

Common Law Director Duties and Shareholder Remedies as codified into the UK Companies Act 2006

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Abstract

The UK Companies Act 2006 is a pioneering statutory instrument, hailed for its success in the codification of common law rules and simultaneously influencing reforms and harmonising the company rules, allowing for easy application and certainty. The general rule is that the twin set of shareholder and directors, through the doctrine of separation of ownership and control, play a critical role in running a company's affairs. Further, the reforms also brought judicial clarity for courts to interpret and apply the law with relative ease and legal certainty. These reforms became the cornerstone of corporate governance, with several commonwealth jurisdictions like South Africa's 2008 Companies Act borrowing heavily from the UK. Correspondingly, the UK Companies Act has been pivotal in setting the scene for South African Companies Act.

This study aims to conduct a qualitative research on the codification of the director's duties in the UK Companies Act 2006, using legal theory. Thus, the empirical basis for this examination includes secondary sources, including a literature review of books, articles, case law and relevant Statutes. Both content and thematic analysis were employed. It is anticipated that the recommendations of this study could assist policy-makers, leaders and contribute to the body of legal knowledge.

Keywords: Codification, Common law, Companies Act, Director's duties, Shareholder Remedies

1. Introduction

The legal basis for directors' duties and shareholder remedies stems from the exigencies of common law and the UK Companies Act as amended. In Company law. The twin sets of shareholders and directors are deemed to play a pivotal role in running the company's affairs as enshrined in the doctrine of "separation of ownership and control."¹ Thus, the 2006 Company law reforms were a welcome move to bring clarity, consistency and legal certainty to the notion of "corporate personality,"² thus separating directors' roles and shareholder powers.

The UK Companies Act 2006 (CA 2006)³ is a pioneering statutory instrument, hailed for its success in codifying Common law rules that found their way to the Act and simultaneously making reforms and harmonising the company rules. Further, the reforms also brought judicial clarity for courts to interpret and apply the law with relative ease and legal certainty. Specifically, the legal relationship between effective shareholder control through an effective board and good corporate governance, as expounded in the Combined Code and the Financial Reporting Council Guidance on Board Effectiveness of 2018,⁴ is the pinnacle of the doctrine of "separation of ownership and control."⁵ Arguably, these reforms became the cornerstone of corporate governance, with several commonwealth jurisdictions like South Africa's 2008 Companies Act borrowing heavily from the UK.

2. Aims and Objectives

The essay critically analyses the relationship between directors' duties and shareholder remedies as codified by the Companies Act 2006. Further, it briefly considers whether the legal environment, after the introduction of the Act, helps businesses to perform better, to be more sustainable in the long term, and to have regard for a wider group of issues as they pursue success. Accordingly, this can contribute to the field of Company law, with particular emphasis on directors' duties and shareholder remedies.

¹ Brenda Hannigan, *Company Law* (4th edn, OUP 2016) 142.

² *Ibid.*

³ UK Companies Act 2006.

⁴ Financial Reporting Council Guidance on Board Effectiveness of 2018>(FRC)
<http://www.frc.org.uk/corporate/combinedcode.cfm>>accessed 4 May 2023.

⁵ Hannigan (n 2).

3. Background of the Study

A corporation, as a distinct legal persona with a “separate legal personality”,⁶ anchors the fundamental principle of the doctrine of separate legal personality,⁷ as rightly enshrined in *Salomon’s case*.⁸ The Salomon case,⁹ at Common law, is arguably at the pinnacle of corporate personality as a distinct legal persona with rights to sue and be sued in its corporate name, with rights and responsibilities equal to that of a person at law,¹⁰ despite its shareholding component.¹¹ The Doctrine of Corporate Personality treats a Company as a distinct legal persona from its Members,¹² giving it rights and responsibilities accepted in law and practice. Although others had described the distinct relationship between a corporate and its members as both a myth and a fiction,¹³ the House of Lords could not allow associating the two as alter ego of each other and provided a solid basis for a corporate to be seen as a separate legal entity duty bound and with an ability to dispense specific responsibilities.¹⁴

A company has no mind of its own. Thus, it must act through a natural person who manages and controls its actions as expounded and settled at law in *Lennard’s Carrying Co Ltd v Asiatic Petroleum Co Ltd*.¹⁵ Thus, the importance of the company reforms that “codified”¹⁶ directors’ duties who are the “agents of the company.”¹⁷ Such duties include fiduciary duties and shareholder rights and remedies.

4. Methodology

The empirical basis for this examination includes primary and secondary sources, including a literature review of books, articles, case Law and relevant Statutes. Statutes like the

⁶ Ibid.

⁷ O Kahn-Freund, ‘Some Reflections on Company Law Reform’ (1944) Vol. 7, No. 1/2 The Modern Law Review 56.

⁸ *Salomon v A Salomon* [1897] AC 22.

⁹ *Salomon v A Salomon* [1897] AC 22.

¹⁰ *Berkey v Third Avenue Rly* [(1926) 244 NY 84 at 94-5.

¹¹ *Ben Hashem v Al Sheaf* [2009] 1 FLR 115 where Munby J. eloquently made a distinct narration and reasoning on the separation of a company from its shareholding even cases where it’s a one band show.

¹² *Salomon* (n 1).

¹³ *Jennings v Crown Prosecution Service*, 2008 UKHL 29.

¹⁴ Charles Wild and Stuart Weinstein, *Smith and Keenan’s Company Law* (5th Edition, Pearson 2011) 9.

¹⁵ *Lennard’s Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 705.

¹⁶ Brenda Hannigan, *Company Law* (4th edn, OUP 2016) 142.

¹⁷ Ibid.

Companies Act 2006,¹⁸ Company Directors Disqualification Act 1986,¹⁹ Insolvency Act 2000,²⁰ and Small Business, Enterprise and Employment Act 2015²¹ have been examined to help on the impact of statutes on the directors and shareholder business involvement. The UK Corporate Governance Code of 2016²² and the South African King IV²³ report have also been used as resources to appreciate provisions in other jurisdictions. The examination further included descriptive methods, which included a theoretical description of the concepts and questions in articulating the subject area.

5. Discussion

5.1 Directors' duties and Accessibility

A company is an artificial construct, which is a “creature of Statute,”²⁴ for all intents and purposes, depends on its members to act above reproach and exercise the “duty of loyalty”²⁵ owing to the general duties set out in Sections 171 to 177 of the Companies Act 2006.²⁶ Directors at company law as “the very ego who is truly in control of the company affairs”²⁷ is enshrined in *Bilta*,²⁸ thus directors were held liable, owing to their duties, although attribution could not be found. Hence, in cases of liability and attribution, courts look behind the company “veil” to establish the true actors, as was expounded in *Prest v Petrodel*,²⁹ thereby endorsing the *Salomon*³⁰ principle. The crucial general duties of the directors include, among others, the “duty of loyalty”³¹ and the “duty of care, skill and diligence”³² as codified in s 171-177 of the Companies Act.³³ The former is a fiduciary duty, and the latter is not because it involves

¹⁸ Companies Act 2006 s170-177.

¹⁹ Company Directors Disqualification Act 1986.

²⁰ Insolvency Act 2000.

²¹ Small Business, Enterprise and Employment Act 2015.

²² UK Corporate Governance Code of 2016.

²³ King Report on Corporate Governance in SA <<https://www.iodsa.co.za/page/KingIII>> accessed 4 May 2023.

²⁴ Hannigan (n 2)

²⁵ Ibid.

²⁶ Companies Act 2006 s171 -177.

²⁷ Ibid.

²⁸ *Jetivia SA and another (Appellants) v Bilta (UK) Limited (in liquidation) and others (Respondents)* [2015] UKSC 23.

²⁹ *Prest v Petrodel Resources Ltd & Others* [2013] UKSC 34.

³⁰ *Salomon v A Salomon* [1897] AC 22.

³¹ Hannigan Ibid.

³² Hannigan Ibid.

³³ Companies Act 2006 s177 -177, the fiduciary duties codified including the general duties of the directors.

negligence, which is a subjective standard.³⁴ The “duty to act *bona fide*”³⁵ and in “good faith”³⁶ as a “fiduciary duty”³⁷ was established as a duty of loyalty in the *Madoff case*.³⁸

The reforms were intended to “improve accessibility”³⁹, especially to the directors who needed to have a legal understanding of their duties, which were generally seen as lacking in the common law. Directors are to exercise their duties all the time as per the provisions. Thus, in *Eclairs Group Ltd v JKX Oil & Gas*,⁴⁰ it was held that the exercise of directors’ powers is limited to the purpose for which they were conferred.⁴¹ The identification principle was expounded in *Tesco Supermarket Ltd v Natrass*.⁴²

5.2 The Subjective and Objective Tests

The twin set tests “*de minimis objective*”⁴³ and “subjective”⁴⁴ standard is explored in *Norman v Theodore*. The objective standard applies to the expertise and skill of a director, while the subjective applies to how a reasonable person would act in similar circumstances. At Common law, courts mainly used the subjective test, which is less onerous. However, the reforms seem to lean more on the objective test, that a director must be judged objectively per the duties owed to the company as per the *Howard case*.⁴⁵ This authority is by virtue of the position occupied by the director as stated in *Lord Diplock in Freeman and Lockyer v Buckhurst Park*

³⁴ David Cabrelli’s Presentation for Universita’ Bocconi on “The Reform of the Law of Directors’ duties in UK Company Law, Edinburgh Research Explorer (2008).

³⁵ *Ibid.*

³⁶ Andrew Keay, Directors’ duties and creditors’ interests, Law Quarterly Review (2014).

³⁷ *Ibid.*

³⁸ *Madoff Securities International Ltd v Raven & Ors* [2013] EWHC 3147.

³⁹ Deirdre Ahern, Directors’ duties, dry ink and the accessibility agenda, Law Quarterly Review, 2012.

⁴⁰ *Eclairs Group Ltd v JKX Oil & Gas* [2015] UKSC 71.

⁴¹ *Ibid.*

⁴² *Tesco Supermarket Ltd v Natrass* [1972] AC 153. Lord Reid established that a company acts through a living person because on its own it has no mind to act negligently.

⁴³ Chris Handrill, ‘The duty of reasonable care, skill and diligence for directors’ (2012) <http://www.redmans.co.uk/the-duty-of-reasonable-care-skill-and-diligence-for-directors/> accessed 22 August 2023.

⁴⁴ *Ibid.*

⁴⁵ *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821.

*Property Ltd*⁴⁶ and endorsed in *Williams & Anor v Natural life*.⁴⁷ An interesting twin set combination “objective subjective” standard was expounded in *Soper v. Canada*.⁴⁸

5.3 Shareholder Remedies

Shareholders' rights and powers are derived from “ownership”⁴⁹ and sanctioned by the statute as expounded in *Ben Hashem v Al Sheaf*⁵⁰, where a company's separation from its shareholding was explored. Shareholders rights include but are not limited to appointing board members, approving annual statements, and remuneration of directors as expounded in Eurosif in the case of the European Union.⁵¹ Shareholder remedies include but are not limited to, the famous “Statutory unfair prejudice” remedy. Thus, action can be brought before courts through Minority shareholders' statutory remedies under the Companies Act 2006 s.994. Voting rights allow majority shareholders to vote out a delinquent director or pass resolutions through “majority rule”⁵² as per the *Foss* rule.⁵³ The shareholder voting rights are “designed to encourage directors’ accountability”⁵⁴ Thus, powers to appoint and dismiss directors solely remain those of the shareholders.

5.4 Legal Remedies

The UK Companies Act 2006 provisions and those of the Insolvency Act 1986 have legal remedies such as the shareholder “derivative action” as enshrined in the *Foss* rule.⁵⁵ Specific legal remedies and actions are available for breach or non-compliance of the director’s duties,

⁴⁶ *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 Q.B. 480.

⁴⁷ *Williams & Anor v Natural Life Health Foods Ltd & Anor* [1998] UKHL 17; [1998] 2 All ER 577. An objective test means that the primary focus must be on things said or done by the defendant or on his behalf in dealings with the plaintiff.

⁴⁸ *Soper v. Canada*, [1998] 1 F.C. 124. It is described as “objective subjective,” thus a consideration of the lower personal skills of directors could be made under this standard.

⁴⁹ *Ibid.*

⁵⁰ *Ben Hashem v Al Sheaf* [2009] 1 FLR 115.

⁵¹ Eurosif, ‘SHAREHOLDER STEWARDSHIP: European ESG Engagement Practice (2013)<<http://www.eurosif.org/wp-content/uploads/2014/06/eurosif-report-shareholder-stewardship.pdf>> accessed 3 May 2023.

⁵² Kershaw, The rule in *Foss v Harbottle* is dead: long live the rule in *Foss v Harbottle*, *Journal of Business Law* (2015).

⁵³ *Foss v Harbottle* (1843) 2 Hare 461.

⁵⁴ Nor Hayati Abdul Samat & Dr. Hansani Mohd Ali, “A Legal Perspective of Shareholders’ Meeting in the Globalised and Interconnected Business Environment” (2015) *Procedia – Social and Behavioural Sciences*, 162 – 169.

⁵⁵ David Kershaw David, The rule in *Foss v Harbottle* is dead: long live the rule in *Foss v Harbottle*, *Journal of Business Law* (2015).

including injunctions to prevent a further breach, set aside a disputed transaction or resolution, restoration of company property held by the director and award of damages. A breach may also be grounds for an executive director's contract termination. In certain circumstances, a director may be disqualified from being a director under the Company Directors Disqualification Act 1986,⁵⁶ for example, when they have been found to have acted *ultra vires*, which attracts liability for unlawful conduct. The law tries to prevent unsuitable individuals from acting as company directors. Such an individual can be disqualified from acting as a director for up to 15 years under the Company Directors Disqualification Act 1986 (CDDA).⁵⁷ The 15 years disqualification was expounded in *Re Sevenoaks Stationers (Retail) Ltd*.⁵⁸

Under Insolvency Act, criminal offences attract criminal remedies, which may be ten years in jail.⁵⁹ The Act, known as a hallmark for the "protection of creditors",⁶⁰ further provided several remedies, including solvent and insolvent businesses, such as class remedy,⁶¹ including "the just and equitable ground"⁶² remedy,⁶³ criminal penalties⁶⁴ and civil penalties,⁶⁵ assign claims,⁶⁶ fiduciary duty breach redress.⁶⁷ Criminal sanctions can include the complicity of third parties who may have participated in defrauding the company.

5.5 Statutory Review and Derivative Actions

The critical question is, are the substantive reforms constraining directors and shareholders as they were at common law? The reforms sought clarity and consistency, which were blurred in Common law, mainly because it depends much on judicial precedents. At Common law, the duty of loyalty was considered a matter of diligence. Under the Companies Act, the duty of loyalty is a director acting *bona fide* in good faith and putting ahead the company's interests. Failure to do this duty was incompetence at Common law which attached compensation, but under the reforms, it is a serious "breach of trust"⁶⁸ therefore, the director would have breached

⁵⁶ Company Directors Disqualification Act 1986.

⁵⁷ CDDA 1986.

⁵⁸ *Re Sevenoaks Stationers (Retail) Ltd* [1990]

⁵⁹ Insolvency Act 1986.

⁶⁰ *Ibid.*

⁶¹ Hannigan (n 4) 694.

⁶² IA 1986, s122(1)(g)

⁶³ This is a shareholder remedy.

⁶⁴ Companies Act 2006, s993.

⁶⁵ IA 1986, s214.

⁶⁶ Small Business, Enterprise and Employment Act 2015, s118; IA 1986, s 213.

⁶⁷ IA 1986, s212.

⁶⁸ *Ibid.*

fiduciary duties were formulated. Part ii of the Act lays down the provisions governing the derivative claims that shareholders can use. Shareholder derivative rights are seen to give more power to the shareholders, including minority shareholders, to bring actions before courts to rectify unratifiable resolutions. A claim based on the derivative rights was explored in the Madoff case.

5.6 Business Impact and Performance

The impact of company law reforms on business success is a contentious debate. Some scholars argue that the reforms brought substantive changes and legal certainty to Company law, thus having a positive impact on businesses. It is argued that the certainty gave more clarity on the different roles played by directors and shareholder powers, which have helped companies to perform better because there is more accountability. To this end, Codification brought legal certainty to the director and shareholder's different roles, thus avoiding unnecessary power dynamics. In the case of the EU, gender disparities in board appointments are an important consideration for women to be included more. The composition and size of the UK Board are significant factors in encouraging performance, thus limiting market manipulation and shareholder involvement. Directors are expected to write annual strategic reports,⁶⁹ helping members to assess board performance. This help to track key performance indicators, among other, "financial indicators,"⁷⁰ "environment",⁷¹ and "employee matters."⁷²

5.7 Corporate Sustainability and Environment

The development of Codes like the UK corporate governance code has improved director performance and accountability and helped with succession, thus enhancing corporate sustainability. A company operates its business activities in the context of society. Therefore, the consideration of the environment is essential. There is also a contentious debate on the role of corporate social responsibility and how it must be positioned within companies. Thus, the codified Act has provisions on the impact of business operations on the community. These include human rights.

⁶⁹ Companies Act 2006 (Strategic Report and Directors Report) regulations 2013 > <https://www.legislation.gov.uk/ukdsi/2013/9780111540169>.

⁷⁰ Ibid.

⁷¹ Ibid.

⁷² Ibid.

6. Conclusion

It is evident from the literature review that the reforms are highly contested. However, there seems to be some consensus that codification was a necessary statutory exercise, notwithstanding the divergent views on whether there were significant changes and substantive departures from common law to Company law. However, there is at least certainty that effective corporate governance is a delicate balance between conflict of interest between shareholder powers and directors' duties. Directors' duties were clarified, and so are the shareholder powers and remedies, owing to the codification.

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