RECONFIGURING THE NO CONFLICT RULE

Judicial Strictures, a Statutory Restatement and the Opportunistic Director

This article explores the scope of the no conflict duty as it applies to company directors in the UK in the light of the bright-line statutory formulation of the duty adopted in the Companies Act 2006. That statutory clarity sits alongside existing judicial disagreements, however, on key aspects of the duty, such as whether directors have a duty to disclose information to their companies and the significance to be attached to the scope of a company's business. The question is whether the statutory formulation affords the courts the opportunity now to develop a more coherent statement of this most important duty.

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I. Introduction

1 One of the main innovations in the UK Companies Act 2006 ("CA 2006") was the inclusion for the first time in the companies legislation of a statement of the general duties of directors.[1] Central to a director's duties, of course, is the long-established equitable rule precluding a fiduciary from entering, without consent, into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect (the no conflict rule),[2] and the equally inflexible rule that, without consent, a person in a fiduciary position is not entitled to profit

1 See Companies Act 2006 (c 46) (UK) Pt 10, ch 2, ss 170–181. The background to the Companies Act 2006 is that the UK conducted a thorough company law review between 1998 and 2001 with a view to modernising the Companies Act 1985. Eventually many of the proposals from the review appeared in the Companies Act 2006 alongside restated provisions of the Companies Act 1985 which was largely repealed as a consequence. For an account of the background, see Hannigan, *Company Law* (Oxford University Press, 2nd Ed, 2009) at pp 29–32; *The Reform of United Kingdom Company Law* (De Lacy ed) (Cavendish Publishing, 2002).

2 *Aberdeen Rly Co v Blaikie Bros* (1854) 1 Macq 461 at 471–472, *per* Lord Cranworth; *Imperial Mercantile Credit Assoc v Coleman* (1873) LR 6 HL 189.

from that position[3] (the no profit rule). Whether one rule or two (a matter of debate), together the two strands[4] express the duty of undivided loyalty owed by a fiduciary to his principal.[5] The rationale for the two strands was explained in *Chan v Zacharia*[6] as follows: the no conflict rule is designed to prevent the judgment of the fiduciary being swayed by self interest and the no profit rule is designed to strip the disloyal fiduciary of gains made by reason of his position or his misuse of company property or opportunity. In most instances, both rules will be relevant, as where a director exploits his fiduciary position or an opportunity presented or information learned in that capacity in breach of the no profit rule and the pursuit of that personal advantage places his personal interests in conflict with the company's interests. It has been suggested, on occasion, that only the no profit rule may apply, with *Regal (Hastings) Ltd v Gulliver*[7] usually cited as an example.[8] There the House of Lords accepted that the directors had acted *bona fide* in the interests of the company so, though they breached the no profit rule by profiting in the course of the execution of their duties as directors,[9] there was no breach of the no conflict rule. Most recently, in *Wilkinson v West Coast Capital*,[10] Warren J commented that it was "not an easy question" as to whether liability could arise independently of the no conflict rule where a profit is made in the course of and by reason of the fiduciary office.

2 As far as these fundamental no conflict and no profit rules are concerned, the key statutory provision is CA 2006 s 175 which provides as follows:

> (1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.[11]
>
> (2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the

3 *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378, HL; also *Parker v McKenna* (1874) 10 Ch App 96; *Boardman v Phipps* [1967] 2 AC 46, HL.

4 See *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638, [2006] FSR 17 at [1306]; *Quarter Master UK v Pyke* [2005] 1 BCLC 245 at [55].

5 *Bristol and West BS v Mothew* [1998] Ch 1 at 18.

6 (1984) 154 CLR 178 at 198; and see *King Productions Ltd v Warren* [2000] 1 BCLC 607.

7 [1967] 2 AC 134, [1942] 1 All ER 378, HL.

8 See too *Boardman v Phipps* [1967] 2 AC 46; Conaglen, *Fiduciary Loyalty* (Hart Publishing, 2010) at pp 116–118.

9 *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 at 144–145, *per* Lord Russell, and at 153, *per* Lord Macmillan, [1942] 1 All ER 378 at 389 and 392.

10 See [2007] BCC 717 at [309]–[312].

11 Note that Companies Act 2006 (c 46) (UK) s 175(7) provides that "any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties".

> company could take advantage of the property, information or opportunity).

3 Other aspects of the no conflict rule are addressed in s 176 (duty not to accept benefits from third parties) and s 177 (duty to declare an interest in the proposed transaction or arrangement with the company) but the focus of this article is s 175.

II. Issues to be addressed

4 Here we will consider the nature of the obligations imposed by s 175 and, in particular, consider the relationship between a director's duty of disclosure and the no conflict rule; the extent to which the scope of a company's business is relevant to the application of the no conflict rule; and the implications of stating the no profit rule as a subset of the no conflict rule, as is done in s 175(2) above. All statutory references in this article are to the CA 2006 unless otherwise indicated.

III. The no conflict rule, old and new

5 As a starting point, we find that CA 2006 s 175(1) mirrors the famous expression of the no conflict rule by Lord Cranworth in *Aberdeen Railway Co v Blaikie Bros*[12] in 1854 who stated that:

> And it is a rule of universal application, that no one, having [fiduciary] duties to discharge shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect.

6 Given the very similar wording in s 175(1), clearly the intention is to continue to apply the no conflict rule as previously established.[13] A director must avoid a situation of conflict or possible conflict because "human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect".[14] Once a conflict or possible conflict arises, the director's duty of undivided loyalty requires him, if he wishes to pursue the

12 (1854) 1 Macq 461 at 471.

13 As to the relationship between the statute and the pre-existing law, see Companies Act 2006 (c 46) (UK) ss 170(3) and 170(4) which provide in essence that the general duties have effect in place of the existing common law rules and equitable principles but regard is to be had to those corresponding rules and principles in interpreting and applying the general duties: see Hannigan, *Company Law* (Oxford University Press, 2nd Ed, 2009) at pp 174–175.

14 *Bray v Ford* [1896] AC 44 at 51, *per* Lord Herschell.

opportunity personally, to communicate the information concerning the situation to the company, it being "information which it is relevant for the company to know".[15] Once the no conflict rule is engaged, it is irrelevant whether the company would, could, might, take the opportunity itself. It is for the company, as the beneficiary of the fiduciary duty, to decide how to proceed and, in particular, where the company does not wish to proceed, the company (*ie*, the shareholders and now the disinterested directors, see CA 2006 s 175(4)(*b*)) may decide to consent to the fiduciary exploiting the situation for his own benefit.[16]

7 One of the key modern decisions on the no conflict rule is *Bhullar v Bhullar*[17] ("*Bhullar*"). Here two directors of a family company were held in breach of the no conflict rule when they acquired property adjacent to the company without telling the company that the property was available for purchase.[18] They had come across the information that the property was for sale quite by chance and in circumstances which had nothing to do with their directorships. The company was a family business which was deadlocked and it had been agreed by the shareholders that the company would not acquire further properties; instead the intention was that the parties would go their separate ways but they had not actually taken any formal steps to bring that about.[19] The court found that the directors' personal interest in acquiring the

15 *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162; *Bhullar v Bhullar* [2003] 2 BCLC 241.

16 At common law, it is not clear whether, if the company decides not to proceed following disclosure, whether that disclosure suffices to extinguish the conflict and allows the director to take the opportunity (see Lord Upjohn in *Boardman v Phipps* [1967] 2 AC 46 at 131 who would say yes), also arguably the case would then fall within Companies Act 2006 (c 46) (UK) s 175(4)(*a*) (duty not infringed if situation cannot reasonably be regarded as likely to give rise to a conflict); or whether there needs to be formal assent to the director's exploitation of it (which Warren J seems to suggest in *Wilkinson v West Coast Capital* [2007] BCC 717 at [302], noting that this is a "very difficult question"). The Companies Act 2006, arguably, supports formal authorisation: see s 175(4)(*b*) (duty not infringed if the matter is *authorised* by the directors) and s 180(4) (duties have effect subject to any rule of law enabling the company to *authorise* anything to be done that would otherwise be a breach of duty). The decision by the company not to proceed is one of those factors (would/could/might factors) which are irrelevant to whether there is a conflict (so s 175(4)(*a*) does not apply): see discussion below. Requiring authorisation also ensures that the company appreciates that the director is to exploit the situation personally which might not be the case where a decision is taken merely not to proceed corporately.

17 [2003] 2 BCLC 241, noted Armour (2004) CLJ 33; Prentice & Payne [2004] 120 LQR 198.

18 See Lord Upjohn's not dissimilar Whiteacre/Blackacre example in *Boardman v Phipps* [1967] 2 AC 46 at 130 – he did not consider that there was a conflict of interest in a trustee personally acquiring an adjoining property (Whiteacre) when the trust (which occupied Blackacre) had no interest in acquiring the property.

19 See *Bhullar v Bhullar* [2003] 2 BCLC 241 at [10] and [22].

land was in conflict with their duty to promote the company's interests which required them to communicate the existence of the opportunity to the company which could then have considered whether to acquire it. There was a real sensible possibility of conflict, the court said, and they were in breach of their duty when they acquired the property for themselves.

8 Two significant issues are highlighted by *Bhullar*. First, the breadth of the no conflict duty. A director can be in breach of the no conflict rule though he does not exploit his fiduciary position or information or opportunity acquired in that capacity. There is no need to show the exploitation of property "belonging" to the company – there is no proprietary element to it[20] – merely a need for a real sensible possibility of conflict and the fiduciary's exploitation of an opportunity in such circumstances.[21] As the company is entitled to the undivided loyalty of its directors, the very act of a director putting himself in a position of conflict or possible conflict is a breach of duty, without more, as was explained in *Quarter Master (UK) Ltd v Pyke*:[22]

> It is not because he has made a profit from trust property or a profit from his fiduciary position that the director is liable under the conflict rule. Rather, it is because, being in a fiduciary position, he has entered into a transaction, inconsistent with his fiduciary duty of loyalty to the company, which has yielded the profit and he has thereby misused his position. The opportunity to make the profit may not arise from the director's fiduciary position; he might just as well have had the opportunity if he had not been in that position but even so, his liability in respect of the profit arises because of the conflict of interest. In many cases, where the conflict rule applies, the director will also have taken advantage of the property of the company or of his fiduciary position but this will not always be so.

9 The second issue arising from *Bhullar* is this "duty" of the director to communicate the existence of the opportunity to the company. It is useful to address this complex issue first before returning to consider the breadth of the no conflict rule.

A. The duty of a director to disclose information

10 In *Bhullar*, Jonathan Parker LJ (with whom Brooke and Schiemann LJJ agreed) concluded that "the existence of the opportunity (to acquire the adjacent property) was information which it was

20 A point reflected in the absence of any reference to property, information or opportunity *of the company* in Companies Act 2006 (c 46) (UK) s 175(2); and see Kershaw, "Does it matter how the law thinks about corporate opportunities?" (2005) 25 *Legal Studies* 533.

21 *Bhullar v Bhullar* [2003] 2 BCLC 241 at [27]–[28].

22 [2005] 1 BCLC 245 at [54]–[55], *per* Paul Morgan QC, sitting as a Deputy Judge.

relevant for the company to know, and it follows that the appellants [directors] were under *a duty* to communicate it to the company"[23] [emphasis added], applying Roskill J in *Industrial Development Consultants Ltd v Cooley*.[24] This approach was developed, controversially, in *Item Software (UK) Ltd v Fassihi*[25] ("*Item Software*") by Arden LJ (with whom Holman and Mummery LJJ agreed) into a prescriptive obligation on a director to disclose his own misconduct to his company,[26] not as a result of some free-standing duty of disclosure,[27] but, as Arden LJ saw it, as part of the fundamental duty of loyalty to which a director is subject, that is the director's duty to act in what he in good faith considers to be the best interests of his company.[28] The Court of Appeal held that the director in question should have disclosed that, while the company was negotiating for the renewal of an important distribution contract, the director was also negotiating to secure the contract for his personal benefit. The court held that the director could not have fulfilled his duty of loyalty to the company except by disclosing his plans, including that he had set up his own company and planned to acquire the distribution contract for himself.[29] In a relatively brief justification of what she described as a new application of the established duty of loyalty,[30] Arden LJ offered three reasons for imposing this obligation to disclose misconduct.[31] It is efficient in economic terms as the company does not have to expend resources in investigating the conduct of its directors, otherwise the enforcement of a liability to compensate the company for

23 *Bhullar v Bhullar* [2003] 2 BCLC 241 at [41].

24 [1972] 1 WLR 443 at 451, [1972] 2 All ER 162 at 173–174. See Finn, *Fiduciary Obligations* (Law Book Co, 1977) at p 240 who agreed with the result but doubted this revolutionary view of directors' duties as expressed by Roskill J; see too Austin, "Fiduciary Accountability for Business Opportunities" in *Equity and Commercial Relationships* (Finn ed) (Law Book Co, 1987) at pp 150–151, who criticises this approach as too broad and onerous and too ambiguous.

25 [2005] 2 BCLC 91, especially at [40]–[41] and [63]–[68].

26 See also *Crown Dilmun v Sutton* [2004] 1 BCLC 468 at [181]; *British Midland Tool Ltd v Midland International Tooling Ltd* [2003] 2 BCLC 523 at [89]. It is not entirely clear whether Arden LJ was limiting the duty to disclosure of misconduct rather than the wider category of "information which it is relevant for the company to know", but, as she bases the disclosure obligation on the duty to act in the best interests of the company, it must also extend to the wider category where such disclosure is in the best interests of the company, see *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 at [44]; Etherton J in *Shepherds Investments Ltd v Walters* [2007] 2 BCLC 202 at [132] clearly sees it as extending to the wider category.

27 Arden LJ expressly stated that she did not consider it correct to infer from *Bhullar v Bhullar* [2003] 2 BCLC 241 or *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162 that a fiduciary owes a *separate* and independent duty to disclose his own misconduct or more generally information of relevance and concern to his principal: see *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 at [41].

28 *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 at [41].

29 *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 at [44].

30 *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 at [44].

31 *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 at [65]–[67].

misconduct would depend on the happenchance of the company finding out about the impropriety;[32] a failure to disclose means that the company may reach erroneous business decisions on incomplete information so to condone non-disclosure is to condone inefficient outcomes; and the requirement of disclosure addresses the agency problem and supports the board in managing its oversight of the conduct of executive directors.

(1) Reaction to Item Software

11 Initially, at least, there was some endorsement of this approach,[33] for example, on the basis that the duty of loyalty should be able to embrace bad faith omissions as well as acts[34] or that "intuitively" Arden LJ's formulation was right, even if it did need some qualification.[35] Some commentators wrestled with trying to formulate the duty in a way they found less radical, such as by stating it as a duty not to act to prejudice the company's interests.[36] There is a degree of difficulty in deciding whether the duty to disclose turns on the director's subjective opinion of what it is in the company's interests to know[37] (in which case would the director ever be found to be liable?[38]) or on an objective assessment by the court of what the director ought to have appreciated the company would want to know[39] (in which case is the

32 Though Arden LJ acknowledged that directors are unlikely to comply with the duty, see *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 at [66].

33 However, such support was often tangential or partial rather than enthusiastic, see Armour & Conaglen, "Directorial Disclosure" (2005) CLJ 48 at 50 and 51 (for company directors, "a helpful rationalisation" of *Bhullar v Bhullar* [2003] 2 BCLC 241 and *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162, and noting the employment of economic analysis); Lowry found Arden LJ's reasoning compelling, "from a pragmatic standpoint", see Lowry, "The Duty of Loyalty of Company Directors: Bridging the Accountability Gap Through Efficient Disclosure" (2009) CLJ 607 at 619.

34 See Watts, "The Transition from Director to Competitor" [2007] 123 LQR 21 at 23–24; Lee & Ho, "A Director's Liberty to Compete" [2007] JBL 98 at 100 (discussing and approving of *Shepherds Investments Ltd v Walters* [2007] 2 BCLC 202 where Etherton J echoed Arden LJ's approach); and see n 53 below.

35 Rebecca Lee thought that a modified version of Arden LJ's proposed duty might be justifiable if it provides, what Lee calls, positive directional content to the fiduciary obligation which mandates a fiduciary to act in the sole (as opposed to best) interests of the company, see Rebecca Lee, "Rethinking the Content of the Fiduciary Obligation" (2009) Conv 236 at 243, 248 and 253.

36 See Ho & Lee, "A Director's Duty to Confess: A Matter of Good Faith" (2007) CLJ 348, but see Rebecca Lee, "Rethinking the Content of the Fiduciary Obligation" (2009) Conv 236 at 252, who rightly notes that this is little different from saying that a fiduciary must not place himself in a position of conflict.

37 See Ho & Lee, "A Director's Duty to Confess: A Matter of Good Faith" (2007) CLJ 348 at 358, and Armour & Conaglen, "Directorial Disclosure" (2005) CLJ 48 at 50.

38 A point acknowledged by Armour & Conaglen, "Directorial Disclosure" (2005) CLJ 48 at 51.

39 See Lee & Ho, "A Director's Liberty to Compete" [2007] JBL 98 at 101–102.

court deciding what is in the best interests of the company?), all of which suggests that deciphering what Arden LJ intended is not easy. Criticism was also made of the unfair outcome in the case.[40] Others queried the "highly contentious proposition" laid down in the case, in effect coalescing duties to disclose and to avoid conflicts under the broad rubric of a fiduciary duty to promote the company's interests[41] and asked whether Arden LJ's analysis is defensible given the uncertainties which it presents as to the scope and content of the duty to act in good faith in the best interests of the company and whether such a duty is fiduciary.[42]

12 Subsequent judicial positions have ranged from apparent support[43] to reluctant following of precedent[44] to searching for an alternative contractual basis for an obligation to disclose.[45] Most recently, however, in *Commonwealth Oil and Gas Co Ltd v Baxter*,[46] the

40 See Berg, "Fiduciary Duties: A Director's Duty to Disclose His Own Misconduct" [2005] 121 LQR 213 at 220 who noted that the application of the new duty in *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 rendered the defendant director liable for substantial damages in circumstances whether he had no liability under the no conflict rule to account for any profit made (as he had made no profit) or to compensate the company for any loss caused (his conduct had not caused the loss incurred by the company). The company lost the opportunity because of the manner in which the managing director conducted the negotiations which caused the other side to walk away.

41 Lee & Ho, "A Director's Liberty to Compete" [2007] JBL 98 at 101.

42 Ho & Lee, "A Director's Duty to Confess: A Matter of Good Faith" (2007) CLJ 348 at 353–354; also Berg, "Fiduciary Duties: A Director's Duty to Disclose His Own Misconduct" [2005] 121 LQR 213 at 220 ("[a] director's fiduciary duties have to be kept within realistic bounds").

43 Etherton J in *Shepherds Investments Ltd v Walters* [2007] 2 BCLC 202 at [132] endorses Arden LJ's approach that the fundamental duty is to act in the best interests of the company, and agrees that there is no separate duty of disclosure, and concludes that disclosure is "a straightforward application of ordinary principles of equity concerning fiduciary duties"; but equally, in the same paragraph, he does link disclosure of misconduct to the need for consent for being in a position of conflict so even here there is some ambiguity.

44 See Jack J in *Brandeaux Advisers (UK) Ltd v Chadwick* [2010] EWHC 3241, [2011] IRLR 224 at [47] who noted that *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 could have been decided on contractual grounds and that the development of the law in this way by the Court of Appeal was unnecessary but the decision was binding on him.

45 See *Helmet Integrated Systems Ltd v Tunnard* [2006] EWCA Civ 1735, [2007] FSR 437; also Edelman, "When Do Fiduciary Duties Arise?" [2010] 126 LQR 302 who argues that fiduciary duties are merely terms expressed or implied in voluntary undertakings (rather than imposed by law or dependent upon status) and who considers that the analysis in the fiduciary cases (and indeed Arden LJ's analysis in *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91) mimics the analysis of implied terms in contract cases. Finding a contractual basis for her approach would not therefore be difficult.

46 [2009] CSIH 75, [2009] SLT 1123 (a Scottish decision, but there is no difference in Scottish law on these matters). The Companies Act 2006 (c 46) (UK) applies,

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Inner House of the Court of Session gave a definite rejection[47] of the approach taken in *Item Software* and *Bhullar*. The Inner House rejected any suggestion from those authorities that a director's fiduciary duties are prescriptive and emphasised that the no conflict obligation does not create any obligation on the part of a director to communicate an opportunity of which he had become aware in a personal capacity to the company, rather the no conflict duty merely bars the director from personally exploiting the opportunity.[48] The President of the Inner House, Lord Hamilton, reserved his position on the analysis adopted by Arden LJ and stated that he was not to be taken as agreeing with the reasoning of the Court of Appeal in *Bhullar*, though he agreed with the result.[49] Lord Nimmo Smith likewise noted that he would not go so far as *Bhullar* or *Item Software* to the extent that they appeared to support a positive duty to disclose or communicate information to the company which it was relevant for it to know, rather, he said, "there is simply the need for disclosure at the stage when informed consent is sought".[50]

(2) A fiduciary duty to act in the interests of the company?

13 It is clearly possible and definitely desirable to confine this obligation of disclosure to its role as a necessary consequence of being in a situation of conflict. The difficulty is that Arden LJ was quite clear that she did not accept that the duty to disclose could be so limited.[51] Hence her decision to base it on the general duty of loyalty expressed in terms of the duty to act in the company's interests. The criticism of the *ratio* in *Item Software* here broadens to a more fundamental objection, namely, that this attempt to impose a prescriptive duty of disclosure is contrary to the established English (and Scottish) position that fiduciary duties are proscriptive rather than prescriptive.[52] The underlying concern being

except as otherwise provided, to the whole of the UK: s 1299. The facts of the case are given later in this article but they are irrelevant for the moment.

47 For a robust rejection by an Australian court, see *P & V Industries Pty v Porto* [2006] VSC 131 where Hollingworth J considered that the duty imposed in *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 was not based on a sound theoretical footing and was justified on the basis of economic analysis which was not an appropriate basis for analysis of fiduciary obligations. Particularly pertinent, perhaps, Hollingworth J concluded, at [45], that "it is not the place for courts to usurp the role of the legislature and, in the process, tinker with established equitable rules such as those that govern the duties of fiduciaries".

48 *Commonwealth Oil and Gas Co Ltd v Baxter* [2009] CSIH 75, [2009] SLT 1123 at [13] and [82].

49 *Commonwealth Oil and Gas Co Ltd v Baxter* [2009] CSIH 75, [2009] SLT 1123 at [14].

50 *Commonwealth Oil and Gas Co Ltd v Baxter* [2009] CSIH 75, [2009] SLT 1123 at [82]. Lady Paton, the other member of the court, agreed with Lords Hamilton and Nimmo Smith, at [98].

51 *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 at 103 ("[i]t would be odd …").

52 The debate on prescriptive/proscriptive duties and the nature of fiduciary duties is beyond the scope of this article, but see in particular, Nolan, "A Fiduciary Duty to

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that prescriptive duties would have a chilling effect on directors' managerial freedom and exercise of business judgement,[53] but more importantly, as Nolan explains, because it is more efficient and more transposable to identify impermissible conduct by a fiduciary than it is to stipulate how an undertaking is to be performed.[54] Nothing in the adoption of the statutory statement in the CA 2006 suggests a shift in that UK position. Indeed the Explanatory Notes to the legislation confirm that the duties are not prescriptive: "[T]he general duties form a code of conduct which sets out how directors are expected to behave: it does not tell them in terms what to do."[55]

14 It is trite law that not all duties owed by fiduciaries are fiduciary duties and not all breaches of duty by a fiduciary are breaches of fiduciary duty.[56] Are the general duties imposed by the CA 2006 fiduciary duties? The statute does not label the duties as fiduciary, rather as the general duties of directors. True, s 178(2) states that the duties (with the exception of the duty of care, skill and diligence under s 174) are enforceable in the same way "as any *other* fiduciary duty" [emphasis added], but it too does not state that the duties are fiduciary.[57] It is also

Disclose?" [1997] 113 LQR 220; Nolan, "Controlling Fiduciary Power" (2009) CLJ 293; also Conaglen, "The Nature and Function of Fiduciary Loyalty" [2005] 121 LQR 452; and Conaglen, *Fiduciary Loyalty* (Hart Publishing, 2010) at pp 201–203 though Conaglen's general thesis that fiduciary duties are fundamentally negative and subsidiary, designed to bolster the performance of the non-fiduciary obligations undertaken, is robustly rejected by Rebecca Lee, see Lee, "In Search of the Nature and Function of Fiduciary Loyalty: Some Observations on Conaglen's Analysis" (2007) 27 Ox JLS 327, equally firmly rebutted by Conaglen, *Fiduciary Loyalty*, above, at pp 97–100. Possibly, the search for the purpose of fiduciary duties is unnecessarily complex and the purpose of the no conflict rule is the self evident one – without it, fiduciaries will favour self interest over the interest of their beneficiaries.

53 Lee & Ho, "A Director's Liberty to Compete" [2007] JBL 98 at 101; although the authors suggest that it is possible to define the *Fassihi* duty narrowly (*ie*, subjectively) in a way that would not interfere with managerial discretion, see at 101–102. They would consider these concerns about prescriptive duties impinging on managerial freedom as pragmatic issues rather than anything affecting the conceptual nature of the duty of loyalty, see Ho & Lee, "A Director's Duty to Confess: A Matter of Good Faith" (2007) CLJ 348 at 357.

54 Nolan, "Controlling Fiduciary Power" (2009) CLJ 293 at 311.

55 See the Explanatory Notes to the Companies Act 2006 (c 46) (UK), para 298. This wording is very reminiscent of that adopted by Lord Woolf in *A-G v Blake* [1998] Ch 439 at 455: "[E]quity is proscriptive, not prescriptive: see *Breen v Williams* (1996) 138 ALR 259. It tells the fiduciary what he must not do. It does not tell him what he ought to do." See also Millett, "Equity's Place in the Law of Commerce" (1998) 114 LQR 214 at 222–223; Nolan, "A Fiduciary Duty to Disclose?" (1997) 113 LQR 220 at 222.

56 *Bristol & West Building Society v Mothew* [1998] Ch 1 at 16; *Hilton v Barker Booth and Eastwood* [2005] 1 All ER 651 at [29].

57 The ambiguity is repeated in the Explanatory Notes to the Companies Act 2006 (c 46) (UK), para 305 which states: "[I]t [s 178] also makes clear that the statutory duties *are to be regarded as fiduciary*, with the exception of the duty to exercise

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noteworthy that that section is headed "Civil consequences of breach of general duties" so its purpose may be merely to emphasise that the duties are owed to the company (s 170) and enforceable in the way that duties owed to the company are enforced and, crucially, attract the remedies that breaches of other fiduciary duties attract. Clearly, some of the duties are fiduciary (for example, the no conflict duty in s 175); some clearly are not (for example, the duty of care, skill and diligence in s 174).[58] What then of the duty to act in the interests of the company, now restated, in the words of CA 2006 s 172, as a duty to act in a way most likely to promote the success of the company? That it states the "time-honoured" duty of loyalty[59] of a director is undisputed. The purpose of that statement, however, is to acknowledge the fiduciary nature of the relationship between the directors and the company (defined for these purposes as the members as a whole) and not to impose a fiduciary duty.[60] As Finn noted, the very generality of the term (in the interests of the members) means that it provides no yardstick against which to measure the propriety of a fiduciary's actions.[61] There is also the difficulty that every case of breach of duty by a director can be seen as a breach of s 172, in which case we either have no need for all the

reasonable care and skill and diligence which is not under the present law regarded as a fiduciary duty."

58 See, for example, Nolan, "Controlling Fiduciary Power" (2009) CLJ 293 at 312 and 315 who queries whether the proper purpose duty, which is not uniquely fiduciary but is invariably attached to a fiduciary, is indeed a fiduciary duty; also Conaglen, "The Nature and Function of Fiduciary Loyalty" (2005) 121 LQR 452 at 457–458; Conaglen, *Fiduciary Loyalty* (Hart Publishing, 2010) at pp 44–50. Flannigan criticises the judges for uncritically labelling the "best interests" and "proper purpose" rules as fiduciary and cogently argues that fiduciary duties should be restricted to the no conflict and no profit rules, which would bring a desirable clarity to this complex area, see Flannigan, "Fiduciary Duties of Shareholders and Directors" [2004] JBL 277, especially at 288–290; also Flannigan, "The Adulteration of Fiduciary Doctrine in Corporate Law" (2006) 122 LQR 449.

59 *Mutual Life Insurance Co of New York v Rank Organisation Ltd* [1985] BCLC 11 at 21, *per* Goulding J.

60 See Conaglen, *Fiduciary Loyalty* (Hart Publishing, 2010) at pp 54–58; Flannigan, "The Adulteration of Fiduciary Doctrine in Corporate Law" (2006) 122 LQR 449 at 453; Flannigan, "Fiduciary Duties of Shareholders and Directors" [2004] JBL 277 at 288–289. However, the judges often refer to breaches of it as a breach of fiduciary duty, see, for example, Lewison J in *Sinclair Investments (UK) Ltd v Versailles* [2011] 1 BCLC 202 at [26] but *cf* treatment in *Re Neath Rugby Ltd, Hawkes v Cuddy (No 2)* [2009] 2 BCLC 426 where the court does not describe the duty as fiduciary. As Flannigan, "The Adulteration of Fiduciary Doctrine in Corporate Law" [2006] 122 LQR 449 highlights, this area is riddled with semantic imprecision; and see Millett LJ in *Bristol and West BS v Mothew* [1998] Ch 1 at 16 ("this branch of the law has been bedevilled by unthinking resort to verbal formulae").

61 Finn, *Fiduciary Obligations* (Law Book Co, 1977) at p 15. See Edelman, "When Do Fiduciary Duties Arise?" [2010] 126 LQR 302 at 322–323 who suggests that an appropriate alternative formulation is to consider the "duty" as little more than an implied term that the fiduciary will act for a proper purpose (something which is expressly required by Companies Act 2006 (c 46) (UK) s 171).

other duties or, more accurately, s 172 itself is not a duty, merely an acknowledgment of the relationship between the directors and the members which generates the duties set out elsewhere in the statutory statement. The position is explained most clearly in the seminal Australian decision, *Breen v Williams*,[62] by Gummow J as follows:[63]

> Fiduciary obligations arise (albeit perhaps not exclusively) in various situations where it may be seen that one person is under an obligation to act in the interests of another. Equitable remedies are available where the fiduciary places interest in conflict with duty or derives an unauthorised profit from abuse of duty. It would be to stand established principle on its head to reason that because equity considers the defendant to be a fiduciary, therefore the defendant has a legal obligation to act in the interests of the plaintiff so that failure to fulfil that positive obligation represents a breach of fiduciary duty.

15 And by Gaudron and McHugh JJ in the same case:[64]

> In this country [Australia], fiduciary obligations arise because a person has come under an obligation to act in another's interests. As a result, equity imposes on the fiduciary proscriptive obligations – not to obtain any unauthorised benefit from the relationship and not to be in a position of conflict. If these obligations are breached, the fiduciary must account for any profits and make good any losses arising from the breach. But the law of this country does not otherwise impose positive legal duties on the fiduciary to act in the interests of the person to whom the duty is owed.

16 There is nothing to suggest that the position is any different in the UK. If anything, the decision to include within s 172 a requirement to have regard to the (non-exhaustive) factors listed,[65] designed to give effect to the concept of enhanced shareholder value,[66] reinforces that the primary function of s 172 is as a relationship provision. It states the fiduciary nature of the relationship between the directors and the members as a whole, modified by statute to have regard to the interests of stakeholders as identified in the section. That it operates at a level of generality and signalling is also reflected in the comments by the then

62 (1996) 186 CLR 71.

63 *Breen v Williams* (1996) 186 CLR 71 at 137–138.

64 *Breen v Williams* (1996) 186 CLR 71 at 113.

65 The directors must have regard to the likely consequences of any decision in the long term (Companies Act 2006 (c 46) (UK) s 172(1)(a)); employees' interests (s 172)(1)(b)); the need to foster business relationships (s 172(1)(c)); the impact of operations on the community and the environment (s 172(1)(d)); the desirability of maintaining a reputation for high standards of business conduct (s 172(1)(e)) and the need to act fairly as between members of the company (s 172(1)(f)).

66 For the background to the content of Companies Act 2006 (c 46) (UK) s 172 and the debate about pluralism and enlightened shareholder value which is the basis for the provision, see Hannigan, *Company Law* (Oxford University Press, 2nd Ed, 2009) ch 9.

Minister for Industry and the Regions, Margaret Hodge, who noted that the statutory statement of general duties, "especially in s 172 … marks a radical departure in articulating the connection between what is good for a company and what is good for society at large" and s 172 "reflects a modern view of the way in which businesses operate in their community".[67] In other words, it is a broad, general, aspirational statement rather than a specific fiduciary duty. The section does not impose any prescriptive duties, nor should it be used as a peg on which to hang a prescriptive obligation to disclose information.

(3) Duty to disclose as a consequence of conflict

17 Given the relative brevity of the discussion in *Item Software* and that the judgment is "not as explicit as it might have been",[68] and given s 172 does not impose a prescriptive fiduciary duty to act in the interests of the company, it is not beyond the courts to nudge the interpretation of *Item Software* to a more orthodox position, as the Court of Appeal showed, *obiter*, in *Helmet Integrated Systems Ltd v Tunnard*[69] quoting Arden LJ herself where she noted, in Item Software, that "the court was not seeking to make any substantive extension of the duties of directors but rather to make the existing liability of the director to account for secret profits and for the diversion of corporate opportunities more effective".[70] Likewise Arden LJ acknowledged in Item Software[71] that the court in *Bhullar* and in *Industrial Development Consultants Ltd v Cooley* may have spoken of a *duty* to communicate simply to explain why a liability to account for secret profits had arisen.[72] After all, if a director finds himself in a position of conflict, "he must resolve it openly or extract himself from it".[73] If a director does nothing in a situation of conflict, if he drives past a property for sale, if he deletes a personal e-mail offering him a business opportunity, his inaction eliminates the conflict which is the law's only concern. On the other hand, if the

67 DTI, *CA 2006, Duties of Company Directors, Ministerial Statements* (June 2007) <http://www.berr.gov.uk/files/file40139.pdf> (accessed 1 September 2011), see the Introduction thereto.

68 Watts, "The Transition from Director to Competitor" [2007] 123 LQR 21 at 23. The lack of clarity is due in part to the brevity of the key passages in *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 at [40]–[44] and [60]–[66].

69 [2006] EWCA Civ 1735, [2007] FSR 437 at [41]. Here the Court of Appeal was able to deal with a disclosure dispute (whether a salesman should have disclosed to his employer that in his private time he was developing a competing product) on contractual grounds.

70 *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 at [63].

71 *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 at [40].

72 In each case, the defendant directors had found themselves in a position of conflict which they had exploited, when the no conflict duty required them to disclose the existence of the conflict and obtain the consent of their beneficiaries to their personal exploitation of the opportunity if they were to avoid a liability to account.

73 *In Plus Group Ltd v Pyke* [2002] 2 BCLC 201 at [87].

director wishes to exploit the situation, then clearly the only way is to disclose the conflict – to communicate the relevant information – to the company and seek consent.[74] Hence, there is an obligation to disclose, but as a consequence of being subject to the no conflict duty. In the cases considered above, there was a conflict of interest and disclosure can be seen in that context. In *Commonwealth Oil & Gas Co Ltd v Baxter*,[75] the director's involvement in a second company which secured an exploration agreement which his company had an interest in securing clearly placed him in a position of conflict. In *Shepherds Investments Ltd v Walters*,[76] which purported to apply *Item Software*, there was a clear basis for liability in the conflict which had arisen there between the director remaining in post while developing and selling his own directly competing products. In *Item Software*, the wrongdoing director was in a position of conflict when pursuing his own interest in securing a contract when his duty required his selfless devotion to securing the contract for his company. That was and is a sufficient basis for liability without the need for any duty to disclose his wrongdoing as an application of a duty to act in the interests of the company.

B. The scope of the business and the breadth of the no conflict rule

18 Returning to the other issue highlighted by *Bhullar*, above, namely, the breadth of the no conflict rule which rendered the directors in that case liable on an acquisition despite the lack of any connection with their directorship and despite the deadlocked company having effectively decided that it would not pursue further acquisitions. The issue is raised by that latter point, whether the scope of a company's business can be used to narrow the application of the duty. At first glance, the "scope of the business" must be relevant. If a director is to avoid a situation where there is a conflict, or possible conflict, between his personal interests and the interests of the company,[77] it must be necessary first to determine what are the company's interests which in turn must be dictated by the scope of the company's business.

74 See *Boardman v Phipps* [1967] 2 AC 46; *New Zealand Netherlands Society v Kruys* [1973] 1 WLR 1126. See Berg, "Fiduciary Duties: A Director's Duty to Disclose His Own Misconduct" [2005] 121 LQR 213 at 217.

75 [2009] CSIH 75, [2009] SLT 1123.

76 [2007] 2 BCLC 202.

77 Note that CA 2006, s 175(7) provides that "any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties".

(1) Real sensible possibility of conflict

19 As Warren J acknowledged in *Wilkinson v West Coast Capital*,[78] a company with wide objects could in theory diversify its business in limitless ways if the necessary funding is available,[79] but the range of possible conflicts, and the boundaries to the rule, were restricted at common law by the application of the much-cited "real sensible possibility" test laid down by Lord Upjohn in *Boardman v Phipps*[80] as follows:

> The phrase 'possibly may conflict' requires consideration. In my view it means that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict.

20 In statutory form, the limitation is negatively expressed in s 175(4)(*a*) so as to exclude from the ambit of the no conflict duty situations that cannot reasonably be regarded as likely to give rise to a conflict of interest, with "likely" continuing to be defined, presumably, as "a real sensible possibility",[81] so there is no change in the law. References hereafter to "possible conflict" or "not reasonably likely" should be read, respectively, in the light of and by reference to s 175(4)(*a*).[82] Obviously, much of the case law discussed below, given its vintage, refers only to a "real sensible possibility of conflict".

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78 [2007] BCC 717.

79 For a company formed under the Companies Act 2006 (c 46) (UK), unless the articles specifically restrict the objects of the company, its objects are unrestricted: s 31.

80 [1966] 2 AC 46 at 124, *per* Lord Upjohn, who dissented on the facts, echoing his earlier comments in *Boulting v Association of Cinematograph Television and Allied Technicians* [1963] 2 QB 606 at 638, [1963] 1 All ER 716 at 730: "It [the no conflict rule] must be applied realistically to a state of affairs which discloses a real conflict of duty and interest and not to some theoretical or rhetorical conflict." This boundary limitation has been consistently applied by the courts, see, for example, *Commonwealth Oil & Gas Co Ltd v Baxter* [2009] CSIH 75, [2009] SLT 1123 at [3] (real, not fanciful, possibilities are in contemplation); *Bhullar v Bhullar* [2003] 2 BCLC 241 at [30]; *Re Dominion International Group plc (No 2)* [1996] 1 BCLC 572 at 597.

81 See, *eg*, *Eastford Ltd v Gillespie* [2010] CSIH 12 at [7] and [11].

82 The positioning of the "not reasonably *etc*" requirement is somewhat odd. It might have been expected that, as the boundary of the duty, which is how it operated at common law, it would have been included within s 175(1). Placing it in s 175(4)(*a*), alongside s 175(4)(*b*) – authorisation of conflicts by directors – might conceivably suggest a change in role and in the burden of proof, *ie*, that a director whom it is alleged is in breach of the no conflict obligation in s 175(1) might defend a claim on either of the grounds in s 175(4), either because the situation could not reasonably be regarded as likely to give rise to a conflict or that the

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21 This "real sensible possibility"/"not reasonably likely" criterion is the only boundary to the apparently limitless no conflict rule.[83] Apparently limitless because the range of activities in which a modern company might have an interest is practically limitless. There are its current activities, possibly its past activities if it might still have an interest in reverting to them, its likely or possible activities if all goes to plan and even the activities it has not yet thought of, but in which it might well have an economic interest in certain circumstances. To what extent of these interests should the protection of the no conflict duty extend? On the director's side, conflict situations may range from direct competition with the company in a clear situation of conflict to indirect interests in activities at the outer range of the company's interests. To what extent should the director's activities be restricted? A balance must be found between providing corporate protection without excessively impacting on the entrepreneurial freedoms of the director to pursue other opportunities and use his skills to their utmost,[84] and the scope of the business must be central to finding this balance. The business should be protected, but only to the extent of its scope and, *vice versa*, a director should be able to pursue his interests so long as they do not fall within the scope of the company's business. The definition of "scope" is then crucial.[85]

22 Yet there is surprisingly little discussion of scope in the cases. This may be because in so many of the cases, the conflict of interest is very evident. The cases are self-selecting, after all, as companies will not sue in respect of situations or opportunities in which they had no interest so we have few reported unsuccessful claims (*Wilkinson v West Coast Capital*[86] is one and is discussed below) to provide parameters against which to measure the successful claimants.[87] The majority of

exploitation of the conflict had in fact been authorised; and see *Lee Panavision Ltd v Lee Lighting Ltd* [1991] BCLC 575 at 581. But, other than the peculiar positioning, there is nothing to indicate that the role of this limitation has altered from the common law position.

83 See *Commonwealth Oil & Gas Co Ltd v Baxter* [2009] CSIH 75, [2009] SLT 1123 at [78].

84 See *Foster Bryant Surveying Ltd v Bryant* [2007] 2 BCLC 239 at 266, *per* Rix LJ.

85 Kershaw, "Does it matter how the law thinks about corporate opportunities?" (2005) 25 *Legal Studies* 533 at 555–557, suggests various limitations to the scope of a business such as restricting the company's protection to any opportunity with a positive net-present value or to activities with a synergy with existing activities or to activities in the business area of the company, which illustrates the difficulty in providing any greater definitional clarity for the opportunistic director. See also Prentice & Payne, "The Corporate Opportunity Doctrine" (2004) 120 LQR 198 at 201–202 (suggesting that anything of economic value to the company could be seen as potentially within the company's line of business).

86 [2007] BCC 717.

87 *In Plus Group Ltd v Pyke* [2002] 2 BCLC 201 (CA) and *Foster Bryant Surveying Ltd v Bryant* [2007] 2 BCLC 239 (CA) are two other examples, but the facts of these cases are exceptional – essentially the directors had been so excluded/forced to resign as

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cases are straightforward claims where the director or former director has secured for himself a contract which the company is or was pursuing, often in circumstances where the director was negotiating on the company's behalf.[88] Many involve situations where a director in post solicits customers or develops products or plans for a competing business which he is in the process of setting up or already carrying on.[89] A few such as *Commonwealth Oil & Gas Co Ltd v Baxter*[90] are slightly more problematic and so there is some discussion of scope. In this case, the company's business[91] lay in onshore oil and gas exploration in Azerbaijan and it was anxious to secure additional opportunities of that nature to which end it needed to secure the agreement of the Azerbaijan authorities, especially of a body called SOCAR. The director secured an agreement concerning possible offshore exploration with SOCAR for another company of which he was an officer and significant shareholder. He did not inform the company of the possibility of securing this agreement, considering that it had no interest in offshore activities which it had never undertaken. The court found that the company probably would have been interested, given its desire to secure new opportunities and develop a relationship with SOCAR, had it known the detail of the situation – the site was offshore but in shallow water, it was in an established oilfield and SOCAR was disposed to grant an exclusive agreement to negotiate with respect to the project.[92] In those circumstances, the court said, a reasonable man in the director's position would have known that such an agreement with SOCAR would have been of interest to the company and the director was in breach of the no conflict rule. In effect, offshore exploration, though not within the company's past or current interests, was sufficiently proximate to the fundamental nature of its activities to fall within the scope of the company's business.[93]

directors that the court concluded there was no conflict of interest since their duties to their companies had effectively ended some time previously.

88 Examples would include *Kingsley IT Consulting Ltd v McIntosh* [2006] BCC 875; *Quarter Master UK Ltd v Pyke* [2005] 1 BCLC 245; *Crown Dilmun v Sutton* [2004] 1 BCLC 468; *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704; *Item Software (UK) Ltd v Fashihi* [2005] 2 BCLC 91; *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162; *Cook v Deeks* [1916] 1 AC 554, PC.

89 Examples would include *Shepherd Investments Ltd v Walters* [2007] 2 BCLC 202; *Simtel Communications Ltd v Rebak* [2006] 2 BCLC 571; *British Midland Tool Ltd v Midland International Tooling Ltd* [2003] 2 BCLC 523.

90 [2009] CSIH 75, [2009] SLT 1123.

91 In fact, the company was a wholly owned subsidiary within a group and the court noted that they tended to ignore the separate legal entities, but nothing turns on that: *Commonwealth Oil & Gas Co Ltd v Baxter* [2009] CSIH 75, [2009] SLT 1123 at [64].

92 *Commonwealth Oil & Gas Co Ltd v Baxter* [2009] CSIH 75, [2009] SLT 1123 at [55]–[58].

93 The director was not in breach of the no profit rule as the opportunity to negotiate with SOCAR for this offshore project had not come to him by virtue of his office as director nor had he used any contacts, knowledge or expertise acquired as director

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23 The case illustrates the strong version of the no conflict rule favoured by the courts. Adopting an open-ended no conflict duty, taking a generous view of the company's interests, eliminating only those situations which are not reasonably likely to give rise to a conflict and attaching less significance to the actual scope of the company's business has various advantages. It creates a bright-line duty which can be clearly articulated. As Lord Upjohn said,[94] "the whole of the law is laid down in the fundamental principle exemplified in Lord Cranworth's statement [in *Aberdeen Railway Co v Blakie Bros*[95]]". It maximises the protection afforded to the company, reinforcing the intended deterrent effect of the rule through the rigour and harshness of its application.[96] Consequentially, as explained above, directors anxious to avoid liability for their personal exploitation of the situation must disclose possible conflicts to the boardroom and seek the consent of the company, and the wider the duty, the wider the obligation of disclosure. Overall, the courts are content to approach the issue in a very fact-specific way, leaving each circumstance to be looked at to determine whether there is a real sensible possibility of conflict, usually followed by the customary recitation as to the strictness with which these equitable principles apply.

24 Against this background, two recent cases merit more detailed consideration. Both cases were decided on the application of the equitable principles rather than the statutory provisions which came into force only on 1 October 2007.

(2) Impossibility of conflict

25 The first, *Wilkinson v West Coast Capital*[97] ("Wilkinson"), involved a dispute as to whether a company could have an interest in an opportunity which its constitution prevented it from pursuing. In this case, it was alleged that two of the directors of a company had acted in breach of their duties when they acquired another business on their own account rather than on account of the company.[98] There was a

of the company. He had learnt of the opportunity through someone whom he had worked with previously, see *Commonwealth Oil & Gas Co Ltd v Baxter* [2009] CSIH 75, [2009] SLT 1123 at [63].

94 *Boardman v Phipps* [1967] 2 AC 46 at 125.

95 (1854) 1 Macq 461 at 471, cited above, see para 5 of this article.

96 One might think the outcome in *Bhullar v Bhullar* unfair, see [2003] 2 BCLC 241 at [22]; and Lord Upjohn in *Boardman v Phipps* made it clear that he found the outcome of that case unfair – the unreasonable and inequitable application of principle, see [1967] 2 AC 46 at 133–134.

97 [2007] BCC 717.

98 The issue arose in the context of a shareholder's petition under Companies Act 1985 (c 6) (UK) s 459 (now Companies Act 2006 (c 46) s 994) alleging unfairly prejudicial conduct.

shareholders' agreement to which all (including the company) were party whereby the consent of 65% of the shareholders was required for any further acquisitions by the company. The two directors owned 50% of the shares and, as shareholders, were opposed to the company acquiring any further businesses.

26 Warren J held that, in these circumstances, where as shareholders, the shareholder-directors were in a position to block any further acquisitions by the company, there was no possibility of the company having an interest in the acquisition.[99] When the two directors took the opportunity personally, therefore, there was no conflict of interest to which the rule could apply. Further, as the opportunity had not come to the two directors by reason of and in the course of their office, there was no breach of the no profit rule either. Warren J considered that the position of a non-shareholder director would have been different[100] and the no conflict rule would have applied, presumably because, for that director, there still would be a possible conflict[101] and, if he wanted to exploit the situation, that director would need the informed consent of the company.[102]

27 The narrowness of the *ratio* in *Wilkinson* must be appreciated. The only reason the acquisition did not give rise to a conflict in the case of the shareholder directors was that the shareholders' agreement made it *impossible* for the company to be interested in the opportunity without their consent which they knew they would withhold. In this way there was no chance of there being a real sensible possibility of conflict. The case can only be of general significance if others are in a position to generate impossibility in this way. Clearly a shareholders' agreement as in *Wilkinson* can be used to achieve this result. A tightly drawn restriction on activities set out in the articles would not suffice, given articles can be changed, unless, perhaps, a shareholders' voting agreement ensured that the votes to alter them could not be obtained so allowing shareholder directors in the manner of *Wilkinson* to maintain the restrictions on the scope of the company's business. A statutory prohibition on activities, which might be relevant in some regulated

99 It was the impossibility of the trust acquiring the shares in *Boardman v Phipps* [1967] 2 AC 46 which so persuaded the minority in that case that there was no liability to account when the fiduciaries acquired the shares in question (see Lord Upjohn, at 119, "of cardinal importance"; Viscount Dilhorne, at 88, 89 and 92, trustee was clear that he would not support the trust acquiring any shares under any circumstances), but the majority favoured liability on the basis of breach of the no profit rule.

100 See *Wilkinson v West Coast Capital* [2007] BCC 717 at [301]–[303].

101 The shareholders' agreement might be flawed, the shareholders might abandon it, the company might see the merits of diversification, *etc*. The non-shareholder director in that situation could not be sure what attitude the shareholders, and therefore the company, might take to further acquisitions.

102 *Wilkinson v West Coast Capital* [2007] BCC 717 at [302].

industries, would suffice since there is no real sensible possibility of conflict in a situation where the company is prohibited by statute from having an interest.

28 It is important to distinguish the legal or structural impossibility which arose in *Wilkinson* from the type of transactional issues which may raise a question mark over whether the company "could or would or might" as a matter of business pursue an opportunity. These transactional issues, which typically concern the availability of finance, the strategic desirability or otherwise of taking the opportunity, or whether the other contracting party would in fact do business with the company,[103] have always been irrelevant to the application of the no conflict duty, as s 175(2) makes clear, for it would involve the court in an analysis of business considerations which are open to manipulation by interested directors.[104] Rather, the duty must be applied objectively by asking whether the opportunity is one in which the company has an interest such that a conflict or possible conflict may arise. In that objective analysis, a structural impediment of the kind found in *Wilkinson* will be relevant and will limit the application of the duty.

(3) Theoretical scope or real scope? No conflict and/or no profit?

29 The second case to consider is *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan*[105] ("*O'Donnell v Shanahan*") where Richard Sheldon QC (sitting as a Deputy Judge, hereafter Sheldon QC) favoured, though the Court of Appeal did not, a more pragmatic assessment of what is a "possible" conflict looking in greater detail at what the company is actually doing rather than what might conceivably be possible. The Court of Appeal also approached the case more on no profit rule terms than no conflict which raises the issue of the relationship between the two strands of the duty of loyalty. A degree of detail is necessary to aid our discussions.

30 In April 1999, one of the two respondent directors, Shanahan, was approached by a vendor to find a purchaser for a particular property.[106] A buyer was quickly found from amongst the company's

103 See, *eg*, *Bhullar v Bhullar* [2003] 2 BCLC 241 (acquisitions not within company strategy); *Crown Dilmun v Sutton* [2004] 1 BCLC 468 (company had financial difficulties); *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443, [1972] 2 All ER 162 (third party would not deal with the company).

104 *Parker v McKenna* (1874) LR 10 Ch App 96 at 118 and 124–125.

105 [2009] 2 BCLC 666, reversing [2009] 1 BCLC 328.

106 While there were two respondents, the court found that practically all the dealings were conducted by Shanahan, but no case was made that any distinction should be drawn between the two respondents: *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [52].

clients on a basis that included the payment of £30,000 commission to the company. The company obtained a valuation report on the property and put forward proposals for bank financing on behalf of the purchaser. The valuation report suggested that the property would be an attractive investment and at least one bank indicated a willingness to fund the acquisition.

31 The first would-be purchaser then unexpectedly withdrew and the directors scrambled to find another purchaser before the vendor too withdrew. Almost immediately they did find a second purchaser, also a client of the company, but he was only willing to proceed on the basis, which they agreed to, that he would share the deal 50/50 with the two respondent directors and that he would not pay a commission to the company.[107] The court found that the third director knew of the two directors' involvement in this way in the second deal within a short time of their agreeing to participate in it.[108] The second deal proceeded to completion. Subsequently, the two respondent directors paid £9,000 to the third director to compensate (approximately) for the company's loss of commission.[109] The court found, as a fact, that had the opportunity of being involved in the acquisition of the property been presented to the company, the company would not have been willing or able to accept the opportunity.[110] Years later, in November 2006, in the context of an unfairly prejudicial petition by the third director/shareholder,[111] the issue arose as to whether the acquisition of a 50% stake in the property by the two directors was in breach of their duties to the company. At first instance, the court found no breach of the no conflict rule or of the no profit rule, but, on appeal, the decision was reversed on both grounds.[112]

107 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [23]–[24].

108 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [32]. The company was a quasi-partnership formed originally between four individuals, but subsequently involving only these three shareholder/directors, each holding 2,525 shares; the fourth shareholder retained 25 shares but had left the business many year earlier. Given the third shareholder/director's knowledge and implicit assent at this stage, it was unfortunate that the two respondents had not sought her formal assent to their acquisition which, the evidence suggests, they could have obtained at that stage. It was only later that the parties fell out.

109 Had the company received a £30,000 commission, it would have been divided equally between the three directors/shareholders as was their custom.

110 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [35].

111 Under Companies Act 1985 (c 6) (UK) s 459, now Companies Act 2006 (c 46) s 994.

112 It may be felt that the result here was unfair. The company would not have taken the opportunity, if it had been offered; at most the company lost a commission on the deal which would have been divided between the three directors and the third director was paid her share of that missed commission; she knew all along that the

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32 At first instance, on the application of the no conflict rule, Sheldon QC considered that there could not be a real sensible possibility of conflict in the circumstances because the company's business was the provision of financial advice and assistance, and though property investment could have fallen within its open-ended objects, actually it was not within the scope of the company's business, a point confirmed by the fact that the respondent directors had a separate property investment company of which no complaint had been made by the third director.[113] Sheldon QC considered that, in deciding whether there is a "real sensible possibility of conflict", it was right to look at the inherent likelihood in fact of the company extending its existing scope of business into areas of business which might give rise to a conflict. In his view, there was no breach of the no conflict rule here, for property investment was not within the company's existing or extended scope of business and there was no realistic prospect that the company would have diversified into property investment.[114]

33 As for the no profit rule, given the scope of the company's business did not extend to property investment, the directors' acquisition did not place them in breach of the rule. While knowledge of the opportunity and information relating to it (*ie*, the financing and valuation reports) did come to the directors in their capacity as directors, in Sheldon QC's view, as the information related to something outside the scope of the company's business, their use of the information could not have been a breach of the no profit rule.[115] Sheldon QC did acknowledge, however, that the authorities suggested that "there is a powerful argument that a director who misuses such information which he has acquired in his capacity as a director should be held strictly liable, even if used for purposes outside the scope of the company's business".[116] As we shall see, the Court of Appeal preferred that strict liability.

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defendants had their own property investment company and she knew almost immediately of their involvement in the 1999 transaction which they conducted largely in front of her.

113 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 1 BCLC 328 at [208]. He did take into account that the company had branched (in the very transaction under scrutiny) into estate agency, but that was some way removed, he said, from contemplating property investment by the company itself.

114 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 1 BCLC 328 at [212].

115 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 1 BCLC 328 at [220]–[225]; if there was any breach of duty arising from the misuse of these reports by the directors, Sheldon QC thought it was with respect to the first would-be purchaser rather than the company, at [229].

116 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 1 BCLC 328 at [226].

34 On appeal, Rimer LJ (with whom Waller and Aikens LJJ agreed) gave the sole judgment, most of which is devoted to the no profit rule rather than the no conflict rule.[117] First, the Court of Appeal firmly rejected the lower court's reliance on *Aas v Benham*,[118] an authority sometimes cited in this context,[119] which decision the court said was specifically restricted to partnerships where the scope of the partnership and a partner's fiduciary duties are determined and circumscribed by the partnership agreement.[120] For that reason, Rimer LJ said, that case is of no relevance in considering the extent and application of the "no profit" and "no conflict" rules so far as they apply to fiduciaries such as trustees and directors who occupy a position and are subject to duties akin to a general trusteeship.[121] Having clarified that point, Rimer LJ went on to note that "the scope of the company's business was in no manner relevantly circumscribed by its constitution".[122] While the company's business initially was the provision of financial advice and assistance, it had diversified into a variety of property and investment roles.[123] In the acquisition at issue, it acted essentially as an estate agent, something which it had not done previously and which, the court thought, indicated that its categories of activities were not closed.[124] The court was not willing then to limit the scope of the company's interests by reference to what it was actually doing. It went on to find that in failing to secure a commission for the company on the second deal in which the respondents participated, they had preferred their own interests to the company's interests in breach of the no conflict rule.[125]

117 Though, as is typical in these judgments, the two strands are interwoven somewhat despite the use of "no profit" and "no conflict" headings.

118 [1891] 2 Ch 244.

119 See *Wilkinson v West Coast Capital* [2007] BCC 717 at [274] and [284]; *Boardman v Phipps* [1967] 2 AC 46 at 90, 110 and 117.

120 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [68]. See too Warren J in *Wilkinson v West Coast Capital* [2007] BCC 717 at [284].

121 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [67]–[69].

122 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [69], possibly an allusion to *Wilkinson v West Coast Capital* [2007] BCC 717.

123 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [5]–[7] (its activities included arranging the purchase and sale of properties, acting as agents for banks and building societies, placing investments for clients, and providing advice on financial and business restructuring).

124 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [53]; "there was no bright line marking off what it did and did not do", at [71].

125 Despite finding that the company's interests were not closed, and despite noting that the "opportunity led the respondents straight into a breach of the no conflict rule", see *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [54], which might have led to the conclusion that taking the opportunity was itself a breach of the no conflict rule, the court limited its finding

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35 As for the no profit rule, the opportunity to acquire the property came to the directors' attention in their capacity as directors of the company acting on the company's business and the information which they relied on in deciding to participate in the acquisition (the bank financing and valuation reports) was also obtained in the course of so acting.[126] The situation justified the straightforward application of the no profit rule, as exemplified by *Regal (Hastings) Ltd v Gulliver*[127] ("*Regal*"). The opportunity, Rimer LJ said, led the respondents straight into a breach of the no conflict rule and taking the opportunity personally made them liable to account under the no profit rule when their proper course should have been to obtain the company's consent to their private venture.[128]

36 Rimer LJ rejected any proposition that the no profit rule did not apply because the acquisition was of a nature outside the scope of the company's business. He said: "The statements of principle in the authorities about directors' fiduciary duties make it clear that any inquiry as to whether the company could, would, or might have taken up the opportunity itself is irrelevant; so also, therefore, must be a 'scope of business' inquiry."[129] Once that inquiry is dispensed with, the court said it was left with a clear breach of the no profit rule where, in the course of acting as directors on behalf of the company, the respondents obtained information relating to the virtue of the property as an investment and were given the opportunity of personally sharing in the opportunity of purchasing it.[130] As is customary, Rimer LJ stressed the rigour with which the no profit rule is applied,[131] citing the well-known decisions in *Parker v McKenna*,[132] *Furs Ltd v Tomkies*[133] and, in relation to *Regal*,[134] the famous dictum by Lord Russell that:

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on the no conflict rule to the directors' failure to secure a commission for the company, see at [75].

126 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [52], [54] and [60].

127 [1942] 1 All ER 378, HL.

128 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [60].

129 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [70]. Rimer J must be talking here about the no profit rule alone, despite his reference to "directors' fiduciary duties", for there is no doubt that the scope of the business and therefore the company's interests are relevant to the no conflict rule, as discussed above.

130 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [71].

131 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [56]–[58].

132 (1874) LR 10 Ch App 96.

133 (1936) 54 CLR 583.

134 *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 at 144–145, [1942] 1 All ER 378 at 386.

> The rule of equity which insists on those, who by use of a fiduciary position make a profit, being liable to account for that profit, in no way depends on fraud, or absence of *bona fides*; or upon such questions or considerations as whether the profit would or should otherwise have gone to the plaintiff, or whether the profiteer was under a duty to obtain the source of the profit for the plaintiff, or whether he took a risk or acted as he did for the benefit of the plaintiff, or whether the plaintiff has in fact been damaged or benefited by his action. The liability arises from the mere fact of a profit having, in the stated circumstances, been made. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account.[135]

37 The Court of Appeal therefore reversed the lower court's decision, finding breaches of both the no conflict and the no profit rules.[136]

38 The different outcomes in *O'Donnell v Shanahan* as between the Court of Appeal and the lower court turn on whether a strict or more pragmatic application of the no conflict rule is required and on whether there is one rule or two. If there is only the no conflict rule and within it a prohibition on exploiting information *etc* in a situation of conflict or possible conflict, then if the no conflict rule is not engaged, logically, there is no breach of the no profit rule either. Once Sheldon QC had concluded (though erroneously as far as the Court of Appeal was concerned) that there was no breach of the no conflict rule, it followed correctly that there would equally be no breach of the no profit rule.[137] On the other hand, the Court of Appeal looked at two free-standing no conflict and no profit rules and concluded that there was a breach of each, though it is clear that the Court of Appeal would have founded liability on the basis of the no profit rule alone.[138]

C. Applying the statute – No conflict assumes centre stage

39 If we turn to look at how these cases would be decided under the statute, we can see clearly the impact of the statutory restatement of

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135 Likewise in *Bhullar v Bhullar* [2003] 2 BCLC 241 at 256, [41], "whether the company could or would have taken the opportunity, had it been aware of it, is not to the point …".

136 The case was remitted for a further hearing to determine whether the failure to account for the profit (if any) made had unfairly prejudiced the petitioner, see *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [82].

137 That Sheldon QC struggled somewhat to that conclusion was a consequence of the authorities supporting a free-standing no profit rule, see *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 1 BCLC 328 at [226].

138 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666 at [52], a "plain case" of breach of the no profit rule.

the equitable principles. Section 175(1) clearly states the no conflict rule, as discussed above, but s 175(2) is not expressed in terms which reflect the no profit rule. There is no reference to profiting by reason of and in the course of the director's office. Not only is the no profit rule no longer stated in those terms, but it is clear that the no profit rule no longer exists as a separate rule (if it ever did), rather s 175(2) places the no profit rule firmly as a subset of the no conflict rule.[139] Under the statute, there is only a prohibition on the exploitation of property, information or opportunity in circumstances in which there is a conflict or possible conflict of interests, whereas, at common law, as noted above, it was possible for a director to fall within the non-profit rule where he profited in the course of and by reason of his fiduciary position, though there was no breach of the no conflict rule. In future, directors profiting by reason of their fiduciary office in circumstances in which there is no conflict of interest will not be liable to account as the no profit rule will no longer apply in those circumstances.[140] There is no stand alone no profit rule.

40 This is a significant clarification of the law and an effective resolution of the rumblings of uncertainty as to whether there are two rules or one, noted above. Only in the post-resignation scenario does the no profit rule alone remain relevant since there can be no question of conflict in that situation.[141] At common law, a former director was always restrained from exploiting information or opportunities arising from his previous position where his resignation was motivated by a desire to obtain or exploit those opportunities.[142] Section 170(2)(*a*) confirms that this post-resignation liability continues and links it explicitly to "the duty" in s 175, so confirming that the liability arises from the exploitation of a prior conflict, specifically "the exploitation of property, information or opportunity of which the director became aware at a time when he was a director".[143] There is therefore a uniform

139 To recap, Companies Act 2006 (c 46) (UK) s 175 provides: (1) A director of a company must avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. (2) This applies in particular to the exploitation of any property, information or opportunity (and it is immaterial whether the company could take advantage of the property, information or opportunity).

140 See Kershaw, "Does it matter how the law thinks about corporate opportunities?" (2005) 25 *Legal Studies* 533 at 540, allowing a director to profit in circumstances where there is no possibility of conflict would shrink the no profit rule back from an over-inclusive application.

141 See *CMS Dolphin Ltd v Simonet* [2001] 2 BCLC 704 at [96]; *Quarter Master (UK) Ltd v Pyke* [2005] 1 BCLC 245 at [57].

142 *CMS Dolphin v Simonet* [2001] 2 BCLC 704 at [96].

143 Companies Act 2006 (c 46) (UK) s 170(2) provides that: "[A] person who ceases to be a director continues to be subject – (a) to the duty in section 175 (duty to avoid conflicts of interest) as regards the exploitation of any property, information or opportunity of which he became aware at a time when he was a director, and (b) to

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basis for liability, whether in post or following resignation, and the basis for liability is a conflict of interest. This clarification is very welcome and should help with the development of a more coherent body of law on this core fiduciary duty. Whether it creates a lacuna in the law by abolishing any stand alone no profit rule depends on the width of the category of case where there could be a breach of the no profit rule without breach of the no conflict rule, for which there would now be no liability under the statute.[144] If the courts continue to favour a strict no conflict rule, there may be little scope for evasion by directors as situations which might previously have been classified as no profit situations may be capable of reclassification as no conflict situations and therefore the directors would still be liable. It is certainly possibly to reclassify *Regal* as a conflict case, indeed Lord Upjohn thought it an obvious case of conflict, "the scheme had been that *Regal* would make a profit – in fact its directors did".[145] Were the facts in *Regal* to recur, the directors would still be liable but their liability would not be expressed as based on profiting by reason of and in the course of the execution of their duties as directors, but rather as being imposed by reason of their exploitation of a situation in which their interests conflicted with the interests of the company contrary to s 175(1). *Regal* remains a valuable authority, particularly on the irrelevance of "would, could, should" issues once a conflict exists, but the (constraining) terminology of "profiting by reason of and in the course of" *etc* has been cast aside.[146] The question to be asked now is the simple question from s 175(1), is the director in a position of conflict or possible conflict?

41 As for the outcome in the cases were the statute to apply, let us see. In *Wilkinson*, the impossibility of the company making the acquisition meant that there was no conflict of interest and no liability at common law and the outcome on no conflict would be the same under the statute. In *Wilkinson*, Warren J went on to admit to some uncertainty as to whether, despite the fact that there was no conflict of

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the duty in section 176 (duty not to accept benefits from third parties) as regards things done or omitted by him before he ceased to be a director. To that extent those duties apply to a former director as to a director, subject to any necessary adaptations."

144 Of course, as most cases involve breaches of the no conflict and no profit rule, there will be no change in directors' liability in most circumstances.

145 *Boardman v Phipps* [1967] 2 AC 46 at 124; and see Kershaw, "Does it matter how the law thinks about corporate opportunities?" (2005) 25 *Legal Studies* 533 at 539–540 ("the shadow of potential conflict hangs over the decision in *Regal*").

146 Likewise the concept of "maturing business opportunities", which was always somewhat underdeveloped and of uncertain standing as a distinct corpus of law in the UK, remains of significance only in that context, of helping identify whether there is a possible conflict, which is admittedly, as Kershaw notes, "Does it matter how the law thinks about corporate opportunities?" (2005) 25 *Legal Studies* 533 at 543–544, how it was generally used in any event; *Bhullar v Bhullar* [2003] 2 BCLC 241 signalled its demise which the statute confirms.

interest, the directors might still have been potentially liable for profiting from their position.[147] The statute resolves that uncertainty. If there is no conflict or possible conflict, and the information is not confidential to the company, there is no liability even if the opportunity comes to the directors in the course of their office.[148] That result is entirely rational and can be justified in policy terms – in the absence of any confidentiality and possible conflict, there is no reason to protect the company and restrict the directors.

42 As for *O'Donnell v Shanahan*, the outcome would be the same given the Court of Appeal concluded there was a conflict of interest so the directors would be liable for breach of duty under s 175(1) but the judgment would be recast in the light of the statute which lends itself to a much simpler analysis. The focus on the no profit rule ceases and there is no longer any need for an extensive discussion of whether the information *etc* was acquired by the directors by reason of and in the course of the execution of their office. The only issue is whether there was a conflict or possible conflict within s 175(1). The Court of Appeal concluded there was and so, under the statute, the directors would still be liable. The real change in the law will only come if the courts were to move from the strict approach evident in the cases to the approach to the no conflict rule and the issue of scope adopted by Sheldon QC as discussed below.

IV. Conclusions

43 Sections 175(1) and 175(2) bring a clear bright-line approach to the no conflict rule, returning to the core principle laid down in *Aberdeen Rly Co v Blaikie Bros*.[149] A director need only ask himself whether a reasonable man looking at all the facts would conclude that

147 See *Wilkinson v West Coast Capital* [2007] BCC 717 at [309]–[312]. Warren J was able to avoid answering that question since there the opportunity to make the acquisition did not come to the directors in their capacity as directors, but he thought there would have been a real issue as to whether the directors were in breach of the no profit rule (by using some company staff and resources to facilitate their acquisition) had a profit been made or a loss suffered by the company, so clearly he did see scope for the application of the no profit rule in circumstances where the no conflict rule did not apply.

148 See Lord Upjohn in *Boardman v Phipps* [1967] 2 AC 46 at 128–129 who had reached this conclusion almost half a century ago, noting that the real rule, as he put it, is that knowledge learnt by a trustee (a director in our context) in the course of his duties as such in general may be used for his own benefit or the benefit of others unless it is confidential information given to him in a fiduciary capacity and its use would place him in a position where his duty and his interest might possibly conflict.

149 To that extent, it meets the goals of accessibility which was one of the main aims of putting a statement of directors' duties in the Companies Act 2006 (c 46) (UK), see Hannigan, *Company Law* (Oxford University Press, 2nd Ed, 2009) ch 7.

there is a real sensible possibility of a conflict or possible conflict between the director's personal interests and the interests of the company.[150] Limiting the application of the no profit rule, and the protection of the company, to cases where there is a conflict or possible conflict is a more balanced approach than the previous position and avoids the risk, as Lord Upjohn commented in *Boardman v Phipps*,[151] of fiduciaries being held accountable through the unreasonable and inequitable application of equitable principles. This return to first principles in ss 175(1) and 175(2) may be seen as a step towards bringing greater coherence and clarity to fiduciary duties in the corporate context,[152] but equally the discussion above highlights a number of uncertainties which have not been addressed by the statute and which remain to be resolved. In tackling these issues as they arise in litigation, it is for the courts to build a more coherent doctrine using the statutory framework.

44 For directors, the problem is less one of understanding the basic parameters of the no conflict rule than of anticipating the breadth of the duty when strictly applied by the courts. This is particularly true when directors' perception of the scope of the company's interests is compared with the court's interpretation, as in cases such as *O'Donnell v Shanahan* or in *Commonwealth Oil and Gas Co v Baxter*. A company which advises on property and financial investments may have an interest in acquiring investment property though it has never done so[153] and an onshore oil company which has never explored offshore may have an interest in offshore contracts.[154] A strict approach means that many proximate opportunities, even though the company would not or could not pursue them, may give rise to possible conflicts of interests which will bring the director within the prohibition in s 175(1). This is where Sheldon QC's approach in *O'Donnell v Shanahan*,[155] which essentially echoes the dissent of Lord Upjohn in *Boardman v Phipps*,[156] would have made a difference had it been endorsed by the Court of Appeal and maybe it

150 See generally Hannigan, *Company Law* (Oxford University Press, 2nd Ed, 2009) ch 7.

151 [1967] 2 AC 46 at 133–134.

152 See Flannigan, "Fiduciary Duties of Shareholders and Directors" [2004] JBL 277 and "The Adulteration of Fiduciary Doctrine in Corporate Law" (2006) 122 LQR 449 who argues cogently for a reduction in obtuseness and the need for a return to clarity and certainty in the application of the core fiduciary obligations of no conflict and no profit.

153 *Re Allied Business and Financial Consultants Ltd, O'Donnell v Shanahan* [2009] 2 BCLC 666. A fashion company may have an interest in the distribution of farm machinery, if the board is actively considering diversification, an example given by Warren J in *Wilkinson v West Coast Capital* [2007] BCC 717 at [253].

154 As in *Commonwealth Oil and Gas Co v Baxter* [2009] CSIH 75, [2009] SLT 1123.

155 *Re Allied Business and Financial Consultants Ltd* [2009] 1 BCLC 328, reversed [2009] 2 BCLC 666 (CA).

156 [1967] 2 AC 46 at 118.

should have been. It requires a more precise analysis of whether there is a real conflict as opposed to a real possible conflict before finding the director in breach of duty.

45 Arguably, a less expansive no conflict rule would be more consistent also with the relaxation evident in s 175(4)(*b*) which for the first time allows disinterested directors (who remain bound, of course, by their general duties) to authorise conflicts of interest.[157] The director in question and any other "interested director" (not defined) is not counted toward the quorum and the matter must be agreed to without their voting or it would have been agreed to if their votes had not been counted.[158] The justifications suggested by the Company Law Review (which preceded the reforms in the CA 2006) for permitting director authorisation included that the alternative common law requirement of shareholder approval is impractical and onerous; it is for the board to make business assessments (while acknowledging the possibility of board collusion); and restricting directors may stifle entrepreneurial activity.[159] The Review concluded that allowing independent board approval would "strike the right balance between … encouraging efficient business operations and the take-up of new business opportunities … and providing effective protection against abuse".[160] The Government agreed that it was important that the no conflict duty did not "impose impractical and onerous requirements which stifle entrepreneurial activity".[161] It remains to be seen what impact, if any, this relaxation will have on directors' behaviour, especially in private companies where the issues surrounding directors' opportunistic conduct tend to be most acute and where, under the statute, the position of minority shareholders may have worsened as they are exposed to some risk of collusive, and undetectable, arrangements between conflicted directors and "disinterested" directors.[162] Unfortunately, it will be difficult even to gauge the extent to which use is

157 Authorisation may be given by the directors, where the company is a private company and nothing in the company's constitution invalidates such authorisation, by the matter being proposed to and authorised by the directors; or where the company is a public company and its constitution includes provision enabling the directors to authorise the matter, by the matter being proposed to and authorised by them in accordance with the constitution: CA 2006, s 175(5).

158 Companies Act 2006 (c 46) (UK) s 175(6). These requirements may mean that in some small private companies, it may not be possible to find enough disinterested directors capable of forming a quorum or voting and so authorisation by the directors may not be possible.

159 Company Law Review, *Final Report*, vol 1 (2001) para 3.23. As to the Company Law Review, see n 1 above.

160 Company Law Review, *Final Report*, vol 1 (2001) para 3.27.

161 DTI, Company Law Reform (2005), Cm 6456, para 3.3.

162 For a more detailed discussion of the issues raised by authorisation by the directors, see Hannigan, *Company Law* (Oxford University Press, 2nd Ed, 2009) at pp 260–268.

made of this procedure for a singular omission from s 175 is any requirement for the disclosure of authorisations sought and granted.

46 Of course, the case law to date by and large reflects the application of the equitable principles as the statutory provisions have commenced too recently (1 October 2007) for much litigation to have worked its way through the system, especially to the higher courts. It may be the courts will alter their approach in tune with the more relaxed view of conflicts of interest evident in the statute. The Court of Appeal's emphatic and traditional approach in *O'Donnell v Shanahan* suggests otherwise, however, and it is not just in that case that the 19th century "safety of mankind" judicial approach, as famously expounded by James LJ in *Parker v McKenna*,[163] has been evident. The same type of language of strictness and rigorous application of principle can be found more recently, for example, in *Imageview Management Ltd v Jack*[164] and *Cobbetts LLP v Hodge*.[165] Perhaps the financial crisis and public concern about standards in boardrooms have provoked a judicial desire, however subconscious, to restate as firmly as possibly the fiduciary obligations of directors.

47 There may then be a certain mismatch between the statutory approach in s 175(4)(*b*) and judicial support for the rigorous application of a strict no conflict rule. Over time, the courts may find that they have fewer opportunities to apply and reinforce this fundamental fiduciary obligation as we move to a world where (supposedly) disinterested directors have authorised the conflict. Our jurisprudence would certainly be the poorer were the parameters of the no conflict rule to be removed from the court room and settled in the boardroom behind closed doors.

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163 (1874) 10 Ch App 96 at 124–125: "[I]t appears to me very important, that we should concur in laying down again and again the general principle that in this Court no agent in the course of his agency, in the matter of his agency, can be allowed to make any profit without the knowledge and consent of his principal; that that rule is an inflexible rule, and must be applied inexorably by this Court, which is not entitled, in my judgment, to receive evidence, or suggestion, or argument as to whether the principal did or did not suffer any injury in fact by reason of the dealing of the agent; for the safety of mankind requires that no agent shall be able to put his principal to the danger of such an in inquiry as that."

164 [2009] 1 BCLC 724 (CA) (emphasising the importance of maintaining high standards of conduct of agents and applying the full rigour of the law to instances of conflicts and secret profit making: "in our age it is more important than it ever was for the courts to hold the precise and firm line" drawn between open honest dealing and secret profits, see at [64], *per* Mummery LJ).

165 [2010] 1 BCLC 30 (no profit rule must be applied strictly; need to adhere to the single-minded duty of loyalty which the law imposes on a fiduciary).