Barwick v English Joint Stock Bank* (1867) 2 Exch 259; *Standard Chartered Bank v Pakistan Shipping Corp* [2003] 1 AC 959, 968, HL.

¹⁰⁹ This section was the derivation, subject to amendments made by the 1928 and 1947 Acts, of 1948 Act, ss 40, 43, 46 and 1985 Act, ss 61, 62, 67–9, 71. Those sections were repealed by Financial Services Act, s 212(3) and Sch 17, Part I and were replaced by s 150 of that Act. The current provision is FSMA, s 90.

(2) The Companies Acts 1900 to 1985

- 1.45** In the period between the end of the nineteenth century and the UK joining the European Community in 1972 a pattern of company law reform emerged under which a committee would be appointed to report on amendments to company law, a Companies Act would give effect to the recommendations adopted by the government, and a consolidating statute would follow. The committees' recommendations invariably responded to recently exposed scandals and mischief arising from the lack of regulation in the original 1862 Act. Thus in 1895 a committee under the chairmanship of Lord Davey reported on what amendments to the Companies Acts were necessary 'with a view to the better prevention of fraud in relation to the formation and management of companies'.¹¹⁰ Some of its recommendations, mainly concerning control of the abuse of the prospectus and registration of charges, were included in the 1900 Act.¹¹¹ The Loreburn Committee¹¹² reported in 1906. Its recommendations were enacted by the 1907 Act and consolidated with the surviving provisions of the Companies Acts 1862–1900 into the Companies (Consolidation) Act 1908. The Greene Committee, under the chairmanship of Wilfred Greene KC (later Lord Greene MR), published its report in 1926. Its recommendations were enacted by the Companies Act 1928 and brought into effect by the consolidating Companies Act 1929. Similarly the Cohen Committee, under the chairmanship of Cohen J (later Lord Cohen) reported in June 1945. Its recommendations were enacted by the Companies Act 1947 and its provisions consolidated into the Companies Act 1948. In June 1962 the Jenkins Committee, of which Lord Jenkins was chairman, published its report. The previous pattern of implementing recommendations was somewhat broken, because the Companies Act 1967 only implemented some of the Jenkins Committee recommendations (eg disclosure and accounts). Its recommendation for reform to give minority shareholders meaningful relief from unfair prejudice was not enacted until 1980, and a consolidating statute did not follow until 1985, by which time there had been several other reforming statutes.
- 1.46** The four twentieth-century Committees proceeded on the basis that the great majority of companies were honestly and conscientiously managed and that, in the words of the Greene Committee, it was 'most undesirable, in order to defeat an occasional wrongdoer, to impose restrictions which would seriously hamper the activities of honest men and would inevitably re-act upon the commerce and prosperity of the country'.¹¹³ The Cohen Committee took a more interventionist view, believing that the fullest practicable disclosure of information concerning a company's affairs should be made to shareholders, creditors, and the general

¹¹⁰ The committee was a distinguished one and included Chitty J, Vaughan Williams J, Mr HB Buckley QC, and Mr F Palmer.

¹¹¹ Companies Act 1900, ss 14–16 contained new provisions for registration of charges. The Davey Committee also recommended reforms to the law concerning qualification shares of directors and the particulars to be stated in a prospectus, which were enacted by the Companies Act 1900. In 1906 the Loreburn Committee found that these requirements were so stringent that they discouraged the use of a prospectus and deterred honest and prudent men from accepting directorships (para 16(3) of its Report). They were repealed and replaced by the less onerous requirements of the 1907 Act.

¹¹² The Loreburn Committee included Mr Gore-Browne and Messrs Palmer and Waterhouse who had been members of the Davey Committee.

¹¹³ Report of the Loreburn Committee at para 8; Report of the Greene Committee at paras 7 and 9; Report of the Cohen Committee at para 5; Report of the Jenkins Committee at paras 11–14.

public, that the requirements of the Companies Acts should be enforced more rigorously, and that improper or dishonest conduct should be investigated and prosecuted.¹¹⁴

None of the Committees made any recommendations in relation to a company's capacity, the ultra vires rule, or the power of directors to bind the company.¹¹⁵ Reform in that area had to await the implementation of the First EEC Directive on Harmonisation of Company Law (paragraph 1.11 above). **1.47**

The process of reform resumed with the Insolvency Act 1976, s 9, and the Companies Acts 1976, 1980, and 1981 (the latter two Acts also giving effect to the Second and Fourth EEC Directives on Harmonisation of Company Law). The reforms made by those Acts were consolidated into the 1985 Act with provisions from the 1948 and 1967 Acts. The following paragraphs provide a brief summary of the course of the reform of the law relating to directors, following the order in which these matters are addressed in this work. **1.48**

Appointment and removal of directors

On the recommendation of the Cohen Committee every company had to have at least one director and a secretary;¹¹⁶ the appointment of a director was to be voted on individually, and the members were given an overriding power to remove a director by ordinary resolution, but without prejudice to the director's right to claim compensation and protest his removal.¹¹⁷ Except that a private company need not have a secretary, these provisions have been adopted by the 2006 Act.¹¹⁸ **1.49**

Directors' duties

In response to the unsatisfactory state of the law in relation to a director's duty of care (paragraph 1.22 above), the Davey Committee recommended a statutory statement of this duty in objective terms: 'Every director shall be under an obligation to the company to use reasonable care and prudence in the exercise of his powers, and shall be liable to compensate the company for any damage incurred by reason of neglect to use such care and prudence.'¹¹⁹ This recommendation was not adopted and the Loreburn Committee did not repeat it. Instead the Loreburn Committee recommended, and the government accepted, that the **1.50**

¹¹⁴ Report of the Cohen Committee at paras 5 and 6.

¹¹⁵ The Cohen Committee considered that 'the doctrine of ultra vires is an illusory protection for the shareholders and yet may be a pitfall for third parties dealing with the company' and favoured its abolition (para 12), but the Jenkins Committee disagreed (paras 35–41). On the recommendation of the Cohen Committee (para 12) a company could change its objects by special resolution without the need for court sanction; 1947 Act, s 76; 1948 Act, s 5.

¹¹⁶ Report of the Cohen Committee at para 55 and 1948 Act, ss 177–9.

¹¹⁷ Report of the Cohen Committee at para 130 and 1948 Act, ss 183 and 184. The Committee also recommended a compulsory retirement age of 70 for directors of public companies: Report at para 131 and 1948 Act, ss 185 and 186, which were re-enacted as 1985 Act, ss 293 and 294 (repealed by the 2006 Act on 1 October 2009). Instead the 2006 Act is concerned to prevent the appointment of under-age directors: ss 157–9.

¹¹⁸ 2006 Act, ss 155, 160, 168, 270, 271.

¹¹⁹ Report of the Davey Committee at para 32 and draft clause 10(2). The Davey Committee recognized that the draft law went beyond any actual decision of the courts. In an appendix to the report (pp 19 and 20) Dr Schuster compared the amount of diligence expected of a director under English law with German law:

German law requires the diligence of a prudent trader, and presumes negligence in case of loss. English law recognises a shadowy liability for 'crassa negligentia' and presumes diligence. German law makes a director liable for non-attendance to his duties; according to English law a director

court should have a statutory power to relieve directors who have acted honestly and reasonably, from liability for negligence or breach of trust.¹²⁰

- 1.51** The Greene Committee said that ‘to attempt by statute to define the duties of directors would be a hopeless task’, but it observed that provisions in the articles or contract exempting directors from liability for negligence or breach of trust gave ‘a quite unjustifiable protection to directors’ and recommended that they should be void. It found the general law of negligence satisfactory, but recommended that, in exercising its power to relieve a director, the court should take into account all the circumstances of his appointment.¹²¹ These recommendations were adopted in the 1929 Act, ss 152 and 372 and, in modified form continue in effect in the 2006 Act.¹²²
- 1.52** The Cohen Committee did not address the issue of directors’ duties, except to advocate strengthening their civil and criminal liability for false and misleading statements in a prospectus.¹²³
- 1.53** The Jenkins Committee rejected the suggestion that the existing law on directors’ duties should be codified, because of the danger that there might be gaps in the law as codified. Instead, it favoured a statement of the basic principles underlying the fiduciary relationship of a director to his company; namely a duty to observe the utmost good faith and act honestly and a duty not to make, and to account for, secret profits.¹²⁴ Attempts were made to include a statutory statement of a director’s fiduciary duties in Companies Bills of 1973 and 1978, but both were lost because of general elections. Instead, the 1980 Act, s 46 introduced a duty owed by a director to the company to have regard to the interests of the company’s employees as well as the interests of its members.¹²⁵

Transactions with directors

- 1.54** Following the recommendation of the Greene Committee, the 1929 Act, s 128 required a company’s accounts laid before the company in general meeting to contain particulars of loans to, and remuneration of, directors other than managing directors.¹²⁶ The 1929 Act included other new provisions to compel transparency in directors’ dealings. A director had

who never attends any board meetings cannot come under any liability, and a director who votes for a resolution sanctioning an ‘ultra vires’ expenditure of the company’s funds is not liable for such expenditure if he has not actually signed the cheque by which such expenditure is effected. [Referring implicitly to *Re Cardiff Savings Bank* [1892] 2 Ch 100 and explicitly to *Cullerne v London and Suburban BS* (1890) 25 QBD 485, CA.]

¹²⁰ Report of the Loreburn Committee at para 24. The recommendation, modelled on Judicial Trustees Act 1896, s 3(1)(a), was enacted as Companies Act 1907, s 32, which is the derivation, with amendments made by the 1928 and 1947 Acts, of 1985 Act, s 727 and of the current 2006 Act, s 1157. Mr Edgar Speyer, a businessman and member of the Committee, added a note on para 24 of the Report in which he said that ‘the immunity of directors from liability for negligence lies at the seat of the deplorable abuses in company matters in this country’ and urged a statutory statement of a director’s personal liability for negligence in the discharge of his duties.

¹²¹ Report of the Greene Committee at paras 46 and 47. Reference was made to *Re Brazilian Rubber Estates Ltd* [1911] 1 Ch 425.

¹²² 1929 Act, s 152 is the derivation of 1985 Act, s 310 (as originally enacted). 2006 Act, ss 232–8 deal with provisions protecting directors from liability.

¹²³ Report of the Cohen Committee at paras 41–6 and 1948 Act, ss 43 and 44.

¹²⁴ Report of the Jenkins Committee at paras 86, 87, 99(a).

¹²⁵ This was re-enacted by 1985 Act, s 309. Employees’ interests are now a factor to be considered in the duty to promote the success of the company (2006 Act, s 172(1)(b)).

¹²⁶ Report of the Greene Committee at paras 48–50. These provisions were the tentative precursors of provisions in 1985 Act, Part X, underpinning directors’ duties and the provisions in the 2006 Act, Part 10,

a duty to disclose his interests in a contract or proposed contract to the board and in default was liable to a fine.¹²⁷ It was not lawful for a director to receive a payment for loss of office in connection with a transfer of all or part of the company's undertaking or property without the approval of the company.¹²⁸

On the recommendation of the Cohen Committee, the tax-free payment of fees and salaries to directors and loans to directors were made unlawful and absolutely prohibited,¹²⁹ and a payment to a director as compensation for loss of office was not lawful unless approved by the company.¹³⁰ The Cohen Committee also recommended that there should be more disclosure of share transactions by directors and that all directors' remuneration should be disclosed, including that earned as managing director or executive, and pensions.¹³¹ These disclosure requirements have been enhanced by subsequent Acts requiring details of remuneration to be disclosed in annual accounts and providing for directors' service contracts to be available for inspection. **1.55**

The Jenkins Committee recommended the prohibition of directors' dealing in options to buy or sell quoted shares or debentures of his company or its associated companies and made other recommendations for reform in relation to compensation for directors' loss of office, disclosure of directors' other interests, and loans to directors. The 1967 Act gave effect to these recommendations by making dealings by directors in options an offence, requiring directors' service contracts to be open to inspection by members, and imposing a duty on directors to notify the company of their interests in shares or debentures of the company or associated companies.¹³² **1.56**

As 'a hasty legislative response' to a number of financial scandals in the 1970s,¹³³ the 1980 Act, ss 47–61 provided that certain transactions in which directors had a conflict of interest were invalid unless disclosed to and approved by the members; namely contracts of employment, substantial property transactions, and loans.¹³⁴ These provisions, which applied to shadow directors,¹³⁵ and the surviving provisions of the 1948 Act concerning transactions with directors were incorporated into the 1985 Act, Part 10.¹³⁶ **1.57**

Chapter 4 (Ch 18 of this work). A company could avoid the need to disclose directors' remuneration by appointing all its directors as managing directors: Cohen Report at para 89.

¹²⁷ 1929 Act, s 149, the precursor of 1985 Act, s 317; now 2006 Act, ss 177 and 182.

¹²⁸ 1929 Act, s 150, the precursor of 1985 Act, s 312; now 2006 Act, ss 215 and 217.

¹²⁹ Report of the Cohen Committee at paras 88 and 90 and 1948 Act, ss 189 and 190. The corresponding sections in 1985 Act (ss 311, 330–42) have been repealed by 2006 Act and replaced in the case of loans by a requirement of members' approval (2006 Act, ss 197–214).

¹³⁰ Report of the Cohen Committee at para 92 and 1948 Act, s 191. This provision, with the related provisions brought into effect by the 1929 Act, were included in 1985 Act, Part 10. The corresponding provisions in the 2006 Act, but in different terms, are ss 215–22. Since the provisions concerning payment for loss of office did not apply to covenanted payments (*Taupo Totara Timber Co Ltd v Rowe* [1978] AC 537, PC), they were riddled with loopholes and easily evaded: Law Commission Joint Consultation Paper *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties* (No 153) at para 4.19.

¹³¹ Report of the Cohen Committee at paras 89, 90, 93 and 1948 Act, s 196.

¹³² Report of the Jenkins Committee at paras 92–8, 99(b)–(p); 1967 Act, ss 25–32; and 1976 Act, ss 24–7. The provisions about options and interests in shares, which were replaced by 1985 Act, ss 323–9 have been repealed by the 2006 Act.

¹³³ Law Commission Consultation Paper *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties* (No 153) at para 1.9.

¹³⁴ 1948 Act, s 190 was repealed.

¹³⁵ The concept of a 'shadow director' was not new to companies legislation. Its features had been used in the Companies (Particulars as to Directors) Act 1917, although the phrase 'shadow director' was not used. After 1980 more extensive use was made of the concept.

¹³⁶ 2006 Act, ss 188–226 are the corresponding provisions.

Shareholders' remedies

- 1.58** The Cohen Committee recognized the need to provide an alternative remedy to winding up for cases of minority oppression, particularly in private companies. The court should have power, if satisfied that a minority of shareholders was being oppressed and that a winding-up order would not do justice to the minority, to make such order as the court thought just, including an order that the minority be bought out at a fair price.¹³⁷ This recommendation was brought into effect by the 1948 Act, s 210, but, as interpreted by the court, the threshold test of oppression proved too onerous to give the section much practical value.¹³⁸ The Jenkins Committee doubted whether s 210 was intended to be interpreted so restrictively and recommended that the section be replaced by one that extended the court's powers and made it clear that it applied to isolated acts as well as to a course of conduct and to the conduct of the affairs of the company in a manner unfairly prejudicial to the interests of some part of the members and not merely in an oppressive manner.¹³⁹ The 1980 Act, s 75 replaced the 1948 Act, s 210 in the wide terms advocated by the Jenkins Committee and without reference to making a winding-up order.¹⁴⁰

Accounts

- 1.59** The Davey Committee recommended that there should be statutory obligations to prepare annual accounts, which should be laid before the shareholders, and to appoint auditors, but it did not favour an obligation to file them with the Registrar.¹⁴¹ The 1900 Act, in ss 22 and 23, only adopted the recommendation for the appointment of auditors. The Loreburn Committee recommended that private companies should be distinguished from public companies and exempt from the requirement to file with the Registrar an annual return and balance sheet, which was brought in by the 1907 Act, s 21.
- 1.60** After noting that there was no statutory obligation to keep proper accounts, the Greene Committee recommended that the law be changed to make the keeping of such accounts compulsory, that a profit and loss account and balance sheet, with directors' report, should be laid before the general meeting every year, and that willful default should be punishable by imprisonment. The recommendation was brought into effect by the 1929 Act, ss 122, 123.¹⁴² The Cohen Committee recommended that the Companies Act should state the form and contents of a company's accounts and identify the matters to be stated in the auditors' report.¹⁴³ The provisions in the 1948 Act, which gave effect to the recommendations of the Cohen Committee, were substantially recast by the 1967 Act, on the recommendation of the Jenkins Committee, and further amended by the 1976 and 1981 Acts.¹⁴⁴ Failure to

¹³⁷ Report of the Cohen Committee at paras 60, 152, 153.

¹³⁸ *Scottish Co-operative Wholesale Society v Meyer* [1959] AC 324, 342, HL. In that case the claim for relief under s 210 succeeded. The only other reported successful application is *Re HR Harmer Ltd* [1959] 1 WLR 62.

¹³⁹ Report of the Jenkins Committee at paras 199–212.

¹⁴⁰ This was replaced by 1985 Act, s 459, which was amended by 1989 Act, s 145 and Sch 19, para 11 and replaced by 2006 Act, Part 30, ss 994–9.

¹⁴¹ Report of the Davey Committee at paras 51–5.

¹⁴² Report of the Greene Committee at paras 67 and 72. The current provisions are 2006 Act, ss 386–9, 393–426.

¹⁴³ Report of the Cohen Committee at paras 96–114.

¹⁴⁴ Report of the Jenkins Committee at paras 330–435; 1967 Act, ss 3–14; 1976 Act, ss 1–20; 1981 Act, ss 1–21.

keep accounts and file returns is a factor to be taken into account in determining whether a director should be disqualified on the ground of unfitness.¹⁴⁵

Maintenance of capital

The only reform recommended by any of the four Committees concerning maintenance of capital was the prohibition on a company giving financial assistance in the purchase of its own shares. From the spectacular corporate collapses during and after the First World War,¹⁴⁶ the Greene Committee identified the ‘highly improper’ practice of a syndicate agreeing to buy from existing shareholders sufficient shares to acquire control of a company and arranging for the company to lend them the purchase money. Such a practice appeared to the Committee ‘to offend against the spirit if not the letter of the law which prohibits a company from trafficking in its own shares and the practice is open to the gravest abuses’. The Committee recommended that a company should be prohibited from giving direct or indirect assistance in the purchase of their own shares.¹⁴⁷ This recommendation was adopted in the 1929 Act, s 45.¹⁴⁸ A director who caused or procured a company to misapply its money in contravention of the prohibition was in breach of his duties and liable to compensate the company for its loss and was also liable to criminal prosecution and imprisonment.¹⁴⁹

1.61

The Jenkins Committee referred to dissatisfaction with the provision, which had become the 1948 Act, s 54, and recommended that it be re-cast so that financial assistance could be given if sanctioned by a special resolution and if a declaration of solvency was filed with the Registrar, thereby protecting the interests of creditors.¹⁵⁰ This recommendation was eventually adopted in the 1981 Act, but under the 2006 Act the restriction on giving financial assistance only applies to public companies.¹⁵¹ The 1981 Act also, for the first time, permitted a company to purchase or redeem its own shares provided that it complied with provisions for the protection of creditors.¹⁵²

1.62

Meanwhile the 1980 Act, ss 39–45 for the first time imposed statutory restrictions on the distribution of profits and assets, so that distributions to members could only be made out of profits available for the purpose.¹⁵³

1.63

Disqualification

The Greene Committee discovered that undischarged bankrupts used companies through which to carry on business and incur credit, to the great risk of persons dealing with the

1.64

¹⁴⁵ CDDA, s 9 and Sch 1, para 4. See the observations of Sir Donald Nicholls V-C in *Re Swift 736 Ltd* [1993] BCLC 896, 900.

¹⁴⁶ *Re Jubilee Cotton Mills Ltd* [1922] 1 Ch 100; [1923] 1 Ch 1, CA; [1924] AC 958, HL, is a well-known example.

¹⁴⁷ Report of the Greene Committee at paras 30 and 31. Lord Greene described the offensive practice that the prohibition was designed to prevent in *Re VGM Holdings Ltd* [1942] Ch 235, 239, CA. In *Steen v Law* [1964] AC 287, 301, PC, Lord Radcliffe referred to the ‘notorious objections’ to the practice.

¹⁴⁸ With amendments made by the 1947 Act, this section was re-enacted as 1948 Act, s 54.

¹⁴⁹ *Re VGM Holdings Ltd* [1942] Ch 235, CA; *Steen v Law* [1964] AC 287, PC; *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555, 1652–9; *Wallersteiner v Moir* [1974] 1 WLR 991, CA. As to criminal liability: *R v Lorang* (1931) 22 Cr App Rep 167.

¹⁵⁰ Report of the Jenkins Committee at paras 170–86, 187(d).

¹⁵¹ 1981 Act, ss 42–4, which became 1985 Act, ss 151–3, 155–8. The current provisions, 2006 Act, ss 677–83, only apply to public companies. By the 2006 Act Commencement Order No 5, Arts 5(2) and 8(b) and Sch 3 1985 Act, ss 151–3, 155–8 ceased to apply to private companies on 1 October 2008.

¹⁵² 1981 Act, ss 46–62. Provisions for purchase and redemption of a company’s own shares are in 2006 Act, ss 684–737.

¹⁵³ These provisions are now in 2006 Act, ss 829–53.

company. It recommended that an undischarged bankrupt should be disqualified from being a director of a company or in any way concerned in its management without the leave of the bankruptcy court and that contravention of this prohibition should be an offence punishable with imprisonment. The recommendation was implemented in the 1929 Act, s 142 and continues in force as the CDDA, ss 11 and 13.¹⁵⁴

- 1.65** Also, on the recommendation of the Greene Committee, the 1929 Act gave the court power to disqualify a person from being a director or concerned in the management of a company for up to five years, but it limited the power to cases of fraudulent trading and other frauds in relation to the promotion or management of the company.¹⁵⁵ On the recommendation of the Cohen Committee the circumstances justifying disqualification were extended to cases of breach of trust and conviction of an offence in relation to companies.¹⁵⁶ The Jenkins Committee recommended further extensions to cover persons convicted on indictment of any offence involving fraud or dishonesty, persons who had been persistently in default in complying with the provisions of the Companies Act, and persons who had shown themselves to be unfit to be concerned in the management of companies through improper, reckless, or incompetent conduct.¹⁵⁷ Those recommendations were partially implemented by the Insolvency Act 1976, s 9 (disqualification for unfitness), the Companies Act 1976, s 28 and the 1981 Act, ss 93 and 94, which, with the disqualification provisions from the 1948 Act, were consolidated in the 1985 Act.¹⁵⁸

Winding up

- 1.66** The Davey Committee recommended radical reform to protect unsecured creditors through provisions making directors personally liable for debts incurred when there was no reasonable expectation that the company would be able to pay them, and also liable to the company for misfeasance for being party to a fraudulent preference and for pledging or disposing of property obtained on credit.¹⁵⁹ None of this was adopted at the time.
- 1.67** The Greene Committee recommended the introduction of a provision to deal with fraudulent trading. There was evidence of persons in control of a company taking a floating charge over all its assets, obtaining goods on credit to 'fill up' the security, and then appointing a receiver who would pay them the sale proceeds. The recommendation was accepted. Directors responsible for carrying on the business of the company in fraud of creditors faced three sanctions: (i) personal liability for the debts and liabilities of the company, with the personal liability being charged on any debts owed to, or security held by, the director, (ii) imprisonment for a criminal offence, and (iii) disqualification for up to five years.¹⁶⁰
- 1.68** Also, on the recommendation of the Greene Committee, the 1929 Act provided that officers of a company in liquidation were liable for a range of offences, punishable with

¹⁵⁴ Report of the Greene Committee at paras 56 and 57. 1929 Act, s 142 was re-enacted, with modifications, as 1948 Act, s 187 and 1985 Act, s 302 (repealed when the CDDA came into force).

¹⁵⁵ Report of the Greene Committee at paras 61 and 62 and 1929 Act, ss 217 and 275.

¹⁵⁶ Report of the Cohen Committee at paras 150 and 153 and 1948 Act, s 188.

¹⁵⁷ Report of the Jenkins Committee at paras 80–5.

¹⁵⁸ 1985 Act, ss 295–302.

¹⁵⁹ Report of the Davey Committee at para 33 and draft clause 11. In *Re Washington Diamond Mining Co* [1893] 3 Ch 95 the Court of Appeal had held that a director was personally liable for misfeasance for causing the company to make a fraudulent preference.

¹⁶⁰ 1929 Act, s 275, which is the precursor of the civil liability in Insolvency Act, s 213 and the criminal offence in 2006 Act, s 993 (which replaced 1985 Act, s 458).

imprisonment, covering fraud and failure to keep proper accounts, and enforcing cooperation with the official receiver or liquidator.¹⁶¹

The Jenkins Committee referred to widespread criticism that the Companies Act did not deal adequately with fraudulent or incompetent directors. It recommended more use of public examinations and extending the fraudulent trading section to reckless conduct, the misfeasance section to cover actionable negligence, and disqualification to cover acting as a receiver or liquidator.¹⁶² **1.69**

Restructuring of the 1985 Act

The 1985 Act had only been in force for a little over one year when many of its sections were repealed and replaced by provisions in other Acts. Provisions about capital issues, including liability for false and misleading statements in listing particulars¹⁶³ were moved to the Financial Services Act 1986 and the new provisions are now in the Financial Services and Markets Act 2000. Provisions about disqualification¹⁶⁴ were repealed and are now in the Company Directors Disqualification Act 1986. Provisions about receivers and winding up¹⁶⁵ were repealed and replaced by provisions in the Insolvency Act 1986. **1.70**

(3) The Insolvency Act and CDDA

As regards insolvency and disqualification, the catalyst for the restructuring of the 1985 Act was the Report of the Cork Committee on Insolvency Law and Practice, published in June 1982. The Insolvency Act 1985 enacted the reforms made in light of the recommendations of the Cork Committee. The new provisions about insolvent companies were then brought into effect by the Insolvency Act 1986, which also included provisions from the 1985 Act about receivers and winding up. The new provisions about disqualification were included in the CDDA, which also includes disqualification provisions from the 1985 Act.¹⁶⁶ **1.71**

The Cork Committee promoted the 'rescue culture',¹⁶⁷ but it also addressed the public interest in the conduct of the management of companies, which included being satisfied (i) whether or not there is any fault or blame attaching to that conduct, (ii) if the conduct merits it, that those responsible for the management are suitably punished, (iii) that the opportunity to repeat that conduct is curtailed or restricted, and (iv) whether or not others are responsible for the insolvency. It found that the treatment of directors of insolvent companies was unduly lenient.¹⁶⁸ It recommended, among other measures, a new wrongful trading provision, automatic disqualification in certain cases, a general strengthening of the existing disqualification regime, and measures to deal with repeated abuse of limited liability through phoenix companies.¹⁶⁹ **1.72**

¹⁶¹ Report of the Greene Committee at paras 58, 60, 67, 72 and 1929 Act, ss 271, 273, 274. The corresponding provisions are in Insolvency Act, ss 206–11.

¹⁶² Report of the Jenkins Committee at paras 496–503.

¹⁶³ 1985 Act, Part III, ss 56, 57, 61, 63–79.

¹⁶⁴ 1985 Act, Part IX, ss 295–302.

¹⁶⁵ 1985 Act, Parts XIX and XX, ss 488–650.

¹⁶⁶ These Acts have been amended by the Insolvency Act 1994, the Insolvency (No 2) Act 1994, the Insolvency Act 2000, and Enterprise Act 2002, Part 10.

¹⁶⁷ Report of the Cork Committee at paras 495 and 1980; *Bristol Airport v Powdrill* [1990] Ch 744, 756, 758, CA; *Powdrill v Watson* [1995] 2 AC 394, 441, 442, HL.

¹⁶⁸ Report of the Cork Committee at paras 1735, 1737, 1739.

¹⁶⁹ Report of the Cork Committee at paras 1758–66 and Chapter 45.

1.73 The reforms in the Insolvency Act of particular relevance to directors are the provisions requiring them to provide information and assistance to office-holders (including ss 235 and 236), the new public examination provision (s 133), the new misfeasance section (s 212), personal liability for wrongful trading (s 214), the restriction on reuse of company names and personal liability for debts in the event of contravention (ss 216, 217), and the new transaction at undervalue, preference, and transactions defrauding creditors provisions (ss 238, 239, and 423). The CDDA, s 6 introduced a new and widely used power to disqualify unfit directors of an insolvent company for up to 15 years.

(4) Reforms to the 1985 Act regime

1.74 In the period after 1986 there were several strands in the reform and modernization of company law and governance under the 1985 Act regime. One strand concerned reform of parts of the 1985 Act. The 1989 Act, which implemented the Seventh and Eighth EC Company Law Harmonisation Directives, made a number of miscellaneous reforms of particular relevance to directors, which have been mentioned earlier in this chapter.¹⁷⁰ It also provided a measure of deregulation for private companies by enabling them to pass written resolutions,¹⁷¹ made reforms in relation to company contracts and the execution of documents,¹⁷² and made it clear that the 1985 Act, s 310 did not prevent a company from purchasing and maintaining insurance for officers and auditors.¹⁷³ The Political Parties, Elections and Referendums Act 2000 prohibited political donations unless authorized by resolution of the company in general meeting and made directors personally liable for damages in respect of any unauthorized donations.¹⁷⁴ The Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 enabled a company to hold shares in its own capital that it had duly purchased as treasury shares.¹⁷⁵ The Companies (Audit, Investigations and Community Enterprise) Act 2004 was a response to weaknesses exposed by the accounting scandals associated with the US companies Enron and WorldCom. Of particular relevance to directors, it inserted new provisions restricting and controlling the indemnification of directors and auditors.¹⁷⁶

1.75 A second strand concerned improvements in corporate governance. Following reports on the role of non-executive directors¹⁷⁷ and directors' remuneration,¹⁷⁸ a Committee

¹⁷⁰ 1989 Act, ss 108–10 inserted into 1985 Act, new ss 3A (statement of company's objects: general commercial company), 35 (a company's capacity not limited by its memorandum), 35A (power of directors to bind the company), 35B (no duty to inquire as to capacity of company or authority of directors), 36, 36A–C (company contracts, execution of documents), 322A (preserving the invalidity of certain transactions with directors). Section 131 inserted a new 1985 Act, s 111A (member's right to damages).

¹⁷¹ 1989 Act, ss 113 and 114 inserting 1985 Act, ss 381A, 381B, 381C, 382A, and Sch 15A.

¹⁷² Section 130 inserted new 1985 Act, ss 36, 36A–36C (company contracts, execution of documents, pre-incorporation deeds and documents).

¹⁷³ 1989 Act, s 137 replaced 1985 Act, s 310(3) with a new provision and inserted a new para 5A in Sch 7.

¹⁷⁴ Section 139 and Sch 19 inserted these provisions into the 1985 Act as ss 347A–347K. These provisions were recommended by the report of the Committee on Standards in Public Life, chaired by Lord Neill of Bladen, published in October 1998. They were replaced, with some minor changes, by 2006 Act, Part 14, ss 362–79.

¹⁷⁵ SI 2003/1116. These provisions were 1985 Act, ss 162A–162G and are now in 2006 Act, ss 724–32.

¹⁷⁶ The C(AICE) Act replaced 1985 Act, s 310 with new 1985 Act, ss 309A–309C and 310 (provisions protecting directors from liability, qualifying third party indemnity provision, disclosure of qualifying third party indemnity provisions, and provisions protecting auditors from liability). The corresponding provisions of the 2006 Act are ss 232–8 in relation to directors and ss 532–8 in relation to auditors' liability.

¹⁷⁷ *Report of the Committee on the Financial Aspects of Corporate Governance* chaired by Sir Adrian Cadbury (1992).

¹⁷⁸ *Directors' Remuneration: Report of a Study Group* chaired by Sir Richard Greenbury (1995).

on Corporate Governance, chaired by Sir Ronald Hampel, published a *Final Report of the Committee on Corporate Governance* (1998) and drew up a Combined Code, stating a set of principles of corporate governance and a Code of Best Practice. The Financial Reporting Council amends and updates the UK Corporate Governance Code.¹⁷⁹ The Code is not legally binding,¹⁸⁰ but listed companies are expected to comply with it or explain departures. The Code requires listed companies to maintain a sound system of internal control to safeguard shareholders' investments and the company's assets.

The third and most important strand of reform has been the work of the Law Commission on shareholder remedies and directors' duties and the work of the Company Law Review in setting out a framework for the fundamental modernization and restatement of company law now found in the 2006 Act. **1.76**

E. Genesis of the Companies Act 2006

In 1992 the Department of Trade and Industry began a review of a number of areas of company law. In February 1995 it asked the Law Commission to review shareholder remedies and make recommendations. The Law Commission, chaired by Arden J, published a Consultation Paper on *Shareholder Remedies* (1996, No 142) and a Report (1997, No 246). Among its recommendations was a new derivative action governed by court rules. This was not implemented at the time, because the issue of shareholder remedies was absorbed into the wider work of the Company Law Review described below. **1.77**

In order to contribute to the work of the CLR, the Law Commission, chaired by Arden J, went on to review the 1985 Act, Part X (enforcement of fair dealing by directors) and consider the case for a statutory statement of directors' duties. In August 1998 the Law Commission published a Consultation Paper, *Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties* (No 153). In September 1999 the Law Commission, now chaired by Carnwath J, published its Report (No 261), recommending a statutory statement, in broad and non-exhaustive terms, of a director's main fiduciary duties and duty of care and skill.¹⁸¹ The terms of the statement reflected the duties identified by the Law Commission from case law (paragraph 1.20 above). Thus a director could only make use of the company's property, information, or opportunities or have a position of conflict of interest if permitted by the company's constitution or if there has been disclosure to and approval by the company in general meeting. The Law Commission also recommended that a director's duty of skill, care, and diligence should be set out in the statute, that the test should be both objective (the knowledge and experience that may reasonably be expected of a person in the same position as the director) and subjective (the director's own knowledge and experience), and that regard should be had to the particular functions of the director and the circumstances of the company, but there was no need for a statutory business judgment rule or statement in relation to delegation or reliance on others.¹⁸² The Law Commission also recommended **1.78**

¹⁷⁹ The current version is dated June 2010.

¹⁸⁰ Nor do departures constitute unfair prejudice for the purpose of a petition under 2006 Act, Part 30: *Re Astec (BSR) plc* [1998] 2 BCLC 556, 590.

¹⁸¹ Report at para 4.48; Appendix A.

¹⁸² Report at paras 5.6, 5.20, 5.29, 5.37. This was accepted by the CLR (CLR: *Developing the Framework* at para 3.87).

the redrafting and simplifying of the 1985 Act, Part X and the repeal of prohibitions on tax-free payments to directors and option dealing by them, as well as the exemption from disclosure of directors' service contracts in respect of overseas employment.¹⁸³

- 1.79** In March 1998 the Department of Trade and Industry launched a wide-ranging review of core company law by an independent steering group, the CLR. The foreword to the consultation paper *Modern Company Law for a Competitive Economy* described the then current framework of company law as 'a patchwork of regulation that is immensely complex and seriously out of date'. The CLR's goal was a framework that was up to date and competitive and which facilitated enterprise and promoted transparency and fair dealing.¹⁸⁴ This could be achieved through clarifying the language and structure of the legislation, removing obsolescent and ineffective provisions, and making full use of electronic communication.
- 1.80** Under the general heading *Modern Company Law for a Competitive Economy* the CLR produced three consultation papers: *The Strategic Framework* (February 1999, URN 99/654), *Developing the Framework* (March 2000, URN 00/656), *Completing the Structure* (November 2000, URN 00/1335) and a *Final Report*, with suggested draft clauses (July 2001, URN 01/942, 943).¹⁸⁵ The overall approach of the CLR was that modern company law should be in 'a coherent and accessible form, providing maximum freedom for participants to perform their proper functions, but recognizing the case for high standards and for ensuring appropriate protection for all interested parties'.¹⁸⁶
- 1.81** One of the core policies of the CLR was the 'think small first' approach to private company regulation and legislative structure.¹⁸⁷ To this end the CLR proposed simplifying and modernizing the law for private companies, by (a) simplifying decision-making procedures (more use of written resolutions), (b) streamlining internal procedures (no need for AGMs or a secretary, and a simpler form of constitution), (c) reducing the burden of financial reporting and audit (extending the small companies regime and raising the audit exemption level), and (d) removing the ban on private companies giving financial assistance in the purchase of their own shares.¹⁸⁸
- 1.82** Another core policy was to provide an inclusive, open, and flexible regime for corporate governance. To this end the CLR proposed a statutory statement of directors' duties and a clarification and updating of the 1985 Act, Part 10, dealing with conflicts of interest. The duty of loyalty, by which directors are bound to promote the success of the company,

¹⁸³ Report at paras 7.99, 11.3–11.7 deal with recommended repeals. The provisions about option dealing were repealed, because of duplication with the Criminal Justice Act 1993. For general recommendations about 1985 Act, Part X, see paras 16.07–16.58.

¹⁸⁴ The CLR's terms of reference are set out in the CLR: *Final Report*, Annex A, p 335.

¹⁸⁵ In addition the CLR published consultation papers on Company General Meetings and Shareholder Communication, Company Formation and Capital Maintenance, and Reforming the Law Concerning Overseas Companies (October 1999, URN/1144–6), Capital Maintenance (June 2000, URN 00/880), Registration of Company Charges (October 2000, URN 00/1213), and Trading Disclosures (October 2000).

¹⁸⁶ CLR: *Strategic Framework* at Executive Summary, para 2.

¹⁸⁷ CLR: *Strategic Framework* at Executive Summary, para 2 and paras 2.25 and 5.2.33; CLR: *Final Report* at paras 1.52–1.55.

¹⁸⁸ CLR: *Strategic Framework* at Executive Summary, para 8; CLR: *Final Report* at paras 2.15–2.19, 2.21, 2.28–2.37, 4.3–4.7, 4.13–4.37, 10.06.

should be informed by ‘enlightened shareholder value’, so that directors manage the business of the company in the long-term interests of shareholders, but in an enlightened and inclusive way, enabling the company to achieve productive relations with a range of interested parties, such as employees, suppliers, and customers. The CLR rejected the ‘pluralist’ approach by which the interests of shareholders are merely balanced with the interests of others affected by the company.¹⁸⁹

To protect the interests of shareholders the CLR recommended a statutory form of derivative action,¹⁹⁰ and that members with an interest in facilitating or condoning misconduct should be disenfranchised.¹⁹¹ The CLR also made a number of recommendations to make sanctions more effective.¹⁹² **1.83**

The government’s response is contained in two White Papers *Modernising Company Law* (July 2002, Cm 5553) and *Company Law Reform* (March 2005, Cm 6456). The government broadly adopted the approach of the CLR. There would be a statutory statement of directors’ duties which would replace the existing common law and equitable rules and which would embed the concept of ‘enlightened shareholder value’ (but without codifying a duty to creditors). One change was that a director would be able to exploit a corporate opportunity with the consent of independent directors.¹⁹³ The government did not agree to codify the *Duomatic* rule.¹⁹⁴ **1.84**

On 1 November 2005 a Company Law Reform Bill was introduced into the House of Lords. The Under-Secretary of State, Department of Trade and Industry (Lord Sainsbury) said it had four key objectives: ‘enhancing shareholder engagement and a long-term investment culture; ensuring better regulation and a “think small first” approach; making life easier to set up and run a company; and providing flexibility for the future.’¹⁹⁵ After extensive revision and a change of name to the Companies Bill, the bill received Royal Assent on 8 November 2006. The 2006 Act also repeals all the provisions of the Companies Act 1985, except for the provisions about investigations contained in Parts XIV and XV, which were amended. **1.85**

F. Reforms Made by the Companies Act 2006

Although it was intended to be more accessible (eg by differentiating the provisions that apply to private and public companies), it must be accepted that the 2006 Act is a daunting piece of **1.86**

¹⁸⁹ CLR: *Strategic Framework* at Executive Summary, paras 5, 5.1.11–5.1.33; CLR: *Developing the Framework* at paras 2.7–2.26, 3.17–3.20, 3.37–3.58, 3.82; CLR: *Final Report* at paras 2.20, 3.5–3.11, 3.21–3.27, 4.8, 4.9, 6.2–6.16.

¹⁹⁰ CLR: *Final Report* at paras 2.23–2.26, 7.41–7.51.

¹⁹¹ CLR: *Final Report* at paras 7.52–7.62.

¹⁹² CLR: *Final Report* at paras 1.17, 15.1–15.77.

¹⁹³ 2005 White Paper at para 3.3.

¹⁹⁴ This was recommended by the CLR in the *Final Report* at paras 2.14, 7.17–7.26; 2005 White Paper at para 4.2. The CLR had recommended codifying a duty to creditors: *Developing the Framework* at paras 3.72, 3.73, 3.81; *Final Report* at paras 3.12–3.20.

¹⁹⁵ Hansard, HL Debate, vol 677, col 182 (11 January 2006). In relation to flexibility for the future, Part 31 of the original Bill gave the Secretary of State wide law-making powers, but this Part was withdrawn. Instead the 2006 Act contains many provisions for the law to be stated in delegated legislation under the negative and affirmative resolution procedures or by the instrument being approved after being made; see ss 1288–92.

legislation. It has 1,300 sections and 16 schedules. It is supported by more than 70 statutory instruments. The following paragraphs highlight the reforms of most concern to directors.

Parts 1–7: The fundamentals of a company

- 1.87** These provisions concern types of company, company formation, a company's constitution, its capacity to act, its name, its registered office, and change of status.¹⁹⁶ There are new provisions, which simplify the procedure for forming a company and its constitution (Parts 2 and 3). Now a single person may form a private or public company.¹⁹⁷ By s 9,¹⁹⁸ to form a company there must be delivered to the Registrar (a) the memorandum of association in the prescribed form authenticated by the subscribers;¹⁹⁹ (b) an application for registration containing prescribed information about the company, including particulars of its proposed share capital (if any) and its first directors and secretaries, with consents to act;²⁰⁰ (c) a copy of the proposed articles unless the applicable Model Article is to apply;²⁰¹ and (d) a statement of compliance in accordance with s 13.
- 1.88** The main change from the procedure under the 1985 Act is that under the 2006 Act the memorandum is a simple document which provides a historical record evidencing the intention of the founder members to form the company and become members. It therefore underpins the statutory contract between members and the company.²⁰² It cannot be changed or updated, but there is no need to do so. The memorandum does not state the company's objects and much of the information that used to be contained in it is now contained in the application for registration.
- 1.89** There are also changes to a company's constitution. The 1985 Act did not refer to a company's constitution as such. Under the 2006 Act, s 17, unless the context otherwise requires, a company's constitution includes its articles²⁰³ and also any resolutions or agreements which affect its constitution.²⁰⁴ The constitution may now include entrenched provisions, which can only be amended or repealed by procedures more restrictive than a special resolution.²⁰⁵ Another change is that a company's objects are unrestricted, giving it the same plenary

¹⁹⁶ As Sir John Vinelott put it in 'Individual Insolvency: The Insolvency Acts 1985 and 1986' (1987) 40 *Current Legal Problems*, 11: 'A company, like a good soldier has a name, a number and a place.'

¹⁹⁷ Under 1985 Act, s 1(3A), inserted by the Companies (Single Member Private Limited Companies) Regulations 1992 (SI 1992/1699) with effect from 15 July 1992, a single person was able to form a private company, but not a public company.

¹⁹⁸ See also the Companies (Registration) Regulations 2008 (SI 2008/3014) and the Companies (Shares and Share Capital) Order 2009 (SI 2009/388).

¹⁹⁹ 2006 Act, s 8.

²⁰⁰ 2006 Act, ss 9–12. For public companies the statement about the company's share capital is linked to Art 2 of the Second Company Law Directive (77/91/EC). For unregistered companies, see the Unregistered Companies Regulations 2009 (SI 2009/2436), regulation 3 and Sch 1, paras 1–3. For companies not formed under companies legislation but authorized to register pursuant to the 2006 Act, s 1040, see Companies (Companies Authorised to Register) Regulations 2009 (SI 2009/2437).

²⁰¹ Pursuant to 2006 Act, s 19, the Companies (Model Articles) Regulations 2008 (SI 2008/3229) prescribe default model articles for private companies limited by shares, private companies limited by guarantee, and public companies.

²⁰² 2006 Act, s 33(1).

²⁰³ 2006 Act, ss 18–20.

²⁰⁴ 2006 Act, s 29. An informal agreement of the type considered in *Cane v Jones* [1980] 1 WLR 1451 would be part of the constitution and subject to the rules about forwarding to the Registrar (s 30) and being provided to members (s 32).

²⁰⁵ 2006 Act, s 22 and for alteration of articles: ss 21–7.

capacity as an individual, unless specifically restricted by its articles.²⁰⁶ The provisions of the constitution 'bind the company and its members to the same extent as if there were covenants on the part of the company and each member to observe those provisions'.²⁰⁷

There are new rules about choice of name and trading disclosures (Part 5). These provisions should be considered with the supporting regulations²⁰⁸ and Part 41, which contains new provisions about business names and provisions derived from the Business Names Act 1985, with changes. One matter of particular significance to directors is that they are no longer personally liable if the company's name is not correctly stated on its contracts and bills, because the 1985 Act, s 349 was repealed with effect from 1 October 2008.²⁰⁹ **1.90**

Part 9: Exercise of members' rights

In recognition of the fact that shares are often held through nominees, there are new provisions, which enable the registered member to nominate another person to exercise members' rights where the company's articles so provide,²¹⁰ or to nominate another person to enjoy information rights where the company is a traded company.²¹¹ **1.91**

Part 10: A company's directors

Now every company must have one natural director, who cannot be under the age of 16, but there are no upper age limits.²¹² There are new restrictions on the disclosure of directors' residential addresses.²¹³ **1.92**

There is a statutory statement of directors' general duties and independent directors are given power to authorize a director to have a conflict of interest or take the benefit of a corporate opportunity.²¹⁴ **1.93**

There are changes to the rules about directors declaring their interests in existing transactions and about transactions with directors requiring approval of members.²¹⁵ Certain restrictions on transactions with directors, formerly contained in the 1985 Act, Part X (enforcement of fair dealing by directors), have been repealed and not replaced by provisions in the 2006 Act.²¹⁶ **1.94**

²⁰⁶ 2006 Act, ss 31 and 39. For charitable companies, see s 42.

²⁰⁷ 2006 Act, s 33(1). Unlike its predecessor (the 1985 Act, s 14(1)), s 33 expressly refers to the company. For cases on former provisions, see *Welton v Saffery* [1897] AC 299, 315 and *Hickman v Romney Marsh Sheep-Breeders Association* [1915] 1 Ch 881. Section 33 (like 1985 Act, s 14) is excepted from the general principle set out in the Contracts (Rights of Third Parties) Act 1999, s 1 and so the provisions of a company's constitution will not confer any rights on persons other than the company and its members.

²⁰⁸ The supporting regulations are: the Companies (Trading Disclosures) Regulations 2008 (SI 2008/495), as amended by the Companies (Trading Disclosures) (Amendment) Regulations 2009 (SA 2009/218), the Company Names Adjudicator Rules 2008 (SI 2008/1738), and the Company and Business Names (Miscellaneous Provisions) Regulations 2009 (SI 2009/1085). Also see the Companies (Unregistered Companies) Regs 2009 (SI 2009/2436) and the Companies (Companies Authorised to Register) Regulations 2009 (SI 2009/2437).

²⁰⁹ 2006 Act Commencement Order No 5, Art 8(b) and Sch 3.

²¹⁰ 2006 Act, s 145.

²¹¹ 2006 Act, ss 146–53.

²¹² 2006 Act, Part 10, Chapter 1, ss 154–69.

²¹³ 2006 Act, Part 10, Chapter 8, ss 240–6.

²¹⁴ 2006 Act, Part 10, Chapter 2, ss 170–81.

²¹⁵ 2006 Act, Part 10, Chapters 3–6, ss 182–231.

²¹⁶ The provisions of 1985 Act, Part 10, concerning transactions with directors, that have been repealed and not replaced are s 311 (prohibition on tax-free payments to directors), ss 323 and 327 (prohibition on directors dealing in share options), ss 324–6, 328, 329, and Sch 13, Parts 2–4 (register of directors' interests), s 342

- 1.95** There are new provisions about qualifying pension scheme indemnity provision in respect of directors' liabilities and ratification of a director's wrongful conduct by independent members.²¹⁷

Part 11: Derivative claims

- 1.96** There is a new statutory procedure for derivative claims by members arising from a breach of duty by directors²¹⁸

Part 12: Company secretaries

- 1.97** There is no need for private companies to have a secretary.²¹⁹

Part 13: Resolutions and meetings

- 1.98** The way in which companies pass resolutions is simplified. The reforms include the following: (a) there are now only ordinary and special resolutions (extraordinary resolutions have been abolished),²²⁰ (b) written resolutions are the normal procedure for private companies,²²¹ (c) all company meetings are convened on 14 days' notice, except public company AGMs which require 21 days,²²² (d) communications in relation to company meetings may be sent electronically,²²³ (e) private companies are no longer obliged to hold AGMs,²²⁴ and (f) there are new provisions for polls for quoted companies.²²⁵

- 1.99** The Companies (Shareholders' Rights) Regulations 2003 have made amendments to Part 13 to facilitate the exercise of shareholders' rights in traded companies.²²⁶

Part 15: Accounts and reports

- 1.100** Directors are under a new duty not to approve accounts unless they give a true and fair view.²²⁷ There are new requirements for a company's annual accounts to disclose information about directors' benefits and for a business review in the directors' report for all companies other than those subject to the small companies regime.²²⁸ The annual accounts of quoted companies must be published on their website.²²⁹ The time for filing accounts and reports with the Registrar is reduced from ten months after the end of the relevant accounting reference period to nine months for private companies and six months for public companies.²³⁰ There is a new

(criminal liability for loans to directors), and ss 343 and 344 (special procedure for disclosure by banks). The government repealed the provisions about the register of directors' interests because the FSA requires disclosure by traded companies to comply with the EU Market Abuse Directive and the government did not wish to extend those requirements to other companies. Because 2006 Act, s 413 makes special provision for disclosure requirements by banking companies, the provisions of 1985 Act, ss 343 and 344 were no longer required.

²¹⁷ 2006 Act, Part 10, Chapter 7, ss 232–9.

²¹⁸ 2006 Act, Part 11, ss 260–4 (claims in England and Wales or Northern Ireland).

²¹⁹ 2006 Act, Part 12, ss 270–80.

²²⁰ 2006 Act, ss 281–3.

²²¹ 2006 Act, ss 288–300.

²²² 2006 Act, s 307.

²²³ 2006 Act, s 333.

²²⁴ The provisions about AGMs for public companies are in 2006 Act, ss 336–40.

²²⁵ 2006 Act, ss 341–54.

²²⁶ SI 2009/1632; implementing Directive 2007/36/EC of the European Parliament and of the Commission of 11 July 2007.

²²⁷ 2006 Act, s 393.

²²⁸ 2006 Act, ss 412, 413, 417.

²²⁹ 2006 Act, s 430.

²³⁰ 2006 Act, s 442.

provision making a director liable to compensate the company for any loss suffered by it as a result of an untrue or misleading statement in, or omission from the directors' report, the directors' remuneration report, or any summary financial statement derived from them.²³¹

Part 16: Audit

There are new provisions to improve the accountability of auditors, including (a) provisions relating to the appointment of auditors of private companies and the disclosure of the terms of an auditor's appointment,²³² (b) a requirement that an auditor's report given by a firm must be signed by an individual as senior statutory auditor,²³³ (c) provisions about offences relating to the audit report,²³⁴ (d) obligations of the auditor and the company to notify the appropriate audit authority if the auditor ceases to hold office,²³⁵ (e) a right of shareholders in a quoted company to raise audit concerns at an accounts meeting of a quoted company,²³⁶ and (f) provisions relating to indemnity and limitation of auditors' liability.²³⁷

1.101

Parts 17 and 18: A company's share capital and acquisition by a limited company of its own shares

There are two relaxations in the capital maintenance rules for private companies. First, a private company may reduce its capital without a court order, provided that the directors make a solvency statement.²³⁸ Secondly, the prohibition on giving financial assistance in the purchase of its own shares no longer applies to a private company (and the 'whitewash' provisions no longer apply to them).²³⁹

1.102

Other new provisions provide that (a) companies no longer have an authorized capital, but shares must have a nominal value and cannot be in the form of stock;²⁴⁰ (b) directors of a private company with only one class of shares may allot shares without prior approval of members (as had been required by the 1985 Act, s 80) unless prohibited by the company's articles;²⁴¹ and (c) a company may redenominate the currency of its share capital.²⁴²

1.103

²³¹ 2006 Act, s 463.

²³² 2006 Act, ss 485(2)–(5), 437, 488, 493, 514.

²³³ 2006 Act, ss 503, 504, 506.

²³⁴ 2006 Act, ss 507 and 508.

²³⁵ 2006 Act, ss 522–5.

²³⁶ 2006 Act, ss 527–31.

²³⁷ 2006 Act, ss 532–8.

²³⁸ 2006 Act, ss 641(1)(a) and (2)–(6), 642–4, 652(1) and (3), 654. See also the Companies (Reduction of Share Capital) Order 2008 (SI 2008/1915), which prescribes the form of solvency statement and provides for the treatment of reserves as distributable profits, unless, where the court confirms the reduction, it orders that it is not distributable.

²³⁹ 2006 Act, ss 677–83 only apply to public companies. Commencement Order No 5, Arts 5(2) and 8(b) and Sch 3 repealed 1985 Act, ss 151–3, 155–8 as regards private companies with effect from 1 October 2008. Paragraph 52 of Sch 4 to that Commencement Order makes it clear that the repeal could not have the effect that a case of financial assistance given by a private company might be impugned under the rule of law derived from *Trevor v Whitworth* (1887) 12 App Cas 409, HL (see commentary in para 7 of the Explanatory Memorandum to Commencement Order No 5).

²⁴⁰ 2006 Act, ss 540(2)–(3), 542, 545, 546.

²⁴¹ 2006 Act, s 550. The directors' power of allotment is of course subject to any pre-emption rights of existing shareholders, which in the case of a private company may be excluded by the articles or disapplied by the articles or special resolution (ss 567 and 569).

²⁴² 2006 Act, ss 622–8.

Part 21: Certification and transfer of securities

- 1.104** There is a new provision, which makes clear the directors' duties when a transfer of shares in or debentures of a company is lodged.²⁴³ As soon as reasonably practicable and in any event within two months after the date of lodgment the company must either register the transfer or give the transferee notice of refusal with reasons. The requirement for reasons is new. If the section is not complied with the company and every officer in default commits an offence.

Part 23: Distributions

- 1.105** The 2006 Act, s 845 provides a solution to a problem in making an inter-group transfer of a non-cash asset at book value, which was thought to have been caused by the decision in *Aveling Barford Ltd v Perion Ltd*.²⁴⁴ The new section enables a company, which has distributable profits, to sell or transfer a non-cash asset to a member of its group at book value without being treated as having made a distribution.

Part 31: Dissolution and restoration to the register

- 1.106** There are new provisions for restoring a dissolved company to the register, either administratively by the Registrar on the application of a former director or member if certain conditions are met, or by the court on the application of a former director and others, provided that the application is made within six years of dissolution (unless the application is for the purpose of bringing a claim against the company for damages for personal injury).²⁴⁵ Under the 1985 Act a former director did not have standing to apply to restore a dissolved company to the register.

²⁴³ 2006 Act, s 771.

²⁴⁴ [1989] BCLC 626. The CLR recommended that there should be provision enabling solvent companies to make inter-group transfers at book value: CLR: *Capital Maintenance: Other Issues* (URN 00/880) at paras 24–43 and CLR: *Completing the Structure* at para 7.21.

²⁴⁵ 2006 Act, ss 1024–32. The CLR recommended administrative restoration to the register in *Final Report* at paras 11.17–11.20.