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"Role of Institutional Investors in Corporate Governance:

A Comparative Analysis"

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Object

The role of institutional investor in recent decades has assumed greater significance in governance of the corporation mainly because of two reasons, firstly because of the large corporate scandals and failures, and secondly due to ever increasing investment by the

institutional investors in the share capital of the company. In a country like India where ownership structure of the corporation is mainly concentrated in promoters, the institutional investors can play a significant role in governance of the corporation and can also act in aid to the minority individual shareholders. The object of this research paper is to investigate the role played by the institutional investors in governance of the corporation. The paper will examine the issues faced by the institutional investors in governance of the investee company. The researcher will conceptualize the existing legal framework regulating the role of institutional investors in India. The paper will also look into the extent to which these regulations are complied by the institutional investors. This paper will also analyse the effectiveness of existing legal framework for corporate governance in India.

Thesis Statement

This paper empirically argues that institutional investors in India are rationally apathetic towards their general meeting rights in comparison to the UK because of concentrated shareholding pattern.

Brief Overview

The researcher aims to deal with the issue of passivity of institutional investors in corporate governance in India in comparison to UK. The shareholders in large corporations are "rationally apathetic" towards their general meeting rights and the stakeholders look up to the institutional investors for effective corporate governance. The research is focused around the power which institutional investors have without responsibility towards the benefit of the stakeholders of the companies in which they invest, despite of possessing expertise and vital information about the affairs of company. The present corporate governance system is not having enough incentive for the profit oriented institutional investors who are grappled with issue of liquidity versus control along with free rider problem. Apart from these the conflict of interest supports the inertia of institutional investors to limit themselves to returns only instead of active participation in company affairs.

This researcher highlights the comparative analysis of Indian and English legal regime governing the arena with highlights of Cadbury, Greenbury, Hampel and Higgs committee reports in the United Kingdom, similarly Kumar Mangalam Birla and Kotak Committee reports which emphasised that institutional investors are obliged to actively participate in corporate governance. The report will conceptualize on resolving the issue by providing statutory as well alternative changes keeping in view OECD Guidelines on Responsible Business and World Bank Recommendations on conduct of institutional investors like active cooperation between investors, incentive compensation, proper record of voting and engagement by the institutional investors coupled with the pivotal role which proxy advisory firms may play in swaying the voting behaviour and

involvement of institutional investors in India so as to strengthen the corporate governance structure in India.

INTRODUCTION

The remarkable work of Berle and Means begins with the statement that "corporations have ceased to be merely legal devices through which private individual business transactions may be carried out".[1] The shareholders in large corporations are "rationally apathetic" towards their general meeting rights and the stakeholders look up to the institutional investors.[2] In modern times also companies are not limited to individual transactions but have presence as a medium of structuring economic life. The influence of the transactions of a company can be felt both by the internal as well as external stakeholders[3]. The profit maximization motive of a company needs a well developed bifurcation of relation between individuals and company, and company and stakeholders at large. This work of separating the relation and fixing the responsibility seems easy but is quite tricky, given the fact that the corporate world is rapidly transforming.

The separation of ownership and control has emerged because of the complex nature of business and the issue encompasses the Board of Directors on one side and the

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[1] Adolf.A. Berle, and Means, THE MODERN CORPORATION AND PRIVATE PROPERTY, 10, (10TH Ed.2009)
[2] Gower and Davis, *Principles of Modern Company Law,* 415, (Tenth Edition 2018)
[3] Pinheiro R., *The Role of Internal and External Stakeholders.* In: Schwartzman S., Pinheiro R., Pillay P. (eds) HIGHER EDUCATION IN THE BRICS COUNTRIES, Vol.44. Springer, Dordrecht, (2015)

stakeholders. On the other side[4] in India, most of the companies are closely held by promoter or promoter group and the Anglo-Saxon Model that exists in US, UK and Australia are inapplicable in the scenario. The shareholders are proportionately small and are not in a position to keep a check on the powers and activities of the Board.

The corporate governance debate has produced a range of suggestions as to how the institutional investors might become more active shareholders. While Sykes proposes a "radical compact" between institutional Investors/ shareholders and the management of large companies, involving negotiation of 5 to 7 year performance targets for executive directors to which salary would be linked, appointment of institutional investor nominees as non executive directors.[5]

Gilson and Kraakman set out a slightly different scheme under which American institutions could elect professional non executive directors to a minority of positions on the board of quoted American companies. In each case the authors envisage no need for legislation for their proposals to be implemented. However, arrangements of this kind have not been observed in practice. The fact that these suggestions have not been observed in practice can be explained largely by reference to the economic incentives and disincentives facing institutional investors. There are numerous disincentives to the performance of detailed monitoring of investee companies.[6] The disincentives reflect what economists refer as agency costs and agency problem. This time from a number of factors, including

1. Liquidity instead of control
2. Lack of incentive
3. Free rider problem
4. The ownership structure
5. Conflict of interest
6. Indirect nature of investment
7. Short term interest

The legal position if a fund manager refuses to vote against, say, a contentious executive scheme proposed by a company's board because of conflict of interest? Or what if a fund manager chooses not to exercise voting rights delegated to it by a pension scheme Trustee client in order to maximize its own expenses? This paper focuses on the legal duties of the institutional investors which are mainly pension funds, unit trusts, foreign institutional investors, insurance and investment companies, and others in regard to corporate governance. The central issue is what extent does the law requires the investment managers and other fiduciaries to play an active role in corporate governance?

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[4] Adolf.A. Berle, and Means, THE MODERN CORPORATION AND PRIVATE PROPERTY, 1, (10TH Ed.2009)

[5] A Sykes, *Proposals for a Reformed System of Corporate Governance to Achieve Internationally Competitive Long-Term Performance*, CAPITAL MARKET AND CORPORATE GOVERNANCE, 111 (Oxford, Cladrendon Press, 1994)

[6] R.J. Gilson and R. Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, Vol.43 STANFORD LAW REVIEW, 863, (1991)

The main corporate governance problem in India is that of controlling the dominant shareholder protection of minority shareholders and other stakeholders as well.

Nowadays, the role of institutional investors is highly debatable because of the fact of the large Investments and no responsibility as a shareholder. The institutional investors have expertise knowledge and capacity keep an effective check on the company in which they invest but there inertia because of the above stated reasons is giving rise to corporate scandals for example, the Satyam scam, Lehman brothers and several other cases.

Hence, there is urgent need to harmonize the issues of corporate governance, so that the institutional investors also feel motivated to participate in corporate governance.

There appears to be two main factor this public concerns

First, feeling that the country is under-performing economically and this lack of competitiveness is in some way attributable to floors in the way companies are operated[7].

Second, there is a concern that the total remuneration packages of directors senior corporate executive are increasing at too rapid a rate[8].

To solve the various issues involved in corporate governance in UK and India, a battery of committees[9] were formed and the recommendations are as follows:

1. In 1991, the Cadbury Committee was formed by the Stock Exchange, Financial and Reporting Council under Sir Adrian Cadbury. While the Cadbury Committee Report has not been implemented by legislation it has secured strong backing. Questions arise concerning the role of institutions in promoting a greater measure of corporate accountability. While inertia maybe a comfortable pillow it has been suggested that institutional investors should be more proactive in securing compliance of various voluntary codes of practice. the Cadbury committee report itself exhorts institutional investors/shareholders[10] and says
"The importance of their collective stake will look to the institutions with the backing of institutional investors committee, use their influence as owners the companies in which they invested comply with the code... the obligation on companies to comply with the code provides institutional and individual shareholders with a ready-made agenda for their representations to boards. It is up to them to put it to good use. The committee is primarily looking to such market based regulation to turn its proposals into action."

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[7] http://www.ecgi.org/codes/documents/hampel.pdf (Last visited on April 19, 2019)
[8] *Id.*
[9] Shiekh and Rees, CORPORATE GOVERNANCE & CORPORATE CONTROL, 1995. The preliminary report of the *Committee on Corporate Governance* was published in August 1997 and the final report was published in January 1998.
[10] https://law.unimelb.edu.au/__data/assets/pdf_file/0017/1710260/150-CorporateGroupsResearchReport1.pdf (Last visited on April 20, 2019)

2. In 1998, the Hampel Committee was formed and in its report it stated that Institutional Investors do not take interest in Corporate Governance and usually do not exercise their voting rights[11](Para 5.2). It also stated that it is not practically possible for the private individuals to have the same amount of information as that of institutional investors (Para 5.24)[12]. Finally, it recommended that the Institutional Investors should use their voting power but did not recommend for making it mandatory (Para 34)[13].
3. In 2003, the Higgs Committee was also of the opinion that Myners Review on Institutional Investment which (Para 1.16) expressed reluctance and concern over the underperformance of Institutional investors has not changed based on analysis of FTSE 350 Companies (Para 3.7). It also observed that Non-executive directors should question the proposal of the board (Para 15.20). Similar was the opinion of the Smith Report of 2003, both were appointed by the UK Government.[14]
4. Indian Committees on Corporate Governance (The researcher is limiting the scope to Kumar Mangalam Birla and Kotak Committee)
   The Kumar Mangalam Birla committee on corporate governance (SEBI committee) similarly emphasizes the role that the institutional shareholders can play in the corporate governance system of a company. "... in view of the Committee, the institutional shareholders put to good use their voting power...".[15](Para 14.14)
   The Kotak Committee of 2017, emphasized for a Stewardship Code for Mutual Funds and also stated that the Stewardship Code is already existing for the Insurance Companies i.e. The Code issued by IRDAI in March 2017(Para 1 and 2). It also recommended for comprehensive policies on discharge of Stewardship responsibilities.[16]
5. World Bank and OECD in brief recommended that[17]
   a. To provide soft incentives to institutional investors and issue some guidelines on comply or explain basis. (Principle 1.G of OECD Guidelines)
   b. To disclose the material conflict of interests as the institutional investors act in fiduciary capacity.

The question arises to what extent can institutional shareholders intervene in the management of Companies? How effective a say can and do they have in the running of Companies? To answer this question adequately a number of legal issues must be addressed.

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[11] http://www.ecgi.org/codes/documents/hampel.pdf (Last visited on April 19, 2019)
[12] *Id.*
[13] *Id.*
[14] http://www.ecgi.org/codes/documents/higgsreport.pdf (Last visited on May 1, 2019)
[15] http://www.nfcg.in/UserFiles/kumarmbirla1999.pdf (Last visited on April 19, 2019)
[16] https://www.sebi.gov.in/reports/reports/oct-2017/report-of-the-committee-on-corporate governance_36177.html, Pg.93 (Last visited on April 9, 2019)
[17] https://www.icsi.edu/WebModules/PP-EGAS-2016%20-%20Full%20Book%20(2)%2002feb2016.pdf (Last visited on April 9, 2019)

I. LEGAL FRAMEWORK AND MARKET MECHANISMS

This chapter will introduce the existing legal framework and market mechanisms for effective corporate governance in India along with an overview of the existing corporate governance debate in India.

1.1 Context of Corporate Governance and Institutional Investors

The problem of corporate governance in India is not similar to US and UK. The concentrated nature of shareholding and emerging capital market mechanism is different from other countries. Even after liberalization the first code of corporate governance came in 1998[18], inspired by US and UK. In 2000, SEBI introduced clause 49 for better corporate governance on the Birla Committee report which was on listing agreement, again a replication of US and UK.[19]

In the aftermath of Satyam scandal in 2009, the government was shocked and consequently the government came out with 2013 Act which enshrined several provisions to improve corporate governance along with parallel amendments and changes by SEBI[20]. The corporate governance problem in India arises out of the nexus that exists between majority and management through the nominees of the majority shareholders.

1.2 Power Structure

The board of directors is vested with enormous executive powers and the General Meeting has legislative powers. The General Meeting cannot interfere with the board of director's function but has power to remove the director by simple majority or ordinary resolution[21] and the General Meeting can also alter the Articles of Association by a special majority. The public listed companies have both executive and non executive directors[22] who delegate some power of Management to senior management viz. MD and CEO. The corporate strategies are made by the board of directors but the implementation is done by the management. With the induction of non executive director (independent directors) on board, the Companies Act fiduciary duties[23] on the directors to act in good faith and best interest of the company as well as the stakeholders.[24]

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[18] http://www.ecgi.org/codes/documents/desirable_corporate_governance240902.pdf (Last visited on March 21, 2019)
[19] https://www.sebi.gov.in/sebi_data/commondocs/cir2803an1_p.pdf (Last visited on March 21, 2019)
[20] In 2014, SEBI amended Clause 49 of the Listing Agreement and in 2015 SEBI came out with SEBI(Listing and Disclosure Requirement), 2015
[21] Sec.169 of Companies Act, 2013
[22] Sec.149 of Companies Act, 2013
[23] Sec.166 of Companies Act, 2013
[24] Gower and Davis, *Principles of Modern Company Law,* 414, (Tenth Edition 2018)

1.3 Agency Problems and Agency Costs

The size and scale of business enhances the agency costs, bonding cost, monitoring cost and residual cost. According to Kraakman[25], there are three types of agency problems, the conflict of interest between 1. Manager [agent] and owner [principle] 2. Controlling shareholder [agent] and minority shareholder [principle] 3. Company itself [agent] and stakeholders like creditors, employees and customers [principle] and others.[26] Now from these agency costs, there arises a question as to why the corporate structure is used even after the agency costs involved. The solution lies in the internal and external monitoring devices curtailing such costs which are as follows:

1. Market Mechanisms like fear of takeover and fear of shut down. The fundraising and incentives of the management is also dependent on the efficiency of corporate governance the underperformers will be replaced by efficient management (in a way managers monitor the managers of other companies).[27]
2. Corporate financial policy.[28]
3. Mandatory disclosure of information to General Meeting and to stock exchanges.[29]
4. Audit by statutory auditor[30] and the audit committee.[31]
5. Non executive director also serve as a check on the management of the company by board of directors.[32]
6. General Meeting and shareholding monitoring which can remove a director and also there is check by institutional investors.[33]
7. Director's fiduciary duties are also a check on the acts of directors working against the company and stakeholder interest.[34]
8. Fear of Investigation and inspection by SFIO or criminal or the court in case of a public interest litigation or special resolution.[35] In case of public listed companies, SEBI can investigate and also penalize the persons at fault.[36]

1.4 Efficiency of present corporate governance regime in India

The outsider model[37] replicated in Indian context is unable to tackle the issues involved in the insider model[38] based Indian companies and it has given rise to many issues.

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[25] Reiner Kraakman *et al*, THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 22 (Oxford:OUP, 2017)
[26] Micheal C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, Vol.3 JOURNAL OF FINANCIAL ECONOMICS, 305, (1976)
[27] H.G. Manne, *Mergers and Market for Capital Control*, Vol.73 JPOL.ECON., 110, (1965)
[28] F.H. Easterbook, *Two Agency Cost Explanation of Dividend,* Vol.74 AMERICAN ECONOMIC REVIEW, 650, (1984)
[29] Sec.134 of Companies Act, 2013
[30] Sec.139 of Companies Act, 2013
[31] Sec.177 of Companies Act, 2013
[32] Sec.149 of Companies Act, 2013
[33] Sec.169 of Companies Act, 2013
[34] Sec.166 of Companies Act, 2013
[35] Sec.206 to Sec.246 of Companies Act, 2013
[36] SEBI Act of 1992

However the outsider model will not fit in the Indian structure of Corporation because the dispute is not between the management and the shareholders but rather the majority shareholders (agent) and the minority shareholders (Principle). The brute majority of the controlling shareholder is negating the presence of independent director on board.

Under such circumstances the probity of the auditors is also questionable. The presence of an independent director in the audit committee will not be fruitful as the Independence itself is a big question mark. Similarly, the market mechanism will not be effective in Indian context where the Corporations are closely held and the promoter of the promoter group is in a position to rebut any takeover attempt.[39]

Further, the monitoring mechanisms by managers will also have minimum effect as there is new demarcation between ownership and management in Indian companies.

II. TOPOLOGY OF INSTITUTIONAL INVESTORS IN INDIA

This part will discuss the role of institutional investors in corporate governance and topology of institutional investors in India.

Topology of institutional investors in India has been described as follows:

Institutional Investors are financial institutions that gather money from the public and invest them in capital market. They accept the fund from the third parties and invest in their own name but on behalf of third parties. Institutional investor giving external finance to Indian listed company can be into lending and investment institution. in India, the landscape of institutional investors can be studied in two phases:
First phase is before 1991 and the second phase is after 1991. The institutional investors in India can be broad categories for the purpose of this study; these are Mutual Fund, Foreign portfolio investors and Insurance Companies.

2.1 Mutual funds

In India Mutual fund is one of the significant institutional investor which invests in security market. The mutual fund industry in India was Monopoly still 1990 with only Unit Trust of India as sole mutual fund operating in India. It was only in 1988, that certain banks were allowed to run mutual fund business in India. However after 1991, the mutual fund

[37] The outsider model of corporate governance is represented by the companies with diffused shareholding nearby large number of shareholder holder small number of shares each, of them holding a controlling or dominating stake.
[38] The insider model of corporate governance is represented by the company is concentrated shareholding whereby single shareholder or group shareholder holds a dominant controlling stakes in the company.
[39] Varottil Umakanth, *The Nature of Market of Corporate Control in India,* NUS Working Paper 2015/011

industry has been opened for private sector and thereafter the mutual fund industry in India is constantly flourishing and developing. Today, the assets under management of mutual fund industry are around 15 trillion as on March 2018. It has grown around 13 percent from the last year when is it event of mutual fund industry where 14.06 trillion. There are 44 Asset Management companies in India with 70 % of market concentrated in hands of top 7 Asset Management companies. The overall growth can be seen below:

Table 1 Growth of Mutual Fund Industry in India: Source website of All India Mutual Fund Industry Association https://www.amfiindia.com/indian-mutual

Year	Assets under Management [in cr]
2004	139616
2005	149554
2006	231862
2007	326388
2008	505152
2009	417300
2010	613979
2011	700538
2012	664792
2013	816657
2014	1211000
2015	1355000
2016	1764700
2017	20 trillion (August 2018)
2018	23.06 trillion (July 2018)

As the size of mutual fund industry has increased their share holding in companies has also increased. The share of mutual fund in India in the top 100 listed companies on Bombay Stock Exchange comes around 5 %.

2.2 Foreign Portfolio Investors

Besides domestic Financial Institutions, the other groups of institutional investor's significant impact on the Indian market also called foreign institutional investors. The holding of foreign institutional investors in the top 100 companies of Bombay Stock Exchange is around 25 %. This significant foreign portfolio investment in India clearly shows their ability to monitor the corporate governance.

The foreign portfolio investment in the Indian companies has been continuously rising since the opening up of economy. FIIs are generally mutual fund Pension Fund refund, financial institution, and others. FIIs in India are regulated by foreign portfolio regulation 2014 which mainly provides for the registration and certain disclosures which is not relevant for the corporate governance. Since the FII are the investors situated outside India and most of the funds are of NRIs the regulation in India concerning them are only restricted to investment limit and source of fund and not related to corporate governance

at all. However, they enjoy all the shareholders rights and privileges granted under Companies Act and SEBI regulations. The participation of foreign institutional investors in India is as mentioned below:

Table 2 Total Investment of FIIs in India Source: https://www.fpi.nsdl.co.in/Reports/Yearwise.aspx?RptType=6

Year	FII investment (in cr)
2012	163347.9
2013	62286
2014	256213
2015	63663
2016	23079
2017	200048
2018 (upto 22nd August 2018)	40195

2.3 Insurance companies

The third most important institutional investors in the Indian listed companies are from the Insurance sector. The Insurance sector led by Life Insurance Corporation of India is the biggest state owned public Insurance Company, which has substantial Holdings in almost all the top hundred listed companies in the Bombay Stock Exchange.

III. CORPORATE GOVERNANCE FROM INSTITUTIONAL INVESTORS PERSPECTIVE

This part will throw light on the corporate governance perspective from institutional investors view.
In India, as the retail investors are usually passive[40] in monitoring the conduct of the corporations, the institutional investors can be a game changer from the corporate governance perspective. The role that institutional investor play in active corporate governance of a company read under the following two headings

3.1 Shareholder rights/ Voting rights

The existence of controlling shareholding in the promoter group makes the exercise of these rights meaningless. This doesn't mean institutional investors should remain passive. The ownership structure of the Indian Corporations is such that the institutional investors can still play an active role from the corporate governance perspective. The average holding of institutional investors together with individual shareholders in large

[40] Gower and Davis, *Principles of Modern Company Law,* 413, (Tenth Edition 2018)

corporations is around 40 to 45 percent.[41] This surely means that promoters cannot get through any special resolution without the support of the institutional investors. The institutional investors in India can no longer afford to hide behind the argument that they don't have controlling interest.

Thus, by aligning along with the shareholders, the institutional investors must play an active role in corporate governance.

3.2 Coordinated Investing

Outside the legal arena the institutional investors can involve in what is known as coordinated investing or relational investing. The institutional investors hold large comic power and must use this leverage in public listed companies to enhance the corporate governance regime in India. Therefore, the economic and capital requirement of a company puts the institutional investors at a higher pedestal and enables them to use that clout to promote an efficient management. Further, if the management doesn't to the demand of the institutional investor they have the option to sell the shares which would lead to fall in prices and thereby harm corporate reputation of the company. This economic clout, if properly used can give the position of a pressure group to the institutional investors in large corporations and thus, can avoid the incentive problem by collective action[42].

IV. PROBLEMS OF INSTITUTIONAL MONITORING AND CORPORATE GOVERNANCE

This part will focus on the problems of institutional monitoring and corporate governance.

The issues faced by institutional investor in monitoring the Governance of a company in India are as follows:

4.1 Liquidity versus Control Dilemma

Most of the institutional investors follow a short-term approach which is oriented towards capital appreciation and not towards corporate governance. The problem of liquidity is highly prevalent open ended Mutual Fund which has to give the redeem option to every investor customer / investor want to sell his share or investment. Thus, most Mutual Funds are active traders and would hesitate to make any investment where the liquidation of assets would be a problem. In addition to this because the mutual funds

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[41] Porter P. David, *Institutional Investor and their role in Corporate Governance: Reflection By a Recovering Corporate Governance Lawyers*, Vol.59 CASE WESTERN RESERVE LAW REVIEW, 627, (2008-2009)

[42] Mary Stokes, *Company Law and Legal Theory*, THE LAW OF BUSINESS ENTERPRISE, Sally Wheeler, OUP, 80-116, 97, (1986)

complete for customers based on their outperform their competitors[43], they are least interested in corporate governance issues.

4.2 Incentive and objectives of institutional investors

The lack of institutional investor's apathy in the governance of corporations is because; it is easy to dump the stocks rather than to participate in the governance of the corporations. When the structure of a corporation is seen from the perspective in which institutional investors function in India except insurance companies all other are responsible to the owner of the funds.

Hence, the primary reason for the apathy is the insufficiency of existing incentive to motivate the institutional investor to monitor the corporate management.

As has been rightly described by Hutton, that institutional investors have become classic absentee landlords, exerting power without responsibility and making not recognizing their reciprocal obligations as owners.[44]

4.3 Insider trading

The institutional investors, in case they become aware about something wrong or some poor governance practice in the corporation, then they will have two options either to sell their shares and move out or they will get actively involved in the affairs of the company.[45]

If nobody is aware about the information in the former option then the institutional investors may be held liable for insider trading. The latter option will be foolish as the share prices will fall as soon as the information is disclosed in the market and ultimately the Institutional Investors will be at loss by selling the shares at a lower price.[46]

4.4 Free Rider problem

Free Rider problem is another hurdle in India as the cost of monitoring with be incurred by one institutional investor and the benefits will be shared by every institutional investor which has invested in the company, the collective action problem views that the cost of organizing the dispersed shareholders will be high and makes them rationally apathetic about the participation in the Governance of the company. Hence, the existence of Free Rider problems makes it even more difficult for the institutional investor's to take an active part in corporate governance because of a competitive market.

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[43] Coffee C. John, Liquidity Vs Control: The Institutional Investor as Corporate Monitor, Vol.91 COLUMBIA LAW REVIEW, 1277, (1991)

[44] Testimony before Senate Committee On Interstate Commerce, 62nd Congress, 2nd Session, Hearings On Control of Corporations, Persons and Firms Engaged in Interstate Commerce, 1(Part XVI), pp. 1146-91. (14-16 December 1911) quoted by Monks and Minow, *Corporate Governance,* 117, (1995)

[45] https://www.nseindia.com/content/research/Paper42.pdf (Last visited on August 21, 2018)

[46] *Id.*

4.5 Ownership structure

If we study the top 100 listed companies in Bombay Stock Exchange and National Stock Exchange, it depends are clear picture majority of the shares are owned by the promoter and Promoter groups which makes any intervention by the institutional investors redundant. [Except in cases of special resolutions]

4.6 Conflict of Interests

Conflict of interest is another hurdle for the institutional investors in Governance of the investee company. Private contracting between the fund manager and the investors, however, is subject to the legal provision that the fund manager is entitled to "the right arising from investment of the funds, assets into securities". This means that voting and other shareholder rights attached to the shares are all conferred upon the fund manager. The way in which the fund manager exercises the shareholder rights on behalf of the fund investors, however, has not been regulated in India. The SEBI Guidelines only prescribe mutual fund accounting policy and disclosure regarding the exercise of that right to the unit holders.

4.7 Applicability of Coase Theorem

The Coase theorem is an economic analysis of law which states that an efficient allocation of resources will occur through market transactions, even if the initial allocation made by the law is inefficient, as long as the transaction costs are zero and the parties negotiate cooperatively.[47] This theorem will not be applicable in case of institutional investors because they have an incentive not to disclose the information about the company to the outsiders because of the impediments stated above, dissemination or transparency on the part of such investors will have a negative impact on their present day working style and will also come along with huge transaction costs.

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[47] Andrew Altman, *Arguing About Law,* An Introduction to Legal Philosophy, 2nd Edition, Wadsworth Publishing Company, Chapter 6, Page 182.

V. AN ATTEMPT TO SOLVE THE ISSUES CONCERNING THE PARTICIPATION OF INSTITUTIONAL INVESTORS IN INDIA

This part will make an attempt to solve the issues concerning the participation institutional investors in India, and the suggestions are as follows:

5.1 Nexus between investors

The collective action of all the investors can avoid the Free Rider problem. However, the SAST Regulations in India has disclosure norms to prevent person from acting in concert and abusing the market.

5.2 Promoting Incentive based Compensation

A fixed incentive for all the institutional investors regardless of their participation is serving as a disincentive for the investor who wants to or who actively get involved in the affairs of the Corporation. Both in mutual fund as well as Pension Fund industry, the fund manager is compensated in terms of the percentage of assets under their control.[48] Therefore, it is argued that incentive compensation based on capital appreciation would be a much effective way to avoid compensation and enhance the participation of institutional investors in India.

5.3 Voting and Engagement Record Keeping

The passive nature of institutional investors can be eliminated which mandatory disclosure requirements concerning the exercise of voting rights. As the information will be in public domain, the institutional investors will be compelled or can be pressurized by the primary investors.

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[48] SEBI (MUTUAL FUND) REGULATION 1996, Regulation 52(2)- "The Asset Management Company make charge the Mutual Fund with investment and advisory fees which are fully disclosed in the offer document subject to the following namely:
i. one and a quarter one percent of the weekly average net assets out outstanding in each accounting year for the scheme concerned, as long as the net assets do not exceed rupees hundred crores, and
ii. one percent of the excess amount of over rupees hundred crores, net assets so calculated exceed rupees hundred crores.
Provided that in case of an index fund scheme, investment and advisory fees shall not exceed 3/4th of one percent of the weekly average net assets."

SEBI in March 15, 2010[49] made it mandatory for all asset management companies in India published year draft policy and procedure for exercising the shareholders rights held by them. To comply with the above guidelines most of the mutual funds in India have disclosed their voting policies as well as voting decision to the ultimate beneficiary. These policies mainly provide for the formation of the committee consisting of senior managers of asset management companies for deciding the issue of proxy voting.

The perusal of these policies gives us an insight that various Asset Management companies in India will vote only on the decision which may affect unit holder's interest otherwise they will abstain from voting. With respect to appointment and removal of directors it provides that Asset Management companies will support the appointment of a competent independent director. When it comes to managerial compensation the Asset Management companies usually support the respective committee as prescribed in law. With regard to shareholder proposal The Stand taken by Asset Management companies is passive in general and for all other purposes the voting is done keeping in mind the interests of the unit holders.

However the survey conducted by the proxy advisor firm in shows that the mutual fund in India mainly remains passive while voting at the investee companies meeting. The survey covers the Annual General Meeting, postal ballot, Court convened meeting and extraordinary General Meeting of the investee companies between 2012 and 2013. The objective of the survey was to get an in depth analysis all the voting pattern by various mutual funds to enhance the ambit of corporate governance in India.

Table 3 Voting Pattern of Mutual Funds in 2012-13 over 5460 Meetings: 3724 AGM, 858PBs, 323 CCMs and 555 EGMs. Source: http://www.ingovern.com/wp-content/uploads/2013/08/Mutual-Funds-Voting-Patterns-2013-Analysis.pdf

Type of Meeting	No. of Resolutions	Voted For	Voted ABSTAINED	Voted AGAINST
AGMs	25,061	11,719	13,037	305
PBs	1890	927	890	73
CCMs	344	154	175	15
EGMS	995	478	479	38
TOTAL	28,290	13,278	14,581	431

The analysis of the above mentioned data clearly indicates that in most of the resolutions the institutional investors have either voted for or abstained from voting. The number of resolutions voted against comparatively very low. In terms of percentage only around 1.5 percent all the resolutions presented by the investee companies where voted against. On

[49] SEBI Circular SEBI/IMD/CIR No 18/198647/2010 Dated March 15, 2010

the other hand, the Asset Management companies have voted in 47 percent of the resolutions and extend in 51.5 percent of the resolutions.[50]

Therefore, even after having circular by SEBI for the voting policies and disclosure requirements for mutual funds in the investee companies, they have still remained dormant.

This clearly shows that the institutional investors should be promoted to exercise their voting rights and ensure a robust corporate governance regime in India.

5.4 Impact of Proxy Advisor or Proxy Advisory Firms

In a recent development, with the advent of proxy advisor, the companies are facing greater pressure from these investors to confirm with good corporate governance practices. The proxy advisory firms are certainly beneficial for the institutional investors who may not be very inclined to do their own research on every proposal of the investee company. These firms reduce the Free Rider problem because most of the institutional investors will act on the research which is provided by these firms without any fear of extra expenses and Free Rider problem.[51] Moreover, institutional investors can avoid conflict of interests by shifting the onus on the advice given by the firms. The proxy advisory in India is at a nascent stage. However, this doesn't mean that proxy advisory firm in India has remained ineffective in ensuring better corporate governance.

5.5 Implementation of a Stewardship Code on the lines of the UK Stewardship Code

UK's Stewardship Code achieved "success" as a "soft law" when it was introduced in 2010. Now, a revised version of the Code has been promulgated, like the UK Corporate Governance Code, on a "comply or explain" basis.[52]

The Code is addressed in the first instance to the fund managers – that is, firms who manage assets on behalf of institutional shareholders such as pension funds, insurance companies, investment trusts and other collective investment vehicles. It sets out good practice on engagement with investee companies, with the goal of helping to improve long term returns to shareholders and the effective exercise of corporate governance responsibilities.[53]

The FRC expects firms subject to the Code to disseminate on their websites how they have applied the Code. However, the responsibility for monitoring company performance does not rest on the fund managers alone, and to that end the Code refers to "institutional investors" generally, and the FRC strongly encourages all institutional investors to report if and how they have complied with the Code. For example, pension

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[50] http://www.ingovern.com/wp-content/uploads/2013/08/Mutual-Funds-Voting-Patterns-2013-Analysis.pdf (Last visited on May 2, 2019)

[51] Gower and Davis, *Principles of Modern Company Law,* 416, (Tenth Edition 2018)

[52] *Id* at 418.

[53] *Id.*

fund trustees and other owners can comply directly or indirectly through the mandates given to fund managers.[54]

VI. CASE STUDIES

1. HDFC - Deepak Parekh Case

Issue

The issue in the present case was with respect to the AGM vote for the reappointment of Mr. Deepak Parekh as non-executive director.[55] The foreign institutional investors voted against Deepak Parekh on the advice of foreign proxy advisory firms.

Rule

According to the Companies Act of 2013, a person can be a director of maximum 20 companies but this provision comes with a proviso which states that the number shall not be more than 10 in case of public companies or private companies that are either a holding or a subsidiary of a public company[56] and further the articles of association can mention the age of retirement for directors, in the absence of which the directors will retire on a rotational basis by the end of every annual general meeting.[57] In the present case, Deepak Parekh needed a special majority/resolution because the age for retirement specified in the articles of association was 75[58] and during his candidature for reappointment he was already 74 years old.

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[54] B. Cheffins, *The Stewardship Code's Achilles' Heel* (2010) 73 M.L.R. 1004.

[55] https://www.livemint.com/Companies/QoOq7HtAt8a2odrQSIn3tL/Deepak-Parekh-HDFC-investors-voted-against-me-due-to-direct.html (Last accessed on May 3, 2019)

[56] Section 149 (1) of Companies Act, 2013

[57] Section 152 of Companies Act, 2013

[58] Public Notice by HDFC which clearly specifies the age of retirement of directors as 75 available at https://images.hdfc.com/s3fspublic/Full%20Notice_2018_1.pdf?AiVoL0VWWZfjhikRD7b5VikMuT_3S7wG (Last accessed on May 3, 2019)

Analysis

The Institutional Shareholder Services LC (ISS) and Glass Lewis, US based proxy advisory firms advised the foreign institutional investors to vote against Deepak Parekh because of three reasons, first being that Parekh holds directorship in around seven different companies *viz.* DP World, Siemens, Indian Hotels Ltd, Vedanta, HDFC Life, Vedanta Resources and HDFC Ltd. which in the opinion of the proxy advisory firm is too much and secondly the proxy advisory firm stated that it doesn't see proper succession planning in the company after Deepak Parekh and lastly the institutional investors were of the view that the board was not independent enough under him.[59] According to the company sources, Mr. Deepak Parekh received 75.14 percent votes in the shareholders meet held on 30th July, 2018.[60]

Conclusion

This case manifests that the foreign institutional investors are becoming active in the exercise of their general meeting rights but the same is not the case with domestic institutional investors who totally supported Mr. Deepak Parekh, this is where the law needs to intervene.

2. TCI Fund Management Ltd. vs. Coal India Case

Issue

This case started in the year 2012[61] and involved a Public Sector Undertaking called Coal India Ltd. in which, Government of India held around 90 percent of shares and the rest 10 percent was held by public shareholders. Now, there was a United Kingdom based institutional investor called The Children's Investment (TCI) Fund Management Ltd. which held 1 percent shares in Coal India Ltd. So this is a case where the government holds 90 percent and TCIF holds 1 percent.[62]

The principle business of Coal India Ltd was extracting coal for both internal consumption as well as exportation to other nations. The question is why would a foreign investor invest in Coal India Ltd. and the answer is that it is willing to get the coal at market value or normal value and have a say in the decisions of the company. Interestingly Coal India's biggest clients within India are thermal power plants, electricity companies manufacturing plants and Indian Railways amongst many others, and the ultimate consumers of these units are normal public who pay less for these services. If we pay

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[59]https://www.livemint.com/Companies/QoOq7HtAt8a2odrQSIn3tL/Deepak-Parekh-HDFC-investors-voted-against-me-due-to-direct.html (Last accessed on May 3, 2019)

[60] *Id.*

[61] http://www.ingovern.com/wp-content/uploads/2012/05/India-Today-7th-May-2012.pdf (Last accessed on May 3, 2019)

[62]http://tari.co.in/wp-content/uploads/2014/02/1344248025Corporate-Governance-Issues-with-Coal-India-and-its-minority-shareholders-06082012.pdf(Last accessed on May 6, 2019)

less for our power then Coal India will be forced to sell its coal at a lower/subsidized price decided by the board of directors under the influence of the nominees of government.[63]

Analysis and Rule

So the case involves around the question as to what should be considered as the '*benefit*' of the company and its shareholders. Consequently, TCIF wanted Coal India Ltd to sell its coal at market price to benefit the shareholders and was of the opinion that it is the responsibility of the board to sell the coal at market price and not at a subsidized rate.[64] The government argued that its objective is not only profit earning but consumer welfare as well.

TCI fund ltd approached the court stating that the directors have not acted according to their fiduciary duties by following the instructions of the government and interesting two things are important firstly, in government companies have government nominees on the board of its companies as a shareholder and secondly, the government can issue instructions to the board of Public Sector undertakings. Therefore, government took a stand that on the basis of the prospectus through which TCIF invested in Coal India Ltd. and all of these conditions were mentioned in it as risk factors "that government will issue instructions to the board", being unsatisfied by the reasoning TCIF approached the court through derivative action suit in Calcutta High Court which admitted the suit but after 2 years TCIF sold its shares[65] and the action became in fructuous.

Conclusion

Even though TCIF sold its shares and went off but in the process Coal India Ltd. renegotiated many of its contracts and therefore the transfer of value from shareholders to consumers (stakeholders) was reduced but interestingly all this happened before Section 166(2) of the Companies Act the game would be interesting to see if a similar case against Coal India Ltd. comes to court.[66]

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[63]http://ak57.in/wp-content/uploads//2012/03/Letter-to-Board-of-CIL-from-TCI-March-12th-2012-docx.pdf(Last accessed on May 5, 2019)
[64] https://www.nseindia.com/research/content/res_QB1.pdf(Last accessed on May 3, 2019)
[65]https://www.firstpost.com/business/money/we-are-like-that-only-why-the-children-investmentfunds-exit-from-coal-india-matters-1994061.html(Last accessed on May 4, 2019)
[66]https://barandbench.com/wp-content/uploads/2016/11/Presidential-Directive-to-Ease-Coal-Supply.pdf(Last accessed on May 7, 2019)

CONCLUSION

It is important to conceptualize that mis-governance is not the sole fault of institutional investors. Institutional investors in India have a passive role but the scenario is changing with time and due to intervention by SEBI. The institutional investors in India still go for 'exit' instead of 'voice'. The lack of apathy of institutional investors cannot be entirely blamed on them as there are many legal, structural and economic hurdles for promoting such passivity.

Further, the market mechanisms in India are not similar to the developed countries and do not provide an effective check on the corporations with insider model. There has been substantial evidence to support that institutional investor can keep a check on the corporations to ensure transparency and effective corporate governance.

The researcher also attempts to provide that efficient policy for voting and proxy firms is required in India. These policy interventions, whether voluntary or mandatory will have an effect on the role played by the institutional investors in corporate governance to avoid conflict of interest and Free Rider problem. The implementation of the Kotak Committee recommendations is necessary for resolving some of the issues that the institutional investors face in India.

The regulation for institutional investors like Mutual Funds should be mandatory as they are profit driven and their performance in terms of capital appreciation is constantly monitored. On the other hand, pension funds and insurance companies are usually long term investors as they do not have an obligation to confide their performance in short-term giving them more space to participate in corporate governance.

Finally, the role of institutional investors cannot be ignored as they are having economic clout in corporations resulting in power without responsibility. The need of the hour is to make regulatory intervention to use the expertise and knowledge possessed by the institutional investors. From the fundraising point of view, an effective role by institutional investors can attract foreign direct investment to Indian economy.
The last suggestion is to implement a Stewardship Code in India on the lines of Kotak Committee Recommendations and UK Stewardship Code, 2012 to reduce the passive behavior of the institutional investors in India.

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Annexure 1

TO WHOM AND BY WHOM ARE THE DUTIES OWED?

To whom are the general duties owed and who can sue for their breach?

The company

straightforward alignment between directors' duties being owed to the company and the company being able to sue for their breach is clearly crucial in maintaining the incentive structures underpinning directors duties. This requires some careful thought about the rules of attribution in company law. In particular, even though a director's wrongdoing is commonly attributed to the company to make the company a wrongdoer and subject to claims brought by third parties, those same attribution rules do not necessarily apply when the company sues its directors. If they did, the company's action might be blocked on the grounds of consent or illegality. It is now recognised, in both civil' and criminal8 law, that to block the company's action against the director on the grounds that the company was is some sense party to the illegality, or knew of and consented to the wrong, would be to undermine the duties owed by directors to their companies and that, except for rare cases,9 this is not the law. Although the fact that it is not the law seems so sensible as not to merit debate, the reason why this is so is less clearly articulated than might be hoped. When, if ever, is a director's act, knowledge, or intention to be attributed to a claimant company? In Bilta (UK) Ltd (In Liquidation) v Nazir, Lord Neuberger put it this wayl°:

"the question is simply an open one: whether or not it is appropriate to attribute an action by, or a state of mind of, a company director or agent to the company or the agent's principal in relation to a particular claim against the company or the principal must depend on the nature and factual context of the claim in question."

A little more guidance will undoubtedly become necessary as more cases test the boundaries, especially in the face of the contrary findings in Safeway Stores Ltd v Twigger." A workable rule of attribution is ideally one which applies generally to individuals, not exclusively to directors, and applies whether the company is a claimant or a defendant. One suggestion is simply that no individual can benefit

7 Bilta (UK) Ltd (In Liquidation) v Nazir [2015] UKSC 23; [2016] A.C. 1 SC at [7]. Attorney-General's Reference (No.2 of 1982) [1984] Q.B. 624 CA; R. v Phillipou (1989) 89 Cr.App.R. 290 CA; R. v Rozeik [1996] B.C.C. 271 CA. 9 The standout exception is Safeway Stores Ltd v Twigger [2010] EWCA Civ 1472 CA, which looks increasingly difficult to justify. The question the court had to answer, and one it conceded was difficult, was whether, if a company had been fixed with the improper intentions of its company officers and subjected to a regulatory sanction (under the Competition Act), could it then seek an indemnity from those same defaulting officers? The answer might seem simple: that the breach of duty by the officers had caused the company a loss, for which it could seek compensation. But this possibility was decisively rejected by the Court of Appeal.

The policy underpinning the Competition Act 1998 was to impose "personal" sanctions on firms, the court held, and this liability could not then be offloaded onto individuals. To reach this end, the court relied on the illegality defence (i.e. the disqualifying principle of ex turpi causa). This decision was considered by the Supreme Court in Bilta (UK) Ltd an Liquidation) v Nazir [2015] UKSC 23; [2016] A.C, 1, and although its correctness was not seriously challenged, its relevance and effect seem now very much confined to the statutory competition code (and its underlying policy): see [83] (Lord Sumption JSC) and [157]—[162] (Lords Toulson and Hodge JJSC), with whom Lord Neuberger PSC seemingly agreed though not expressing any conclusive view ([31]), to BIlta (UK) Ltd (In Liquidation) v Nazir [2015] UKSC 23; [2016] A.C. 1 SC at [9], expressly agreeing with agree with Lord Mnnce's analysis at [37]—[44]. Safeway sitnw Lid v nvigger [2010] EWCA Civ 1472 CA, and also see fn,9, above. in Bilta,(UK) Lid (In Liquidation) v1Vcrzir [2015] UKSC 23; [2016] A.C. 1 SC, Lord Neuberger said, at [31], that he "would take a great deal of persuading that the Court of Appeal did not arrive at the Correct conclusion in [the Safeway] case". However, Lords Toulsory and Hodge were more critical: paras [157]-[162]; [466]

from claims which rely on their own acts counting as corporate acts so as to give them either a claim or a defence against the company.'2 This would explain most of the decided cases, but not all.'3

Individual shareholders We shall leave the derivative action until Ch.17. However, we need to touch briefly on the question of duties owed by directors directly to individual shareholders. It is clear that the statutory duties are owed only to the company, but equally clear that the Act does not purport to answer the question whether fiduciary or other duties are owed by the directors to shareholders individually. That issue is left to the common law. Traditionally, and still today, the common law has been reluctant to recognise directors' general duties as being owed to shareholders individually. This is hardly surprising. Recognition of duties owed individually would undermine the collective nature of the shareholders' association in a company. It would also undermine the rule that the duties are owed to and are enforceable by the company. If the directors owed to individual shareholders a set of duties parallel to those owed by them to the company, the restrictions on the derivative action could easily be side-stepped by means of the individual shareholder suing to enforce, not the company's rights, but his or her own rights.14 However, the precept that directors' duties are not owed to individual shareholders applies only to those duties which directors are subject to simply by virtue of their appointment and actions as directors. There may well be in a particular case dealings between one or more directors and one or more of the shareholders as a result of which a duty of some sort becomes owed by a director to one or more shareholders. This principle is now fully accepted in English law as a result of the decision of the Court of Appeal in Peskin v Anderson,'5 where Mummery LJ distinguished clearly between the fiduciary duties owed by directors to the company which arise out of the relationship between the director

12 See S. Worthington, “Corporate Attribution and Agency: Back to Basics” (2017) 133 LQR (forthcoming). 13 In particular, it does not explain Safeway Stores Ltd v Twigger [2010] EWCA Civ 1472 CA, already discussed; nor the case of Stone & Rolls Ltd v Moore Stephens [2009] UKHL 39; [2009] 1 A.C. 1391, discussed below at para.22-41, where the House of Lords concluded by a narrow majority that the illegality defence (ex turpi causa) applied to prevent a company from suing its auditors for their failure to detect fraud in circumstances where the fraud had been perpetrated by the very person who had formerly controlled the company. See however Moulin Global Eyecare Trading (In Liquidation) v The Commissioner of Inland Revenue [2014] HKCFA 22 Hong Kong Court of Final Appeal at [101] (Lord Walker NPJ); and Bilta (UK) Ltd (In Liquidation) v Nazir [2015] UKSC 23; [2016] A.C. 1 at [24]—[30] (Lord Neuberger PSC); [46]—[50] (Lord Mance JSC); [79]—[81] (Lord Sumption JSC); and [136]—[154] (Lords Toulson and Hodge JJSC). For comment on both cases, see fn.12. 14 On similar grounds the court rejected an attempt to create a parallel set of duties owed by directors to individual shareholders via implied terms in the articles of association: Towcester Racecourse Co L:d v The Racecourse Association Ltd [2003] 1 B.C.L.C. 260. Peskin v Anderson [2001] 1 B.C.L.C. 372 at 379. To the same end, see Sharp v. Blank [2015] RWHC 3220 (Ch).

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and the company, and fiduciary duties owed to shareholders which are dependent upon establishing “a special factual relationship between the directors and the shareholders in the particular case”. The crucial question, therefore, is what sort of dealing needs to take place between director and shareholder in order to trigger a fiduciary or other duty owed to an individual shareholder by the directors. Such a duty will certainly arise where, on the facts, the directors place themselves, as against shareholders individually, in one of the established legal relationships to which fiduciary duties are attached, such as agency. This may arise, for example, where the shareholders authorise the directors to sell their shares on their behalf to a potential takeover bidder.’ 6 If, in the course of such a relationship, the directors come across information which is pertinent to the shareholders’ decision whether or on what terms to sell the shares, they would normally be obliged to disclose it to the shareholders on whose behalf they are acting. On the other hand, in Percival v Wright,” which is the leading authority for the proposition that the directors’ duties as directors are not owed to the shareholders individually, the directors purchased shares from their members without revealing that negotiations were in progress for the sale of the company’s undertaking at a favourable price. They were held not to be in breach of duty through their non-disclosure. Here, though, the shareholders approached the directors directly and sought to persuade the directors to purchase their shares themselves rather than to act as the shareholders’ agents to sell the shares to third parties. Nevertheless, there is no doubt that the directors of a company are likely to have much more information at their disposal about the company and so are likely to be at an advantage when dealing with the members. The law of agency, as we have just seen, will cover some, but not all of this ground. Can the doctrine of a “special factual relationship” be extended beyond the law of agency? Commonwealth authority established some time

ago that it can. In Coleman v Myers18 the New Zealand Court of Appeal found that a fiduciary duty of disclosure arose, even in the absence of agency, in the case of a small family company where there was a gross disparity of knowledge between the directors and the shareholders and where the shareholders of the company had traditionally relied on the directors for information and advice. When the directors negotiated with the shareholders for the purchase of their shares and, therefore, were clearly not acting on behalf of the shareholders, they were nevertheless held to be subject to a fiduciary duty of full disclosure of relevant facts about the company to the shareholders. The New Zealand decision was approved by the English Court of Appeal in Peskin v Anderson,19 though the English decision also reveals the

16 Briess v Woolley [1954] A.C. 333 HL; Allen v Hyatt (1914) 30 T.L.R. 444 PC. 17 Percival v Wright [1902] 2 Ch. 421. This applies even if all the shares are owned by a holding company with which the directors have service contracts: Bell v Lever Bros [1932] A.C. 161 HL. 18 Coleman v Myers [1977] 2 N.Z.L.R. 225 NZCA. In the Supreme Court (ibid.) Mahon J had held that Percival v Wright was wrongly decided but the Court of Appeal distinguished it. See also Brunningshausen v Glavanics (1999) 46 N.S.W.L.R. 538 CANSW. 19 Peskin v Anderson [2001] 1 B.C.L.C. 372 at 397, following the decisions of Browne-Wilkinson VC in Re Chez Nico (Restaurants) Ltd [1991] B.C.C. 736 at 750 and, though not cited, of David, . Mackie QC in Platt v Plait [1999] 2 B.C.L.C. 745 (the Court of Appeal in that case did nOtdeal with.:- the point:. [2001] 1 698).

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limits of the rule. In the English case, directors were not obliged to disclose to shareholders their plans for the company, even though the shareholders' decision on the sale of their shares would have been affected by the knowledge, where the directors were not parties to or otherwise involved in the sale of the shares, and the company's interests arguably required the directors' plans to be kept secret until they matured.2° This means that, despite the recent significant developments in English law based on a "special relationship" exception to the general proposition that directors do not owe duties directly to the shareholders, the exception is essentially one of significance for family or small companies, and does not substantially reduce, within companies with large shareholder bodies, the significance of the general proposition. The cases already noted affirm that this is true even where advice is given by directors in the course of a takeover bid. In Re A Company21 Hoffmann J held that directors were not obliged to offer their shareholders advice on the bid, but, if they did so, they must do so "with a view to enabling the shareholders to sell, if they so wish, at the best price" and not, for example, in order to favour one bid, which the directors supported, over another, which they did not.22 This identifies two strands: the directors' advice must be careful, and must also be given so as to achieve its (proper) purposes, and not the directors' own (improper) purposes.23 Neither strand imports a "fiduciary" duty of loyalty to the shareholders.

Other stakeholders

If British company law has been reluctant to recognise general duties owed by directors to individual shareholders, it perhaps goes without saying that it has not recognised such duties owed to individual employees or creditors24 or other groups25 upon whom the successful functioning of the company depends. It is important to distinguish this issue (duties owed directly to stakeholder groups)

20 Similarly, see Sharp v Blank [2015] EWHC 3220 (Ch), with Nugee J denying the directors owed a fiduciary duty to the shareholders in the context of Lloyds Banking Group's acquisition of Halifax Bank of Scotland Plc. 21 Re A Company [1986] B.C.L.C. 382. The case involved an application under s.459 (see Ch.20, below), but the judge's analysis appears to have related to the common law. 22 See also Re Charterhouse Capital Ltd [2014] EWHC 1410 (Ch) at [276] in particular (Asplin J) , as affirmed in [2015] EWCA Civ 536 CA (in particular, [50]). In addition, takeover bids for public and listed companies will be governed by the City Code on Takeovers and Mergers (below, Ch.28), which both requires directors to give advice and attempts to ensure that that advice is given to serve the shareholders' needs. These more demanding provisions of the Code will in practice overtake those of the common law. 23 On proper purposes requirement, see below, para.16-26. 24 Yukong Line Ltd v Rendsburg Investments Corporate (No.2) [1998] 1 W.L.R. 294; and see above at para.9-11. 25 e.g. the beneficiaries of a trust which the company, as trustee, is managing: Bath v Standard Land Co Ltd [1911] 1 Ch. 618; Gregson v HAE Trustees Ltd [2008] EWHC 1006 (Ch); [2008] 2 B.C.L.C. 542, confirming that although the beneficiary could not pursue a claim against the director directly (since the director's duty was owed to the trustee company, not to the beneficiary, although the beneficiary was in turn owed duties by the trustee company), the beneficiary would; in any event, be protected by the liquidator's ability to pursue the insolvent trustee company's claim against its-defaulting director.

Hy Revenue and Customs v Holland" divided 3:2 over what Lord Collins described as differences over matters of law and principle.3' The issue was whether an individual who was the only active director of the sole corporate director32 of the principal companies was, in those circumstances, also a de facto director of the principal companies, held to be part of the corporate governance of them and having fiduciary and other directors' duties imposed on him in relation to them. Those in the majority thought that such a finding would contradict the principle of separate legal personality, and reflect a failure to recognise the distinction between a company and its directors, where, as here (so they held), the individual had done nothing other than discharge his duties a director of the corporate director, and in circumstances where the law condones corporate directorships.33 This argument has its attractions. Indeed, it follows, although not explicitly, the approach adopted in determining the individual liability of company directors to third parties in contract and in tort in circumstances where the company, by virtue of the acts of its directors, is also liable to the same parties.34 In the fiduciary arena it is suggested that the question to ask is not whether the purported director assumed fiduciary responsibilities to the company; the answer to that, at least from the director, is likely to be precisely not (and hence the corporate directorship structure).

Better to ask, as in negligent misstatement cases,35 whether, in the circumstances, and looking at what the purported director did, the company is entitled to demand that the individual be subjected to fiduciary obligations. Where the formal structure of a corporate directorship has been transparently erected, the answer is surely no, even though, absent that structure, it would perhaps equally certainly have been yes. The practical effect in Holland was that the principal companies' acknowl-edged liability to the Inland Revenue was not met by the principals, which were insolvent, nor by the corporate director, which though liable was an undercapital-ised intermediary, nor by Holland, since he was not a de facto director of the

30 Commissioners of HM Revenue and Customs v Holland [2010] UKSC 51; [2010] 1 W.L.R. 2793 SC. 31 Commissioners of HM Revenue and Customs v Holland [2010] UKSC 51; [2010] 1 W.L.R. 2793 SC at [53]. 32 This is no longer permitted: every company must now have at least one human director (s.155); and corporate directorships will be fully prohibited (subject to exceptions) as a result of new ss.156A-156C, introduced by s.87 of the Small Business, Enterprise and Employment Act 2015 (commencement expected October 2016). 33 Commissioners of HM Revenue and Customs v Holland [2010] UKSC 51; [2010] 1 W.L.R. 2793 SC at [25], [28]—[29], [39]—[40], [42]—[43], [94]—[96]. Also see previous note. This follows the trend in other jurisdictions where the legislature has intervened to require that all directors be natural persons: e.g. as under the Corporations Act 2001 s.201B (Australia), the Canada Business Corporations Act 1985 s.105(1)(c), the New York Business Corporation Law s.701, and the Delaware General Corporate Law s.141(b) (see [2010] UKSC 51; [2010] 1 W.L.R. 2793 Sc at [96], Lord Collins). 34 See above, paras 7-34 and 7-37 et seq. By contrast, see [2010] IJKSC 51; [2010] 1 W.L.R. 2793 SC, [117]—[118] (Lord Walker) on the approach in tort cases. 3$ Where, again, the question is often said to be simply whether the adviser "assumed" responsibility, for-the advice being given, although the court, taking a more objective approach, seems to search for whether the advisee is entitled to insist that the adviser did so do. That

unlike a de facto or properly appointed director, had not undertaken to act on behalf of the company and so had not put him- or herself in a fiduciary relationship with the company. This decision showed the continuing influence of the trustee analogy in the development of directors' duties, although earlier editions of this book had suggested that the analogy was an unfortunate one, since it provided a relatively easy route for the true mover behind the company's strategy to distance him- or herself from liability for the decisions taken, by appointing a compliant board and giving it instructions at crucial points.43 By contrast, almost a decade later the equally careful analysis of Newey J in Vivendi SA v Richards" doubted this approach and concluded that, by definition of the role,' a shadow director's self-appointed involvement in influencing governance decisions must at law inevitably mean that shadow directors commonly owed fiduciary duties to at least some degree.46 This judicial and statutory change is welcome. If the purpose of the law of directors' duties is to constrain the exercise of the discretion vested in the board, it would be unfortunate if those rules did not reach all those involved in that exercise. The

early source of this definitional difficulty probably lay in the firm distinction which the courts sought to draw between a de facto and a shadow director. Although the language used to define a shadow director is of some antiquity,47 the term “shadow director” was applied as a short-hand way of referring to the definition only in the Companies Act 1980. As we have indicated, this was done in order to make clear the scope of application of the specific duties created by that Act which applied to certain transactions entered into by directors with their companies, the modern forms of which we discuss below. The 1980 Act set the courts off on the task of defining the difference between a de facto and a shadow director. In Re Hydrodam (Corby) Ltd” Millett J took the view that in nearly all cases the two categories were mutually exclusive:

“A de facto director...is one who claims to act and purports to act as a director, although not validly appointed as such. A shadow director, by contrast, does not claim or purport to act as director. On the contrary, he claims not to be a director. He lurks in the shadows, sheltering behind others who, he claims, are the only directors of the company to the exclusion of himself.”

43 The judge did accept that the shadow director might attract liability under the rules relating to the involvement of third parties in breaches of directors’ duties (see below, para.16-134), but these provisions are relatively restrictive. 44 Vivendi SA v Richards [2013] EWHC 3006; [2013] B.C.C. 771. 45 Sukhoruchkin v Bekestein [2014] EWCA Civ 399 CA [39]—[41], notes the differences in approach between Ultraframe and Vivendi without preferring one or other, but also notes that any conclusions are necessarily built on the foundation of the UK statutory definition of a shadow director, and so may not be appropriate in the context of other statutory definitions (as in the instant case). See [2013] EWHC 3006 [133]—[145], especially [142]. See also Smithton Ltd v Naggar [2014] EWCA Civ 939 CA at [33]—[45] (Arden L.T). The Law Commissions also took the view that the shadow director was subject to the common law duties (as they then were) and certainly ought to be “where he effectively acts as a director through the people he can influence”: Law Commission and Scottish Law Commission, Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties, A Joint Consultation Paper, 1998, para.17.15. The CLR took a similar view: ,_ Completing, para.4,7. .47 It seems to have been introduced by the Companies (Particulars as to Directors) Act 1917 : 48 Re Ifydrodam (Corby) Ltd 1994] 2 B.C.L.C. 180, 183.

This view that the categories are mutually exclusive is increasingly doubted,'“ but nevertheless it remains important to draw some distinction in a statutory context because certain statutory provisions apply to both shadow directors and directors whilst others apply only to directors, in which category the courts have long included de facto directors. Nevertheless, the modern view, especially given the statutory change in terminology in s.170(5), is that the differences between the two categories of directors should not be the main focus of attention when deciding the applicability of the general statutory duties of directors. As Robert Walker LT pointed out in Re Kaytech International Plc,5° “the two concepts do have at least this much in common, that an individual who was not a de jure

director is alleged to have exercised real influence in the corporate governance of a company".51 In principle, the general duties should apply to all these people with "real influence". If there is a difference, it is practical, and likely to be that the general rules should be applied to shadow directors only to the extent that they have exercised control over the board: it is not inherent in the definition of a shadow director that he or she should have controlled all the activities of the board52; by contrast, most de facto directors assume general directorial responsibilities. Finally, in the context of shadow directors, two statutory exceptions are provided. First, it is recognised that boards are very likely—indeed are well-advised—to act in accordance with the directions, advice or guidance of their professional advisers or of parties acting under statutory or Ministerial authority. These advisers are not thereby to be regarded as shadow directors (s.25 1(2)). Secondly, and perhaps more controversially, a company is not to be regarded as the shadow director of its subsidiary for the purpose of the general duties by reason only that the directors of the subsidiary are accustomed to act on the instructions of the parent (s.251(3)).53 And, although the Act is silent on this, the parent is also unlikely to be classified as a de facto director, rather than a shadow director, if it is not involved in a direct way in the central management of the subsidiary. A parent company can thus impose a common policy on the group of companies which it controls without placing itself in breach of duty to the subsidiary (for example, because the group policy is not in the best interests of the subsidiary). Note, though, that s.251(3) does not answer the separate question

49 As well as the cases which follow, see too MaKillen v Misland (Cyprus) Investments Ltd [2012] EWHC 521, which describes de facto and shadow directors at [19]-[31], concluding at paras [32]-[34] that there is no sharp dividing line between the two classes (David Richards J); similarly, see Smithton Ltd v Naggar [2014] EWCA Civ 939 CA at paras [33]-[45] (Arden LJ). 5° Re Kaytech International Plc [1999] 2 B.C.L.C. 351, 424 CA. 51 Also see Commissioners of HM Revenue and Customs v Holland [2010] UKSC 51; [2010] 1 W.L.R. 2793 at [110] and [127]—Lords Walker and Clarke respectively, although both dissenting on the majority's finding that the defendant was not a de facto director. 52 Secretary of State for T•ade and Industry v Deverell [2001] Ch. 340 at [35] CA. The conclusion to be drawn from all these cases is perhaps that it is often possible to conclude that the shadow director owes all the general duties or dejure directors in relation to any decisions where he or she directed the . outcome, but whether the shadow director is also subject to other duties, e.g. on pursuing core opportunities (see below, para,16-86), needs to be more carefully determined on a case by case basis. • See also Vivendi SA v Richards [2013] EWHC 3006 at [133]-[145] (Newey J); and Sthithton Ltd v Naggar[2014] EWCA Civ 939 CA at [33]-[45] (Arden LT). 53 A non-corporate controlling shareholder does not have the same protection, [474]

of whether the directors of the subsidiary can agree to implement the group policy without placing themselves in breach of duty to the subsidiary, which is discussed in para.16-36, below.

Senior managers

The general statutory duties set out in Ch.2 of Pt 10 clearly do not apply to managers who are not directors of the company. However, it is important to note that, when applying the law relating to directors' duties, the courts do not distinguish between the actions of the director as director and actions as manager, where the director is an executive director of the company. Those duties will apply to both aspects of the director's activities.54 In consequence, some actions by senior managers of the company, provided they are also directors of the company, will be subject to the controls of the general statutory duties. Although management theory may posit that it is the role of the board in large companies to set the company's strategy and to oversee its execution, rather than to execute it itself, the law of directors' duties does not make this distinction in the case of a director who has both a board position and a non-board executive function. This is consonant with the traditional provision in companies' articles that the management of the company is a matter for the board of directors. However, it can also be asked whether these general statutory duties (or common law fiduciary duties) apply to the senior managers of the company who are not formally appointed as directors. In Canadian Aero Services Ltd v O'Malley the Canadian Supreme Court approved a statement from an earlier edition of this book that directors' common law fiduciary duties (as they then were) apply to those "officials of the company who are authorised to act on its behalf and in particular to those acting in a senior management capacity".55 That view has not been adopted expressly in any English court. Moreover, it is clear that, in principle, the employment relationship is not a fiduciary relationship, so that it would be inappropriate to apply the full range of fiduciary or directors' duties even to senior employees. However, this proposition is subject to a number of qualifications. First, a senior employee who does in fact discharge the duties of a director may be classed as a de facto director, under the principles discussed above. Secondly, the courts have held that, as a result of the specific terms of an employee's contract and of the particular duties undertaken by him or her, a common law fiduciary relationship may arise between employee and employer, even in the case of employees who are not part of senior management, though the fiduciary duty may be restricted to some part of their overall duties.56 The view of the Canadian Supreme Court is not inconsistent with these developments, since it too was derived from an analysis of the functions of the employees in question as

54 For an illustration, see item Software (UK) Ltd v Fassihi [2005] 2 B.C.L.C. 91 CA, where the consequence of this approach was to subject the director to a higher standard of fiduciary duty than would have been applicable had he only been an employee, albeit a senior one. 55 Canadian Aero Services Ltd v O'Malley (1973) 40 D.L.R. (3d) 371 at 381. 56 University of Nottingham v Fishel [2000] LC.R. 1462; Shepherds Investments Ltd v Walters [2007] I,R,L.R. 110; Helmet Integrated Systems Ltd v Ilinnard [2007] I,R.L.R. 126 CA; Ranson v Customer Systems Plc [2012] EWCA Civ 841, The issues remain controversial: see the disagreement in Generics (UK) Ltd v Yeda Research & Development Co Ltd [2012] EWCA Civ 726 at [19]—[36] (Sir

senior management employees, though there will be scope for argument on the facts of each case about how extensive the fiduciary aspects of the employee's duties are. It goes without saying that, should a senior manager place him- or herself in an agency relationship with the company, then the normal fiduciary i incidents of that relationship would arise. Thirdly, the implied and mutual duty of trust and confidence which is imported into all contracts of employment can in some cases operate in substantially the same way as certain directors' general duties.57 This is particularly the case in relation to competitive activities on the part of an employee or the non-disclosure by senior managers of the wrongdoing of fellow employees and in some cases their own wrongdoing.58 The exclusion of senior managers as such from the statutory general duties of directors probably depends upon the continuation of the UK practice, as recommended in the UK Corporate Governance Code,59 that the board should contain a substantial number of executive directors. If British practice were to move in the US direction of reducing the number of executive directors on the board, sometimes to one (the CEO), and there are indications of a move in that direction, then confining the statutory duties to members of the board might become a policy which needed to be re-considered.6° Finally, the above discussion has concerned the fiduciary duties of employees and directors. In relation to the statutory duty of care (see below), which equally applies only to directors, the common law duty of care required of employees

Robin Jacob) contrasted with [41]—[84] (Etherton 11), with whom Ward LJ was persuaded to agree ([91]—[121]). Generally, see Airbus Operations Ltd v Withey [2014] EWHC 1126 QB; Halcyon House Ltd v Baines [2014] EWHC 2216 QB. 57 Note, however, that the employee's duty of "mutual trust and confidence" finds its roots in contract rather than the law of fiduciary obligations, as emphasised by Lewison LJ (with whom Lloyd and Pill LJJ agreed) in Ranson v Customer Systems Plc [2012] EWCA Civ 841 CA, at [36]—[40]; and the distinction between the contractual duty of fidelity and the duties of a fiduciary are discussed at [41]—[43]. 58 Shepherds Investments Ltd v Walters [2007] I.R.L.R. 110 at [129]—[130]; Sybron Corp v Rochem Ltd [1984] Ch. 112 CA; Tesco Stores Ltd v Pook [2004] I.R.L.R. 618. On disclosure of wrongdoing, the main difference between a senior manager and a director concerns the extent to which they are obliged to disclose their own wrongdoing: see Bell v Lever Bros [1932] A.C. 161 HL (suggesting an employee is never under a duty to disclose his own wrongdoing); and Item Software (UK) Ltd v Fassihi [2005] 2 B.C.L.C. 91 CA, taking a narrower view. However, all may depend on the employee's contract: in Ranson v Customer Systems Plc [2012] EWCA Civ 841 CA, it was held that an employee can have an obligation to disclose his own wrongdoing, but that this can only arise out of the terms of the contract of employment, not by any analogy with the fiduciary duties owed by company directors (see [44]—[61]). The analysis may matter: Threlfall v ECD Insight Ltd [2012] EWHC 3543 at [111]—[126] (Lang J); Haysport Properties Ltd v Ackerman [2016] EWHC 393 (Ch). 59 See para.14-69. 60 Contrast the Australian Corporations Act 2001, which defines an "officer", in s.9, as a person Ai) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the entity; or (ii) who has the capacity to affect significantly the entity's financial standing", and then makes officers

subject to many of the statutory duties applying to directors (see ss.179 et seq.). CA 2006 does not take this approach with directors' duties (ss.170 et seq.), although elsewhere it does make rules which apply more generally to "officers" (defined inclusively in s.1173), typically in connection with reporting requirements (see, e.g. s.113(7)). Even though corporate directors are to be abolished (see above, fn,32), it remains possible, it seems, to have "corporate officers" (see 0122). seems to come very close to that now required of directors (taking account of the fact that the application of the reasonable care standard will produce different results in different circumstances).6'

Former directors

At common law the general duties of directors attach from the date when the director's appointment takes effect62 but do not necessarily cease when the appointment ends. The second part of the common law position is explicitly confirmed by s.170(2) which provides that a person who ceases to be a director continues to be subject to two of the seven general duties, namely those relating to corporate opportunities of which he had become aware whilst still a director and the taking of a benefit from a third party in respect of acts or omissions whilst still a director. However, those two duties are to be applied by the courts to former directors "subject to any necessary adaptations", for example, to take account of the fact that the former director may no longer have up-to-date knowledge of the conduct of the company's affairs. In this way it can be said that liability is imposed in respect of actions which straddle the time before and after the director ceased to hold office.63 Particularly difficult issues can arise in relation to the analysis of actions by directors, whilst still directors, but after they have given notice of resignation. In such cases the director is not (yet) a former director and the issue is discussed below at para.16-94.

Directors of insolvent companies

When a company enters into an insolvency procedure (liquidation, administration or receivership), the situation under British law, unlike that in the US, is that the powers of the directors are substantially curtailed and the direction of the business passes into the hands of the insolvency practitioner appointed to act in one or other of these roles and who acts in the interests of the creditors. This is likely to have a substantial impact on what the law of directors' duties requires of the directors in practice, but does not in principle relieve the directors of their obligations to the company.64

61 For employees see Lister v Romford Ice and Cold Storage Co Ltd [1957] A.C. 555 HL; and Janata Bank v Ahmed [1981] I.C.R. 791 CA and for the duty of care required of directors, see the following section. For a case where the defendant was sued for breach of his duty of care both as a director and as an employee, see Simtel Communications Ltd v Rebak [2006] 2 B.C.L.C. 571. 62 In Lindgren v L & P Estates Ltd [1968] Ch. 572, the Court of Appeal rejected an argument that a "director-elect" is in a fiduciary relationship to the company. 63 This point is discussed further below in relation to the taking of corporate opportunities, which is where it most often arises. See the approach

in Thermascan Ltd v Norman [2011] B.C.C. 535. (4 Directors cannot, for example, be held liable for the failure to exercise powers which they, no longer have. In Ultraframe (UK) Ltd v Fielding [2005] EWHC 1638 at [1330] Lewison J suggested the "no conflict" rule would not apply either (though the "no profit" and basic loyalty duties would continue to bite). Also see paras 9-4 et seq. and 9-11 et seq., above.

Annexure 2

INTRODUCTION TO DIRECTORS' VARIOUS DUTIES OF GOOD FAITH LOYALTY AND

Historical background As noted earlier, the duties of good faith and loyalty which the law requires of directors were developed by the courts by analogy with the duties of trustees. It is easy to see how, historically, this came about. Prior to the Joint Stock Companies Act 1844 most joint stock companies were unincorporated and depended for their validity on a deed of settlement vesting the property of the company in trustees. Often the directors were themselves the trustees and even when a distinction was drawn between the passive trustees and the managing board of directors, the latter would quite clearly be regarded as trustees in the eyes of a court of equity in so far as they dealt with the trust property. With directors of incorporated companies, the description "trustees" was less apposite because the assets were now held by the company, a separate legal person, rather than being vested in trustees. However, it was not unnatural that the courts should extend it to them by analogy. For one thing, the duties of the directors should obviously be the same whether the company was incorporated or not; for another, historically the courts of equity tended to apply the label "trustee" indiscriminately to anyone in a fiduciary position. Nevertheless, to describe directors as trustees is today neither strictly correct nor invariably helpful.[67] In truth, directors are agents of the company or (when acting together) one of its organs, not trustees of its property. But, as agents, the directors stand in a fiduciary relationship to their principal, the company. The duties of good faith and loyalty which this relationship imposes are in material respects identical with those imposed on trustees. Moreover, when it comes to remedies for breach of duty, the trust analogy can provide a strong remedial structure. Directors who dispose of the company's assets in breach of duty, for example, are regarded as committing a breach similar to a breach of trust, and those persons (including the directors themselves) into whose hands the assets come may find that they are under a duty to restore the value of the misapplied assets to the company.[68] The analogy of directors as agents of the company is also less than perfect, however. The authority of the directors to bind the company as its agents normally depends on their acting collectively as a board, unless authority has (or can be assumed to have) been further

[67] Re City Equitable Fire Insurance Co [1925] Ch. 407 at 426 (Romer J).

[68] "It follows from the principle that directors who dispose of the company's property in breach of Property fiduciary duties are treated as having committed a breach of trust that a person who receives that s said with knowledge of the breach of duty is treated as holding it upon trust for the company. He is said to be a constructive trustee of the property", per Chadwick LJ in JJ Harrison (Properties) Ltd v. Harrison [2002] 1 B.C.L.C. 162, 173.

delegated under the company's constitution upon an individual director. By contrast, their duties of loyalty are owed by each director individually. One of several directors may not as such be an agent of the company with power to saddle it with responsibility for his acts, but he will invariably be a fiduciary of it, and will also owe separate but related equitable duties. To this extent, directors again resemble trustees who must normally act jointly but each of whom severally owes duties of loyalty towards the beneficiaries. Moreover, as noted earlier, when the directors act collectively as a board, the modern view is not so much that they are agents of the company but that, so long as they act within their powers, they act as the company. Given the modern statutory statement of the general duties owed by directors, these analogies and their various limitations are of less substantive importance than they once were. Nevertheless, an eye must be kept on them for two reasons: the statutory duties themselves are subject to interpretation in the light of analogous common law cases (s.170(4)); and the remedial consequences of statutory breaches remain to be determined by the appropriate corresponding common law rules (s.178).

Categories of duties

Turning now to the main elements of the directors' duties of good faith and loyalty, we divide them as below into six categories, following the scheme of the Act. The first three categories describe distinct duties, all being concerned with the manner in which directors exercise their powers, being that the directors must:

(1) act within the scope of the powers which have been conferred upon them, and for proper purposes; (2) exercise independent judgment; and (3) act in good faith to promote the success of the company.

The final three categories are all examples of fiduciary duties of loyalty, and in particular the rule against directors putting themselves in a position in which their personal interests (or alternatively their duties to others) conflict with their duty to the company. However, it is useful to sub-divide this "no conflict" principle further because the specific rules implementing the principle differ according to whether the conflict arises:

(4) out of a transaction with the company (self-dealing transactions); (5) out of the director's personal exploitation of the company's property, information or opportunities; or (6) out of the receipt from a third party of a benefit for exercising their directorial functions in a particular way. For the purposes of statutory enactment and analysis it is inevitable that the duties are separated out in some way such as that adopted in the 2006 Act. However, s.179 specifically provides that, except where a duty is explicitly excluded by something in the statute, "more than one of the general duties may apply in any given case". This provision applies also to the duty of care. In practice, here as in other areas of the law, the facts will frequently suggest breach of more than one of the duties and, where this is so, the claimant can choose to pursue all or any of them.

DUTY TO ACT WITHIN POWERS

Requiring the directors to act only within the powers that have been conferred upon them is an obvious duty for the law to impose. Indeed, this is not a duty confined to directors, or even to fiduciaries; later on we shall examine similar restrictions as they apply to shareholder. As regards the directors, however, s.171 deals with two manifestations of this principle: the director must "act in accordance with the company's constitution" and must "only exercise powers for the purposes for which they are conferred". We look at each in turn.

Acting in accordance with the constitution

Constitutional limitations

In contrast to many other company law jurisdictions, the main source of the directors' powers is likely to be the company's articles, and the articles, therefore, are likely also to be a source of constraints on the directors' powers. The articles may confer unlimited powers on the directors, but they are likely in fact to set some parameters within which the powers are to be exercised, even if the limits are generous, as they typically will be. So, it is perhaps not surprising that s.171 contains the obligation "to act in accordance with the company's constitution". And it should be noted that the term "constitution" helpfully goes beyond the articles. It includes resolutions and agreements which are required to be notified to the Registrar and annexed to the articles, notably any special resolution of the company.[69] It also embraces any resolution or decision taken in accordance with the constitution and any decision by the members of the company or a class of members which is treated as equivalent to a decision of the company.[70] Thus, the duty includes an obligation to obey decisions properly taken by the shareholders in general meeting, for example, giving instructions to the directors without formally altering the articles. This duty was recognised in the early years of modern company law and is reflected in a number of nineteenth-century decisions, usually involving the purported exercise by directors of powers which were ultra vires the company[71] or payments of dividends or directors' remuneration contrary to the provisions in the company's articles.[72] The remedies for this type of breach are considered below.

Other situations?

Besides limitations on the directors' powers suggested by s. 171 (i.e, limitations found to the company's constitution or in the general limitation on the exercise of powers for

[69] 2006 Act ss.17, 29-30.
[70] 2006 Act s.257.
[71] Re Lands Allotment Co [1894] 1 Ch. 616 CA.
[72] Re Oxford Benefit Building and Investment Society (1886) 35 Ch.D, 502 (an early example of a company's accounts recognising profits which had not been earned); Leeds Estate Building and Investment Co v Shepherd (1887) 36 Ch.D. 787. It might be said that the requirement upon the directors to repay the dividends was based on the illegality of their payment as a matter of statute or common law, but the directors were also required to repay their remuneration, the payment of which was objectionable only because it was done in breach of the company's articles. (The articles entitled the directors to remuneration only if dividends of a certain size were paid, a rule which, perhaps naturally, encouraged the directors not to be too careful about observing the restrictions on their dividend payment powers.)

improper purposes), the general law may also limit what directors may do (or what companies may do, which will necessarily control the actions of the board), or limitations may be found in the Companies Act or in the common law relating to companies. Often these provisions will suggest that liability is strict, in that the motivations of the director arc immaterial. As well, these provisions may set out the consequences of any failure to abide by the relevant rules, and, where this is the case, those rules will prevail. But where no remedies are specified, the law of directors' duties may provide an answer, directly or by analogy.

Improper purposes

The rule

The second proposition contained in s.171(b) is that a director must "only exercise powers for the purposes for which they are conferred". Often the improper purpose will be to feather the directors' own nests or to preserve their control of the company in their own interests, in which event it will also be a breach of one or other of the various duties, considered below, to act avoid conflicts and to act in good faith to promote the success of the company. Indeed, the particular wording of the s.172(1) statutory duty to act in good faith to promote the success of the company can be seen as assisting generally in defining proper purposes. But even if no other breach is committed, directors may nevertheless be in breach of this particular duty if they have exercised their powers for a purpose outside those for which the powers were conferred upon them. The improper purposes test, like the requirement to act in accordance with the company's constitution, is an objective test.[73] Or, more precisely, the question of whether a particular purpose is proper or not is a question of law, decided objectively, while the question of which purposes actually motivated the particular director in question is, of course, subjective.[74] Notice the narrow limits to the proper purposes Wile: if the directors have acted for purposes which are objectively proper, not improper, then the court will not, in addition, review the decision as also being either reasonable or unreasonable,[75] with the potential for substituting their own view as to the judgements the directors should have reached in managing the company.[76] The leading authority in this area is the 2015 Supreme Court decision in Eclairs Group Ltd v JKX Oil & Gas Plc,[77] but it is helpful to begin discussion with an earlier decision. The statutory formulation of the proper purposes duty reflects the prior common law case law. That case law was reviewed by the Privy Council in Howard

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[73] Howard Smith Ltd v Ampol Ltd [1974] A.C. 821 at 834 PC; citing Fraser v Whalley (1864) 2 H.C.M. & M. 10; Punt v Symons & Co Ltd [1903] 2 Ch. 506; Piercy v Shills & Co Ltd [1920] 1 Ch. 77; Ngurli v McCann (1954) 90 C.L.R. 425 Aust. HC; Hogg v Cramphorn Ltd [1967] Ch. 254 at 267. The "improper purpose" test, as a requirement distinct from good faith in the common law test, has been rejected, however, in British Columbia: Teck Corp Ltd v Millar (1973) 33 D.L.R. (3d) 288.

[74] But see Eclairs Group Ltd v JKX Oil & Gas Plc [2015] UKSC 71 at [15] (Lord Sumption SCJ), it seems confining himself to the latter point.

[75] Although it may of course review them as being negligent or not: s.174.

[76] The best analysis of this is probably in the trusts case, Edge v Pensions Ombudsman [2000] Ch. 602 CA at 627E-630G; but also see Equitable Life Assurance Society v Hyman [2002] 1 A.C. 408 HL at [17]-[21].

[77] Eclairs Group Ltd v JKX Oil & Gas Plc [2015] UKSC 71. Noted, Worthington [2016] C.L.J. 202.

Smith Ltd v Ampol Petroleum Ltd,[78] which considered the decisions on this subject of courts throughout the Commonwealth. It concerned, as have many of the cases, the power of directors to issue new shares, but the duty is by no means so confined.[79] In this case a majority shareholder (Ampol) in a company called Millers made an offer to acquire the shares in Millers it did not already own. However, the directors of Millers preferred a takeover offer from Howard Smith, which could not succeed so long as Ampol retained a majority holding. Consequently, the directors caused the company to issue sufficient new shares to Howard Smith that Ampol was reduced to a minority position and Howard Smith could launch its offer with some hope of success, since its bid price was higher than Ampol's. It was argued that the only proper purpose for which a share-issue power could be exercised was to raise new capital when the company needed it.[80] This was rejected as too narrow.[81] There might be a range of purposes for which a company may issue new shares—a view reflected in the statutory reference to proper purposes in the plural. It might be a proper use of the power to issue shares to use that power in order to secure the financial stability of the company[82] or as part of an agreement relating to the exploitation of mineral rights owned by the company.[83] Provided the purpose of the issue was a proper one, the mere fact that the incidental (and desired) result was to deprive a shareholder of his voting majority or to defeat a takeover bid would not be sufficient to make the purpose improper. But if as in the instant case, the purpose of the share issue was to dilute the majority voting power so as to enable an offer to proceed which the existing majority was in a position to block,[84] the exercise of the power would be improper despite the fact that the directors were acting in what they considered to be the best interests of the company, and were not motivated by a desire to obtain some personal advantage.

Which purposes are improper?

Perhaps the greatest puzzle in this area is to know by what criteria the courts judge whether a particular purpose is proper. This is generally stated to be a matter of construction of the articles of association.[85] That is all very well if the articles are prescriptive, but this is rarely the case. In Howard Smith v Ampol, for example, the clause

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[78] Howard Smith Ltd v Ampol Petroleum Ltd [1974] A.C. 821 PC.
[79] The principle applies generally. For examples in relation to other powers, see Stanhope's Case (1866) L.R. 1 Ch. App. 161; and Manistys Case (1873) 17 S.J. 745 (forfeiture of shares); Galloway v Halle Concerts Society [1915] 2 Ch. 233 (calls); Bennett's case (1854) 5 De G.M. & G. 284; and Australian Metropolitan Life Association Co Ltd v Ure (1923) 33 C.L.R. 199 Aust. HC (registration of transfers); Hogg v Cramphorn Ltd [1967] Ch. 254 (loans); Lee Panavision Ltd v Lee Lighting Ltd [1992] B.C.L.C. 22 CA (entering into a management agreement); Equitable Life Assurance Society v Hyman [2002] 1 A.C. 408 HL; Criterion Properties Plc v Stratford UK Properties LLC [2003] B.C.C. 50 CA (giving joint venture partner an option to be bought out at a favourable price); Re HLC Environmental Projects Ltd (In Liquidation) [2014] B.C.C. 337 (payments made when the company was in financial distress).
[80] This has often been assumed and the directors had apparently been so-advised and sought unsuccessfully, to show that this was their purpose.
[81] Howard Smith Ltd v Ampol Petroleum Ltd [1974] A.C. 821 at 835-836 PC.
[82] Harlowes Nominees Ply Ltd v Woodside Oil Co (1968) 121 C.L.R. 483 Aust. HC.
[83] Teck Corp Ltd v Miller (1972) 33 D.L.R. (3d) 288 BC Sup.Ct.
[84] Or, conversely, to block a bid: Winthrop Investments Ltd v Wilms Ltd [1975] 2 N.S.W.L.R. 666 NS WCA.
[85] Re Smith and Fawcett Ltd [1942] Ch. 304 at 306.

giving the directors power to issue shares was drawn in the widest terms. The "purposes" limitation which the Privy Council read into the directors' powers derived not from a narrow analysis of that clause, but from placing the share issue power within the company's constitutional arrangements as a whole, as demonstrated in particular by the terms of its articles of association. In essence, to do what the directors did in that case was regarded as undermining the division of powers between shareholders and the board which the articles had created[86]; and in that context the case comes close to deciding that it is always a breach of the directors' duties to exercise their powers to promote or defeat a takeover offer, which decision should be left to the existing body of shareholders. This is certainly the proposition upon which the City Code on Takeovers and Mergers (the Takeover Code) is based, which provisions will prevail once a bid for a listed company is imminent. In Criterion Properties Plc v Stratford UK Properties LLC,[87] however, neither Hart J nor the Court of Appeal ruled out the possibility that in some cases it might be a proper purpose of the exercise of directors' powers for them to be used to block or discourage a takeover, but the issue was not presented in a sharp fashion in that case, since both courts were agreed that the "poison pill" adopted by the directors in that case was disproportionate to the threat faced by the company. It follows from this approach, however, that in a different type of company with a different constitution, in which, say, ownership and control were not separated, a broader view might be taken of the directors' powers under the articles. In other words, the context is all-important. This seems to be the explanation of the expansive approach taken in Re Smith and Fawcett Ltd,[88] where the clause in question (regarding the admission of new

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[86] Howard Smith Ltd v Ampol Petroleum Ltd [1974] A.C. 821 at 837 PC: "The constitution of a limited company normally provides for directors, with powers of management, and shareholders, with defined voting powers having to appoint the directors, and to take, in general meeting, by majority vote, decisions on matters not reserved for management. Just as it is established that directors, within their management powers, may take decisions against the wishes of majority shareholders, and indeed that the majority of shareholders cannot control them in the exercise of these powers while they remain in office so it must be unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. To do so is to interfere with that element in the company's constitution which is separate from and set against their powers". This principle was applied by the Court of Appeal in Lee Panavision Ltd v Lee Lighting Ltd [1992] B.C.L.C. 22, where the incumbent directors entered into a long-term management agreement with a third party knowing, that the shareholders were proposing to exercise their rights to appoint new directors.

[87] Criterion Properties Plc v Stratford UK Properties LLC [2002] 2 B.C.L.C. 151 (Hart J); [2003] 2 B.C.L.C. 129 CA. The issue was not analysed by the House of Lords, which focused on the logically prior question of the director's authority (actual or apparent) to enter into the contract on behalf of the company: [2004] 1 W.L.R. 1846. The "poison pill" arrangement entitled the joint venture partner of the potential target company (Criterion) to require Criterion to buy out its interest in the venture on terms which were very favourable to the partner and thus very damaging economically to Criterion. However, this arrangement was capable of being triggered not only by a takeover but also by any departure of the existing management of Criterion, even in circumstances, which in fact arose, which were wholly unconnected with a takeover.

[88] Re Smith and Fawcett Ltd [1942] Ch. 304 CA, where in a quasi-partnership company it was held that the directors, in exercising a power to refuse to register a transfer of shares, could "take account of any matter which they conceive to be in the interests of the company ... such matters, for instance, as whether by their passing a particular transfer the transferee would obtain too great a weight in the councils of the company or might even perhaps obtain control" (at 308). Similarly, see Gain= v National Association of Mental Health [1971] Ch. 317. In modern law the position would now have to be considered in the light of any "legitimate expectations" enforceable under s.994.

members to a small company) was widely construed so as to produce the effect equivalent to the partnership rule of strict control by the board over the admission of new members. But these illustrations indicate the difficulty, and provide little by way of real guidance when the context is novel, as it was in Eclairs Group Ltd v JKX Oil & Gas Plc.[89] The opposing judgments as the case made its way up to the Supreme Court are instructive. JKX suspected a hostile takeover by Eclairs, one of its shareholders, whom it alleged was seeking to destabilise it and ultimately acquire it at less than its proper value. The directors of JKX had the power[90] to request details of the parties who held interests in Eclairs' shares, and to disenfranchise Eclairs if it failed to respond adequately to the request. This the company did. It was not disputed that the power to disenfranchise had been exercised so as to disentitle these shareholders from voting at JKX's AGM, thus ensuring the passage of certain resolutions, rather than for the purpose of enforcing the company's demand for information. At first instance,[91] Mann J held this to be an improper purpose, so the purported restrictions on voting were held ineffective.

The Court of Appeal allowed the appeal (Briggs LJ dissenting),1 29 distinguishing previous cases of improper purposes on three overlapping grounds13°: that here the purported "victim" was a "victim of his own choice, not a victim of any improper use of a power of the board of directors" since it was his choice how to respond to the questions properly raised131; that since no restrictive purposes had been expressed in the statute or the articles, none should be implied unless that was necessary to their efficacy; and, in any event, a restricted proper purpose test would essentially frustrate the purpose or utility of the provisions in question. Although the Court of Appeal did not put it so strongly, their expansive approach could essentially denude the proper purposes doctrine of any substantive role whenever a power was expressed in wide terms—as powers typically are. The Supreme Court disagreed, holding unanimously that the proper purpose doctrine had a central role to play in controlling the exercise of power by directors. But they too provided little guidance as to how these "proper purposes" should be discovered. Lord Sumption SCJ, with whom the other judges agreed, suggested that the relevant improper purposes would "usually [be] obvious from [the] context", and should be inferred from the "mischief' which might follow from exercise of the power.'32 That is not much to go on, but, taking the cases together, perhaps two broad categories of "improper purpose" can be identified as operating quite generally, even when powers are expressed in the widest possible terms: use of a power for the purpose of "feathering the director's nest" (these are the easy cases) or for influencing the outcome of existing constitutional balances of power in the company (the harder cases) will typically be regarded as improper.133 Note that it is not the incidental, or even inevitable, delivery of these ends which is outlawed: many perfectly proper actions by directors will deliver such results. Rather, it is this being the motivation for the exercise of the power, where that motivation has been deemed improper. But even this is not the end of the analysis; there is a further question.

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[89] Eclairs Group Ltd v JKX Oil & Gas Plc [2015] UKSC 71.
[90] Under Pt 22 of the 2006 Act (see ss.793 et seq.) and the company's articles.
[91] Eclairs Group Ltd v JKX Oil & Gas Plc [2013] EWHC 2631 (Ch).

When is a power exercised for improper purposes?

Directors are rarely actuated by a single purpose. This was true in the Howard Smith case, where the company did have a genuine need for fresh capital. If the directors are motivated by a variety of purposes, some proper and some improper, how should the courts determine whether the exercise of power is tainted? Section 171(b) indicates that a director must “only exercise powers for the purposes for which they are conferred”. This suggests that any improper

129 Eclairs Group Ltd v JKX Oil & Gas Plc [2014] EWCA Civ 640. 130 As summarised by Lord Sumption SCJ at [2015] UKSC 71 at [28]. 131 Eclairs Group Ltd v JKX Oil & Gas Plc [2014] EWCA Civ 640 at [136]. 132 Eclairs Group Ltd v JKX Oil & Gas Plc [2015] UKSC 71 at [31] and [30] respectively. For earlier academic considerations, see Completing, para.3.14; and R.C. Nolan, “The Proper Purpose Doctrine and Company Directors” in B. Rider (ed.), The Realm of Company Law (Kluwer Law International, 1998). 133 In the same vein, it would be improper for a director to act for the purpose of favouring his or her .nominator, with the cases again suggesting, if only by inference, that a “bit far” test is appropdate: -see, e.g. Kuwait Asia Bank EC v National Mutual Life Nominees Ltd [1991] 1 A.C. 187 PC:

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motivating purpose will constitute a flaw. Nevertheless, and perhaps for very pragmatic reasons, that has never been the rule applied in the corporate context except where the exercise of power is motivated by the director’s dishonesty or self-interest.134 Otherwise the courts have typically suggested that a decision will be considered flawed only if the proven improper purpose is the “primary” or dominant purpose for the decision,135 or if the decision would not have been taken “but for” the improper purpose (even if the improper purpose was not the dominant purpose),’ 6 or perhaps an either/or version of these two tests 137 if it is thought that they are likely to lead to different answers on the facts. Each alternative poses enormous forensic difficulties, since all require proof of matters peculiarly within the minds of the directors and in relation to which the directors’ evidence is “likely to be both artificial and defensive”.138 But in Eclairs Group Ltd v JKX Oil & Gas Plc, Lord Sumption SCJ (with whom Lord Hope SCJ agreed) put forward a principled preference for the “but for” test139:

“The fundamental point [in selecting the right test], however, is one of principle. The statutory duty of the directors is to exercise their powers ‘only’ for the purposes for which they are conferred. If equity nevertheless allows the decision to stand in some cases, it is not because it condones a minor improper purpose where it would condemn a major one. ... The only rational basis for such a distinction is that some improprieties may not have resulted in an injustice to the interests which equity seeks to protect. Here, we are necessarily in the realm of causation. ... One has to focus on the improper purpose and ask whether the decision would have been made if the directors had not been moved by

it. If the answer is that without the improper purpose(s) the decision impugned would never have been made, then it would be irrational to allow it to stand simply because the directors had other, proper considerations in mind as well, to which perhaps they attached greater importance. ... Correspondingly, if there were proper reasons for exercising the power and it would still have been exercised for those reasons even in the absence of improper ones, it is difficult to see why justice should require the decision to be set aside."

However persuasive that might seem, and whatever the practical advantages of a single simple test, the majority of the Supreme Court declined to commit themselves to this as a statement of the law, given that the issues surrounding mixed purposes had not been argued before the Supreme Court)" The matter thus remains unsettled. But it is hard to fault the logic that a decision should be held improper only if it would not in fact have been taken the way it was but for

I" Eclairs Group Ltd v JKX Oil & Gas Plc [2015] UKSC 71 at [17] (Lords Sumption and Hodge SCJJ); citing Mills v Mills (1938) 60 C.L.R. 150 at 185-186 Aust. HC, where Dixon J indicated the difficulties. 135 Howard Smith Ltd v Amp°, Petroleum Ltd [1974] A.C. 821 at 832 PC (Lord Wilberforce). 136 Mills v Mills (1938) 60 C.L.R. 150 at 186 Aust. FIC; Whitehouse v Carlton House Pty (1987) 162 C.L.R. 285 at 294 Aust. HC: although this interpretation, supported in Eclairs Group Ltd v JKX Oil & Gas Plc [2015] UKSC 71 by Lord Sumption SCJ (with whom Lord Hope SCJ agreed) (at [21]—[22]) was doubted by Lord Mance SCJ (with whom Lord Neuberger PSC agreed) (at [53]). See also Hirsche v Sims [1894] A.C. 654 PC; Hindle v John Cotton Ltd (1919) 56 S.L.T. 625. 378 Eclairs Group Ltd v JKX Oil & Gas Plc [2015] UKSC 71 at [49]. 13 Eclairs Group Ltd v JKX Oil & Gas Plc [2015] UKSC 71 at [20] (on the "primary" purpose test), and see too [54] (on both). n _4 Eclairs Group Ltd v JKX Oil & Gas Plc [2015] UKSC 71 at [21], but see generally [21]—[23]. 94o Mance SCJ (with whom Lord Neuberger PSC agreed) set out his doubts at [2015] UKSC 71 at [51]--[54].

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the improper consideration. If that test is not met, then—as Lord Sumption put it—no injustice has been done, and the decision should stand. The only troubling element is the hypothetical rider aired by the court. The problem raised was this: assume the directors in fact decided the way they did only because of the presence of an improper purpose, but they might still have decided the same way had that improper purpose not been present. Should their decision then be allowed to stand? The answer, surely, is no, it should not stand. Principle suggests the court's task is simply to determine whether the decision actually taken by the directors should stand. It is not to hypothesise about what the directors might have done for exclusively "proper" motivating purposes. The focus of the court's intervention is not on judging the practical outcome reached, but on judging the directors' motivations in reaching it. And in any event, in practice the question would

seem impossible to contemplate sensibly on most facts before the court: JKX and Howard Smith are surely illustrative of that—the directors could insist they would have taken the same decisions if acting only for proper purposes, but their targets and timing make that seem unlikely. Despite this, in the early stages of the JKX litigation, Mann J raised this question himself, and also held that the facts supported the conclusion that the JKX directors would indeed have taken the same decision if they were acting for exclusively proper purposes, but he declined to let the company take the argument at that late stage in the litigation.mi

Remedies

The directors necessarily breach the duty in s.171 if they act contrary to its provisions; it is irrelevant that the contravention was in the interests of the company, or that the directors were not subjectively aware of their breach of S.171.142 In other words, directors are under a duty to acquaint themselves with the terms of the company's constitution and its limits, and to abide by them. A breach by the directors of s.171 affects the validity of any decision so made, and that in turn may affect third parties relying on the decision. In addition, if the flawed decision causes loss to the company, the company may seek compensation from its defaulting directors. The relevant remedies map the common law and equitable rules (s.178). Starting with the validity of the flawed decision: at common law different legal consequences follow for acts done without power (or "in excess" of power, s.171(a)) and acts done within power but in abuse of it (s.171(b)). At common law, where an act or decision of the directors is beyond their constitutional capacity as set out in the company's constitution (and subject to claims of ostensible authority) (i.e. in breach of s.171(a)), it is void, i.e. of no effect. Moreover, this is also one of the situations where the trust analogy is used to strong effect. If the contravention of the constitution has involved the improper distribution of the company's assets, the directors are regarded by analogy as if in

141, Eclairs Group Ltd v JKX Oil & Gas Plc. [2015] 1.11CSC 71 at [42]-1431 142 See the'cases cited in Inn.106 and-109.

breach of trust and are liable to replace the assets, whether or not they were the recipients of them.'`" This gives the directors a strong incentive to remain within the company's constitution."' Where the directors act for an improper purpose (in breach of s.171(b)), however, then at common law their act is voidable by the company (i.e. valid until set aside by the company, and incapable of being set aside if third party rights have intervened),145 not void as in the case where the directors purport to exercise a power they do not have. Thus, bona fide third parties are safe if they act before the shareholders (or liquidator, or other) set aside the directors' decision."' In both cases, however, the impact of these common law rules on third parties' interests has now been substantially softened by the statutory protections (especially s.40) for those dealing with the company in good faith."' In favour of such persons the powers of the directors to bind the company are treated as free of any limitation contained in the company's constitution. Helpful as this is to third parties, it does not help the directors, for s.40(5) makes it clear

that liability on the part of the director to the company may be incurred under s.171, even if—perhaps especially if—the third party with whom the directors dealt on behalf of the company is able to enforce the transaction against the company."s In fact, to the extent that s.40 protects the position of third parties as against the company it increases in importance the company's potential remedy against the director. Companies that are now restricted in their ability to escape from transactions with third parties on the grounds that the directors have exceeded their powers may be tempted to look to the directors to recover compensation for the loss suffered as a result of entering into them. It is also worth recalling at this point the related provisions of s.41, which apply where the third party contracting with the company is a director of the company or a person connected with the director. Then the protection afforded by

143 See the cases cited in fnn.106 and 109. The most recent Supreme Court authority on quantification of this form of compensation comes from the non-company case of AIB Group (UK) Plc v Mark Redler & Co Solicitors [2014] UKSC 58 SC. I" They might escape liability, however, where, for example, the provisions of the constitution were not clear; and see also the discussion of s.1157, below, para.16-133. ias See the analysis of the cases in Hunter v Senate Support Services Ltd [2004] ENVHC 1085 (Ch); [2005] 1 B.C.L.C. 175, [173]–[179]. Note the importance of the absence/excess of authority versus abuse of authority distinction in Hogg v Cramphorn [1967] Ch. 254—a decision to attach multiple voting rights to shares issued to the company's pension fund, in breach of the company's articles, was ineffective, whereas the issue itself, for improper purposes, was voidable only; Guinness v Saunders [1990] 2 A.C. 663 HL—fixing of directors' remuneration by a boa'rd committee, rather than the full board, in breach of the articles, meant that the decision was void and the recipient director had to repay the money; Smith v Henniker-Major Co [2003] Ch. 182 at [48]—inquorate board meeting. cf. Hely-Hutchinson v Brayhead Ltd [1968] 1 Q.B. 549, where the correct body acted but the director was in breach of his obligation under the articles to comply with disclosure provisions: here the decision was voidable but not void. 146 Bamford v Bamford [1970] Ch. 212 CA (ratification by shareholders of. decision taken for an improper purpose); and Criterion Properties Plc v Stratford UK Properties LLC [2004] 1 W.L.R. 1846 (on the application of the statutory protection for the benefit of third parties). 4 See above, at para.7-9. Unless the third party is a director of the company or a person connected with the director. See s.41 and above, para.7-13. 148 2006 Act s.40(1).

s,4() does not apply and instead s.41 imposes liability both on directors who authorise such transactions (as s.171 does)'49 and on the director'5° (or connected person) who enters into the transaction with the company.151 Both sets of directors are liable to account to the company for any gain made from the transaction and to indemnify the company for any loss which it suffered as a result of the transaction. Section 41 in its specific area of operation thus reinforces the principle underlying s.171 that directors should observe the limitations on their constitutional powers. The jurisdiction to bring claims is worth further comment. It is clear that both duties stated in s.171 are owed to the company, as are the other statutory duties, and so may be pursued by the company

directly, or by shareholders in a derivative claim. But can the defaulting directors be sued by parties other than the company? A failure on the part of the directors to observe the express limits on their powers contained in the company's constitution (i.e. s.171(a) breach) may also put the company in breach of the contract with the shareholders created by the articles. As we saw in Ch.3,'52 at least some breaches of the articles by the company can be complained of by a shareholder, who might, for example, obtain an injunction to restrain the company from continuing to act in breach of the articles—in effect restraining the directors from causing the company to act in breach of its articles. Equally, such acts by the directors may form the basis of a claim in unfair prejudice. Where the breach is of the duty to act for proper purposes (i.e. s.171(b)), however, then allowing a wider class of people to complain has been more poorly defended; no case seems to have turned on standing. In some cases, minority shareholders have been allowed to sue but the question of their standing has often not been argued nor its basis explained.'53 As a matter of logic and of equitable precedent, this duty to act for proper purposes, owed by directors to the company, may also be owed (at common law only, since there is no enacted statutory equivalent) by the directors to a wider class of people, entitling this wider class to seek common law or equitable remedies from the directors for breach.'54 Alternatively, or in addition, and as described above, the directors' wrongs to the company may entitle the shareholders to pursue related or parasitic remedies,

149 Liability under s.171 is preserved by s.41(1) but it would seem more attractive to proceed under s.41 where this is possible. 150 Including a director of the company's holding company. 151 The transaction itself is voidable by the company (s.41(2) and (4)), but not void, as it would be at common law. It will cease to be avoidable if (a) restitution of the subject-matter of the contract is not possible; (b) the company has been indemnified for the loss suffered; (c) the rights of bona fide purchasers without notice have intervened; or (d) the shareholders in general meeting have ratified the transaction. 1" See above, para.3-18. 153 See many of the cases cited earlier, including the leading case of Howard Smith v Ampol [1974] A.C. 824 PC. By contrast, in Eclairs Group Ltd v JKX Oil & Gas plc [2015] UKSC 71 SC, the shareholders would be expected to have jurisdiction to complain. 154 For an attempted defence of this, see S. Worthington, "Directors' Duties, Creditors' Rights and Shareholder Intervention" (1991) 18 Melbourne University Law Review 121, 125-30.. Also see Equitable Life Assurance Society v Hyman [2002] 1 A.C. 408 HL.

such as for breach of the contract in the articles (although note the arguments against),155 or a claim in unfair prejudice.156 Finally, as noted earlier, these remedies are sometimes applied by analogy when 16-32 directors act, not contrary to the company's constitution, but contrary to some other statutory or common law rule which constrains the powers of directors to act in particular ways.'57 If the rule itself does not set out specific consequences of failure, then the law of directors' duties may provide an answer, directly or by analogy. We have already seen an example of this situation in Ch.1 2 where the directors, in breach of the Act, made a distribution to shareholders otherwise than out of profits. In the absence of statutory specification of the liabilities of

the directors to the company in that situation, the courts have had recourse to the notion that if directors, "as quasi-trustees for the company, improperly pay away the assets to the shareholders, they are liable to replace them".'58 Another example is to be found in Ch.1 3,i59 where directors are regarded as having acted in breach of trust when they used the company's assets to give financial assistance for the purchase of the company's shares in breach of the statutory prohibition. In this way, directors who apply the company's assets in breach of restrictions contained in the Act are made liable to replace them. It is not thought that these liabilities, derived from the trustee-like duties imposed on directors in the handling of the company's assets, have been overtaken or displaced by the statutory duties set out in Ch.2 of Pt 10 and in s.1 7 1 in particular. What is even more typical in this area is that different potential routes lead to the same remedial ends. An illustration is found in the decision of the Court of Appeal in MacPherson v European Strategic Bureau Ltd.'6° Here the directors of an insolvent company caused it to enter into a number of contracts which, the court found, amounted to an informal winding up of the company. Under the contracts, the directors as creditors were the primary beneficiaries rather than the creditors of the company as a whole, as would have been the case had the company been wound up formally under the provisions of the Act and the insolvency legislation. Chadwick LI said that it was a breach of the duties which directors owe to the company for them to attempt such a scheme161:

"It is an attempt to circumvent the protection which the 1985 Act aims to provide for those who give credit to a business carried on, with the benefit of limited liability, through the vehicle of a company incorporated under that Act."

155 But for the perhaps preferable view that acting for an improper purpose is an abuse of power but not a breach of the articles see Winthrop Investments Ltd v Whirls Ltd [1975] 2 N.S.W.L.R. 666 NSWCA. Also see Rolled Steel Products (Holdings) Ltd v British Steel Corp [1986] Ch. 246. 156 Re Sherborne Park Residents Co Ltd (1986) 2 B.C.C. 528. 157 See above, para.16-25. 158 Per Sir George Jessel MR in Flitcrofi's case (1882) 21 Ch. D. 519; quoted with approval by the Court of Appeal in Bairstow v Queen's Moat Houses Plc [2001] 2 B.C.L.C. 531. See above, para.12-13. 159 At para.13-56. See also the discussion of Re Duckwari (No.2) [1998] 2 B.C.L.C. 315 CA, below at fn.277. 160 MacPherson v European Strategic Bureau Ltd [2000] 2 B.C.L.C. 683. "161 MacPherson v European Strategic Bureau Ltd [2000] 2 B.C.L.C. 683 at 701,

DUTY TO EXERCISE INDEPENDENT JUDGMENT

In consequence, the contracts were not enforceable by the directors (who were obviously aware of the facts giving rise to the breach of duty) against the company. This case can thus be seen as demonstrating a limitation on the directors' powers derived from the statutory rules on limited liability and payments to shareholders out of capital. It could also be seen as a breach of the directors' core duty of loyalty (discussed immediately below) as it applies in the vicinity of insolvency where the creditors' interests are predominant

DUTY TO EXERCISE INDEPENDENT JUDGMENT

At common law, this issue is typically described as a duty not to fetter the exercise of discretion. In s.173, this is put in positive terms, as a duty to exercise independent judgment. At the level of principle the requirement is uncontrover-sial. However, there are four points relating to the practical working of this principle which need to be considered.

Taking advice and delegating authority

First, and perhaps most obviously, the principle does not prevent directors seeking and acting on advice from others. Indeed. the board might well infringe its duty to take reasonable care if it proceeded to a decision without appropriate advice from outsiders (investment bankers, lawyers. valuers). What the board cannot do is treat the advice as an instruction, although in complex technical areas the advice may leave the board with little freedom for manoeuvre, for example, where lawyers advise that the board's preferred course of action would be unlawful. The board must regard itself as taking responsibility for the decision reached, after taking appropriate advice. Secondly, just as the duty of care does not prevent a board from delegating its functions to non-board employees (provided it has in place appropriate internal controls—see above), so the duty to exercise independent judgment does not prohibit such delegation.'62 However, it seems that s.173 was not intended to overrule the common law rule that delegatus non potest delegare, i.e. that a person to whom powers are delegated (as powers are to directors under the articles) cannot further delegate the exercise of those powers, unless the instrument of delegation itself authorises further delegation.163 In practice, wide powers of further delegation are conferred on the directors by the articles, and it is indeed difficult to see how the board of a large company could otherwise effectively exercise its powers of management of the company. However, this rule means that the articles may effectively prevent further delegation beyond the board by simply not providing for this.

162 See Madoff Securities International Ltd v Raven [2013] EWHC 3147 (Comm) at [191] (Popplewell I). '63 Cartmells' case (1874) L.R. 9 Ch. App. 691. On the Government's intention to preserve this lute see I-IC Debs, Standing Committee D, Company Law Reform Bill, Fifteenth Sitting, 11. July 2006 (Afternoon), col. 600 (the Solicitor-General).

Exercise of future discretion Thirdly, it was debated at common law whether the non-fettering rule prevented a director from contracting with a third party as to the future exercise of his or her discretion. The answer ultimately arrived at was that this was permissible in appropriate cases. The starting point at common law, despite the paucity of reported cases on the point,'" seems to be that directors cannot validly contract (either with one another or with third parties) as to how they shall vote at future board meetings or otherwise conduct themselves in the future.165 This is so even though there is no improper motive or purpose and no personal advantage reaped by the directors under the agreement. This, however, does not mean that if, in the bona fide exercise of their discretion, the directors have entered into a contract on behalf of the company, they cannot in that contract validly agree to take such further action at board meetings or

otherwise as is necessary to carry out that contract. As was said in a judgment of the Australian High Court'66:

"There are many kinds of transaction in which the proper time for the exercise of the directors' discretion is the time of the negotiation of a contract and not the time at which the contract is to be performed...1f at the former time they are bona fide of opinion that it is in the best interests of the company that the transaction should be entered into and carried into effect, I can see no reason in law why they should not bind themselves to do whatever under the transaction is to be done by the board."

The principle in Thorby v Goldberg was applied by the English Court of Appeal in Cabra Estates Plc v Fulham Football Club,167 so as to uphold an elaborate contract which the directors had entered into on behalf of the company for the redevelopment of the football ground and under which, inter alia, the club was entitled to some £11 million and the directors agreed to support any planning application the developers might make during the coming seven years. This is surely correct: if individuals may contract as to their future behaviour in these matters, it is desirable that companies should be able to do so too. The application of the "no fettering" rule would make companies unreliable contracting parties and perhaps deprive them of the opportunity to enter into long-term contracts which would be to their commercial benefit.

164 But see Clark v Workman [1920] 1 Ir.R. 107; and an unreported decision of Morton J in the Arderne Cinema litigation, below, at paras 19-10 et seq.; and the Scottish decision in Dawson International Plc v Coats Paton Plc 1989 S.L.T. 655 (1st Div.) where it was accepted that an agreement by the directors would be subject to an implied term that it did not derogate from their duty to give advice to the shareholders which reflected the situation at the time the advice was given. CGS Contrast the position of shareholders who may freely enter into such voting agreements: below, paras 19-25 et seq. What if the directors and the members enter into an agreement which fetters the directors' discretion? This was discussed, but not clearly settled, by the Canadian Supreme Court in Ringuet v Bergeron [1960] S.C.R. 672, where the majority held the voting agreement valid because, in their view, it related only to voting at general meetings. The minority held that it extended also to directors' meetings and was void, but they conceded that the position might have been different had all the members originally been parties to the agreement: see ibid., at 677. But cf. Fulham Football Club Ltd v Cabra Estates Pk [1994] 1 B.C.L.C. 363 at 393. 166 Thorby v Goldberg (1964) 112 C.L,R. 597 Aust. HC, per Kitto J at 605-606. 167 Cabra Estates Plc v Fulham Football Club [1994] 1 B.C.L.C. 363 CA; noted by Griffiths [19933 J.B.L. 576.

Section 173(2)(a) now provides that the duty to exercise independent judgment is not infringed by a director acting "in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors". In the parliamentary debates this provision was described as enshrining the Cabra Estates decision,'68 including presumably the rider that the agreement must be one entered into

by the directors in the bona fide opinion that it is in the best interests of the company to do so (i.e. "duly" entered into). Section 173(2)(b) goes on to state that no breach of the independent judgment rule arises if the director acts "in a way authorised by the company's constitution". Thus, the articles may authorise restrictions on the exercise of independent judgment, which might be a useful facility in private companies. However, s.173(2)(a) protects the directors only from the argument that they have failed to exercise independent judgment by entering into the agreement which restricts their future freedom of action. Can the subsequent exercise of their powers as the contract demands be said to be a breach of their core duty of loyalty, if at that time they no longer believe it to be in accordance with their core duty to act in accordance with the contract? There are a number of cases in which, where shareholder consent has been required for a disposal of assets or for a takeover, the courts have been reluctant to construe agreements on the part of the directors not to co-operate with rival suitors or to recommend a rival offer to the shareholders as binding the directors, if they come to the view that the later offer is preferable from the shareholders' point of view.169 This line of cases might be justified on the basis that shareholders are peculiarly dependent upon the advice of their directors and that they might find themselves in a poor position to take the decision which had been put in their hands, if they were given advice by the directors which did not reflect the situation as the directors saw it at the time it fell to the shareholders to take their decision. The continuing validity of the no fettering rule in this context could be reconciled with the provisions of s.173 on the basis that that section deals only with the fiduciary duties owed by the director to the company (see s.170(1)), whereas the situation just mentioned triggers the duty owed by directors to the shareholders to give them advice in the shareholders' best interest, if they choose to give them advice at al1.17°

Nominee directors

Finally, the independent judgment principle could cause difficulties for "nominee" directors, i.e. directors not elected by the shareholders generally but appointed by a particular class of security holder or creditor to protect their interests. English law solves such problems by requiring nominee directors to

168 See HC Debs, Standing Committee D, Company Law Reform Bill, Fifteenth Sitting, 11 July 2006 (Afternoon),-col. 600 (the Solicitor-General). 169 John Crowther Group Plc v Carpets International [1990] B.C.L.C. 460; Rackham v Peek Foods Ltd [1990] B.C.L.C. 895; Dawson International Plc v Coats Paton Plc, 1989 S.L.T. 655. The correctness of these decisions was left open by the Court of Appeal in Cabra Estates. Even here it must be accepted that the shareholders may in consequence lose a commercial opportunity which would otherwise be open to them. See the discussion below at paras 28-36 et seq. 1" See above, para.16-6.

ignore the interests of the nominator,"1 though it may be doubted how far this junc fion is obeyed n practice. The Ghana Companies Code 1973 adopted what in mightin permitting nominee directors to be regarded as the more realistic line by permive special, but not

exclusive, consideration to the interests" of the nominator, bgut even this formulation would not permit the "mandating" of directors and thus the creation of a fettering problem.

DUTY TO PROMOTE THE SUCCESS OF THE COMPANY

Settling the statutory formula The duty to promote the success of the company is the modern version of the most basic of the duties of good faith or fidelity owed by directors. It is the core duty to which directors are subject, in the sense that it applies to every exercise of judgement which the directors undertake, whether they are testing the margins of their powers under the constitution or not and whether or not there is an operative conflict of interest. Together with the non-fiduciary duty to exercise care, skill and diligence, the duty to promote the success of the company expresses the law's view on how directors should discharge their functions on a day-to-day basis. Thus, it is not surprising that its proper formulation has always been controversial, and perhaps never more so than during the deliberations of the CLR and the passage of the 2006 Act through Parliament, since this was an area of directors' duties where it was not proposed that the statute should simply repeat the common law. The common law duty was typically formulated as one which required the directors to act in good faith in what they believed to be "the best interests of the company". This, predictably, follows the equivalent formulation in relation to trustees, who are required to act bona fide in the best interests of their beneficiaries. That historical common law formulation differs in significant ways from what is now found in s.172(1) of the Act. This section requires the director to act "in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole"; and then sets out a non-exhaustive list of six matters to which the directors must "have regard" when deciding on the appropriate course of action. The common law formulation made it clear that the duty was owed to the company, so that only those who could claim to act as, or on behalf of, the company could enforce the duty. Section 170(1) repeats that. But, that aside, the Common law formulation that directors must act in the interests of "the company" was seen by many a being close to meaningless in providing guidance to directors. Because the company is an artificial legal person, it was seen as

171 troulting v ACTT [1963] 2 Q.B. 606 at 626, per Lord Denning MR; Kuwait Asia Bank EC National Mutual Life Nominees Ltd [1991] 1 A.C. 187 PC. The latter case shows that this principle has the advantage of not making the nominator liable for any breaches of duty to the company by the nominee director. Also see Thompson v The Renwick Group Plc [2014] EWCA Civ 635 CA, where health Court rejected the view that a parent assumes a duty of care to employees of its subsidiary in hoe_4.1th a safety matters by virtue of that parent company having appointed an individual as director °f its subsidiary company with responsibility for health and safety matters.

impossible to assign interests to it unless one goes further and identifies the - couripa.ny with the interests of one or more groups of human persons. As Nourse LJ remarked, "The interests of a company, as an artificial person, cannot be distinguished from the interests of the persons who are interested in it".172 In practice, the common law

normally identified the interests of the company with those of its shareholders, current and future if that was appropriate,173 and thus took the further step envisaged by Nourse LJ. In addition, at common law it was seemingly permissible for the directors to take into account stakeholder interests when acting in the interests of the company. The point was made a long time ago, albeit in the context of ultra vires, by Bowen LJ, who famously said: "The law does not say that there are to be no cakes and ale, but there are to bieno cakes this ale except such as are required for the benefit of the company".74 It is in h sense that the view of the Law Society,175 opposing any statutory reformulation as being unnecessary, can be understood; they urged instead that "the concept of the company as a legal entity separate from its members, and in whose interests the directors must act, is well understood". If the old test of "the interests of the company" was too vague, what should a clearer statutory version require? Given the concentration of economic power in large companies, the question of which interests the directors were required to pursue when exercising their powers was of considerable interest and controversy across the political spectrum. Should the directors be required to act in the interests of the shareholders (the shareholder primacy model), or should they perhaps give equal status to all the company's various stakeholders, including not simply the shareholders but also employees, customers, suppliers, and indeed even the local community and the environment (the pluralist model)? The different interests ranged on either side added heat to the debate. The final outcome was, perhaps predictably, something between these two extremes, although undoubtedly closer to the first and so also to the old common law test. The statutory formulation clearly rejects the "pluralist" approach, at least to the extent that it might have given all stakeholders some sort of equivalent status, allowing all to have the right to enforce directors' duties. But, at the other end of the spectrum, shareholder primacy was refined: the shareholders or members are certainly to be the primary object of the directors' efforts, hence the current formulation that the director must act "in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole"; but the directors are also subject to an obligation (not merely a power), although clearly a subordinate obligation, to "have regard to' the interests of other stakeholders. The subordinate nature of this second duty is

172 Brady v Brady [1988] B,C.L.C. 20 at 40 CA. 173 Gainian v National Association for Mental Health [1971] Ch. at 330: "both present and future members". Also see below, para.16-46. "4 Hutton v West Cork Railway (1883) 23 Ch, D. at 673, the "cakes and ale" being in this case gratuitous benefits for the employees, For this reason directors can normally justify modeset; business-related political or charitable donations on the part of their companies, though the broader public policy issues arising out of such donations are recognised in the requirement that su ne donations be disclosed in the directors report and in some cases approved by the shareholders: se '.below, paras 16-50 and 21-23. 05 The Law Society, Company Law Reform White Paper, June 2005, p.6.

made clear by the words "in doing so", i.e. in discharging the central duty. Put another way, the shareholders' position as the object of the directors' efforts is not shared with

other groups of persons upon whose success the company's business m' ay be thought to depend, for example, its employees or other stakeholders. To this extent, the rule of.shareholder primacy is reiterated in the section. The strategy of rejecting pluralism but adopting a modernised version of shareholder primacy emerged from the CLR, and was described there as a philosophy of "enlightened shareholder value (ESV)".176 Thus, in promoting the success of the company for the benefit of its members as a whole, s.172(1) requires that the director:

"in doing so [must] have regard (amongst other matters) to—(a) the likely consequences of any decision in the long term, (3) the interests of the company's employees, (c) the need to foster the company's business relationships with suppliers, customers and others, (d) the impact of the company's operations on the community and the environment, (e) the desirability of the company maintaining a reputation for high standards of business conduct, and the need to act fairly as between members of the company (s.172(I))"

The ESV approach can be said to embody the insight that the success of the company or the interests of the shareholders are not likely to be advanced if the management of the company conducts its business so that its employees are unwilling to work effectively, its suppliers and customers would rather not deal with it, it is at odds with the community in which it operates and its ethical and environmental standards are regarded as lamentable. However, it is crucial to note that the interests of the non-shareholder groups are to be given consideration by the directors only to the extent that it is desirable to do so in order to promote the success of the company for the benefit of its members as a whole. The non-shareholder interests do not have an independent value in the directors' decision-making, as they would have under a pluralist approach. For this reason, it seems wrong in principle to regard the section as requiring the directors to "balance" the interests of the members with those of the stakeholders. The members' interests are paramount, but the interests of stakeholders are to be taken into account when determining the best way of promoting the members' interests. It may be asked whether the ESV approach amounts to a development or a repetition of the common law. The answer is that it represents a development, but a modest one. What the Act adds to the common law is a duty on the part of the directors to take account of stakeholder interests when it is in the interests of the success of the company for the benefit of members to do so (but not a corresponding right in the stakeholders to enforce that duty). However, the statutory restatement may nevertheless have an impact, if only by disabusing those directors and their advisers who might have been inclined to take an unduly narrow interpretation of the duty previously held. If the move from permission to well-described obligation is what lies at the root of the ESV approach, it becomes of peat importance to know how the duty

176 See. Developing, Ch.3 and Completing, Ch.3.

will. be enforced. As argued immediately below, s.172 imposes a mainly " subjective test,' so, as with the predecessor common law duty, litigation is likely to be relatively

uncommon and probably even less often successful. This is because it is very difficult to show that the directors have breached this duty of good faith, except in egregious cases or cases where the directors have, obligingly, left a clear record of their thought processes leading up to the challenged decision.' 78 Instead, the major role in giving some degree of practical substance to the ESV duty will lie in the extended reporting requirements to shareholders by directors, as described in Ch.21.179 This was as envisaged by the CLR, which saw the ESV approach to directors' duties and enhanced reporting requirements as closely linked.'8° Finally, and for the avoidance of doubt, the duty of the directors to promote the success of the company for the benefit of its members does not exempt the company from compliance with its other legal obligations, for example, health and safety or discrimination legislation, even if it could be shown that non-compliance would promote the company's overall success.

Interpreting the statutory formula

Defining the company's success

Several important points arise on the interpretation of the language contained in this section. First, it is to be noted that corporate success for the benefit of the members is the word used to identify the touchstone for the exercise of the directors' discretion. Success is a more general word than, for example, "value", which it might have been thought was what the shareholders are interested in. However, the more general word is clearly the appropriate one, because not all companies formed under the Act are aimed at maximising the financial interests of their members. Companies may be charitable; they may have non-profit-making objectives without being charities, as in the case of a company formed by leaseholders to hold the freehold of a block of flats; they may be companies set

177 LNOC Ltd v Watford Association Football Club Ltd [2013] EWHC 3615 (Comm) at [64] (HH Judge Mackie QC). 178 The classic case where the directors did all too clearly reveal their reasoning is Dodge v Ford Motor Co (1919) 170 N.W. 668. Henry Ford openly took the view that the shareholders had been more than amply rewarded on their investment in the company and so proposed to declare no further special dividends but only the regular dividends (of some 60 per cent per annum!) in order to reduce the price of the cars, to expand production and "to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes" (at 683). This was held to be "an arbitrary refusal to distribute funds that ought to have been distributed to the stockholders as dividends" (at 685). See the current regulations on narrative reporting (which apply to financial years ending on or after 30 September 2013) as set out in the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013. These followed from a BIS consultation on narrative reporting, The Future of Narrative Reporting—A further consultation (2011) and The Future of Narrative Reporting: The Government Response (2012) https://www.goRuk/government/consultations/the-future-of-narrative-reporting-a-further-cOniultation [Accessed 5 May 2016]. 18P 'Developing, para2.22.

-up within a corporate group simply to hold a particular asset rather than to exploit - it; even though the overall purpose of the group is to make profits; or they may be commercially-oriented but without aiming to distribute profits, in which case the company may, but is not obliged to, be incorporated as a CIC. In all these cases, maximising the value of the company is not the primary objective of its tnembers and perhaps not even an objective at all. Section 172(2) makes it clear that: “where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.” The underlying thrust of the section is that it is the members who are to define the purposes of the company against which the directors can give meaning to the requirement to promote its success. The definition of the purpose of the company may be set out in its constitution. This is less likely to be the case now that the company is no longer required to have an objects clause, but certainly in the case of companies with non-commercial or non-profit objectives this fact is likely to appear clearly enough from the company’s articles. In other words, the position may turn out to be that the company is to be regarded as a commercial company, unless its constitution indicates otherwise, and so in the typical case the directors will define success in commercial terms. A more important underlying question is the extent to which the section is intended to constrain directors’ decisions about precisely how to pursue the success of the company. Should the company aim for expansion through a series of takeovers or by organic growth? Should the company aim for expansion at all or for exploitation of a niche position? It seems clear that the section does not intend to address this sort of issue at all. This is to be left to the directors, who in turn are accountable to the shareholders for their decisions through the company’s corporate governance mechanisms rather than through the courts. To this end, the section imposes a subjective test for compliance: the director must act “in the way he considers, in good faith, would be most likely to promote the success of the company”. This aspect of the statutory duty is one shared with the previous common law formulation, and that was interpreted by the courts in such a way as to leave business decisions to the directors. As Lord Greene MR put it in Re Smith & Fawcett Ltd, directors were required to act “bona fide in what they consider—not what a court may consider—is in the interests of the company”.18’ In most cases, it is true, compliance with the rule that directors must act in good faith was tested on commonsense principles, the court asking itself whether it was proved that the directors had not done what they believed to be right, and normally accepting that they had unless satisfied that they had not behaved as honest men of business might be expected to act. However, even where the director had not acted as an honest business person might be expected to act, this is not necessarily a demonstration of breach of the duty of good faith. Thus, in one case where the directors’ decision had caused substantial harm to the company it was held that this was merely a piece of evidence, perhaps a strong piece, against their contention that they had acted in good faith, rather than proof 18i “and not for any collateral purpose” [this closing phrase seeing its statutory parallels in s.171(b)]: [1942] Ch. 304 at 306 CA.

absolute that they had not."2 These decisions on the meaning of good faith in the context of the core duty of fidelity at common law seem equally applicable to the statutory duty,

Failure to have regard, or due regard, to relevant matters The concept of ESV enshrined in the statutory duty imposes an obligation on directors to "have regard" to the list of factors set out in subs.172(1)(a)—(f). Does this give rise to a corresponding power in the courts to scrutinise the decisions of directors to establish whether they have indeed taken account of these factors, or perhaps even whether, on an objective basis, they have taken appropriate account of these factors? The answers to these questions seem inextricably linked to the "improper purposes" issues discussed earlier (s.171(b)); the older common law rule similarly juxtaposed the two requirements.'" On the first question, a proper reading of the section does suggest that a failure by directors to have regard to each item on the list of factors would constitute a breach of duty and render the directors' decision challengeable. This principle was already established at common law, although perhaps in a more limited form: although much was left to the directors' discretion (as described below) in determining what was in the interests of the company, the directors might breach that duty where they failed to direct their minds at all to the question of whether a transaction was in the interests of the company, even though a board which had considered the question might well have acted in the same way. A good illustration of the principle is afforded by Re W&M Roith Ltd.18" There the controlling shareholder and director wished to make provision for his widow. On advice, he entered into a service agreement with the company whereby on his death she was to be entitled to a pension for life. On being satisfied that no thought had been given to the question whether the arrangement was for the benefit of the company and that, indeed, the sole object was to make provision for the widow, the court held that the transaction was not binding on the company.' In this case it might be said that the straightforward financial success of the company was clearly compromised by the decision, since the widow was unlikely to provide the company with any corresponding corporate benefit. In such circumstances, the directors needed to be able to demonstrate that their decision was based on due consideration of the corporate benefit, and this they could not

182 Regentcrest Plc (In Liquidation) v Cohen [2001] 2 B.C.L.C. 80. See also Extrasure Travel Insurances Ltd v Scattergood [2003] 1 B.C.L.C. 598 at [90]. It is to be noted that in neither the formulation of Lord Greene MR nor in s.172 is there a requirement upon the director to act "honestly" as well as "in good faith", though the word "honestly" is used in a number of court decisions in this area. However, the CLR did not believe that the adverb "honestly" added anything of importance to the requirement of good faith and its use might create uncertainty, and so it did not recommend its use either here or elsewhere in the statutory restatement: Completing, para.3.13. 183 Re Smith and Fawcett Ltd [1942] Ch. 304 at 306 CA (Lord Greene MR). 184 Re W&M Roith Ltd [1967] 1 W.L.R. 432. 185 Following Re Lee, Behrens & Co Ltd [1932] 2 Ch. 46; but cf. Lindgren v L&P Estates Ltd the commercial merits. [1968] Ch. 572 CA, where it was held that there had been no failure on the part of the directors to consider.

However, had they been able to do that, the court would have been unlikely to second-guess their conclusions even if the court itself might not have reached the same decision. But this strict approach might be thought impractical. By contrast, in Charterbridge Corp I. Lloyds Bank,187 the directors of a company forming part of a corporate group had considered the benefit of the group as a whole, but without giving separate consideration to that of the company alone, when they caused the subsidiary company of which they were directors to give security for a debt owed by the parent company to a bank. It was held, perhaps surprisingly given the accepted common law formulation of the requirement on directors, that "the proper test in the absence of actual separate consideration must be whether an intelligent and honest man in the position of a director of the company concerned could have reasonably believed that the transactions were for the benefit of the company". Here the collapse of the parent company would have been "a disaster" for the subsidiary.'" The decision perhaps suggests that although directors must act in ways they consider would be most likely to promote the interests (or the success) of the company, it is also true that where, objectively, on balance, their decision can be seen to do that, it will not be overturned; the directors will not be held to be in breach of their duty at common law to act in the interests of the company (or, under the statute, their duty to promote the success of the company) merely because they did not give explicit thought to the question, at least in the absence of proven detriment.'``-' On the other hand, and despite the Charterbridge decision, it must be said that the core duty of good faith does not recognise a duty "to the group" or to other companies in the group. It insists that the main focus of directors must be on the interests of their subsidiary, even if it accepts that the interests of the subsidiary are in many cases intimately related to the continuing existence of the group.'9°

186 Similarly, see Scottish Co-operative Wholesale Society Ltd v Meyer [1959] A.C. 324 HL. 187 Charterbridge Corp v Lloyds Bank [1970] Ch. 62. A similar approach has been adopted in the area of unfair prejudice. See Nicholas v Soundcraft Electronics Ltd [1993] 1 B.C.L.C. 360 CA. 188 cf. Extrasure Travel Insurances Ltd v Scattergood [2003] 1 B.C.L.C. 598, accepting the law as stated in the Charterbridge case, but coming to a different conclusion on the facts because (a) the directors of the subsidiary never considered whether the survival of the parent was crucial to the subsidiary; and (b) no reasonable director would have concluded that the steps taken by the directors would lead to the survival of the parent. 189 Re HLC Environmental Projects Ltd an Liquidation) [2014] B.C.C. 337 at [92]—[93] (John Randall QC); Green v El Tai [2015] B.P.I.R. 24 Ch D at [110] (Registrar Jones); Madoff Securities International Ltd v Raven [2013] EWHC 3147 (Comm) at [194]. 19° See also Lindgren v L & P Estates Co Ltd [1968] Ch. 572, 595, per Harman Li (no duty owed by director of holding company to subsidiary); and Bell v Lever Bros Ltd [1932] A.C. 161 at 229, per Lord Atkin (no duty owed by director of subsidiary to the parent company). The statutory qualification to the definition of a "shadow director" in s.250(3) (above, para.16-8), excluding a company in relation to its subsidiaries, supports this approach. The cases do not distinguish between wholly-owned subsidiaries and those with outside minority shareholders. Only in the latter case does the imposition of a group policy potentially have an adverse effect on the interests

of the shareholders, for which the unfair prejudice provisions may now provide a remedy (see Ch.20). It should also be noted that it is apparently legitimate for the company's articles to permit or require the directors to take into account the interests of other companies in the group, because in that way it could be said that the articles have defined what is to be regarded as "success" for the company in question.

Directors in corporate groups must guard against their inevitable inclinations- to promote the interests of the group as a whole (or some part of it). These cases all concern the common law duty. Their analysis is in principle equally applicable to breaches of the statutory provisions, and indeed finding a breach of the core statutory duty of good faith on the ground ltihaetly ndnuotaellr the required interests have been taken into account is perhaps more likely ESV approach because the statute is so much clearer about the precise range of matters to which directors must have regard in the discharge of their duty to promote the success of the company for the benefit of its members. To that extent, the retreat from the strict approach in Re W & M Roith Ltd 91 is welcome. Moreover, since the statutory list of factors is non-exhaustive, it would follow that a director would be in breach of duty in failing to take account of any matter which he or she considered relevant to the decision in question. However, in truth the statutory formulation largely makes explicit what was already implicit in the earlier common law, so it does not require boards to approach decision-making, or to document their decisions, in a totally novel fashion. Of course, to the extent that boards might previously have ignored potential adverse impacts on shareholders' interests by failing to analyse the impact of a proposed decision on non-shareholders, the section should produce a change of practice. On the second question, of whether the directors have not simply taken account of the listed factors but have taken appropriate account of them, the earlier common law cases suggest that the courts will generally resist any request to second-guess the directors' judgement of how best to act in the interests of the company.'92 The only exception is perhaps when, in the court's view, no reasonable director could have considered the chosen course of action to be in the company's interests (by analogy with the public law "Wednesbug unreasonable-ness" test). Such facts as raise this concern are often seen to go to the question of whether the court believes that the director did in fact consider the relevant matter at all (and so is part of the analysis of the first question just considered), but to the extent that the court's determination is not simply evidential, but judgemental, the resulting judicial oversight of directors' management decisions has remained very restrained, and in any event is limited to overturning the impugned decision, not substituting the courts' decision (except to the extent that this is implicit in the courts' unravelling of what has been done). Indeed it is notable that the architect of the public law Wednesbury principle, Lord Greene MR, was also the judge who in Re Smith & Fawcett (quoted earlier) was concerned to stress the freedom of directors from control by the courts in the exercise of their good faith judgement, while also adding a "proper purposes" limitation analogous to the public law principle and to the statutory principle now found in s.171(b). The most authoritative statement of this approach to judicial review is that of Lord Woolf in Equitable Life Assurance Society v Hyman,'93 although his

191 Re W & M Roith Ltd [1967] 1 W.L.R. 432, 192 See above, para.16-40; and. Edge v Pensions Ombudsman [2000] Ch. 602 at 627E-630G CA; Equitable Life Assurance Society v Hyman [2002] 1 A.C. 408 at [17]—[21] HL. 193 Equitable Life Assurance Society v Hyman [2000] 2 All E.R. 331 at [17]—[21] CA (per Lord Woolf). In the House of Lords ([2002] 1 A.C. 408) Lord Steyn dealt with the case as a matter of an implied term in a contract, whilst Lord Cooke, dealing with it as a matter of the exercise was not part of the arguments of the other two judges in that 'case (or in e House of Lords on appeal). The complaint in this case was between groups of corporate creditors each complaining about the effect of the directors-' decision; in_ other cases where the Wednesbuty principle has been invoked, the disputes have typically been among members of the company about their rights and interests as shareholders rather than disagreements about the setting of the company's business strategy.194 It might be thought, therefore, that the inclusion in subs.(1)(f) of "the need to act fairly as between the members of the company" as one of the factors of which the directors need to have regard could turn out to be significant, although the shareholders typically have more amenable avenues for complaint than reliance on a duty the directors owe to the company. Indeed, it might be better, analytically, to see this type of objective judicial review, where relevant, as situated under s.171(b), with s.172 merely providing an explicit list of proper considerations required to be taken into account in directors' decision-making. Such an approach would effectively align s.171(b) "improper purposes" with the mandatory considerations listed in s.172, but would remind complainants of the inherent limitations in the claim being advanced. And to the extent that unfair treatment of minorities by controlling persons is the chief mischief to be dealt with, a remedy can alternatively often be provided under the unfair prejudice provisions discussed in Ch.20. Whatever the better classification of these claims, it seems clear from the course of parliamentary debates on the Bill that the Government did not intend in its formulation of s.172 to introduce a wide-ranging judicial review of the decisions of directors. In an earlier version of what became s.172, the duty to act in good faith was set out in subs.1 and the list of ESV factors in subs.3. Later they were brought together in subs.1. As the Minister for Industry and the Regions explained in the parliamentary debates:

"In [the House of Lords], the clause was amended to bring together what are now its subsections and make even clearer—I hope to hon. Members and certainly to those outside who will have to use the law—our intention that, while a director must have regard to the various factors stated, that requirement is subordinate to the overriding duty to promote the success of the company."

In addition, the Minister continued, the bringing together of the two previously separate subsections involved the deletion "from the clause of a second 'must', which we considered could be perceived as creating a separate duty". Finally, and most importantly:

discretion for a proper purpose, did not cite the Wednesbury principle but confined himself to mention of the Howard Smith v Ampol case (see fn.109, above). See also

Hunter v Senate Support Services Ltd [2005] 1 B.C.L.C. 175 at [165]–[232]. 194 See the previous note and the cases referred to therein. However, it should also be noted that Re Smith & Fawcett Ltd was itself an intra-member dispute.

“we believe it essential for the weight given to any factor to be a matter for a director’s good - faith judgment. Importantly, the decision is not subject to the reasonableness test that appears in other legislation ....That is in sharp contrast to, for example, decisions on public laws to which courts often apply such a test.”‘ 95 For all these reasons, it appears that the deferential approach of the common law to directors’ judgements in relation to the core duty of good faith and fidelity was intended to be applied also to its statutory reformulation. A duty to disclose wrongdoing In an interesting decision, in Item Software (UK) Ltd v Fassihii” the Court of Appeal held that a director was under a duty to disclose his own breaches of fiduciary duty, an obligation apparently derived from, i.e. was an aspect of, the core duty of good faith and loyalty.197 At first sight this is a draconian duty. However, in many cases it will add little to the director’s potential liability for breaches of fiduciary duty, though in some cases, as in this one, it will. The director had committed a breach of the corporate opportunity rule (discussed below) by attempting to persuade a client of the company to renew a contract with him personally rather than with the company. In the end, the client renewed the contract with neither the director nor the company. Against orthodoxy, the company sued for damages (not profits) for breach of the corporate opportunity doctrine, but failed because the trial judge had held that the client did not take the director’s offer seriously. However, the court also found that, had the company known of the director’s activities, it would have accepted an offer to renew from the client which it in fact rejected. Thus, the company’s loss was the profit it would have made on this admittedly not favourable contract, but that loss could be recovered only if the director should have told the company of his underhand activities, a duty which the court found to exist. The case has been thought in some quarters to create a new and free-standing “duty of disclosure” on directors, but it is submitted that this is not the case. In fact, seen as a part of the core duty of good faith and loyalty, rather than as a free-standing duty of disclosure, the decision seems unproblematic. The core duty must require a director to bring to the attention of the board threats to its business of which the director becomes aware. The twist in this case was that the duty was imposed even though the threat arose out of the director’s own wrongdoing, but it would be odd if the director’s wrongdoing could relieve him or her from a course

195 HC Debs, Standing Committee D, Company Law Reform Bill, Fifteenth Sitting, 11 July 2006 (Afternoon), all quotations from cols 591-592. At one stage the duty of the director to take into account the listed factors was qualified by the phrase “so far as reasonably practicable” but this was deleted, perhaps because of the suggestion in the phrase of an objective test for review of the directors’ decision. See also HL Debs, vol.681, cols 845-846, 9 May 2006 (Lord Goldsmith, on Report). 196 Item Software (UK) Ltd v Fassihi [2005] 2 B.C.L.C. 91. Also see GHLM Trading Ltd v Maroo [2012] EWHC 61 (Ch); IT Human Resources Plc v Land [2014] EWHC 3812 (Ch). 197 See Stupples v Stupples & Co (High Sycombe) Ltd [2012] EWHC 1226 (Ch) at [59] (HHJ David Cooke).

Further, in First Subsea Ltd v Balltec Ltd [2014] EWHC 866 (Ch), Norris _I emphasised (at [191]) that the duty to "self-report" is "not a discrete and free-standing duty. It is one aspect of a bundle of interrelated obligations which together constitute 'good faith' and loyalty'."

of action which would otherwise have to be taken,'" The main obstacle in 'reaching this result was the earlier decision of the House of Lords in Bell v Lever 199 which had been interpreted by some as laying down a general -Bros Ltd, principle that a director's own wrongdoing never had to be disclosed, The court was able to accept the result in that case by confining it to the situation where the director was negotiating compensation for the termination of his or her services with the company or an improvement in the terms of his or her employment, on the grounds that disclosure in such a case would be "contrary to the expectations of the parties'?" However, outside the context of the director negotiating terms of service with the company, a duty to disclose others' or one's own wrongdoing can be regarded as a normal incident of the core duly of fidelity, where the director is aware that the facts of which he or she is in possession should be given to the company if it is to protect and further its own interests.

The problem of "short-termism"

The common law focus on shareholders led to a widespread but, it is submitted, erroneous view that the law required directors acting in the interests of shareholders to prioritise their short-term interests. The better view, it is suggested, is that the directors were not bound to any particular timeframe; on the contrary, they must take into account both the long- and the short-term interests of the shareholders and strike a balance between them.2°' The CLR proposed in its draft statement of directors' duties to specify an obligation on the directors to take into account "the likely consequences (short and long term) of the actions open to the director".2°2 A.s we have seen, s.172 refers merely to "the likely consequences of any decision in the long term". If anything, the omission of the reference to short-term interests in the non-exhaustive list emphasises the importance of long-term consequences. That bias is repeated in the UK Corporate Governance Code.2°3

198 See Shepherds Investments Ltd v Walters [2006] I.R.L.R. 110 at [132]. 199 Bell v Lever Bros Ltd [1932] A.C.161. 20° Bell v Lever Bros Ltd [1932] A.C.161 at [57]—presumably because the parties were on opposite sides of a negotiation. 2°1 See Counsel's Opinion quoted in the Report by Mr Milner Holland of an investigation under s.165(b) of the Companies Act 1948 into the affairs of the Savoy Hotel Ltd and the Berkeley Hotel Company Ltd, Board of Trade, 1954. This somewhat obscure source has long been regarded as the locus classicus on this point. See also Gainian v National Association for Mental Health [1971] Ch. at 330: "both present and future members". 2_02 CLR, Final Report I, p.345 (Principle 2, Note (1)). 2°3 CGC, A.1-Main Principle. See too BIS, A Long-Term Focus for Corporate Britain: A Call for Evidence (2010), Responses were published, but then nothing more was done: see https://www.govectk/

government/consultations/a-long-term-focus-for-corporate-britain-a-call-for-evidence [Accessed 13 February 2016].

Corporate groups

We have already considered the potential problem faced by directors within corporate groups, where their instinct may be to look to the overall success of the group, whereas their duty of good faith and loyalty is owed only to their appointing company.204

Employees Among the factors to which a director of a company must have regard under s.172(I) are "the interests of the company's employees". This is as one would expect: any comprehensive list of stakeholder interests will necessarily include the employees. But the practical impact of this on employees is limited. Indeed, it was said of the predecessor provision205 that its real impact was to dilute directors' accountability to shareholders rather than strengthen accountability to employees. This is because employees cannot use the section offensively, whilst directors can use it defensively when sued by shareholders, by arguing that a decision apparently unfavourable to the shareholders is unchallengeable because it was taken in the interests of the employees.206 Writ large, this illustrates the argument against the pluralist approach to this core duty of good faith. So long as the duty is perceived subjectively, increasing the number of equal-status groups whose interests the directors must promote makes proof of breach difficult, almost to the point of impossibility. Correcting that defect by making the duty objective, however, paves the way for excessive judicial intervention in the taking of board-level decisions, thus inducing caution on the part of those who ought to be risk-takers. The best view is probably that any broadly-formulated pluralist provision could not by itself operate so as to alter the decision-making processes of a board unless coupled with further changes in company law, such as board-level representation for the relevant stakeholder groups. There is, however, one particular derogation from the core duty which is made in favour of employees. This is to be found in s,247, involving the power to make gratuitous payments to employees on the cessation of the company's business, as discussed at para.7-29.

Creditors

There is one surprising omission from the statutory list of matters to which the directors must have regard, namely, the interests of the creditors, except to the extent it is embraced by subs.172(1)(c). Of course, so long as the company's business is flourishing, the creditors' position is not prejudiced by such an omission. Their contractual rights against the company plus the company's desire to preserve its reputation and thus access to future credit will act so as to protect

2" Sec above, para.16-36. Companies Act 1985 s.309, although expressed in different terms to s.172(1)(b). 206 cf. Re Saul D, Harrison & Sons Plc [1995] 1 B.C.L.C. 14 at 25 CA, where resort was had to the Companies Act 1985 s.309 to undermine the shareholder petitioning under 459 against the board/majority shareholders of the company, the creditors. However, once the company's fortunes begin to decline, conflict

between the interests of the shareholders and the creditors may emerge in a strong form; the directors have an incentive to take excessive risks to protect their own and the shareholders position, knowing that, if the company is in the vicinity of insolvency, the downside risk will fall wholly on the creditors, whilst the upside benefit will get the company out of trouble. We have already seen in Ch.9 how this problem is dealt with, both by statutory insolvency laws operating in the lead up to insolvency, and by common law rules operating still earlier. The CLR considered whether these statutory and common law rules should be reiterated, or even expanded, in s.172,207 but in the end the many perceived difficulties were all avoided by the simple strategy of providing, expressly, in s.172(3), that the duty imposed under that section "has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company". The detail thereby comprehended is covered in Ch.9.208

Donations

In the abstract, a decision on the part of the directors to give the company's assets away would appear to be a clear example of a decision not taken in good faith to promote the success of the company for the benefit of its members. On the other hand, companies are always being approached to support various causes, worthy or less worthy, and do in fact make donations of various sorts. Company law has sought to distinguish between donations which promote the company's business (legitimate) and those which do not (illegitimate). Traditionally, that distinction was drawn by the law relating to ultra vires, but now the focus is on directors' powers: in the absence of an express provision in the articles or elsewhere conferring upon directors the authority to make donations, is there an implied power to do so in order to further the company's business?209 And if there is such a power, has it been exercised appropriately?210 This second question has various strands. Thus, in Re Lee, Behrens and Co Ltd,2" where the company's constitution conferred an express power on the directors to make the gift in question, Eve J identified the relevant tests as follows: "(i.) Is the transaction reasonably incidental to the carrying on of the company's business? (ii.) Is it a bona fide transaction? and (iii.) Is it done for the benefit and to promote the prosperity of the company?" In practice, the courts have tended not to examine very closely the link between the donation and the company's business when it seemed to them that

201 See CLR, Final 1, para.3.17 and p.348 (Principle 9); Modernising Company Law, Cm. 5533-1, July 2002, paras 3.11-3.12. 208 See paras 9-4 et seq. X09 The courts are likely to give a positive answer to this question. 210 Thus, in Evans v Brunner, Mond & Co Ltd [1921] 1 Ch. 359, where the question was whether a shareholders' resolution expressly conferring power on the directors to make a certain class of donation was ultra vires, Eve J said obiter of the authority conferred by the resolution that it "is certainly impressed with this implied obligation on those to whom it is given, that they shall exercise the discretion vested in them bona fide in the interests of the company whose agents they are". 21 Re Lee, Behrens and Co Ltd [1932] 2 Ch, 46. Also see MSL Group

Holdings Ltd v Clearwell International Ltd [2012] EWHC 3707 (QB) (Sir Raymond Jack) at [41]—[42], [45].