THE DIRECTOR'S DUTY OF GOOD FAITH

By Ross W. Parsons*

THE DISCIPLINE OF THE GENERAL LAW

It is a standard opening of any discussion of the general law duties of a director to point to a contrast between the stern duty of good faith[1] which, it is said, the law imposes on him and the relaxed standard of care which the law is content to ask of him. Judges, we are told, are equipped to assess good faith but generally, they lack the commercial experience on which to found the fine decisions which would be called for if the law imposed something more than a relaxed standard of care. Reassuring observation is offered to the effect that so long as the law ensures that directors' hearts are pure, it may not matter that some directors are incompetent.

It is not the province of this essay to expound the *Re City Equitable*[2] principles, or to ask whether section 124(1) of the Uniform Companies Act, in requiring directors to 'use due diligence' demands a higher standard of care than may be expressed in those principles.[3] Certainly the *Re City Equitable* principles impose a relaxed standard.[4] They seem content to ask of a director that he do only as much as one might fairly expect of someone as stupid and incompetent as the director happens to be, which, one would have thought, is not a standard at all.

This essay is concerned with the principles which make up the duty of good faith. It will appear that there is reason to challenge the assumption that these principles impose a stern discipline on directors. It is true that one of the principles—a director must not enter into a contract or transaction in which he has an interest or duty which conflicts with his duty to act in the interests of his company—is puritan in its inflexible morality. A director may not even put himself in the way of temptation. But the principle

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1 Sir Douglas Menzies has referred to the 'very high' standard of good faith imposed on directors and the 'positive hardship to the directors in some cases': 'Company Directors' (1959) 33 *Australian Law Journal* 156, 157.

2 *In re City Equitable Fire Insurance Co. Ltd.* [1925] Ch. 407.

3 *Cf. Byrne v. Baker* [1964] V.R. 443 noted (1964) 38 *Australian Law Journal* 251, where the view is taken that it does not.

4 Menzies, (1959) 33 *Australian Law Journal* 156, 163-164 predicts that the duty of care will in the future be determined by 'present day standards' as to what is expected of directors. The President of the newly-formed Australian Division of the Institute of Directors has declared that the first objective of the Institute is to 'define the standards of ethical conduct of directors': *Sydney Morning Herald*, 26th November, 1964. An objective standard of care geared to the professional director may be too much to ask of the amateur director who could possibly make a valuable contribution to management. The Greene Committee, *Company Law Amendment Committee Report* (1925-26) Cmd. 2657 para. 46, thought that this should be relevant to the grant by the Court of relief under the United Kingdom equivalent of s.365 of the uniform Act. Some of the words of s.365—'having regard to all the circumstances of the case including those connected with his appointment'—have their origin in a recommendation of the Committee (para. 47).

will have no application in regard to contracts which a director makes with the company, or in which he is interested, if appropriate words of release have been included in the articles of association and the director concerned has given what may be only ritual notice to his fellow directors. And, whether or not release is available in this manner, the principle will have no application if the shareholders, including the director himself where he is a shareholder, have by resolution condoned the director's actions.

Release of the director from a duty not to put himself in the way of temptation does not mean that he is entitled to yield to temptation. He remains subject to the discipline of the principle that he must act in the interests of the company. But this principle, it will be seen, is of limited utility. Some formulations would deprive it of very nearly all significance. Thus it is said that a director is required to do only what he thinks is in the interests of the company. So far as this means that a director can set his own standard, it would reduce the duty of good faith to no less futility than the futility of the duty of care as it is expressed in the *Re City Equitable* principles. Happily the law has not wholly abandoned the task of determining what may be regarded as the interests of the company: it asserts some prerogative. Nonetheless the concept remains miserably indeterminate. Where the director's action relates to the rights *inter se* of shareholders there is little to guide the court save a direction to seek the interests of the company in the interests of the elusive 'individual hypothetical shareholder', an entity whose existence is asserted with monotonous repetition in the law reports, but who remains singularly lacking in substance.

The duty to act in good faith is owed to the company and not to individual shareholders. It is true that an individual shareholder may, by way of a special representative procedure, be able to assert the breach of duty owed to the company. Recovery, however, must be for the benefit of the company in whatever form the proceedings are constituted, and the recovery may bring about a result which the lawyer will no doubt cherish as a legal curiosity, but which the layman will tolerate only if he has a taste for the ironic. In *Regal (Hastings), Ltd. v. Gulliver*[5] for instance, the loss suffered by the former shareholders was recovered from the directors for the benefit of the new shareholders whose transactions with the directors were the occasion of the loss and who had not themselves suffered.

The Uniform Companies Act, in section 124 has attempted some statutory formulation of the principles which make up the duty of good faith.[6] But the achievement in law reform, it will be seen, is modest indeed.

[5] [1942] 1 All E.R. 378.
[6] S.124 first appeared in the Victorian Companies Act 1958, s.107.

THE DUTY OF GOOD FAITH

The precise legal category in which a director belongs has been debated in academic and judicial writing. All are agreed that he is a fiduciary of some kind, perhaps a kind all his own.[7] As a fiduciary he must act in good faih. The principles which make up the duty of good faith may, though not definitively expressed, be formulated thus:

I. A director[8] must not place himself or allow himself to be placed in a situation in which he has an interest or duty which conflicts with his duty to act *bona fide* for the benefit of the company of which he is a director.

II. A director must act *bona fide* for the benefit of the company of which he is a director.

I. THE NO-CONFLICT PRINCIPLE

The principle is sometimes expressed as a prohibition on the making by a director of a profit from his office. Such a formulation is too limited. It will be seen that it covers only one aspect of the principle. A director may be in breach of duty, such that a contract by which he has sold property to the company is voidable at the option of the company, notwithstading that he has made no profit on the sale and notwithstanding that the contract is fair. And, though this perhaps may be arguable a director in breach of duty may be answerable to the company in damages, whether or not he has made a 'profit' in some accounting sense, if the contract he has made with the company is unfair.

THE CONFLICT SITUATIONS

It will rarely be difficult to identify the interest of the director or his duty to a third party which may be in conflict with his duty to the company. However, there are some situations, where it is questionable whether the director is under any duty to act for the benefit of his company. The categories of situations adopted in what follows are arranged in a way which places first the situations which more clearly raise the duty.

A. *Director contracting with the company of which he is a director or being interested in a contract with the company of which he is a director*

These are the classical conflict situations.

There is a sufficient interest to bring the principle into operation if the director holds shares in a company with which the company

[7] *Cf. Re International Vending Machines Pty. Ltd.* and the *Companies Act* (1963) 80 W.N. (N.S.W.) 465, 473, *per Jacobs J.*

[8] The duty of good faith, though here referred to as the duty of a director, is imposed on any officer of a company whose office carries the responsibility to exercise discretion in the management of the company.

of which he is a director is contracting, even though he holds those shares as trustee for another.[9] In such cases it is not necessary that his be a subtantial shareholding: there does not appear to be a *de minimis* rule.[10]

Percival v. Wright[11] is authority for the proposition that the director's duty of good faith is not owed to a shareholder in the company of which he is a director,[12] and that there is thus no conflict of duty and interest which the shareholder can assert when the director contracts with a shareholder in the company. There does not, however, appear to be any decision on the duration of the duty. It may be asked whether the duty attaches though the director has resigned from the board before he contracts with the company.[13] The fiduciary duty of a promoter lingers on after the promotion is complete. A contract a promoter makes with the company will be voidable unless it is made after full disclosure of all material facts to an 'independent board'.[14] The duty will come to be spent at some point of time, but clearly it is not co-terminous with the duration of the promotion. The resignation of a director will no doubt have the effect, independently of any provision in the articles, of making it possible for the board to conclude a contract with him: the company is otherwise entitled to the services of its directors as an entire board, including the services of the director who seeks to contract with the company. It is nonetheless arguable that the former director remains subject to the duty of good faith and is obliged to make full disclosure of all material facts to an independent board, if the board's action in contracting with him is to be an effective waiver of that duty. This would be to equate the director's duty after he ceases to be a director with the promoter's duty. The promoter will in many

9 *Transvaal Lands Co. v. New Belgium (Transvaal) Land and Development Co.* [1914] 2 Ch. 488. The conflict of duty thus arising is of a different order from the conflict which arises where a director holds shares as trustee in the company of which he is a director. His duty to act *bona fide* for the benefit of the company as director may call for action affecting the interests of some or all of the shareholders, different from what may be called for by his duty to protect the interests of his *cestuis que trust.*

10 *Ibid.* p. 503 *per* Swinfen Eady L.J.

11 [1902] 2 Ch. 421.

12 It was the view of Lord Atkin in *Bell v. Lever Brothers Ltd.* [1932] A.C. 161 that no duty of good faith is owed to the holding company by a director of the company's subsidiary. Lords Blaneburgh, Warrington and Thankerton, however, seem to have assumed that a duty is owed to the holding company in these circumstances. Statements will be found in the authorities which are inconsistent with the *Percival v. Wright* principle. Thus in *Richard Brady Franks Ltd. v. Price* (1937) 58 C.L.R. 112, 143 Dixon J. said 'the fiduciary duty of the director is to the company and the shareholders'. And there is a recognition of an exception to the *Percival v. Wright* principle in the assumed irrelevance of the rule in *Foss v. Harbottle* (1843) 2 Hare 461, in the High Court decision in *Ngurli v. McCann* (1953) 90 C.L.R. 425.

13 In *Gray v. New Augurita Porcupine Mines* [1952] 3 D.L.R. 1 (P.C.) importance seems to have been placed on the fact that Gray was technically still a director at the time of the compromise agreement with his company though he did not take any part in the decision of the board to make the agreement.

14 It might be thought that once the company has an independent board it is able to take care of itself. The principles make assurance doubly sure.

cases also have been a director and similar policies against overreaching explain the duties. On the other hand it may be thought curious that a director, under a release clause in the articles,[15] should find it easier to contract with the company while he is a director than after his retirement. And the requirement that there be an independent board, while certainly a part of the law as to promoters' duties, does not seem to apply to a solicitor-fiduciary or an agent-fiduciary who is not a director. The solicitor in *Regal (Hastings), Ltd. v. Gulliver*,[16] escaped liability to account because he had the consent of the board even though the board at the time was acting on his advice. The agent in *Peninsular and Oriental Steam Co. Ltd. v. Johnson*[17] escaped liability to account for the commissions on insurance which it had placed for the company, because the taking of the commissions had the sanction of the board, even though the board was clearly not independent.

RELEASE FROM DUTY

The protection of the principle which forbids a director to enter a situation of conflict of duty and interest may be waived by the company. But, so long as the director remains a director, the general law insists that the board cannot act for the company in contracting with him.[18] The contract must be made with him by the company in general meeting or a purported contract made with him by the board must be ratified by a majority vote in general meeting. An ordinary resolution is sufficient and the articles will determine who may vote and other conditions of such a resolution.[19] The contract must be made after full disclosure by the director of all material facts.[20] Presumably, disclosure to the general meeting must be made

15 Discussed *infra* p. 10 ff.

16 [1942] 1 All E.R. 378. Sir Douglas Menzies' explanation, (1959) 33 *Australian Law Journal* 156, 159 of the solicitor's success on the ground that he was not a fiduciary is, with respect, in conflict with principle and the judgments in the case.

17 (1938) 60 C.L.R. 189.

18 *Gray v. New Augurita Porcupine Mines* [1952] 3 D.L.R. 1, 13 (P.C.); *Benson v. Heathorn* (1842) 1 Y. & C. C.C. 326-62 E.R. 909; *Imperial Mercantile Credit Association v. Coleman* (1871) L.R. 6 Ch. App. 558. The principle is not part of American law. The majority view in America is that the board may contract with the director provided the director's presence is not necessary for a quorum and his vote is not necessary to carry the board's resolution.

19 In this there is an expression of the principle that the duty is owed to the company and not to the individual shareholder. The Jenkins Committee, *Report of the Company Law Committee* (1962) Cmd. 1749, paras 93 and 99(i) has recommended (post n.34) that in the case of a 'golden-handshake' agreement between the company and a director, a special resolution should be necessary. The recommendation would preserve the need for a corporate act of waiver but at the same time increase the protection of the individual shareholder.

20 'The amount of detail required must depend in each case upon the nature of the contract or arrangement proposed and the context in which it arises . . . [The director's] declaration must make his colleagues "fully informed of the real state of things" (see *Imperial Mercantile Credit Association (In liquidation) v. Coleman* (1873) L.R. 6H.L. 189, at p. 200 *per* Lord Chelmsford); *Gray v. New Augurita Porcupine Mines* [1952] 3 D.L.R. 1, 14. And see the judgment of Vaughan Williams L.J. in *Costa Rica Railway Company, Limited v. Forwood* [1901] 1 Ch. 746,

in the notice of meeting. Disclosure at the meeting, when the result of the vote may depend on proxies held by the directors, will not suffice.

Early in the history of modern company law it became the practice to insert clauses in articles of association which purported to allow the board on behalf of the company to contract with one of its own members or to enter into a contract in which one of its own members had an interest, and this, according to some clauses, without any disclosure of material facts.[21] The policy of the strict rules of the general law, it was said, must in some way be a policy which would not insist that it is in the commercial interests of the company that it should not have, as some of its directors, men who are connected with potential customers or potential sources of supply; this policy would be defeated if every contract in which any one of these directors is concerned required ratification by the general meeting after full disclosure.[22] In his more ambitious moments the draftsman purported to exempt a director from all aspects of his general law duties, both his duty of good faith and his duty of care.

The clauses were given effect by the courts[23] though the theoretical basis of the drafting technique is not obvious. Some theoretical basis can be established by arguing that the release clause in the articles goes to the determination of what is for the 'benefit of the company'. The argument would be that the clause does not exclude the duty of good faith, it merely explains the content of that duty. Thus the Lord Chancellor in *Imperial Mercantile Credit Association v. Coleman*[24] took the view that the shareholder had notice in the articles of the terms on which he entrusted his property to the management of others and must be taken to have accepted those terms. He thus equated the attenuation of duty achieved by a release clause in the articles with the attenuation of duty which unquestionably may re-

761 citing *Dunne v. English*, (1874) L.R. 18 Eq. 524 and *Albion Steel and Wire Company v. Martin* [1875] 1 Ch.D. 580. The majority view in American law recognizes that there may be a condonation by the general meeting if there has been full disclosure provided, however, that the director shows that the contract was objectively fair: *Wiberg v. Gulf Coast Land & Development Co.* (1962) 360 S.W. 2d. 563.

21 The release clause in the articles of the Niger Company is, it is submitted, the explanation of the holding of *Bell v. Lever Bros. Ltd.* [1932] A.C. 161 that the contracts were not voidable for non-disclosure. The contracts were made on 19 March 1929, some time before the United Kingdom Companies Act 1929 (which included provisions which are the sources of ss. 123 and 133 of the Uniform Act), came into force. Had those provisions been in force, the result in the case would have been the other way.

22 This is the justification offered by the Lord Chancellor in *Imperial Mercantile Credit Association v. Coleman* (1871) L.R. 6 Ch. App. 558.

23 *Bell v. Lever Bros. Ltd.* [1932] A.C. 161; *Costa Rica Railway Company, Limited v. Forwood* [1901] 1 Ch. 746 (C.A.). See also the *Report of the Company Law Amendment Committee* (1925-26) (The Green Committee) Cmd. 2657, para. 46 and the clause in the articles in *Re Brazilian Rubber Plantations & Estates, Limited* [1911] 1 Ch. 425.

24 (1871) L.R. 6 Ch. App. 558, 568-569.

sult from the provisions of a will or other instrument by which property is vested in another on trust. There is the difference however that the maker of a will is setting the terms of a trust in relation to his own property and there is good reason, one would have thought, why the draftsman of articles of association should not be permitted prospectively to settle the terms on which directors will deal with the property of investors. The terms of the articles of association will not be disclosed in the prospectus, and, of course, there may not be a prospectus.

Whatever may be the theoretical basis, the draftsman must now contend with subsection (1) of section 133 of the Uniform Companies Act which provides:

> Any provision, whether contained in the articles or in any contract with a company or otherwise, for exempting any officer or auditor of the company from, or indemnifying him against, any liability which by law would otherwise attach to him in respect of any negligence default breach of duty or breach of trust of which he may be guilty in relation to the company, shall be void.[25]

When the form of words the draftsman has chosen can be characterized as an 'exempting' provision, the section must avoid the provision unless it is saved by section 123 and Table 'A' which assume the validity of a clause allowing a director to contract with the company through the board.[26] A clause drafted as an attenuation of duty rather than an exemption may escape section 133 but a wise draftsman will be content with the measure of exemption for which there is authority in section 123 and Table 'A'.[27] No draftsman will seek to release a director from the obligation of disclosure imposed by section 123—any less disclosure will at least involve the director in a criminal offence. A clause is sometimes included allowing a director to vote as a member of the board on a contract in which he is

25 The paternalistic philosophy of s. 133 of the uniform Act contrasts with the *laissez faire* assumptions of the Lord Chancellor in the *Imperial Mercantile Credit Association Case*. The origin of s. 133 is in a recommendation of the Greene Committee (Cmd. 2657, para. 46). The Committee said: 'It is fallacious to say that the shareholders must be taken to have agreed that their directors should be entitled to take shelter behind the article'. The Lord Chancellor's view was put to the Committee in a memorandum submitted by the Law Society (Minutes of Evidence, xlix). The Law Society memorandum conceded that notice of the clause in the articles 'should perhaps be given in the prospectus'. The context of the Committee's recommendation suggests that s. 133 was intended to deal primarily with clauses exempting from liability for breach of the duty of care and this would explain the absence of any express correlation of s. 133 with s. 123. But s. 133 clearly extends to exemption clauses which relate to the duty of good faith.

26 Fourth Schedule Table 'A', Article 81.

27 The Table 'A' release clause will be effective, it is submitted, not only to preclude voidability of the contract but also other remedies against the director; either by account of profits or damages. Note, however, the contrary view in relation to a clause in similar terms taken by Dixon J. in *Peninsular & Oriental Steam Navigation Company Ltd. v. Johnson & Others* (1938) 60 C.L.R. 189, 252. The drafting of Table 'A' suggests no more than a limited awareness of the relevant principles: it is only a release clause by implication.

interested. Such a clause seeks to increase the measure of release beyond the clause in Table 'A'. The draftsman thus hazards the security of contracts in which a director is interested. It is true that the rule in *Foss v. Harbottle*[28] will for the time being protect a director who controls or who has the support of those who control the company. But the lesson, it will be seen, of *Regal (Hastings) Ltd. v. Gulliver*[29] is that a director has need of a continuing assurance that affairs beween himself and the company are in order; against the day when there is a change in control or there is a liquidation of the company.

So far as the director is required by section 123 to disclose the 'nature of his interest', the measure of disclosure is no less than would be required by the general law in a disclosure to the general meeting.[30] But in some circumstances the section is content with a general notice of the director's position as an officer or member of a company or partnership which is contracting with his company.[31] Thus there is less protection against self-dealing when a director contracts with the company than there is under the general law when a promoter contracts with the company. There is less protection in another respect also. Under a Table 'A' clause a director may not vote on the board in regard to a contract in which he is interested. There is, however, no requirement that the board be 'independent' of the director.[32] A promoter who contracts with the company must contract through an independent board.

Having thus limited the protection against self-dealing which may have been afforded by the general law the Uniform Act endeavours to counter the more likely abuses by a variety of expedients. In some provisions the Uniform Act is content to rely on the deterrence which is involved in the prospect of publicity for the transaction. Thus section 162 and paragraph 1 (1) of the Ninth Schedule require that the profit and loss account must disclose 'the total of the amount paid to the directors as remuneration for their

28 (1843) 2 Hare 461. 29 [1942] 1 All E.R. 378.

30 *Gray v. New Augurita Porcupine Mines* [1952] 3 D.L.R. 1, 14.

31 Section 123(4).

32 The majority view in American law seeks to overcome this deficiency by requiring that the contract between the director and the company must be shown by the director to be objectively fair (which, presumably, is a requirement for validity additional to the requirement that there has been full disclosure to the board) and that the director show that his presence was not necessary to a quorum of the board and that his vote was not necessary to carry the resolution: *Shlensky v. South Parkway Building Corporation* (1960) 166 N.E. 2d. 793; *Winger v. Chicago City Bank & Trust Co.* (1946) 67 N.E. 2d. 265; *Harriman Welding Supply Co. v. Lake City Corporaton* (1959) 330 S.W. 2d. 564; *Buck v. Northern Dairy Co.* (1961) 110 N.W. 2d. 756; *Wiberg v. Gulf Coast Land & Development Co.* (1962) 360 S.W. 2d. 563. One might ask whether the requirements of objective fairness will be determined by reference to the facts known to the director at the time of the contract or by reference to what the facts turn out to have been?

Some States have statutes imposing tests of the validity of contracts with directors: See the account in Baker & Carey, *Cases and Materials on Corporations*, at p. 440 ff.; (1949) 23 *Cornell Law Quarterly* 445.

services'. There is, however, a significant exception in regard to the remuneration of service by directors, and it is only the aggregate remuneration which must be disclosed. Moreover there would not appear to be any obligation of disclosure save in regard to money payments. Happily there is a much more powerful provision in section 131 relating to the disclosure of directors' emoluments on requisition by members. The wide definition of 'emoluments' applies and the disclosure must be of the emoluments of each director to which the requisition relates.[33]

In other provisions the Uniform Act insists on disclosure to and approval by the general body of shareholders or, in one instance, by the shareholders whose interests are especially affected. By section 129(1)(a) it is unlawful for a company to make to any director any payment, by way of compensation for loss of office as a director of that company or of a subsidiary of that company or as consideration for or in connection with his retirement from any such office, unless particulars with respect to the proposed payment (including the amount thereof) have been disclosed to members of the company and the proposal has been approved by the company in general meeting.[34] When any payment has been unlawfully made the amount received by the director is deemed to have been received in trust for the company. Where, however, the payment has been made to the director in connection with an offer to shareholders to acquire their shares and particulars of the payment have not been given to shareholders in the notice of the offer made for their shares, the amount received by the director is deemed to have been received by him in trust for any person who has sold his shares in response to the offer. If a director who is to retire receives more for his shares than the other shareholders who have sold, the excess is deemed to have been a payment to him by way of compensation for loss of office.[35]

In one provision, the Uniform Act simply forbids a transaction in which it was thought there was a special risk of self-dealing. Section

33 The uniform Act thus rejects the view taken by the *Committee on Company Law Amendment* (The Cohen Committee) that the privacy of the income of each director should be respected (Cmd. 6659/1945 para. 89). Perhaps we are not as sensitive in Australia: salaries, especially those of academics, public servants and parliamentarians seem to be newsworthy.

34 The Jenkins Committee (*Report of the Company Law Committee*, Cmd. 1749/62 para. 92) has recommended that the provision of the United Kingdom Companies Act 1948 which corresponds with s. 129 of the uniform Act should be amended to require approval of the company by special resolution and that disclosure be required, in seeking such approval, of receipts by the director which are otherwise exempted by s. 129 from disclosure and approval. A payment to a retiring director in respect of the relinquishment of his rights under a service agreement is, it is submitted, within s. 129. *Cf.* however the view expressed by Hudson J. in *Lincoln Mills (Australia) Ltd. v. Gough* [1964] V.R. 193.

35 The raising of a trust for the persons who have disposed of their shares is an isolated attempt to overcome the rule in *Percival v. Wright* [1902] 2 Ch. 421. See *infra* p. 409.

125 forbids a company making a loan to a director of the company or of a related company, or to guarantee or provide any security in connection with a loan made to such a director by any other person.[36]

REMEDIES

A director who relies on a release clause in the articles or on the consent of the company in general meeting carries the onus of showing that all the conditions necessary to a valid release or consent have been satisfied.[37] Where a director contracts with the company or is interested in a contract with the company, and the contract is not saved by a release or consent, the company's primary remedy is to avoid the contract.[38] In some circumstances, however, the company may not be able to avoid. Thus *restitutio in integrum* may no longer be possible,[39] or, in a case where the other party to the contract is not the director, the company may not be able to avoid because the other party was unaware of the director's breach of duty. The extent to which the other party must have been privy to the director's breach of duty has not been examined in any detail in the authorities. In *Richard Brady Franks Ltd. v. Price*,[40] Dixon J. said that the company will not be entitled to rescission against a third party who has dealt with the company *'bona fide'* and without notice'. Starke J. in *A. M. Spicer & Son Pty. Ltd. (in liquidation) v. Spicer and Howie*[41] took the view that the other party must not only have known the facts but also that they involved a breach of duty.[42] The effect of this view would be to allow the third party to act upon his own ideas of what will be a breach of duty by the director, which may or may not correspond with the director's or the law's ideas.

Where it is not open to the company to avoid or where the company does not elect to avoid the contract, it may be entitled to remedies by way of an account of profits or by way of damages. A remedy by way of an account of profits will only be available if it

36 The prohibition does not apply to anything done by a proprietary company. The Jenkins Committee (Cmd. 1749/1962 para. 98) has recommended that this privilege should be withdrawn. The Committee recommendation indicates a hardening of opinion against loans to directors. The Greene Committee in 1926 (Cmd. 2657, para. 48) said that it was not 'practicable or desirable to prohibit such loans'.

37 *Gray v. New Augurita Porcupine Mines* [1952] 3 D.L.R. 1, 14.

38 *George A. Bond & Co. Ltd. v. Bond* (1930) 30 S.R. (N.S.W.) 15.

39 As in *Gray v. New Augurita Porcupine Mines, supra* n. 37.

40 (1937) 58 C.L.R. 112, 142.

41 (1931-32) 47 C.L.R. 151, 176.

42 S. 119 of the uniform Act may have some bearing. A clause in the articles in the *Spicer Case, supra* n. 41 in terms similar to s. 119 was held by Starke and Evatt JJ. to be sufficient to save the contract from Rescission. S. 119 merely states one aspect of the rule in *Royal British Bank v. Turquand* (1855) 5 El. & Bl. 248, 119 E.R. 474; (1856) 6 El. & Bl. 327, 119 E.R. 886. Where there is a release clause which has not been complied with, for example because the director voted, the third party will be entitled to rely on that rule. Presumably, even where there is no release clause the third party will be entitled to assume that there has been condonation by the general meeting. But this may be an unwarranted extension of the rule in *Royal British Bank v. Turquand, ibid.* into the area of abuse of authority.

can be shown that the contract is a purported sale to the company of property which the director had acquired for the company so that in equity it already belonged to the company.[43] In this case the director is entitled only to his expenses in acquiring the property and in conveying it to the company. To the extent that the amount he has received from the company is greater he must account.

Where the contract does not involve a sale to the company of property the director has acquired for the company, the company's only remedy will be in damages for breach of duty. In this connection there is some doubt as to the company's right to damages where it has paid more for property than it was worth or has sold property for less than it was worth. Sir Owen Dixon, in a number of judgments, denied that damages in the amount of the difference were recoverable in these situations on the ground that to allow such damages would be to rewrite the contract.[44] But his view seems to have been rejected in *Gray v. New Augurita Porcupine Mines*.[45]

It is implicit in the principle forbidding a conflict of duty and interest that the company's remedies do not depend on showing that the director has sought to further his own interests at the expense of the company. The company is entitled to avoid the contract whatever the director's intention may have been and whether or not the con-

[43] *Peninsular & Oriental Steam Navigation Co. Ltd. v. Johnson* (1938) 60 C.L.R. 189, *per* Latham C.J., at p. 213, *per* Dixon J., at pp. 246-247. The distinction between a profit made by a director in selling property to the company at a price greater than he paid for it, and 'damages' the company has suffered by being sold something at a price greater than its true value is insisted on by Latham CJ. and Dixon J. in the *Peninsular & Oriental Case*, (1938) 60 C.L.R. 189, 213, 246. The distinction is thoroughly obscured in the Privy Council judgment in *Gray v. New Augurita Porcupine Mines* [1952] 3 D.L.R. 1.

[44] In *Peninsular & Oriental Steam Navigation Co. Ltd. v. Johnson* (1938) 60 C.L.R. 189, 248-9 and *Tracy v. Mandalay Pty. Ltd.* (1953-54) 88 C.L.R. 215, 239-40 citing *In Re Cape Breton Co.* (1884) 26 Ch.D. 221; (1885) 29 Ch.D. 795 and *Burland v. Earle* [1902] A.C. 83. He took the view that a remedy in damages was equally unavailable against the director where the contract with the company involved not the director himself but a company in which the director was interested. While such a contract may be rescinded if the other party is privey to the director's breach of duty and *restitutio in integrum* is possible, it would appear that in no circumstances can the other party be called on to account or be made liable in damages. This is the assumption in *Costa Rica Railway Company Ltd. v. Forwood* [1900] 1 Ch. 756 (Byrne J.).

There is some support in American authorities for the view taken by Sir Owen Dixon: these authorities would confine it to cases where rescission is still available but the company has elected not to rescind. If rescission is not available the authorities would allow damages in the amount by which what the company has paid exceeds the value of the property the director has sold to it: *New York Trust Co. v. American Realty Co.* (1926) 155 N.E. 102.

Sir Owen Dixon did concede that the company might have a remedy in damages in respect of the loss it has suffered on 'the whole transaction', though it is not clear exactly what basis of calculation this would involve.

[45] *Supra* n. 13. The case did not involve a sale of property, but the giving of an account of 'profits' (*semble* damages) is inconsistent with the view taken by Sir Owen Dixon. There is another significant aspect of the case, obscured by denoting the remedy as an account of 'profits': the Privy Council dismissed as irrelevant the fact that the company might fairly have settled with the director for an amount less than the damages he had caused to the company and the profits for which he was accountable.

tract is objectively fair to the company.[46] Where the company is entitled to an account of profits, it is irrelevant that the property sold by the director to the company was sold at a fair price. The objective fairness of the contract will be relevant only in the calculation of damages, if damages is the remedy the company seeks.

B. *The making of gains in the course of office*

A reward paid to the director by a third party for the director's services in securing some action by the company or in the expectation that he may be able to secure some action, involves a breach of duty.[47] There is a breach of duty notwithstanding that the form of the reward is such that he company could not itself have received it.[48] There is a breach of duty if the director makes use for his own purposes of the company's property or of confidential information about the company's business or its customers.[49] In these situations what has been done by the director is so related to the functions of his office[50] that there is clearly a duty on him to act for the benefit of the company.

A sufficient relation between the making of the gain and the functions of the director's office is equally evident in other situations which are commonly referred to as appropriations of company opportunities. *Cook v. Deeks*[51] is the classical illustration.

There is, however, a question whether a duty to act for the benefit of the company will be raised where the situation is such that the action of the director, while relating in some way to the functions of his office, could not bear on company interests. *Regal (Hastings), Ltd. v. Gulliver*,[52] in its facts, is no doubt a marginal case, but there was nonetheless a possible bearing of the directors' actions on company interests: the decision not to subscribe on behalf of the company for the whole of the share capital in the subsidiary may well have been a wise decision, but it remains true that the directors did take a decision on behalf of the company when their own interests were also in play. A similar situation was disclosed in *Ngurli Pty. Ltd. v.*

[46] *Gray v. New Augurita Porcupine Mines* [1952] 3 D.L.R. 1, 14, citing *Parker v. McKenna* (1874) L.R. 10 Ch. 96 and *Costa Rica Ry Co. v. Forwood* [1901] 1 Ch. 746.

[47] In *re Domestic Devices Ltd.* (1931) 31 S.R. (N.S.W.) 8.

[48] *Boston Deep Sea Fishing & Ice Co. v. Ansell* (1888) 39 Ch.D. 339 and see Vaughan Williams L.J. in *Costa Rica Railway Company Limited v. Forwood* [1901] 1 Ch. 746, 761 (C.A.).

[49] *Measures Bros. Ltd. v. Measures* [1910] 1 Ch. 336; [1910] 2 Ch. 248; *British Industrial Plastics v. Ferguson* [1938] 4 All E.R. 504.

[50] The test of relation to the functions of the director's office cannot be whether the transaction out of which the profit arose was one which the director had authority to enter into as agent for the company. The director will normally have no authority except as a member of the board. A test of this kind is, however, suggested by Dixon J. In *Peninsular & Oriental Steam Navigation Co. Ltd. v. Johnson* (1938) 60 C.L.R. 189, 252 to determine whether there was a duty situation involving an agent-fiduciary.

[51] [1916] 1 A.C. 554.

[52] [1942] 1 All E.R. 378.

McCann[53] but was not the subject of decision. The governing director of Ngurli Pty. Ltd. failed to subscribe for shares in another company with the result that under the articles of that company the shares were then offered to him in his own right and he accepted the offer.

There are, however, situations involving opportunities for gain by a director, which although they may arise in the course of his office are not such that his action in exploiting the opportunity could bear on the interests of the company. The situation of a director dealing in the securities of his own company may be a situation of this kind. The principle of *Trevor v. Whitworth*[54] precludes the company itself from dealing in its own securities. There is a bearing on the interests of the company only if it is assumed that the dealings by the director will affect the compay's reputation in a way which will impair its capacity to raise new capital.[55]

The statutory duty raised by section 124(2) of the Uniform Act[56] may go beyond the general law—the subsection restates the general law in regard to the use by the director of confidential information about the company's business or its customers, and the appropriation of company opportunties. It is assumed that the words 'make use of . . . to gain' or 'to cause' used in the subsection require that the officer must have intended to gain an improper advantage for himself or to cause detriment to the company. To read the words as meaning 'with the result that' might be to impose a strict liability on a director for a business judgment he has made as director which in

[53] (1953-54) 90 C.L.R. 425.

[54] (1887) 12 App. Cas. 409.

[55] In *Reading v. Attorney-General* [1951] A.C. 507 a soldier for reward protected an illicit transaction from discovery by being present in uniform and the Crown was held entitled to recover the reward. Lord Porter (with whom Viscount Jowett concurred) took the view that the effect of the soldier's conduct on the interests of the Crown was irrelevant. He adopted a passage from the judgment of the trial judge (Denning J.) who said: 'It matters not that the master has not lost any profit, nor suffered any damage. Nor does it matter that the master could not have done the act himself', *ibid.* p. 514. *Furs Ltd. v. Tomkies* (1935-36) 54 C.L.R. 583 offers several formulations of a test of a sufficient relation of the gain to the functions of the office, for example: 'His fiduciary character was alike the occasion and the means of securing the profit for himself'—*per* Rich, Dixon and Evatt JJ. at p. 598. Their Lordships in the *Regal Case* [1942] 1 All E.R. 378 offered various formulations: 'by reason and in the course of that fiduciary relationship'—*per* Lord Russell, p. 385; '. . . in the course of their management . . . they utilized the position and knowledge possessed by them in virtue of their office as directors . . . '—*per* Lord MacMillan, at p. 391; 'the opportunity and the knowledge . . . came to them . . . *in their position as directors*'—*per* Lord Wright, at p. 393; 'By use of his fiduciary position'—*per* Lord Porter, at p. 395. But none of these formulations is helpful in settling the question raised in the text.

[56] Section 124(2) provides:

'An officer of a company shall not make use of any information acquired by virtue of his position as an officer to gain directly or indirectly an improper advantage for himself or to cause detriment to the company'.

Subsection (3) imposes the sanctions. It provides:

'An officer who commits a breach of any of the provisions of this section shall be—
(a) liable to the company for any profit made by him or for any damage suffered by the company as a result of the breach of any of those provisions; and
(b) guilty of an offence against this Act.
Penalty: Five hundred pounds.'

fact results in loss to the company. But the subsection may well have extended the general law by making it unnecessary to show that the director's action in exploiting an opportunity which has come to him in the course of his office could have a bearing on the interests of the company. It would appear to have been aimed at the 'insider-dealing' situation. The words used in the subsection were no doubt inspired by the terms of the Cohen Committee Report[57] relating to share transactions by directors. While condemning 'insider-dealing' the Committee preferred to recommend control by way of ensuring publicity of transactions by a director in the securities of his own company.[58] Provisions to ensure publicity were incorporated in the United Kingdom Act of 1948 and have been taken up by the Uniform Act in sections 126, 127 and 178.[59] The Uniform Act has, it would seem, added the discipline of section 124(2).[60]

There are, however, problems of interpretation and the scope of the subsection will depend on the meaning the courts give to the key words 'improper advantage'. The Cohen Committee thought that directors' actions might be called improper if 'they act not on their general knowledge but on a particular piece of information known to them and not at the time known to the general body of shareholders'[61]. An 'advantage' may be shown in the buying, selling or subscribing for securities: thus criminal proceedings will be available in a wide range of situations. But the civil remedy[62] requires that a 'profit' to the director or a 'detriment' to the company be shown. 'Profit', presumably, is something different from 'advantage'. The word may refer to a realized profit. Even if realization is not the test, one cannot say that being saved from a loss, by selling before the fall, is a 'profit', though it is clearly an 'advantage'. The subsection may be wide enough to include dealings through an interposed company though it does not appear to be wide enough to cover

[57] *Report of the Committee on Company Law Amendment* (1945) Cmd. 6659 para. 86. It will be noted that the words 'improper' and 'advantage' are used in the Report.

[58] 'The fact that disclosure is obligatory will, of itself, be a deterrent to improper conduct, and the shareholders can, if they think fit, ask for an explanation of transactions disclosed in the return which we recommend': Cmd. 6659 para. 87.

[59] The Jenkins Committee (Cmd. 1749, para 99 and see paras. 88-91) has recommended amendments to these provisions which will increase the measure of publicity of insider-dealing transactions. A recent amendment to s. 178 of the New South Wales Companies Act has substantially increased the powers of an inspector appointed to investigate ownership of shares or debentures. The new s. 178 gives effect to a recommendation by Mr Ryan, Registrar of Companies, N.S.W., in his *Report of an Investigation into Certain Dealings in the Shares of Ducon Industries Limited* (1963), N.S.W. (N.S.W. Government Printer, p. 45383-1).

[60] American law has gone much further than the United Kingdom Act and the uniform Act. *Cf.* Securities Exchange Act 1934, s. 16 and the indication in *Brophy v. Cities Services Co.* 70 A.2d. 5 of recognition of a general law doctrine which would give a remedy to the company apart from the Federal statute. The Securities Exchange Act provisions were the subject of evidence given before the Jenkins Committee by Mr M. F. Cohen and Professor Louis Loss: See Minutes of Evidence, 19th day, paras. 6693ff.

[61] Cmd. 6659 para. 86.

[62] S. 124(3).

dealings by relatives and friends: the director may have gained the improper advantage 'for himself'. It may not be wide enough to cover mutual 'backscratching': this will depend on how far the word 'indirectly' can be taken.[62a] There will be difficulty in proving that the director did in fact make use of the information. And this difficulty will be increased, in civil proceedings, by the onus of proof which must be related to the gravity of a wrong which, by the section, is also a crime.[63] The subsection imposes the duty on anyone who is an 'officer'[64] and this word is defined, 'unless the contrary intention appears', so as to include an 'employee'. It may be that the courts will find a contrary intention. The fiduciary duties at general law apply only to officers whose functions require the exercise of discretion: there are duties of fidelity imposed on an employee by the general law but these are not, in the present context as high as the duties of a fiduciary.

The remedy given by section 124(2) in an 'insider-dealing' situation is given to the company and not to the person who has dealt with the director and whose interests are clearly at risk. In *Percival v. Wright*[65] it was sought to extend the director's duty of good faith so that it would be owed to each shareholder as well as to the company. The case involved an 'insider-dealing' situation. Wright J. refused to extend the duty and his judgment has come to be regarded as definitive. However the Jenkins Committee has now recommended that the effect of *Percival v. Wright* should be reversed by the giving of a special statutory remedy to a person who suffers loss as a result of dealing with the insider.[66] The remedy recommended

62a The Report of Mr Ryan, Registrar of Companies (N.S.W.), on certain dealings in the shares of Ducon Industries Limited (N.S.W. Government Printer, p. 4583-1) illustrates some of the difficulties in the application of section 124(2). Mr Ryan concluded that although the director did make use of inside information to advance the financial position of his children, this was not sufficient to constitute an indirect advantage of the kind contemplated by section 124(2). He was also of the opinion that a disclosure of such information to friends and associates in the hope of probable reciprocity in the future was of itself likewise insufficient (Report p. 29).

63 Whether s. 124 has weakened the sanctions of civil law proceedings against directors for breaches of duty depends on the question of the appropriate standard of proof of the breach alleged. *Cross on Evidence* (2nd ed., 1963) p. 99 considers the question settled by *Hornal v. Neuberger Products Ltd.* [1957] 1 Q.B. 247; [1956] 3 All E.R. 970 where the Court of Appeal concluded, in apparently general terms, that proof on a preponderance of probability will suffice when the commission of a crime is alleged in a civil action.

The Australian law on the subject has recently been the subject of a decision in the High Court in *Rejfek v. McElroy* (1965-6) 39 A.L.J.R. 177.

64 *Cf.* s. 124(1) (discussed *infra* pp. 417, 418) which imposes duties on a 'director'.

65 [1902] 2 Ch. 421.

66 Cmd. 1749/1962, para. 99 and see paras. 88-91. The Committee conceded that the individual will have difficulty in establishing the facts which entitled him to a remedy. The register of directors' shareholdings may provide the scent, but tracking a particular transaction where there have been contra-deals through the Stock Exchange may prove impossible without the assistance of an investigation under s. 178.

The provision recommended by the Committee seems intentionally to have

is not by way of extension of the general law duty such as was sought in *Percival v. Wright*. Such an extension would leave the remedy too narrow: a person who buys from a director may not already be a shareholder in the company. A dealer in the options market would not be protected by a remedy confined to a shareholder.

As well as giving a remedy to the company the Federal Securities legislation in the United States has given a remedy to the individual with whom the director or officer has dealt. Section 17(a) of the Securities Act, 1933 and 10(b) of the Securities Exchange Act, 1934 and rule 10(b)–5 made under the latter section impose an affirmative obligation to disclose, not only upon a director or officer, but also upon a controlling shareholder and upon the members of their immediate families. Whether the obligation extends to one who has been 'tipped-off' by an insider is obscure. The obligation clearly arises in a purchase by the insider. It extends also to a sale, at any rate, when the person buying is already a shareholder. The obligation arises whether or not the transaction is on an exchange—which seems to involve the consequence that the insider cannot deal safely until the information in his possession has been made public. The duty to disclose relate to any 'fact coming to their knowledge by reason of their position, which would materially affect the judgment of the other party to the transaction'.[67]

In a number of jurisdictions the general law has rejected *Percival v. Wright*. The 'special facts' doctrine established by the United States Supreme Court in *Strong v. Rapide*[68] has come to mean that there is a duty to disclose when 'any fact or condition, enhancing the value of the stock, is known by the officer, not known by the stockholder and is not to be ascertained by an inspection of the books'.

The availability of remedies both to the company and to the individual poses problems of correlation of remedies which do not appear to be settled.

There will of course be no cause for a remedy in favour of the buyer where a director sells his shares to someone who takes with full knowledge of all material circumstances. But the buyer may have been prepared to pay more to the director for his parcel of shares in the hope that the director might influence other shareholders to accept offers made by the buyer. In that event the interests of these

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excluded a purchase, by a director of a bidding company, of shares to which the bid relates. In such a case the director would in any event be held to have acquired the shares in trust for his company and be liable to account to his company.

The Committee has also recommended the enactment of a formulation of some part of the general law principles which make up the duty of good faith, but the formulation would not seem to overcome doubts as to the availability to the company of a general law remedy in respect of insider-dealings. The words of the Committee recommendation follow closely the terms of s. 124(2) of the uniform Act with one vital difference: the remedy will depend on showing a detriment to the company. (Cmd. 1749/1962, para. 99 and see paras. 86-87.)

[67] *Kardon v. National Gypsum Co.* 73 Fed. Supp. 798. [68] 213 U.S. 419.

other shareholders call for protection. There is a statutory provision in section 129 of the Uniform Act which will go some distance towards giving such protection. The provision, so far as it extends, will give a remedy to the shareholder who has sold ths shares to the buyer for less than the price the buyer has paid to the director, if the additional consideration paid to the director has not been disclosed to the shareholder. But the section has no application unless the director is to retire: the intention may be that he should remain a director and accommodate his actions to the wishes of the buyer. It may therefore be important to know whether the general law principle will protect the interests of the other shareholders.[69] There may be a sufficient connection between the making of the gain by the director and the functions of his office where he has made use of his position as director to persuade the other shareholders to accept the buyer's offer. There will, however, be cases where the director has not supported the buyer's offer: he may have come into line later, induced by a more generous offer for his parcel of shares. There is a much discussed decision by a United States Court of Appeals in *Perlman v. Feldman*[70] which, on one interpretation, holds that control which attaches to a substantial parcel of shares may not be sold for the benefit of the holder of those shares. The remedy given against the seller of the controlling parcel of shares was in favour of all the shareholders in the company, in their own rights, other than the buyer. Clearly if any remedy against the director is to be given, some such compromise with the rule in *Percival v. Wright* is called for so as to avoid multiplying the absurdities of *Regal (Hastings) Ltd. v. Gulliver*.[71] . .

RELEASE FROM DUTY

A director may retain gains obtained in the course of his office if he has the consent of the company in general meeting.[72] Whether there

69 The statutory duty of disclosure imposed by s. 184 of the uniform Act in a take-over bid situation would not appear to extend to any special price being paid to the director.

70 (1955) 219 F. 2d. 173.

71 [1942] 1 All E.R. 378. The remedy given in *Perlman v. Feldman, supra* n. 70 may be thought more sensible than that afforded to the individual by s. 129 of the uniform Act under which recovery is available only to the shareholders who have sold their shares. Presumably the *Perlman v. Feldman* remedy would also have been extended by the Court to a shareholder who had sold his parcel to the buyer at a price less than that received by the controlling shareholder.

72 Consent of the company given by the board would not be sufficient even if the director took no part in the board's decision, *supra* n. 18. The director in *Furs Ltd. v. Tomkies* (1935-36) 54 C.L.R. 583 would not, it is submitted, have escaped liability if he had had the approval of the board: certainly the advice of the chairman, given after something much less than a full disclosure, to 'do the best he could for himself' was not sufficient. With respect, Sir Douglas Menzies in (1959) 33 *Australian Law Journal* 156, 158 distorts the facts somewhat when he says that the director had 'acted in accordance with the advice of his co-directors'.

The rule as to the effect of consent in general meeting stated in the text is subject of course to s. 129—presumably a resolution in general meeting by the new shareholders will not preclude redress by the former shareholders under subsection (3).

can be a valid release clause which will cover such gains is doubtful.[73] In the 'contracting with the company' situation, the Uniform Act assumes the validity of a release clause which goes no further than the Table 'A' clause and provided always that there has been the disclosure called for by section 123.[74] The theory that a release clause operates by attenuation of duty would support an argument that other release clauses, which are not expressly drafted as exempting clauses, can stand despite section 133. But a director relying on such a clause will come upon anxious times if there is a change of control or a liquidation occurs.

REMEDIES

The primary remedy available to the company when a director has made a gain in the course of this office will be an account of profits or alternatively, in some circumstances, a common law action for money had and received.[75] It is not necessary to show that the company has suffered any loss.[76] Where it has suffered loss, there will also be a remedy in damages, though any profits recovered will go in mitigation of damages. These remedies lie against the director. Where a gain has been made by another company in which the director is interested there is no question of an account against that company[77]: the account must go against the director and then only for the amount of any benefit he has received by an increase in the asset backing of his shares as a result of the gain by the company.

73 Some awkward questions are posed in regard to release or consent by the restatement, and perhaps the extension, of the general law in s. 124(2). A release clause which survives s. 133 may perhaps preclude a wrong under s. 124(2) insofar as it makes the 'advantage' not 'improper'. But it may be asked whether the consent of the company given subsequently to the taking of the advantage, can cure a wrong under s. 124(2)? Presumably it could not relieve against criminal liability. No doubt a compromise agreement between the company and the director could relieve him from civil liability: the compromise agreement, if it had complied with the articles, would have given relief in *Gray v. New Augurita Porcupine Mines* [1952] 3 D.L.R. 1. But will a gratuitous general meeting consent be effective to relieve the director from civil liability when this would be to condone a crime? The question is especially relevant to the exception to the rule in *Foss v. Harbottle* (1843) 2 Hare 6161: an individual shareholder may bring a derivative suit in respect of a wrong done to the company which could not be condoned by resolution in general meeting. It may be that s. 124 of the uniform Act, in making it a crime for a director to fail to show 'due diligence', has rejected *Pavlides v. Jensen* [1956] Ch. 565 for Australian law.

74 It is assumed that the release clause contemplated by s. 123 will cover only cases where the director himself contracts with the company or where the existence of the contract has implications for the director as in the case of *A. M. Spicer & Son Pty. Ltd. (in liquidation) v. Spicer and Howie* (1931-32) 47 C.L.R. 151. It will not extend to the taking by the director of some reward from a party to a contract with the company.

75 *Reading v. Attorney-General* [1951] A.C. 507 *per* Lords Jowitt, Porter and Oaksey; *Regal (Hastings) Ltd. v. Gulliver* [1942] 1 All E.R. 378 *per* Viscount Sankey, Lord Russell of Killowen and Lord Porter.

76 *Regal (Hastings) Ltd. v. Gulliver* [1942] 1 All E.R. 378; *Furs Ltd. v. Tomkies* (1935-36) 54 C.L.R. 583.

77 At any rate for the full amount of the gain: *Peninsular and Oriental Steam Navigation Co. Ltd. v. Johnson* (1938) 60 C.L.R. 189, 252 *per Dixon J.*

Difficulty in ascertaining the amount of the profit which has accrued to the director 'will not deter the Court from doing as well as may be'.[78]

In many situations accounting for profits to the company may afford no recompense to the individual shareholder or other person who has suffered by the director's breach of duty. Accounting to the company for profits which the director has made by an 'insider-dealing' will involve some recompense to the person with whom the director has dealt only if that person has become or continues to be a shareholder—the extent of his recompense will depend on the extent of his shareholding. So far as the director is himself a shareholder, some of the profits for which he accounts to the company will ensure to his own benefit. The arithmetic of varying situations yields only bewildering absurdity.

Good sense directs that in 'insider-dealing' situations of the kind involved in the *Regal Case*, statute should come to the aid of the general law by directing the recovery of profits by the persons who have in fact suffered the loss. In the case of gains made by directors in a take-over bid situation, section 129 of the Uniform Act, it has been noted, comes to the aid of general principle and thus sets the model for other reforms.

C. *The making of gains otherwise than in the course of office*

It may be asked whether the facts will raise a duty, and thus a situation of conflict of duty and interest, where a director seeks a gain which is clearly not in the course of his office but which is sought in circumstances where the interests of the company are nonetheless at risk. The typical situation is a director engaging, whether alone, in partnership or as a director in another company, in activities which compete with the business of the company of which he is a director. Such authority as there is supports the view that competition does not raise a duty[79] though there is a body of opinion which would say that it should.[80] There may be some difficulty in fixing on the appropriate remedy. Presumably, if the director com-

[78] *Costa Rica Railway Company Ltd. v. Forwood* [1900] 1 Ch. 756, 765 *per* Byrne J. citing the Lord Chancellor in *Docker v. Somes* (1834) 2 My. & K. 655-57. Would some part of the remuneration arising from the service agreement in *Furs Ltd. v. Tomkies* (1935-36) 54 C.L.R. 583 have been recoverable from the director had it been sought? The amount is to be assessed at the moment of receipt of the profit, *e.g.*, where the director's gain is in the form of shares in the company which are now worthless: *Wheal Ellen Gold Mining Co. v. Read* (1908-09) 7 C.L.R. 34; In *re Domestic Devices Ltd.* (1930) 31 S.R. (N.S.W.) 8.

[79] Chitty J. in *London and Mashonaland Exploration Co. v. New Mashonaland Exploration Co.* [1891] W.N. 165, adopted by Lord Blanesburgh in *Bell v. Lever Bros. Ltd.* [1932] A.C. 161. But *cf.* Lord Denning in *Scottish Co-operative Wholesale Society v. Meyer*, [1959] A.C. 324, 368. It seems however to have been agreed in *Bell v. Lever Brothers Ltd.* that the speculations by the directors were breaches of duty because they were related to their offices by virtue of the 'pool agreement' which made dealings by the directors company dealings.

[80] Gower, *Modern Company* (2nd ed.) pp. 496-497. Sir Douglas Menzies in (1959) 33 *Australian Law Journal*, 156, 160.

petes as a sole trader, he could be required to account for profits he has made on contracts which might have been made on behalf of the company. Where he competes in partnership, the partnership could be required to account. Where however he is the director of another company which competes, an account against that company would only be appropriate if it were aware of the common directorship,[80a] though the director himself might be called on to account, to the extent of his proprietary interest as a shareholder, in the profit earned by the company. And, conceivably, he could be made liable in damages to the extent of the whole profit, though there would be some awkward issues of causation.

It is no doubt open to the general meeting to condone the act of competition. Whether a release clause in the articles will be effective raises again the problems of the theoretical basis of such a clause and of the correlation of sections 123 and 133.[81] The validity of a release clause could be supported by an argument that subsection (5) of section 123 of the Uniform Act contemplates a release clause which will extend to competition situations as well as contracts-with-the-company situations, provided always that the disclosure required by the section has been made to the board.[82]

PROCEDURAL ASPECTS

The duty of good faith is owed to the company and the rule in *Foss v. Harbottle*[83] requires that proceedings for breach must be brought by the company. However, an individual shareholder may bring a 'derivative' suit to assert a remedy, for the benefit of the

[80a] Presumably it is aware if the information is contained in its own register of directors: s. 134.

[81] There was a release clause in the articles in *Bell v. Lever Bros.* [1932] A.C. 161 but at the relevant time the United Kingdom Companies Act 1929, which included a provision which is the source of s. 133 of the uniform Act, was not yet in force. *Supra* n. 21.

[82] While s. 123(5) of the uniform Act implicitly approves a release clause by way of exception to s. 133, it will be noted that no release clause has in fact been included in Table 'A'. The subsection seems to require an exercise in prediction by the director. The prediction, it would seem, must be made at the time specified in subsection (6)—when he becomes a director, or, if already a director, when he commences to hold the office or possess the property. Strangely, a change in the situation thereafter may not raise a statutory duty to disclose. The mere fact that the memorandum of another company in which the director holds an office includes an object authorizing the carrying on of the same activity as that carried on by the company of which he is director is probably not enough to raise the duty to disclose. The fact that the company in which he holds the office subsequently diversifies by calling on the object will not raise the statutory duty to disclose unless the director thereafter for a time ceases to be a director and is then restored to office, so that there is a new point of time at which he 'becomes a director'.

There is a question of what is meant by 'office'. Does the word include being a partner in a competing business or a sole trader in a competing business? It may be that the partner and sole trader situations are covered by the words 'possesses property'. There is a question of what other situations of possessing property are within the subsection. It may be that the director owns a patent or land, exploitation of which may be affected by the company's activities.

[83] (1843) 2 Hare 461.

company, in respect of the breach of duty.[84] In one of the rules relating to the derivative suit, there is an important correlation with the rule that the company may condone breaches of the duty not to allow conflict of duty and interest. An individual shareholder may only bring a derivative suit if he alleges a breach of duty which cannot be condoned by the general meeting, and can only succeed if he establishes such a breach of duty.[85] It is not enough for him to assert and prove that the wrong has not in fact been condoned by a resolution in general meeting.

The absence of such a resolution is relevant only in proceedings brought directly by the company. In *Regal (Hastings) Ltd. v. Gulliver*[86] it was said that a majority resolution in general meeting, had it been secured by the directors, would have been a good defence. A condonation in this way is, it seems, final. It is of no moment that because of a change in shareholding or for some other reason majority opinion is no longer favourable. The *Regal Case* is, however, authority that it is no defence for a director to say, when proceedings are taken against him by the company directly, that at the time of his breach of duty or at some subsequent time the majority would have condoned the breach had it been asked.[87] It may be that an informal unanimous consent will be a good defence.[88] In other contexts there are decisions that an informal unanimous consent may amount to a corporate act.[89] But there is obvious wisdom in securing appropriate resolutions of the general meeting in anticipation of a change of control whether as a result of a take-over bid, or a negotiated sale of

84 Where the remedy sought is under s. 124(2) of the uniform Act, for example in an insider-dealing situation, there is a question whether a derivative suit may be brought. S. 124 makes the director 'liable to the company' and it could be argued that this does not justify a proceeding in which the company is defendant. The substance of a derivative suit is, however, the assertion of a liability to the company.

85 The reason for allowing a derivative suit is that the wrongdoers, being in control of the company, would see to it that the company did not take proceedings. Does it follow that a derivative suit will not lie when the company is in liquidation? The question was raised but not decided by McLelland C.J. in *Woods v. Cann* (1963) 80 W.N. (N.S.W.) 1583. Section 305, it might be noted, involves an assumption that the liquidator may not be a sufficient champion of the company's rights.

86 [1942] 1 All E.R. 378.

87 This is implicit in the House of Lords judgments in the *Regal Case* [1942] 1 All E.R. 378. A solicitor advising clients on the sale of the share structure of a company should see to it that appropriate disclosures have been made and resolutions condoning breaches of duty are minuted before the sale is made. The power of the company to condone is, presumably, more extensive than the power of the Court to grant relief under s. 365 of the uniform Act. The Court must satisfy itself that the director acted reasonably. The directors in the *Regal Case, ibid.* did not seek relief under the United Kingdom Act s. 448 (uniform Act, s. 365). On the circumstances in which relief is appropriate see *Re. International Vending Machines Pty. Ltd. and the Companies Act* (1963) 80 W.N. 465.

88 This was the view of Rich, Dixon and Evatt JJ. in *Furs Ltd. v. Tomkies* (1935-36) 54 C.L.R. 583, 592 'no director shall obtain for himself a profit . . . unless all the material facts are disclosed to the shareholders and by resolution a general meeting approves of his doing so, *or all the shareholders acquiesce*' (italics supplied).

89 *In re Express Engineering Works Ltd.* [1920] 1 Ch. 466; *In re Oxted Motor Co. Ltd.* [1921] 3 K.B. 32; *Parker & Cooper Ltd. v. Reading* [1926] Ch. 975; *Freeman & Lockyer v. Buckhurst Park Properties Ltd.* [1964] 1 All E.R. 630.

a company's share structure as a continuing business undertaking or as a loss-company.

There is support for the view that the rule in *Foss v. Harbottle* does not preclude a suit by an individual shareholder in his own right to restrain or set aside the director's action where a breach of the director's duty of good faith affects the capital structure of the company to the detriment of the shareholder who brings the proceedings.[90] The problem of correlating the right to bring such a suit with the rule that the company may condone some breaches of duty is not dealt with in the authorities. The suit brought by the individual shareholder appears as much directed to vindicating a duty owed to the company as is the derivative suit. He is permitted to bring the proceedings because he suffers in a special way from the breach of duty. The typical situation is a share issue made by the directors to themselves: would it be sufficient in a suit by an individual shareholder to show that a share issue to directors made by the board did not comply with the conditions of a release clause in the articles?

II. THE DUTY TO ACT BONA FIDE FOR THE BENEFIT OF THE COMPANY

Until this point it has not been necessary to consider the exact scope of the duty to act *bona fide* for the benefit of the company. Where the principle forbidding conflict of duty and interest is in play, it is enough to show that the situation is such that the duty to act for the benefit of the company is raised. Proof of breach of this duty is not a condition of recovery.

The company will have to show a breach of the duty to act for the benefit of the company if it is to recover against a director in a case where a release clause in the articles otherwise precludes recovery. And there will be cases where no interest or duty of the director was present: the most that can be shown is that the director sought to serve the interests of third persons—employees of the company, a political party or the public at large, which, it may be, are not coincident with the interests of the company.

The duty to act for the benefit of the company imposes a test of the validity of directors' actions which is distinct[91] from the tests imposed by the doctrine of *ultra vires* and the doctrine which sets the scope of the authority of directors as agents of the company.[92] The doctrine of *ultra vires* is concerned with limits on the powers of the company set by the objects clause in the company's memorandum. The doctrine as to the scope of the authority of directors is concerned with the distribution of authority to exercise those powers. Both doctrines are, at least primarily, concerned with the objective categori-

90 Gower, *Modern Company Law* (2nd ed.) 537 and cases there cited.

91 But see p. 423 *infra*.

92 In *Mills v. Mills* (1938) 60 C.L.R. 150 there were distinct issues, the one as to the authority and the other as to whether that authority had been abused.

zation of action. The principle which requires that a director act for the benefit of the company is concerned not with the objective qualities of the action of the director but with his intention.

Rich J. on several occasions referred to the 'duty to act for the benefit of the company' as a 'cant expression . . . but not yet a "shibboleth"'.[93] Some formulations of the principle promise to deprive it of all but the vaguest meaning. Thus there are judicial and academic statements that a director is bound to act in what he believes, but not necessarily what the court believes, is for the benefit of the company.[94] These statements might of course be discounted as referring only to the means adopted and not the end which the directors seek to serve, as saying that the law will determine what are to be regarded as the interests of the company but will not question the wisdom of the director's decisions as to the means to serve those interests.[95] But the statements are clearly meant to go further and to leave the determination of what is the benefit of the company to the directors. Taken so far, the principle that a director must act for the benefit of the company can only survive as a basis of judgment if one seeks to distinguish what a director has done from what that director feels he ought to have done. A principle which must be tuned to the wavelength of the directors' conscience may be welcome to a theologian but will be of little significance as a legal control.

From such formulation of the principle has come the attractive but deceptively simple shorthand which asserts that a director must act 'honestly'.[96] With a nice regard for economy in words, but with little regard for determinateness and for the rule which will require strict construction of a statute imposing criminal liability, section 124(1) of the Uniform Act provides that 'a director shall at all times act "honestly" '[97]. It may be that 'honestly' is an even less demanding standard than the standard of the director's own ideas as to the benefit

[93] In *Richard Brady Franks Ltd. v. Price* (1937) 58 C.L.R. 112, 138; *Mills v. Mills* (1938) 60 C.L.R. 150, 169.

[94] *Per* Lord Greene M.R. in *In re Smith and Fawcett Limited* [1942] Ch. 304, 306 (but see the explanation of the case offered *infra* p.); *per* Latham C.J. and *per* Rich J. in *Richard Brady Franks Ltd. v. Price* (1937) 58 C.L.R. 112, 135, 138; Gower, *Modern Company Law* (2nd ed.) 474.

Those who champion this formulation cannot deny that the law will impose an ultimate test of the reasonableness of the director's belief. The test of reasonableness is inherent in the evidence rule in the judgment of Bankes L.J. in *Shuttleworth v. Cox* [1927] 2 K.B. 9 (*infra*) and that evidence rule has not been challenged.

[95] *Cf.* Lord Evershed M.R. in *Greenhalgh v. Arderne Cinemas Ltd.* [1951] Ch. 286, 291: ' . . . the case may be taken of an individual hypothetical member and it may be asked whether what is proposed is, in the honest opinion of those who voted in its favour, for that person's benefit.'

[96] The Jenkins Committee (Cmd. 1749/62, para. 99 and see paras. 86-87) makes confusion worse confounded by recommending a formulation to be included in the United Kingdom statute requiring a director to observe good faith and act honestly.

[97] What ever meaning is given to the word 'honestly', s. 124(1) cannot fix the measure of the general law duty which is expressly preserved by subsection (4).

of the company.[98] Indeed an argument could be made that a director is 'honest' so long as he does not endeavour to conceal any aspect of his actions from the company, whatever his motives.[99]

Any formulation of the principle which would leave the determination of the benefit of the company to the dictionary of the director's conscience would have to dismiss as irrelevant speculation all judicial and academic observations on what are properly to be regarded as company interests. Thus there is a continuing debate, at least in academic writing, whether company interests comprehend the interests of employees of the company, the creditors of the company, the consumers of the company's products and the community at large.[99] There is authority that a director appointed by a class of shareholders may not identify the interests of the company with the interests of the class of shareholders by which he was appointed.[1]

[98] S. 365 contemplates that a director who has acted honestly may be in breach of duty so as to require relief. And the Jenkins Committee formulation, *supra* n. 96, would support this interpretation.

[99] *Cf.* Savoy Hotel Case, Report of the Inspector, (H.M.S.O., 1954); Gower, 'Corporate Control' (1955) 68 *Harvard Law Review* 1176; *Dodge v. Ford Motor Co.* (1919) 170 N.W. 668. It would seem that the interests of employees (*cf. Re William Brooks & Co. Ltd.* and the *Companies Act* (1962) 79 W.N. (N.S.W.) 354) consumers and the public at large do not enter the calculation. The interests of creditors and debenture holders do not enter the calculation (*Richard Brady Franks Ltd. v. Price* (1937) 58 C.L.R. 112; *In re Atlas Engineering Company* (1889) 10 L.R. (N.S.W.) Eq. 179. The Report of the Inspectors Appointed to Investigate the Affairs of Sydney Guarantee Corporation Limited (1964) (N.S.W. Government Printer G 56171-1) contains a recommendation (p. 55) that the trustee for debenture holders should have the right and duty to appoint a director where the company has borrowed from the public an amount in excess of 100 per cent of paid-up capital. Such an appointee would, however, have a difficult role; *Cf.* the attempts by Professor Gower and Jacobs J. to ameliorate his position, *infra* notes 100, 111 and 123.

[1] The judgments in *Scottish Co-operative Wholesale Society v. Meyer* [1958] 3 All E.R. 66, [1959] A.C. 324, though concerned with the statutory duty not to oppress assume that at general law a director appointed by one class of shareholders is not entitled exclusively to consider the interests of that class. The same assumption is made in the cases which hold invalid a contract by which a director agrees to act on the instructions of those who appoint him: *Clark v. Workman* (1920) 1 I.R. 107; *Horn v. Faulder & Co. Ltd.* (1908) 99 L.T. 524; *Bergeron v. Ringuet et Page et al* (1958) Q.B. 222, (Quebec court of Queen's Bench) noted (1959) 37 *Canadian Bar Review* 492. The director who is a nominee of a substantial shareholder is between the devil and the deep blue sea. Happily perhaps for his peace of mind he is most often unaware of the company law principles. No doubt he will only remain a director while he furthers the wishes of the shareholder by whom he was appointed. In his draft Companies Act for Ghana, Professor Gower has endeavoured to save the special representative director from his dilemma by a statutory provision which one suspects, obscures the dilemma but does not remove it: . . . when appointed by, or as representative of, a special class of members, employees or creditors [a director] may give special but not exclusive consideration to the interests of that class? *Final Report of the Commission of Enquiry into the Company Law of Ghana* (1961), p. 145, s. 203(3) (Government Printer, Accro). Another attempt to avoid the dilemma is made by Jacobs J. in *Levin v. Clark* (1963) 80 W.N. (N.S.W.) 485, *infra* n. 123.

An aspect of the problem which has not been considered is whether the shareholder who nominates a director does not himself become a director and subject to the same duty of good faith as the law imposes on his nominee. He is certainly a director within the definition in s. 6 of the uniform Act and thus within the meaning of the word in s. 124(1) and he is an 'officer' within the meaning of that word in s. 124(2). It seems good sense that he is also one to whom the general law duty

While the commercial interests of the company enter the calculation, they enter only so far as they bear on the 'long-term interests of the general body of shareholders',[2] or, in the language of Lord Evershed M.R., of the 'individual hypothetical shareholder.'[3] There are cases which hold that it is not in the interests of the company that any group of shareholders should by action taken as directors seek to entrench their control against the challenge of others seeking control.[4] Two of these cases, *Piercy v. Mills*[5] and *Ansett and Others v. Butler Air Transport Ltd*;[6], expressly reject the dictionary of the directors' conscience: in neither case was the directors' action saved by the fact that they believed that their control was in the best interests of the company. The dictionary of the directors' conscience was at least impliedly rejected in *Ngurli Pty. Ltd. v. McCann*.[7] There the share issue was made by the governing director on professional advice that the issue was a proper exercise of his powers because the company had been formed for tax-planning purposes and, presumably, the interests of the company and the tax-plan were to be identified.

Professor Gower would attempt to give significance to these observations and authorities by insisting that there is a further principle, distinct from the principle which requires a director to act for the benefit of the company. This further principle would require a director to exercise his powers for a 'proper purpose', the propriety of purpose being determined by the law.[8] In his draft Companies Act for Ghana,[9] Professor Gower endeavours to marry the director's con-

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extends. *Cf.* Jacobs J. in *Re Broadcasting Station 2GB Pty. Ltd.* (1964-5) N.S.W.R. 1648, 1663.

2 *Savoy Hotel Case, Report of Inspector* (H.M.S.O. 1954) 23. Thus the directors may not indefinitely plough back profits refusing the pay a dividend: *Cf.* the policy of the management of Broken Hill Proprietary Ltd., discussed *Sydney Morning Herald*, 16, 17, 18 December 1964.

3 *Greenhalgh v. Arderne Cinemas*, [1951] Ch. 286, 291 adopted by the High Court in *Ngurli Pty. Ltd. v. McCann* (1953) 90 C.L.R. 425.

4 *Punt v. Symons & Co.* [1903] 2 Ch. 506; *Piercy v. S. Mills & Co. Ltd.* [1920] 1 Ch. 77; *Grant v. John Grant & Sons Pty. Ltd.* (1950-51) 82 C.L.R. 1, 32 *per* Williams J.; *Ansett & others v. Butler Air Transport Ltd.* (1957) 75 W.N. (N.S.W.) 299.

The case is, however, different if the directors are ' . . . resist(ing) pressures upon the shareholders and attempt to infiltrate into the company . . . [by outside interests] . . . when the directors believe . . . that such an activity would be detrimental to the company as a corporate structure'. *Savoy Corporation v. Development Underwriting* (1964) 80 W.N. (N.S.W.) 1021, 1027, *per* Jacobs J. citing a passage from the judgment of Isaacs J. in *Australian Metropolitan Life Assurance Company Limited v. Ure* (1923) 33 C.L.R. 199, 217.

5 [1920] 1 Ch. 77.

6 (1958) 75 W.N. (N.S.W.) 299, 303 (Myers J.): 'Whether the directors believed their policy to be the best or not, and whether their policy was in fact the best or not, I am satisfied that their only purpose in issuing the shares was to ensure that there would always be a majority in the company to carry out the policy which the directors thought would be the best. This is precisely what directors cannot do.'

7 (1953) 90 C.L.R. 425.

8 Gower, *Modern Company Law* (2nd ed.) pp. 476-477.

9 *Final Report of the Commission of Enquiry into the Company Law of Ghana* (1961) Government Printer, Accra.

ception and the law's conception of benefit of the company. In one provision he would leave the 'best interests of the company' to the director's determination,[10] with some reservations,[11] and in another he would assert the law's prerogative.[12]

Ngurli Pty. Ltd. v. McCann[13] is authority for the proposition that the purposes of the promoter, at least when they are not expressed in the memorandum or articles, are not relevant to the determination of the interests of the company.[14] But the memorandum and articles probably have some bearing. It may be asked whether the result in *Ngurli Pty. Ltd. v. McCann*[15] would have been different had the objects of the company included an independent object of 'furthering the purposes of the governing director in regard to the minimising of taxation'? The vesting of power in the company by paragraphs (a) and (b) of section 19 of the Uniform Act would appear to create company interests in patriotism, charity and defence which are independent of the other interests of the company.[16] One would hope, however, that an independent object 'to make gifts' taken by way of an express provision in the memorandum must be exercised in the interests of the company as determined by reference to all of its objects. If this is not so, it will follow that the independent objects clause has not only sterilised[17] the doctrine of *ultra vires* but has gone some distance towards sterilising the equitable principle that powers must be exercised in the interests of the company, by

[10] *Ibid.*, p. 145, s. 203(2): 'A director shall act at all times in what he believes to be the best interests of the company as a whole so as to preserve its assets, further its business, and promote the purposes for which it was formed, and in such manner as a faithful, diligent, careful and ordinarily skilful director would act in the circumstances.'

[11] The words 'so as to preserve its assets, further its business, and promote the purposes for which it was formed' in s. 203(2), *supra* n. 109, are a significant reservation. They did not appear in the Draft Report. There is a reservation also in the terms of s. 203(3): 'In considering whether a particular transaction or course of action is in the best interests of the company as a whole a director may have regard to the interests of the employees, as well as the members of the company . . . '

[12] *Ibid.*, p. 146, s. 204: 'The directors shall not, without the approval of an ordinary resolution of the company, exceed the powers conferred upon them by this Code and the company's Regulations or exercise such powers for a purpose different from that for which such powers were conferred notwithstanding that they may believe such exercise to be in the best interests of the company'.

[13] (1953) 90 C.L.R. 425.

[14] *Cf. Re Harmer* [1958] 3 All E.R. 689. The moral of these cases is that one can look a gift horse in the mouth. The fact that the complaining shareholders had received their shares by way of gift did not colour the Court's interpretation of the benefit of the company (*Ngurli Pty. Ltd. v. McCann supra* n. 112) or of 'oppression' (*Re Harmer*).

[15] (1953) 90 C.L.R. 425.

[16] These provide: (a) power to make donations for patriotic or for charitable purposes; (b) power to transact any lawful business in aid of the Commonwealth in the prosecution of any war in which the Commonwealth is engaged.

[17] This is for practical purposes the result of *Cotman v. Brougham* [1918] A.C. 514. *Cf.* the lament by Lord Wrenbury at p. 523. It may be that Australian Courts were not parties to the unconditional surrender. *Stephenson v. Gillanders* (1931) 45 C.L.R. 476 has never been accorded the attention it deserves. Dixon J. in that case read down a widely drafted paragraph in an objects clause, and although he did not say expressly that the paragraph would otherwise have been nugatory, this is the clear inference from his judgment.

making it impossible to identify the interests of the company in cases which do not involve the rights of shareholders *inter se*. In *Hall Parke v. Daily News*,[18] there was no independent object of making gifts. Had there been such an object the directors' action would have been good so far as the doctrine of *ultra vires* was concerned. Would it also have passed the test of the equitable principle?

In *Woods v. Cann*,[19] McLelland J. took the view that the articles of the company contemplated that the interests of one class of shareholders might be preferred to the interests of another class in the exercise of the board's power to sell the company's undertaking and, the sale which had been challenged before him might therefore be regarded as for the benefit of the company.[20] Wherever action under the articles will affect one group of shareholders differently from another, the application of the principle requiring that the action shall be for the benefit of the company becomes a disconcerting exercise. That the action results in a discrimination which the articles direct and which the directors know would follow, is not evidence of improper intention. The law cannot insist on equal treatment in the face of rights to preferential treatment given by the articles.[21] The question posed by *Woods v. Cann* is whether the case is any different where differential treatment, though not a necessary consequence of action under the articles, is nonetheless contemplated by the articles. Does a discretion, for example to pay differential dividends to different classes of shareholders, justify any exercise of that discretion with whatever intention? In *Re Smith and Fawcett Ltd.*[22] the exercise of a discretion to approve transfers of shares was upheld because in the circumstances the director had at least been true to his own conception of the interests of the company and this was 'on the true

18 [1961] 1 All E.R. 695.

19 (1963) 80 W.N. (N.S.W.) 1583.

20 His Honour was, however, at pains to backstop his reasoning by findings of fact that the interests of the ordinary shareholders had not in fact suffered: their capital he thought had not been prejudiced by the sale because it had already disappeared with no foreseeable prospect of ever being recovered and their interests as tenants were protected in any event by the Landlord and Tenant Act.

21 S. 65 of the uniform Act, indeed, is intended to give special statutory protection to rights for preferential treatment where those rights are challenged by action under the articles, or, *per* Else Mitchell J. in *Fischer v. Easthaven* 80 W.N. (N.S.W.) 115, by action to change the articles. The policy of s. 65 is in some contrast with the position taken by Rich J. in *Peters' American Delicacy Co. Ltd. v. Heath* (1939) 61 C.L.R. 457 that there is, *a priori*, an ideal set of articles and that an amendment to bring articles into accord with this ideal is for the benefit of the company.

It is significant that the cases concerning the duty of the general meeting to act for the benefit of the company have generally been concerned with preventing amendments to the articles. The assumption is that once the articles have been amended there will be a redefinition of company interests and that action under the amended articles will not be subject to further challenge. This assumption is express in the judgment of Dixon J. In *Peters' Case* (1939) 61 C.L.R. 457, 499. Nonetheless, a too enthusiastic insistence on the articles for the time being as the test of company interests must lead to the conclusion that there can never be a valid amendment to the articles!

22 (1942) Ch. 304.

construction of the articles, the only matter on which the directors (had) to pay regard'.[23] The case supports the reasoning of McLelland J., in *Woods v. Cann.* There is, however, an unwillingness in *Re Smith and Fawcett Ltd.* to allow logic to carry the matter to the point where the articles will by a redefinition of duty have placed directors' self-dealing beyond challenge.[24] The case, in the result, is not helpful to a draftsman who would seek to know what form of words will be a legitimate redefinition of the interests of the company. It is not easy, for example, to see precisely why the director enjoyed a freedom of action in *Re Smith and Fawcett Ltd.* in regard to approving a share transfer which he was denied in *Piercy v. Mills* in regard to a share issue.[25]

The assumption so far made in this essay is that the effect of a release clause in the articles or of a consent in general meeting is only to preclude liability under the principle that a director must not place himself in a position where his duty and his interest conflict, and that the director remains subject to the duty to act for the benefit of the company.

The measure of relief from the duty to act for the benefit of the company which may be achieved by a release clause raises yet again questions of theoretical justification of such a clause and the correlation of sections 123 and 133 of the Uniform Act. So far as a court can be persuaded not to construe a release clause as an 'exempting' clause[26] (which would be avoided by section 133) it is arguable, following *Woods v. Cann* and *Re Smith and Fawcett Ltd.*, that the clause may achieve a substantial attenuation of the duty to act for the benefit of the company. We may expect an attempt to uphold, as an attenuation of duty, a clause which purports to allow a director appointed by a class of shareholders or by debenture holders to consider only the interests of the persons by whom he was appointed. If the attempt is successful we will have come to accept an idea of differential duties of directors. The interests of the company will depend on the director whose duty is in question.[27]

[23] *Ibid.*, p. 309.

[24] *Ibid.*, at p. 308. For a frank attempt to draft the duty of good faith out of the law controlling directors see the model article in Adams and McMahon, *Australian Tax Planning with Precedents* (1961) p. 163: 'It shall be no objection to the exercise of this option that such exercise is solely in the interests of the governing director and not in the interests of the company as a whole'.

[25] [1920] 1 Ch. 77.

[26] S. 75(1) and s. 89(1) assume a distinction between a clause which exempts from liability and a clause which sets the degree of care and diligence required of a trustee. One suspects that the distinction is without substance, but it offers some basis for judicial decision.

[27] Professor Gower is prepared to contemplate differential duties. His draft Companies Act for Ghana attempts to marry conflicting interests by a formula which provides that 'a director . . . when appointed by or as representative of, a special class of members, employees or creditors may give special, but not exclusive, consideration to the interests of that class'. Final Report, *supra* n. 111, p. 145, s. 203(3). Jacobs J. is equally flexible: *Levin v. Clark* (1963) 80 W.N. 485, 495: 'It may be

The draftsman may, of course, be content to rely on the exceptions to section 133 to be spelt out of section 123 and this will fairly pose the question of the limits of those exceptions. Some release from the duty to act for the benefit of the company seems implicit in any clause allowing a director to contract with his company: if the duty to act for the benefit of the company is a duty to act at all times with a predominant motivation to serve the interests of the company, it would be quite unreal to expect that a director who contracts with the company could observe that duty. But the release clause contemplated by section 123 need not and should not be taken to allow him to sacrifice company interests to his own interests by making an unfair contract with his company.

It may be that consent in general meeting can go some way to relieve against a failure to act for the benefit of the company. It is an inference from the rules which determine the conditions of a derivative suit that the effectiveness of consent in general meeting is qualified only by the condition that the majority must not by the resolution have sought to commit 'a fraud on the minority'. It may not always be a fraud on the minority to condone a director's action which is a breach of his duty to act for the benefit of the company. At this point the question is not so much the motivation of the director as the motivation of the meeting in condoning his action and the governing principle is that the general meeting must have acted '*bona fide* for the benefit of the company'. It is not proposed here to explore the ambit of this principle and the differences of substance which may distinguish it from the verbally identical principle which applies to the conduct of a director.[28] But even if it is assumed that

in the interests of the company that there be upon its board of directors one who will represent [an interest outside the company] and who will be acting solely in the interests of such a third party, and who may in that be properly regarded as acting in the interests of the company as a whole.' More recently in *Re Broadcasting Station 2G.B. Ltd.* (1964-5) N.S.W.R. 1648, his honour took a somewhat different view of the duty of the nominee director. He said (at p. 1663): 'I am satisfied that these additional directors were, to all intents and purposes, the nominees of the Fairfax companies who would be likely to act and who would be expected by the Fairfax interests to act in accordance with the latter's wishes . . . It is my view that conduct of the kind which I have related is not reprehensible unless it can also be inferred that the directors so nominated, would so act even if they were of the view that their acts were not in the best interests of the company'.

[28] There are times when one is led to doubt the existence of a principle imposing a duty on the general meeting. But *Greenhalgh v. Arderne Cinemas Ltd.* [1951] Ch. 286, in the United Kingdom, and *Peters' American Delicacy Co. Ltd. v. Heath* (1939) 61 C.L.R. 457 and *Australian Fixed Trusts v. Clyde Industries* (1959) S.R. (N.S.W.) 33, in Australia, are sufficient authority that there is such a principle. Nonetheless, there does seem to be some difference, at least in emphasis, between the director's duty and the duty of the general meeting. *Cf. Ngurli Pty. Ltd. v. McCann* (1953) 90 C.L.R. 425, 438-9, *per* Williams A.C.J., Fullager and Kitto JJ. Any formulation of general meeting duty will have difficulty in digesting the proposition, which has been often asserted, that 'shareholders even where they are also directors are not trustees of their votes and as individuals in general meeting can usually exercise their vote for their own benefit', *ibid.*, p. 439. It is sometimes said that the duty rests on the general meeting only in regard to amendment to the articles. The judgment in *Ngurli Pty. Ltd. v. McCann* (1953) 90 C.L.R. 425

the duty on the general meeting is the same in substance as the duty on the director, it does not follow that there must always be a failure by the general meeting to act for the benefit of the company should it resolve to condone the director's breach of his duty.[29] A director is in breach of duty if he was wrongly motivated even if no harm to company interests has in fact resulted and, in these circumstances one would think, a condonation by the general meeting need not necessarily be wrongly motivated. It is even possible that a condonation will be valid notwithstading that the director's action was wrongly motivated and caused harm to company interests, though it is not easy to see how this can be so unless the general meeting duty is a lesser duty than the duty on the director.

Where there has been an actual resolution by the general meeting condoning a director's action and subsequently the company proceeds against the director, or a derivative suit is brought by a shareholder, the question will be whether the resolution was in fact wrongly motivated. Where there has been no resolution to condone and a derivative suit is brought by a shareholder the question will be whether the general meeting could resolve to condone and not be wrongly motivated in doing so. Both questions are, however, likely to involve the same processes. Where there is no direct evidence of the motivation of the general meeting in resolving to condone, the court will have to fall back on the rule of evidence formulated by Bankes L. J. in *Shuttleworth v. Cox Brothers & Co. (Maidenhead) Ltd.*[30] and ask whether the resolution is such that 'no reasonable man could consider it for the benefit of the company'.

Where a director's failure to act for the benefit of the company affects the capital structure of the company to the detriment of an individual shareholder, that shareholder it would seem may take proceedings, without using the derivative form, for rescission or for an injunction to restrain the director's act. The question was raised earlier in this essay[31] whether it was sufficient for the shareholder in such proceedings merely to make out that the director has acted in a duty-interest conflict situation and is in this respect in breach of duty.

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clearly rejects this view. It is probable, however, (*supra* n. 120) that the articles for the time being enter the calculation of what are company interests and to this extent there is a difference between amendment to the articles and action under the articles.

29 There is a distinction between condonation and release by accord and satisfaction. If there has been an accord and satisfaction entered into either by the board or by the general meeting, the company, or shareholder bringing a derivative suit must assert the invalidity of the accord and satisfaction, and, in the case of a derivative suit, that the invalidity could not be cured by condonation. The fact that a derivative suit has already commenced does not deprive the board or the general meeting of any power it may otherwise have had to enter into an accord and satisfaction: *Peninsular & Oriental Steam Navigation Co. Ltd. v. Johnson* (1938) 60 C.L.R. 189. Dixon J. at p. 239 expressed the view that the Court would normally, if asked, intervene to restrain such a settlement *pendente lite*.

30 [1927] 2 K.B. 9. See *infra* p. 51.

31 *Supra* p.

The question is whether the rule in a derivative suit that the shareholder must show a wrong which cannot be condoned in general meeting applies with equal force to such proceedings. The argument against the application of the rule would be that the shareholder proceeds in his own right:[32] no doubt his right will be dissolved by an actual valid condonation by the general meeting, but the mere possibility of such a condonation should not defeat him.[33]

Where the principle forbidding a transaction which involves a conflict of duty and interest is relied on, the plaintiff carries the onus of showing a transaction which involves a conflict. It is then for the director, if he can, to establish that the conditions of a valid release or consent have been satisfied.[34] The plaintiff who would rely on the defendant's failure to act for the benefit of the company carries the onus of proving the breach of duty. The onus is on the plaintiff to establish that the defendant did not intend to benefit the company.[35] It is not enough to show that he had some other purposes in mind as well as the benefit of the company: *Mills v. Mills* requires the plaintiff to show that the delinquent director's predominant intention was to serve those other purposes.[36] It seems, however, that if the plaintiff can show those other purposes and a predominant intention to serve them, he need not show any harm to company interests: he need not show that the director in fact sacrificed company interests. In cases such as *Mills v. Mills*, involving the rights *inter se* of shareholders, where the only guide to company interests is that in substantial character 'the individual hypothetical shareholder', the plaintiff may well find it helpful not to be obliged to identify company interests and show the intentions of the defendant in regard to those interests. Where, however, the case involves principally the commercial interests of the company, which may the more easily be identified, the plaintiff will discharge the onus by showing that the defendant knowingly sacrificed company interests.[37] In many cases, of course,

32 With some special consequences in regard to issue estoppel discussed in *Ansett & Others v. Butler Air Transport Ltd. and Ors* (1958) 75 W.N. (N.S.W.) 299.

33 In *Piercy v. S. Mills & Co. Ltd.* [1920] 1 Ch. 77 the individual shareholder was successful notwithstanding that it might have been argued that there could have been a valid general meeting condonation. Mayo J., the judge at first instance, in *Ngurli Pty. Ltd. v. McCann* (1953) 90 C.L.R. 425 applied the derivative suit rule but his understanding of the law was not discussed in the High Court: (1953) 90 C.L.R. 425, 427. It may be inferred that the High Court did not think that the action of the managing director could have been condoned and it thus rejected a view that any 'honest' action is condonable: the governing director acted honestly in the sense that he responded to the directions of his conscience and his professional advisers; all of whom told him that company interests and his own interests coincided because the company had been formed for tax-planning purposes.

34 *Gray v. New Augurita Porcupine Mines* [1952] 3 D.L.R. 1, 14.

35 *Richard Brady Franks Ltd. v. Price* (1937) 58 C.L.R. 112, especially *per* Latham C.J., p. 135, and *per* Rich J., p. 138.

36 *Mills v. Mills* (1938) 60 C.L.R. 150.

37 *Richard Brady Franks Ltd. v. Price* (1937) 58 C.L.R. 112, 144-5, *per* Dixon J. It is not enough to show that the director sacrificed the interests of persons other than the company, e.g., debenture-holders, *ibid.*, p. 135, *per* Latham C.J.

the plaintiff will have no direct evidence of the intention of the director. He must then call on whatever inference may be drawn from the application to the facts of the rule propounded by Bankes L.J. in *Shuttleworth v. Cox Brothers & Co. (Maidenhead) Ltd.*[38]: 'The [action] may be so oppressive as to cause suspicion on the honesty of the person responsible for it, or so extravagant that no reasonable man could really consider it for the benefit of the company. In such cases the Court is, I think, entitled to treat the [action] as it does the verdict of a jury, and to say that the [action] shall not stand if it is such that no reasonable man could consider it for the benefit of the company'.[39]

It is an indication of the uncertainty and poverty of our law as to what company interests are, that this rule of evidence has not given rise to a body of law comparable, for example, to that part of the law of negligence which has developed out of the test of the validity of a jury decision that there must have been facts on which the jury could find as it has done.[40]

THE METHOD OF REFORM

It is a fair conclusion that the duty of good faith, far from being a close control on his actions, need not trouble a director unduly, so long as he acts under articles which have been drafted circumspectly and is equipped with professional advice to protect him against the unnecessary ill which befell the directors in the *Regal Case*.

It may be thought then that there is a case for radical reform of the principles which express the duty of good faith. There is virtue, doubtless, in judicial and legislative action to resolve many of the uncertainties which beggar this part of the law. But some of the uncertainties reflect an unwillingness to control management by a set of commandments, and in this there may be wisdom. Any thoroughgoing reform directed at imposing a stern discipline on directors would need to be accompanied by a reform of procedure. Vindication of such principles as there are is mightily discouraged by the fact that the shareholder who brings a derivative suit must assume the risk that in defeat he will have to meet all costs, and must be content to receive only taxed costs in the victory he has won for all shareholders. Radical reform of the principles and the procedures by

38 [1927] 2 K.B. 9.

39 [1927] 2 K.B. 9, 18. The rule of evidence is referred to by Latham C.J. in *Richard Brady Franks Ltd. v. Price* (1937) 58 C.L.R. 112, 136, in its application to proof of a director's breach of duty.

40 Thus the significance of discrimination between shareholders resulting from the action challenged has been raised in a number of cases, yet they offer but little guidance. Discrimination against a shareholder on the ground that he was trustee for unit trust holders led McLelland J. in *Australian Fixed Trusts v. Clyde Industries* (1959) S.R. (N.S.W.) 33 to find that the resolution challenged before him was not properly motivated. The uniform Act now insists that the very same discrimination must be accepted by the trustee; it must be a term of the trust deed: s. 80(1)(g).

which they are vindicated may open the way to 'strike suits' in which the complainants are more concerned to be bought out than to vindicate the principles. Section 186 of the Uniform Act is a radical and new departure in basic principle: it imposes a duty 'not to oppress' which is, at least in its terms, independent of the duty of good faith. And the section sets the complaining shareholder free from the constraints of the rule in *Foss v. Harbottle*. There is some suggestion that this section has brought the strike suit to Australian experience.[41]

Perhaps the better way to go forward is by adding to the patchwork of specific provisions of the Uniform Act which deal specially with situations in which abuses of power are most likely. A number of recommendations of the Jenkins Committee commend themselves. There should be an amendment to allow recovery by the individual who has suffered loss as a result of an insider-dealing, and section 124 (2) should be amended to correlate the remedies which will then be available to the company and the individual shareholder. Section 129 should be amended to widen the circumstances in which the approval of the general meeting is necessary to validate a payment to a director on retirement—including retirement from an appointment as a service director—and the majority required for such an approval should be increased.

Section 126 of the Uniform Act should be amended so as to ensure that the register of directors' shareholdings is more freely available to shareholders. This would be to follow a recommendation of the Jenkins Committee[42] which seeks to give more powerful expression to the faith of the Cohen Committee that 'the best safeguard against improper transactions by directors . . . is to ensure that disclosure is made of all their transactions in the shares or debentures of their companies'.[43] Regrettably, the Jenkins Committee did not show the same faith in the policy of disclosure regarding a director's transactions with his company[44] and, in particular, his receipts of emoluments from his company. The Committee's views on disclosure of directors' transactions contrast with those of William L. Cary the former Chairman of the United States Securities and Exchange Commission.[45] There

41 And there is some indication that Australian courts are disposed to limit the operation of the section in a way which will make the substance of the duty a close relative, if not the identical twin, of the duty of good faith. This would seem to be the effect of the judgment of Jacobs J. in *Re Broadcasting Station 2G.B. Pty. Ltd.* (1964-5) N.S.W.R. 1648. The duty to act for the benefit of the company goes to the intention of the directors. The directors in that case could not be said to be in breach of that duty simply because their being directors endangered the company's licence to operate the radio station. One would have thought, however, that a finding of oppression under s. 186 was not excluded. *Cf. Re Harmer*, [1958] 3 All E.R. 689 interpreting the equivalent United Kingdom provision; Romer L.J. insisted that oppression is an objective fact and not a matter of intention.

42 Cmd. 1749/1962, para. 99(9).

43 Cmd. 6659/1945, para. 87.

44 Cmd. 1749/1962, paras. 95-96.

45 William L. Carey, 'Corporate Standards and Legal Rules' (1962) 50 *California Law Review* 408.

does appear to be more than a little force in the comment made recently by Mr Cary that if management transactions are so frequent that disclosure would be a burden, there is all the more reason why the transactions would be of great interest to the shareholders.[46] And shareholders have an obvious interest in knowing how well rewarded are the company's executives: their interest should outweigh any interest of the director in the privacy of his financial status.

The requirements as to the content of the director's report imposed by the Uniform Act have been made more demanding by recent amendments,[47] but there are a number of recommendations made by the Jenkins Committee[48] as to the content of the director's report or chairman's statement which are worthy of attention.

The Committee has recommended that the model of section 129 should be followed in regard to the disposal of the whole or substantially the whole of the company's undertaking. If the Committee's recommendation is adopted, abuse of the director's authority will be precluded by a denial of authority without the co-operation of the general meeting and, by way of exception to the *Foss v. Harbottle* rule, any shareholder will be entitled to proceed to restrain an excess of authority.[49] The Committee has also recommended that limitations be imposed on the authority of directors in regard to share issues[50] so as to require the co-operation of the general meeting. Disclosure to the general meeting will in each case become a condition of effective action by management.

There is much of the philosophy of the tax evader in the director who would abuse his authority. There is an attitude of mind which rejects the call of obligation, moral or legal, if it is thought that others are profiting by disregarding that obligation. Indeed, there comes a point when response to the call of obligation may bring a warped feeling of guilt: one is a 'sucker' to respond. A close interest in company affairs by an informed financial press supported by an alert and skilled corps of administrators enforcing disclosure and, when need be, undertaking tasks of detection by inspectorship are the prime conditions of a healthy state of corporate enterprise.

46 *Ibid.*, p. 412.
47 New South Wales Companies (Amendment) Act 1964, amending s. 162(6).
48 Cmd. 1749/1962 para. 122, and see paras. 114-116.
49 *Ibid.*, para. 122, and see paras. 117-118.
50 *Ibid.*, para. 122 and see paras. 119-121.