Chapter- 5

Directors duties of Care and Skill

The director of a company occupies a very important position. He has to manage the funds of the company running into crores of rupees. Hence for a company to be successful the director must possess appropriate qualification. The corporate executive are today possessed of "immense power which must be regulated not only for the public good, but also for the protection of those whose investment are involved" Directorship will always be suspect and capable of abuse "some directors will always be faithless to their trust. They can capitalise their strategic position in the company to serve their own interest" The law therefore, continues to struggle against their actions and impose upon them certain duties which, when properly enforced without giving rise to favor and driving away from the field competent men may materially reduce the chances of abuse. 1

Most of the principles which are discussed were settled in the courses of the 19th century by Chancery Judges. In the area where in was practicable and realistic to draw a fairly close parallel with trustees and other fiduciaries the equitable rule served, and the courts had the precedents and the experience to put up with the conduct of directors whether a man had acted honestly, whether he had exceeded his
authority, whether he had put his personal interest in conflict with his fiduciary obligations, whether he had exercised a discretion properly in all these matters the court was on familiar ground. When confronted with other issues, however the Judges had no precedents and no standards to go on e.g. the absentee director; the great bulk of wholly discretionary decisions no matters of policy, the making of valuations and estimates the deliberate encountering risk. The court in these matters simply opted out; using the laissez-faire theory as excuseless to justify its nonintervention "The Company must take the consequences of having intrusted there moneys to persons of sanguine temperament"

In the present century there are indications that the courts have come to acknowledge that they ought to not to remain wholly aloof in these matters. The fusion of common law and equity, and the recognition by the commercial world of standards of good business practice have helped towards the establishment of the concept of the "reasonable director" There are many things which a director is called upon to do which demand no specialised knowledge and in this matters is no required to show "reasonable" or "ordinary" care and prudence. In essence, these situations involve one basic question and that is did the director make adequate inquiries personally before acting? Was he justified in trusting to the integrity of another, in relying on the judgment or the recommendations of his fellows or some servants or agent in accepting some system handed from a previous generations of
administrators? Although initially the codes preferred to treat this as an issue of bonafide an objective approach is favored in modern cases. In fact it is probable that the change is more one of language than of substance, for most directors can be expected to have a degree of common sense and the making of reasonable inquiry before entering in to any transaction such as buying or selling property or lending or paying money, is an every day matter even for laymen. And we have seen that the courts, under the old subjective approach, still insisted on elementary standards of prudence, and were equate folly with dishonesty. 2 On the other hand the law still declines to impose objective standards either of business competency or of technical skill. The standard of skill and care which the law expects of a company director in the performance of office duties derives from the case law. The directors having duties of honesty and good faith as quasi-trustees are however, in striking contrast to their qualification and obligations of skill and diligence. It is also almost impossible to frame rules which will apply to the different circumstances of different companies. Directors like other agents have to display some degree of both but the courts have found difficulty in deciding how much. The reason of course, is the difficulty the codes find in dealing with problems of business economics and administrations. It is easy to be wise after the event, and recognising this, the courts have been unwilling to condemn directors where loss has been occasion to the company because the course of business events have been misjudged.
In the past the courts have been reluctant to impose onerous standards of care and skill on directors and have been willing to impose liability only when the directors imprudence has been so great and so manifest as to amount to gross negligence. The reluctance may stem from the difficulty in ascertaining to loss caused to the company by the directors mismanagement. The real reasons for this are, however is mainly historical. Many of the cases reflect a time when directors merely attended Board meetings were figureheads, adornments to the company publications, title people with time on their hands. In keeping with this state of affairs, the courts recognised them as amateurs who did not possess any particular executive skill and upon whom it would be unreasonable to impose onerous standards of care or skill. Another difficulty was that if a higher degree of care and skill was to be required then this might involve judicial assessment of managerial skills of the individuals concerned. Some thing which the courts have always been reluctant to do. In Re Forest of Dean Coal Mining Company;

The question was whether Barrett as a director was liable to the company for failing to take steps to recover moneys which were due to the company from one Johnson under a transaction which had taken place three years before Barrett’s appointment Jessel M.M. held that, whatever might have been the position in the case of a trustee in he strict sense, a director was under no such duty.
J R S S E L M. R. . . . Directors have sometimes been called trustees, or commercial trustees, and sometimes they have been called managing partners, it does not much matter what you call them so long as you understand what their true position is, which is that they are really commercial men managing a trading concern for the benefit of themselves and of all the other shareholders in it. They are bound, no doubt, to use reasonable diligence having regard to their position, though probably an ordinary director, who only attends at the board occasionally, cannot be expected to devote as much time and attention to the business as the sole managing partner or an ordinary partnership, but they are bound to use fair and reasonable diligence in the management of their company's affairs, and to act honestly.

But where without fraud and without dishonesty they have omitted to get in a debt due to the company by not suing within time, or because the man was solvent at one moment becomes insolvent at another, I am of opinion that it by no means follows as a matter of course, as it might on the case of ordinary trustees of trust funds or of a trust debt, that they are to be made liable. Traders have a discretion as to whether they shall sue their customers, a discretion which is not visited in the trustees of a debt under a settlement . . . such a case as this has, in my opinion, no direct relation to the rule which makes it incumbent on a trustee to sue a
debtor at once under pain of having the liability for the debt afterwards thrown upon him, on the ground that if he had sued he could have got the money...

[In] my opinion no such liability attaches to directors of Joint Stock Company. They must, as ordinary managing partners of a trading concern, be allowed a discretion, and not be too much interfered with by the court, or have inquiries made by the court as to whether the debtor could have paid at a partnership moment a larger or a smaller amount if he had been sued...

Again, directors are called trustees. They are no doubt trustees of asset which have come into their hands, or which are under their control, but they are not trustees of a debt to the company. The company is the creditor, and as I said before they are only the managing partners, in my opinion it is extravagant to call them trustees of a debt when it has not been received ... A director is the managing partner of the concern, and although a debt is due to the concern I do not think it is right to call him a trustee of that debt which remains unpaid, though his liability in respect of it may in certain cases and in some respects be analogous to the liability of a trustee...

The next question which we have ask is whether a director is a fiduciary?.
A fiduciary is someone who undertakes to act for or on behalf of someone else in circumstances which give rise to a relationship of trust and confidence between the parties. Directors are in a fiduciary relationship with their company and owe fiduciary duties stemming from the primary obligation of loyalty. Describing a relationship as "fiduciary" is the start, not the end of the inquiry because the precise scope of the duties owed by a fiduciary depends on the nature of the particular relationship in question. In the case of directors, there exist a large body of case law in which the nature and extent of their duties to their company have been examined and from which a picture of the parameters of the fiduciary relationship can be drawn. The law has traditionally imposed fiduciary duties on directors on the basis of the conventional model of the corporate structure in which the directors manage the company it may be more in line with the typical present day management structure of large companies to say that senior managers, not all of whom are directors, manage the company whilst the board comprising some senior manager and some non executive directors who are not involved in the daily operations, devises strategy decides upon major transactions and supervises management. Where senior managers run the daily operations of the company under the supervision of the board, the relationship between them and the company may be one of trust and confidence giving rise to fiduciary duties.
In applying the general equitable principle to company directors four separate rules have emerged these are (1) that directors must act in good faith in what they believe to be the best interest of the company (2) that they must not exercise the powers conferred upon them for purposes different from those for which they were conferred (3) that they must not fetter their discretions as to how they shall act (4) that without the informed consent of the company they must not place themselves in a position in which their personal interests or duties to other persons are liable to conflict with their duties to the company.

Duty to act in good faith in the interests of the company

The duty to act in good faith in the interest of the company is an essentially subjective obligations but who operated in a careful way. Directors who are positively dishonest which can be made out through them of their fiduciary duty, and oppressive or extravagant conduct by directors may cast doubt on their honesty. Where the circumstances are not sufficiently definite to indicate dishonesty directors may still be in breach of duty if their decisions are not taken genuinely in what they believed to be the interest of the company. Genuineness denotes a greater degree of objectivity than an approach which simply equates good faith with honesty and although directors could not be held to be in breach of this duty merely because the court disagrees with their
assessments of what is in the interest of the company, patent unreasonable ness may lead to the court to conclude that the directors were not genuine in their belief concerning the companies interest.

We may as well as explain the meaning of the interest of the company:- This issue is explored a depth in this chapter. The interest of the company for the purpose of this duty one normally equates with a long term interests of its shareholders. By statute the directors are required to consider employees interest but this does not oblige or permit, the directors to give preference to the interest of employees. The identification of the companies interest with those of its shareholders brakes down a company this will destroy the value of the shareholders interest. 4 Gething and others v.Kilner and others 4

Facts of the case are as follows:- R Co a considerable mileage of canal, mostly derelict, and valuable, land in the centre of Manchester. A property development company, T C ltd, sought to acquire R Co’s asset for development purpose. After negotiations the chairman of T C ltd reached agreements in July 1971 R. company that on the basis offer by TC Ltd £200 for every £100 of our company stock, the directors of R Company would recommenced acceptance of an offer to the R company stockholders. A joint announcement was made by the company’s on first September. Later in September the director of R company on the merit of the offer. Concurrently the boards of R
company and TC Ltd cooperated in the preparation of a draft joint offer
document including a letter from the chairman of R company
recommending the offer to R company stockholders and stating that the
directors had carefully considered the offer in consultation with their
financial advisors. HC and sons and considered the terms fair and
reasonable on the 5th October HC and sons advised the board of R
company that the offer was inadequate and that its acceptance should
not be recommended to the stockholders in view of the advice received
R company and TC Ltd were unable to send their circular letters to
stockholders drafted. Instead TC Ltd sent out third circular letters to
stockholders on 18th October, making no mention of HC and sons report
but stating that the R companies directors had irrevocably the offer in
respect of their holdings an had undertaken to recommend other
stockholders to accept the offer.

On 29th October R company issued a circular letter advising that HC
and sons had reached the conclusion that the terms of the offer
represented too large a discount on the current values of the companies
net asset that the directors disagreed with that view and continued to
recommend all stockholders to accept the offer.
The court held that

The directors of an offeree company owned a duty to their shareholders which included the duty to be honest and not to mislead. Any minority shareholders of such a company could properly complain if they were being wrongfully subjected to the power of compulsory purchase by the offeror company under section 209 of the companies' act 1948. In the absence of bad faith however on the part of the boards of R company and TC Ltd or of conduct so unreasonable as to approach bad faith and as the directors of R company held and could reasonable hold that the offer was advantageous to stockholders and hence the interlocutory injunction could not be granted.

In most case compliances with the rule that the directors must act honestly and in good faith is tested on commonsense principles, the court asking itself whether it is proved that the directors have not done what they honestly believed to be right and normally accepting that they have unless satisfied that they have not behaved has honest men of business might be excepted to act. Directors are required to act "bona fide in what they consider-not what a court may consider-is in the interests of the company. . . ." on the face of it, this duty is simply to display subjective good faith. But not withstanding that it is for the directors and not the court to consider what is in the interests of the company, they may breach that duty notwithstanding that they have not
acted with conscious dishonesty but have failed to direct their minds to
the question whether a transaction was in fact in the interest of the
company. 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 agreements 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.

Despite the separate personality of the company it is clear that the
directors are not expected to act on the basis of what is for the economic
advantage of the corporate entity, disregarding the interests of the
members. They are, for example, clearly entitled to recommend the
payment dividends up to the members and not are expected to deny
them a return on their money by ploughing back all the profits so as to
increase the size and wealth of the company. If, as will normally be the
case, the directors themselves are shareholders, they are entitled to
have some regard to their own interests as shareholders not to think only
of the others. As it was happily put in an Australian case, they are "not
required by the law to leave in an unreal region of detached altruism and
to act in a vague mood of ideal obstruction from obvious facts which
must be present to the mind of any honest and intelligent man when the
exercise his power as a director."

Until the 1980 Act is seemed that the only interest to which the
directors were entitled to have regard were the long term interests of the
members. As it had become a cliché, repeated in the chairmen’s speech
at almost every capital AGM of a public company, that “this company
recognizes that it has duties to its members, employees, consumers of
its products and to the nation,” this some what anachronistic and was
modified, but only in relation to employees, under what are now sections
309 and 719 of the act and section 187 of the insolvency act 1986. What
is relevant in the present context his section 309. under that, the matters
of which directors are to have regard in the performance of their
functions “include the interests of the company’s employees in general,
as well as the interests its members.” However subsection (2) provides
that: “accordingly the duty imposed by this section on the directors is
owned by them to the company ( and the company alone ) and is
enforceable in the same way as any other fiduciary duty owed t a
company by its directors” which means that the employees as such have
means of enforcing it.

This grudging recognition that the interests of the company include
those pf its workforce has not been extended. The Courts have even
been reluctant to recognize that the directors have any right, let alone
duty, to regard to the interests of creditors. But it cannot be right to deny that the interests of the company in all circumstances mean those members and employees only. If the company's capital has been lost the members and employees only. If the company's capital has been lost the members have no financial interest in the company. The directors must, in those circumstances, have regard to the interests of debentureholders and other creditors and, if they do not, but continue the company's business while it runs into insolvency, they are likely to find themselves held guilty of fraudulent or wrongful trading. As lord Diplock said in Lonrho Ltd v. Shell Petroleum: "it is the duty of the board to consider... the best shareholders but may include those of its creditors." And so long as the company remains a going concern the company's best interests may well be served by having regard to the other interests; dissatisfied customers and an aggrieved public or Government Department are not conducive to the future prosperity of the company. Hence it is generally possible to justify charitable donations and even contributions.
Share holders interests:

"In the interests of the company's" has traditionally meant in the interests of the shareholders and it is the directors' subjective opinion as to the interests of the corporators as a general body. Balancing the short-term interests of the present numbers against the long-term interests of future members, which counts. Notwithstanding the subjective test a decision by the directors may be set aside if it is such that no reasonable man could consider it to be bona fide in the interests of the company but the courts rarely interfere.

It can be seen therefore that while directors may not owe any fiduciary duties to shareholders as such, the position is redressed to some extent by defining their duty to act bona fide in the interest of the company in terms of the interest of the shareholders, albeit according to the directors view of those interest.

Normally the duty requires directors to treat all shareholders equally. For example, they cannot make calls on some numbers while payment is outstanding on other members' shares. But the equality of individual shareholder doe not always requires identity of treatment. In Mutual Life Insurance Corporation of New York v. Rank Organisation Ltd that the court accepted it was in the best interest of the defendant company to offer its share for sale on a preferential basis to its existing shareholders other than those resident in North America. This was done
in order to avoid the onerous disclosure requirements of the US and Canada and was not unfair to those excluded shareholders whose existing holdings and right were unaffected.

Where there are different classes of shareholders, so decisions may adversely affect the interest of one class and benefit another, the question is not so much of the interest of the company at all as one of what is fair as between different classes of shareholders. The fact that the decisions ultimately taken by the directors also benefit themselves as shareholders does not necessarily mean it is invalid. Directors are not required to live in an unreal world of detached altruism.

Where the company is one of a group, the directors must continue to act in the interests of that company and not look solely to the overall interests of the group. This is not to deny, of course, that the interests of the group may be relevant to deciding what is the interest of the company. The proper approach is to consider whether an intelligent and honest man in the position of the director of the company concerned, in the whole of the existing circumstances, have response reasonably believed that the transaction was for the benefit of the company. Especially where a director is appointed as nominee of a particular shareholder or class of shareholders, his overriding responsibility remains to the company as a whole.
Creditors' interests:

As we have seen, directors do not owe duties to shareholders as such. Neither do they owe duties to the company's creditors. The orthodox position being as stated by Dillon LJ in *Multinational Gas and Petrochemicals Co v. Multinational Gas and Petrochemicals Service Ltd*: directors owe fiduciary duties to the company though not to the creditors, present or future, or to individual shareholders.

**Liquidator of West Merica Safetywear Ltd v. Dodd**

Albert Dodd was a director of West Merica Safetywear Ltd and also of its parent company, AJ Dodd & Co Ltd. The liquidators of both companies explained to Dodd that the bank accounts of both the companies were not to be operated. Despite this he transferred £4,000, which was paid by a debtor, from the bank account of West Merica to the accounts of AJ Dodd and Co Ltd. The intention behind doing this was that it would reduce the bank overdraft of AJ Dodd and Co.
DIRECTORS MUST EXERCISE THEIR POWERS FOR PROPER PURPOSES

A director must exercise fiduciary powers for the purposes for which they were conferred, but how are such purposes to be determined? The company's memorandum and articles would seem to be an obvious starting point since it is from this documents that directors derive their powers but, typically in practice the powers granted to the directors by the company's constitution are drafted in general terms and do not expressly state the purposes for which they can be exercised; nor can such purposes be easily inferred merely from the documents themselves. 8

The leading authority explaining how the purposes for which a power may be exercised are to be determined is the decision of the privy council in Howard Smith Ltd v. Ampol Petroleum Ltd 9 Lord Wilberforce, delivering the judgment of judicial committee, emphasized that the process is not exactly one involving the laying down of precise limits beyond which the directors could not pass. Rather, the task of the court is: is to start with a consideration of the power whose exercise is in question…. Having ascertained, on a fair view, the nature of this power, and having defined as can best be done in the light of modern conditions that, or some, limits within which it may be exercised, it is then
necessary for the court, if a particular exercise of it is challenged, to examine the substantial purpose for which it was exercised, and to reach a conclusion whether that purpose was proper or not. In doing so it will necessarily give credit to the bona fide opinion of the directors, if such is found to exist, and will respect the judgment as to matters of managements; having done this the ultimate conclusion has to be as to side of a fairly broad line on which the case falls.

This statement is in many ways typical of the court's approach to corporate disputes, emphasizing as it does due respect for directors business judgment and eschewing close examination of their action in favor of a broad brush treatments. Nevertheless, it thus indicate question whether a power has been exercised for a proper purpose is a question of law and that the directors opinion of the propriety of their action is not conclusive. The duty to use powers only for the purposes for which they were conferred thus imposes on directors a more exacting standard than the duty to act in the interest to he company, which is essentially a subjective duty though with a minimum threshold of genuineness; the court's can more readily review a decision as an improper exercise of fiduciary power than as a decision which could not have been arrived at genuinely in the interest of the company.
Like many of the reported decisions on the duty to exercise the powers for proper purposes was concerned with a directors fiduciary power to issue shares. The flexible, pragmatic approach advocated by Lord Wilberforce means that it would be wrong to attempt to delimit precisely and exhaustively the purpose for which the power to issue shares may properly be exercised. Certainly, raising capital is a purpose for which the power may be exercised but there are other purposes, such as making of bonus issues, the promotion of an employees' share scheme, the forming of a link between the allotted and the company with a view to securing the financial stability of the company, or the obtaining of a valuable business opportunity for the company, for which the power may also properly be exercised. Any purpose which is expressly authorized by the company's constitution would necessarily amount to a proper purpose.

Although it may not be possible to state precisely all of the purpose for which the power to issue shares may properly be exercised, it is clear from Smith v Ampol and earlier cases that there are certain purpose which can definitely be described as improper exercise of the fiduciary power to issue shares. Directors must not 'use their fiduciary power 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, the reason being that it would be unconstitutional for the directors.
ensure that, even if the bid were successful, the hotel would be beyond
with restrictive covenants as to user. The object of the scheme of to
Sayre's employees' pension scheme and then leased back to the group
the hotel was sold to a company controlled by the trustees of the
the various group companies developed an implemented scheme whereby
important hotel within the group and redevelop the site. The directors of
in 1964. Releasing that a bidder's successful would close down an
conducted by Mr. William Holland, O.C., the report on which was published
illustrated by the investigation of the affairs of the Savoy Hotel Group
would seem to be equally applicable to other public company. This is
an adoptable approach embodied in the authorities relating to share issue
The power to issue shares is now regulated by statute but the

in warranting a hostile bid.

Corporate control by holding shares is a favored bidder and thereby
power to alienate shares so as to direct the operation of the market for
bid but, because of the proper purpose rule, they can not exercise their
power subject to any of good faith advice the shareholders to reject the
their directors to reject the

Thus, using a takeover bid as an example, if directors genuinely believe
company's shares, and the power that accompanies majority share
the company's shares in that way. The location of the ownership of

the bidder's control, thus insulating against a change of use. Mr. Milner Holland QC accepted that the directors had proceeded with the scheme in the genuine belief that it was in the interests of their companies but by analogy with the share allotment cases concluded that the directors had exercised their fiduciary powers of management for an improper purpose.

More recently, in *Lee Panavision Ltd v. Lee Lighting Ltd*, 10 applying Howard smith *v.* Ampol, the court of appeal held that it was unconstitutional for the directors to purport to tie up the management of the company by way of a management agreement at a time when they knew that the shareholders were intending to change the managerial control of the company by removing the old board appointing new directors. The decision of Hoffmann J in *Re a Company* further supports the proposition that directors who seek to use their powers in a way which prevents shareholders from accepting an offer from a particular bidders are acting for an improper purpose. Conduct designed to frustrate a bid would also infringe the takeover code were that applies.

The proper purpose requirement has been applied to other powers normally vested in directors by the terms of the company's articles, including the power to make calls on shares and the power to forfeit for nonpayment of calls. It also applicable to provisions in articles which
empower directors to decline to register transferees of shares as the registered holders.

An article entitling the director to refuse to register the transfers of shares is commonly included in the article of private companies. Its inclusion reflects the resemblance between some private companies and partnerships: where a company is, in effect, an incorporated partnership, the shareholders-partnership are likely to be concerned about the identity of transferees of the shares, and the directors' power to refuse to register transfers provides a way of monitoring this and preventing the registration of unwelcome individuals that they acted solely in order to deal with it particularly when the action they took was unusual or even extreme.

A part from unusual or extreme situations, however, the reluctance of the court to review matters of business judgement would be likely to limit the extent of the inquiries into substantial purposes.

Consequences of improper purpose

Where a fiduciary power is exercised for and improper purpose, it is possible to analyse the situation in two ways—either as an abuse of power or as a purported exercise of a power that the directors do not have, that is, an excess of authority. The share allotment cases such as Hogg v Cramphorn and Smith v Ampol adopt the abuse of power analysis. An allotment of shares made for an improper purpose is prime
facie valid notwithstanding the directors' breach of duty but, if it is made to a person or person who are aware of the impropriety, it is liable to be set aside at the instance of the company. On agency principles, an agent who exceeds his authority does not succeed in binding the principles; the act is void as far as the principle is concerned unless the principle chooses to adopt what was purportedly done on the behalf. In Hogg v Cramphorn, as well as the share allotment, the director made a loan to trustees for a purpose which was held to be improper. Buckley J held that the loan was to be treated as having been made by directors in excess of theirs of their powers with the result that the moneys lent remained the property of the company held by the trustees upon a resulting trust for the company. In Lee Panavision Ltd v Lee Lighting Ltd, similarly, the Court of Appeal refused an injunction to enforce a management agreement pending full trial of the action on the grounds that the agreements, which was unconstitutional, was beyond the directors power. The authorities offer little guidance as to when analysis based on power is more appropriate than that based on excess of authority although it appears that this may depend on the nature of the power in question. Excess of authority and abuse of power may even coincide.

As far as the directors are concerned, if they use their power for an improper purpose and, as a result, the company loses out. If the
Directors benefit personally from their breach of duty, they will be liable to account to the company for the benefit that they receive. Directors must exercise their power for proper purpose for which such an powers are constructed to have been conferred.

**PUNT v. SYMONS & CO. LTD**

BYRNE J... I now come to the last and most important point. It is argued on the evidence that but for the issue by the directors of the shares under their powers as directors, and, therefore in their fiduciary character under the general power to issue shares, it would have been impossible to pass the resolution proposed; and that the shares were not issued bona fide, but with the sole object and intention of creating voting power to carry out the proposed alteration in the articles. On the evidence I am quite clear that these shares were not issued bona fide for the general advantage of the company, but that they were issued with the immediate object of controlling the holders of the greater number of shares in the company, and of obtaining the necessary statutory majority for passing a special resolution while, at the same time, not conferring upon the minority the power to demand a poll. I need not go through the affidavits. I am quite satisfied that the meaning, object and intention of the issue of these shares was to control the holders of a very considerable majority. A power of the kind exercised by the directors in the case, is one which must be exercised for the benefit of the company: primarily it is given
them for the purpose of enabling them to raise capital when required for the purpose of the company. There may be occasions when the directors may fairly and properly issue shares in the case of company constituted like the present for other reasons. For instance, it would not be at all an unreasonable thing to create a sufficient number of shareholders to enable statutory power to be exercised; but when I find a limited issues of shares to person who are obviously meant and intended to secure the necessary statutory majority in a particular interest, I do not think that it is a fair and bona fide exercise of the power . . .

If I find as I do that share have been issued under the general and fiduciary power of the director for the express purpose of acquiring an unfair majority for the purpose of altering the right of parties under the articles, I think I ought to interfere, I purpose to grant an injection ... persons. The power to refuse registration of a transferee may be limited to particular circumstances or may be drafted in unqualified discretionary terms. In the former situation, the proper purpose requirement applies but the later courses defines the proper purpose rule out of existance-directors may exercise the power for any purpose they think fit-although the obligation to act in good faith in the company's interest must still be observed. A provision restricting the transfer of shares would be unusual in the article of a public company, and, in the case of a listed company,
could be incompatible with stock Exchange requirements concerning the transferability of shares.

**Mixed Purpose**

Directors, when exercising a power vested in them under company’s constitution, may have more than one purpose in mind. Some of the purpose may be permissible, but other may be impermissible. In that situation, the impermissible purpose will not taint the exercise of the power provided that the substantial purpose or purpose for which it was exercised were proper. This concession to directors’ discretion means that, for example, a transaction entered into by the directors to secure commercial advantages for the company but which (as the directors are well aware) carries with it the incidental advantages of making the company less vulnerable to an unwelcome takeover bid could be upheld. A careful examination of the facts would be required to determine the directors’ substantial purpose in entering into any such transaction:

**Unfettered discretion**

We now turn to certain objective standards which must be compiled with notwithstanding the presence of good faith and proper motive. Before dealing under the next head, with the more important of these, there is one which is often ignored but which appears to exist and need mention.
Since the director’s powers are held by them as fiduciaries of the company they cannot, without the consent of the company, fetter their future discretion.

Thus, it seems clear and the no rules and general principal, despite the paucity of reported cases on the point, that the directors cannot validly contract (either with one another or with third parties) as to how they shall vote in future board meetings. This is so even though there is no improper motive or purpose (thus infringing the previous rules) and no personal advantages reaped by the directors under the agreement.

This, however, does not even 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 actions at the board meeting as necessary to carry out that contract. As was said in the judgment of the Australian court.

* There are many kinds of transaction in which the proper time for the exercise of the directors’ discretion in the time of the negotiation of the contract and not the time at which the contract is to be formed. ... If at the former time they are bona fide of the opinion that is in the best interest of the company that the transaction should be entered into and carried into effect. I can see no reason in the law why they should not
blind themselves to do whatever under transaction is to be done by the board.

Indeed, it may be that if there is voting agreement between all the members and directors which provides that they shall vote together at all meetings, whether general meetings or directors' meetings, it may be that they will vote together.

CONFLICT OF DUTY AND INTEREST

The fundamental duty of a fiduciary is to be loyal to the person for whom, or on whose behalf, he acts. From this basic principle stem a number of rules which are intended to preclude a fiduciary from being swayed in his action by considerations of personal interest of third parties. An underlying issues in the application of these rules to directors is whether it is appropriate to apply to directors the very strict standards that were first developed in relation to the trustee, or whether the commercial nature of the relationship between the participants in a company justifies a more flexible and pragmatic approach.

The court will not examine the fairness, or otherwise, of the term of a contract between a director and the company and will treat the director as having infringed the rules even though the deal may be entirely

337
This rule has only to be stated, however, to
commercially impossible for it to apply entirely
without qualification: that would mean, for example, that director could
not even have service contracts. The qualification that makes this rule
practically operative is that a director can contract, have an interest in a
contract, with the company where either this is authorized by the
company's article or the interest has been properly disclosed to the
company and the company has consented to the director's participation.
The 'company' for the purpose of disclosure and consent means the
shareholders in general meetings but this requirement can be, and
normally is, modified by the article to provide for the board to act instead
of general meetings for this purpose. The reason why the consent
function is vested in the shareholders in general meeting unless the
article otherwise provide is that the company is entitled to the
disinterested advice of all of its directors and this is impossible where
some of them are conflicted out by their personal interest in the matter.

A Article of Association tends to follow the Table A model with respect
to the procedure for permitting directors to contract with, or to have
interest in contracts with, the company. Under Table A, a director is
permitted:
(a) to be a party to, or otherwise interested in, a transaction or agreements with the company or in which the company is otherwise interested; and

(b) to be a director, officer or employee of any body corporate promoted by the company or in which the company is otherwise interested; the directors may also be a party to, or be interested in, any transaction or arrangements with such a body corporate;

provided that, in either cases, the direction has disclosed to the directors the nature and extent of any material interest in any matter must not count in the quorum or vote at any broad meeting where that matter is considered. Compliance with the procedure specified in the article ensures that the directors is then not accountable to the company for any benefits derived from any such transactions, agreements, directorship, office or employment, nor is any such transactions or arrangements liable to give a general notice of interest of which a director is unaware is deemed not to be his interest provided it was unreasonable to expect the directors to have that knowledge.
Statutory Duty of Disclosure to the Board

Statutes place a further disclosure obligation on directors in respect of interest that they have in company contracts. Companies Act 1985, s 317 imposes a duty on directors to declare at a meeting of the directors the nature of any interest that they have in any contract, or proposed contract, with the company. There are certain procedural requirements in this section which are not expressly mirrored in the Table A disclosure obligation: the disclosure must be made at a meeting of the board and, with some exceptions, it must be made at the time when the question of entering into the contract is

IMPERAL MERCANTILE CREDIT ASSN v. COLEMAN 13

Coleman, a stockbroker, was a director of the appellants company. At a meeting of the directors, he proposed that the company should undertake to place the debentures of a certain railway company for a commission of one and half percent. He disclosed that he was interested in the transaction and offered to leave the room, but he did not reveal the nature of his interest, viz., that he himself has agreed to place the debentures at a commission of 5 per cent, the company, having accepted the proposal, claimed that Coleman should account to it for the difference between the two amounts of commission. There was at no
time any disclosure to the company in general meeting. It was argued that the retention of the profit was authorised by the terms of an article which provided that a director should vacate his office if he failed to disclose his interest in a contract to the board: the House of Lords, without expressly ruling that the profit was retainable disclosure in accordance with the article was made held that there had not in any cases been a disclosure adequate to comply with the article.

LORD CAIRNS. Under the agreements made on 10 June the debentures were, with a trifling exception, taken by the association; and the result was that Mr Coleman having the disposal of which he was to receive a large remuneration, secured that remuneration to himself or his firm, by disposing of the property to an association of which he was a trustees and directors.

Now it does not admit of arguments that, if there was nothing more in the case, this is a transaction which could not for a moment be supported in a court of equality, and that Mr Coleman would have to account to the association for his profit upon the sale, which profit was in reality so much money taken by him from the association. That this would be so in an ordinary case appears to have been clearly the opinion of the Lord Chancellor, and was not indeed disputed at your Lordship' Bar.
My Lords, I observe that Mr Coleman states that it was no object to him to place these debentures with the association, and that other finance companies were ready to undertake the business on the same or lower terms. It is extremely difficult to reconcile these statements with those contained in the latter of Mr Coleman of 4 January 1864 to Sir Morton Peto, which I have already read. But putting that aside, it is not the practice of a court of equality to inquire into the merits of a particular contract made by one who is at once buyer and seller. The court does not permit such a contract to be made, and obliges the person who makes it to surrender any benefit he has obtained.

The main arguments, however, for the respondents was based on what is said to have taken place on 10 June 1864 (when the contract with the association was made), coupled with the 83rd clause of the articles of association. Mr. Coleman thus described what took place. In his answer, after stating how proposal was brought before the meeting, he says, "The defendant Coleman stated openly to the meeting that he was interested in the sale. These debentures, and offered to leave the room whilst the proposal for their sale to the association was discussed, but the chairmen said it was unnecessary...

declaration must make the other directions fully informed about the position and it is thus implicit in the requirement to disclose the nature of an interest that the extent of it may have to be disclosed.

Failure to Comply with Disclosure Requirements

342
The consequence of failure to comply with the requirements of the articles with regard to disclosure of interests is that contracts between a director and the Company are avoidable and may be set aside at the instance of the company provided the general conditions for avoidance are satisfied. The general bars to avoidance (or rescission as this process is also described) are affirmation of the contract by the company, lapse of time, intervention of third party rights and the impossibility of returning the parties substantially to their pre-contractual position. Where, for example, a director has acquired property from the company without proper disclosure of his interest but that property has since been resold to a third party who is a bonafide purchaser of value, the company will not be able to avoid the contract and recover the property. Where the director's interest in the contract is indirect because it is derived from having an interest in another company (second company) with which the company (first company) enters into a contract, the principle of separate legal personality will mean that the first company will not be able to avoid the contract unless either the veil of incorporation of the second.

HELY-HUTC\text{\textemdash}INSON v BRAYHEAD LTD\textsuperscript{14}

LORD DENNING M.R...Accepting that Mr. Richards had actual authority to make these contracts, there still remains these second point; Lord Suede was a director of Bray head. He had an interest in these contracts and did not disclose it. He failed to comply with section.199 of the Companies Act 1948 and with article 99 of the articles of association. He did not disclose the nature of his interest to any board meeting as he should have done. His failure is a criminal offence. It renders him liable to a fine not exceeding Rs. 100/- But how does it affect the contract? His Lordship referred to Kaye v Croydon Tramways and continued; It seems to me that when a director fails to disclose his interest, the effect
is the same as non-disclosure in contracts uberrimae fidel, or non-disclosure by a promoter who sells to the company property in which he is interested; see Re cape Breton Co., Burland v Earle. Non-disclosure does not render the contract void or a nullity. It renders the contract voidable at the instance of the company and makes the director accountable for any secret profit, which he has made.

At first sight article 99 does present difficulties. It says that; 'A' director may contract with and be interested in any contract or proposed contract with the company either as vendor, purchaser or otherwise, and shall not be liable to account for any profit made by him by reason of any such contract or proposed contract be declared at a meeting of the directors as required by and subject to the provisions of section 199 of the Act'.

On the wording it might be suggested that there is no contract unless the director discloses his interest. In other words, that disclosure is a condition precedent to the formation of a contract. But I do not think that is correct. All that article 99 does is to validate every contract when the directors make proper disclosure. If he discloses his interest, the contract is not voidable, nor is he affairs of the construction company was eminently satisfactory, but so far as railway construction was concerned the whole of their reputation for the efficient conduct of their business had been gained by them while acting as directors of the Toronto Construction Company. In 1911, and probable at an earlier date, the three defendants had settled that they would no longer continue business relationships with the plaintiff. It is unnecessary to seek the cause of the quarrel, or to determine whether they had good reason for the opinion that they had formed. There was nothing to compel them to work with or for the plaintiff, and it is impossible to see that they were bound to continue their relationship with him by any legal or moral consideration. They were, however, involved within in different
reciprocal duties, by reason of their relationship in connection with the Toronto Construction Company, and if they desired freedom to act, without regard to the restrictions that those relationships imposed, it was necessary that they should terminated their position as directors and shareholders in the company and place it in dissolution. This they could easily have accomplished owning to the fact that they held three-fourths of this share capital. It is suggested that they might also have resolved at general meeting of the company that the company should no longer continue the work. This would have been all but equivalent to a resolution of voluntary liquidation; but even this step was not taken.

While still retaining their duties to the company of which the plaintiff was a shareholder entirely unchanged, they proceeded to negotiate with Mr. Leonard for the New Shore Line contract, in reality on their own behalf, but in exactly the same manner as they had always acted for the company, and doubtless with their claims enforced by the expeditious manner in which they while acting for the company, had cause the last contract to be carried.

Relationship that existed between Messrs. Deeks and Hinds and the Company that they controlled. Now it appears plain that the entire management of the company, so far as obtaining and executing contracts in the east was concerned, was in their hands, and, indeed, it was in part this fact, which was one of the causes of their disagreement with the plaintiff. The way they used this position is perfectly plain. They accelerated the work on the expiring contracted of the company in order to stand well with the Canadian Pacific Railway when the next contract should be offered, and although Mr. MaLean was told that the acceleration was to enable the company to have any chances whatever of acquiring the benefit, and avoided letting their co-director have any chances whatever of acquiring the benefit, and avoided letting their co-
director have any knowledge of the matter. Their Lordships think that the statement of the trial judge upon this point is well founded when he said that 'it is hard to resist the inference that Mr. Hinds was careful to avoid anything which would waken Mr. Cook from his fancied security', and again, that 'the sole and only object on the part of the defendants was to get rid of a business associate whom they deemed, and I think rightly deemed, unsatisfactory from a business standpoint'. In other words, they intentionally concealed all circumstances relating to their negotiations until a point had been reached when the whole arrangement had been concluded in their own favour and there was no longer any real chance that there could be any interference with their plans. This means that while entrusted with the conduct of the affairs of the company they deliberately designed to exclude, and used their influence and position to exclude, the company whose interest it was their first duty to protect.

It is quite right to point out the importance of avoiding the establishment of rule as to director's duties, which would impose upon them burdens so heavy and responsibilities so great that men of good position would hesitate to accept the office. But, on the other hand, men who assume the complete control of a company's business must remember that they are not at liberty to sacrifice the interests which they are bound to protect, and, while ostensibly acting for the company, divert in their own favour business which should properly belong to the company they represent.

Their Lordships think that, in the circumstances, the defendants T.T. Hinds and G.S. and G.M. Deeks were guilty of a distinct breach of duty in the course they took to secure the contract, and that they cannot retain the benefit of such contract for themselves, but must be regarded as holding it on behalf of the company.
There remains the more difficult consideration of whether this position can be made regular by resolutions of the company controlled by the votes of these three defendants. The Supreme Court have given this matter the most careful consideration, but their Lordships are unable to agree with the conclusion which they reached.

In their Lordships' opinion the Supreme Court has insufficiently recognized the distinction between two classes of case and has applied the principles applicable to the case of a director selling to his company property which was in equity as well as at law his own, and which he could dispose of as he thought fit, to the case of a director dealing with property which, though his own at law, in equity belonged to his company. The cases of North-West Transportation Co. v. Beatty and Burland v. Earle both belonged to the former class. In each, directors had sold to the company property in which the company had no interest at law or in equity. If the company claimed any interest by reason of the transaction, it could only be by affirming the sale, in which case such sale, though initially voidable, would be validated by subsequent ratification. If the company refused to affirm the sale the transaction would be set aside and the parties restored to their former position, the directors getting the property and the company receiving back the purchase price. There would be no middle course. The company could not insist on retaining the property while paying less than the price agreed.

This would be for the court to make a new contract the parties. It would be quite another thing if the director had originally acquired the property, which he sold to his company under circumstances which made it in equity the property of the company. The distinction to which their
Lordships have drawn attention is expressly recognized by Lord Davey in Burland v Earle.

During the whole of the discussion, up till the time when prices were fixed, it does not appear that at any moment the representatives of the Canadian Pacific Railway Company were told that this contract was in any way different from the others that had been negotiated in the same manner on behalf of the Toronto Construction Company, although it was plain that Mr. Leonard had been told by Mr. Deeks, when he was engaged on the Georgian Bay and Seaboard line, that when it was finished Messrs Deeks and Hinds intended to go on their own account and leave Mr. Cook. But after all the necessary preliminaries of the contract had been concluded Mr. Hinds made to Mr. Leonard this statement; 'Remember, if we get this contract it is to be Deeks and I, and not the Toronto Construction Company'. On 12 March 1912 there was meeting of directors of the Toronto Construction Company, at which the three defendants were present, and they resolved that a fresh meeting of the shareholders be held to consider the question of the voluntary liquidation of the Company. Ultimately, after sundry meetings which are really not material, on 26 April 1918 resolutions were passed owing to the voting power of the defendants G.S. Deeks, G.M. Deeks and T.B. Hinds, approving the sale of part of the plant of the company to the Dominion Construction Company, and that the directors were authorised to defend this action, which had in the meantime been instituted.

Two questions of law arise out of this long history of fact. The first is whether, apart altogether from the subsequent resolutions, the company would have been at liberty to claim from the three defendants the benefit of the contract which they had obtained from the Canadian Pacific Railway Company; and the second, which only arises if the first be
answered in the affirmative, whether in such event the majority of the shareholders of the company constituted by the three defendants could ratify and approve of what was done and thereby release all claim against the directors.

It is the latter question to which the Appellate Division of the Supreme Court of Ontario have given most consideration, but the former needs to be carefully examined in order to ascertain the circumstances upon which the latter question depends.

It cannot be properly answered by considering the abstract relationship of directors and companies; the real matter for determination is what, in the special circumstances of this case, was the company can be lifted or the director occupies a position in relation to the second company whereby his knowledge can be attributed to it so as to prevent it from being a bonafide purchaser without notice of the contravention.

The equitable remedies available to the company in circumstances where the contract cannot be avoided for whatever reason, are shrouded in some obscurity. There is a line of authority to the effect that where the fiduciary acquires property in a personal capacity and then, without disclosing the interest, resells it at a profit to the company, rescission is the companies' only remedy, and that the company cannot claim an account of profit. This rule has been described as 'anomalous' and it merits slightly closer examination. The first point to note is the limit of these authorities: they establish only that the company can recover none of the difference between the price at which the fiduciary acquired the property and the price at which it was resold to the company in circumstances where it cannot be shown that the resale price was inflated. If a director sells property to the company for more than its existing market value the director should, on normal principles, be liable
to account to the company for the unauthorized profit represented by the
difference between market value and the price paid.

Secondly, in recent years the courts have been particularly concerned to
uphold the strict prophylactic function performed by fiduciary obligations
and, with that in mind, they have dealt strictly with fiduciaries who have
failed to meet the high standards that the law expects of persons in that
position. The older cases which limit the company's remedy in the event
of non-disclosure to rescission are out of line with that trend. An
illustration of this strict approach is provided by Re Duckwari pic. In this
case it was held that where a director did not disclose an interest in a
transaction whereby a company a company acquired property at a price
which was a fair market price at the time of the transaction but the
market in that type of property subsequently collapsed, the director was
liable to make good the company's loss as represented by the difference
between what it paid for the property and the price for which it later
realised it. Although that case concerned a specific statutory obligation
to indemnify the company for losses in respect of substantial property
transactions which had not been properly authorised in accordance with
the requirements of the companies legislation, the Court of Appeal
reasoned that the conclusion so reached was consistent with the
position under the general law relating to fiduciaries. The court held that,
by not securing the required consents, the directors had disposed of the
company's property (the purchase price) in breach of trust and that the
interested director was liable to indemnify the company for all loss
resulting from that disposal. The Court of Appeal did not consider the
line of authorities limiting the company's remedies in respect of voidable
contracts to rescission. The decision indicates that the courts may now
recognize that a wider range of remedies is available in respect of a
contract tainted by non-disclosure than older authorities seemed to
accept. Another potentially relevant remedy that is recognised in recent
cases is equitable compensation, although, as yet, the rules regarding issues of causation, remoteness and quantification have not been fully worked out.

Although it is cited here as being indicative of a stricter approach, it should also be noted that the analysis in the Duckwari decision raises some difficult questions for aspects of company law discussed elsewhere in this book. Characterizing a situation where a contract is voidable for non-disclosure as a breach of the director's duty to look after the company's property as if they were trustees, may throw into doubt the availability of ratification in these circumstances. It also appears to undermine the basis on which it is said that articles can modify the requirement for the shareholders to act as the consenting body in respect of contracts in which directors have a personal interest.

Failure by a director to comply with Companies Act 1985, s317 leads to fine. Although the matter is not entirely beyond doubt, the better view is that non-compliance with the statutory obligation does not itself make a contract voidable. This may be little more than a theoretical point in the normal type of situation where the company's articles follow the form of Table A with the consequence that the disclosure requirements under the articles and Companies Act 1985, s317 are broadly co-extensive. It would be significant if the company had articles which laid down requirements with regard to company contracts which were entirely different from those in Companies Act 1985, s317: an extreme example, and one that would be unlikely to be encountered often in practice for obvious reasons, would be a set of articles which overrode the common law rule altogether and permitted contracts between directors and the company without any disclosure or other procedural safeguards. Although Companies Act 1985, s31 invalidates provisions in articles which seek to modify the duties to which directors are subject under the
general law, the rule that a director may not contract with the company
has been classified as a ‘disability’ rather than a ‘duty’ for this purpose,
with the consequences that articles in the form of this example may be
permissible. Articles could not, however, override Companies Act 1985,
s317 because that is a non-excludable ‘duty’. If articles were to
dispense altogether with disclosure requirements in respect of directors’
interest, on the basis of the view outlined in this paragraph, the effect
would be that a director who did not disclose an interest in a contract
would incur the statutory penalty of a fine but the contract would not be
voidable.

Director’s duties to individual members

Directors owe duties to their companies, but they owe no general
fiduciary or other duties to individual members of their companies when
negotiating and carrying out transactions with such members, and this is
so whether the directors act on behalf of themselves or the company.

Directors may purchase shares from members of their company, and are
under no duty to disclose information in their possession, which might
induce the members to demand a higher price Percival v Wrights.
This decision has been much criticized on the ground that it does not
seem just that the directors should profit because of inside information,
which they have acquired as directors and which is not available to
investors generally. However, the principle established in this case still
stands, i.e., directors do not ‘hold a fiduciary position as trustees for the
individual shareholders’, though they do stand in that position in relation
to the companies itself.

The plaintiff’s solicitor wrote to the secretary of the company asking if he
knew anyone willing to buy their shares. The plaintiffs were told that the
chairman and two other directors were willing to buy them. The sale of
the shares to them took place. The directors did not tell the plaintiff's
that they were negotiating for the sale of the company's entire share
capital to a potential purchaser at a considerably higher price per share.
There was though no firm offer, which the board could lay before the
shareholders and the negotiations ultimately fell through. The plaintiff's
brought this action against the directors seeking to have the sale of the
shares set aside on the ground that they should have disclosed the
negotiations.

It was held that:

During the negotiations the directors did not hold a fiduciary position as
trustees for the individual shareholders.

Swifen Easy J: It is urged that the directors hold a fiduciary position as
trustees for the individual shareholders, and that, where negotiations for
sale of the undertaking are on foot, they are in the position of trustees for
sale. The plaintiff's admitted that this fiduciary position did not stand in
the way of any dealing between a director and a shareholder before the
question of sale of the undertaking had arisen, but contended that as
soon as that question arose the position was altered. No authority was
cited for that proposition, and I am unable to adopt the view that any line
should be drawn at that point. It is confident that a shareholder knows
that the directors are managing the business of the company in the
ordinary course of management, and implicitly releases them from any
obligation to disclose any information so acquired. That is to say, a
director purchasing shares need not disclose a large casual profit, the
discovery of a new vein, or the prospect of a food dividend in the
immediate future, and similarly a director selling shares need not
disclose losses, these being merely incidents in the ordinary course of
management. But it is urged that, as soon as negotiations for the sale of
the undertaking are on foot, the position is altered. Why? The true rule is that a shareholder is fixed with knowledge of all the directors' powers, and has no more reason to assume that they are not negotiating a sale of the undertaking than to assume that they are not exercising any other power. It was strenuously urged that, though incorporation affected the relations of the shareholders to the external world, the company thereby becoming a distinct entity, the position of the shareholders in an unincorporated company. I am unable to adopt that view. I am therefore of opinion that the purchasing directors were under no obligation to disclose to their vendor shareholders the negotiations which ultimately proved abortive. The contrary view would place directors in a most invidious position, as they could not buy or sell share without disclosing negotiations, a premature disclosure of which might well be against the best interests of the company. I am of the opinion that directors are not in that position. There is no question of unfair dealing in this case. The directors did not approach the shareholders with the view of obtaining their shares. The shareholders approached the directors, and named the price at which they were desirous of selling. The plaintiffs' case wholly fails, and must be dismissed with costs'.

This case establishes that the fiduciary duties of a director are not generally owed to individual shareholders but to the company. However, exceptional circumstances may exist were fiduciary duty does arise in favour of shareholders.

Directors may constitute themselves the agents of individual members of a company to carry out particular transactions, and they then owe the same fiduciary duties to such members as any other agent owes to his principal. In a case, the directors induced the shareholders to give them options for the purchase of their shares by representing (falsely) that the shares were needed to effect an amalgamation with another company.
But they used the options to buy the shares themselves and then resold them at a profit.

Duties of directors to outsiders

Again there is no contractual or fiduciary duty to outsiders, and the directors are not liable if the company breaks its contracts. However, when the directors make a contract with an outsider on behalf of the company, the directors may be liable, as other agents are, for breach or warranty of authority. The basis of this action is that an agent warrants to the third party that his principal has the capacity to make the contract and that he, the agent, is authorized to make it.

The action has been successful where a company having borrowing power has in fact succeeded it. The difference in the company cases is that the third party is deemed to have notice of the company's powers and cannot therefore be misled. It is not thought likely that the directors can be sued where the company is a statutory company and the contract is patently ultra vires, because this would involve the plaintiff's pleading ignorance of the statute, and ignorance of the law is the generally an excuse. The law has also regarded outsiders as having constructive notice of the objects clause of a registered company, but it is the better view that an action against the directors of a registered company would succeed because the directors are misrepresenting the contents of the member random and / or articles which would probably be regarded a misrepresentation of fact and therefore actionable. It should, of course, be noted where s9 of the European Communities Act 1972 applies that will be no constructive notice in the outsider by virtue of that statute.
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Duty of non-executive director

It has been laid down that in the application of the standards of care and skill, no distinction can be made between executive and non-executive directors, on facts, the two non-executive directors were held guilty of negligence in as much as they signed blank cheques which enabled the executive director to act at pleasure in completing the cheques. They were held liable to compensate the company for its loss. Summarising the present position of the duty of care and skill, the Court crystallized it into the following three points:

1. There ought to be an exhibition of such a degree of skill as may reasonably be expected from a person with the particular director's knowledge and experience.

2. The director has to exercise in the performance of his duty such care as an ordinary man might be expected to do on his own behalf and

3. All powers vested in directors must be exercised in good faith and in the interest of the company.

Special protection against a liability that may have been incurred in good faith. Where it appears to the court that the director sued "has acted honestly and reasonably, and that having regard to all the circumstances of the case, he ought fairly to be excused. The court may relieve him either wholly or partially from his liability on such terms as it may think fit."

Thus three circumstances must be shown to exist. The position must be such that the person to be excused is shown to have acted firstly,
honestly, secondly, reasonably, and thirdly having regard to all the circumstances he ought fairly to be excused.

A good illustration is Colridge’s Patent Ashphalt Co.

A company was formed for the protection of certain compositions of amount for making roads. Owning to great increase in motor traffic a profitable purchase in making roads and it was proposed that the company should embark upon this new business. After consulting the company’s solicitors who advised that the scheme was not ultra vires, the directors applied the company’s capital, but the new business proved a failure.

They were sued for misapplication of funds. But the court allowed relief. “They were acting for the benefit of the company and with the best advise”. Similarly, in a case before the Orissa High Court, where the annual general meeting of a company could not be held in line on amount of the dissolution at the material line of the company’s board of directors by a court orders the court great relief against liability for difficult. The Kerala High Court granted relief to a director who had not disclosed that his joint family was carrying on a contract with the company. The same having been entered with by his deceased father eighteen years ago had, he being not an active member of the family, did not know it. Where a statement in the prospectus was that the company had 15 year experience in its line of business, where as the experience was that of the partnership which it had fallen over and the business was commenced a bit late than what was started in the prospectus, the directors were held not guilty of misrepresentation relief against prosecution was granted. The Calcutta High Court refused to grant relief in a case where there was a default in holding five successive meetings. Similarly, where the directors over drew their
of the being voted to them in future, the court held that
it be said to be acting reasonably and ought not to
be excused or directors who knowingly accepted deposits beyond
statutory limits. No relief was allowed to directors who had collected
contribution under the employees, that Insurance Act and the Provident
Fund Act but did not pay the employees according as their claims
became due. Relief has been allowed according as their claims became
directors only for the purpose of rendering some professional or
technical service. Such directors may not be aware of what
administration directors have been doing. Relief was allowed in
anticipation to two Japanese directors who were not concerned with the
duty to day management of the company. Part-time directors are not
entitled to any special consideration, but they may be more readily
relieved where no evidence of their role in management is adduced.

Duty to attend board meetings.

Duties of directors are of intermittent nature to be performed at periodical
board meetings. In other words they are not bound to pay continuous
attention to the affairs of the company. "They do not undertake to
manage the company". A director is not even bound to attend all the
meetings of the board although he is an obligation to attend whenever in
the circumstances he is reasonably able to do so.

According to section 203(g) the office of a director will be vacated if he
absents himself from three consecutive meetings of the board or
whichever is longer, without obtaining leave of absence from the board.
Moreover, a director's habitual absence from board meetings may taken
in the light of other circumstances, become evidence of negligence on
his part. In an early case in which liability was imposed for failure in this
respect, the court said "If some persons are guilty of gross non-
attendance and the management entirely to others, they may be guilty of this means if breaches of trust are committed by others?

**Duty not to delegate**

Generally a director has to perform his functions personally, he is bound by the maxim delegates non-protest delegate. Shareholders have appointed him because of their faith in his skill, competence and integrity and they may not have the same faith in another person. The role is however, not inflexible. In the following two cases at least delegation is proper and valid. Firstly, a delegation of functions may be made to the extent to which it is authorised by the Act or Articles of Association of the Company. Secondly, these are certain duties, which may, having regard to the exigencies of business, properly be left to some other officials. These two exceptions permit a reasonable distribution of work among all the directors and other officials of the company. Now if a co-director or other official to whom a function is so delegated commits a fraud and the company suffers a loss, to what extent are the other directors liable.

In this case a banking company had suffered heavy loss on account of advances of money made to irresponsible persons and without security and also on account of payment of dividends out of capital. These losses were due to the mechanism of the Chairman and the manager who manipulated the accounts and showed a profit. At a meeting of the board, the dependent was ensured of the correctness of the accounts and therefore, be gone his authority to the payment of a dividend which was obviously paid out of capital.

He was sued for the losses, but was held not liable.

Lord HALSBUR observed.
Each and all of the charges may be disposed of by the proposition that Mr. Coyle was not himself conscious of any one of these, this being done. It cannot be expected of a director that he should be watching the inferior officers or verifying the calculations of auditors. Business of life could not go on if people could not trust those who are put in a position of trust for the express purpose of attending to the details of management. He could have been held liable only if he had some reasonable grounds to suspect the honesty of the other officials.

This principle was followed by the Madras High Court P.Doss v. C.P. Connell C.P. Connell and another (Joint Official Liquidators) 18 – Respondents Leach C.J. This appeal and Appeals Nos. 27 of 1937 and 28 of 1937 arise out of a misfeasance summons taken out by the Official Liquidators of the General Banking Corporation Limited against the directors of that Company. The appeals have been heard together and it will be convenient to deal with them in one judgment. The Company was registered on 11th May 1933, for the purpose inter alia of doing all kinds of banking business. The promoter was one P.K. Nair, a barrister-at-law, who was at the time and has since remained an undischarged insolvent Nair, who was respondent 9 in the proceedings before the learned trial Judge, arranged that he should, be appointed legal adviser to the Company and the advisory director. A prospectus was prepared, but fortunately there was no general application made to the public to subscribe shares. There were eight other directors, who were respondents 1 to 8. Two of them, respondent 3 and 5 (B. Gulabachand Sowcar and M.L. Ranganayakulu), were not served and they took no part in the proceedings. Respondent 4, A. Madhava Rao who was the chairman of the Company, and Nair absconded before the proceedings commenced. The Official Liquidators sought to make all
the respondents, except respondent 3 and 5, liable under S.235, Companies Act, 1913, for (1) a sum of Rs.49,887.20 which has been misappropriated by Nair, and (2) a sum of Rs.63,319.30, representing liabilities incurred by the Company from the date it started was issued on 4th September 1933, and business was actually commenced on the 7th of that month. The bank's doors were closed on 16th February 1934 a compulsory winding up order was passed. Gentle.J before whom the case came held that respondents 1, 2 and 4 (Rao Bahadur M.C. Rajah.V. Venkateswara Sastrulu and A.Madhava Rao) were each liable to pay the sum of Rs.4,988.72 claimed as the first item and respondent 2, 4 and 6 (respondent 6 being D. Doss) were each responsible for the payment of the sum of Rs.6,331.93 the second item claimed. He also held that in respect of the sum of Rs.6,331.93 respondent 1 was liable to pay Rs.2,833.99 and respondent 7, Rs.5,408 these sums being calculated in accordance with the dates on which they resigned from the Board of Directors. Appeal No.26 is the appeal of respondent 6 in respect of the sum of Rs.6,331.93. Appeal No.27 is by respondent 7 in respect of the sum of Rs.5,408; and Appeal No.28 embraces the appeals of respondents 1 and 2 in respect of the sum of Rs.4,988.72 that of respondent 1 in respect of the sum of Rs.2,833.99 and that of respondent 2 in interest of the sum of Rs.6,331.93. Respondent 4 has not appealed and the learned Judge has become final as against him.

The nominal capital of the Company was Rs.1,00,000 divided into 2,000 shares of Rs.50 each of the Rs.50 payable on each share, Rs.10 was payable on application. Rs.15 on allotment and the balance in five equal installments. The Articles of Association provided that the business of the Company might be commenced as soon as 50 shares, that is Rs.2,500 had been subscribed. Before the company was incorporated, a draft agreement had been prepared under which the Company was to advance to Nair a sum of Rs.10,000 on the security of his interest in the
assets of the Indian Law Times Ltd., and a life policy of Rs.10,000. The Indian Law Times Ltd. had been acquired by Nair and his insolvency arose in connection with this business. The arrangement was that of the loan of Rs.10,000 Rs.5,000 should be paid to Nair for the purpose of enabling him to redeem the assets of the Indian Law Times Ltd., From the hands of the official assignee. After the incorporation of the Company, the agreement was executed and in due course Nair executed the requisite mortgage deed. Although business was not started until 7th September 1933, advertisements were inserted by Nair in the local press on 21st June and 15th July 1933, calling for applications for posts on the staff of the Company. It was intimated that the successful candidates would be required to deposit security for the proper performance of their duties. Applications were received in the course of July and August and a number of appointments were made, the persons appointed furnishing security in the aggregate sum of Rs.10,720. It is true that Nair was an undischarged insolvent, but insolvency does not necessarily mean that a man is a dishonest man. There is here an entire absence of anything, which would point the finger of suspicion to either the chairman or to Nair in the matter of these appointments. There was certainly no reason for any of the directors to suspect that Nair would utilize the security deposits for his own purposes, and there is no reason to suspect that the chairman knew that he was so doing. It is abundantly clear from the minutes that when it was discovered that Nair had utilized these security deposits for his own purposes, the matter was immediately taken up by the directors and he was called upon to repay. Nair appears to have utilized Rs.4,500 of the deposits towards the Rs.5,000 which was to be paid to him under the mortgage for the purposes of redeeming the assets of the Indian Law Times Limited, but instead of redeeming those assets he kept the money. But nobody knew about this until afterwards. The authority's show that where there is an indemnity clause of the kind we have here,
not only must a director be guilty of negligence, but he must know that he
is committing a breach of duty or is recklessly careless in the matter.

In the present case the learned trial Judge has held that they did know
and we are in entire agreement with him. This means that the directors
allowed this Company to open its doors and keep them open for months
knowing full well that 8,103 had not been compiled with, that the
Company had no capital with which to carry on business and that
deposits made by customers in current and other accounts were being
utilized by the management for the payment of wages and current
expenses without any likelihood of the company being able to pay back
such moneys. In other words they (in this case even if it be said that
these respondents acted honestly, it cannot be said that they acted
reasonably and we are unable to grant them any relief under this
section. The order of the learned Judge against respondents 1, 2, 6 and
7 in respect of item 2 of the claim will therefore stand. As the appellants
have succeeded in part and failed in part, we do not propose to make
any order as to costs. The liquidators will have their costs out of the
assets of the Company.

On the same principle, directors were held not liable for misappropriation
of stores by the stores manager or for payment of dividends on false
accounts declared at a meeting where the director sought to be made
liable was absent or for allowing by one of the two directors, the
Company premises, to be used for gaming purpose without license, the
other director knowing nothing.
LEACH C.J. AND LAKSHMAN RAO J.

T.S. PLS. Thinnappa Chettiar and others - Appellants.

G. Rajagopalan, Official Liquidator of Oriental Investment Trust Ltd., Madras and others - Respondents

Leach C.J. - These three appeals arise out of proceedings instituted under S.235, Companies Act, by the Official Liquidator of the Oriental Investment Trust Ltd., which is in the process of being wound up compulsorily under an order of this Court passed on 21st July 1939. The Company was incorporated on 6th September 1936. The first directors were C. Abdul Hakim, P.V. Swamithan, V.K.R. S.K. Viswanthan Chettiar, S. Subbaraya Mudaliar, T.R.M.T. S.P. L. Palaniappa Chettiar and P.L.V. A. Ramanathan Chettiar. C. Abdul Hakim and P.V. Swaminathan died before the liquidation commenced and Kashi Viswanthan after the misfeasance summons had been heard. On 1st April 1937, T.S.P.L.S. Thinnappa Chettiar joined the Board. Charges of misfeasance were preferred against Kashi Viswanthan, S. Subbaraya Mudaliar, Palaniappa, Ramanathan and Thinnappa. It was claimed that as the result of their misconduct they were liable jointly and severally in the sum of Rs. 2,77,531.5.9. The learned Judge (Bell J) considered that S. Subbaraya Mudaliar had not acted unreasonably and was entitled to the benefit of S. 281, Companies Act. He found that the Official Liquidator had established a charge of misfeasance against the other respondents and that the loss was to be apportioned as follows: Kashi Viswanthan and Ramanathan were to be jointly and severally liable for Rs. 1,11,909.10.0, Palaniappa for Rs. 18,651.9.8 and Thinnappa of Rs. 18,651.9.8. Appeal No. 44 of 1942 has been preferred by Thinnappa, App.No.47 of 1942 by the legal representatives of Kashi Viswanthan and App.No.52 by Palaniappa. Ramanathan has not appealed. He
abandoned on 22nd June 1939 after it has been discovered that he had misappropriated large sums belonging to the company.

Madras Kashi Viswanthan's brother Narayanan, with whom he was joint, was in charge of the business there but there is no doubt that the management of the Madras branch was largely in the hands of Ramanathan. Ramanathan had acquired a good reputation in the Chettiar community and was its representative on the Madras board of Directors of the Reserve Bank of India. The authorised capital of the company was Rs. 25,00,000 divided into 25,000 shares of Rs. 100 each. At the time of the liquidation, only 6,068 shares had been issued and they were merely paid up to the extent of Rs. 25 per share. This gave a working capital of a little over Rs. 1,50,000. The objects for which the company was formed were those of an investment trust company, but very little investment business was done. Ramanathan was allowed to control the business of the company and at once commenced gambling in differences in shares. He did this with the full knowledge and consent of his brother directors. This matter has been discussed in the judgement which we have just delivered in O.S.A. No. 40 of 1942 and it is unnecessary to repeat all we have said there.

The paid up capital of the Company was not sufficient for the transactions, which Ramanathan was entering into on behalf of the company and he was authorized by the directors to borrow money from the V.K.R.S.T. firm. Including interest the company of the gambling which was indulged in is to be gathered from the fact the not withstanding the comparatively small amount of capital available the transactions entered into during the short existence of the company at the time of the liquidation was only Rs. 20,000.
Ramanthan betrayed the trust, which was placed in him. He also indulged in gambling in differences on his own behalf and to a large extent he utilized for his own purposes the moneys which he borrowed from the V.K.R.S.T. firm on behalf of the company. He also indulged in gambling in differences on this own behalf and to a large extent he utilized for his own purposes the moneys which he borrowed from the V.K.R.S.T. firm on behalf of the company. He succeeded in deceiving his brother directors, the auditors of the company and the partners of the firm until the month of March 1939, when he debited to his personal account with the company the moneys which he had borrowed for the company from the firm. On 13th June 1939 the auditors prepared a balance sheet, which showed that Ramanthan had taken altogether Rs. 1,42,632.6.3. The Board very complacently agreed to treat this account as representing loans from the company to Ramanthan. This was done because he said that he possessed securities in Bombay which were sufficient to meet his liability and he undertook to hand them over to the company. Kashi Viswanthan sent his representative with Ramanathan to Bombay to take delivery of the alleged securities, but when they arrived in Bombay Ramanathan absconded. Criminal proceedings were instituted against him and a warrant was issued for his arrest, but this has never been executed. The amount which official Liquidator sought to recover in the misfeasance proceedings represented what the company had lost by reason of these gambling transactions and what the company had to pay to the V.K.R.S.T. firm in respect of Ramanthan's borrowings. O.S.A. No. 40 of 1942 arose out of an action instituted by the firm to recover what Ramanthan had borrowed under the authority given to him by the company. The action was tried by Bell J. Who held that the company was not liable to make repayment. The firm appealed and we have felt constrained to disagree with the learned Judge's finding. We have held that the company is liable to the firm for the moneys borrowed by Ramanathan.
The main question which arise in the present appeals are whether the appellants are liable to replace the moneys which Ramanthan lost in the course of the transactions in differences which he entered into on behalf of the company and whether they are liable to make good the money which the company has had to repay to the firm. The learned Judge held that they were liable in respect of the gambling losses, but not in respect of the borrowings because considered that the company was not liable to repay the firm. If, however, on appeal the company was found liable to in respect of the borrowings that appellants' liability would, he said, be correspondingly increased. We concur entirely with the finding of the learned Judge that the appellants are liable for the loss incurred by the company in permitting Ramanathan to gamble in differences. Contracts of such a nature are unenforceable under the general law and they certainly did not fall within the transactions contemplated by the memorandum of association. The company had, of course, the power to buy shares and to sell them again should it be deemed advisable to do so, but by no stretch of imagination can it be said that gambling it be deemed advisable to do so, but by no stretch of imagination can it be said that gambling in differences on the stock exchange is legitimate business for an investment trust. All that the learned counsel have been able to say on behalf of the appellants is that all the directors bona fide believed that this was legitimate business and that therefore the Court should exercise its discretion under S.281, Companies Act. Before S.281 can invoked it must be shown that the directors have acted reasonably as well as honestly and in permitting Ramanathan to gamble in differences they were not acting reasonably. They cannot even say that they came to know of the nature of these transactions at a later stage. In the statutory report, which was prepared on 10th April 1937, it was disclosed that the company had received in payment of differences Rs. 11,904. 14.8. and had paid out in similar transactions the sum of Rs.
While directors are not trustees in the technical sense they hold a fiduciary position with regard to the assets of the company and the appellants were guilty of a grave breach of duty in allowing the company's funds to be dissipated in this way. It has been pointed out that all the balance sheets, except the last one, which was drawn up as on 31st March 1839 were approved of by company in general meeting. But this makes no difference to the position. There can be no ratification of an illegal contract so far as the company is concerned. The more difficult question is whether the appellants can be called upon to make good to the company the Rs. 1,36,274.1.2 which the company has to repay to the V.K.R.S.T firm is respect of Ramanathan's borrowings. That Ramanthan was duly authorised to borrow from the firm is not, and cannot be, disputed. It is now common ground that he used these moneys for the payment of his own gambling transactions. If the directors had been aware of the fact that Ramanthan was using the company's funds in this way and had neglected to interfere they would undoubtedly be liable, but we are satisfied that they did not know until all the money had been borrowed and misappropriated. Therefore the Court has to decide whether their ignorance was due to their own negligence. On behalf of Thinnappa and Palaniappa it is said that they should not be judged by the same standard as Kashi Viswanthan, as he was a managing director. We will first discuss the law so far as it applies to ordinary directors and then consider the position of Kashi Viswanthan as a managing director. In passing it may be mentioned that the assets are sufficient to pay all the creditors and therefore only the shareholders are concerned.

In (1884) 25 ch.D.752, Chitty J. held that an innocent director cannot be held liable for the fraud practiced by his co-directors in issuing to the shareholders false reports and balance sheets, provided that the books and accounts of the company have been kept and audited by duly
appointed and responsible officers and he has no ground for suspecting fraud. In that case Chitty. J. pointed out that no one was bound to presume a fraud and that the directors were not bound to examine entries in the company's books agreed with what was said in these cases. In the present case it cannot be said that either Thinnappa or Palanippa had any ground for suspecting that Ramanthan was acting fraudulently. The company had appointed a firm of qualified auditors and until Ramanthan had completed his misappropriations the auditors themselves were entirely in the dark. The balance sheets of 31st May 1937, and 31st October 1937, which were the last to be drawn up until the fraud had been discovered, had been passed by the auditors. When the statutory report was drawn up on 3rd April 1937, there was owing by the company to the firm Rs. 1,06,000. The balance sheet of 31st May 1937, showed that the amount owing to the creditors had been reduced to Rs. 54,987.0.4 and that of 31st October 1937, showed that there was only due to the V.K.R.S.T. firm Rs. 5575.11.0. Therefore, it may safely be taken that the directors had no ground for suspicion. They acted improperly in allowing Gamanathan to gamble on the stock exchange and for this we hold them liable, but they were not put on inquiry whether Ramanthan was borrowing money from the firm on behalf of the company and utilizing for himself.

The result is that the appellants together with Ramanathan must be held liable for the loss sustained by the company as the result of the gambling in differences, but not for the loss caused by Ramanathan's misappropriations. Kashi Viswanthan's legal representative says that the learned Judge erred in differentiating between the appellants, as they are jointly and severally liable to the company.
We consider that his argument is sound, except that Thinnappa cannot be made liable for any loss suffered before he joined the board. This is not a case in which the appellants can invoke S. 281, Companies Act. It is common ground that the losses up to the date when Thinnappa joined and severally liable in this sum. The liability of Thinnappa will be Rs. 1,04,980.12.0 (Rs. 1,36,092.3.6 less Rs. 31,111.7.6). Ramanathan will, of course, be liable for the Rupees 1,41,439.2.3. as well. Interest at the court rate will run from 17th July 1942, the date of the final order of the learned Judge. That order will be amended in accordance with this judgement. We do not propose to decide whether in law there is any right of contribution between the directors' interest. This question must be left to be decided in other proceedings should the occasion arise. At the moment the Court is only concerned with the loss suffered by the company by reason of the misfeasance of the appellants as directors, and so far as the company is concerned they are all liable to make good the loss on the gambling.
Foot Note:

1. Singh Avathar
2. Company Law by Kenneth Smith
3. 1878, 10th Ch. D.453.
4. 1972 1 ALLER
5. 1980 1 WLR 627 at 634.
6. 1985 BCLC 11
7. 1974 AC 821 PC
8. 1988 BCLC Court Of Appeal
9. Lecture on company law by SHA
10. 1974 AC 821 PC
11. 1991 BCC 620 CA
12. 1067 CH 254 ALLER 420
13. 1903 2 CH 506 chancery division
14. 1873 LR 6HL 189 house of lords
15. 1968 2B 549 court of appeal
16. 1902 2CH 421 chancery division
17. 1921 1CH 543 125 LT 255
18. Company law by parranjappa
19. AIR 1938 Mad 124
20. AIR 1994 Mad 536