Companies Act 2006 (UK): A new approach to directors' duties

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The United Kingdom has enacted its first codified statement of the duties of directors in the Companies Act 2006 (UK). This article explains the thinking behind this statutory statement and points out that it reflects the "enlightened shareholder" model of directors' duties. This means that directors must promote to the success of the company for the benefit of its members, rather than for the benefit of different interest groups, but at the same time they must have regard to the interests of other parties which contribute to the company's success. This article contains a commentary on the new provisions and an evaluation. It also refers to the recent reports of the Australian Joint Parliamentary Committee on Corporations and the Corporations and Markets Advisory Committee which both considered whether there should be an equivalent provision in Australia to the new codified statement of directors' duties in the UK.

INTRODUCTION

The United Kingdom's new *Companies Act 2006* (UK) received Royal Assent on 8 November 2006. It is the largest UK Act ever, having about 1,300 sections.[1] Its size, however, is not the only thing that makes this Act remarkable. Although much of the Bill is not new, and merely consolidates earlier legislation, the new Act makes significant changes in certain areas. In particular, for the first time, there is a codified statement of the general fiduciary duties of directors. Previously, the general law, not the Companies Acts, governed the fiduciary duties of directors, and the case law is extensive. The codification of directors' duties is a new and radical departure for UK company law. However, the content of the codified statement does no more than reflect existing good practice. The aim of this article is to outline and evaluate the new codified statement. As I am a serving judge, any view that I express as to the effect of the new provisions must be provisional, as the views of a judge can change as a result of adversarial argument when the issue is finally argued in court.

HISTORY OF THE REFORMS

It has become traditional in the UK to have a new Companies Act about once every 20 years. In the second half of the 20th century Parliament got into the habit of amending the consolidation Act by a series of smaller Acts and then having a new consolidation Act. Thus, the *Companies Act 1948* (UK) was amended in 1967, 1980, 1981 and 1983, and the resulting Acts were then consolidated by the *Companies Act 1985* (UK). Over time it became clear that there were many shortcomings in that Act, particularly in relation to the statutory restrictions on transactions between directors and their companies (such as loans, service agreements, compensation for loss of office and so on[2]), and the prohibition on a company providing financial assistance for the purpose of a purchase of its own shares.

The Department of Trade and Industry (DTI), which is the UK government department with primary responsibility for company law, held a number of consultation exercises in the 1980s and

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[1] The new Act will come into force in stages starting in January 2007. The government has announced that it intends to bring most of the new provisions on directors' duties and derivative actions into force on 1 October 2007 (written statement by the Minister for Industry and the Regions, 28 February 2007)..

[2] Following a series of scandals in the 1970s the *Companies Act 1948* (UK) was amended to include a whole raft of extra rules for directors designed to reinforce the normal fiduciary duties, which became Pt X of the *Companies Act 1985* (UK). They include a prohibition on substantial property transactions and long service contracts without the prior consent of the company in general meeting.

1990s on particular areas that needed reform and built up a "blood bank" of ideas for reform, but these all came to naught. Then, in about 1995, the DTI conceived the idea that the Law Commission of England and Wales, together with the Scottish Law Commission, might be able to help. This was the first time that the DTI had asked the Law Commissions to make recommendations on company law reform. Unlike the Law Commission of New Zealand, the Law Commission of England and Wales had not previously been asked to make any recommendations in the field of company law. The first project was one on shareholder remedies. In due course the DTI gave the Law Commissions a second project on company law. The terms of reference were to consider whether there should be a statutory statement of directors' duties and also whether there should be any amendments to the complex statutory restrictions on transactions between directors and their companies in Pt X of the *Companies Act 1985*. I was the Chair of the Law Commission of England and Wales from January 1996 to the end of January 1999 and was involved in much of the work on both projects. The reports of the Law Commissions, *Shareholder Remedies*,[3] and *Directors' Duties*,[4] made a material contribution to the important changes to the law made by the *Companies Act 2006*.

The way the Law Commission approached the project on *Shareholder Remedies* was to identify the principles that ought to underline the law on shareholder remedies and this approach was repeated when the question of codifying directors' duties was considered. The methodology was important because it enabled there to be a review from first principles. The same approach was adopted in the project on directors' duties.

In 1998 the DTI decided to set up its own review of the whole of company law, known as the Company Law Review. That review was conducted by a Steering Group, of which I was also a member. The composition of the Steering Group was carefully chosen to ensure representation of the major interest groups in company law. Accordingly the Steering Group included not only lawyers but also accountants, financial journalists, directors and economists.

The Steering Group of the Company Law Review applied the same methodology as the Law Commission. It sought to identify the guiding principles for legislation on the relevant topic. It also made a practice of consulting widely on any problem that had discovered and any provisional recommendation that it made. All these factors put the Steering Group in a strong position to conduct a major rethink of company law from the bottom up.

The Company Law Review considered questions arising across the full range of company law, and its final report was presented to the Secretary of State for Trade and Industry in July 2001. In July 2002, the government published a White Paper accepting most of the recommendations. It then started preparing the new Companies Bill. This was finally introduced into Parliament in November 2005.

WHY CODIFY DIRECTORS' DUTIES?

Unlike Australia, the UK did not have even the most general statement of the duties of directors in its Companies Acts prior to the 2006 Act. Accordingly, the UK has gone in one move from a Companies Act with no statutory statement of directors duties to one which has an extensive statement of the general duties of directors. The statement will apply in place of the equivalent duties imposed on directors under the general law.

In the UK, the question whether the duties of directors should be codified has exercised commentators for over 100 years. So why did the UK opt for a comprehensive codified statement at this stage? The answer is that the climate of opinion had changed. Codification of directors' duties had previously been seen as the search for the Holy Grail, on the grounds that it would be virtually impossible to express in the words of a statute all the intricacies and nuances of the general law. Today, however, the imperative is to improve corporate governance, and the codification of directors'

[3] *Shareholder Remedies* (1997, Law Com No 246). One of the principal recommendations in this report was the replacement by a statutory derivative action of the rule in *Foss v Harbottle* (1843) 2 Hare 461, which governed the circumstances in which a minority shareholder could sue of behalf of his company.

[4] *Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties* (1999, Law Com No 261; Scot Law Com No 173).

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duties is seen as having a role to play in this process. If it reflects best practice, it will guide all directors towards higher standards. Codification should also make the law more accessible to directors and their advisers. Empirical research done for the Law Commissions showed widespread support among serving directors for a statutory statement of directors' duties. This was particularly the case among smaller companies where the directors often did not have access to legal advice. Thus, the current approach towards codification of directors' duties is that it is not just a question of lawyers' law but can play an essential part in making positive improvements in corporate governance. It is important to emphasise that the Law Commissions were not concerned with the question whether there should be any change to the content of directors' duties.

GUIDING PRINCIPLES OF COMPANY LAW

As I have said, the Company Law Review followed the approach of the Law Commission in identifying the principles on which any new legislation should be based. It came to the conclusion that there were certain high-level general principles that ought to apply to company law. I will merely mention those high-level general principles which are relevant to the codification of directors' duties. First, the Steering Group considered that the law on directors' duties should be accessible and clear. This is self-explanatory though it may be difficult to achieve in practice. Secondly, the Steering Group took the view that company law generally had to be enabling rather than prescriptive in its approach. In other words, all aspects of regulation had to be justified. Thirdly, the Steering Group identified the need for company law to be efficient in its operation and to enhance international competitiveness. This has always been a major issue for British company law. Fourthly the Steering Group emphasised that any new companies legislation had to recognize the modern asset mix of companies. In the past, companies had in the main had tangible assets such as mining gear or railway rolling stock. The modern company's assets often consist largely of human resources and intellectual property.

This last point may appear to be mundane, but in my view it is more important than it appears. In effect the Steering Group of the Company Law Review was saying that times had changed. The attitude of well-run companies to those groups which were essential for the success of the company had changed. This is so, for instance, in relation to employees. In Victorian times, when the first Companies Act was passed, company law treated employees rather like tangible assets, and companies did not seek to foster their relationships with them. These days, running a company is seen much more as a collaborative exercise between employees and management. Thus the reference here to the change in asset mix is a reference to a much more fundamental change in the approach that good businesses adopt to their relationships with employees and indeed all the other groups of persons involved in the business, such as suppliers, the community and so on.

When the Steering Group of the Company Law Review made its final report, it made three major recommendations. First it recommended that company law be refocused on the private company, treating the rules for public companies as exceptions to the general rule. This contrasts with the previous approach in the Companies Acts of treating the public company as the norm and the private company as the exception. Today, the number of private companies vastly exceeds the number of public limited companies. The second main recommendation was to improve corporate governance. This was to be done in a number of ways but principally by the codification of directors' duties. The third major recommendation was for institutional structures to keep company law up to date. The government did not accept this last recommendation, and I need say no more about it.

STAKEHOLDER QUESTION

The decision that directors' duties should be codified immediately led to a debate as to what has become known as "the stakeholder question". In other words, before directors' duties can be codified, it is necessary to decide in whose interest should companies be run. Should it be run in the interests of employees or in the interests of shareholders or in the interests of the community? There were two principal schools of thought about the answer to this question:

A. The school of thought known as pluralism: under this school of thought, the purpose of the company is to serve the interest of many different interest groups or stakeholders, that is

shareholders, employees the community and so on. People who support this approach consider that the duties of directors should be widened so that they are owed to a wider group of people than the shareholders.

B. The school of thought favouring the enlightened shareholder model: under this school of thought, the purpose of the company is to create value for the benefit of shareholders but this should be done by taking a long-term view of the company, and thus the relationships which the company has with suppliers, employees, the community and so on have to be fostered.

The Company Law Review preferred the enlightened shareholder approach. This acknowledges that at the end of the day it is the interests of shareholders which count. The interests of shareholders also give motivation to investors and directors to maximise profits for the benefit of the nation's economy. However, the approach is said to be enlightened when it proceeds on the basis that a company's potential for success can best be realised through maximising the relationships which the company enjoys with stakeholder groups. What tends to happen in practice where the approach is less enlightened is that boards take the view that their duty to act in the best interests of shareholders requires them to make short-term decisions to obtain short-term profits. This view is undesirable for a number of reasons, not least because the brunt of these decisions are often borne by other groups who have also contributed to the success of the company. Well-run companies today appreciate the role of these groups.

The Company Law Review therefore concluded that directors' duties should be stated in statutory form in a manner which reflected the enlightened shareholder model and existing best practice, that is to say which reflected both the need to make profits for shareholders but also the need to consider the interests of other stakeholder groups. In this way, the time horizons for decision-making would be improved and the directors guided towards a more enlightened approach to relationships with third parties, such as employees and suppliers.

Technical difficulties of codification

Opponents of codification argue that the process of codification will inadvertently alter the law and, more importantly, stultifies its development. They contend that codification also leads to increased transaction costs as there is an increased need for directors to take advice, at least when the restatement is first enacted. They also make the point that codifying statutes become less accessible over time once the courts have started interpreting them.

As against these points, however, it has to be borne in mind that at the present time the duties of directors have to be deduced from large quantities of case law. Codification of directors' duties makes the law clearer and more accessible to directors and their advisers to a significant degree. This should help directors in practice because directors are frequently called upon to make speedy decisions.

The other potential advantage of codification is that it provides an opportunity to correct minor defects in the present law. There were considered to be certain situations relating to corporate opportunities in which fiduciary duties no longer corresponded to accepted norms of modern business behaviour. Accordingly, there are two areas where the statutory statement of directors' duties departs from the existing law. Both concern corporate opportunities and will be examined in the context of the relevant section.

It should be recognised that the codification of directors' duties presented a considerable challenge to those responsible for the drafting. The statement had on the one hand to be clear and accessible and to make the law more predictable, and yet on the other hand not be such as to lose the advantages of flexibility and inherent capacity to develop which judge-made law has.

New provisions

The codified statement of directors' duties now appears in ss 170-181 of the *Companies Act 2006*. For convenience, the relevant sections are set out in the appendix to this article, together with the new section on ratification of acts of directors (s 239) the new definitions of "director" and "shadow director" (ss 250, 251) and the new sections on derivative actions (ss 260-264). In the following paragraphs, I shall explain some of the features of the new codified statement of directors' duties.

Shareholder orientation

The first point to note is that the newly codified duties of directors are stated to be owed to the company. Therefore codification of the directors' duties by the *Companies Act 2006* does not open up the prospect of the duties being enforced by persons other than the company, or members acting on its behalf via the new derivative action procedure or by a liquidator in the event of winding up.

To whom do the duties apply?

There are three categories of directors to whom the duties apply in different ways:

1. Directors in office are subject to all the duties.
2. Former directors are subject to certain aspects of the fiduciary duties even after they have ceased to be a director. These duties include the duty not to exploit opportunities of which the director became aware while he was a director. The statutory statement thus applies to a former director with necessary modifications (s 170(2)).
3. Shadow directors (defined in s 251) are subject to some of the duties as if they were directors formally appointed: (see s 170(5)).

Extensive substitution but statement not exclusive

A quick glance at the appendix will show that the new codified statement contains seven duties: the duty to act within powers (s 171); the duty to promote the success of the company (or duty of loyalty) (s 172); the duty to exercise independent judgment (s 173); the duty to exercise reasonable care, skill and diligence (s 174); the duty to avoid conflicts of interest (s 175), the duty not to accept benefits from third parties (s 176) and the duty to declare an interest in a proposed transaction or arrangement (s 177).

This is a more extensive statement of directors' duties than that appearing in Ch 2D of the Australian *Corporations Act 2001* (Cth). Chapter 2D sets out the duty of care and diligence (s 180). It also sets out the duty of good faith, which includes the duty to act in the best interests of the corporation and to use powers for a proper purpose (s 181). The Australian Corporations Act also sets out the duty not to use the position of director for personal advantage or to damage the corporation (s 182). The duties in the UK's *Companies Act 2006* are more extensive: see for example, s 172 on the duty to promote the success of the company. However, unlike the Australian Corporations Act, the *Companies Act 2006* does not create criminal offences if the duties in the *Companies Act 2006* are breached.

Section 170(3) goes on to provide that the newly codified duties have effect in place of the common law rules and equitable principles applying in relation to directors. This means that the newly codified duties are to be substituted for the equivalent duties under the general law. However, this does not necessarily mean that if there is any other duty that has not been codified, such as a duty to act fairly as between different classes of shareholder, that duty no longer exists. The new codified statement of directors' duties does not exclude that possibility.

Interpretation

There is a very important provision in 170(4). This provides for the general duties set out in the statutory statement to be "interpreted and applied in the same way as the common law rules or equitable principles" on which the duties are based, and requires the court to have regard to "the corresponding common law rules and equitable principles in interpreting and applying the general duties" (s 170(4)). It will be extremely interesting to see how the courts deal with this novel provision. Statutory interpretation in the UK has undergone considerable development in recent years due to the doctrine of primacy of European Union law (which requires UK courts to disapply legislation which is inconsistent with law of the European Union) and also to the statutory obligation in s 3 of the *Human Rights Act 1998* (UK) to interpret legislation so far as possible in conformity with the rights conferred by the European Convention on Human Rights.[5] These methods of interpretation may result in the

[5] See, eg *Ghaidan v Godin-Mendoza* [2004] 2 AC 557.

court adopting a strained interpretation. In Australia too, as I understand it, the courts have a duty to interpret the legislation with a view so far as possible to its being constitutional.

The first task of the court when faced with a problem of interpreting the newly codified duties will be to identify the relevant common law rule or equitable principle. These are rules and principles developed by the courts. It could be said that the court should have regard only to the common law rules and equitable principles as developed by the courts prior to the enactment of the *Companies Act 2006*. It seems unlikely that such a result was intended, since in theory the courts do not change the law by their later decisions but merely declare it. In those circumstances it is doubtful whether the courts will be limited to the law as it stood prior to the 2006 Act. Of course, the general law on the directors' duties codified by the 2006 Act will be replaced by the Act and will therefore not itself develop further in the courts of the UK, but many of the fiduciary duties owed by company directors are owed by other fiduciaries, and the general law formerly applying to directors may therefore be said to have developed as part of the development of the law regarding the duties owed by agents in similar positions. Moreover, the courts may decide that the way that the general law on the fiduciary duties of directors is developed in other common law jurisdictions also represents the law of the UK. These are some of the questions which the courts may in due course have to decide under this section.[6]

The remedies which flow from breach of a fiduciary duty under the general law often differ from those available for other breaches. The remedies available for breach of fiduciary duty are preserved by s 178. Accordingly the rule that the evidential burden of proof shifts to the defaulting fiduciary when an account of profits is ordered would seem to be preserved.[7]

Duty to act within powers

Section 171 imposes the familiar duty that directors should act within their powers and use those powers for the purposes for which they were conferred. The main authority in England on the latter point is *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, a decision of the Privy Council on appeal from the Supreme Court of New South Wales. Accordingly, it is unnecessary to add anything further on this point.

Duty to promote the success of the company

The duty to promote the success of the company in s 172 is the newly formulated fiduciary duty of loyalty. The duty of loyalty is now expressed as a duty to promote the success of the company. This formula replaces the duty to act in what the director in good faith considers to be in the interests of the company. The duty remains a duty owed to the company and the company alone.

It is s 172 that enshrines the principle of enlightened shareholder value: hence the important words "for the benefit of its members as a whole". To perform this duty, the directors must have regard to all relevant considerations, including (so far as relevant) those listed in s 172(1)(a) – (f). This list is not exhaustive but highlights areas of particular importance. It is worthy of note that s 172(1)(b) (the interests of the company's employees) is not new. Section 309 of the *Companies Act 1985* already provides that, "The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members".

The weight to be given to particular matters will remain a matter for the judgment of the directors. It seems unlikely that the courts are to be required to substitute their views on such matters for those of the directors. In identifying the relevant considerations, the directors will be expected to act with reasonable skill and care in accordance with the further duty considered below.

Section 172 states that a director must "have regard" to relevant matters. This does not mean that a director must act with the aim of furthering those matters, for example the interests of the company's

[6] See Bennion, *Statutory Interpretation* (4th ed) p 762ff. The recent case of *Harding v Wealands* [2006] 3 WLR 83; [2006] UKHL 32 is an interesting example of a case where the House of Lords declined to apply an updating interpretation. In that case the words were "questions of procedure" appearing in a statute in the field of private international law.

[7] See, generally *Murad v Al Saraj* [2005] EWCA Civ 959; (2006) 65 Camb LJ 278; (2006) 122 LQR 11, applying the decision of the High Court of Australia in *Warman International v Dwyer* (1995) CLR 544.

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employees. They must give these matters appropriate weight. However, lip service is unlikely to constitute appropriate consideration. A director must genuinely take the relevant matters into account, but his decision need not be dictated by them if that is not, in his good faith opinion, appropriate for the purpose of promoting the success the company as a whole. The relevant matters are often set out in the papers presented to the board of directors, and directors will generally be able to rely on such papers having been being properly prepared. Board minutes are always important, and it would be sensible for directors to ensure that the minutes identify the relevant considerations for the purpose of s 172(2). However, where there are board papers, the minutes can often do this by reference to the board papers.

The existing fiduciary duty of loyalty is capable of adaptation and application in many situations. For example, in *Item Software v Fassihi* [2005] 2 BCLC 91, the facts were that one director advised another director on negotiations with a major supplier with whom he had already been in negotiations privately and personally with a view to setting up his own business and taking that supplier with him. He advised his fellow director to insist on terms which he knew the supplier would not accept in the expectation that those negotiations would fail and he would be able to set up his company and obtain the source of supply for his own benefit. He did not succeed in obtaining any benefit for himself, so that all the company could sue him for was his failure to disclose his own breach of duty to the company. It was held on these facts that the director was in breach of his duty to act in the best interests of the company when he gave advice without disclosing his conflict of interest and breach of duty. It was unnecessary to find that there was a hitherto unknown duty owed by a fiduciary to disclose his own wrongdoing. The answer was found by explicating the traditional duty of loyalty.

Consequences of breach

The consequences of a breach of a newly codified duty are the same as under an existing law (s 178).

Prior sanction

The current law on prior authorisation of what would have been a breach of duty is preserved (s 180).

Insolvency

Section 172(3) states that the new duty of loyalty "has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company". Thus, s 172(3) recognises that the duty of loyalty may be displaced when the company becomes insolvent. The Act does not deal with the obligations of directors when a company is approaching insolvency because the law in this area is unclear and the decision was taken to leave the law to develop in this area. Once a company becomes insolvent, certain acts of a director may not only be in breach of his fiduciary duties. He may also in a serious case incur liability for wrongful trading under s 214 of the *Insolvency Act 1986* (UK).

In its final report, the Company Law Review referred to two approaches. The first is that, as the company became insolvent, the directors should consider the interest of creditors and not just those members. Thus directors would need to have regard to creditors as the company approached insolvency and not just when the company actually became insolvent. Supporters of this approach point to authorities such as *Nicholson v Permakraft* [1985] 1 NZLR 242, a decision of the Court of Appeal of New Zealand where Cooke J held that, as a matter of business ethics, directors should consider whether what they do would prejudice their company's practical ability to discharge promptly debts owed to current and likely continuing creditors. This is not so much a duty to creditors as a duty to the company itself. The second approach is that such a rule would lead to great uncertainty and have a chilling effect on decision-making by directors. As I have said, the Act leaves the general law to develop on this point.

Duty to exercise independent judgment

Section 173 requires a director to exercise independent judgment, but this does not prevent him from entering into an agreement which fetters his discretion or from delegating his powers in accordance with a company's constitution.

Duty to exercise reasonable care and diligence

Historically, the duty of care and skill owed by directors was treated as predominantly subjective. The relevant test was how much skill should a person with this particular director's knowledge and experience show. If the director did not attend board meetings, the company had no remedy. However, the courts developed the law and s 174 reflects the law as it has now evolved.

It will be noted that s 174 does not provide for a business judgment rule as in Australia. Under s 180(2) of the Australian Corporations Act, the business judgment rule provides a safe harbour for directors who take decisions acting in good faith and for a proper purpose, having properly informed themselves of the matter in advance and having no conflict of interest and rationally believing that the transaction is in the corporation's best interests. When the business judgment rule applies, the director is deemed not to have committed a breach of his statutory duty of care and diligence.

However, like the Australian courts, the courts now appreciate that in large modern corporations, there is a distinction between oversight and management. A director may very well be in the position simply of making decisions on the basis of information provided by other people. Every company must have a system of control to ensure that full and accurate information is disclosed. Only in that way can directors inform themselves about the company's affairs. This means that the nature and extent of the duty of skill, care and diligence will depend on such factors as the size, location and complexity of a company's business and the urgency of any decision.

Some directors have special skills. For example, they may have special knowledge or professional qualifications. The formulation in s 174 takes account of the special background, qualifications and management responsibilities of a particular director. The standard of skill and care expected from such a person is correspondingly greater. On the other hand, a director is not excused because he lacks the basic attributes that a director should have.

Directors hold different types of responsibilities, for example non-executive directors will have less burdensome duties than those imposed on financial or other executive directors. The formulation in s 174 accepts this differentiation and takes account of it by relating the knowledge, skill and experience that may be expected of a director to the functions which he performs.

Duty to avoid conflicts of interest

Section 175 deals with conflicts of interest. It is to be noted that the general law about liability to account for secret profits has apparently been converted into a duty. Hitherto a director has not owed a company a duty not to become a director of a company with a competing business, provided always that he does not disclose confidential information or misappropriate property of the company. However, s 170(4) may require s 175 to be interpreted in accordance with the pre-existing law.

It is to be noted that a duty cannot be regarded as infringed if the situation cannot be regarded as "likely" to give rise to a conflict of interest (s 175(4)). It is not enough that there is a mere possibility of conflict in circumstances not contemplated.

Contrary to the existing law, transactions or arrangements in which a director is interested will not always have to be approved by the company in general meeting. There are two new exceptions to this rule to s 175(5), and these are the two respects in which the law of directors' duties have been expressly changed by the codified statement of their duties. In a private company, unless the articles otherwise require, the board of directors will be able to give the necessary approval. This will also be possible in a public company if its constitution enables directors to give approval in these circumstances. These changes were made to facilitate the exploitation of corporate opportunities which might otherwise be left to waste because of the expense of convening a general meeting.

Duty not to accept benefits from third parties

This is covered by s 176. Unlike the duty covered by the previous section this duty is not subject to any provision for board authorisation. The duty is not infringed if the benefit is unlikely to result in a conflict of interest.

Duty to declare interest in proposed transactions or arrangements

Section 177 replaces the familiar rule. Companies may impose additional requirements for approval in their articles. There must be proper disclosure of the nature and extent of the interest, but a director is

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not required to make disclosure if his fellow directors already know of his interest. This provision reflects recent case law. Nor is the director in breach if he could not reasonably have been aware of the matters requiring disclosure. The interested director may participate in decision-making with regard to a transaction in which he has an interest depending on the articles.

Cumulative effect

In any given situation more than one duty may apply (s 179).

Ratification

The general law is preserved by s 239, save that where material the votes of the directors involved and their connected persons are disregarded unless the resolution is passed by unanimous consent. Previously the votes of the directors could be counted on any resolution for ratification of their own acts amounting to breach of duty, unless the passing of the resolution by use of their votes amounted to what was called a fraud on the minority. Under this exception, a member who sought to challenge a resolution would have to show that the wrongdoers controlled the company and that the resolution gave the majority some benefit of which the minority were deprived. These rules have now been changed. However, the rule that there must be full and frank disclosure before any resolution is put to the company in general meeting is not affected. Nor is the rule that ratification is not effective when the company is insolvent or is nearing insolvency.

AUSTRALIAN JOINT PARLIAMENTARY COMMITTEE AND THE CORPORATIONS AND MARKETS ADVISORY COMMITTEE

In June 2006, the Joint Parliamentary Committee on Corporations in its report on *Corporate Responsibility: Managing Risk and Creating Value* considered whether the duties of directors in the *Corporations Act* of Australia should also be amended on the lines of the enlightened shareholder model. The Committee adopted the enlightened shareholder model as its preferred approach to directors' duties. However, after careful consideration, the Committee rejected the idea of similar legislative amendment in Australia. What is right for Australia is not of course a question for me or on which I am competent to comment. The Committee's first reason was that what became s 172(2) (set out in the appendix to this article) created uncertainty, but it seems that the Committee may have misunderstood the purpose of this provision. As the explanatory notes published when the Bill was introduced state:

> Subsection (2) addresses the question of altruistic, or partly altruistic, companies. Examples of such companies include charitable companies and community interest companies, but it is possible for any company to have "unselfish" objectives which prevail over the "selfish" interests of members. Where the purpose of the company is something other than the benefit of its members, the directors must act in the way they consider, in good faith, would be most likely to achieve that purpose. It is a matter for the good faith judgment of the director as to what those purposes are, and, where the company is partially for the benefit of its members and partly for other purposes, the extent to which those other purposes apply in place of the benefit of the members.

Secondly, the Committee thought that the duty to have regard to certain interests created uncertainty. It said that there was no guidance as to what form that regard should take. For my part I do not see that legislation could sensibly do this. It is for the directors to do that which in the circumstances is appropriate. If they have to close a factory because the manufacturing business being conducted there is losing money and cannot be made profitable, they are still going to take that decision even after having regard to, for example, the interests of employees. The duty of loyalty is ultimately shareholder-orientated. The Committee's third reason was that it thought that it would create a "tick-box mentality" rather than encourage meaningful corporate governance. As I explain in the next section of this article, it is unlikely that the courts will become involved in disputes about the process of corporate decision-making unless it results in a breach of duty which causes damage or loss to the company. The advantage of the new statement of the duty is that it reminds directors when making decisions to do what is now best practice, that is to look to the longer term and to the effect of their decisions on the relationships which matter to the company.

The Corporations and Markets Advisory Committee published its report, *The Social Responsibility of Corporations* in December 2006. It considered the UK's new duty on directors to promote the success of the company. It also concluded that it was unnecessary to amend the Australian Corporations Act on the same lines. It was not persuaded that the elaboration of interests that the directors could take into account would improve the quality of corporate decision-making. It considered that a list of interests to be taken into account would give guidance as to how various interests were to be weighed, prioritised or reconciled. It concluded that the courts, through their interpretation of the duty to act in the "best interests of the company", could assist in aligning corporate behaviour with changing community expectations. As I have said, empirical research done in the UK showed that there was substantial support among directors for a statutory statement of duties, and accordingly the view is taken that the newly codified statement of duties can play an important part in improving corporate decision-making. Questions as to how different interests are to be balanced in any particular situation must be a question for directors making the relevant decisions and cannot be prescribed in advance by legislation.

CONCLUDING POINTS

"Process" challenges

Some people have expressed concern that the new duty to promote the success of the company will encourage people to challenge board decisions on the grounds that the board has failed to take into account all relevant considerations. Alternatively, they say that the new duty to have regard to a number of matters will lead to a "compliance driven" approach which is equally damaging because it leads to a slowing down of the process of decision-making and to a concentration on form rather than substance.

It is likely that at least when the Act is first brought into force there will be a number of challenges to decisions made by boards of companies in circumstances where such challenges would not previously have lain. That is only natural. Moreover, process challenges are familiar in public law or when the exercise by a judge at his or her discretion is challenged. However, company law is different. First, there is no basis on which one party to a transaction could seek to assert that a decision was not binding on the other party, simply because the board of directors of that other party had failed in the proper performance of their duties to consider the interests of some group or other. If directors come to a decision which is in breach of duty, the decision is voidable at the instance only of the company to whom the duties are owed. Thus the counterparty to a transaction will not be in a position to challenge the transaction on the grounds of a breach of duty by the directors.

The only persons who can challenge a breach of duty by directors of a company are the company itself, or its liquidator, or a member suing on behalf of the company and using the new derivative action procedure discussed below or (until the new Act comes into force) using relief granted by the court in unfair prejudice proceedings. If there has been no change of management or insolvency, the company itself is unlikely to want to sue, even if the directors negligently failed to take into account the interests of some particular group. Likewise, a liquidator is unlikely to sue unless there is a reasonable prospect of damages. When the 2006 Act comes into force, the ability of a member to sue on behalf of the company will be heavily circumscribed by the new derivative action procedure. Relief in unfair prejudice proceedings in the form of leave to sue the directors pursuant to what is now s 461(2)(f) of the *Companies Act 1985* will also have to meet the same conditions in future.

Link between the codification of directors' duties and the new derivative action

So far as the members are concerned, any legal proceedings which they bring on behalf of the company against the directors will have to be brought within the very strict rules on derivative actions introduced by other provisions of the *Companies Act 2006*. So far as the law of England and Wales is concerned, the original purpose of the new statutory derivative action procedure was simply to implement the recommendation of the Law Commission that there should be a statutory procedure to replace the old rule in *Foss v Harbottle*. It will be recalled that members wishing to bring derivative

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actions had to bring themselves within the exceptions to that ancient rule and that the exceptions were not available where it was alleged that a director had acted negligently. In addition the meaning of wrongdoer control (which had to be established if the member relied on the exception for fraud on the minority) was unclear. The Law Commission recommended that it should be possible to bring a derivative action for negligence against a director as well as an action for breach of fiduciary duty provided that certain conditions were fulfilled. That situation will now be capable of being the subject of a derivative action.

However, when the Bill was introduced there was much discussion as to whether the new statutory statement of directors' duties and the new derivative action procedure would lead to an increase in litigation against company directors. There have been some large settlements in cases brought against directors in the US, for example in cases involving Enron, WorldCom and Global Crossing. To meet this concern, the new provisions were strengthened to make it unlikely that the new statutory derivative action would result in an increase of shareholder litigation in the UK.

The new provisions are set out in the appendix to this article. Section 260 defines what is meant by a derivative claim. It has to involve a claim against a director (s 260(3)). Section 261 deals with the procedure for obtaining the court's permission to continue a derivative action. Permission of the court is required under the existing procedure in England and Wales (Civil Procedure Rule 19.9). Section 261 provides that the court must dismiss the application if there is no prima facie case for granting permission. If that hurdle is crossed, the court goes on to consider whether to grant permission. Section 263 sets out the criteria to be applied by the court in deciding whether to give permission. This section was inserted to allay the fears of some business people that the new statutory derivative action would lead to US-style class actions. In particular the court must not give permission if a person acting in performance of his duty of loyalty as a director would not seek to continue the action on behalf of the company, and the court must have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter. In addition the court must not give permission if the action has been authorised or ratified by the company. When giving permission, the court can impose conditions. The Secretary of State is given power to specify further criteria.

Accordingly, where what has occurred is merely a failure in the process of decision-making by directors required by s 172, with no adverse financial effect on the company, it is difficult to see that any court would give permission for a derivative action to be brought.

The restrictions on bringing derivative actions in the *Companies Act 2006* are more stringent than those in the provisions of Pt 2F.1A of the *Corporations Act 2001* of Australia. Even so, some recent empirical research carried out on the operation of these provisions has shown that there been practically no increase in the number of derivative actions since they were first enacted in 2000.[8] Most of the judgments in derivative actions were found to have been delivered in the courts of New South Wales. In no reported case did the court make what is termed in English law a "pre-emptive costs order", that is, an order at the outset of the proceedings that the costs of the derivative action should be borne by the company in any event.

Evaluation of the new codification

The codification of directors' duties in the *Companies Act 2006* is extremely ambitious. However, it has been carefully considered over many years. The work in this field began with the inception of the Law Commission's project on Directors' Duties in 1998. The Company Law Review took the matter forward and investigated the difficulties with great care. The DTI too, on receiving the report of the Company Law Review, consulted very widely and considered all the available options. The approach of all three bodies was to seek to obtain consensus among the various groups interested in company law. The process has been long drawn out and required much stamina.

The corporate vehicle is an ingenious institution for the creation of wealth, but opinion on how wealth should be created has changed in the period since its first creation. The codification of

[8] See Ramsey I and Saunders BB, "Litigation by shareholders and directors: An empirical study of the Australian statutory derivative action" (2006) 6 *Journal of Corporate Law Studies* 397.

directors' duties in the *Companies Act 2006* serves to bring about the reconnection of the corporate vehicle with the society in which it operates. It is likely to improve the quality of corporate decision-making with benefits for the rest of society. Over time it is also likely to lead to a much greater consciousness on the part of companies of the debt they owe to the other groups who contribute to their success, in particular employees and the communities in which they operate.

Meanwhile the codification of directors' duties in the *Companies Act 2006* will present an immense challenge to the courts. No doubt there will be problems from time to time with the language, and courts will have to do their best to give effect to the direction in the statute that the duties are to be interpreted and applied in the same way as common rules or equitable principles and that the courts are to have regard to the corresponding common law rules and principles in that process. The courts will have to ensure that the codified statement operates in accordance with the provisions of the Act.

APPENDIX: COMPANIES ACT 2006 (UK)

GENERAL DUTIES OF DIRECTORS

Introductory

170. Scope and nature of general duties

(1) The general duties specified in sections 171 to 177 are owed by a director of a company to the company.

(2) 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 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.

(3) The general duties are based on certain common law rules and equitable principles as they apply in relation to directors and have effect in place of those rules and principles as regards the duties owed to a company by a director.

(4) The general duties shall be interpreted and applied in the same way as common law rules or equitable principles, and regard shall be had to the corresponding common law rules and equitable principles in interpreting and applying the general duties.

(5) The general duties apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply.

The general duties

171. Duty to act within powers

A director of a company must:

(a) act in accordance with the company's constitution, and

(b) only exercise powers for the purposes for which they are conferred.

172. Duty to promote the success of the company

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company.

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

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(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.

173. Duty to exercise independent judgment

(1) A director of a company must exercise independent judgment.
(2) This duty is not infringed by his acting:
 (a) in accordance with an agreement duly entered into by the company that restricts the future exercise of discretion by its directors, or
 (b) in a way authorised by the company's constitution.

174. Duty to exercise reasonable care, skill and diligence

(1) A director of a company must exercise reasonable care, skill and diligence.
(2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with:
 (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and
 (b) the general knowledge, skill and experience that the director has.

175. Duty to avoid conflicts of interest

(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).
(3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company.
(4) This duty is not infringed:
 (a) if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest; or
 (b) if the matter has been authorised by the directors.
(5) Authorisation may be given by the directors:
 (a) 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
 (b) 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.
(6) The authorisation is effective only if:
 (a) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the director in question or any other interested director, and
 (b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.
(7) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

176. Duty not to accept benefits from third parties

(1) A director of a company must not accept a benefit from a third party conferred by reason of:
 (a) his being a director, or
 (b) his doing (or not doing) anything as director.
(2) A "third party" means a person other than the company, an associated body corporate or a person acting on behalf of the company or an associated body corporate.
(3) Benefits received by a director from a person by whom his services (as a director or otherwise) are provided to the company are not regarded as conferred by a third party.
(4) This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.
(5) Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

177. Duty to declare interest in proposed transaction or arrangement

(1) If a director of a company is in any way, directly or indirectly, interested in a proposed transaction or arrangement with the company, he must declare the nature and extent of that interest to the other directors.
(2) The declaration may (but need not) be made:
 (a) at a meeting of the directors, or

(b) by notice to the directors in accordance with:
  (i) section 184 (notice in writing), or
  (ii) section 185 (general notice).

(3) If a declaration of interest under this section proves to be, or becomes, inaccurate or incomplete, a further declaration must be made.

(4) Any declaration required by this section must be made before the company enters into the transaction or arrangement.

(5) This section does not require a declaration of an interest of which the director is not aware or where the director is not aware of the transaction or arrangement in question.
For this purpose a director is treated as being aware of matters of which he ought reasonably to be aware.

(6) A director need not declare an interest:
  (a) if it cannot reasonably be regarded as likely to give rise to a conflict of interest;
  (b) if, or to the extent that, the other directors are already aware of it (and for this purpose the other directors are treated as aware of anything of which they ought reasonably to be aware); or
  (c) if, or to the extent that, it concerns terms of his service contract that have been or are to be considered:
    (i) by a meeting of the directors, or
    (ii) by a committee of the directors appointed for the purpose under the company's constitution.

Supplementary provisions

178. Civil consequences of breach of general duties

(1) The consequences of breach (or threatened breach) of sections 171 to 177 are the same as would apply if the corresponding common law rule or equitable principle applied.

(2) The duties in those sections (with the exception of section 174 (duty to exercise reasonable care, skill and diligence)) are, accordingly, enforceable in the same way as any other fiduciary duty owed to a company by its directors.

179. Cases within more than one of the general duties

Except as otherwise provided, more than one of the general duties may apply in any given case.

180. Consent, approval or authorisation by members

(1) In a case where:
  (a) section 175 (duty to avoid conflicts of interest) is complied with by authorisation by the directors, or
  (b) section 177 (duty to declare interest in proposed transaction or arrangement) is complied with,

the transaction or arrangement is not liable to be set aside by virtue of any common law rule or equitable principle requiring the consent or approval of the members of the company.
This is without prejudice to any enactment, or provision of the company's constitution, requiring such consent or approval.

(2) The application of the general duties is not affected by the fact that the case also falls within Chapter 4 (transactions requiring approval of members), except that where that Chapter applies and:
  (a) approval is given under that Chapter, or
  (b) the matter is one as to which it is provided that approval is not needed,

it is not necessary also to comply with section 175 (duty to avoid conflicts of interest) or section 176 (duty not to accept benefits from third parties).

(3) Compliance with the general duties does not remove the need for approval under any applicable provision of Chapter 4 (transactions requiring approval of members).

(4) The general duties:
  (a) have effect subject to any rule of law enabling the company to give authority, specifically or generally, for anything to be done (or omitted) by the directors, or any of them, that would otherwise be a breach of duty, and
  (b) where the company's articles contain provisions for dealing with conflicts of interest, are not infringed by anything done (or omitted) by the directors, or any of them, in accordance with those provisions.

(5) Otherwise, the general duties have effect (except as otherwise provided or the context otherwise requires) notwithstanding any enactment or rule of law.

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181. Modification of provisions in relation to charitable companies

(1) In their application to a company that is a charity, the provisions of this Chapter have effect subject to this section.

(2) Section 175 (duty to avoid conflicts of interest) has effect as if:

(a) for subsection (3) (which disapplies the duty to avoid conflicts of interest in the case of a transaction or arrangement with the company) there were substituted:

> "(3) This duty does not apply to a conflict of interest arising in relation to a transaction or arrangement with the company if or to the extent that the company's articles allow that duty to be so disapplied, which they may do only in relation to descriptions of transaction or arrangement specified in the company's articles."

(b) for subsection (5) (which specifies how directors of a company may give authority under that section for a transaction or arrangement) there were substituted:

> "(5) Authorisation may be given by the directors where the company's constitution includes provision enabling them to authorise the matter, by the matter being proposed to and authorised by them in accordance with the constitution."

(3) Section 180(2)(b) (which disapplies certain duties under this Chapter in relation to cases excepted from requirement to obtain approval by members under Chapter 4) applies only if or to the extent that the company's articles allow those duties to be so disapplied, which they may do only in relation to descriptions of transaction or arrangement specified in the company's articles.

(4) After section 26(5) of the *Charities Act 1993* (c 10) (power of Charity Commission to authorise dealings with charity property etc) insert:

> "(5A) In the case of a charity that is a company, an order under this section may authorise an act notwithstanding that it involves the breach of a duty imposed on a director of the company under Chapter 2 of Part 10 of the *Companies Act 2006* (general duties of directors)."

(5) This section does not extend to Scotland.

…

239. Ratification of acts of directors

(1) This section applies to the ratification by a company of conduct by a director amounting to negligence, default, breach of duty or breach of trust in relation to the company.

(2) The decision of the company to ratify such conduct must be made by resolution of the members of the company.

(3) Where the resolution is proposed as a written resolution neither the director (if a member of the company) nor any member connected with him is an eligible member.

(4) Where the resolution is proposed at a meeting, it is passed only if the necessary majority is obtained disregarding votes in favour of the resolution by the director (if a member of the company) and any member connected with him.
This does not prevent the director or any such member from attending, being counted towards the quorum and taking part in the proceedings at any meeting at which the decision is considered.

(5) For the purposes of this section:

(a) "conduct" includes acts and omissions;
(b) "director" includes a former director;
(c) a shadow director is treated as a director; and
(d) in section 252 (meaning of "connected person"), subsection (3) does not apply (exclusion of person who is himself a director).

(6) Nothing in this section affects:

(a) the validity of a decision taken by unanimous consent of the members of the company, or
(b) any power of the directors to agree not to sue, or to settle or release a claim made by them on behalf of the company.

(7) This section does not affect any other enactment or rule of law imposing additional requirements for valid ratification or any rule of law as to acts that are incapable of being ratified by the company.

…

Meaning of "director" and "shadow director"

250. "Director"

In the Companies Acts "director" includes any person occupying the position of director, by whatever name called.

251. "Shadow director"

(1) In the Companies Acts "shadow director", in relation to a company, means a person in accordance with whose directions or instructions the directors of the company are accustomed to act.
(2) A person is not to be regarded as a shadow director by reason only that the directors act on advice given by him in a professional capacity.
(3) A body corporate is not to be regarded as a shadow director of any of its subsidiary companies for the purposes of:

Chapter 2 (general duties of directors),
Chapter 4 (transactions requiring members' approval), or
Chapter 6 (contract with sole member who is also a director),

by reason only that the directors of the subsidiary are accustomed to act in accordance with its directions or instructions.

…

DERIVATIVE CLAIMS IN ENGLAND AND WALES OR NORTHERN IRELAND

260. Derivative claims

(1) This Chapter applies to proceedings in England and Wales or Northern Ireland by a member of a company:
   (a) in respect of a cause of action vested in the company, and
   (b) seeking relief on behalf of the company.

This is referred to in this Chapter as a "derivative claim".
(2) A derivative claim may only be brought:
   (a) under this Chapter, or
   (b) in pursuance of an order of the court in proceedings under section 994 (proceedings for protection of members against unfair prejudice).
(3) A derivative claim under this Chapter may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company.
The cause of action may be against the director or another person (or both).
(4) It is immaterial whether the cause of action arose before or after the person seeking to bring or continue the derivative claim became a member of the company.
(5) For the purposes of this Chapter:
   (a) "director" includes a former director;
   (b) a shadow director is treated as a director; and
   (c) references to a member of a company include a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law.

261. Application for permission to continue derivative claim

(1) A member of a company who brings a derivative claim under this Chapter must apply to the court for permission (in Northern Ireland, leave) to continue it.
(2) If it appears to the court that the application and the evidence filed by the applicant in support of it do not disclose a prima facie case for giving permission (or leave), the court:
   (a) must dismiss the application, and
   (b) may make any consequential order it considers appropriate.
(3) If the application is not dismissed under subsection (2), the court:
   (a) may give directions as to the evidence to be provided by the company, and
   (b) may adjourn the proceedings to enable the evidence to be obtained.
(4) On hearing the application, the court may:
   (a) give permission (or leave) to continue the claim on such terms as it thinks fit,
   (b) refuse permission (or leave) and dismiss the claim, or
   (c) adjourn the proceedings on the application and give such directions as it thinks fit.

262. Application for permission to continue claim as a derivative claim

(1) This section applies where:
   (a) a company has brought a claim, and
   (b) the cause of action on which the claim is based could be pursued as a derivative claim under this Chapter.
(2) A member of the company may apply to the court for permission (in Northern Ireland, leave) to continue the claim as a derivative claim on the ground that:

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(a) the manner in which the company commenced or continued the claim amounts to an abuse of the process of the court,
(b) the company has failed to prosecute the claim diligently, and
(c) it is appropriate for the member to continue the claim as a derivative claim.

(3) If it appears to the court that the application and the evidence filed by the applicant in support of it do not disclose a prima facie case for giving permission (or leave), the court:
(a) must dismiss the application, and
(b) may make any consequential order it considers appropriate.

(4) If the application is not dismissed under subsection (3), the court:
(a) may give directions as to the evidence to be provided by the company, and
(b) may adjourn the proceedings to enable the evidence to be obtained.

(5) On hearing the application, the court may:
(a) give permission (or leave) to continue the claim as a derivative claim on such terms as it thinks fit,
(b) refuse permission (or leave) and dismiss the application, or
(c) adjourn the proceedings on the application and give such directions as it thinks fit.

263. Whether permission to be given

(1) The following provisions have effect where a member of a company applies for permission (in Northern Ireland, leave) under section 261 or 262.

(2) Permission (or leave) must be refused if the court is satisfied:
(a) that a person acting in accordance with section 172 (duty to promote the success of the company) would not seek to continue the claim, or
(b) where the cause of action arises from an act or omission that is yet to occur, that the act or omission has been authorised by the company, or
(c) where the cause of action arises from an act or omission that has already occurred, that the act or omission:
(i) was authorised by the company before it occurred, or
(ii) has been ratified by the company since it occurred.

(3) In considering whether to give permission (or leave) the court must take into account, in particular:
(a) whether the member is acting in good faith in seeking to continue the claim;
(b) the importance that a person acting in accordance with section 172 (duty to promote the success of the company) would attach to continuing it;
(c) where the cause of action results from an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be:
(i) authorised by the company before it occurs, or
(ii) ratified by the company after it occurs;
(d) where the cause of action arises from an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company;
(e) whether the company has decided not to pursue the claim;
(f) whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member could pursue in his own right rather than on behalf of the company.

(4) In considering whether to give permission (or leave) the court shall have particular regard to any evidence before it as to the views of members of the company who have no personal interest, direct or indirect, in the matter.

(5) The Secretary of State may by regulations:
(a) amend subsection (2) so as to alter or add to the circumstances in which permission (or leave) is to be refused;
(b) amend subsection (3) so as to alter or add to the matters that the court is required to take into account in considering whether to give permission (or leave).

(6) Before making any such regulations the Secretary of State shall consult such persons as he considers appropriate.

(7) Regulations under this section are subject to affirmative resolution procedure.

264. Application for permission to continue derivative claim brought by another member

(1) This section applies where a member of a company ("the claimant"):
(a) has brought a derivative claim,
(b) has continued as a derivative claim a claim brought by the company, or
(c) has continued a derivative claim under this section.

(2) Another member of the company ("the applicant") may apply to the court for permission (in Northern Ireland, leave) to continue the claim on the ground that:
  (a) the manner in which the proceedings have been commenced or continued by the claimant amounts to an abuse of the process of the court,
  (b) the claimant has failed to prosecute the claim diligently, and
  (c) it is appropriate for the applicant to continue the claim as a derivative claim.
(3) If it appears to the court that the application and the evidence filed by the applicant in support of it do not disclose a prima facie case for giving permission (or leave), the court:
  (a) must dismiss the application, and
  (b) may make any consequential order it considers appropriate.
(4) If the application is not dismissed under subsection (3), the court:
  (a) may give directions as to the evidence to be provided by the company, and
  (b) may adjourn the proceedings to enable the evidence to be obtained.
(5) On hearing the application, the court may:
  (a) give permission (or leave) to continue the claim on such terms as it thinks fit,
  (b) refuse permission (or leave) and dismiss the application, or
  (c) adjourn the proceedings on the application and give such directions as it thinks fit.

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