the company and any officer in default[270] but it does not confirm or invalidate the appointment. The presence or absence of the director's name on the company's file may, however, be relevant to the question of whether a person has been 'held out' as a director to third parties.[271] Note that CA 2006, s 162(6)[272] (Register of Directors) treats a shadow director as a director and officer of the company.

WHO ARE THE OFFICERS?

2.135 The word 'officer' will often be found in the Acts when a person is being fixed with liability for company offences. Thus, CA 2006, s 162,[273] requiring registration of directors and secretaries, says that 'the company and every officer of the company who is in default is liable to a fine and, for continued contravention, to a daily default fine'. This is the characteristic language employed by CA 2006 for the enforcement of its requirements. Several points may be noted:

(1) CA 2006, s 1121 provides that 'officer' includes a director, manager or secretary. Thus, the definition is not exhaustive but will inevitably comprise all those engaged in management at a senior level, whatever they may be called. An auditor is an 'officer' for some purposes but not for others, but normally a person employed as an independent professional, such as a solicitor or accountant, does not fall within the definition.[274]

(2) How then does an officer become liable to criminal proceedings and a default fine? He does so if he 'knowingly and wilfully authorises or permits the default, refusal or contravention mentioned in the enactment'.[275]

(3) What is the default fine itself? All fines (except those for serious offences tried before a jury) are subject to a 'statutory maximum' fine.[276] Daily default fines vary from offence to offence under CA 2006 but are either one-tenth or, more commonly, one-fiftieth of the statutory maximum.[277]

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270 CA 2006, s 1121 (formerly CA 1985, s 730).
271 See 4.74 et seq.
272 Formerly CA 1985, s 288.
273 Formerly CA 1985, s 288.
274 *Carter's Case* (1886) 31 Ch D 496.
275 CA 2006, s 1121(2) (formerly CA 1985, s 730(4)).
276 Magistrates' Courts Act 1980, s 32, as amended by Criminal Justice Act 1991, s 17(2)(c). A different sum may be prescribed pursuant to Magistrates' Courts Act 1980, s 143.
277 CA 2006, s 1121(2) (formerly CA 1985, s 730(4)), and see CA 2006, s 1125.

CHAPTER 3

APPOINTMENT OF DIRECTORS

IDENTIFYING A COMPANY'S DIRECTORS

3.1 A company is an artificial person created and endowed with a legal personality by the Companies Acts. It must therefore act through human agents acting on its behalf. Its most important agents are its directors. There is no statutory definition of a director in the Companies Act 2006. The closest there is to a definition is the statement in s 250 that the word 'director' includes 'any person occupying the position of director, by whatever name called'. However, under general company law, it can be said that the directors are those who are responsible for the day-to-day direction and management of the company's business, and the exercise of its powers in matters within the board's remit. It does not matter if those people are given some other name – in, for example, the company's articles of association.[1] So the articles of association of a company may refer to its 'council of management' or 'executive committee' rather than its 'directors', but if the members of those bodies are responsible for managing the business of the company, and exercising its powers, they are its directors in company law, insolvency law, and any other law referring to a company's directors. Any provision in any such law that applies to directors applies equally to them.

3.2 How, therefore, are directors appointed and by whom? The answer lies in the articles of association. English law gives almost complete freedom to the promoters of a proposed company, and to its shareholders once it is incorporated, to set out in its articles their choice of machinery for this purpose. The only exception is where two or more directors are to be proposed for election to a public company, when a special rule applies about the form of resolutions to appoint a director.[2] A motion for the appointment of two or more persons as directors by a single resolution must not be put forward unless it has been agreed to at the meeting without any vote being given against it. Thus, CA 2006 does not say that directors must be appointed by the members in general meeting (although it does say that they may always be removed by an ordinary resolution of the members, no matter what the articles say, provided a particular procedure is followed).[3] The inquirer must, therefore, look at the articles and what he is likely to find there is summarised below.

1 CA 2006, s 250.
2 CA 2006, s 160.
3 CA 2006, s 168.

APPOINTMENT OF FIRST DIRECTORS ON INCORPORATION

3.3 When registering a company, the information filed with the Registrar of Companies must include details of the proposed first directors of the company.[4]

If the proposed director is an individual[5] (that is, a human being, as opposed to a corporate director), his details including his name and any former name; his address for service of documents (which does not have to be his residential address – for example, it can be 'the company's registered office'); the country or state (or part of the United Kingdom) in which the director is usually resident; his nationality; his business occupation (if any); and his date of birth.

His 'name' means his Christian name (or other forename) and surname. Although, if he is a peer, or normally known by a title, he can give his title instead of his Christian name (or other forename) and surname, or in addition to either or both of them.

His 'former name' means any name or names by which he was formerly known for business purposes. However, there are exceptions:

- Peers and individuals formerly known by a British title do not have to give the names they were known by before they adopted or succeeded to their title.
- If the former name was changed or stopped being used before the director reached 16 years of age this need not be given.
- If the former name was changed or stopped being used 20 years or more before their appointment this need not be given.[6]

Individual directors must also give a 'usual residential address'. If this is the same as the service address they have given, they can simply say so rather than write it out again. But if the service address they have given is 'the company's registered office', the residential address must be set out in full.[7]

Under CA 2006 directors' residential addresses are what is known as 'protected information'[8] and must not be disclosed to third parties, except in certain circumstances, by either the company itself or Companies House.[9]

If the proposed director is a body corporate, or a firm that is a legal person under the law by which it is governed,[10] the details to be given are:

4 CA 2006, s 12. The hard copy form is Form IN01 (Application to register a company).
5 CA 2006, s 163.
6 CA 2006, ss 12(2) and 163.
7 CA 2006, s 165.
8 CA 2006, s 240.
9 See Chapter 8 for the detailed rules.
10 CA 2006, s 164.

- its corporate or firm name;
- its registered or principal office;
- if it is a company in the European Economic Area,[11] and the First Company Law Directive[12] applies, details of the register where it is registered (including details of the relevant state), and its registration number, must be given;
- in any other case, the following must be given—
  - the legal form of the company or firm and the law by which it is governed, and
  - if applicable, the register in which it is entered (including details of the state) and its registration number in that register.[13]

The First Company Law Directive is the EU Directive requiring (among other things) that EU companies file basic company documents at a company registry, and publish them (or parts of them) in a national gazette. It also requires that those documents be available for public inspection.

If the information is given on the hard copy statutory form IN01 that has to be filed with Companies House when incorporating a new company, that form must be signed by the subscribers – the proposed members of the company – or by an agent on their behalf. Each proposed director and (if the company is a public company and therefore required to have one, or is a private company and chooses to have one – see 2.54) the proposed secretary must sign his consent to becoming a director. The form also includes a statement of compliance with the requirements of the Act.

If the information is filed electronically, each director must currently indicate his consent to becoming a director.[14]

When the Registrar has issued the certificate of incorporation, the new company comes into existence, with the directors who have consented to act in the information submitted to the Registrar automatically becoming its first directors by virtue of the incorporation of the company.[15] Purported appointments made by any other means would be equally ineffective.

3.4 The effect of CA 2006 is, therefore, to make inclusion of the directors' details in the filed information, and the subsequent issue of the company's certificate of incorporation, the only means by which the first directors may be appointed. However, old articles may refer to the appointment of the first directors in one of three ways.

11 This means the 27 Member States of the EU and also Switzerland, Iceland, Norway and Liechtenstein.
12 68/151/EEC.
13 CA 2006, s 164.
14 See Registrar's (Electronic Form) Rules 2012, available at http://resources.companieshouse.gov.uk/about/policyDocuments/registrarsRules/volume1.pdf.
15 CA 2006, s 15(4) and 16(6).

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Articles may repeat the provisions of the Companies Acts

3.5 Some companies' articles contain a provision that merely repeats what CA 2006 (or whichever of its statutory predecessors, such as CA 1985 or CA 1948, was in force when the particular company was formed) provides – ie that the persons named in the information submitted to the Registrar automatically constitute the first directors. While fairly common in old articles, it is almost never seen in modern articles. For example, while the 1948 Table A, reg 75 contained such a provision, there was none in the 1985 Table A (or Transitional Table A – see **2.110**) and there is none in any of the model form articles prescribed under CA 2006 (see **4.4**).

3.6 There have been instances in which an objection to a particular director's appointment has been anticipated from one or more of the subscribers. In such instances, articles have been drafted which provide for appointment to be by a majority of the subscribers, rather than all of them. This is not usually effective, since the filed information containing the details of the proposed first directors etc must, if submitted on a hard copy statutory form, be signed by, or by an agent of, all the subscribers and this must be done, of course, before incorporation, ie before the articles take effect. Dissentients would therefore have a de facto veto in any event, which they could exercise simply by refusing to sign the statement or refusing to authorise the agent to do so, unless the majority can obtain a court order forcing them to sign.[16]

If filed electronically, the information must be submitted by an authorised 'presenter' – a body or person pre-registered with Companies House for the purposes of electronic filing. When information is submitted electronically by the presenter, it is acting as agent for all the subscribers in the same way as on submission of a paper form so that, presumably, dissentients would also be able to veto an appointment by refusing to authorise the presenter to submit the information to Companies House.

In practice, though, where information is presented by an agent, whether on hard copy form or electronically, the agent will rarely seek a specific authority to sign the form or submit the data from the subscribers. The theoretical ability of dissentients to veto an appointment by refusing to authorise an agent to sign on their behalf will therefore be illusory in practice.

Articles may name the first directors

3.7 Articles of old companies would often name the first directors of the company, though this is seldom found in more modern articles. Such a nomination is ineffective under the Companies Acts. If the incorporation details include particulars of a director, he or she automatically becomes a director on incorporation, and if they do not, that person most certainly does not automatically become a director on incorporation. However, the subscribers,

[16] In practice, however, it would be simpler to abandon the company, perhaps with a view to substituting another with different subscribers.

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having agreed the terms of the articles among themselves, have made a contract. They are therefore contractually bound to observe any nominations made in those articles. If any of them fails to do so – for example, either by attempting to include directors in the filed information that differed from those named in the articles, or from omitting directors named in the articles from the information filed – any of the others could (theoretically) take legal action for a breach of contract against them. If this was picked up before the details were filed, even a majority of the subscribers could be restrained from breaching their agreement. Indeed, the courts would probably be prepared to order reluctant subscribers to file information containing details of all the directors nominated by, and only those nominated by, the articles. Once the company is formed, the position is less clear. The courts may be prepared to force the shareholders to make amends by removing and/or appointing directors after incorporation, so the composition of the board matches what it says in the articles – but the directors appointed automatically by virtue of CA 2006 will be the directors of the company in the meantime. Or the courts might refuse to force the shareholders to change the board, and award damages instead. To avoid disputes, and the consequent uncertainty that can arise, the subscribers should all ensure that the directors named in the articles, and those whose details are included in the information filed with the registrar of companies, are the same.

Articles may specify appointor

3.8 Very rarely, there may be a provision in old articles that purport to give some third party the power to appoint the first directors – for example, the intended parent company of the new company. This is not effective in relation to the first directors.

APPOINTMENT OF SUBSEQUENT DIRECTORS

3.9 Once the company has been incorporated, the manner in which subsequent appointments are made is governed by the articles, with one exception, set out in CA 2006, s 160, which came into force on 1 October 2007, and is discussed at **3.11**.

3.10 The following are examples of provisions for appointment of directors commonly found in company articles.

Appointment by ordinary resolution of members in general meeting

3.11 The model form articles prescribed pursuant to CA 2006 provide[17] that any person who is willing to act as a director, and whose appointment would be

[17] At art 17 in the model form for private companies limited by shares, and art 20 in the model form for public companies.

lawful, may be appointed to be a director by an ordinary resolution of the members. No distinction is drawn between directors being appointed to fill a vacancy or being appointed as additional directors.

For older companies, to which either the 1985 Table A or Transitional Table A, reg 78 applies,[18] this provides that:

> 'the Company may by ordinary resolution appoint a person who is willing to act to be a director either to fill a vacancy or as an additional director ...'.

A person is appointed to fill a vacancy if he is appointed to replace a previous director who has ceased to hold office by reason of death, resignation, disqualification or, if appointed for a specified period, expiry of that period. Under Table A the power to fill up such vacancies continues, although a general meeting has been held, if the vacancy has not been filled. A person is appointed as an additional director if his appointment increases the number of members of the board beyond its previous level.

If it applies, reg 78 in both the 1985 and Transitional Table A is usually subject to reg 76 (unless the particular company's articles say that it is not), which is intended to prevent the members from giving too much of a shock to the board when appointing directors. Regulation 76 provides that no one (except directors retiring by rotation at an AGM – see 3.22) can be proposed for appointment by the members of the company unless either:

- they have been recommended by the existing directors; or
- a member has given signed notice of the proposal, containing the details of the proposed director that have to be included in the Register of Directors and his or her consent to act, to the company at least 14 clear days (and not more than 35 days) before the meeting.

Regulation 77 of both the 1985 Table A and the Transitional Table A, if it applies, then provides that notice must be given to those entitled to attend the general meeting, of the intended appointment. This must give information about those persons who are recommended for appointment or reappointment, or in respect of whom notice of the intention to propose him as a director has been given under reg 76. Again, the information must be the same as will be required to be included in the company's Register of Directors. The period of notice is not less than seven nor more than 28 days before the date of the meeting.

Public companies are subject to the additional restriction in CA 2006, s 160. This provides that two or more directors of a public company must not be appointed by a single resolution unless 'it has first been agreed to by the

[18] For even older companies, reg 97 of the 1948 version of Table A corresponds broadly with reg 78 in the 1985 Table A and the Transitional Table A and expressly specifies an ordinary resolution to replace a dismissed director, and reg 94 of the 1948 version specifies an ordinary resolution to increase or reduce the number of directors.

meeting without any vote being given against it' – i e everyone must either have voted in favour or abstained. Thus, the members of a public company cannot be presented with a situation where they have to choose all or none of the proposed directors. Although an appointment in contravention of CA 2006, s 160 is void, whether or not it was objected to at the time, acts done in good faith by the director may be validated by CA 2006, s 161 (see 3.88 et seq).

Generally, when appointing additional directors, the members should take care that the resulting number of directors does not exceed any number they have specified as the maximum permitted number of directors. If it does, they need to resolve to increase that maximum number before making the appointment.

3.12 In some companies, the articles provide for specially loaded (often called 'enhanced') voting rights to be exercisable on certain resolutions – for example, they might provide that a member voting against an ordinary resolution to remove a director from office has 1,000 votes per share. The intention is to enable directors who also hold shares in a company to use their votes as shareholders to block any attempt to remove them from office as director. Such loaded voting rights, if properly drafted, are effective, and can significantly alter the results of a vote on a resolution to which they apply.[19] See **10.16**.

3.13 Under CA 2006, s 288, it is possible for members of a private company to appoint a director by written resolution signed (if the appointment can be made by an ordinary resolution) by the members representing a simple majority of the total voting rights of the eligible members, in which case there is no need for a meeting. There is no need for the articles to contain a specific authority for this.

'Eligible members' are those who would have been entitled to vote on the resolution at a general meeting if one had been held, on the date the written resolution is first circulated. The procedure to be followed is described in Chapter 10. The section overrides procedural restrictions in the articles and does not require the length of notice specified by reg 76 in the 1985 Table A or the Transitional Table A or any equivalent provision of the company's articles.

Nomination by specified parties

3.14 The articles (although not the model form for either private or public companies, or the 1985 or Transitional Table A) sometimes provide that the majority member(s) may appoint (and, usually, remove) directors in writing. This may be useful where a company is a subsidiary, where there are very few members or where there may be inconvenience or difficulty in holding meetings. Similar provisions can be made for the right of holders of specific blocks of shares to nominate a proportion of the board. Voting rights of this type are common in the USA where they ensure that minorities have a voice on the board. They are rarer under English company law where, in the absence of

[19] *Re NFU Development Trust Ltd* [1972] 1 WLR 1548; and *Bushell v Faith* [1970] AC 1099.

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special articles, the holders of more than 50% of the total voting rights can control the composition of 100% of the board. However, they are becoming more common here and there is much to be said for the greater use of them. For example, in the typical case of an 'incorporated partnership' with two or three equal shareholders, one party may be denied representation on the board if the others choose to absent themselves from meetings or succeed in voting down his nominee. The only remedy is an expensive, protracted and uncertain expedition to the Chancery Division.[20] This could be avoided if the articles gave to each party the right to appoint, in writing, a specified number of directors.[21]

Nomination pursuant to agreement for sale of shares

3.15 It is possible for an agreement for the sale of strategic blocks of shares to provide for an appointment to the board. For example:

- the seller may undertake that the purchaser (or his nominee) shall become a director; or
- the purchaser may undertake that the seller acquires or retains a place on the board – which may, in many cases, be part of the 'price' of the shares.

3.16 This private agreement cannot, of course, operate as a contract binding the other members in the same way as the articles. The party giving such an undertaking can perform his agreement only to the extent that he commands the necessary votes.

3.17 The agreement may, in some cases, run into legal difficulties. In *Wilton Group plc v Abrams*,[22] the seller of some 14% of the company's issued shares was promised a very lucrative service contract by the purchaser, whose agreement to buy was, in turn, conditional on his and his nominees' appointment to the board. The court refused to enforce the agreement, describing it as 'commercially disreputable' in the case of a listed company. The main reason for this was the service contract. This would have to be voted for by the new directors – the seller would be disqualified by his interest in the contract – and those directors would very probably be in breach of duty to the company. They would be voting in pursuance of the agreement and without proper regard to the company's best interests. This objection might, indeed, be made in the case of any company except a closely held private company; but the objection is particularly strong in the case of a listed company, many of whose members would have little chance of knowing what was happening.

3.18 Some commentators go further and argue that the *Wilton* decision extends to any agreement for board representation, even though untainted by any connection with private profit in the form of a service contract. This is probably going too far. Unlike the service contract, the board appointments will have to be voted at a general meeting. Here the members have a fairly good chance of observing which way the wind blows and voting accordingly; furthermore, the members voting pursuant to the agreement are in principle entitled to vote in their own interests as they see them. This is a principle which is dislodged only by evidence of serious misbehaviour prejudicing the interests of the company as a whole, which seems a somewhat exaggerated description of such an agreement.

20 *Re Lundie Bros Ltd* [1965] 2 All ER 692; *Re Westbourne Galleries Ltd* [1972] 2 All ER 492.

21 If a corporate member has the power to appoint a majority of directors it will become a holding company within the meaning of CA 2006, s 1159 and a parent undertaking for accounting purposes under CA 2006, s 1161.

22 [1990] BCC 310. The price of the shares had been reduced by 15% in exchange for the more than reasonable salary specified by the agreement.

Appointment by the directors

3.19 The model form articles for both private and public companies limited by shares also provide, at arts 17 and 21 respectively, that any person who is willing to act as a director, and may lawfully be a director, may be appointed by a decision of the directors. The model articles do not specify a maximum number of directors.

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The 1985 and the Transitional Table A, reg 79, if they apply, enable the directors (by a majority vote):

(1) to fill casual vacancies; and
(2) to add to the board.

Under the 1985 Table A and the Transitional Table A it is possible for the members to specify a maximum number of directors so they provide that no appointment is permitted that would exceed any maximum number of directors specified by the members in, or in accordance with, the articles.

3.20 The power to fill casual vacancies does not apply to vacancies that occur because a director is appointed for a specific period that has now expired, as this cannot be 'casual'. An appointment to replace such a director is an appointment of an additional director.

3.21 There is nothing to prevent the articles from omitting the members' power to appoint directors so that, apparently, it is only the directors who can do so. A residuary power remains, however, with the members and such an article will not take away those powers unless it so provides in the clearest terms.[23]

Retirement of directors by rotation at the annual general meeting

3.22 Under the 1985 Table A (and many previous Tables A), a proportion of the directors (usually one-third) appointed by the members are required to 'retire by rotation' at the annual general meeting (AGM) and then have to submit themselves to re-election if they are to stay in office. Directors appointed

23 *Worcester Corsetry v Witting* [1936] Ch 640.

CHAPTER 6

DUTIES OF DIRECTORS

KEY DUTIES OF DIRECTORS

6.1 Several key directors' duties are codified in the new Act. However, it must be emphasised that these are just a number of duties which are owed by directors to their companies. It would be wrong to consider them in isolation from all the other duties which fall upon directors. For example, as noted elsewhere in this book, they must maintain proper books of account and other company records; they must make returns as required by various provisions of the company legislation; they must not trade the company when it should be obvious to them that an insolvent liquidation is inevitable; and they must have regard to other areas of law such as environmental law, health and safety law, employment law and competition law. The list is almost endless.

- Directors must have regard to the interests of the employees, the suppliers, the customers, the environment and the community.
- Directors must act in good faith to promote the success of the company for the benefit of its members.
- Directors must know the constitution of their companies and act within their powers.
- Directors must show the care skill and diligence that can be expected of them having regard to their subjective skill and experience or that which is to be objectively expected of such a director of such a company, whichever is the higher.
- Directors must not allow a conflict to arise between their interest in themselves and their duty to their companies.
- Directors must not receive any benefit from a third party by reason of his being a director.

SOURCES OF DUTIES

6.2 The duties of directors derive from their position in relation to the company, as this has evolved through decisions of the courts. Although successive Companies Acts have increasingly regulated particular types of transaction involving directors, they did not impose any general duty of good

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faith or competence. It is necessary before going any further, therefore, briefly to analyse the position of directors in terms of the general law. It is an amalgamation of several elements:

(1) *Agent*, in that the director acts not on his own behalf but that of the company.
(2) *Trustee*, in that although he does not own company assets he controls the assets and exercises powers for the company's benefit and not his own. As such, he owes fiduciary duties to the company. The consequence of this is that he is answerable as a trustee for any misapplication of the property of the company for which he is responsible.[1] Further, as a trustee an action against a director in his capacity as a trustee will not be time barred, since there is no time limit in respect of actions for trust property.[2]
(3) *Employee*, in that a paid, executive director has similar rights and duties to those of any other employee.
(4) *Professional adviser*, in that he renders services for reward (even as a non-executive fee-earner) and must accept the burden of skill and care which falls upon independent contractors of that type.[3]

6.3 The agency aspect of the director's role has recently been considered by the House of Lords in two cases. In *Williams v Natural Life Health Foods*[4] it was held that a director of a limited company was only personally liable for loss suffered as a result of negligent advice given by him on behalf of the company if he had assumed personal responsibility for that advice. Such an assumption of responsibility had to be determined objectively. The absence of personal dealings points strongly against an assumption of responsibility.

6.4 Lord Steyn said:[5]

> 'A moment's reflection will show that, if the argument were to be accepted in the present case (i.e. that the director could be held to be personally liable) it would expose directors, officers and employees of companies carrying on business as providers of services to a plethora of new tort cases … If [the director] is to be held liable to the plaintiffs, it could only be on the basis of a special relationship between himself and the plaintiffs.'

[1] See *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2011] 2 BCLC 501. Lord Neuberger MR said (at para 34): 'Although company directors are not strictly speaking trustees, they are in a closely analogous position because of the fiduciary duties which they owe to the company: *Bairstow v Queens Moat Houses plc* [2001] 2 BCLC 531, 548. In particular they are treated as trustees as respects the assets of the company which come into their hands or under their control: per Nourse LJ in *Re Duckwari plc (No 2)* [1999] Ch 253, 262. Similarly, a person entrusted with another person's money for a specific purpose has fiduciary duties to the other person in respect of the use to which those monies are put.'

[2] Limitation Act 1980, s 21(1).

[3] These aspects of the directors' position are also considered at **2.117** et seq.

[4] [1998] 2 All ER 577.

[5] *Williams v Natural Life Health Foods* [1998] 2 All ER 577 at P 585h.

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6.5 He gave an example of the possibility of a personal reliance developing by quoting the decision on the Court of Appeal in *Fairline Shipping Corpn v Adamson*[6] where the plaintiffs sued the defendant, a director of a warehousing company, for the negligent storage of some perishable goods. The contract had been between the plaintiff and the company, but the director was nevertheless held to be personally liable because he had written to the customer and rendered an invoice in a manner sufficient to create the impression that he was to be regarded as personally responsible for the services. Moreover, if there exists a special relationship between a director and a third party in circumstances where there is an assumption of responsibility by the director then liability arises under the principle set out in *Hedley Byrne & Co Ltd v Heller & Partners*.[7]

6.6 However, a director cannot hide behind the vicarious liability of his company where he is fraudulent. In *Standard Chartered Bank v Pakistan National Shipping Corporation*[8] a director knowingly and deliberately made a false statement in order to obtain payment on a letter of credit. The House of Lords held that a director could not escape personal liability for deceit on the ground that what he did had been done on behalf of and for the benefit of his company. Although an agent might assume responsibility on behalf of another person without incurring personal liability in respect of a negligent misrepresentation (as had been the case in *Williams*[9]), the same reasoning could not be applied in the case of fraud. As Lord Hoffmann put it:[10]

> 'No one can escape liability for his fraud by saying "I wish to make it clear that I am committing this fraud on behalf of someone else and am not to be personally liable".'

The director in this case was being sued for his own tort rather than for his company's tort.

6.7 This approach has recently been followed by the Court of Appeal in a case which puts a new gloss on the personal liability of a company director for his company's debts. It is well known that a director who allows his company to trade after the time has been reached when he should have realised that it could not get out of its difficulties can be made personally liable for wrongful trading. However, the number of wrongful trading cases which actually get to court are perhaps surprisingly few. In part this is because the action has to be brought by a liquidator who will, almost inevitably, be bringing the proceedings from a position of weakness. The more insolvent the company, the less money he has to commence proceedings against delinquent directors. Moreover, there is little or no incentive for a creditor who feels himself to have been particularly

[6] [1974] 2 All ER 967.

[7] [1963] 2 All ER 575.

[8] [2002] UKHL 43, [2003] 1 All ER 173.

[9] *Williams v Natural Life Health Foods* [1998] 2 All ER 577.

[10] *Standard Chartered Bank v Pakistan National Shipping Corporation* [2002] UKHL 43, [2003] 1 All ER 173.

done down by the wrongful trading to offer to fund the proceedings because any recovery made by the liquidator goes into his pot for the creditors generally because the court has no power to target the award in the direction of a specific creditor.

But the Court of Appeal has recognised the possibility of a creditor in very specific circumstances suing a director and recovering for his own benefit. The right arises under a little used statutory provision from the early nineteenth century. Section 6 of the Statute of Frauds (Amendment) Act 1828 provides:

> 'No action shall be brought whereby to charge any person upon or by reason of any representation or assurance made or given concerning or relating to the character, conduct, credit, ability, trade, or dealings of any other person to the intent or purpose that such other person may obtain credit, money or goods upon, unless such representation or assurance be made in writing, signed by the party to be charged therewith.'

The language is archaic and certainly not the easiest with which to get to grips; nor is it helped by its being expressed in the negative. But change it into the positive and its significance becomes more apparent. An action may be brought:

- against a person who has made a representation in writing;
- and has done so fraudulently;[11]
- as to the ability of another person;
- to pay for goods or credit supplied to that other person.

In *Contex Drouzhba Ltd v Wiseman*[12] the Court was faced with the following facts. W, a director, signed on behalf of his company a document which contained a promise that the company would pay for goods to be ordered in the future. The trial judge found as a matter of fact that the company did not have the capacity to pay, nor had it any chance of gaining that capacity.

There was a submission on behalf of the director that he had signed the document on behalf of the company rather than in his personal capacity. However, it was clearly established by the House of Lords in *Standard Chartered Bank v Pakistan National Shipping Corporation*[13] that a director cannot avoid liability for his own fraud by claiming he was merely acting on behalf of his company.

The Court of Appeal accordingly found the director personally liable on his fraudulent deceit.

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[11] Although the term 'fraud' is not used in the statutory provision, the Court of Appeal regarded it as axiomatic that there had to be an element of fraud, having regard to the fact that the statute under consideration was the Statute of Frauds (Amendment) Act. The term fraud was given the meaning attributed to it in *Derry v Peek* (1889) 14 App Cas 337, i e actual knowledge or recklessness.

[12] [2007] EWCA Civ 1201.

[13] [2003] 1 AC 959.

This is a useful case. Sellers might even consider asking the directors of companies buying goods or services from them to write a letter confirming the ability of the company to pay for whatever is ordered. Then, in the event of the company's being unable to pay, the directors can be personally sued.

6.8 The director does not fall exactly within any of the categories referred to above since his function is unique, but his duties derive from principles applicable to them, and break down into two broad types – duties of 'good faith' and duties of skill and care. Virtually every duty or liability can be seen to fall under one or other of these headings, and the obligations imposed by more recent Acts may be categorised in a similar way.

6.9 There is, as we shall see, not a great deal of debate about the content of the duties gathered under the heading 'good faith'. Those gathered under the heading 'care' raise more problems. There are various reasons for this. First, until relatively recently case-law may well have understated the extent of a director's ordinary obligation to exercise a reasonable level of diligence and skill in the performance of his functions. Secondly, increasing statutory duties almost certainly carry over into increased demands upon the director to show proper competence and attention to his functions. Thirdly, the lengthening arm of insolvency law imposes direct liability and possible disqualification for certain types of misbehaviour, which may include inattention or incompetence. Not only has this had implications for directors; insofar as insolvency law imposes greater burdens on directors than those previously imposed by the courts, it has also been the cue for the courts themselves to do the same. Fourthly, where a company is insolvent, there are significant signs that insolvency officers such as liquidators, taking their lead from the reformed insolvency laws, are subjecting the conduct of directors to much more rigorous scrutiny, as a matter of routine, than was the case even a few years ago. This is particularly so since late 1994 when the Department of Trade and Industry (DTI) adopted a far more rigorous approach to the pursuit of unfit directors. The role of the DTI was replaced by the Department for Business, Enterprise and Regulatory Reform (BERR) and then the Department for Business, Innovation and Skills (BIS).

6.10 A useful and authoritative guide to the practical and ethical aspects of this subject is published by the Institute of Directors (*The Director's Handbook* (2005)).

The Companies Act 2006

6.11 CA 2006 contains an intended codification of directors' duties. However, the changes probably go rather further than this as will be noted later in this chapter.

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DUTIES TO WHOM

6.12 The general rule is that directors' duties are owed to the company and not to individual shareholders,[14] nor to the company's creditors.[15] This was confirmed by the Court of Appeal in *Stein v Blake*.[16] The plaintiff and the defendant were each 50% shareholders in the relevant companies. The defendant was the sole director of these companies and he transferred their assets to other companies which were under his control. The plaintiff claimed that the defendant had been in breach of fiduciary duty in misappropriating the assets and sought to recover the loss sustained by him in the diminution in the value of his shares as a result of the misappropriation. It was held that the plaintiff had no separate cause of action. The loss was one that was recoverable only by the company and not by the shareholder. Indeed, the Court of Appeal felt that the case was so hopeless that leave to appeal should never have been granted in the first place and set aside the leave which an earlier Court of Appeal had granted.

6.13 This case was followed the decision of the House of Lords in the case of *Johnson v Gore Wood & Co (a firm)*.[17] Johnson had owned almost all the shares in his company, W Ltd. The company suffered a substantial loss as a result of alleged negligence by its solicitors. The company's claim against the solicitors was compromised. Johnson then made a personal claim. Lord Bingham made the following points:

- Where a company suffers loss because of a breach of duty owed to it, only the company may sue in respect of that loss. A claim may not be brought by a shareholder to make good a loss in the value of his shares where that loss merely reflects the loss suffered by the company.
- Where a company suffers loss but has no cause of action to sue to recover that loss, the shareholder in the company may sue in respect of it (assuming that he has a cause of action), even though the loss is a diminution in the value of the shareholding. (See the *George Fischer* decision[18] at **6.15**.)
- A shareholder can also sue in his own name notwithstanding that his company has suffered loss as a result of a breach of duty owed to it if he can show that a breach has occurred of a separate and distinct duty independently owed to him.

6.14 Thus the general rule remains: where a company has suffered a loss as a result of a breach of duty to it, only the company can sue for redress. A shareholder cannot claim for the diminution in the value of his shareholding. This is so even where the company is the shareholder's alter ego.

14 *Percival v Wright* [1902] 2 Ch 421.
15 *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258.
16 [1998] 1 All ER 724.
17 [2001] BCC 820.
18 *George Fischer (GB) Ltd v Multi-Construction Ltd* [1995] BCC 310.

6.15 Having said that, the court accepted the ruling in *George Fischer (GB) Ltd v Multi-Construction Ltd*[19] that where the company had no cause of action but the shareholder did, the shareholder could recover even if the loss was the diminution in the value of his shareholding. In that case the plaintiff was the 100% parent company of an operating subsidiary. The plaintiff and the defendant entered into a contract for the design and construction by the defendant of a warehouse and distribution centre. Three cranes were designed and installed by a third party as subcontractors. The design of the cranes was faulty and the third party contractors admitted and accepted liability. The plaintiff claimed damages for, inter alia, increased costs of operation and loss of sales. The defendant defended these claims on the basis that these were losses sustained by the operating subsidiary of the plaintiff rather than of the plaintiff itself. The Court of Appeal held that the plaintiff was entitled to recover under these heads.

6.16 Three reasons were given for this finding:

- The issue was not whether the shareholder had a right of action at all, but rather under what heads damages could be claimed by a party having a right of action for breach of contract.
- The plaintiff's evidence that the effect of a £1 loss to the subsidiary company resulting from the breach of contract would be a £1 loss to the balance sheet or to the profits of the parent company had not been challenged by the defendant.
- The loss claimed by the plaintiff was not too remote.

6.17 It is perhaps difficult to see how this fits in with the House of Lords judgment in *Johnson v Gore Wood*.[20] However, the House said that the shareholder's claimed losses were personal except for the part of the claim relating to payments which otherwise the company would have made into the shareholder's pension fund. The loss occasioned by the company's payment in breach of duty was no more than a reflection of the company's own loss. Accordingly the claim in this regard should be struck out. An alternative claim based on the fact that the value of shareholder's interest in the company would have increased if the payments had not been made was also simply a reflection of the company's own loss. Again, therefore, this claim should be struck out. However, so far as the claim was for enhancement of the value of the shareholder's pension fund if the payment had not been made was unobjectionable since it was personal to the shareholder and so should be allowed to stand.

6.18 The Court of Appeal reviewed the law again in *Giles v Rhind*.[21] Giles and Rhind had been directors and almost equal shareholders of a pre-cooked food company, SHF Ltd. There was a shareholders' agreement which contained

19 [1995] BCC 310.
20 *Johnson v Gore Wood & Co (a firm)* [2001] BCC 820.
21 [2002] EWCA Civ 1428.

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a confidentiality clause. Venture capital was attracted into the company from a provider of this sort of capital, Apax Ltd. The solvency of SHF Ltd largely depended upon a contract with Netto Food Stores Ltd. Rhind sold his stake in the company to Apax Ltd, started his own company and allegedly poached the Netto Food Stores contract for another company, M W Foods. In 1994 SHF Ltd started proceedings against Rhind for breach of duty. However, shortly afterwards it went into receivership and the action was discontinued. Two years after this Giles brought proceedings in his own name against Rhind. The reported case concerned a preliminary point that had been raised by the Master: did Giles have locus standi to bring proceedings? It was held that he could bring proceedings. *Johnson v Gore Wood*[22] was distinguished on a number of grounds:

- In *Johnson* the shareholder and the company were virtually indistinguishable. This was not the case in *Giles v Rhind*.
- In *Johnson* the company had commenced proceedings and had compromised them. This had not happened in *Giles v Rhind*. There proceedings had been commenced but discontinued because of the company's insolvency.
- In *Johnson* the proceedings had been brought on the assumption that the solicitors owed a separate duty to the shareholder, but the nature of the case was such that it was not easy to assume that such a totally independent duty existed. In *Giles v Rhind* there was a shareholders' agreement that gave specific rights to the contracting parties including the claimant.
- In *Johnson* the loss in the value of the shares was directly reflective of the company's loss. In *Giles v Rhind* the claimant's losses were more than 'merely reflective'. The shares became valueless because the company was destroyed.
- In *Giles v Rhind* the claimant was trying to recover something different from what the company would have sought to recover. The company's claim was for damages for breach of contract. The claimant, however, wanted redress for the complete destruction of the company.

6.19 Other possible exceptions to the general rule that director's duties are owed to the company, rather than to individual shareholders or to creditors, will be discussed as they arise. First, however, the general rule leads inevitably to the question – how is the company to enforce those duties when the directors are in control of its affairs, including the commencement of proceedings? The courts have never found a completely satisfactory answer to this question, although the so-called 'derivative action' by a minority shareholder is an established possibility.[23] Since a director's duty is owed to the company, and the company in general meeting can usually ratify, or indeed pardon, a director's

[22] *Johnson v Gore Wood & Co (a firm)* [2001] BCC 820.

[23] *Wallersteiner v Moir (No 2)* [1975] QB 373 at 508n. But it is rarely a simple matter to bring such an action: see 8.136 et seq and 9.71 et seq. Another possibility which should not be ignored is an action by new controllers of the company, or by an insolvency officer.

defaults, majority control will often prevent action being taken by the company itself. Questions are always therefore likely to arise where the director in question votes his own shares in support of such a resolution,[24] but this is the sort of interference with the director's proprietorial right to vote his own shares which the courts will countenance only in exceptional cases.[25] In *Northern Counties Securities Ltd v Jackson & Steeple Ltd*[26] Walton J stated that a shareholder may have more than one capacity within his company. Thus it is quite conceivable that in the case of a director who is also a shareholder, he may take one course in his capacity as a director and then a totally different course as a shareholder. There is no provision in Table A regarding a director's capacity to vote in general meetings equivalent to Table A, regs 94 and 95 the last two which preclude him generally from voting at board meetings on a matter in which he has a personal interest.

6.20 However, it should be noted that in *Cook v Deeks*[27] the House of Lords made it quite clear that directors could never use their voting dominance in general meeting to ratify a fraud that they have committed. Notwithstanding a purported ratification by fraudulent majority directors, aggrieved minority shareholders were permitted to bring derivative proceedings.

It is to be hoped that *Cook v Deeks* remains good law. However, this is not without some doubt. The Companies Act 2006 put the rules on ratification on a statutory footing.[28] It is expressly provided that ratification applies to the 'conduct of a director amounting to negligence, default, breach of duty or breach of trust in relation to the company'.[29] Fraud is clearly a breach of trust. Therefore on the face of it, it might be that fraud can today be ratified. In *Franbar Holdings Ltd v Patel*[30] counsel sought to argue that under the codified provision any act could be ratified by the members so long as it was not ultra vires the company. William Trower QC (sitting as a deputy judge of the High Court) rejected this submission. Indeed he went even further: 'Section 239(7) explicitly preserves any rule of law as to acts that are incapable of being ratified by the company. This will include acts which are ultra vires the company in the strict sense, but it seems to me that it will also include acts which, pursuant to any rule of law, are incapable of being ratified for some other reason.' It is to be hoped that this is the approach that the courts will consistently take.

6.21 In 1980, Parliament provided shareholders with the right to complain to the court of conduct which was 'unfairly prejudicial' to their interests; but it has only been in recent years that the courts' interpretation of this remedy,

[24] In *Hogg v Cramphorn* [1967] Ch 254 the court excluded wrongfully issued shares from the resolution ratifying the directors' conduct in issuing them.

[25] *Northern Counties Securities Ltd v Jackson Steeple Ltd* [1974] 1 WLR 1133.

[26] [1974] 1 WLR 1133.

[27] [1916] AC 554.

[28] CA 2006, s 239.

[29] CA 2006, s 239(1).

[30] [2008] EWHC 1534 (Ch).

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confirmed by amendment to the legislation, has begun to give it real teeth, and then usually, though not exclusively, only in the case of smaller and private companies.

'The company'

6.22 When the director is told that his duties are owed to the company, he may well ask what this means. The company is something of an abstract concept: is a director to have regard to the interests of the present members, or those of future members, or some combination of the two? The question is most acute where the two interests conflict, for example, where there is a choice between paying profits by way of dividend and retaining them against future needs. Here the director is entitled and indeed bound to exercise his business judgment in striking a balance between two legitimate but competing demands.[31] Similarly, where directors receive a takeover offer unwelcome to them, they must tread carefully so as not to prevent the present membership from having a fair and informed opportunity to consider and accept the offer. There may be genuine grounds for belief, however, that the offer is not in the long-term interests of the company (including perhaps those of the workforce: see **6.32–6.33**) and the directors may, on that basis, refuse actively to promote an offer which merely provides the present membership with the best currently available price for their shares.[32] To say that directors must always promote such an offer would, of course, come dangerously close to a breach of the general rule that duties are not owed to shareholders as such.

The Companies Act 2006

6.23 As has been stated, CA 2006 seeks to codify a number of key directors' duties. Thus CA 2006, s 172 provides that a director must act in the way he considers, in good faith, would be likely to promote the success of the company for the benefit of the members as a whole. If the purposes of the company consist of or include purposes other than the benefit of its members, his duty is to act in the way he considers, in good faith, would be most likely to achieve those purposes – though it is somewhat unclear whether those purposes are those of the members or those other than those of the members!

6.24 In fulfilling this duty, the director will have, so far as practicable, to have regard to:

- the likely consequences of any decision in the long term;
- the interests of the company's employees;

[31] See Megarry J's remarks in *Gaiman v National Association for Mental Health* [1970] 2 All ER 362: 'The interests of some particular section or sections of the [company] cannot be equated with those of the [company] and I would accept the interests of both present and future members of the [company] as a whole as being a helpful expression of a human equivalent.'

[32] *Re a Company (No 008699 of 1985)* [1986] BCLC 382.

- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between members of the company.

6.25 However, any provision set out above must be implemented subject to any enactment or rule of law requiring directors to consider or act in the interests of creditors of the company.

Creditors

6.26 The established rule is that directors owe their duties to the company, and not to its present or future creditors as such (see **6.12** et seq). There have, in recent years, been judicial comments which might be construed in the opposite sense. In *Winkworth v Edward Baron Development Co Ltd*,[33] Lord Templeman said:

> '... a company owes a duty to its creditors, present and future ... to keep its property inviolate and available for repayment of its debts. The conscience of the company, as well as its management, is confided to its directors. *A duty is owed by the directors to the company and to the creditors* of the company to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefit of the directors themselves to the prejudice of the creditors.' (Emphasis added.)

However, perhaps the correct interpretation of this passage is that while there is no duty owed directly to the creditors, there is one owed indirectly, albeit through the duty owed to the company not to dissipate assets, and this is a duty which can be enforced by a liquidator for the benefit of the creditors as a whole rather than by a particular creditor directly.

The relationship between s 172(1) which requires the promotion of the success of the company for the benefit of the members and s 172(3) which requires regard to be had to the interests of creditors in certain circumstances must be that if the company is approaching insolvency the latter provision trumps the former. In *Bilta (UK) Ltd (In liquidation) v Nazir*,[34] Patten LJ said: 'the obligation to act in the interests of creditors arises in circumstances where the company is or is likely to become insolvent and is no more than a statutory recognition of the decision of this court in *West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250.'

[33] [1987] 1 All ER 114 at 118, HL.

[34] [2013] EWCA Civ 968.

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6.27 Despite s 172(3) which might be regarded as expressing the duty to creditors on a statutory footing the law does not appear to have changed so as to afford a direct personal remedy to a creditor who claims that directors have mismanaged the company's affairs or even misappropriated its assets. Indeed, in *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd*,[35] Lord Templeman said: 'A director does not by reason only of his position as director owe any duty to creditors or to trustees for creditors of the company.' Thus, there seems no possibility that a creditor could personally bring an action against a director for breach of duty. The real development appears to have been the recognition that, once the company is insolvent,[36] a major change in interest takes place. The members' residual interest in the company's assets is replaced by the interest of the creditors, who will be repaid, if at all, from those assets. This is reflected by a change in the substance of the directors' duties: in exercising their functions, they must now have regard to the interests of the creditors.[37] *It does not follow that the duty is owed to the creditor, or to any particular creditor*, and there are indeed very sound reasons why not. The interests of creditors will often vary as widely as their ability to safeguard themselves. The whole point of insolvency law is to impose a regime of equality on these divergent interests – an impartial insolvency officer[38] is appointed to ensure that, as far as may be, the assets are efficiently gathered in, realised and applied in discharging the company's debts on a pro rata basis. This may be an equality of misery for the creditors, but it is based on the premise that to allow creditors to continue to take their own actions against the company would benefit only those strong enough to pressure the company into payment or swift enough to obtain judgments which it is still able to pay. The insolvency officer therefore represents the interests of all the creditors: he has a wide variety of redress against delinquent management, and it would be both pointless and damaging to have his functions bypassed by a particular creditor making a claim on his own account. The true position is reflected in *West Mercia Safetywear Ltd v Dodds*.[39] Here a director used company funds to pay off a debt owed by its holding company, which he had personally guaranteed. He knew at the time that both companies were insolvent. The liquidator of the subsidiary recovered the payment from the director on the basis that he was in breach of duty to the company, 'when, for his own purposes, he caused the £4,000 to be transferred in disregard of the interests of the general creditors'. In this case, the Court of Appeal adopted the approach of the Australian court in *Walker v Wimbourne*[40] and the New Zealand court in *Kinsela v Russell Kinsela Pty Ltd*.[41] In particular, Dillon LJ approved the following dictum of Street CJ in the *Kinsela* case:[42]

[35] [1991] 1 AC 187.

[36] Or, perhaps, once insolvency is a real possibility.

[37] It follows that no member can complain if his interests are thus subordinated to those of the creditors.

[38] Ie a liquidator or, less commonly, an administrator.

[39] [1988] BCLC 250, CA.

[40] (1976) 137 CLR 1.

[41] (1986) NSWLR 722.

[42] [1988] BCLC 250 at p 252.

> 'In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise to ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the creditors intrude. They are respectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency or the imposition of some alternative administration.'

6.28 The interests of creditors, then, supply the content of a duty which continues, nevertheless, to be owed to the company itself. Frequently, the duty will actually be enforced not by the company but by an insolvency officer who, on appointment, not only takes over the company's claims but also has a battery of remedies of his own.

6.29 There are, however, further considerations. The onset of financial difficulties which marks the shift in content of directors' duties outlined above will also be the trigger for an obligation, imposed by the Insolvency Act 1986, s 214, to begin to act in protection of the interests of creditors.[43] Very often, the only way to protect those interests will be to have an insolvency officer appointed, in which case management of the company will be removed from the board. Secondly, the 'interests' of creditors are frequently conflicting rather than uniform; some may benefit from an immediate realisation of assets, others from keeping the healthier parts of the business intact. Specifically, secured creditors are in a much stronger position than unsecured creditors, since assets are already earmarked for the discharge of the debts owing to them and they are generally able, therefore, to look after themselves. Although it would be wrong for the directors altogether to ignore the interests of secured creditors,[44] they may legitimately consider that those of the unsecured creditors require more immediate protection.

6.30 Finally, there is a problem which has yet to be considered by the courts, which tends to divide the world into members, on the one hand, and creditors, on the other. Many modern forms of lending give the lender rights of control or participation in the company which begin to blur this distinction. Although the issue is unlikely to arise except in relation to larger, and probably listed, companies, there remains a question of how such interests are properly characterised in terms of the 'director's duty to the company', discussed above.

[43] For a discussion of s 214, see 7.42 et seq.

[44] And extremely dangerous, since they may be able summarily to dismember the company.

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CHAPTER 9

RELATIONS OF DIRECTORS WITH ONE ANOTHER

SUMMARY OF CHANGES IN THE COMPANIES ACT 2006

9.1 Before looking at this topic in any depth, it is significant to note it should be noted that the Companies Act 2006 (CA 2006) introduced a significant change to the way most companies, and especially small private companies will be run in the future. This is that general meetings will usually be replaced in the future by written resolutions.

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DISAGREEMENT ON THE BOARD: MAJORITY DECIDES

9.2 We have seen that directors act collectively as a board, although the power to delegate is usually given to them by a company's articles. Questions of their relations with one another do not normally arise unless there is disagreement between the directors, default by one or more of them, or some allegation of personal liability emanating from some breach of duty.

9.3 What is the position where disagreements occur – as they often will? The articles usually provide (eg Table A, reg 88[1]) that questions at board meetings[2] shall be decided by a *majority* of votes, each director having one vote (and, where the articles provide for an alternate director – and the model form articles do not – a director who is also an alternate for another having an additional vote for his absent appointer). Thus, the primary rule is that disagreements are resolved, if necessary, by a simple counting of heads, the chairman usually being given a casting vote by the articles in the event of a tie. The size of the shareholding which the director may control or represent is therefore irrelevant so long as the company has not adopted a special article giving weighted voting rights at board meetings or voting in accordance with the number of shares held. The legal status and responsibility of every director is exactly the same. This is something which has to be borne in mind in private family companies, where the controlling or founding director may be required by the courts, if necessary, to pay due respect to the rights of his colleagues.[3]

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1 And see the 2008 model articles for private companies limited by shares art 7 and for public companies art 13.

2 The procedure at meetings is discussed in Chapter 10.

3 By an order under CA 1985, s 459 (now CA 2006, s 994); *Re HR Harmer Ltd* [1958] 3 All ER 689.

RESPONSIBILITIES OF DISSENTIENTS: FIRST RE-INVESTMENT TRUST LTD

9.4 Conversely, the other directors must beware of becoming 'yes' men to a dominant chairman or managing director as they, too, run the risk of liability for breach of duty if they fail to play their proper part. The reality of this danger was vividly illustrated in the inspectors' report in the case of *First Re-investment Trust Ltd and other companies*[4] where an entire board of a quoted company was found wanting on this score. The co-directors were all experienced city businessmen and yet they allowed themselves to get into a situation where they were acting as 'rubber stamps' to the investment decisions of the chairman, who entirely dominated the board.

9.5 As a result, the chairman was enabled to buy assets for himself at a price which represented only a fraction of their true value. The chairman knew this; offers had already been made by third parties, which he did not disclose, and shortly afterwards the assets were resold by him at their full value. All the members of the board were found to be in breach of duty, but the report is particularly instructive in indicating the degree of responsibility in each case:

(1) The chairman was acknowledged to be the dominant director; it was he who had the personal interest in the transactions, and he was found to have knowingly broken his duties of good faith and skill and care, and to be guilty of grave mismanagement.

(2) His deputy or 'confidential adjutant' was the only other director who knew the true story, but he claimed to be totally subordinate with a status no higher than that of a clerk:

> 'He stated that he had never learned the duties of a director nor read any book or paper of any kind concerning directors' duties ... he had never formed any independent judgement on the matters under inquiry; and that he did not understand the significance of his actions, in particular that they were capable of constituting breaches of his duty as a director.'[5]

His counsel argued that on the basis of the *Re City Equitable*[6] standard, and having regard to the director's own knowledge and capacity, he was not in breach of duty.[7] The inspectors rejected this; he knew the facts and

[4] Department of Trade (HMSO, 1974) paras 241–324. It will be appreciated that, even at common law, this could have been stopped, and stopped by a minority in all probability. The transactions, if not approved in advance by the general meeting, would also be voidable (CA 1985, s 322). The principles discussed apply, however, to the responsibility of individual directors for breach of duty to the company (to which should be added, on the facts mentioned, liability to indemnify it (CA 1985, s 322(3)).

[5] Paragraph 242.

[6] *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407.

[7] The subjective standard put forward by the court in *Re City Equitable Fire Insurance Co Ltd* is certainly no longer the appropriate test. CA 2006, s 174 provides that for the duty of care, skill and diligence a director must show the higher of the skill and experience which he actually has or that which a person in his position might reasonably be expected to possess.

must have known that breaches of duty were being committed. Moreover, when the chairman failed to make a proper disclosure of his interest at the board meeting, it was the deputy's duty to remedy the omission. This would have been a painful prospect indeed for someone who saw himself merely as a confidential clerk, but the inspectors concluded that nothing less was expected of him. He was, accordingly, found to have been knowingly guilty of the same breaches of duty as the chairman even though the degree of blame was less.

(3) The third director did not know of the chairman's plans and said that he would have been horrified if he had known. Moreover, he had become increasingly unhappy about the autocratic style of management and the 'rubber-stamp' function of the board and he had criticised it. His counsel claimed that on the principles of *Re City Equitable*, he was not negligent and was entitled to rely on the chairman on matters properly delegated to him.[8] But the inspectors pointed out that when being asked to ratify the chairman's investment decisions at the board meetings, he could not escape his duty to exercise his own judgment. Although acting in good faith, he had therefore failed to meet the required standard of skill and care.

The inspectors went on to indicate the positive steps which they thought he should have taken:

(a) criticism he had expressed, but the very fact that he did so should have alerted him to the need for full scrutiny;

(b) formal protests, recorded in the minutes, should have been the next step; followed by

(c) threat of resignation and resignation itself if the situation was not remedied. The director said he did not resign because he felt he could improve matters from within; but this was not good enough for the inspectors. They pointed out that to justify such a view he must have been able to point to genuine improvements in the system, and these had not occurred.

He was therefore in breach of duty.[9]

(4) The fourth director was also ignorant of the scheme and had been equally dissatisfied with the chairman's style of management. He had taken his opposition to the point of resigning from two of the other companies in the group on the ground that 'he was being asked to be a rubber stamp'. Moreover, in the present case he was the only director who sought an explanation of the share price at any board meeting. When asked why he did not resign from the company under investigation, he replied: 'I was foolish enough to think that I could change things. I thought that there were glimmers of light coming.' The inspectors accepted his sincerity but pointed out that he could not escape criticism for his continued

[8] But at best this case shows that he would not be liable for acts done at a meeting from which he was absent and where he had no knowledge of those acts. Today, even that might not be sufficient.

[9] Had he known of positive misappropriation of the company's assets, it is thought likely that he would have had to stay, rather than resign and, if all else failed, alert the members: see 9.19 et seq.

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participation in this system of management. This should be tempered because of the firm line which he had taken with the other companies and because he had, at least, questioned the chairman in the present case – but he was still in breach of his duty of skill and care.

9.6 It will be noted that the conduct of these four directors attracted criticism at four different and descending levels; but in each case it was sufficiently blameworthy to amount to a breach of duty. The lesson seems clear – silence is never enough. A director, however minor or subordinate his role, has a positive duty to apply his own judgment to company matters. If he is not satisfied, he must speak up; then he must record a formal objection in the minutes, and if things still do not change, he must resign unless the company is threatened by insolvency. Otherwise he will bear some of the responsibility for defaults in which he has no part and which he may even have opposed.[10] Since the sort of actions which went unchecked here could easily lead to eventual corporate insolvency, a director would also do well to consider his potential liability for wrongful trading – see the Insolvency Act 1986, s 214 (7.42 et seq).

9.7 It should be added that the rather low subjective standard of care expected of a director in *Re City Equitable*[11] was ignored by Hoffmann LJ in *Re D'Jan of London Ltd*[12] where the learned judge said that the standard today is as accurately described in the Insolvency Act 1986, s 214, namely that a director should show the higher of the skill which may be expected of a person in his position and that actually possessed by him; and this is confirmed by CA 2006, s 174 which came into force on 1 October 2007.

9.8 It will be observed that the Report referred to here is approaching 40 years antiquity at the time of writing. But what it says is of relevance today. Becoming a director involves the acceptance of great personal responsibility. It is incumbent upon directors to understand what their job involves.

9.9 In *Madoff Securities International Ltd v Raven*[13] it was the High Court that gave useful guidance on the application of directors' duties to act in a company's best interests, now codified in the statutory duty to promote the success of the company, where directors are dealing with a strong, dominant, experienced and high-profile co-director.

The guidance was given in actions against co-directors of business fraudster Bernie Madoff for breach of their directors' duty to act in the best interests of the company and promote the success of the company for the benefit of its members as a whole. The basis of the allegations was that they had wrongly

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[10] As in *Ramskill v Edwards* (1885) 31 Ch D 100 where a director who signed a cheque for an unauthorised loan was held liable, even though he had protested.

[11] *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407.

[12] [1993] BCC 646.

[13] [2013] EWHC 3147 (Comm).

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deferred to Mr Madoff's strong personality and reputation, and his apparent business experience and nous on certain matters, when they should have questioned and challenged him.

The court's guidance can be summarised as follows:

- The test of whether a director believed he was acting in the best interests of the company is subjective.
- Directors are collectively responsible for the management of their company, whatever their individual areas of responsibility, and have a duty to ensure that they are informed about what is going on across the company and to participate in the overall management of its affairs.
- That said, it is perfectly legitimate (and, in practice, often necessary) to delegate specific responsibilities to individual directors.
- Each director must apply their mind, and exercise their independent judgment as to whether it is in the best interests of the company, when deciding whether to do as they are told by a shareholder.
- A director who does not apply their mind to whether a decision or action is in the company's best interests is not immediately in breach of his duties. Instead, the test is whether an honest, intelligent director of the company could, in all the circumstances, have reasonably believed the decision or action was in the company's best interests.
- A director who knows that another director is misapplying company assets and does nothing is breaching his directors' duties.
- If a director is so intimidated, dominated, manipulated etc by another director that it amounts to a total abrogation of their responsibilities (for example, they simply do as they are told without question), he or she is breaching their duties.
- But if a director has no reason to suspect a fellow director's competence, skill or integrity, they are entitled to rely on his or her judgment, information and advice.
- A director whose views are a minority on the board is not obliged to resign, or to refuse to join in implementing a particular decision just because they disagree with it, provided that they are satisfied the majority view is being put forward in the best interests of the company.

In the circumstances, Bernie Madoff's co-directors were all exonerated from the allegations that they had breached their duties but co-directors of a strong, dominating and experienced personality should consider taking independent advice on whether they have breached, are potentially liable to breach, and how to avoid breaching, their duties as directors, including their duty to promote the success of the company by acting in what they honestly believe to be its best interests, by serving on the board with that director or agreeing to do as the dominant director says.

The Companies Act 2006

9.10 The Companies Act 2006 gives statutory confirmation of the decision of Hoffmann LJ in *Re D'Jan of London Limited*.[14] By s 174 directors must exercise reasonable care, skill and diligence. This means the care, skill and diligence that would be exercised by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions of the director within his own particular company, and the general knowledge, skill and experience that the director actually has.

REMEDIES

Action in board meeting

9.11 Having considered the extent of his responsibilities, our director must now decide what to do if he finds himself in disagreement with the policy of his colleagues.[15]

9.12 The first and most obvious step is to raise the matter in a board meeting. If no meeting is in prospect, he should ascertain from the articles whether he has the right to convene a meeting of the directors. Under art 9 of the model articles for private companies limited by shares and art 8 for public companies[16] a director may and the secretary on the requisition of a director must, at any time, summon a meeting of the directors.[17] However, there is, naturally, no certainty that the other members will attend with the attendant risk that any meeting of the board might be inquorate.

9.13 If a director raises the matter in dispute at a board meeting and he is outvoted, he must consider whether he will accept the position or whether he will take further action and, if so, what steps are open to him. His decision must largely depend upon the degree of importance which he attaches to the question.

9.14 On all but the most important questions – including any matter affecting the company's solvency – a director who has been overruled by his colleagues should accept the decision of the majority. He may regret that he has been unable to make his point and if he judges the matter to be of sufficient importance, he may insist that his dissent is minuted; he may even feel resentful that his advice is not being followed, but nevertheless he should bear in mind that in deferring to the wishes of the majority he may be doing what is best for the company and that the interests of the company should take precedence over his own feelings.

[14] [1993] BCC 646.
[15] See also Institute of Directors *The Director's Handbook* (2005).
[16] The corresponding provision in the 1985 Table A is reg 88.
[17] It is arguable that a director has power to summon meetings by virtue of his office unless the articles actually exclude it.

9.15 The CA 2006 makes it clear that while generally a director has to act in good faith in a manner most likely to promote the success of the company for the benefit of its members as a whole, the interests of the creditors become paramount where the company is approaching insolvency (s 172).

9.16 In certain circumstances, however, a director is justified in refusing to accept the decision of his colleagues and in taking further action. Indeed, it may not only be his right, but his duty to do so as we have seen at **9.4** et seq. For example, he may consider that he has not been given a fair hearing before the board, and in that event possibly his best course of action is to circulate to his colleagues a full memorandum setting out his views, so that the matter may be reconsidered.

9.17 More serious is the case where a director considers that some action proposed by the majority is unlawful, or not in accordance with the standards of conduct which should be observed. Even where he is unable to criticise it on grounds it is unlawful or as being contrary to business ethics, he may consider that the action proposed will have results which will be so detrimental to the interests of the company that, if persisted in, he cannot take any responsibility for it.

9.18 As has been emphasised elsewhere in this book, a director occupies a fiduciary position in relation to the company. If, therefore, he knows that the board is intent upon a course of action which in his view is unlawful, or will be disastrous, he is not fully discharging his duties if he merely votes against the proposal at a board meeting. He should, of course, do this but in addition he must insist on his objections being recorded in the minutes. Having done so he must then consider whether any further action on his part is called for, such as insisting on the company's legal advisers being consulted.

9.19 The CA 2006 re-emphasises this point. A director must act in accordance with the company's constitution and exercise his powers only for the purposes for which they are conferred (s 171).

Action in general meeting

9.20 If his opposition is unsuccessful, and he feels that the question is so serious as to justify an open conflict with the rest of the board, a director can also ventilate the matters in dispute at a general meeting of the company.

9.21 If he controls, or can count on the support of, a substantial proportion of the total voting power, this may prove an effective method of dealing with the matter. It is true that it is not competent for a general meeting to reverse any decision taken by the board, and it may be difficult to find a majority able to bind the board to a course of action which it must follow in relation to matters which under the articles are vested in the board (see **4.52** et seq), but no board of directors can for long carry out a policy against the expressed wishes of the shareholders.

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9.22 The form in which the matter could be raised is a resolution that the meeting has no confidence in the policy being carried out by the board, or a resolution for the appointment of a shareholders' committee (possibly with an independent chairman), to investigate the question; or a resolution for the removal of directors and the appointment of others in their place; or, in cases where an investigation is required, a resolution under the Companies Act 1985 (CA 1985), s 431 for the appointment of an inspector by the Department for Business, Innovation and Skills (BIS). Proper notice of any resolution must be given in accordance with CA 2006 and the articles, and in the case of a resolution for the removal of directors, this must be 'special notice' as required by CA 2006, s 168 unless the company has adopted a special article which allows for the removal of a director by some means other than by ordinary resolution under the s 168 procedure, for example, an article permitting removal by the passing of a special resolution.[18]

9.23 The provisions of CA 2006, s 316 regarding the circulation of members' resolutions and statements on requisition, are useful in such circumstances.[19] The general meeting may be the annual general meeting (AGM) of the company or, if the director cannot wait until the next AGM but can control, or enlist the support of, members holding not less than one-tenth of the paid up shares, he can have what prior to 1 October 2007 was known as an extraordinary general meeting (now simply referred to as a general meeting) called under the provisions of CA 2006, s 303.

The Companies Act 2006

9.24 The CA 2006 removes much of the law relating to meeting from a company's articles and instead moves it to CA 2006 itself. Nevertheless the rules remain substantially the same. Directors (in the plural, so this means collectively through a board meeting) may call a general meeting of the company (s 302). Members (and this includes a director/member) having at least 10% of the paid up capital of a company can requisition a general meeting (s 303). And any director can apply to the court for the court to order the holding of a general meeting (s 306).

9.25 The right of members to ask the company to circulate a statement will be found in s 314. A company can apply to the court to be relieved of this requirement where it feels that the right enjoyed by the members in this regard is being abused (s 317).

[18] See Chapter 12; the resolution under s 303 may be an ordinary resolution, notwithstanding anything to the contrary in the articles. If, as sometimes happens with older companies, the articles provide for a special resolution, a 75% majority would be required and it would be easier to follow the special notice procedure, which cannot be excluded by the articles. The director must also beware articles giving directors extra votes in general meeting on a resolution for their removal; such articles are valid: *Bushell v Faith* [1970] AC 1099.

[19] Particularly because the special notice procedure ensures that members receive notice of the resolution before the next meeting but does not compel its inclusion on the agenda: *Pedley v Inland Waterways Association Ltd* [1977] 1 All ER 209.

Resignation

9.26 If reference to a general meeting is impracticable, or is unsuccessful, a director can signify his opposition by resigning from the board, and in some cases this is the best course he can adopt. In such circumstances, it may be that, in fairness to the shareholders, he should publish a statement setting out his reasons for the step he is taking.

9.27 On the other hand, a director who finds himself in this position should consider carefully before he decides to resign and, in making his decision, he should try to put personal preferences on one side and assess what is in the best interests of the company. He may come to the conclusion that more harm will result from his departure than if he remains on the board and endeavours to put things right. In that case, he may find himself being asked, in due course, to show that he has been able to improve the situation by staying on the board. If he cannot see any signs of such an improvement, he should again consider whether to resign.[20] In regard to resignation when things are going seriously wrong within a company, the case of *Re CS Holidays*[21] is instructive. The case concerned disqualification proceedings against a director. He had formed the view that the company was trading at considerable risk to the creditors and the situation was such that it would have been prudent for him to resign as a director. He did not, however, resign. Chadwick J held that this did not necessarily lead to the conclusion that he was unfit to be concerned in the management of a company. In the circumstances, the director had used such influence as he had to bring trading to an end. On the other hand, in *Re DKG Contractors Ltd*,[22] the court was concerned with a company run by a husband and wife. The husband claimed to have resigned as a director several months before the insolvent liquidation of the company. The trial judge, John Weeks QC, clearly refused to accept such resignation. Both husband and wife were held liable for, inter alia, wrongful trading and misfeasance.

9.28 Sometimes a director who is taking a line opposed by the majority will find himself under strong pressure from his fellow directors to resign. This may take the form of a threat to use majority voting power in a general meeting to pass a resolution for his removal from office under the provisions of the articles or under CA 2006, s 168.

9.29 No doubt most directors in this position would, if they considered only their personal preferences, choose to resign rather than be removed, with all the publicity and unpleasantness which the latter may involve. Nevertheless, in this as in other matters, a director should have regard to the interests of the company and this may lead him to the conclusion that he should not give way.

[20] And indeed it may be his duty to do so if he is not to be saddled with the responsibility for what his colleagues are doing (see 9.4 et seq); again, however, subject to the proviso that, if the issue relates to the company's solvency, resignation may be counter-productive for the director himself.

[21] [1997] BCC 172.

[22] [1990] BCC 903.

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After all, if his opponents carry out their proposal to move a resolution for his removal under CA 2006, s 168, he will have the right of having a statement circulated to the members and it may well be his duty, in all the circumstances, to refuse to resign so that his opponents will have to make good their threat before the shareholders in general meeting, when he will be able to put his side of the case.

Inspection by BIS

9.30 Where a director considers that the actions of his colleagues involve serious irregularities, it may be that his best course of action is to invoke the intervention of BIS which has power under CA 1985, ss 431 and 432[23] to appoint inspectors to carry out an investigation of a company's affairs and under CA 1985, s 442 to appoint inspectors to investigate ownership, control or material influence over the company. These powers have been summarised at 8.162 et seq, but it may be useful to re-examine them in relation to the position of a dissatisfied director.

9.31 Under CA 1985, s 431, BIS may order an investigation into a company's affairs on the application of not less than 200 members or members holding not less than one-tenth of the issued shares (in the case of a company not having a share capital, the application must be by not less than one-fifth of the members). Section 431 may also be invoked by the company if the objectors can raise a majority for an ordinary resolution.[24] The application must be supported by such evidence as BIS may require for the purpose of showing that the applicants have good reason for requiring the investigation and BIS may, before appointing an inspector, require the applicants to give security, to an amount not exceeding £5,000, for payment of the cost of the investigation. The names of the complainants and the nature of the charges made are not disclosed to the directors of the company, although those who will be censured by the inspectors and possibly disqualified by the courts must, in the course of the investigation, be given a chance to meet the case against them (see 8.162 et seq).

9.32 Proceedings under CA 1985, s 431, therefore, may be appropriate where a director can obtain sufficient support from other shareholders and the matters complained of are sufficiently grave to warrant the appointment of an inspector.

9.33 Irrespective of any application by members, BIS has also the power to appoint inspectors under CA 1985, s 432. This provides that BIS *must* order an investigation if the courts, by order, declare that the company's affairs should be investigated by an inspector appointed by BIS (CA 1985, s 432(1)); and BIS *may* do so if it appears that the company's business is being conducted or has

23 These references are correct; this part of CA 1985 remains in force having not been consolidated into CA 2006.

24 In the case of *First Re-investment Trust Limited* (9.4 et seq) the board passed a resolution requesting the DTI to appoint inspectors and the DTI then exercised its discretionary power under CA 1985, s 432.

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been conducted in a manner which is fraudulent, unlawful or unfairly prejudicial to some of its members, or its members have not been given all the information with respect to its affairs which they might reasonably expect (CA 1985, s 432(2)(b)).

9.34 The provisions enabling the company's affairs to be investigated are, potentially, a powerful deterrent to malpractice. First, there is the threat of publicity. The assumption is that the inspector's report will be published.[25] Secondly, the report may lead to BIS taking action by applying for an order under CA 1985, s 460 to protect the members or for disqualification of directors (as from 1 October 2007 the authority for this became CA 2006, s 995). In an extreme case, BIS might apply to the court to have the company wound up under the Insolvency Act 1986, s 124A. In any proceedings, whether brought by BIS or not, the report is admissible as evidence of the inspectors' opinions, and in an application for disqualification based on the report it is evidence of the facts found by the inspectors. There is a third threat. The inspectors have power to compel directors and others to produce documents and answer questions (if necessary, on oath). Refusal may lead to contempt proceedings. It must be said, however, that information so obtained under compulsion cannot be used as evidence in a subsequent prosecution against the director concerned. This was the decision of the European Commission of Human Rights in *Saunders v United Kingdom*,[26] a case which arose out of the conviction of Ernest Saunders following the Guinness investigation (Registrar of the European Court of Human Rights press release 407). The Commission found that it was an infringement of the human right to a fair trial under the European Convention for the Protection of Human Rights that there had been a failure on the part of the prosecuting authorities to prevent the use of a confession obtained under compulsion of law in a criminal prosecution. It might be commented that this is a somewhat disappointing decision in that it ignores the significant difference in intellectual ability between the street criminal being given a particularly hard time in the course of a police investigation, and the successful and experienced businessman being investigated by BIS. Furthermore, it disregards the origin of the human rights movement in the protection of citizens against over-aggressive States. Whatever epithets might be applied to BIS, 'over-aggressive' is not one of them.

9.35 Having said this, it would appear that such evidence can be used in disqualification proceedings. This was the decision of the Court of Appeal in *R v Secretary of State for Trade and Industry ex parte McCormick*.[27] It was explained that there was a real doubt whether disqualification proceedings were criminal since they could not result in the deprivation of liberty, livelihood or property. If an investigation reveals something seriously amiss, there is now provision for the inspectors' inquiry to be suspended while the matter is investigated by the Serious Fraud Office (SFO). The SFO may itself compel

25 The inspectors may, however, be appointed under CA 1985, s 432 on the basis that their report will not be published.

26 *Application No 19187/910* [1997] BCC 872.

27 [1998] BCC 379.

parties to produce documents and answer questions, but there is a limit to the uses to which the SFO is able to put the answers it receives and, unlike the inspectors, it is an investigating authority subject to the requirements of the Police and Criminal Evidence Act 1984. It must caution parties in more or less the same way as the police must caution a suspected burglar. Contrast the position of the director appearing before company inspectors – no caution, no privilege against self-incrimination, and perhaps no warning until very late in the day that he is not a witness but a suspect.

9.36 On the other hand, in *Secretary of State for Trade and Industry v Bairstow*[28] the Court of Appeal held that findings of fact made by the trial judge in proceedings for breach of duty by a director were not admissible in subsequent disqualification proceedings against the same director. Sir Andrew Morritt V-C took the view that he saw 'no reason why it should be manifestly unfair to the Secretary of State that he should be required to prove the serious allegations he makes with regard to the conduct of [the director concerned]'.

9.37 Under CA 1985, s 442, BIS may appoint an inspector to investigate and report on the membership of a company and otherwise with respect to the company for the purpose of determining the true identity of persons who are or who have been financially interested in the success or failure (real or apparent) of the company, or able to control or materially to influence the policy of the company.

Changes occasioned by the Companies (Audit, Investigations and Community Enterprise) Act 2004

Background

9.38 As has been seen the Secretary of State enjoys many powers under various pieces of companies legislation to investigate the affairs of a company and other related matters.

9.39 Traditionally most such investigations are carried on under CA 1985, s 447.[29] Under this, members of Company Investigations, part of the Insolvency Service (formerly the Companies Investigations Branch of BIS), and other competent individuals can be authorised to require the production of documents and also to require explanations of any document from the person producing it or from any past or present officer or employee of the company.[30]

9.40 In the early years of the century the decision has been taken to strengthen the then current regime, though without varying the grounds for such

[28] [2003] BCC 682.

[29] Such investigations might be carried out where there is suspicion of fraud, misfeasance, misconduct, conduct unfairly prejudicial to shareholders or failure to supply shareholders with information they may reasonably expect.

[30] While these inquiries are confidential, there is a regime permitting disclosure of information to other regulators.

investigations. This was done in the Companies (Audit, Investigations and Community Enterprise) Act 2004 (C(AICE)A 2004).

9.41 The main changes:

- gave investigators a general power to require relevant information;
- provided statutory immunity from liability for breach of confidence where information is provided voluntarily to Company Investigations in certain circumstances;
- gave inspectors and investigators a power to require entry into premises used for company business and a right to remain there for the purposes of the investigation; and
- provided a more effective sanction for non-compliance with CA 1985, s 447 and also provided a sanction for non-compliance with the power to require entry into premises.

9.42 These will now be considered.

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Power to require documents and other information

9.43 CA 1985, s 447 which allowed investigators to require the production of books and papers was repealed and replaced by a completely new provision.[31] These changes came into force on 6 April 2005.

9.44 There were perceived to be two major weaknesses in the provision as it stood:

- There was no general power for answers to be required to questions not related to the documents produced.
- While persons other than the company could be required to produce company documents in their possession and also other documents held to the order of the company, there was some argument as to what other types of documents could be so demanded.

9.45 The Secretary of State now has power to require a company to produce such documents[32] and such information as may be specified in his directions.[33] He may also authorise[34] an investigator[35] to require such documents and information.[36]

[31] C(AICE)A 2004, s 21.

[32] This includes information in any recorded form (see CA 1985, s 447(8), inserted by C(AICE)A 2004, s 21).

[33] CCA 1985, s 447(2), inserted by C(AICE)A 2004, s 21.

[34] Presumably this will be when the decision is taken to start the investigation into the company.

[35] This is the first time the term 'investigator' has been used, but it seems to accord rather well with the Orwellian 1984 regime seemingly being introduced.

[36] CCA 1985, s 447(3), inserted by C(AICE)A 2004, s 21.

9.46 In one sense this power is narrower than previously enjoyed by the Secretary of State in that he can only require documents[37] from the company. On the other hand, it is also wider in that information as well as documents can be sought. But while the Secretary of State does not have power himself to require documents and information from persons other than the company, the powers with which he can imbue his investigators permit them to require the documents and information from other persons.[38] These powers are wider than those previously enjoyed by BIS officials.

9.47 The investigators' powers are extremely wide. If a document is not produced, an investigator can require an explanation as to where it is. He can also require any person to explain his conduct or even to give his personal opinion. It is also clear that the investigators can require not only documents in a person's possession belonging to the company. Reference is to the production of 'such documents (or documents of such description) as may be specified in the directions'.[39]

Information provided: evidence

9.48 A statement made by a person pursuant to a requirement under this provision can be used as evidence against him.[40]

9.49 However, in criminal proceedings against a person charged with a relevant offence,[41] no evidence relating to a statement may be adduced by or on behalf of the prosecution and no question relating to it may be asked by or on behalf of the prosecution unless evidence relating to it is adduced or a question relating to it is asked in the proceedings by or on behalf of that person.[42]

Provision for security of information obtained

9.50 CA 1985, s 449 was also replaced. Clearly much information obtained during the course of an investigation under CA 1985, s 447 is confidential. For this reason s 449 restricted the uses to which such information could be put, but at the same time inserted a number of gateways through which it could legitimately be put.

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37 Any documents and information required must be produced in legible form (see CA 1985, s 447(9), inserted by C(AICE)A 2004, s 21).

38 Compare CA 1985, s 447(2) and CA 1985, s 447(3).

39 CA 1985, s 447(2) and (3).

40 CA 1985, s 447A(1), introduced by C(AICE)A 2004, s 25 Sch 2, Part 3.

41 This means an offence other than one under CA 1985, s 451 (provision of false information to BIS inspectors or investigators), an offence under the Perjury Act 1911, s 5 (making a false statement under oath) or its Scottish equivalent. These are, of course, express statutory provisions designed to discourage false statements and so perhaps the fact that prosecutions under these are possible should not be too surprising.

42 CA 1985, s 447A(2).

9.51 CA 1985, s 449 has three main purposes:

- to consolidate the many amendments that have been made over the years to this provision and to put them into a single consolidated statement of the law;
- to provide a number of new gateways, especially to the Regulator of Community Interest Companies and the prescribed body under CA 1985, s 14;[43] and
- to apply the restrictions on disclosure and gateways to information obtained by the Secretary of State under CA 1985, s 448A and to information obtained by investigators during a visit to premises under CA 1985, s 453A.

9.52 The CA 1985, s 449(8) lists a number of persons to whom information can legitimately be disclosed. These are:

- the Secretary of State;
- the Department of Enterprise, Trade and Investment for Northern Ireland;
- the Treasury;
- the Lord Advocate;
- the Director of Public Prosecutions;
- the Director of Public Prosecutions for Northern Ireland;
- the Financial Services Authority;
- the Financial Conduct Authority;
- the Prudential Regulation Authority;
- the Bank of England;
- a constable;
- a procurator fiscal; and
- the Scottish Ministers.[44]

9.53 Disclosure can be made for the following purposes:

- a disclosure for the purpose of enabling or assisting a person authorised under CA 2006, s 457 to exercise his functions;[45]
- a disclosure for the purpose of enabling or assisting an inspector appointed under CA 1985, Part XIV to exercise his functions;[46]

43 This the body prescribed for the supervision of periodic accounts and reports of issuers of listed securities.

44 CA 1985, Sch 15C, inserted by C(AICE) 2004, Sch 2, Part 3 as amended by Companies Act 2006 (Consequential Amendments etc) Order 2008, SI 2008/948, arts 3(1)(b), 6, Sch 1, Pt 2 and Financial Services Act 2012, s 114(1), Sch 18, Pt 2.

45 This is a person authorised to apply to the court in respect of defective accounts.

46 CA 1985, Part XIV contains the investigation and inspection provisions enjoyed by BIS.