

Example by StudyDriver

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Advice on Company Law Example

Structure: Analysis, Legal rules and Application Introduction and General Analysis Peter, Alan, Sarah and Paul are the four directors and shareholders of East Ltd. The majority shareholder is John. Paul is both the company's managing director and chairman. The company's articles of association are based on Table A. Paul was approached by West Ltd, which was interested in purchasing a piece of vacant land belonging to East. At a board meeting, Paul told the fellow directors that as the planning permission was unlikely to be granted whether East Limited was prepared to sell the land to West. The land was sold to West, for A£1.5 m. On completion of the sale, Paul received a bonus of A£50,000 from West, for which he informed Alan and Sarah. Last month, West asked Paul if he would like to purchase shares in West. As West's share price had recently increased in value, Paul decided to invest A£15,000 of his money in West shares. John has discovered that (i) the land sold by East to West has been developed by West and sold for A£6m and (ii) Paul's shares in West have doubled in value. **Advise John as to what action, if any, he can take on the company's behalf. The company's annual general meeting is due to be held next month**

1. Was the behaviour of Paul prejudicial to other directors and shareholder? 2. Can Paul take the bonus which resulted out of the transaction? 3. Is the fiduciary duty of Paul as a director in conflict with his personal interest? 4. Does he need consent from the company to take the shares in West Ltd? 5. Secret profit by Paul and consequent accountability 6. Remedies available for majority shareholder **Application** Under the new

proposals for “Modernising Company Law” white paper which contains important proposals with regard to a contract which a company itself is unable to accept due to the lack of resources for example, then a director may be able to take that contract personally for his own benefit. This allows directors to make full use of information, property etc which belong to the company for their own benefit without the consent of the shareholders and members provided that they obtain the authorisation from the Board of Directors to do so. The important difference here which must be noted is, in the case of private companies, the board of directors will have such powers as to authorise a director to exploit a corporate opportunity like that unless it has been expressly denied in the company’s constitution. On the other hand, in the case of Public limited companies, the board of directors will not have such powers bestowed upon them as they need authorisation from the shareholders first unless a specific provision to authorise such transaction has been made in the company’s constitution. In this scenario, Paul has notified the Board about East Limited’s interest in buying the land and the Board, although based on his instructions regarding planning permission they have agreed to sell the land to West Limited. In “CMS Dolphin Ltd v Simonet[1] it was held by Lawrence Collins J that a director was liable for breach of fiduciary duty in diverting a business opportunity from his company although the director in question had left the company. However, even after leaving the company a director’s fiduciary duties continue and therefore he may not divert business opportunities from the company or misuse information while he was acting as a director of his previous company. In this particular case the director took all the company’s staff and its main clients with him and set up in business on his own”. In Smith Stone and Knight Ltd (“SSK”) v Birmingham Corporation” (BC”)[2] a subsidiary owned by SSK carried out business activities from a piece of land owed by SSK. A compulsory purchase order was issued by BC. Compensation for loss of business was to be paid to the company and its owner. However, the subsidiary company did not own the land and so BC refused to pay any compensation. It was held that the subsidiary company was an agent of SSK and therefore BC must pay compensation.

Director’s Fiduciary Duties A director has a duty towards a variety of people who are interested in the Company such as to the company itself, to its employees, to the shareholders and to its creditors. Under the Common law a director is expected to manage the company in accordance with the Companies Act and its constitution and to exercise reasonable skill and care. A director is also expected to act bona fide in the best interest of the company. This then follows that a director is expected to avoid conflict of interest with the company and must not make any

secret profit by disclosing any interest in the contract company or whether he/she is likely to be involved and any profit or financial benefit he receives from it.[3] A director is also expected to use his powers for a proper purpose. Paul as a director of the company is in a fiduciary position and therefore must not make an undisclosed profit using his position as a director. He was only approached by East Limited because of his position as a director of the company. He must disclose this to the other directors, Peter, Alan, Sarah. The fact that West Limited was unable to purchase the land because Paul told the Board of Directors that the planning permission would not be granted and therefore could not obtain the benefit from developing that land, depends upon whether Paul had knowledge of East Limited's intentions to develop the land. It would have been better to obtain consent from the company in a General meeting to take that contract and keep the profits before actually taking the contract. It is a well established principle that there should not be a conflict between their fiduciary duties and their personal interest and they must not use the company's assets, opportunities or information without obtaining consent from the company based on full information. Furthermore, Paul would have to account for A£50,000 he received on completion of the sale of that land to the company. In *Boston Deep Sea Fishing Co v Ansell*[4] A was one of the directors of B Co and was paid a commission on the contract by the shipbuilders. A was also a shareholder of an Ice company who was supplying ice to the B Co. A received a bonus when he employed Ice Company in respect of B Co's fishing smacks. It was held that A must account to B Co for the commission and the bonus he received although B Co could not have received any bonus from the Ice company as it was not a shareholder in that company. Generally if there is a conflict between a director's personal interest or his duty to another then the court will intervene to set aside the transaction without inquiring whether there was any breach of the director's duty to the company which is an over-riding principle of equity[5] Therefore, Alan and Sarah may prevent him from taking and keeping the A£50,000 he received as a bonus on completion of the sale of the land, stating that there is a conflict of interest[6] and that this must be recorded in the minutes in detail so that there is no suspicion of secret dealings. On the other hand, they could approve his bonus payment as well as his purchase of East Limited's shares when they contacted him as he is unlikely to be classed as just another investor, by East Limited in the Annual General Meeting. According to *Profession Gower*[7] when a director makes a contract with another business in his own personal capacity [8] he would have to account for the profit he makes out of any such contract. Paul was contacted by East due to his position as a director in West and therefore he was able to

buy shares in East. It would be difficult for him to argue that he invested A£15,000 of his own money as a private investor mainly because East is not a PLC and therefore its shares are not available for the public and being a limited company its shares are only marketed privately. Therefore any profit he makes out of those shares he will have to account for it. **Advice and Remedies** i) It is possible to ratify unauthorised transaction by passing an ordinary resolution at a General Meeting and it cannot be just by the Board of Directors[9]. In order to avoid the injustice due to the absolutist nature of fiduciary duties Paul may seek relief from the court if the court believes that he had acted honestly and reasonably. With regards to his bonus of A£50,000 which he told two of the directors about, this establishes that he has acted honestly and reasonably however it would not be the case with regards to his purchase of shares in East. John as a majority shareholder can motion for the removal of Paul as a director of the Company. Any director can be removed from their office by an ordinary resolution of the members.[10] Therefore, in order to remove Paul as a director of the company a resolution in general meeting with a simple majority is needed and this applies notwithstanding the contrary provisions in the company's Articles. The procedure for removal of a director is set in section 303 of the Act, which provides for an ordinary resolution, that is, by majority of votes in the general meeting a director can be removed from his or her office. However, if the directors are the major shareholders then the minority shareholders have very limited rights to object the way the majority directors are running the affairs of the company. If the director is removed from the office it terminates any service contract it may have with the company. The amount of damages the director may be able to claim usually depends up on the remuneration package under his contract with the company.

Bibliography and References 1. Business Law and Practice by Scott Slorach & Jason Ellis published by Blackstone press. 2. Business Law by Stephen Judge, second edition published by Macmillan law masters. 3. Company Law, by Charles worth & Morse 16th Edition published by Thomson, Sweet & Maxwell. 4. Gower & Davies' Principles of Modern Company Law 7th Edition, by Paul L Davies published by Thomson, Sweet & Maxwell 5. www.Nortonrose.com/articles 6. Department of Trade & Industry web site: Modernising Company law White paper 7. Company Law by Janet Dine, Macmillan Law Masters, and third edition 8. Lifting the Corporate Veil by Neil Chandler www.exchangechambers.co.uk 9. Pennington's Company Law, 8th edition published by Buttersworths 1

Footnotes

[1] 2002 BCC 600; [2001] 2 **B C L C 704** Ch D Gower and Davies' **Principles of Modern Company Law**, 7th Edition, **page 422** [2] [1939] 4 All ER 116, Gower and Davies' **Principles of Modern Company Law**, 7th Edition, page 182 [3] Section 317, 320 and 330 of the Companies Act 1985. [4] 1888 ch D 339 CA, **Company Law**, by Charles worth & Morse page 275-276 [5] Vinelott J, **Movitex Ltd v Bulfield** (1988) page 183 **Company Law** by Douglas smith. [6] Section 317 Companies Act 1985 [7] page 184 **Company Law** by Douglas smith [8] **Aberdeen Railway co v Blaikie Bros** (1874) **Company Law** by Douglas smith page 184 [9] **Hogg v Cramphorn** (1967) **Company Law** by Douglas smith page 187 [10] Section 303 Companies Act 1985: