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**Director's Duties of "No Conflict" and "No Profit"
Re Allied Business and Financial Consultants Ltd
[2009] 2 B.C.L.C. 666**

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Introduction

Petitions brought in terms of s.994 of the Companies Act 2006 (formerly s.459 of the 1985 Act) are usually to enforce an informal arrangement between shareholders in a "quasi-partnership" company where one party alleges that the others have acted contrary to his expectations, by excluding him from management or failing to pay dividends. The categories of prejudice are not closed and in *Allied* the petitioner, "O", argued that breach of the strict duties that a director, as a fiduciary, owed to a company not to enter into an engagement in which he had a personal interest conflicting with the interests of the company and not to obtain for himself a profit by means of a transaction in which he was concerned on behalf of the company constituted unfairly prejudicial conduct. The Court of Appeal (Rimer, Aikens and Waller L.J.J.) examined the wide scope of the duties and the potential defences that: (a) the engagement was not an opportunity that the company would have taken; and (b) shareholder acquiescence.

The facts

O, S and L, all former bank managers, set up the company in which they were directors and equal shareholders in 1989 to carry on business providing financial advice and assistance; its memorandum of association specified:

"the business of financiers, bankers, financial agents" and "any other trade or business which can, in the opinion of the Board of Directors, be advantageously carried on by"

the company. The company operated as a quasi-partnership company and it was understood that the directors would work substantially full-time. S and L were also involved in property investment on their own account; although O had no wish to be involved in those dealings she was aware of them and had not complained about them at the time or suggested they were incompatible with S and L's role in the company or that any of the property acquisitions should have been channelled through the company. The judge at first instance had found that the property deals were not a breach of the understandings between the shareholders when the company was established.

In 1999 S acted, for the first time, as an “estate agent” for two clients of the company in the sale and purchase of an investment property (“the Property”); the company was to receive £30,000 commission if the deal went ahead. When the prospective purchaser withdrew, S and L identified another company client who was interested. That client, however, stipulated that he would only become involved if S and L also acquired an interest in the Property and if the commission due to the company was cancelled. S and L agreed and the Property was bought by a company in which S, L and the company client were equal shareholders. S and L also compensated O for the loss of her share of the commission. The judge found that O was aware of S and L’s interest in the purchase of the Property but that she did not complain about it until the petition was raised in November 2006. He also found that O would not have been prepared to take on the risk to herself personally that the acquisition of the Property would have entailed, nor undertake the significant guarantee liabilities involved in enabling the deal to go ahead. He concluded that the company would not have taken up the opportunity in place of S and L because O would not have put up her share of the funds or undertaken the guarantee liabilities.

The company’s business dwindled from 2002 and was killed off by the s.459 petition, which the judge described as the “last roll of the dice” for O. She sought an order that S and L buy her shares in the company at a price calculated on the basis that the company had the benefit of the purchase of the Property. These proceedings dealt only with the issue of whether the Company’s affairs had been conducted in a manner that was unfairly prejudicial to O’s interests as a member of the company, while the issue of the appropriate relief was to be determined later.

The law

O’s claim under s.459 [“the company’s affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members generally or of some part of its members (including at least himself)”] was that S and L’s acquisition of the property was so unfairly prejudicial because it breached the “no conflict” and “no profit” rules. The “no conflict” rule is set out by Lord Cranworth in *Aberdeen Railway Co v Blaikie Brothers* (1894) 1 Macq 461, at [471]:

“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 is bound to protect. So strictly is this principle adhered to, that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into.”

Lord Upjohn in *Boardman and Another v Phipps* [1967] 2 A.C. 46, at [124B–124D], added that:

“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.”

The no-profit rule is set out in *Regal (Hastings) Ltd v Gulliver* [1967] 2 A.C. 134 by Lord Russell of Killowen (at [144G–145A]):

“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.”

The consequence of the breach of either rule is or may be that the fiduciary is required to account for the profit made by him by such breach.

The first instance decision

The judge first found that the purchase of the Property did not fall within the scope of the company’s business of providing financial advice, even though the objects set out in the Memorandum were wide enough to cover property investment. As a result, he found that there was no real sensible possibility of a conflict in S and L acquiring an interest in the Property and hence no breach of the “no conflict”. He also found that there was no breach of the “no profit” rule; even though the opportunity had come to S and L in their capacities as directors of the company, the purchase of the Property had not been a maturing business opportunity for the company since there was no suggestion that the company might buy it and property investment was outside its usual business.

The appeal

Rimer L.J. said at [52] that, subject to the issue of whether the purchase of the Property was within the scope of the company’s business, he saw the case as plainly one:

“in which [S] and [L] had (without the company's informed consent) adopted for their private benefit a business opportunity that came to them in their capacities as directors of the company with the consequence that they would in principle be accountable to the company for any profit derived from it.”

He noted that central to the judge's reasoning was his finding that the acquisition by S

and L of their interest in the Property was of a nature falling outside the scope of the company's business. However, at [70], he said that the statements of principle in *Boardman* and *Regal* 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. The point is that the existence of the opportunity is one that it is relevant for the company to know and of which the director has a duty to inform it. It is not for the director to make his own decision that the company will not be interested and to proceed, without more, to appropriate the opportunity for himself. His duty is one of undivided loyalty and this is one manifestation of how that duty is required to be discharged.”

S and L were liable to account to the Company for any profit. He also found a breach of the “no-conflict” rule in the failure by S and L to ensure that the company earned the commission even though S and L had compensated O for her own loss in that regard.

S and L argued that O had not proved that any breaches of duty had unfairly prejudiced her interests as a member of the company since the company could not and would not have taken up the opportunity to invest in the Property and, further, she had acquiesced by failing to complain until the presentation of the petition seven years later. Rimer L.J. rejected the acquiescence argument on the ground that O had not been given sufficient information by S and L about all aspects of the deal and, thus, did not have full knowledge of the facts. At [81] he noted that the issue of whether there were any profits from the deal that would have to be accounted for by S and L was complicated by the facts that it was not known if any profits had been made and that the company was insolvent so there might be no recovery for O. He concluded that the fair course would be to remit to the judge the issue of whether the failure to account to the company for the profit (if any) resulting from the deal had unfairly prejudiced O as a member of the company and to what (if any) relief she would be entitled.

Conclusion

Allied emphasises that the “no profit” and “no conflict” rules are pretty unforgiving. Even though a petitioner might not at the end of the day be able to establish any relevant prejudice arising from a failure to account, the cost of the proceedings to a director will still be substantial. The prudent course is always, of course, to obtain the company's approval, however artificial that might seem.