The academic debate concerning on the directors duties is one of the oldest issues in company law and the corporate governance. The common law gave the directors a large degree of latitude in terms of standard of care expected of them. Before *Re City Equitable Fire Insurance Co. Ltd*[1], the duty was that "directors are bound to use fair and reasonable diligence in the management of their company affairs and to act honestly".

After *Re City Equitable Fire Insurance Co. Ltd, Romer J* stated that a "director must act honestly and must also exercise some degree of both skill and diligence". Romer J added three guidelines to determine the director's duty of care. Firstly there is "no duty on a director to exhibit in the performance of the duties a greater degree of s kill than may reasonably be expected from a person of his knowledge and experience". Secondly "a director is not bound to give continuous attention to the affairs of his company". Thirdly "in respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly".

In *Norman v Theodore Goddard*[2], Hoffmann J accepted that the appropriate test was accurately stated in s 214(4) of the Insolvency Act 1986, which defines negligent conduct for the purposes of 'wrongful trading'. The 1986 Act defines negligent conduct by a two tier test firstly the objective test being that "the general knowledge, skill and experience that may reasonably be expected of a person caring out the same functions as are carried out by that director in relation to the company". Secondly the subjective test being "the general knowledge, skill and experience that the particular director has".

The effect of s.214 (4) of the Insolvency Act 1986 is that a director's actions will be measured against the conduct expected of a reasonable diligent person. This is therefore an objective test. The intervention of statue in particular the Company Directors Disqualification Act (1 986) and Insolvency Act (1986), S (214) extended and refined director's duties in respect of the failing company introducing an objective standard. However subjective consideratio n will take into account on the level of any particular special skills a director may possess.

Company law review went on advocate two possible approaches to reform, which it termed the 'enlightened shareholder value' and the 'pluralist' model". The main difference between these two lies in relation to what happens when there is a clash of interest between the shareholder and other stakeholders[3].

The enlightened shareholder value model provides that "directors must promote the success of the company for the benefit of its member but also need to foster on long term and short term and the

---

[1] [1925] Ch 407, CA
[2] [1991] BCLC 1028
[3] Brenda Hannigan, Company law,(2nd edition, Oxford university press, Oxford 2009)pg 213

wider factors where relevant such as the company's employees, effects on environment, supplier and creditor[4]".

On the other hand pluralist requires the "directors to balance these potentially conflicting of interest, without giving automatic priority to the shareholders. Although the review did express some support for the objectives behind the pluralist approach which main concern was that it could see no practical way of enforcing such a duty? This was largely due to practical reasons which including the problem associated with policing the directorial discretion to override the interest of shareholders in favor of other stakeholders" [5]

The new codified directors' duties come into effect in two stages: on 1 October 2007 and 1 October 2008.The question may arise whether the newly enacted Company Act successfully clarifies the law in respect of the ambiguity and uncertainty from the previous provision of Company Act [6]?

A company has separate legal entity distinct and it is separate from its shareholders, a company is not an agent of its shareholders, this principle was established in *Salomon v Salomon*[7], a company can own property and its properties are not the properties of its shareholders *Maclaine Watson & Co Ltd v International Tin*[8]. In spite of being a separate legal entity itself a company can only act through its directors[9]. Under the previous Law [10]the definition of a director included any person caring out the role of director and included a 'shadow director' and the Act 2006 preserves this definition[11]. Directors are not automatically employer of their companies. A director may have a separate contract of service with the company. A term in the director's contract which provides that the director's shall be employed for more than five years which cannot be terminated by company through notice and it must be appointed by the general meeting under Companies Act 2006,s(319). However law commission takes a different view where it recommends that the term of the office in S (319) should be removed from five to three years

---

[4] The Bogus Argument [1998]19 Co Law 34

[5] Boyle and Birds, company law(6th edi, Jordans,Bristol 2007)

[6] "…..*the main purpose in codifying the general duties of directors is to make what is expected of directors clearer and to make the law more accessible to them and to other" per* Lord Goldsmith, Lords GrandCommittee,6thFebruary 2006,column 254

[7] [1897]AC 22 HL

[8] [1989]3 All ER 523& 531

[9] Ben Pettet, *company and Capital Markets Law,*(3rd edn,Londman Law Series, Harlow 2009)pg138

[10] Companies Act 1985,S(741)(1) 'includes any person occupying the position of director by whatever name called'.
Insolvency Act 1986,S(251),The Company Directors Disqualification Act 1986,S(22),where it extended to include shadow directors.

[11] Company act 2006,S(170)(5), "the general duty apply to shadow directors as well the director of the company"

Prima facie a company is formed as public and private, where in large public companies the directors are classified as executive and non executive directors. Executive directors are those directors who actually concerned on the management of the company and non-executive directors are directors of the company who are members of the board of directors of a company. They are not involved in the day-to-day running of business but monitor the executive activity and contribute to the development of strategy [12]

UK company law has traditionally given prima facie interests of the shareholders. On the other hand the corporate power have an enormous effect on society and have very narrow accountability to shareholders which is clearly insufficient to protect the society's interests. So the interests of stakeholders must also be taken into account, which may sometimes outweigh the shareholders interests or at least stand equal to them in relation to primacy.

Before CA 2006, the duties of directors of a company mostly governed by the equitable principles and the common law of negligence. In *Percival v Wright*[13]it was established that directors are fiduciaries, who owe duties to the company, not to the individual shareholders. Subsequently in *Brien v Wolley*[14]*,* the court stated that "*if there had been a special relationship of trust between the directors and the shareholders".* Then a director may owe a duty to individual shareholders. A similar duty of care recognised in *Perkin v Anderson*[15]*,* which reaffirmed the general principle in relation to common law position on director's duties. Here the directors were not to owe a duty to former shareholder to inform about the disposal of a company asset. Since there was no special factual relationship generating a fiduciary obligation, so the directors owed no duty of disclosure. In relation to the creditors, directors generally did not owe duties but in the event a company was insolvent, it has been held that they must have regard to the interest of creditors *West Mercia Sasafetywear Ltd v Dodd* [16]and *Winkworth v Edward Baron Development Co ltd* [17]*.*

The duties of the directors under Companies Act 2006

The nature and extent of the duties of directors defined in Companies Act 2006 in S 170(1), and the general duties specified in Section 170 to 177 of the Act.

In S(170)(3) of the Act laid down the general duties of the directors which are based and the way to applied as common law rules and equitable principle. However in S (170) (4) stated that the "*general duties shall be interpreted and applies in the same way as common law rules or equitable*

[12] Brenda Hannigan, Company law,(2nd edition, Oxford university press, Oxford 2009)pg116,117,118
[13] [1902]2 Ch 421
[14] [1954]AC333 HL
[15] [2001]1 BCLC 372,CA
[16] [1988]BCLC250,CA
[17] [1987]1 All,ER1143,HL

principles". Therefore, it appears that the 2006 Act sets out the relationship between the statute and the common law.

From the wording of the section it appears that subsection (a) of s.171 codifies the common law principle that directors must act within the limits of the company's constitution, which is defined by s.17 as including the company's articles and any shareholder resolution and agreements. In s.171 is similar to the previous formulation of the common law duties "within powers or under the company constitution and for those purposes any powers are conferred". Essentially this would require an assessment of the nature and the scope of these duties under the previous law. Therefore, the law relating to acting bona fide or proper purpose tests, under the case laws should be examine and it needs to be seen whether 2006 Act addresses the ambiguity present in the present common law.

There are two elements are distinct duties as clarified in *Bishopsgate Investment Management Ltd v Maxwell*[18], and it was only logical that the 2006 Act accorded them separate provisions in the Act. The proper purpose doctrine was found in *Smith & Fawcett*[19] where Lord Greene stated that "a director must not exercise their power for any collateral purpose. A relatively modern and authoritative view on the approach to be taken towards the proper purposes doctrine was delivered by the Privy Council[20]*",* where it was held that the directions breached the duty by allotting share for reducing the majority holding of two other shareholders. Lord Wilberforce stated that to determine whether the directors have been breached their duty a twofold process should be followed: firstly *"*whether the nature and limits exercised in a fair manner. Secondly whether the power was exercised was proper or not. Therefore s.171 effectively codifies the previous common law and with it brings the uncertainty previously existent in this area of law*".*

Duty to exercise independent judgment

Section 173 of CA 2006 encapsulates another aspect of the duty of good faith , where director must exercise an '*unfettered discretion'*.

"A director who has committed himself to vote in a particular way on some issue will be in breach of duty unless that commitment was itself undertaken for genuine commercial reasons [21]." *Fulham BC v Cabra Estates*[22]*,* where it held that the directors were not breach of duty because they had committed themselves to a long-term policy for commercial reasons.

Director's duty to exercise reasonable care, skill and diligence

---

[18] [1993] Ch 1, CA
[19] [1942]ch 304
[20] In Howard Smith Ltd v Ampol Petroleum Ltd (1974) Ac 821, PC
[21] Ben Pettet, *company and Capital Markets Law,(*3rd edn,Londman Law Series, Harlow 2009)pg158
[22] [1992] BCC 863

The duty of care, skill and diligence is not fiduciary duties, which make clear from CA 2006, s178 (2). It is statutory statement of a common law duty of care imposed on who assume responsibility for the property and affairs, which governed by the normal common law rules as to liability for negligence[23],its also been explained by *Lord Millett LJ in Bristol &West Building Society v Moth ew*[24]*.* In previous common law which divided into two streams. Firstly those cases when the courts generally had low expectation of the standard of the care to be expected of directors and the secondly those cases decided after the *Donoghue v Stevenson*[25]*.*

In *Re Cardiff Saving Bank,Marquis of Bute's Case*[26]*,*where *Stirling J* formulated what has been described as the 'intermittent' theory of directors duties such as a directors must exercise care at the meeting at which he is actually present, but owes no duty to a ttend any specific meeting or even any meeting at all[27]

The standard of care[28] previously was that directors were required to use "fair and reasonable diligence in the management of their company affairs and to act honestly". The approach of Neville J[29] was one where a semi-subjective standard of care was preferred. The duty was held to be that "director must use reasonable care must be measured by the care an ordinary man might be expected to take in the same circumstances on his own behalf ".

The effect of s.174 (2) is that it adopts in *Re D'Jan of London Ltd* where Lord Hoffmann's position and mirrors the wrongful trading provision under s 214(4) of the IA 1986. Therefore under the new provisions a director's actions will be measured against the conduct expe cted of a reasonably diligent person namely the subjective test. However recent cases have adopted a strict approach towards the standard of care expected of directors.

It appears that the duty set out in s.174 adopts the *Norman v Theodore*[30] test prescribed in the Insolvency Act 1986 for judging whether directors are in breach of their duty under the section. The courts are familiar with this test which they have used to assess compliance with a director's common law duty of skill and care and this is like ly to continue under the 2006 Act as well.

The duties of directors to avoid conflict of interest

---

[23] Brenda Hannigan, *Company Law,*(2nd edn, Oxford Uni press, Oxford 2009) pg 223
[24] [1996} 4 ALL ER 698 at 711-12
[25] [1932] AC 562, HL
[26] [1892]2 Ch 100
[27] Alan Dignam & John Lowry, *Company Law,(5th edi,*Oxford Uni press, Oxford 2009)pg320
[28] *Re Forest of Dean Coal Mining Co* [1878] 10 Ch D 450
[29] *Re Brazilian Rubber Plantations and Estates Ltd, 1911] 1 Ch. 425*
[30] [1991] B.C.L.C. 1028

The core obligations is a duty of an directors is loyalty[31], which includes two key components: a duty to avoid conflicts of interest *Aberdeen Railway co v Blaikie Bros*[32] and not to make secret profits from their fiduciary position (*Keech v Sandford*)[33].these long established principles are stated in CA 2006,S175 as follows:

Section 175 of the CA 2006 "seeks to restate the core fiduciary duty of a director to avoid a conflict between his or her own personal interest with the interest of the company[34], albeit with some modification". The policy underlying equity's anxiety in this regard explained by *Lord Herschell* in *Bray v Ford*[35]

Section 175 (1) CA 2006 "Requires a director of a company to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company[36]". This may happen in circumstances where director's personal interest confli cts with their duty owed to the company as explained by Deane J in Chan v Zacbaria[37]

In *Aberdeen Railway co v Blaikie Bros*[38]stated that "a fiduciary duties of directors are three types such as, to act bona fide in the interests of the company, secondly a duty to exercise their power under the company's articles and memorandum of association and finally conflict of interest and not to profit from their position as a director of the company ". In *Re Smith & Fawcett Ltd*[39] Lord Greene stated that "…directors must exercise their discretion bona fide in what they consider, not what a court may consider, is in the best interest of the company *".* So directors should always work for the benefit of the company not for any other interest *Neptune ltd v Fitzgerald (No 2)*[40]*.* The determination of good faith involves both subjective and objective assessment. The subjective test is whether the directors honestly believed that his act or omission was in the interest of the company. The issue is the directors state of mind *Regenterest plc v Cohen*[41]*,* an objective assessment would require asking whether a reasonable man in the position of a director. However an objective view was taken by *Pennycuick* in *Charterbridge Corporation Ltd v Lloyd's Bank Ltd*[42]. In *Allied Business & Financial Consultants Ltd v Shanahan*[43] "the director's duty not to make a secret profit when property investment fell outside the scope of the company's business, which was to offer financial and business advice ".

---

[31] 'The Nature and Function of Fiduciary Loyalty'[2005]121 LQR 452
[32] [1854]1 Macq 461,*per Lord Cranworth*
[33] [1726] Sel Cas Ch 61
[34] Ben Pettet, *company and Capital Markets Law,(*3rd edn,Londman Law Series, Harlow 2009)pg160
[35] [1896]AC 44,HL
[36] http://www.opsi.gov.uk/acts/acts2006/pdf/ukpga_20060046_en.pdf
[37] [1984] 154 CLR 178, HC of A
[38] [1854]1 Macq 461,Lord Cranworth,
[39] [1942]1 ALL ER 542,Ch 304
[40] [1995] BCC 1000
[41] [2001]2 BCLC 319 Ch D, *Sir Johathan Parker*
[42] [1970]Ch 62 Ch d
[43] [2009] EWCA Civ 751

So, it is strongly arguable that the fiduciary duties i ncumbent on directors is the duty to ensure that conflicts of interest do not arise with the company and that the director does not make secret profits, as such actions may result in directors having to account for any profit made f rom such a transaction. However the reports ruling in the *CA Re Allied Business & Financial Consultants Ltd*[44], also reported as *O'Donnell v Shanahan* "on whether the acquisition of a property as an investment opportunity by two directors with the knowledge of a third director, who did not personally want to take on the risk herself, unfairly prejudiced her interests as a member of the company and was in breach of the "no conflict" and "no profit" rules". [45]

In *British Midland Tools Ltd v Midland International Tooling Ltd* [46], "a director's duty to disclose the company information of activities that may damage the company's interests, where four of the directors planned to set up a new business competing with their new owners ". In *Extrasure Travel Insurances Ltd v Scattergood*[47], "on when incompetent but honest intentions amount to breach of fiduciary duty and the test for determining when a director has acted in the best interests of the company[48]"

Upjohn LJ in Boulting v ACTAT [49] said "the scope of the no-conflict rule, it must be applied realistically to a situation which discloses a real conflict of duty and interest' and not to some 'theoretical or rhetorical conflict".

In *Cook v Deeks*[50] the Privy Council held that the defendants had a contract on behalf of the Toronto Co. *Lord Buckmaster* said that "the directors: their influence and position to exclude, the company whose interest it was their first duty to protect "

In *Canadian Supreme Court in Canadian Aero service Ltd v O' Malley* [51], *Laskin J* stated that "by taking into account all the circumstances surrounding a particular breach including the director's fides as the general standard of loyalty, good faith and avoidance of a conflict of duty and self - interest…must be tested in each case by many factors".

On the other hand, the courts continue to harness equity's strict prophylactic view of fiduciary liability where a director has misappropriated a corporate opportunity for his own benefit, it has explained *Don King production Inc v Warren*[52] and *Gencor ACP Ltd v Daldy*[53], Similar reasoning

---

[44] [2009] EWCA Civ 751
[45] Director's duties of "no conflict" and "no profit", Bus. L.B. 2010, 105(Apr), 2-4.(Business Law Bulletin)
[46] [2003]2 BCLC523
[47] [2003] 1 BCLC 598
[48] Directors beware", Stephen Arthur, Tru. & E.L.J. 2003, 52, 18-20
[49] [1963]2 QB 606,CA
[50] [1916]1 AC 554
[51] [1973]40 DLR (3d) 371
[52] [2000]1 BCLC 607
[53] [2000]2 BCLC 734

can be seen in *Crown Dilmum v Sutton*.[54] The s.175 of CA 2006 the aims is to promote that a director should not only consider his personal interest but also the interests of persons connected with him or her in deciding whether there is a conflict situation can arise. However one of criticism of the 2006 Act is that the effect of the broad duty is lessened to a great extent by the various exemptions the section itself provides.

Who can enforce and how to enforce the breach of director's duty

Foss v Harbottle[55] is a leading English precedent in corporate law. In any action in which a wrong is alleged to have been done to a company, the proper claimant is the company itself. This is known as "the rule in *Foss v Harbottle*", and the several important exceptions that have been developed are often described as "exceptions to the rule in *Foss v Harbottle*" amongst these is the 'derivative action', which allows a minority shareholder to bring a claim on behalf of the company.

Now in order to evaluate whether or not the situation of minority shareholders has been improved by the enactment of the Companies Act 2006, it is necessary to look at the various remedies offered to minority shareholders under it:

Firstly, further reform with regard to minority shareholders has been made by sections 260-269 of the Companies Act 2006 which have now replaced the common law rules associated with the general principle laid down in Foss v Harbottle as far as they apply to derivative claims. S.260 defines a derivative claim as proceedings by a member of a company in respect of a cause of action vested in the company and seeking relief on behalf of the company. The new rules contain an *exclusive* list of grounds under s260(3), which further states that only where a cause of action arises from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company [56],.

The intention behind permitting derivative claim against 'another person' is to allow whether the claim made against "a person who has assisted a directors in a breach of duty or a person who is recipient of corporate assets in circumstances where he knows the directors is acting in breach of his duties however to suing them derivatively must be their involvement in the directors breach of duty". A derivative claim cannot be brought where the breach of duty is solely reason for the third party such as a negligent auditor.

The company law review steering group agreed that the derivative claim should be put on a statutory basis on which restricted to breaches of directors duties including the duty of care and skill, which should not be confined to cases of self serving negligence or worse [57]. However, the view of

---

[50] [2004] EWHC 52(Ch)

[51] [1843] 67 ER 189

[56] Ben Pettet, *company and Capital Markets Law,(*3rd edn,Londman Law Series, Harlow 2009)pg 223-227

57 CLR *Development the Framework,*para 4.127: *Final Report ,*n.2,para.7.46

CLRSG that the law on ratification should be modernised and simplified, which is proposed in the new companies legislation[58].

The statutory derivative claim does not formulate a substantive rule to replace the rule in Foss v Harbottle, but rather a new procedure for bring actions based on the existing rules. On the oth er hand, the section does not seek to overturn these well-established principles[59]. So it is suggested that instead the implement the recommendation of the law commission that there should be a 'new derivative procedure with more modern, flexible, and acces sible criteria for determining whether a shareholder can pursue an action'.

There were particular concerns about introducing the statutory statement of director's duties specifically the obligation in CA 2006 , under section 172 which require directors to p romote the success of the company[60]. The concern was that shareholders activists might use the combination of the new derivative procedure and s 172 to challenge business decisions of directors on the basic of an alleged failure to have regard to the factor s set out in the section. A derivative claim could be argued to use to seek judicial review in effect of commercial decision of management.

It is also appears that the new regime will potentially allow a broader range of claims to be brought more easily than the case in the common law. E.g, an employee or an environmental group holding shares could potentially bring an action under the new provision alleging that the directors are in breach of their duty by not taking into account their interest as required by the new statement of director's duties.

Directors who wish to stay out of trouble will probably be wise to view the unfair prejudice law as a very broad type of director's duty, at procedural level the unfair prejudice remedy has an even greater impact in the law on director's duties[61].

By considering the above overall discussion, it is suggested that the remedies for the breach of director's duties should be stated in the statue along with the substantive duties. It is noted that section 178 applies on ly to the general duties which is laid put in s171 to s177. However, it is also noted that the second proposition in s178 is not applied to the duty to exercise reasonable care, skill and diligence in line with the modern view that this is not a fiduciary duty. The remedy for that duty is normally confines to damages.There are also number of uncertainties as to whether the remedy available is personal or proprietary.

---

[58] Ben Pettet, *company and Capital Markets Law,(*3rd edn,Londman Law Series, Harlow 2009)pg223

59 Explanatory notes on the companies Act 2006,para 491

[60] Brenda Hannigan, *Company Law,*(2nd edn, Oxford Uni press, Oxford 2009)

[61] Ben Pettet, *company and Capital Markets Law,(*3rd edn,Londman Law Series, Harlow 2009

Bibliography:

Books:

1. Alan Dignam & John Lowry, (2009) Company Law, 5th Edition, Oxford University Press
2. L.C.B. Gower and Paul L. Davies, (2008) The Principle of Modern Company Law, 8th Edition, Sweet & Maxwell Ltd.
3. Len Sealy and Sarah Worthington, (2008) Cases and Materials in Company Law, 8th Edition, Oxford University Press
4. Mayson, French & Ryan on, (2009) Company law, 25th Edition, Oxford University Press
5. Stephen Griffin, (2006) Company law Fundamental Principles, 4th Edition, Pearson Education Limite
6. Ben Pettet,(2009),Company Law,3rd edition, Pearson Education Ltd
7. Brenda Hannigan, *Company Law,*(2nd edn, Oxford Uni press, Oxford 2009
8. Boyle and Birds, company law(6th edi, Jordans,Bristol 2007)

Statute:

1. Derek French, (2009-2010) Blackstone's Statutes on Company Law

Article, Report and White Papers:

1. Director's duties of "no conflict" and "no profit", Bus. L.B. 2010, 105(Apr), 2-4.(Business Law Bulletin)
2. Conduct amounting to a breach of the conflict of interest duty" Stephen Griffin, Co. L.N. 2010, 268, 1-3.
3. "Re Allied Business & Financial Consultants Ltd: scope of no conflict and no profit rules considered", Co. L.N. 2009, 259, 7.
4. "A sprouting duty of honesty and loyalty? Companies Act 2006", Mark Hsaio I.C.C.L.R. 2009, 20(9), 301-308
5. "Directors' duties", Stephen Barc., C.S.R. 2003, 27(13), 99.
6. 1999 "Fiduciary duties as default rules, European influences and the need for caution in the use of economic analysis" Janet Dine, Comp. Law. 1999, 20(6), 190-195
7. "Directors' duties", Stephen Barc., C.S.R. 2003, 27(13), 99.

8. “Directors' duties - breach of fiduciary duties”, Archana Sinha, I.C.C.L.R. 2002, 13(7),

Websites:

1. http://www.berr.gov.uk/bbf/co-act-2006/white-paper/page22800.html (Accessed)
2. http://www.opsi.gov.uk/acts/acts2006/ukpga20060046_en_1 (Accessed)
3. http://www.lawcom.gov.uk/docs/lc246.pdf (Accessed)
4. http://www.frc.org.uk/about/auditorliability.cfm (Accessed)