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Legal Powers, Duties and Liabilities of Management

With particular references to Algerian company Law

Thesis submitted for the degree of L.L.M

by

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Dedication

To the memory of my grandfather Ahmed

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Acknowledgments

My sincere thanks are due to all who have given me their generous help in completing this thesis. In particular I would like to mention my special appreciation to my supervisor, Mr Ian Swinney, who helped me considerably throughout the period of my research. The thesis would not have been completed without his guidance, suggestions and critical comments.

I must also express my thanks to the Algerian Government namely the Ministry of Higher Education for the financial support without which the present study would never have been achieved. The generous assistance of Glasgow University staff is highly appreciated.

Finally, I wish to convey my profound gratitude to my father, my mother, and my wee brother Boualem for their meaningful assistance and encouragement.

Summary

The present thesis attempts to study the current legal position of the company directors' function. This involves an examination of the legal rules and principles that regulate their managerial duties, powers and liabilities.

The thesis is divided into six chapters. The first chapter is intended to shed some light on forms of business associations and its basic characteristics, by illustrating the similarities and the differences which do exist between parallel types of companies in both Britain and Algeria. The illustration will include sources, classification of commercial companies, structure of the board of directors in both British public companies and Algerian société par action. Besides the role and qualification of directors would be considered.

Chapter Two discusses the issue of corporate power and highlights the legal nature of directors' powers to conduct the company's affairs, the scope of these powers and the sources from which they are derived.

Chapter three clarifies the question of delegation of directors powers by prescribing the legal basis of delegation, the nature of powers that can be delegated by the board of directors to a managing director or to a committee of directors, and finally the protection of third parties dealing with the company from the delegates acts.

Chapter four explores the obligations and duties to

which directors are bound to pay due regard when conducting the business of the company. This includes first their fiduciary duties, namely; the duty to act *bona fide* in the best interest of the company, the duty to act for a proper purpose and the duty to avoid a conflict of interest and duty. Second, their common law duties of care, diligence and skill.

Chapter five is concerned with the legal liability of company directors. It considers the separate legal personality of a company and its effect on directors liability. It also deals with the two ways in which directors' acts create a liability in the company: first, where directors are treated as the company's agents and act for the company, and secondly, where directors acts are treated as the company's acts and finally discusses who is the alter ego of the company.

The last chapter examines the legal foundations and the circumstances under which the directors may be held personally liable. This includes their personal liability on contracts; in delicts/torts in addition to their statutory liabilities such as liability for misrepresentation (mis-statement), fraudulent trading and wrongful trading. Disqualification of directors and its grounds are also considered. Finally, the chapter shed some light on a number of ways in which directors may be relieved from liability. namely; ratification, relief by the articles, relief by the court.

List of Abbreviations

A.C	Appeal Cases
A.L.Q	Arab Law Quarterly
AllE.R	All England Law Reports
B.C.C	British Company Law Cases.
B.C.L.C	Butterworths Company Law Cases
C.A	Companies Act
C.B.I	Confederation Of British Industry
C.C.C	Canadian Criminal Cases
C.C.H	Commerce Clearing House , Inc.
C.D.D.A	Company Directors Disqualification Act
C.L.J	Cambridge Law Journal
C.L.R	Canada Law Reports
C.M.T.C	Corporate Management Tax Conference
Can.B.Rev	Canadian Law Review
Cass.Civ	Cassation Civile
Ch. App	Law Reports, Chancery Appeals
Ch	Law Reports, Chancery
Ch.D	Law Reports, Chancery Division
Cmnd	Command Papers, 5th Series
Co.Law	Company Lawyer
Col.L.R	Columbia Law Review
Crim.App.Re	Criminal Appeal Review
Crim.L.R	Criminal Law Review
D.L.R. 3d	Dominian Law Reports, 3rd Series (Can)
D.T.I	Depratment of Trade and Industry

E.&B...................... Ellis & Blackburns Queens Bench Report
E.R........................ English Reports
F.T.L.R................. Financial Times Law Reports
H.L........................ House of Lords
H.M.S.O................ Her Majesty's Stationary Office
I.A.........................Insolvency Act
I.C.L.Q..................International and Comparative Law Quarterly
Int.Bus.Lawy...... International Business Lawyer
Journ. Soc.......... Journal des Sociétés
J.C.P..................... Jurisclasseur Périodique
J.L.& Economics. Journal of Law and Economics
J.L.S..................... Journal of The Law Society of Scotland
Jur.Rev................ Juridical Review (Scot)
K.B....................... King's Bench
L.C........................ Lord Chancellor
L.Q.R.................... Law Quarterly Review
L.R........................ Law Reports
L.S.Gaz................ The Law Society's Gazette
L.T........................ Law Times Reports
M.L.R....................Modern Law review
M.R........................Master of The Rolls
Macq....................Macqueens Scotch Appeal Cases
Marq.Law.Rev......Marquette Law Review(USA)
Mel.U.L.R............ Melbourne University law Review
Mich. L.R............ Michigan Law Review
N.L.J.................... New Law Journal
N.Y....................... New York
O.P.U....................Office de Presses Universitaires

P.E.P.................... Political and Economic Planing]

PRO NED............. The Promotion for Non-Executive directors

Q.B....................... Law Reports, Queens Bench

Q.B.D.................... Law Reports, Queen's Bench Division

R.A.S.J.E.P.......... Revue Algerienne des Sciences Juridiques, Economiques et Politiques

Rev.Soc............... Revue des Société

R.I.D.C................. Revue International de Droit Compare

R.I.D.P................. Revue International de Droit Pénal

Rev.Soc............... Revue des Sociétés

Rev.Trim.dr. Com-Revue Trimisterial de Droit Commercial

S.A....................... South African Law Reports

S.C....................... Session Cases (Scot)

S.J....................... Solicitors' Journal

S.L.R.................... Scottish Law Review and Sheriff Court Reports

S.L.T.................... Scots Law Times

T.L.R.................... Times Law Reports

Tulane.L.Rev....... Tulane Law Review

U.Tasm.L.R.......... University of Tasamania Law Review

V.C...................... Vice Chancellor

W.L.R.................. Weekly Law Reports

West.Aust.L.Rev. University of Western Australian Law Review

Introduction

The company is the backbone of the industrial society. Whether private or public, large or small, and it constitutes the heart of business life. Without it, industry and commerce could not function. Accordingly, the manner in which this institution is run and the persons who manage it is an issue of overwhelming legal, economic and political significance.

The established rule is that the management of modern companies is carried out by two principal organs, the members in general meeting and the board of directors. Through their control of the composition of the board of directors and their ability to regulate the directors powers by altering the companies articles which confer those powers, the members may be said to be the supreme body with the ultimate authority. However, although this may still be true in the case of small size firms with a small number of shareholders, it would be impossible for the members in large companies to exercise any detailed control over the day-to-day running of the company by the directors. This may be attributed to a number of factors such as the increasing size, diversity and complexity of modern business, growth of the equity interest in a company, and the increase in the number of shareholders.

As early as 1776 Adam Smith stated:

> " The trade of a joint stock company is always managed by a court of directors. This court, indeed, is frequently subject, in many respects, to the control of a general court of proprietors. But the greater

> part of those proprietors seldom pretend to understand anything of the business of the company; and when the spirit of faction happens not to prevail among them, [they] give themselves no trouble about it, but receive contentedly such half-yearly or yearly dividend as the directors think proper to make to them. This total exemption from trouble and from risk, beyond a limited sum, encourages many people to become adventures in joint stock companies , who would upon no account hasard their fortunes in any private co-partnery".[1]

This development is often described as the divorce of ownership from management. Indeed, the separation between owners and directors become a well recognised fact in modern company law. As a result of this separation the managerial powers have shifted from the members to the directors. This put directors in a much stronger position than the members allowing them to dominate the affairs of the company.

Undoubtedly a company's directorship is seen now as one of the top jobs in industrial societies. Indeed, a directors position especially in large companies such as ICI, BP, G.E.C, and Ferranti International appears to be the same as the position of higher rank civil servants and politicians in terms of huge amounts of money and assets which they control and the number of people they represent. In fact, boards of directors now become a very real device for power and status. They play a vital role in determining the government economic policy since the whole economy looks to their competence and ability. It should be noted that no economic reforms can be

1- Smith , A., An Inquiry into the Nature and Causes of the wealth of Nations, (1776) Book V , Chapter 1, Part | | | , art. 1, p. 232

achieved without reforming the managerial function. As a result of this development the company's directorship has become one of the most important issues in company law which has received a consistent attention over the last decade as pressures for reform have increased.

The subject of management and control comprises a broad spectrum of issues. The present thesis, however, focuses attention on some important problems that have a close correlation with the directors function. In so doing, it points out to a variety of specific problems of administering companies in different stages of development. The thesis analyses the principles of law governing the managerial function and prescribing the directors powers and privileges that are conferred on them to run the day-to-day company's affairs and the duties to which they are bound to pay due regard while performing their function; the liabilities and responsibilities which they may incur while acting on behalf of the company. The study involves a statement of the current statutory provisions applicable to the directors as well as consideration of the common law principles developed through cases. In addition, it is attempted through the thesis to demonstrate the Algerian position in some areas of law particularly points in respect of which a comparison would be useful. As Algeria is a codified civil law system on French pattern and so differs in the solutions offered to similar problems.

The thesis begins with a description of business associations that exist under British and Algerian law illustrating the similarities and differences which do exist between parallel types of associations in both countries. This includes the classification, the nature, and the principle sources of the law applicable to commercial companies as well as the main classifications adopted in both legal systems. The structure of the board of management in both British public company and Algerian société par action is also considered. Furthermore, as the appointment of non-executive directors in large public companies has increased noticeably in recent years, considerations are given to highlight the position of this relatively new category of directors and their role in managing the company as a whole.

The purpose behind the brief mention of the above information is to pave the way for a clear understanding of the principal elements which constitute the core of this study, namely, Powers, Duties and Liabilities of Management.

The Subject " Powers of Management " covers a wide range of legal problems which cannot all be dealt with here. Instead some specific legal points will be discussed in detail, such as the legal nature of the managerial powers and their main sources. This leads us to determine the legal position of a director which is one of the unsettled issues in British Company law.

Nowadays there is a growing tendency in most company laws in different legal systems to concentrate powers of management in fewer hands in order to give management an independent position and to keep it free from outside interference, especially from shareholders. Consequently, the present board possess practically all powers of management while very few powers are retained by the company in general meeting. However, these extensive powers invested in directors are not limitless but subject to a number of restrictions.

In fact the scope of directors' authority and the extent to which a company can be bound by the acts of individual directors is a complicated area governed by diverse statutory (Section 9 of the European Communities Act 1972, now section 35 of the the Companies Act 1985) and judge made rules, such as the rule in Royal British v. Turquand (1856) 6 E & B 327, The doctrine of constructive notice and the ultra vires rule which is one of the landmarks of British law that has no place in Algerian or continental law. Although as a general rule the directors' powers can only be exercised at board meetings. This principle of collective management was developed to protect shareholders against ill-considered transactions. However, it is realised that directors cannot properly perform their functions without delegating certain of their discretionary authority to other executives. Thus , in practice the articles usually permit extensive delegation of power to a committee of directors (consisting of either of a single director or several directors) or to managing director.

In return for this wide range of powers, directors are subject to a number of obligations and duties: Some are laid down by statute and the majority are found only in common law. However, it has been established that a director owes two types of duty to the company; that is, they act within the scope of powers granted by the internal regulations and bona fide in what they consider in the best interest of the company. Thus they are not allowed to act for a "collateral purpose" or use their powers and position to benifit themselves. In addition, They are required to exercise whatever skill they possess showing a standard of reasonable care they articulate.

Although the director when acting as agent binds the company and not himself, there are certain circumstances in which he becomes personally liable. Indeed, directors can no longer rely for protection on the separate personality of their company as "lifting the corporate veil" has become a more and more common occurrence. Thus a director who fails in his duty to to the company has unlimited liability for any resultant loss. There are various grounds on which directors may be held personally liable. For instance, statutory liabilites contracts, delicts and civil wrongs. According to section 310 of the Companies Act any provision in the internal regulations or elsewhere that purports to exempt directors (or other officers) from any other liability arising from "negligence, default, breach of duty or breach of trust" is void. Nevertheless, there are a number of ways under which a director may be relieved from his liability. This includes ratification by the shareholders in general meeting, a provision in the articles of association or a relief by the court if certain requirements are satisfied.

The thesis will conclude with a brief evaluation of the practical importance and effectiveness of the rules governing the directors function.

Chapter One

Some Legal Aspects regarding Business Associations British and Algerian Law

A discernible phenomenon in company law is that groups of companies take extremely diverse forms as a result of the nature and variety of transactions in national and international commercial life. Accordingly, the legal forms or structures which are adopted for the purpose of conducting business activity are in most cases similar in many countries.

The legal forms of business organisations in use in both Britain and Algeria today, can be arranged into four major categories: Sole traders, Partnerships, Companies, Public Corporations. The first three forms are to found in the private sector and the latter form represents the public sector; since it is regarded as the preferred form of the state intervention in the economy.

This chapter intends to highlight some important points regarding private business associations in both British and Algerian Company law. This includes:

1. Sources, classification and structures of commercial companies;
2. Structure of the Board of Management;
3. The role and qualification of directors.

Section 1: Sources and Classification of Commercial Companies

1.1. Sources

In Algeria business associations are governed by the commercial code of September 26th, 1975 book 4 under the title of commercial firms (article 544 to 640) and the civil code 1975 that contains general rules that apply to all kinds of companies and to civil companies specifically (articles from 416 to 449). The new commercial code 1975 deals with amongst other subjects the formation, structure and management of private sector companies. This demonstrates some similarities to certain aspects of the French commercial codes through a circuitous route.[1] However, it constitutes a new body of domestic law. These trends are of course not confined to the civil and commercial codes but cut across the whole code of administrative law as well as private law. Unlike France, Algerian judicial organisation does not have separate commercial courts with exclusive commercial jurisdictions and particular rules of proceedings. However, within each tribunal or court and at the supreme court, there are commercial chambers ("section commercial" of the tribunal, "chambre commercial" of the court and the supreme court) which specialise in commercial matters. The civil procedure code (code de procedure civile) governs procedures for hearing and settling all the cases brought before tribunals, courts and the supreme court. Generally speaking it can be said that the Algerian Commercial Code 1975 has retained French legal principles and codifications which derive its existence from Roman Law and regional customs. In Britain, however, there is no separate system of commercial law but it is regarded as part of the general law of the country and not as the law of a particular class of persons.[2] The equivalent body of rules developed as an integral part of the common law, although the customs that were current among the merchants of the day did play their part in shaping it.[3] Indeed, it can be noticed that many of the basic principles of British Company law are not embodied in statutes, as the common law influence is still strong at the present time.[4] However, the development in national and international commercial transactions in most countries especially in western Europe due to the influence of European Community harmonisation programme led to reconsider their legislation as the only effective way to cope with the current changes. In Britain, there has been a whole series of Companies Acts. The current statutes being the Companies Act 1989; Insolvency Act 1986; Company Directors Disqualification Act 1986; Financial Services Act 1986; Business Names Act 1985. The Partnership Act 1890, and Limited Partnership Act 1907. Nevertheless, much of the law relating to partnership is still to be found in the cases, as it is with companies.

1.2. Classification

The two basic forms of business organisation in both Britain and Algeria are: The partnership, where either all or some of the members are responsible for the liabilities of the firm, and the limited company, where none of the members is liable for the company's debts.

As with other civil law systems, in Algerian law, there is a single classification which comprises both partnerships and companies. Thus societé, depending on the context in which it is used, may refer to partnership, or to a company, or to both. Therefore, the societés en nom collectifs (SNC) are general commercial partnerships; the partnership governed by the civil code is the societé civile; and the limited partnership is the societé en commandite simple (SCC); the societé par action and societé a responsabilité limitee are public limited company and private limited company respectively. The term societé is defined under article 416 of the Civil Code 1975 as a contract by which two or several persons undertake to contribute assets in kind or money to an undertaking of a pecuniary nature with the object of sharing profits and bearing losses.

"La société est un contrat par lequel deux ou plusieurs personnes s'obligent a contribuer a une enterprise d'ordre pécunaire, par la prestation d'apports en nature ou en numéraire, en vue de se partager les bénéfice et de supporter les pertes qui pourront en résulter".

Companies may be civil or commercial depending on their form or their object. This classification reflects a crucial distinction between the civil law, which is the general law embodied in the Civil Code and supplementary legislation, and the commercial law whose base is the Commercial Code. The latter applies to traders (commerçants) who are defined as persons who are principally engaged in "acts of commerce" (actes de commerce).[5] It differs both substantively and procedurally from the civil law. For example, it involves a different judiciary; it employs different rules of proof and it includes the bankruptcy law, which does not apply to persons not engaged in commerce. Nevertheless, the commercial law rests upon and presupposes the civil law which is applicable whenever the commercial law is silent upon a particular point[6]. In addition the distinction between civil and commercial companies is a practical importance and result in the following consequences:

1- Commercial Companies are subject to the rules applicable to all traders[7] such as the requirements to keep certain books and to prepare an annual auditted accounts to take each year a balance of the assets and the liabilities of the company and all the accounts, in order to establish the balance sheet and the profit and loss account. On the other hand a civil partnership or company is subject to the provisions of the civil code as to the annulment of contracts (e.g for mistake or fraud) and the civil period of limitations (5 or 30 years) applies to proceedings for annulment (articles 416-449 of the civil code).

2- Civil companies acquire legal status (personalité morale) as soon as the contract is formed, whereas commercial companies acquire legal status on registration at the register of commerce.

3- Commercial companies are subject to bankcruptcy proceedings; they are under the jurisdiction of the commercial section of the tribunal and of the court.

4- Commercial companies are subject to special fiscal regulations.

5- Although the Civil Code 1975 lays down the common grounds for dissolution of all types of partnerships and companies whether civil or commercial, commercial partnerships and companies may additionally be dissolved for other reasons which do not apply to civil concerns.

Article 544(1) of the Commercial Code provides that "the Commercial character of a partnership or a company is determined by its form or by its objects".

"Le caractére commercial d'une societé est determiné par sa form ou par son objet."

It follows from this that a partnership or a company which has neither a commercial form nor commercial objects is a civil partnership or company. According to article 544(2), the following companies are commercial in consideration of their form whatever their object is:

1- Sociétés par actions (joint stock companies)

2- Sociétés a responsabilité limiteés (SARL) (The limited liability company)

3- Sociétés en nom collectifs (general partnerships)

Since commercial companies are regulated by the Commercial Code, they must be created under one of the three mentioned forms which the commercial code describes.

Furthermore, sociétés which are commercial by reason of their form are further divided into societé de personnes (or sociétés par interêts) and sociétés de capitaux (or sociétés par actions). The former category, which represented by the sociétés en nom collectifs (general partnerships) are those where the personal characteristics of the participants are mutually important and therefore their interests in the association (intérêts) are not freely transferable. In this, it is very similar to civil companies. These personal elements also dominate the relationship between the partnership and third parties, because partners are personally and individually liable to creditors of the partnership for the whole of its debts and obligations.[8] In British law this also can be noticed in the restrictions on the transfer on the individuals' interest in the partnership and the provisions concerning the dissolution of the partnership in the event of a fundamental change in the qualities of any of the partners. Moreover, "The foundation stone of the partnership edifice is mutual confidence and where confidence is reposed equity insists that it shall not be abused." [9] Whereas in the société de capitaux represented by stock companies the personality of the individual members (the personal elements) is not so important, since its primary purpose is to rise capital to attain the companies' objects. Consequently, shares (actions) in such entities may usually be freely transferable. However, the sociétés á responsabilité limitée incorporate characteristics of each class, but in Algerian legislation the balance has been tipped somewhat in favour of aligning it more with the latter.[10]

Certain companies are commercial by virtue of their objects; any partnership or company which is formed to engage in commercial acts repeatedly and continuously as a business, is a commercial association under article 1 of the commercial code 1975 which defines a trader (commerçants) in this way. Further, the notion of commercial act is itself defined in article 2, 3 4 which list the commercial acts by virtue of its nature, form and objects respectively.

Unlike Algerian and French law, British law does not have this division into the twin regimes of civil and commercial law. The only main and relevant classification made under British law is that between incorporated and unincorporated associations. Although British associations do have characteristics of sociétés de personnes and societés de capitaux this division seems to be irrelevant and of no significance.[11] Indeed, it is argued that this distinction is not entirely accurate on the grounds that individuals (personnes) are needed by the company as well as the partnership, and capital (capitaux) is required not only by the company, but also by the partnership.[12]

1.3. Nature and Structure

As seen earlier the term societé is defined by article 416 of the civil code 1975 as "a contract whereby two or more persons undertake to contribute assets in kind or money to a concern of a pecuniary nature with the object of sharing profits and bearing losses". It follows from this article that all business associations are contract-based entities. In other words the contract element appears to dominate the nature of the société since it is constituted by the members' agreement. Thus, the contract of société is like any other contract and is subject to the same conditions and requirements. It can be entered into only with the consent of all the parties. Where the consent is lacking, the company never comes into existence; the same thing applies in the event of any misunderstanding as to the nature of the contract, the purpose of the company, or any of the essential elements of the contract.[13] Consent may be rendered defective by fraud or mistake. In such a case the contract of organisation is voidable. In addition, this consent to a contract to form a company must be given by persons having legal capacity to conclude a contract of the particular nature involved. In principle, anybody has the capacity to enter into a contract unless he has been declared by law totally or partially disabled. The civil code lays down the rules applicable to minors, to persons prohibited under court orders or under the law, and to other persons deprived of capacity (e.g., through unsoundness of mind). Furthermore, the object of this contract must be a lawful one. If the object is contrary to law and order or to morality, the contract is void. Article 96 of the civil code 1975 provides "Le contrat est nul si l'objet est contraire á l'ordre public ou aux bonnes moeurs".

In addition to the above general conditions that apply to all contracts, there are four basic conditions which are necessary to the contract by which companies are constituted. This includes:

1 - the intention of making profits (i.e., the purpose of the partnership or company must be to make profits. Therefore, it is necessary that the objects or activities which the partnership or company is formed to achieve or carry on should be capable of making profits.[14] The word 'profit' has a broad meaning which would include anything that increases the value of the associates' property or decrease in the expenses or losses of the associates.[15]

2 - the pooling of assets; the persons forming a company (participants) are required to make a contribution to the company's assets and without this contribution, the company cannot exist. This contribution may be in cash, in kind or in services, and in some cases it may consist simply of a promise of activity in the company's interests such as a promise to manage the company's affairs.[16]

3 - sharing of profits and losses: as the company's members are entitled to share profits, they are equally required to contribute to the losses that may be incurred by the company.[17]

4 - *affectio societatis* : this is defined as "the specific intention to constitute or create a company".[18] Indeed, a partnership or company cannot exist without such intention on the part of all the members to act together and on an equal footing to achieve a common goal.

In British law, however, section 1(1) of the Partnership Act 1890 provides as follows: "Partnership is the relation which subsists between persons carrying on a business in common with a view of profit". It appears from that section that the relationship is a contractual one. As Lord Lindley's authoritative work states "Partnership, though often called a contract, is a relation resulting from a contract. The statutory definition does not state from what the relation arises, but that an agreement, express or implied, is the source of the relation was clearly established before the Act and may be inferred from its provisions".[19] This can also be seen with companies where the contractual element between members seems evident from the terms of section 14(1) of the Companies Act 1985. The latter provides that the memorandum and articles of association (the constitutive document) when registered, bind the company and its members to the same extent as if they respectively had been signed and sealed by each member. It may be deduced from this that the memorandum and articles of association constitute a contract between the company and each member.

In these circumstances it can be said that the contract that lies behind the creation of a partnership or setting up a company is subject as is any other contract to clauses concerning capacity, object and defects to nullity of the contract, and therefore may render the partnership illegal or in the case of a company, members may find that their individual contracts to suscribe for shares can be vitiated by fraud, misrepresentation, duress or lack of capacity. Nevertheless, it is argued[20] that the contractual elements appear partiucularly strong in the case of *société*, as the *contrat de société* has a dual role, it is not only one of the formalities required for formation, but also a juridical agreement whereby the participants unite so as to attain their common objectives. Moreover, the term societé means both the contract and also the association which created by the contract.[21] In other words, the contract of societé gives birth to a juridical body that is distinct from its participants.

Section 2: The legal structure of the board of management

In most legal systems a company is governed by two primary organs: the shareholders and the board of directors. In theory, ultimate power in the modern company resides in the general meeting of shareholders. This is demonstrated by the fact that it has power of appointment and removal of the members of the board of directors; approves financial reports submitted by the board, disposes of earnings; and makes management decisions, which exceed the authority of the board of directors. In short, although it would be possible for the company in a general meeting to exercise all the powers of the company (especially in the case of one- or two-man companies), it would not be practicable for day-to-day management to be conducted by such an organ, particularly in large complex companies. This is certainly true in companies that require high standards and a well qualified body to run its affairs. Hence company legislation in different legal systems provide that a business corporation shall be managed by its board of directors which is the essential nucleus that makes a corporation a workable type of institution[22]. Indeed one of the advantages of membership of a company is that it enables the individual whose resources to engage fully in a certain industry or trade are insufficient, to combine with others and form an association or corporation in order to share profits and without having to take part in its management[23].

Unlike a company, a general rule in partnership is that all the partners are entitled to partake in the management of the firm's affairs unless the partnership agreement provides otherwise. Clearly, each partner is *ipso facto* a manager[24]; on the other hand, a shareholder of an incorporated company need not concern himself in the day-to-day management of the company. As has been stated earlier, the board of directors constitutes a necessary device to monitor the company's business, and employees' activities. However, the size, and structure of this vital legal organ differs from one legal systems to another and from one type of company to another.

This section will focus on structure of board of directors in both public companies and their counterparts in Algerian law.

2.1.- Structure of the Board of Directors in British Public Companies

Although public companies in Britain are few in number by far, with less than 1% of all incorporations in Britain, they are highly significant in terms of employment, investment and the creation of wealth[25]. This type of company acts through two main organs, the shareholders and the board of directors between whom the powers of the company are divided. Although in theory the members in general meeting are to be the supreme organ in the company by their control of the composition of the board of directors and their ability to regulate the directors' powers by altering the articles which confer those powers, the members may be said to be the ultimate authority.

However, in practice, the shareholders at a general meeting have shown themselves unable to exercise any detailed control over the day-to-day running of the company especially in large companies[26]. Indeed, one of the main economic purposes which the public limited companies have fulfilled is the accumulation of capital from different numerous sources for the benefit of the investors and of a society as a whole. Therefore, it will be in the interest of the shareholders to hand over the management of the company's affairs to a smaller group better equipped with special abilities and skills many shareholders may not themselves possess[27]. This places the directors in a stronger position than the members to influence the conduct of the company's affairs[28].

As a general rule, there are close similarities in the governance processes and board structures of public companies in different areas of activity. However, it can be said that there is a considerable variability between these companies in their approach to corporate management, this seems to be normal since the public companies (PLCs) vary from the vast corporate group with many subsidiaries, branches and thousands of employees, to a small public company whose ownership is in a few hands. In other words, in British public companies, the larger the company the bigger the board tends to be.[29]

The general law in force in the United Kingdom at present neither requires nor prohibits the setting up of a two-tier board system of administration for limited liability companies. The main requirement of the law is that every company must have a board of directors. The minimum number who must hold office at any time is two in the case of a public company incorporated on or after November 1 1929, and one in the case of a private company or a public company incorporated before November 1 1929.[30] For the rest the matters are largely left to be settled by the Articles of Association.

In most cases, companies adopt the articles set out in Table A found in Companies (Table A to F) Regulations 1985, modified according to their requirements. Table A provides that directors are initially to be appointed by the subscribers to the memorandum of association, and thereafter by the annual general meeting, except in the case of casual vacancies which are to be filled by the remaining directors until the next annual general meeting[31]. In addition, directors must be appointed individually on separate resolutions[32] so as to prevent the combination of directors whom the members wish to appoint with those whom they do not want. Table A also provides that one or more directors may be appointed managing director by the directors as a whole. These appointments can be revoked at any time subject to any agreement, and are also to terminate on the person ceasing to be a director. Furthermore the directors are empowered to confer upon a managing director or directors extensive powers to such an extent that they can delegate the whole of their own powers[33]. Any such delegation may be made subject to any conditions the directors may impose, and either collaterally with or to the exclusion of their own powers and may be revoked or altered at any time[34]. Consequently, it can be said, that the distinction between executive and non-executive directors does appear in British company laws if only in Table A, and there is no provision in the law which prohibits the adoption of articles of association which implement the dualist system to a much greater degree[35].

In practice, most public companies in the United Kingdom adopt a unitary board of management and tend to avoid the need to form formally two-tier systems of organisation. Despite this the fact that the general opinion of company lawyers in countries of the European Community is that the dual board system providing for a supervisory and an executive board, has much to commend itself and should be prescribed for large companies in the community[36]. This view was first presented by the European Community Fifth Directive 1972 which was concerned with board structures and employees participation, and proposed that all large companies should have two-tier boards. The supervisory board would be responsible for generally overseeing the company; monitoring and supervising the executive actions of the management board, with the duty, and the sanction, of appointing and if necessary, removing the members of the management board who are responsible for running the business[37]. The attitude of management in the United Kingdom, as presented for example, by the Confederation of British Industry has been opposed to the concept of the two-tier board and its view is that "the sense of collective responsibility for the conduct of business is best preserved where all the directors meet in a single board"[38]. Nevertheless, it is argued that the view of the C.B.I against the dual board system is not an accurate one since the latter does not prevent the directors, supervisory and executive, from sitting as a single board if the occasion demands it[39]. Moreover it is believed that the British managers have preferred to perform their duty of management under a single board system on the basis of its simplicity keeping a single decision-taking centre at the head of the firm, and ensuring a continuity of membership and thinking from senior management up to the directorial level[40]. It has been argued that there is no need to operate a two-tier system since it can be substituted by dividing the functions of different kinds of directors instead, and attaining the same goals which are expected to be achieved by the former system. Indeed, the managing director, or committees of managing directors function in the United Kingdom boards is quite similar to that of the management board in the German two-tier structure, while non-executive directors attend less frequently and exercise a role very similar to that of the German supervisory board[41].

However, in practice it is quite obvious that an informal separation of function does not provide the same guarantees as a formal separation (dual system). Furthermore, in many cases "non-executive directors do not have supervisory functions at all, indeed it may find it very difficult to exercise such functioning even if they wished to do so, by reason for example of their minority position, their lack of time and information, or their dependence in fact upon the executive directors' good-will"[42].

As an example it is worthy of note that French company law provides two alternative systems of management for Société Annoyme, namely, a unitary board and a two-tier system. The latter seems to have many more advantages than disadvantages, but it has so far been adopted by only a small number of companies[43]. This tendency may reflect the great advantages of the single board system, in which the members of the board, executive and non-executive are appointed and removed by the general meeting. This gives the latter a greater control over the executive members than in the case of the two-tier system[44]. Many British companies do operate a two-tier system in functional terms, and in some economic areas the two tiers are particularly noticeable, for example, Banks and Insurance companies and certain very large companies tend towards this structure[45]. The opposition to the general imposition by law of a two-tier system can be clearly noticed in several statements issued by different bodies, namely, the Confederation of British Industry[46]. The Stock Exchange[47], the Law Society's Standing Committee on Company Law[48] and the British Institute of Management's Study Group on Company Affairs[49], the Conservative Party indicated that it was not convinced that the two-tier board was particularly suitable in the British context[50]. On the other hand, the Labour Party's attitudes is in favour of the introduction of the two-tier system of boards in the larger companies[51]. Also the Trade Union Congress (T.U.C) stated that: "The system of two-tier boards is probably a desirable development"[52].

An obvious solution to the problem of separating the functions of executive action and supervision, as seen in British point of view is to appoint non-executive directors to the board. The appointment of such directors has been boosted in recent years by the C.B.I; by the last British Labour Government, as well as the Institute of Directors. It has been admitted that the presence of non-executive directors provides shareholders and members of the general public with a guarantee that directors are acting in their interest and also it is conventionally believed that non-executive directors may constitute a valuable source of expertise and experience, particularly in economic and financial matters[53]. In the Government White Paper on the Conduct of Company Directors, 1977,[54] it was stated that: "Non-executive directors can bring to the board a breadth of knowledge and experience which the company's own management may not possess"....Furthermore, the PRO NED (the promotion for non-executive directors) explains that : "The purpose of appointing non-executive directors is to provide the board with knowledge, expertise, judgment and balance which may not be available if the board consists only of full-time executives"[55]. Also, the Institute of Directors recommends that "every company should have a minimum of two non-executive directors who are independent"[56]. Although the Confederation of British Industry (C.B.I) has expressed itself against the dual board system, it has formed the view that

> "the inclusion on the board of non-executive directors is highly desirable....by virtue of the fact that unlike executive directors, they are not closely involved in the day-to-day affairs of the company, and they are in a better position to see the company as a whole and to take a critical view of it "[57].

It has been noticed that most of the discussion about non-executive directors in British companies have only sought to draw a distinction between the executive directors who are described as full-time employees of the company, responsible according to the terms of their service contract and involved of the managing the business, and others who are known as non-executive directors. However, at present, no distinction has been drawn under British Company law between the types of directors, and executive and non-executive directors are not recognised and such categories are unknown to the Companies Acts [58]. Consequently, they are responsible on equal footing for the direction, executive action, supervision and accountability of the company[59], and their duties and liabilities regarded to be the same, even though an executive may have further duties resulting from his service contract but these duties are superimposed on his duties as a director [60].

It can be concluded that the idea of appointing to a board a number of directors who are not full-time salaried officials of the company, has long been regarded as one way of assuring shareholders, and to a lesser extent, society at large, that the senior executives account to someone other than themselves. In addition, it is believed that they may play an important role as watchdogs[61]. In practice however, it is admitted that non-executive directors frequently do not do what is expected of them (supervision), the fact shows that most of them are appointed to the board so as to benefit the board with their expertise in different areas of business, and in some cases, they are in close relationship with the owners of the company or are retired employees. Therefore it can be said that non-executive directors cannot do their task effectively unless they are provided free access to management information and to have an increase in their number on the board. This is done in American law[62], in order to strengthen their position to exercise a real influence which is expected from them, as well as to support the British view as a substitute of a two-tier board system.

2.2.- Structure of the board of directors in sociétés par actions

Under Algerian law, the management of société par action differs from other types of companies such as société a' responsabilité limitée (SARL) and société en nom collectif (SNC) which are managed by one or more directors. Indeed, the intervention of the legislature in regulating the société par action by statutory provisions (from article 611 to 684 of the commercial code 1975) seems to be wider compared to other kinds of companies.

According to the commercial code 1975, every société par action must have three main organs, namely;

1 - conseil d'administration (the board of directors) which is the body of management that ensures the running of the company's business (articles 611 to 640);

2 - assemblée générale (general meeting) which is a body of deliberation (articles 641 to 655);

3 - commissaires aux comptes (auditors) as a body of control (articles 678 to 684).

The société en commandité par action, therefore, must be managed by a board of directors (conseil d'administration) which is composed of at least three directors and not more than seven, or not more than fourteen, if two or more companies have merged.[63]

Directors are elected from among the shareholders by the constitutive general meeting or, in the case of directors other than the first, by an ordinary general meeting. The actual duration of the tenure of office is determined by the company statutes. However, the law prescribes a maximum of six years in the case of a director elected by the general meeting, or three years if he is nominated in the statutes.[64] Unless the statutes provide otherwise, directors may be reelected. They may also be dismissed at any time by the general meeting[65]. In case of a vacancy by reason of the death or resignation of one or more of the directors, the board of directors may, in the period between two general meetings make provisional appointments. If the number of directors falls below the legal minimum, the remaining directors must immediately convene an ordinary general meeting in ordre to restore the full complement of the board.[66]

Directors must be shareholders of the company. They must hold a number of shares representing at least 20% of the company's capital.[67] These shares (20%) are not transferable, since they are regarded as a security for the company (actions de guarantie) in the case of directors' misconduct. If on the date of his appointment a director does not own the required number of shares or if, during his term as a director, he ceases to own them, he will be deemed to have resigned from office, if he has not rectified his situation within three months.[68]

The board of directors (conseil d'administration) must elect one of its members as president and he must be an individual (natural person).[69] The president is appointed for the period laid down in the statutes of the company, but this may not exceed the period of his appointment as director.[70] He may also be dismissed by the board at any time[71]. The president may be assisted by one or more general managers (directeurs généraux) who will have the same powers with respect of third parties as the president.[72] In the event of the president's death, resignation or dismissal, the general managers will, unless the board decides otherwise, continue in office and retain their powers until the new president has been appointed. Finally, it must be noted that the Algerian legislature adopts a single board system in managing the société par action, and does not provide any alternative system as French company law does.

Section 3: <u>Role and Qualification of Directors</u>

In the early stages of evolution of a company, the base of ownership tends to be narrow, that is, one or a few persons are owners, directors, officers and managers. This was primarily due to the small size of the companies and to some extent the nature of the relatively simple and narrow commercial transactions. In other words, where shares are held in a small number of hands, it will be possible for shareholders to more or less directly control the decision makers (board of directors) Through ratifying and monitoring important decisions and fixing incentives and rewards. This tendency is still present in small companies.

Indeed, among many heads of small businesses there is a belief that the board of directors serves no useful purpose. It has been argued that a board exists solely because the law requires it. Thus the board is seen as a necessary nuisance[73].

In contrast, the most striking feature of modern corporations is the principle of separation of ownership and managerial control. The reason for separation reflects the nature of modern companies which usually takes the form of complicated groups of subsidiaries with a substantial number of shareholders. Another observation is that growth in company size is normally accompanied by growth in the number of owners. Clearly, there is a need to provide a mechanism whereby, those owners who cannot be active in company management, have their rights translated into executive action - the board of management (directors).

The size of modern companies likely to make a holder of shares experience a loss of control over his/her resources because ownership is so broadly dispersed across large number of shareholders. This may explain why the typical shareholder cannot exercise real power to oversee managerial performance in modern corporations[74]. Furthermore, shareholders generally have shown themselves unable or unwilling to fulfil a monitoring function[75]. In addition lack of sophistication and capacity of management on the part of majority of shareholders is a contributing factor. The prime reason put forward by Professor Axworthy[76] is that "it is inefficient for most shareholders (those with small investments relative to the total shares in their corporation) to expand much effort on participation and control." Accordingly, in law and practice, shareholders entrust the monitoring of agents within the corporation to other agents, the directors, to act on behalf of them and conduct the company's business and affairs. Thus the existence of the Board of directors in modern company is not only a requirement of law but is clearly a practical necessity to provide a single and organised chain of command for effective management. Consequently, it is important to note that the directors take on a new and increased importance as 'representatives' of the shareholders and as custodians of their interests, hence if shareholders will not, or cannot, monitor the operations of the corporation and its senior employees, the directors, may in fact be the only intra-corporation monitors, because "according to the legal model of corporations, it is the *situs* of essentially all of the corporate power and the responsibility for corporate actions"[77]. Business corporations in many states, e.g Britain, Algeria, France are required *ex lege* to be managed by its board of directors[78]. It can be safely argued therefore, that the primary responsibility for the welfare of a corporation is entrusted to its board which is the facilitator for continuing a business enterprise.

Unlike a partnership, a corporation's existence does not terminate with changes in the membership; individual members of various groups come and go, but the enterprise itself continues if it renders a useful service to its investors (shareholders) and is properly managed. The legal necessity for corporations being governed by a board of management becomes apparent. While the number of members in boards differ from one legal system to another, the legislators intention can be seen as uniform.

Section 282 of the Companies Act 1985 requires that every private company and every public company registered before 1 November 1926 should have one director, and that every public company should have two directors. Algerian law requires that a stock company (société en commandité) is to be administered by a board of directors (conseil d'administration) of not less than three and not more than seven directors.[79] Article 576 provides that a limited liability company shall be managed by one or more individuals. The French law of companies states that a public company (société annonyme) must be governed by a board of directors comprising not less than three and not more than twelve members,[80] and private companies (société a` responsabilité limitée) are managed by one or more managers (gérants) under the direction and control of the members.

It is clear therefore that the legislature in different legal systems emphasise and attach importance to the number of directors of a company.

It is generally agreed that the effectiveness of a board of directors depends upon the abilities of the members of the board and their approach to the office. It must be noted that "investment in companies constitutes the most important single item of property, but whether this property brings profit to its owners no longer depends on their energy and initiative but on that of the management from which they are divorced"[81].

It is obvious that the eligibility and qualification of directors is a sensitive legal issue that must be taken into consideration before a proper analysis can be made of the legal powers and liabilities of management. Although company law recognises the vital role played by the board of directors, the issue regarding their competency and qualification has not received sufficient attention. This is rather surprising in spite of the close correlation between effective (successful) management and qualification. Indeed the relation between management and qualification can be regarded as opposite sides of the same coin.

As a general rule, company laws contain a limited number of statutory inroads on directors qualifications, for example, section s.302, 1985 Act provides that a director cannot be bankrupt, section s.296, 1985 Act must not be a convicted criminal and section 293 provides that a person who has attained the age of 70 cannot be appointed director of a public company or a private company which is a subsidiary of a public company, and a director reaching that age must vacate office at the conclusion of the next annual general meeting, unless the articles provide otherwise or the director is appointed or approved by a resolution of which special notice stating his age has been given. Algerian law requires that a director must have full capacity to be eligible for appointment to the office of a director, since he is not only an agent of the company but he is its legal representative (representent legal)[82]. Similar requirements can be found in French law where it is provided that a director must have the capacity to be an agent (mandataire) that is to say the civil capacity of common law (la capacité civile de droit commun)[83] and also he must not be deprived from the right to manage a company by an order of the court or an administrative authority. In addition, a person engaged in certain professions such as notary, advocate, accountant cannot be a director.[84]

British law has consistently adopted the attitude that directors need have no special qualifications at all for office[85]. That is to say, no qualifications are required for a director; subject to this, anyone can be a director. There is no educational requirement nor any other test of fitness or character.[86] Therefore, it is evident that directors need have no special qualification and the shareholders are entitled to choose whom they wish.

Neville J. in Re Brazilian Rubber Plantation and Estates Ltd[87] said

"a director is, I think, not bound to bring any

> qualifications to his office. He may undertake the management of a rubber company, in complete ignorance of everything connected with rubber without incurring responsibility for mistakes which may result from such ignorance".

The courts defend their liberal attitude by saying that if shareholders appoint bad directors, they must take the consequences: "It was the misfortune of the company that they choose such unwise directors."[88] However, there is a considerable body of opinion which take the view that the modern public company director is no longer an amateur but has now acquired, and now asserts, a professional status together with professional skills[89]. Thus it is suggested that directors should be made to conform to professional standards of care similar to those attached to doctors, surgeons, lawyers, accountants and architects etc[90]. As Mr Arkel (Chairman of the Council of the British Institute of Management) stated [91] "'The bridge' of an industrial company is its board of directors." Accordingly, it is necessary that directors should comply with certain conditions of qualification requirements. These may include having formal educational training in business management, or have experience in the field, or at least attending special courses and training before being appointed to a post of directors. It is possible to argue that failures of the company is the first clear sign of a director's incompetence; this is supported by Mr. Arkel who stated that "managing or supervising, the management of the company needs intensive training and experience."[92] In this context, it is worthy to note that French law had attempted to some extent to regulate and overcome the problem of competence within the management of the company. This included some areas and kinds of companies. This was reflected in article 596 of "code de la santé publique" decree, of October 5th, 1953 which provides that in public companies (sociétés annonymes) which are engaged in preparation or wholesaling medical products (produit pharmaceutique). The president and the majority of members of the board (les administrateurs) must be graduates in pharmacy. "Dans les societés annonymes de préparation ou de vente en gros des produits pharmaceutiques, que le président et la majorité des administrateurs aient le diplome de pharmacien."[93] However, it has to be acknowledged that it is quite unreasonable to expect every director, especially in a very large company, dealing with many transactions and complex affairs to have equal knowledge and expertise in every area of corporation management. Professor R. Parssons noted that "reassuring observation is offered to the effect so long as the law ensures that directors' hearts are pure it may not matter that some directors are incompetent"[94], for example, in a large car manufacturing company, the role and expertise of one director may be in mechanical engineering; consequently, if a board reaches a decision on corporate marketing, the director (engineer) by virtue of his lack of knowledge and experience in such an area will be very dependent upon his colleague who is well qualified in this branch. However this has no impact on qualification requirements since the directors in the board act collectively. Thus the individual skills and knowledge of members collectively constitute a competent and experienced board.

In contrast to British law, French law requires that each director must hold an appropriate number of shares in the company as fixed by its articles of association (statutes). Therefore all directors must be shareholders. Hence if a director does not hold the requisite number of shares when he is appointed he must acquire them within three months or resign[95]. These qualifying shares are designated directors' fidelity shares (actions de guarantie des administrateurs)[96] and are not merely a qualification holding but they constitute a guarantee deposit from which the company can reimburse itself in the event of mismanagement or negligence by the members of the board of management. Accordingly, the stated shares must be deposited in the company's treasury and must personally be owned by each director, they must be nominal, and not bearer shares and must be stamped to indicate that they are not transferable.[97] The Algerian legislature goes further in emphasising the share qualification requirement; this can be noted in article 619 of the commercial code 1975 which provides that "the board of directors must be proprietors of a number of shares representing at least 20% of the firm's capital. These shares are affected in their totality by a guarantee of all the acts of management, even of those which would be exclusively personal to one of the directors. Furthermore, they are inalienable. In addition, auditors shall ensure and be responsible for compliance with the provisions of article 619 and must note any violation thereof in their report to the annual shareholders meeting[98]. The legislature substantiates this onerous requirement by describing this shares as an incentive for encouraging directors in exercising care in running the affairs of the company. A drawback is that a share qualification may constitute a stumbling block in restricting unreasonably the persons best able to take up office. Besides, the percentage required usually is so small as not to really influence the situation. Consequently, the modern tendency, especially in large companies, is to exempt directors from the requirement of qualification shares. As stated earlier, the Companies Act 1985 does not require that a director must be a shareholder but the articles of association may require it. Section 291 of the Companies Act 1985 provides that

> "It is the duty of every director who is by the company's articles required to hold a specified share qualification, and who is not already qualified, to obtain his qualification within two months after his appointment, or such shorter time as may be fixed by the articles".

It is quite obvious from this section that share qualification is not a mandatory requirement, but it hinges on the articles of association of every company. The object of requiring directors to hold qualification shares has generally been to ensure that directors have a personal interest in the company (Archer's Case)[99]. Also a director need not devote any particular part of his time or his continuous attention to the company's business (Re City Equitable Fire Insurance CO LTD)[100], although it has been suggested a director should attend most board meetings. This did not, though, establish liability in cases such as Re Dunham & Co.[101] and The Marquis of Butes case[102], and only one successful case where directors have been held liable for non-attendance is reported - Charitable Corporation v. Sutton.[103] However, as it is known the main reason of appointing a director is to ensure the good running of the business and to safeguard the company from becoming insolvent. This goal would not be attained without devoting his full time and attention to the day-to-day management of the company. Thus, a statutory provision defining the real role of directors could usefully be introduced in future legislation.

Notes:

1- D'Aigrement, G.L, & Dean, J.P., "Legal Aspects of Doing Business with Algeria", (1987)2 A.L.Q. 148 at p.151

2- Schmitthoff, C.M., (ed), Palmer's Company Law, Vol. 1, The treatise, 24th edition, 1987, at p. 1672

3- Drury, R.R., "Legal Structure of Small Businesses in France and England", (1987) 27 I.C.L.Q 510, at p.514

4- ibid

5- Article 1 of the Commercial Code 1975 provides "Sont Comerçants ceux qui exercent des actes de commerce et en font leurs profession habituelle".

6- Church, E.M., Business Associations Under French Law, 1960, at p. 29-30

7- See articles 9,10, 11, 12 of the Algerian Commercial Code 1975

8- Le Gall, J., French Company Law, 1974, at p. 15

9- Ivamy, E.R.H., Underhill's Principles of the Law of Partnership, 10th edition, 1975, p.77

10- El Manzalaoui, A.H., Sociétés Commerciales, Algiers, 1984,at p. 68

11- Drury, R.R., supra, note 3, p. 515

12- Frommel & Thompson, Company Law in Europe, 1975, at p.16

13- Church, supra, note 6, at p. 34

14- Le Gall, supra, note 8, at p. 3

15- Church, supra, note 6, at pp. 3-4

16- Le Gall, J., supra, note 8, at p. 3

17- art. 416 of the Civil Code provides "....with the object of sharing profits and bearing losses".

18- Church, supra, note 6, at p. 48; Hamel, J., "L'affectio Societatis" (1925) Rev.Trim.dr.Com. 761

19- Scamell, E.H. & Banks, R.C., (editors) Lindley on the Law of Partnership, 15th edition, 1984, at p. 16

20- Drury, R.R., supra, note 3, p. 518

21- Ibid

22- Copeland & Towl, The Board of Directors and Business Management, Boston, 1947, at p.3

23- Hornby, J.A., An Introduction to Company Law, 1969, at p. 139

24- Hadden, T., Company Law and Capitalism, London, 1972, at p. 157

25- Tricker, R.I., Corporate Governance Practices, Procedures, and Powers in British Companies and their Boards of Directors, 1984, at p.179

26- Axworthy, C.S., "Corporate Directors Who Needs Them?" Seminar held at the Faculty of Law, University of Glasgow, November 1987, at p. 13

27- Bulletin of the European Communities, Employee Participation and Company Structure in the European Community, (Supplement) 1975, at p. 16

28- Frommel & Thompson, supra, note 12, at p. 574

29- Tricker, R.I., supra, note 25, at p. 179; see also Brooks,C., Board of Directors in British Industry, 1979, at p. 26

30- Companies Act 1985, section 282(1) to (3). Table A art. 64 provides that "Unless otherwise detemined by ordinary resolution, the number of directors (other than alternate directors) shall not be subject to any maximum but shall not be less than two".

31- Table A, 1948 Companies Act, articles 75, 89, 90,91, 92, and 95.

32- Companies Act 1985, section 292

33- Table A, Companies Act 1985, article 72; see also Chapter three of this thesis.

34- Ibid

35- Bulletin of the European Communities, supra, note 27, at p.101

36- Schmitthoff, C.M., (ed), The Harmonisation of the European Community Law, 1973, at p.23

37- Tricker, R.I., supra, note 25, at p. 197

38- Confederation of British Industry statement on a new look at the responsibilities of the British public company, (CBI 1972) para 2.49 and 2.59; Schmitthoff, supra note 36, p. 24

39- Schmitthoff, supra note 36, p. 24

40- Denton, G., Beyond Bullock, (Economic Implications of Worker Participation in Control and Ownership of Industry) published by the Federal Trust for Education and Research, London, 1977 at p.10

41- Ibid

42- See The Board of Directors, Management Survey, Report no. 10 carried out by Political and Economic Planning (P.E.P) for the British Institute of Management. 1972

43- Le Gall, supra, note 8, p.149

44- Schmitthoff, C.M., "New Concepts in Company Law", (1973), J.B.L. at p. 319

45- Bulletin of the European Communities, supra, note 27, at p. 101

46- Confederation of British Industry, The Responsibilities of the British Public Company, 1973, at pp.40-42

47- The Stock Exchanges View, Company Law Reform, November 1973

48- Observations on points of principle on the draft proposal for a fifth directive, March 1974

49- Final Report, March 1974

50- Department of Trade and Industry, Company Law Reform, Cmnd. 5391, paras. 60 and 61

51- The Community and the Company, Reform of Company Law, Report of Working Group of the Labour Party Industrial

Policy Sub-Committee. London, The Labour Party, 1974, p. 14

52- EEC Proposals on Aspects of Company Law: Application to Briatin- TUC comments, January 30, 1973, para 9(i)

53- Brooks, C, supra, note 29, at p.37; see also Jacobs, E.J. "Non-Executive Directors", (1987), J.B.L. 269

54- The Conduct of Company Directors, White Paper, Cmnd. 7037, HMSO, November 1977

55- Role of the Non-Executive Directors: A booklet prepared for PRO NED (The Promotion for Non-Executive Directors) February 1984. In an article in the Financial Times, Friday, June 24th 1988, at p. 16 entitled "More a Question of ' what happens if?'" Sir John Harvey-Jones (Former Chairman of Britain's biggest chemical group I.C.I) noted that it is valuable to look for non-executive directors "who give you a chance to fill gaps in your board that are difficult to fill from in-house."

56- Institute of Directors, A Code of Practice for the Non-Executive Directors: Non-Executive appointments service, 116, Pall Mall, London, SW1 5ED, 1982

57- Confederation of British Industry, The Responsibilities of the British Public Company: Company Affairs Committee; Lord Watkinson, (Chairman), 1973 at p. 37

58- Tricker, R. I., supra note 25 at p.167

59- Ibid at p. 18; see also Schmitthoff, C.M., (ed), Palmer's Company Law, vol. 1, The Treatise, 24th edition 1987 at p. 908

60- Tricker, R. I, The Independent Director, a study of the non-executive director and the audit Committee, 1978, at p.21

61- Department of Trade and Industry, Conduct of Company Directors, Cmnd 7037, London, HMSO, 1978, at pp. 5-6

62- The management direction by executive directors is the norm in British public companies. By contrast in large United States companies, independent direction is the norm, with a majority of outside directors.

63- Articles 611(1) of the Commercial Code "La société par action est administrée par un conseil d'administration composé de trois membres au moins et de 7 membre au plus; toutefois, en cas de fusion, ce nombre de 7 pourra être dépassé jusqu'à concurrence du nombre total des administrateurs en fonction depuis plus de six mois dans les sociétés fusionnées, sans pouvoir être superieur a 14".

64- Article 612 "les administrateurs sont nommés par l'assemblée générale constitutive ou par l'assemble générale ordinaire. Dans le cas prévu a l'article 610, ils sont désignés dans les statuts. La duré de leurs fonctions est determinée par les statuts sans pouvoir excéder six ans en cas de nomination pas les assemblées générales et trois ans en cas de nomination dans les status."

65- Article 613: "Les administrateurs sont rééligibles, sauf stipulation contraire des status. Ils peuvent être revoqués à tout moment par l'assemblée générale ordinaire".

66- Article 617 "En cas de vacance par décés ou par démission d'un ou plusieurs siége d'administarteurs le conseil d'administration peut, entre deux assemblées générales, procéder a des nominations a titre provisoire.

Lorsque le nombre des administrateurs est devenu inférieur au minimum légal, les administrateurs restants doivent convoquer immédiatement l'assemblée générale ordinaire en vue de compléter l'effectif du conseil".

67- Article 619(1):"Le conseil d'administration doit être propriétaire d'un nombre d'actions représentants au minimum, 20% du capital social".

68- Article 619(3):"Si au jour de sa nomination, un administrateur n'est pas propriétaire du nomber d'actions requis, ou si en cours de mondat, il cesse d'en être proppriétaire, il est réputé démissionaire d'office, s'il n'a pas régularisé sa situation dans le délai de trois mois."

69- Article 634:"Le conseil d'administration élit parmi ses membres un président qui est á peine de nullité de la nomination, une personne physique. Il determine sa rémunération".

70- Article 635:" Le Président est nommé pour un durée qui ne peut excéder celle de son mandat d'administrateur. Il est rééligible."

71- Article 635(2):"Le conseil d'administration peut le révoquer a tout moment. Toute disposition contraire est reputée non écrite".

72- Article 639: "Les directeurs généraux sont révocables a tout moment par le conseil d'administration, sur proposition du président..."

73- Juran & Louden, The Corporate Director, New York 1966, at p. 21

74- Demestez, H, "The Structure of Ownership and the Theory of the Firm", 1983, 26 J.L.& Economics, at p. 375

75- Axworthy, C.S., supra, note 26, at p. 13

76- Ibid

77- Ibid, at p. 6

78- Section 282 of the Companies Act 1985; article 611 of the Algerian Commercial Code 1975, article 85 of the French Law of Companies Act 1966.

79- Article 611(1) of the Algerian Commercial Code 1975 "La société par actions est administrée par un conseil d'administration composé de trois membres au moins et de 7 membre au plus; toutefois, en cas de fusion, ce nombre de 7 pourra être dépassé jusqu'á concurrence du nombre total des administrateurs en fonction depuis plus de six mois dans les sociétés fusionées, sans pouvoir être supérieur á 14."

80- Article 89(1) of the French Commercial Code 1966 "La société anonyme est administrée par un conseil d'administration composé de trois membres au moins et de douze membres au plus".

81- Gower, L.C.B., The Principles of Modern Company Law, 4th edition, 1979, at p.10

82- Mahrez, A., Droit Commercial en Algerie (Sociétés Commerciales) 2nd edition, 1980, at p. 287

83- Juglart & Ippolito, Cours de Droit Commercial, vol. 2, 4th edition, 1971, at. p. 431

84- Le Gall, J., supra, note 8, at p. 131

85- Trebilcock, M.J., "The Liability of Company Directors for Negligence", (1969)32 M.L.R 499 at p. 509

86- Powell-Smith, V., The Law and Practice Relating to Company Directors, 1969, at p. 15

87- [1911] 1 ch. 425

88- Per Hatherly, L.C. in Turquand v. Marshall, (1869) L.R. 4 Ch. App 376, 388

89- Trebilcock, M.J., supra, note 85, at p. 509

90- Ibid

91- A Letter in the Times, Monday, 17th June, 1974, at p.16 entitled "Management Reform - The Need for a Flexible Approach to Change" by John Arkel.

92- Ibid

93- Hamel & Legard, Traité de Droit Commercial, vol. 1 Paris, 1954, at p. 761

94- (1966), 5 Melb. Univ. L.R 395

95- Article 95(3) of the French Commercial Code, 1966

96- Church, E.M. supra, note 6, at p. 366

97- Ibid

98- Article 621 of the Algerian Commercial Code, 1975

99- [1892]1 Ch. 322; Schmitthoff, C.M., Palmer's Company Law, vol.1, 22nd edition, 1976, at p. 642

100- [1925] 1 Ch. 407

101- (1883) 25 Ch.D. 752; 50 L.T. 523

102- (1892) 2 Ch. 100

103- (1742) 2 Atk 400

Chapter Two

Directors' Powers

Section 1: Legal Nature of Directors' Powers

Although a company is regarded in all modern company laws as a legal person with rights and duties, it cannot act for itself as it is an inanimate entity. Thus, all acts and transactions that are attributed to it can only be performed through the medium of humans who constitute the company's living existence and mind. Generally speaking, a company acts through its board of directors or through the members in general meeting, and these two bodies are entitled between themselves to exercise all the powers of the company. As Greer LJ in Shaw John & Sons (Salford) Ltd. v Shaw[1] stated[2]: "A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting."

Although the Companies Act does confer some of the company's powers on the board and on the general meeting, the distribution of powers between the board and the general meeting is still unclear. This may be ascertained to the fact that there is no specific provision on how the company's powers are distributed between these two bodies. Indeed, unlike American law and the laws of most European countries, British law does not regard certain powers as managerial and therefore inalienable by the board.[3] The division of company powers and functions between its board and its shareholders in general meeting is left to be prescribed by the company's memorandum or articles of association. Theoretically, the general meeting could direct the affairs of the company if the constitution of the company so provided, but apart from very small companies, this would not be very practicable.[4] Indeed, it would be virtually impossible for a company - especially a large one - to run its business efficiently if management decisions had to be referred to the general meeting for approval. Accordingly, the decision-making process involves the executive authority of the company to be vested in its board of directors whose duty is to ensure that that the business is carried on in compliance with the memorandum, articles of association and customary business practices. As the Jenkins Report noted: "If directors are to manage their company efficiently they must, within broad limits, have a free hand to do what they consider best in the interest of the company".[5]

Thus, in practice, the articles of association of a company commonly delegate to its board of directors, by article 70 of Table A 1985 or by other similar provision, all the powers of the company not required by the Act or by the articles to be exercised by the company in general meeting. Article 70 of Table A 1985 which is adopted by most British companies provides that: "Subject to the provisions of the Act, the memorandum, the articles of association, the business of the company shall be managed by the directors who may exercise all the powers of the company". Once the articles have given the directors full powers to manage the company's affairs, the shareholders cannot interfere. In other words, if it appears from the proper construction of the articles that a particular power is vested in the board of directors only, and the board is competent and willing to act, the general meeting cannot control, interfere with or direct the board regarding the exercise of this power. The only way in which the general meeting can control the exercise of these powers vested by the articles in the board is by altering the articles, or by removing or refusing to re-elect the directors whose actions they disapprove. This is expressed by Greer LJ in Shaw (John) & Sons (Salford) Ltd v. Shaw[6]:

> "...If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of the shareholders."

However, although the members cannot treat the directors as their agents and overrule them in the exercise of their powers, it is quite possible for the articles to vest the same powers in members and directors concurrently, in which case in the event of a conflict the members' decision would generally prevail over that of the directors because the members in general meeting are the superior authority.[7]

In Algeria as in the United Kingdom, companies are administered and governed by directors called "administrateurs". They are vested with all the powers necessary to carry on the business of the company in a similar manner to the United Kingdom position. The supervision of the shareholders always is present and they regularly convene in general meetings. Article 622 of the Algerian Commercial Code 1975 provides that: "The board of directors is vested with the most extensive powers to act under any circumstances in the name of the company; they exercise them within the limits of the firm's objectives and subject to powers expressly attributed by law to shareholders."

> "Le conseil d'administration est investi des pouvoirs les plus étendus pour agir en toute circonstance au nom de la société; il les exerce dans la limit de l'objet social et sous réserve de ceux expressément attribués par la loi aux assemblées d'actionnaires".

From this it appears clearly that company directors both in Britain and Algeria enjoy a wide range of powers to act on behalf of the company. However, despite these extensive powers vested in them, the shareholders in general meeting still retain a strong position in the company since they have the ultimate control over the board and the affairs of the company. They are able at any time to remove the directors, and they also have the right to alter the articles of association of the company.

Neither the Algerian Commercial Code nor the British Companies Act define a director, although section 741(1) provides that "The term director' includes any person occupying the position of a director, by whatever name called." It follows from that section that a director is recognised not by his title but by his function which depends on the nature of the company, the provision of the articles and the contents of the director's service contract - if he has one. A company may describe its directors as, for example, 'governors', 'trustees' or 'council members' without affecting the legal status as directors[8].

The nature of the legal relationship between a director and the company of which he is a director is not defined by the Companies Acts and only appears from an analysis of the authorities.[9] The nature and position of company directors has given rise to considerable debate, which was stimulated by the need to regulate the conduct of directors by placing them into predetermined legal category and apply the rules governing that category.[10] This is reflected in the different attempts to describe a director's legal status in relation to the company. They have been regarded as agents[11], trustees[12] and fiduciaries.

Lord Johnson in McLintock v. Campbell[13] stated " the director's functions are in one view those of the agent, and in another those of the trustee. But the former predominate over the latter." Similarly in Regal (Hastings) v Gulliver[14] Lord Russel said: "Directors of a limited company are the creatures of statute and occupy a position peculiar to themselves. In some respects they resemble trustees, in others they do not. In some respects they resemble agents, in others they do not." In some respects they resemble managing partners, in others they do not. It is believed that directors' powers derive from a fusion of Common Law and equitable principles of agency and trusteeship which is now the subject matter of an elaborate network of Common Law and Statute Law principles.[15] It is quite common for the articles of association to provide for the company's business to be managed by the board so that the acts of directors become the acts of the company i.e. when acting for the company, a director legally binds it as if he were its agent. The logic is that since directors act for a corporate body, they must necessarily be agents of that body. Certainly the relationship embodies some legal characteristics of agency, for example, directors like any other agents incur no personal liability on contracts made by them on behalf of the company, within the scope of their authority.[16] However, there are some peculiarities in the relationship between director and company which strain the agency analogy. The artificial nature of the principal makes it quite difficult to see the normal agency-principal relationship between directors and the company. Even assuming that shareholders are the principals, the control aspect is very difficult to discern, since the directors are not necessarily subject to the wishes of the majority shareholders. Therefore, as was pointed out in Northern Counties Securities Ltd. v. Jackson and Steeple Ltd.[17] the director is "an agent who casts his vote to decide in what manner his principal shall act". With his co-directors a director controls the activities of his company so his powers are greater than those normally accorded to an agent.[18] Furthermore, since the directors are given control of the company's affairs and property, their position in fact exceeds that of ordinary agents. A link with managing partners of an unincorporated firm is sometimes stressed:

> "It is a fallacy to say that the relation is that of simple principal and agent. The person who is managing for himself as well as others...I think it is more nearly true to say that [directors] are in the position of managing partners, appointed to fill that post by mutual arrangement between all the shareholders"[19].

This view is supported by Buckley, L.J. in Gramaphone and Typewriter Ltd. v. Stanley[20],

> "The directors are not servants to obey directions given by the shareholders as individuals; they are not agents appointed by and bound to serve their shareholders as their principals. They are persons who may by the regulations be entrusted with the

> control of the business, and if so entrusted, they can be dispossessed from that control only by the statutory majority which can alter the articles. Directors are not, I think, bound to comply with the directions even of all the corporators acting as individuals".

As in the United Kingdom, the view that directors are agents of the company is still popular in some legal systems such as Algeria and many European countries which followed the earlier French model (French Companies Act 1867) now replaced in France in 1966.

Directors are to be described as mere agents of the company whose powers are governed by the rules of 'mandate' (mandat). However, this concept of mandate is not the exact equivalent of the British concept of agency. The French Civil Code conceives mandate (mandat) as a contract between the principal (mandat) and the agent (mandataire) which includes the granting of power to the agent to represent the principal. Thus, basically the authority of the agent to bind his principal in dealings with third parties depends on the mandate he has received.[21] Under Algerian Law, a board of directors is regarded as an important organ in the company's body, and empowered *ex lege* to represent the company in its transactions according to the provision of law, and not merely as mere agents for the shareholders with powers limited by a contract of agency, since if he exceeds those limits, he loses his status as an agent and he will not bind the company. This is because a board of directors in the view of the Algerian legislature is regarded as a legal representative (representant legal) of the company and its powers are defined and limited by law.

Another view is to describe directors as trustees of the company, its money and property, i.e., they hold the company's property in their hands or under their control in trust for the company. Accordingly, they are required to apply such property for the purpose specified by the company's constitution and a misapplication of it constitutes of breach of trust.[22] As Sealy[23] pointed out: "The concept had its origin in the fact that in the earliest companies, the director was a trustee in the full technical sense." This is so especially before 1844 when most joint stock companies were unincorporated and the property was vested in the trustees of the company, who were often directors. During the 19th century the fiduciary duties that were imposed on trustees were extended by way of analogy by the Chancery Court to include all persons who acted in a fiduciary capacity, such as agents, company promoters and directors of companies[24] who are often described by the court as trustees. However, as Professor Pennington said:

> "This did not mean that other persons who acted as representatives really were trustees, but simply that fiduciary duties similar, or in some cases, identical to those imposed on trustees were imposed on them in equity. The description of directors as trustees was metaphorical".[25]

Indeed, the description of directors as trustees seems today to be inaccurate and less convincing. For example, although the fiduciary duties owed by a director and a trustee tend to be identical. Their duties of care and skill breaks this analogy since they are fundamentally different.[29] This is the view of Romer J in Re City Equitable Fire Insurance Co.[27] who said:

> "It has sometimes been said that directors are trustees. If this means no more than that directors in the performance of their duties stand in a fiduciary relationship to the company the statement is true enough. But if the statement is meant to be an indication by way of analogy of what those duties are, it appears to me to be wholly misleading. I can see but little resemblance between the duties of a director and the duties of a trustee of a will or of a marriage settlement".

Moreover, the theory regarding directors as trustees has limited support in the older textbooks and reports, and Sealy[28] argues that the description is wrong for three reasons:

1- The earliest cases in which directors were held liable on trust principles all concerned Corporations. (Charitable Corporation v. Sutton, (1742) 2 A t k 400)

2- It is obvious that the directors of a deed of settlement company and the trustees of its property were not usually the same group of persons. The directors and trustees had been treated as distinct working bodies with distinct functions .

3- Finally, it would be clear in the early cases of directors' obligations if the directors were in fact, trustees. But the contrary is indicated; in some cases an incorporated body has no trustee at all (Foss v. Harbottle, [1843] 2 Hare 416; Aberdeen Rly v. Blaikie Bros [1854] 1 Macq. 461. It is also submitted that directors are really only quasi-trustees or fiduciaries. This is because:

1- The company's money is not vested in them but in the company (a trustee is the owner of the property and deals with it as principal, as owner, and as master).

2- Their duties of care are not as onerous as those of trustees.

3- Their functions are not the same as those of trustees. Despite the fact that similarities can be found between directors and trustees there remain a number of differences. A main area of resemblance lies in the property concept, where directors and trustees each control a fund in which others are beneficially interested. However, this analogy breaks down, as ownership or property of the company is vested in the company, as a legal person and not in the directors themselves as in trusteeship. In addition the ordinary rules applicable to trustees do not affect directors.[29] In Smith v. Anderson[30] James, L.J clarified this difference by saying:

> "A Trustee is a man who is the owner of the property and deals with it as principal, as owner, and as master subject only to an equitable obligation to account to some persons to whom he stands in the relation of trustee...The office of a director is that of a paid servant of the company. A director never enters into a contract for himself, but enters into contracts for his

> principal, that is, for the company of whom he is a director and for whom he is acting. He cannot sue on such contracts nor be sued on them unless he exceeds his authority."

An appropriate description is that of Professor Lindgren[31] who observes that "Analysis of the theoretical status of directors demonstrates that they are not properly classified either as agents or trustees but are *sui generis* ....like the shareholders in general meeting, it (the board of directors) is a constitutional organ of the body corporate."

The main reason behind the definition of the true position of directors is that to understand the nature of their legal powers and duties and consequently the rules applicable to them. Indeed, as Sir George Jessel[32] MR put it:

> "...It does not much matter what you call them as long as you understand what their true position is, which is really that they are commercial men managing a trading concern for the benefit of themselves and of all the other shareholders.... They are bound to use fair and reasonable diligence in the management of their company's affairs, and act honestly."

Section 2: <u>Scope of the Directors Powers</u>

It is quite common for modern company law to lay down a number of regulations or sections to grant to the directors all powers except those which are reserved by the Act or regulations to the shareholders in the general meeting. A norm for such provisions are to be found in both British and Algerian law.

Article 622 of the Algerian Commercial Code, 1975 provides that "the board of directors is invested with the most extensive powers to act under any circumstances in the name of the company; they exercise them within the limits of the firm's objectives and subject to the powers expressly attributed by law to the shareholders' meeting"[33]. Article 70 of Table A stipulates: "Subject to the provisions of the Act, the Memorandum and the Articles and to any directions given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company". This provision replaces article 80 of 1948 table A.

It is clear from the above articles that the board of directors can exercise any of the powers of the company which have not been vested in the shareholders either by the Act, the Articles, or a resolution in general meeting. However these delegated powers must be exercised by directors acting collectively (not individually as in the case of partners). It follows that *prima facie* neither an individual director or any group of directors has any powers conferred on him or them, and seems that in the absence of an express authorisation in the articles or other appropriate constitutional document the board will have no power to delegate such powers[34]. The reason for this is that when they act jointly, viz, as a board, they clearly constitute one of the primary organs of the company whose powers are expressly defined in the companies constitution, i.e, in its Memorandum and Articles of Association. Besides, the virtue of acting collectively is to benefit the company of their combined wisdom and experience[35]. As a result of this, decisions of the directors must be taken at a meeting properly convened and held. However, since commercial life requires greater flexibility and simplicity in its procedures because of the great importance of time for dealing in their transactions such as buying and selling shares or lending or borrowing money with interest. Such matters therefore may not be decided on as quickly as commercial matters may require if any decision upon them involves a directors meeting. Hence, it is customary for the Articles of Association to allow a resolution in writing signed by all the directors, or all the directors resident in the United Kingdom, to be effective without a meeting (article 93). Moreover, the Articles usually authorise the directors to delegate any of their powers to the committee of directors (article 72) and to appoint one or more of their body to act as managing director (article 72). But as D. G. Rice pointed out: "The extent which an agent can bind a company has always been hedged about with uncertainty and doubt, particularly so where its directors - its principal executive agents - are in way concerned"[36].

The position is simplest and clearest where directors act jointly as a board, since this organ can commit the company in respect of any matter. On the face of it when any individual director purports to act or to enter into a transaction on behalf of the company, questions may arise regarding the extent and the degree of authority vested in him by the board. Nevertheless, where a director has validly been given express authority to enter into a contract on behalf of the company, the latter will be bound and no difficulty will arise at all. However, the authority that can be vested in the director in dealing with third parties on behalf of the company is not always clearly set out in writing in its constitution i.e the Memorandum and Articles of Association. That is to say that the director's power is not always express. In fact a director's authority may be actual, apparent, or deemed. (The latter is envisaged by the Companies Act 1985, s.35).

2.1.- Actual authority: was described by Diplock L.J. in Freeman & Lockyer v. Buckhurst Park Properties (Mangal) Ltd.[37] as follows:

> "An actual authority is a legal relationship between principal and agent created by a consensual agreement to which they alone are parties. Its scope is to be ascertained by applying ordinary principles of construction of contracts, including any proper implications from the express words used, the usages of trade, or the course of business between the parties. To this agreement the contractor is a stranger; he may be totally ignorant of the existence of any authority on the part of the agent. Nevertheless, if the agent does enter into a contract pursuant to the "actual" authority, it does create contractual rights and liabilities between the principal and the contractor."

Thus, if the director acts as the company's agent and within the scope of his actual authority, the company will find itself legally bound to a third party who enters into a transaction. Furthermore, this actual authority may be express or implied authority. It is express when it is put in words, written or otherwise. This means an explicit conferring of authority on a director. For example in the Articles[38]. As Lord Denning MR described it [39] "it is express when it is given by express words, such as when a board of directors pass a resolution which authorises two of their number to sign cheques." The main source of these express powers are: the Articles of Association, resolutions of board of directors and to some extent the main Acts or Statutes that regulate commercial companies.[39(a)] However, the latter are usually rather vague and tend to describe the directors' powers within the corporation in regard to internal matters with less clarification to their authority when dealing with third parties. It is worth mentioning that it must not be assumed that everything is *ultra vires* if it is not expressly written in the company's constitution. Indeed, without such wording of powers, a director may be fully vested with appropriate authority to act on behalf of his/her company. This is known as <u>implied authority</u> (inherent or presumptive authority). It is not expressed in Statutes, Articles of Association, or board resolutions but it is derived from the position which the individual holds. If for example, he is appointed managing director, then implied authority will vest him with the usual authority of a managing director. As Lord Denning MR pointed out in Hely Hutchinson v. Brayhead Ltd.[40]:

> "It is implied when it is inferred from the conduct of the parties and the circumstances of the case, such as when the board of directors appoint one of their number to be managing director. They thereby impliedly authorise him to do such things as fall within the usual scope of that office".

However, it is submitted that the director's office or position is not the only way to prove the implied authority to be vested in the director.

2.2.- Apparent Authority: Although if a director has no actual authority, either express or implied he may appear to third parties to have authority. For example, a director can bind the company in a transaction which would normally be within the power of a director of his type, even if his powers have been restricted by the articles or the board. Thus, a third party can assume that a properly appointed managing director has been delegated all the normal powers. In (Kreditbank Cassel GmbH v. Shenkers[41] Atkin LJ said:

> "If you are dealing with a director in a matter in which normally a director would have power to act for the company, you are not obliged to inquire whether or not the formalities required by the articles have been complied with before he exercises that power".[42]

Similarly, a director 'held out' by the company as being the managing director can bind the company even if he has not been formally appointed. In Freeman and Lockyer v Brockhurst Park Properties (Mangal) Ltd [43], the articles contained a power to appoint a managing director, although no appointment was made. The board allowed one of the directors to undertake the management of the company, in the course of which he engaged a firm of architects. The company subsequently refused to pay the architects' bill, on the grounds that the individual director had exceeded his authority. The Court of Appeal held that the company was bound by the contract since the director's act in engaging the plaintiffs was within the ordinary ambit of the authority of a managing director and the plaintiffs did not have to inquire whether he was properly appointed, it was sufficient for them that under the articles of association there was in fact power to appoint him as such and accordingly the defendant company were liable for the plaintiffs' fees. In the words of Willmer LJ[44]:

> "In the present case the plaintiffs do not have to rely on the articles of association of the defendant company in order to establish their claim. They are thus not caught by the ratio of the decision in Houghton's Case[45]. The plaintiffs here rely on the fact that [K], to the knowledge of the defendant company's board, was acting throughout as managing director, and was therefore being held out by the board as such. The act of [K] in engaging the plaintiffs was clearly one within the ordinary ambit of the authority of a managing director."

Thus, it is clear that by applying the doctrine of ostensible authority the company is no less bound than it would have been had the authority been express. The definition of the term 'apparent' or 'ostensible' authority was expressed by Diplock LJ in Freeman's Case as follows:

> "An 'apparent' or 'ostensible' authority,...is a legal relationship between the principal and the contractor created by a representation, made by the principal to the contractor, intended to be and in fact acted upon by the contractor, that the agent has authority to enter on behalf of the principal into a contract of a kind within the scope of the 'apparent' authority, so as to render the principal liable to perform any obligations imposed upon him by such contract. To the relationship so created the agent is a stranger. He need not be (although he generally is) aware of the existence of the representation but he must not purport to make the agreement as principal himself. The representation, when acted upon by the contractor by entering into a contract with the agent, operates as an estoppel, preventing the principal from asserting that he is not bound by the contract. It is irrelevant whether the agent had actual authority to enter into the contract".

According to Lord Justice Diplock's analysis before any company may be held liable or bound by the acts of an agent who had no actual authority, four conditions must be available:

a- A representation must be made to the contractor that the agent had the authority to enter on behalf of the company into a contract of the kind sought to be enforced;

b- That representation must be made by a person or persons who had actual authority to manage the company's business, either generally or in respect of those matters to which the contract relates;

c- The contractor relied upon this representation;

d- Finally, a company was not deprived of its capacity, i.e, no limitation on the company's Memorandum or Articles of Association making the contract *ultra vires* or prohibiting the delegation of authority to enter into a contract of that kind to the agent[46].

Apparent authority of a director, or any corporate agent may be determined from all the facts and circumstances of the case. It was held in an American case[47] that:

> "The principal's manifestations giving rise to apparent authority may consist of direct statements to the third person, directions to the agent to tell something to the third person or the granting of permission to the agent to perform acts and conduct negotiations under circumstances which create in him a reputation of authority in the area in which the agent acts and negotiates".

Sometimes the term apparent authority seems to be ambiguous and gives rise to confusion with implied authority. However, it is believed that the two concepts are clearly distinct. Apparent or ostensible authority, as it is sometimes called, is not really authority at all. As Professor Montrose put it[48] "Apparent authority is really equivalent to the phrase "appearance of authority". There may be an appearance of authority whether in fact or not there is authority." It is also submitted that the actual authority, unless the language explicitly points to the contrary, is confined to acts done for the benefit of the principal.[49] Thus, if an agent does an act which is within the class of acts set out in the actual authority, it is nevertheless not within the actual authority unless done for the principal's benefit.[50]

As far as apparent authority is concerned, if an act is within the class of acts to which the apparent authority extends, it is within the apparent authority, and binds the principal, whether or not done for the principal's benefit[51]. If the directors exercise the above powers (express or apparent) *bona fide* and in the benefit of the company as a whole, the company will be bound by their acts.

After highlighting the different extensive powers and authority that are enjoyed by the directors and agents of the company, it should be noted that those powers are not absolute or limitless, but they are subject to a number of rules and regulations under which they (powers) must be exercised. As has already been noted in the previous section, the first fiduciary duty imposed on directors is that not to exceed the powers and authority lawfully conferred upon them. Otherwise they will be liable to compensate for any damage suffered by the company in consequence. For example, directors who make *ultra vires* payments are liable to make good the loss to the company [52]. Indeed, to bind a company it is not enough that an act is within the powers of the company under the statutes, the

Memorandum and Articles , but it also has to be within the scope of authority of the person who performed the act. Hence, it is believed that in order to bind the company to an act, the act should first be within the capacity of the company. Otherwise, the company cannot be bound since it lacks the legal capacity to incur responsibility for it. It is quite clear that a company registered under the Companies Act 1985 does not have the capacity of a natural person, but is limited to carrying out the purposes that are set out in the objects clause of its constitution[53]. In other words, the company's capacity is determined by its objects stated in its Memorandum (constitution). For the Companies Acts requires a company on its incorporation to specify its objects[54]. Lord Cairns said in Ashbury Rly Carriage and Iron Co. v. Riche[55]: " The Memorandum of Association is, as it were, the area beyond which the action of the company cannot go. " It follows that the statement of the company's objects is of a considerable importance. As pointed out by Lord Parker of Waddington in Cottman v. Brougham[56]:

> "The truth is that the statement of a company's objects in its Memorandum is intended to serve a double purpose. In the first place it gives protection to subscribers who learn from it the purposes to which their money can be applied. In the second place, it gives protection to persons who deal with the company, and who can infer from it the extent of the company's powers. The narrower the objects expressed in the memorandum, the less is the subscribers' risk, but the wider such

> objects, the greater is the security for those who transact business with the company."

Hence the objects clause in the memorandum defines the extent of a company's capacity, and therefore, transactions entered into which do not fall within the scope of a company's express objects or powers, or which are not reasonably incidental thereto, are *ultra vires* the company. As Buckly J said[57]: "A corporation cannot do anything except for the purposes of its business.... everything else is beyond its power and is *ultra vires*." Such transactions are void and cannot be ratified by shareholders.

As stated earlier, in Algeria as in Britain, directors of companies (les administrateurs) are vested with all necessary powers to carry on the business of the company. Their powers are only restricted where there is an express provision in the statutes (statuts) for the general meeting to authorise a particular transaction. However, an important difference can be noticed between Algerian law and British law in respect of powers which can be exercised by directors. In Britain, those powers are restricted to the objects stated in the Memorandum of Association (e.g the funds of the company can only applied in carrying out its authorised objects). Everything that does not come within the objects or reasonably incidental thereto, is *ultra vires* the company and cannot be ratified even by every member in general meeting[58]. Conversely, any act *ultra vires* the director but *intra vires* the company, is regarded as invalid, unless and until it is ratified by the shareholders. On the other hand, such a limitation on the powers of directors does not exist in Algeria and France since the company there is regarded as having the same legal capacity as any individual being. This is due to the adoption of the notion of juristic personality. Therefore no contract can be deemed void just because it is outside the scope of objects stated in the articles of association. Indeed, directors can be held liable for mismanagement, but there is no question as to the validity of the contract as such. It will bind the company unless it has been specifically stated in the articles of association that it was beyond the powers of directors to so bind the company in that way. Clearly, it can be said that some contracts may be *ultra vires* the powers of directors and need to be ratified by the general meeting of the shareholders but they can never be *ultra vires* the company.

It is widely recognised that the *ultra vires* doctrine is a special aspect of the British system of law and creates a fundamental difference between the British and the continental conception of juristic personality[59].

The original attraction of the *ultra vires* rule was that by limiting the powers of the company itself the shareholders could limit the powers of the directors and ensure that the company engaged only in the activities for which it was set up [60] and it is also believed that the rule protect the shareholders of the company so that they know the objects in which their money is to be employed; and to protect creditors by ensuring that the company's funds are not dissipated in unauthorised activities[61].

A short definition of the doctrine of *ultra vires* is given in Gower[62] which states:

> "A company which owes its incorporation to statutory authority cannot effectively do anything beyond the powers expressly or impliedly conferred upon it by its statute or memorandum of Association - any purported activity in excess will be ineffective even if agreed to by all members."

The strict sense of *ultra vires* means the acts done beyond the powers of the company. In the case of registered companies this means acts outside the scope of the objects of the company set forth in the 'objects clause' of its memorandum of association[63]. However, the expression *ultra vires* is used in many different contexts. It is sometimes used to describe acts which are not beyond the capacity of the company, but simply beyond the powers of the directors or a simple majority of the shareholders[64]. The term is also used in its wider sense to describe transactions which, although within the scope of the powers of the company, are entered into for unauthorised purpose, or they are illegal as being prevented by the provisions of the Companies Acts. However, it is submitted that the term *ultra vires* should be used only in its strict sense and other uses are to be avoided since they can cause confusion between the principle of *ultra vires* and other distinct legal principles[65]. As an established rule at common law any act beyond the company's powers is void and directors who engage in *ultra vires* transactions may become liable either to third party who enters into a void contract or to their company for breach of their duty to it. Furthermore, as agents of the company the directors who induce the other party to enter into a contract beyond the capacity of the company, may be liable for breach of warranty of authority [66]. As against the company "an *ultra vires* agreement cannot become *intra vires* by reason of estoppel, lapse of time, ratification, acquiescence or delay"[67]. In Ashbury Rly Carriage and Iron Co. v. Riche[68] a case which was concerned with the contract to purchase a concession for making a railway in Belgium, it was held that the contract was *ultra vires* the company and void so that not even the subsequent assent of the whole body of shareholders could ratify it. However, even though the *ultra vires* transaction cannot be enforced the other party may use certain consequential remedies either against the company or against the directors or others. For example, when a loan is *ultra vires* (but not illegal) the guarantor of the company's obligation may be sued on this contract of guarantee even though the principal obligation is void[69]. It is suggested that a distinction must be made between contracts which are *ultra vires* a company and contracts which are *intra vires* and within the director's powers but entered into for an improper purpose. In the latter case, the transaction will be invalid only against an outsider who has actual knowledge of that purpose[70]. The reason is because the company has the capacity and the fault lies not in the absence of power but in the use of power[71]. In contrast, an *ultra vires* contract is void at its beginning[72] since the company has no power or capacity at all. Consequently the transaction will be void irrespective of knowledge. This is pointed out by Vaughan Williams LJ in Re David Payne & Co. Ltd. [1904] 2 Ch. 608, "The question of knowledge would be absolutely immaterial if the transaction was void in the sense that nothing could put it right". It is therefore submitted that a transaction made under an express power for some purpose outside the scope of the company's authorised activities should not be considered to fall within the *ultra vires* doctrine as generally understood.

Although such transactions will, where the outsider has knowledge of the purpose, be treated by the courts in the same way as a 'true' *ultra vires* contract, their invalidity arises from a different cause.[73]

The main justification of the *ultra vires* rule is that the third party knows or has the opportunity of knowing that the act done on behalf of the company is *ultra vires* the company. In order to achieve this result the 1985 Companies Act provided that the Memorandum of the company must state the objects of the company[74], and must be delivered to the registrar of companies[75]. Hence, the constructive notice principle is regarded as an assumption of the law which provides that third parties dealing with a company are deemed to have notice of the company's objects and certain other public documents concerning the company, in particular special resolutions.[76] The main grounds for this principle is that the company has disclosed its memorandum. This is a judge made rule deduced from the requirement of registration and the right to public inspection. It is submitted that this doctrine operates to cut down the authority which an outsider might otherwise think a director possesses. It does not, however, operate as a positive doctrine. Thus when a transaction is an unusual one, the outsider cannot rely on the doctrine in order to bind the company even though the transaction in question might have been authorised by the articles.[77] The harshness of this doctrine is, however, mitigated by the rule in Turquand's Case.[78] This rule is designed to protect "outsiders dealing with the seemingly authorised agents of the company"[79] by providing that such outsiders are not required to inquire into the internal proceedings of the company but can assume that all has been properly complied with. Lord Hatherly pointed out in Mahony v. Liquidator of East Holyford Mining Co.[80]

> "...When there are persons conducting the affairs of the company in a manner which appears to be perfectly consonant with the articles of association then those dealing with them, externally, are not to be affected by any irregularities which may take place in the internal management of the company".

Prior to the 1972 Act the powers of the company's officers to bind it were subject to the rule (Royal British Bank v. Turquand which can be summarised as follows:

1- A company will be bound to acts done by its officers if:

a- The act appears to be in accordance with the memorandum, articles of association and other public documents, even if certain internal regulations which ought to be complied with as regards the exercise and delegation of authority were not complied with.[81]

b- A document purported to be sealed by or signed on behalf of the company was held out as genuine by an officer acting within his actual, usual or apparent authority. [82]

Of similar effect but based on agency rather than Turquand as strictly applied is:

c- An act, though outside the scope of authority, was done by an officer who is or is held out by the company as a particular type of officer who usually has the power to do such an act. Further, even if this particular type of officer does not usually have the power to do such an act, a company is still bound if it held the officer out as having such authority by an officer acting within his actual, usual, or apparent authority.

2- A company will not be bound to acts done by its officers if:

a- The act is contrary to the memorandum or articles of association or to any other public document [83].

b- The act is contrary to other documents and the internal regulations of the company (not public documents) and the person dealing with the company knows, or because of suspicious circumstances was bound to inquire, that the act is contrary to other documents and internal regulations.

c- The act was done by an officer who is, or is held out by the company as a particular type of officer and the person dealing with the company knows, or because of suspicious circumstances was bound to inquire[84], that the officer had not been appointed as that particular type of officer, or that he had no actual authority to do such an act.

d- A document purporting to be sealed or signed on behalf of the company, by an officer who did not have actual, usual, or apparent authority, is proved to be a forgery[85].

It is believed that British law is well in advance of other legal systems in providing the protection of third parties afforded by the rule in Royal British Bank v. Turquand[86]. The latter has been regarded as the most efficient rule of company law for ensuring that persons dealing with the company are fairly treated by producing common sense solutions and reducing the negative effects and the injustices worked by the *ultra vires* rule[87] which is described as one of the most controversial rules of Company Law.[88]

There appears to be a general agreement, that a strict application of *ultra vires* rule may constitute a stumbling block in conducting business with a company. Consequently, the doctrine has been eroded in modern company law, particularly in favour of third parties dealing with the company in good faith. Furthermore, it can be noticed nowadays that objects clauses are usually drafted in such wide terms that enable the company to engage in any activity it might conceivably want[89]. All this has led to a suggestion that the *ultra vires* is no longer desirable and should be abolished so as to give companies all the powers of a natural person.

As early as 1945 the Cohen Committee commented that the doctrine served "no positive purpose" and was a cause of unnecessary prolixity and vexation"[90]. Professor Gower also expressed the view that the doctrine had become "...merely a trap for the unwary third party and a nuisance to the company itself".[91] Similarly, in a recent report[92], Dr Prentice suggested that the doctrine should be totally abolished, and a company should have capacity to do any act whatsoever. He concluded that the doctrine as it now stands: "...imposes an unnecessary burden on companies and those with whom they deal without there being any compensatory advantages." In addition to the abolition of the *ultra vires* rule, Dr Prentice has recommended that the concept of constructive notice insofar as it relates to the memorandum and the articles of association should also be abrogated:

> "A fully effective abrogation of the doctrine of *ultra vires* must obviously go hand in hand with the repeal of the doctrine of constructive notice. Otherwise, the effects of the doctrine of *ultra vires* could be achieved indirectly by inserting in

a company's articles limitations on the authority of a company's organ or agent to bind the company".[93]

In spite of a number of critics, suggestions and recommendations, the *ultra vires* rule (doctrine) is still in existence. However, although not abolished, it was limited by article 9 (1) of the European Communities Act 1972 which is now equivalent to section 35 of the Companies Act 1985 which in turn has been replaced by new sections of the Companies Act 1989,(part v ss 108-112). The original provisions provide as follows:

1- In favour of a person dealing with a company in good faith, any transaction decided upon by the directors is deemed to be one which it is within the capacity of the company to enter into, and the power of the directors to bind the company is deemed to be free of any limitation under the Memorandum or Articles of Association.

2- A party to transaction so decided on is not bound to enquire as to the capacity of the company to enter into or as to any such limitation on the powers of the directors, and is presumed to have acted in good faith unless the contrary is proved.

It is clear that this provision does not abolish the *ultra vires* doctrine but it modifies it in favour of third parties dealing with a company in good faith. In other words, it does not render an *ultra vires* contract *intra vires* the company but simply enables a person dealing with a company to enforce an *ultra vires*contract. The provision also applies to the situation where, even though the transaction is *intra vires*, the directors themselves lack authority to enter into it[94]. In addition, section 35 abolishes the doctrine of constructive notice in so far as it relates to transactions entered into by the board of directors.[95] However, it is submitted that section 35 by its wording could give rise to a number of important legal issues that have to be clarified. For example it would seem that by its wording that the scope of section 35 concerns only "transactions decided on by the directors" and therefore does not apply to transaction entered into by a managing director on behalf of the company unless it is a transaction that has also been "decided on by the directors"[96]. This will also be the case when a transaction is entered into by the company's other directors and officers as individuals or indeed by a committee of the board.[97] Furthermore, there have been difficulties in deciding whether section 35 or its predecessor covers gratuitous transactions[98]. Thus as Collier[99] noted, although section 35 gives some protection to persons dealing with the company, it still does not answer some important questions such as the exact meaning of the phrase "good faith", does it include someone who has been put on inquiry ? Who exactly is a "person dealing with a company"; Does it include a member? When is a transaction "decided upon by directors" and when is it not?

However, it seems that the British legislature has realised the importance of the above points and the necessity of providing a clear interpretation of section 35. This is embodied in the very recent Companies Act 1989 under which a number of amendments are made. Unlike the former section 35 the phrase " decided on by the directors " is no longer found. The new section 35(1) states that " The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's memorandum." However, according to section 35(2) a member of the company may still bring an action to restrain the doing of an act which, but for s.35(1), would be beyond the company's capacity. Section 35(3) preserves the duty of directors to observe any limitations on their powers as a result of limitations placed in the company's memorandum.

An action by the directors which, but for s.35(1) would be beyond the company's capacity may only be ratified by the company by special resolution. A resolution which ratifies such action does not affect any liability incurred by the directors or any other person, but a further special resolution is necessary to relieve directors from personal liability.

The power of directors to act on behalf of the company has now been clarified by section 35 A of the Companies Act 1989 which expressly states that: "In favour of a person dealing with a company in good faith, the power of the board of the directors to bind the company, or authorise others to do so, shall be deemed to be free of any limitation under the company's constitution". This section makes it clear, that when the directors delegate their authority, for example to managing director, then decisions taken by the managing director are in fact decisions by the board of directors. In addition, section 35 A (2) gives a wide interpretation to the word "dealing". It now includes a transaction or other act to which the company is a party. Thus, the doubts about (as to) whether gratuitous promises was a transaction for the purpose of section 35 is removed, and gratuitous promises may now be covered, and a beneficiary may be able to rely on section 35 A. Finally, section 35 A (2) makes it clear that knowledge that the directors are acting beyond their powers does not necessarily imply bad faith. "A person shall not be regarded as acting in bad faith by reason only of his knowing that an act is beyond the powers of the directors under the company's constitution". The position therefore will be when the recent reforms, following Dr Prentice's recommendations are brought into force into the Companies Act 1989:

Any challenge to the companies capacity by the contents of its memorandum is prevented. However, a member has the right to prevent the company acting out with the memorandum, but cannot (1) restrain an act done in implementation of a prior contract which would otherwise be *ultra vires* or (2) which has been ratified by a special resolution (Companies Act 1985, s.35 (1)(2).

The board, or any person authorised by it, is freed from any restriction which is contained in the memorandum or articles on their powers to bind the company. This is only in favour of a person dealing with the company and acting in good faith. Mere knowledge of the restriction does not of itself create bad faith.(Companies Act 1985 s.35 A (1)(2)

A similar right to restrain such unauthorised acts is given to the members, but here ratification can be given by ordinary resolution to validate the transaction but a special resolution is required to free the directors from liability for their breach of duty.

Linked to this is s.711 A of the 1985 Act (inserted by s,142 of the 1989 Act) which attempts to abolish the constructive notice rule, although s711 A (2) may create so much uncertainty as to make the attempt ineffectual.

Finally, directors of the company or any holding company including any person connected with that director is subject to s.322 A of the 1985 Act. That section makes any transaction carried out in excess of the board's authority with such a person voidable at the instance of the company. irrespective of its avoidance the person in question is liable to account for any gain or compensate for any loss. Again, conditions apply which (1) prevent ratification, (by special resolution if the directors liability is to be cancelled) or (2) exclude avoidance on the grounds: restitution is impossible; indemnity against loss is given; or *bona fide* third party rights have been acquired on the property.

Section 3: - Sources of Directors' Powers

Although the recent years have witnessed a great deal of discussion and analysis on the subject of managerial powers by company lawyers and academics in most legal systems of the world, the source of these powers is still unclear and ambiguous. Despite the importance of this legal issue, little work has been done on it. Therefore, it would be worthwhile at this stage to annalyse the source from which the directors' powers derive. This necessarily involves throwing light on a number of different legal theories and views regarding the source of directors' powers.

There are three views which attempt to explain the source of directors' powers. The first view submits that the powers of management are conferred on directors by the company; the second view believes that the 'purpose' (objet social) is the basis and the main source of powers since these powers are vested in directors mainly to enable them to attain the company's objects and can never be used for any other purpose beyond the company's objects. The third view is that the nature of the director's function implies these powers, the origin being legal not conventional.[100]

3.1.- Shareholders as a source of power

There is a considerable body of opinion which suggests that directors derive their managerial powers from the shareholders, i.e they posses their powers by virtue of the general delegation made by the collective body of shareholders. This is based on the number of statutory rights and powers that can be exercised by the company in general meeting.

Indeed, by examining these powers we can clearly see that the Companies Act confers exclusive control on the general meeting. It is also submitted that "the directors' powers of management are derived from the shareholders' right to manage their company's affairs, and therefore to be found in the company's articles. The extent of the power to manage is therefore a question of construction.[101]

It is well recognised that the general meeting, more than any organ or officer of a company, holds a very powerful position. In fact, up to the nineteenth century the courts' attitude was that the general meeting was the company[102]. Furthermore, in theory, although not in practice, it is regarded as a supreme body in the company. Under the Companies Acts[103] the shareholders in general meeting are empowered to choose and appoint directors to manage the company. In like manner they are vested with the power to remove directors from office at any time by an ordinary resolution requiring special notice.[104] The shareholders in general meeting own the company, determine what its constitution shall be. One of the most important statutory powers of the shareholders is that the power to alter the Memorandum and Articles of Association that is provided by section 9(1) of the Companies Act 1985. "Subject to the provision of this Act and the conditions contained in its Memorandum, a company may, by special resolution, alter its articles." This quotation of powers is reinforced by their right to ratify directors actions and to relief them from breach of duty.

The same section can be found in the Algerian Commercial Code 1975, article 641 provides "The extraordinary general meeting of shareholders alone has the power to amend any of the provisions of the statutes (statuts); any clause to the contrary shall be of no effect".

It is indeed an important power. It provides the shareholders with different channels to exercise their control on directors' functions. For example, by altering or adding to the Articles, the general meeting can delegate the company's powers to the persons they choose. They are also able to make changes to the scope of powers that may be exercised by the company for example by widening the extent of the directors' powers or imposing certain limitations to restrict them [e.g. to make some changes to the company's objects]. Moreover, it enables the shareholders to control the means that determines who should exercise the powers of the company and control the manner in which such powers must be exercised. From the fact that directors are legally required to act within the company's objects and exercise their powers in accordance to them, it can be said that their powers are subject to the shareholders' will, since the company's objects are fixed and can be altered by them.

The French authors of the nineteenth century went further. They argued that the contract of mandate (le contrat de mandat) concluded between the director (representant) and the shareholders (associés) constituted the source and legal foundation of the directors' powers. The same position can be found under Algerian law, for example in société a responsabilité limitée, the Algerian Company Law expressly confers on the shareholders the right to fix the extent of the powers of the mangers (gérants). Article 577(1) "In relation between shareholders, the powers of the mangers are determined by the statutes; where the statutes are silent, they are determined by article 554".

> "Dans les rapports entre associés, les pouvoirs des gérants sont determinés par les status, et dans le silence de ceux-ci, par l'article 554".

In addition, some of the directors acts are subject to prior approval of the shareholder, such as creating mortgages which exceeds a certain amount of money fixed by the company. This emphasises clearly the extent of the shareholders authority over directors.

3.2.- Company's object (objet social) as a source of powers.

Although directors' function (functional theory) stipulates the vestment of directors with a wide range of powers to act on behalf of the company, i.e. directors are vested with extensive powers by virtue of their function, it is quite clear, however, that their function is to run the day-to-day management of the company's business, and the main reason (cause) of this attribution of powers is to realise the company's objects (objet social) for which the company is incorporated, since the latter is the *raison d'être* of the company, i.e. the main reason of the directors company's existence, and shareholders' unification. Indeed, even the scope of the directors' powers as stated in the previous section is limited by the company's objects. Thus, as Jean Paillussea[106] pointed out: "The object of the company (objet social) command the attribution of powers to the organs of management". Therefore, it may be said that the company's object is the source of directors' powers.

3.3.- Functional Theory (directors function as a source of powers):

In spite of the arguments stated above, supporters of the 'functional' theory reject the idea of shareholders as a source of directors' powers. They argue that "it is wrong to say that directors (representants) receive these powers by a voluntary concession of the shareholders since this function itself supposes the existence of the powers."[107] Clearly from this view the origin of power is rather legal than contractual. For example, in America the powers were considered original, and "derivative" only in the sense of being received from the state in the act of incorporation (Hoyt v. Thompson's Executor, 19 N.Y.207 (1859)[108]. As Harry G. Henn[109] pointed out: "Under the concession theory, directors' powers are derived from the state, not delegated by shareholders. Most statutes vest in the board of directors the management of the corporation". In France, the partisans of the above theory (functional theory) argue that despite the fact that the board of directors in theory is subject to the control of the shareholders' assemblies and receives power by delegation. However, as the board is legally responsible for the management of a company, it must be admitted that the board has certain powers by the nature of its office and is not dependent upon a delegation theory[110]. This view was adopted by the French Supreme Court, in a landmark case:

> "The company is an organisation whose organs are hierarchical, and in which the administration is exercised by a board of directors elected by the general assembly; It is not within the competence of the general assembly to encroach upon the prerogatives of the board of directors"[111].

Currently, the directors' powers are determined either by the articles or internal regulations of the company. [This is the position in Britain, article 70 of Table A, Companies Act 1985], or the relevant statute (code) regulating corporate bodies [the position in Algeria, article 622 of the Commercial Code 1975].

Under British law, most of the company's powers are conferred by Table A on the board of directors. While some of these powers are expressly entrusted to them by individual articles, the major part of these powers are vested in them by the general delegation of article 70 of the Companies Act 1985 that provides: "Subject to the provisions of the Act, the Memorandum and the Articles and to any direction given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company."

Such an article vests the board with very wide powers, leaving to the company in the general meeting only the statutory powers, such as the amendment of the Memorandum and Articles (ss. 4 and 9), alteration of the share capital (ss. 121 and 135), or removal of directors (s. 303), and any special powers reserved by the articles for the general meeting viz. the power to determine the directors' remuneration (Table A, article 82), and to determine the number of directors. (Table A article 64).

Sullivan[112] argues that Table A, in addition grants to the directors some specific powers in relation to liens, calls, sharetransfers, borrowing and dividends, the most recent of their powers have to be deduced from article 80 (now article 70). He adds:"Thus it is not a residual regulation supplementing a range of powers specifically conferred but the prime resource of directors authority within the company." Identical general delegation of powers can be found in Algerian law. Article 622 equivalent to article 70 of Table A. It provides:

> "The board of directors is invested with the most extensive powers to act under any circumstances in the name of the company; they exercise them within the limits of the company's objectives and subject to the powers expressly attributed by law to shareholders meeting."

The above articles show clearly the extent of the legislature's intervention to regulate the directors powers by legal provision in both Britain and Algeria. Therefore, it can be easily argued that the law is a primary or main source of powers for directors.

The clarification of the source of director's powers is one of the important issues. The difference between the theories and views stated above have certain repercussions in practice. Indeed, the situation of the director (représentant) and third parties changes by adopting one view or another. For example, by adopting the classic conception[113] of powers proceeding from the principal, the third party who wants to contracts with the representant is required to consult the statutes (statuts) to ensure that the representant is competent and vested with necessary powers to bind the company, otherwise the third party will face the risk of dealing with an incompetent person.

In contrast, under the functional conception the protection of third parties is completely assured, and they are under no obligation to check the statutes since any act or contract that has a relationship with the company's objects is legally binding on it.[114]

Finally it can be deduced from what has been said, that the attribution of powers to one particular source is inaccurate and incomplete. In fact, directors derive their powers from different sources, such as Companies Act and regulations, shareholders, company's objects. All these sources constitute a legal foundation of the general investment of managerial powers in the board of directors.

In conclusion it can be noted that the general vesting of powers in the directors is effective and expedient to directors to cope with their heavy tasks and promoting the company's business whose prosperity and failure hinges on their progress. The general vesting of powers also provides the company with sufficient legal status and third parties dealing with the company will no longer be required to look outside the Acts and Memorandum and Articles of Association to ensure that the directors are competent to enter into a particular transaction. It is unlikely that a precise specification of directors' powers would necessarily better protect third parties since the law provides sufficient protection against abuse of directors' powers. Indeed, it would be an impossible task to enumerate the powers of directors since the number and variety of transactions which might be undertaken defy a complete categorisation.

Notes

1- [1935] 2 K.B. 113

2- Ibid. at p.134

3- Pennington, R.R., Company Law, 5th edition, 1985, at p. 649

4- Powell-Smith, V., The Law and Practice Relating to Company Directors, 1969, at p.103

5- Report to the Company Law Committee (Jenkins Report), 1962, Cmnd.1749 para 109

6- [1935] 2 K.B. 113 at p. 134; see also Scott v. Scott [1943] 1 All E.R. 582; Automatic Self Cleansing Co. v. Cunningham [1906] 2 Ch.34

7- Pennington, R.R. supra, note 3, at p. 650

8- Wright, D., Rights and Duties of Directors, 1987, at p.5

9- De Houghton, C.D., The Company ; Law, Structure, and Reform in Eleven Countries, 1970, at p. 142

10- Farrar, J, H., Company Law, 1985, at p. 306

11- Ferguson v. Wilson [1866] 2 Ch.89; Aberdeen Rly Co. v. Blaikie Bros. [1854] 1 Macq. 461

12- Great Eastern Rly Co. v. Turner, (1872) 8 Ch.App. 149 at p. 152. per Lord Selbourne; Re Lands Allotment Co. [1894] 1 Ch. 616 at p. 631. Per Lord Lindley, L.J.; Selangor United Rubber Estates Ltd. v. Gradock (a bankrupt) (no. 3), [1968], 2 All E.R. 1073 at p. 1091-1094, [1968] 1 W.L.R 1555 at p.1574-1577 per Ungoed - Thomas J.

13- 1916 S.C. 966 at p. 980; 53 S.L.R 697; 1916 2 S.L.T. 115

14- [1942] 1 All E.R. 378,387

15- Farrar, J.H., "Abuse of Power by Directors", (1974), C.L.J 221 at p. 223

16- Directors may be held personally liable under S. 349(4) of the Companies Act 1985

17- [1974] 2 All E.R. 625

18- Wright, D., supra, note 8, at p. 6

19- Automatic Self Cleansing Filter Syndicate Co. Ltd. v. Cunninghame, [1906] 2 Ch.34 at p. 45 per Cozens-Hardy L.J

20- [1908] 2 KB 89 at p. 105-6

21- Frommel & Thompson, Company Law in Europe, 1975, at p. 42

22- Selanger United Rubber Estates Ltd. v. Gradock (no.3) [1968] 1 W.L.R. 1555

23- Sealy, L.S., "The Director as Trustee", (1967) C.L.J at p. 83

24- Pennington, R.R., Directors' Personal Liability, 1986 at p.34

25- Ibid, p. 34-35

26- Gower, L.C.B., Principles of Modern Company Law, 4th edition, 1979, at p. 571-572; Regal Hastings Ltd. v. Gulliver [1967] 2 A.C. 134 at 147; Re Kingston Cotton Mill(no.2) [1896] 1 Ch.331. 345. Vaughan Williams J said: "a director is in a sense a trustee."

27-[1925] Ch.407 at p.426

28- Sealy, L.S, supra, note 23, at p. 84

29- Schmittoff, Palmers Company Law, Vol 1, The Treatise, 24th edition, 1987,p.628; for example the provisions of the Trustee Act 1925 including section 61 (the relief provision) do not apply to directors.(The Trustee Act 1925 does not apply to Scotland).

30- (1880) 15 Ch.D. 247

31- Lindgren, K.E., "The Fiduciary Nature of the Company Boards to Issue Shares",(1971-1972)10 west. Aust. L. Rev. 364 at p.366

32- Re Forest of Dean Coal Mining Co.(1878) 10 Ch.D.450

33- Article 622 "Le Conseil d'administration est investi des pouvoirs les plus étendus pour agir en toute circonstance au nom de la société; ils les exerce dans la limite de l'objet social et sous resérve de ceux expressément attribués par la loi au assemblée d'actionnaires".

34- Cartmell's Case (1874) L.R. 9 Ch.App 691. But see Freeman & Lockyer v. Buckhurst Park Properties (Mangal) Ltd. [1964] 1 All E.R.630

35- Read, A, The Company Director and His Functions, Powers, and Duties, 4th edition, 1971 at p.43

36- Rice, D.G.,"Power of a Director to Bind the Company," (1959) JBL, at p.332

37- [1964] 2 Q.B.480

38- Farrar, J.H., Company Law, 1985, at p. 301

39- Hely Hutchinson v. Brayhead, Ltd. [1968] 1 QB, 549.

39(a)- For example article 70 of Table A, Companies Act 1985; article 622 of the Algerian Commercial Code 1975.

40- [1968] 1 Q.B. 549

41- [1927] 1 K.B. 826

42- Ibid, at p. 844. This dictum was expressly approved by Scrutton and Slesser L.JJ in British Thomson- Houston v. Federated European Bank [1932] 2 K.B. 176 at p. 181-83

43- [1964] 2 Q.B. 480

44- Ibid, at p. 497

45- [1959] J.B.L at p. 336 et seq.

46- Farrar, J.H., supra, note 38, p. 302.

47- Hawaiin Paradise Parke Corp. v. Friendly Broadcasting Co., 414 F 2d 750 (9th cir. 1969); see also Prentice, R.A., Law of Business Organisations, 1987, at p. 299

48- Montrose J.L., "The Basis of the Power of an Agent in Cases of Actual and Apparent Authority" (1937) Can. Bar. Rev. 756, 764; see also Smith Watt's Mercantile Law, 8th edition, 1924, at p. 177

49- Hambro v. Burnand, [1904] 2 K.B. 10; Reckitt v. Barnnet, Pembroke & Salter, Ltd. [1929] A.C. 176

50- Except in those rare instances where the actual authority expressly gives the agent power to do acts not for the principals benefit; see Montrose J.L., "The Apparent Authority of An Agent of a Company", (1934) L.Q.R. 224 at p. 228

51- Corporation Agencies v. Home Bank of Canada [1927] A.C. 318 Lloyd v. Grace, Smith & Co. [1912] 716 is a code in tort.

52- Re Sharp [1892] 1 Ch. 154; Cullern v. London & Suburban Building Society (1890) 25 Q.B.D. 485, 490

53- With the exception of Germany, all the original members of the EC had a corresponding principle, known in French as specialité statutaire according to which the company could not enter into transactions falling outside its objects (objet social) as expressed in the articles (statuts).

54- Companies Act 1985, S.2(1) (c)

55- (1875) L.R 7 HL 653

56- [1918] A.C. 514

57- Re David Payne & Co. Ltd. [1904] 2 Ch. 608 (C.A.)

58- The company is not prevented from acting, but has no legal existence outside its objects embodied in the memorandum i.e. Acts not complying with the memorandum and *ex lege*, are *ultra vires* and do not bind the company

59- Escarra, J., "Some Points of Comparison Between The Companies Act 1948 and the French Law of Companies", (1951), 11 C.L.J., at p. 24-25

60- Wright, D., supra, note 8, p. 25

61- Ashbury Carriage Co. v. Riche (1875) L.R. 7 H.L. 653, see especially, Per Cairns L.C. at p.p. 667-668; see also Furmston, "Who Can Plead that a Contract is *Ultra Vires* ?", (1961) 24 M.L.R at p. 83

62- Gower, L.C.B., The Principles of Modern Company Law, 3rd edition, 1969, at p.83

63- In the case of statutory Companies created by private Act of Parliament, the Act itself will define the company's objects. This will usually be done in much narrower terms than the"objects clause" of a modern registered company

64- Boyle, A.J. et all., Boyle and Bird's Company Law, (1987) at p. 72

65- Gower, L.C.B., supra, note 26, at p. 165

66- Boyle and Birds, supra note, 64, at p. 88

67- Per Russel J in York Corporation v. Henry Leetham & Sons Ltd.,[1924] 1 Ch. 557 at p. 583

68- (1875) L.R. 7 H.L. 653

69- Garrard v. James [1925] Ch. 616

70- Re David Payne & Co. Ltd., [1953]1 All E.R. 634; Re Introduction Ltd [1970] Ch.199

71- Bastin, N.A., "Company Powers and the *Ultra Vires* Doctrine", (1971), J.B.L, 268 at p. 269

72- Ashbury Rly Carriage & Iron Co. v. Riche, (1875) L.R. 7 H.L 653

73- Bastin, N.A., supra, note 71, at p. 272

74- Companies Act 1985, s.2(1)(c)

75- Section 10(1) of 1985 Companies Act

76- Mahoney v. Liquidator of East Holyford Mining Co. (1875) LR7 HL 869; Irvine v Union Bank of Australia (1877) 2 A.C. 366

77- Rama Copn Ltd & Co. v. Northard, Lowe and Wills Ltd., [1927], 1 K.B.246

78- (1856) 6 E & B 327

79- Boyle, A.J. et all, supra, note 64, at p. 99

80- (1875) LR 7 HL 869 at p.894

81- Turquand Case, supra, note 78; Mahoney v. East Holyford Mining Co., supra, note 76

82- Uxbridge Building Society v. Pickard, [1939] 2 K.B. 248, C.A.

83- This is because a person dealing with the company is deemed to have notice of its public documents, see Ernest v. Nicholls (1875) 6 H.L.C. 401

84- Underwood Ltd., v. Bank of Liverpool [1924], 1 K.B.775, C.A.; Liggett (Liverpool) v. Barclays Bank [1928] 1 K.B. 48; Houghton & Co. v. Northard Lowe & Wills [1927] 1 K.B. 246, A.C.; Freeman's Case, supra

85- Ruben v. Great Fingall Consolidated [1906] A.C. 439, H.L., Per Lord Loreburn at p. 443

86- Pennington, R.R., supra, note 3 at p. 149

87- Ibid., It should be noted that Turquand cannot extend or overrule Ultra vires **acts**.

88- Stanely, Davies, "The *Ultra Vires* Rule ", (1986) N.L.J 907

89- Wright, D., supra, note 8, at p. 25; For example, S.110 of the Companies Act 1989 inserts a new S.3 (a) into the Companies Act 1985 which provides that:

"Where the company's memorandum states that the object of the company is to carry on business as a general commercial company-

(a)- the object of the company is to carry on any trade or business whatsoever, and

(b)- the company has the power to do all such things as are incidental or conducive to the carrying on of any trade or business by it."

90- Report of the Committee on Company Law Amendment Cmd 6659, (1945) p. 10; see also The Jenkins Committee, Cmnd 1749, para 35-43

91- Gower, supra, note 26, at p. 168

92- Department of Trade and Industry, Reform of the *Ultra Vires* Rule (Consultative Document) 1986; see also Stamp, M., "Reform of the *Ultra Vires* Rule: A Consultative Document" (1986) N.L.J, 971

93- Ibid, p.22

94- Farrar, J.H., supra, note 38, at p. 302

95- Ibid

96- It has nevertheless been held in one case that the statutory provision does apply to a transaction entered into by a single director (see International Sales and Agencies Ltd. v. Marcus [1982] 2 All E.R.551)

97- e.g., appointed under 1948 Table A, article 102, or 1985 regulations, article 72.

98- Wooldridge, F., "Abolishing the *Ultra Vires* Rule", (1989) 133 S.J. at p. 714

99- Collier, J.G., "The Exercise of Director's Authority - Companies Act 1985, section 35", (1986) C.L.J, 207 at p. 209; see also Wooldridge, supra, note 98. The author submitted that "Like section 9(1) of European Communities Act 1972, section 35 of the Companies Act 1985 has a number of defects. It only protects third parties, and not the company itself."

100- Berr, C., L'Exercice Du Pouvoir Dans Les Sociétés Commerciales, 1961, at p. 29

101- Mayson & French, A Practical Approach to Company Law, 3rd edition, (1987) at p. 320; Tricker, The Independent Director, A Study of the Non-Executive Director and of the Audit Committee, 1978, at p. 5 "The authority of directors to exercise power over the company stem from company law and the company's articles of association, But the law still recognises an ultimate authority vested in the owners."

102- Gower, supra, note 26, at p. 143; Attorney General v. Davy (1741) 26 E.R. 531

103- Table A articles 73-80; article 612 of the Algerian Commercial Code 1975

104- section 303 of the Companies Act 1985

105- Thaller et Percerou, Traité Elimentaire De Droit Commercial, 7th edition, 1925, no. 392 et s.

106- Paillusseau, J., La Société Annonyme: Technique D'organisation de l'Entreprise, 1967, at p. 165. "L'objet social commande l'attribution de pouvoirs aux organes de gestion."

107- Berr, C., supra, note 100, at p. 30 "Il est faux de dire qu'ils recoivent ce pouvoir par une concession volontaire des associés. C'est leur fonction même qui suppose l'existence du pouvoirs".

108- Delforge, R, "Non-Delegate Powers of Board Directors," (1950) 34 Marq.Law. Rev., at p. 49

109- Henn, H.G., Law of Corporations, 2nd edition, 1977, at p.415

110- Starr, R.I., "Protection of Stockholders Rights in the French Société Anonyme" (1965) 40 Tulane Law Rev., at p. 73

111- Cass. Civ, June, 4th 1946; (1946) J.So 344; (1944) J.C.P.2318; There are UK parallels such as Automatic Self-Cleansing Filter Syndicate Co. Ltd v. Cuninngham, [1906]2 Ch.34; John Shaw & Sons (Salford) Ltd v. Shaw and Shaw, [1935]2 K.B.113

112- Sullivan, G.R., "The Relationship Between the Board of Directors and the General Meeting in Limited Companies", (1977) 93 L.Q.R. at p. 570-571

113- Berr, C., supra, note 100 at p. 30

114- Ibid

Chapter Three

Delegation of Directors' Powers

The previous chapters have shown how both British Companies Acts 1985 and the Algerian Commercial Code 1975 entrust the management of the company's affairs and business in the board of directors, regarding the latter as the appropriate and the competent organ to operate such an important function.

As a general rule the powers of directors can only be exercised by them collectively or collegiately as a board, and therefore no individual director or board of directors has inherent power to delegate any of its powers to one or more of its members or to other persons[1], unless there is authorisation in the Memorandum[2] or Articles. However it is quite common to insert in the Articles of Association power for the directors to appoint one or more of their body to be managing director or directors, or a president (président du conseil d'administration) in the case of an Algerian company (Société en commandité par action)[3], and to pay him or them special remuneration, delegating to him or to them such powers as are necessary[4]. Indeed, Articles of Association usually vest the board with the power to appoint any persons, whether directors or members of the company or not, to be the attorneys of the agents of the company for such period as the board thinks fit with the authority to exercise any of the directors powers during that time [5].

The adoption of the provisions stated above by most modern companies may be attributed to the exigencies of business and commercial life in the 20th century, and particularly to the complexity of transactions carried on by such companies. Furthermore, the running of a large company would be practically impossible if all decisions required a board meeting. Therefore the board's function is usually confined to the formulation of general policy leaving the day-to-day decision making to the executive or managing directors or committee of directors.

As Goel said: "The main task rather is formulation and direction of the board, basic and general business policy as a 'management tool', co-ordination of the executive functions and exercise of overall control and supervision of the corporate affairs"[6]. Consequently, the delegation of directors' powers and functions, all or part of it, become as a matter of necessity especially in the case of large companies with substantial shareholdings and branches.

As Dickson M. Sounders pointed out:

> "From the very beginning of the use of the company structure as a device for carrying of the business and activities of man, it has been apparent that the nominal brain, the board of directors, could not feasibly run the affairs of the inanimate entity unless certain powers could be delegated to officers and agents".[7]

This chapter examines:

1- Legal Basis of directors' powers to delegate; and

2- The Extent and scope of the directors' authority to delegate; and

3- Delegate's acts and protection of third parties at common law.

Section 1- Legal basis of directors' powers to delegate

One of the important characteristics of British Company law regarding company management is that a board of directors must act collectively or collegiately as one unit. Consequently, neither an individual director nor any group of directors has any power conferred on him or them, and in the absence of an express authorisation in the Articles of association or other appropriate constitutional document the board will have no authority to delegate its powers[8]. Unlike USA[8(a)], in Britain directors do not receive their powers from the state in the Act of incorporation but derive them mainly from the shareholders under the Articles of Association[9], which are adopted and can be freely altered by the shareholders themselves in general meeting by passing a special resolution (Companies Act 1948, s. 66). Like any other power, in the absence of any proper authorisation in the Articles of Association the board of directors is not allowed to delegate any of its powers to any person or persons even if that person is a member of the board. This rule is justified on the grounds that the directors' powers have been delegated to them by the shareholders and by applying the maxim: *"Delegatus non potest delegare"* - they could not delegate these powers. This maxim applies because the directors' powers are derivative or that they are delegates within the meaning of the maxim. The rule applied in the maxim is that "no delegation without permission". It is submitted in De Bussche v Alt, that:

> "this maxim when analysed merely imports that an agent cannot without authority from his principal, devolve upon another obligations to the principal which he has himself undertaken to personally fulfil; and that, inasmuch as confidence in the particular persons employed is at the root of the contract of agency, such authority cannot be implied as an ordinary incident in the contract"[10].

In Howard's Case[11], regarding the right of the board of directors to delegate their power of allotting shares to a manager and two private directors. Turner L.J. affirmed the decision of Kindersley V.C who said[12]:

> "I think they are precluded from doing it, because, by the terms of the deed of settlement, they are the body to whom is delegated by the shareholders at large the office to deal with shares. Having that office delegated to them by the body of shareholders, the persons interested in it, they have no power, without special authority from the persons who had given them that delegated office, to delegate it to a different body themselves".

On the same point Trebilcock noted: "If specific powers or discretions are delegated to directors under a company's articles, then they will not normally be entitled to sub-delegate those powers or discretions"[13]. However the board of directors like an ordinary agent, they may delegate their routine or non-discretionary powers (functions) to the executive agents or servants and no authorisation is required[14]. In sum, it can be said that the board of directors cannot delegate its powers unless allowed to do so by the Memorandum or Articles of Association. In practice, however, it is usual for a company's Articles to contain clauses empowering the directors to delegate their powers. Article 72 of Table A provides that "The directors may delegate any of their powers to any committee consisting of one or more directors. They may also delegate to any managing director or any director holding any other executive office such of their powers as they consider desirable to be exercised by him. Any such delegation may be made subject to any conditions the directors may impose, and either collaterally with or to the exclusion of their own powers and may be revoked or altered. Subject to any such conditions, the proceedings of a committee with two or more members shall be governed by the articles regulating the proceedings of directors so far as they are capable of applying".

It is quite clear from the above articles that the board of directors in running the day-to-day management of the company can delegate its powers either to a committee or to a managing director.

1.1.- Delegation to committee

It is quite common for the articles to allow the board to delegate any of their powers to committees consisting of such director or directors as the board thinks fit (art. 72)[15]. According to this Article, such a committee may consist of one director[16]. In Re Taurine Company[17], the question was whether the directors may delegate their power to a committee of one. In this case the board delegated all their powers to one person according to article 43[18] of the articles of Association of the company. Cotton L.J. while examining this question said[19]:

> "There is nothing in my opinion, in the articles to prevent the appointment of a committee of one. It is very unusual but still it may be done. As was pointed out, Table A recognizes the fact that one person may be appointed a committee. A committee means a person or persons to whom powers are committed which would otherwise be exercised by another body."

Where powers are delegated to a committee they may be general, including all the powers of the board, or limited to a particular function, as examining and passing transfers for registration and sealing share certificates.[20] A power to delegate does not mean that the delegate is to part with his powers in a manner to exclude his further authority, so a board which delegates powers to a committee may revoke the delegations at any time, either expressly, or impliedly, by the board exercising the delegated powers itself.[21] In addition, the board may revoke the appointment of any member of the committee at any time, even though the member of the committee was appointed for a fixed period[22] and the responsibility for performance of their duties remains with the board.[23]

1.2.- Delegation to a managing director

A managing director may be defined as "an executive director appointed by the board and to whom the board has delegated certain powers of management under the Articles of Association"[24]. Currently, the managing director constitutes an important organ in the modern company where most of the company's powers which have been primarily delegated to the board are sub-delegated to him or them[25]. Indeed, in some companies the managing director is largely responsible for the general management and control of the company, rather than the board, and nowadays the term 'managing director' may denote the most senior management post in the company[26]. The purpose of appointing a managing director or directors is to ensure that the day-to-day management of the company's business is conducted by one or a few persons who may be required to devote their whole time and attention to the company affairs.[27] As already said the general rule is that directors cannot appoint one of themselves to an office of profit or delegate power to a managing director unless expressly empowered by the Articles or by a resolution of the company[28]. For example, in Nelson v. James Nelson & Sons[29], Swinfen Eady L.J in the Court of Appeal said:

> "Unless there is a power given to the directors by the articles to appoint a managing director it is not competent for them to make such an appointment....The articles may give a power to the directors to appoint one of their number to be managing director, but no power to revoke or cancel the appointment. The company may keep that power in its own hands to be exercised in general meeting".

However, in practice the articles often allow the directors to appoint one or more of their body to be managing director or directors and to pay him or them special remuneration, delegating to him or them such powers as necessary. Such a power is conferred by Table A, article 72 and 84 of Table A, Companies Act 1985[30].

Article 84 of Table A provides "Subject to the provisions of the, the directors may appoint one or more of their number to the office of managing director ...any such appointment ...may be made upon such terms as the directors determine and they may remunerate any such director for his services as they think fit". When the articles empower the directors to appoint a managing director, the company in general meeting cannot interfere and cannot itself make such an appointment without first altering the Articles[31].

A managing director has two functions and two capacities[31(a)], those of a director and managing director and holds a very different office to other executive directors. Unlike the latter, the managing director's function is to exercise powers delegated to him by the directors as well as powers of management. Whereas, for example, the secretary or manager who is also a director occupies an office as an executive in conjunction with, but separately from, his directorship[32]. The managing director has no specific powers accorded to him by law[33] but depend both upon the articles which confer a power on the board to appoint a managing director and upon the terms of the contract by which he is employed[34]. In Re Newspaper Proprietary Syndicate Ltd.[35], Cozens-Hardy, J. said: "A managing director is only an ordinary director entrusted with some special powers". These special powers are derived from the terms of his appointment and may, in fact, turn him into an extraordinary director.

Although the exact legal position of managing director in relation to their company is rather hard to define. However, there are a number of cases which form a chain of authority supporting the general proposition that a managing director, apart from context, was not in the employment of the company. For example, in Dunston v. Imperial Gas Light and Coke Co[36], it was pointed out that a director is not a servant but a manager, and in Hutton v. West Cork Railway Co.[37] a dictum of Lord Bowen that a director is not a servant was relied on. Again in Normandy v. Ind. Coope & Co[38] it was decided in the judgment of Mr Justice Kekewich that no managing director or other director fell within the phrase "Persons in the employment of the company" mentioned in the articles. The same view was adopted by the Scottish judges. In Kerr v. Walker[39], they treated the managing director as a director and not an employee of the company. In the latter case Lord Fleming said: "I quite accept the view that a director is an agent and not a servant of a company and I think it follows that a managing director must be regarded not as a servant of the company but as an agent with managerial functions". The last case in this line is Re Anderson v. James Sutherland (Peterhead) Ltd[40], where the question regarding the managing director's position again raised i.e, is a managing director employed by the company?[41] Lord Stevenson answers in the negative. He submits that: "In my opinion, a managing director is in the position of a master. He is the director appointed by the board of directors to carry out the duties of conducting the business of the company... He conducts the business as the appointee of the directors and subject to their supervision. "In my opinion, he is not a servant of the company, nor in the employment thereof, and is not subject to the provisions of Article 14..."

Due to the important role entrusted to the managing director, his usual authority has a wide scope and extends to the management of the ordinary business of the company[42]. In addition, he is invested with apparent authority to ensure the running of the company's business in the usual way and it is his responsibility to manage the company's affairs within the framework of policy determined by the board. The same view can be found under Algerian

Company law, e.g. Article 367 of the Commercial Code 1975 provides that the president carries out "on his own responsibility, the general management of the company". It is also submitted that a managing director also often makes company policy. As Willett notes:

> "the board cannot make the whole of the policy itself; it cannot have adequate information to enable it to do so. Top managers do not merely run the company from day to day within a framework of policy, but to a significant extent they initiate and determine that policy"[43]
>
> .

The managing director therefore, can perform all acts, enter all transactions and conclude all contracts necessary to ensure a successful management. However, it was submitted that the managing directors' apparent authority is confined to commercial matters.[44] For example, he has no authority to approve transfer of shares in the company or to alter its register of members, or to sell the company's business[45]. Under Algerian law, the president is invested with the most extensive powers to act on behalf of the company in all circumstances, subject to two limitations.[46] However, in dealing with third parties, the president is regarded as the legal representative of the company. As a matter of practice it may happen that the person dealing with the company, because of certain circumstances such as time, place[47], find it very difficult to check the Commercial Register to ensure that the president is acting within the limits of his legal powers. Moreover, to provide a sufficient protection to third parties dealing with the company and to strengthen the company's trust, the Algerian legislature submits that the company must be bound by acts of the President even outside the company's objects, unless it can prove that the third party knew that the act was outside the company's purpose, or he must have known that this was so from the circumstances. The mere publication of the company's statutes is not sufficient and cannot constitute such proof[48]. This legal rule was previously approved by the doctrine and jurisprudence. Indeed, the modern French jurisprudence went further in widening the extent of this rule. For example, it was submitted that the company must be bound by the acts of the president even if his membership or presidency was void[49].

According to article 624 of the Algerian commercial code 1975 the board of directors may delegate the power to give guarantees on behalf of the company, or the power to create mortgages or changes over its assets up to a maximum limit fixed by the board in respect of each transaction or globally.[50] In the absence of such delegation, any such transactions requires the specific authority of the board[51]. A delegation cannot be given to the president for more than one year at a time[52]. If a transaction is entered into which which exceeds the limit fixed by the board for an individual transaction, the company can repudiate it, and will not then be responsible to the other party to the transaction, even if he was unaware that a limit had been imposed.[53] As a result of this, a third party dealing with the president such as a creditor who intends taking a guarantee or security from the president should ensure that the transaction has been expressly authorised by the board.[54]

Despite the wide range of powers enjoyed by the managing director (Britain) and the president (Algeria), the board of directors still has the last word and the widest power of curtailing the range of managing director's activities. [Caddies v. (Harold) Holdsworth and Co. (Wakefield) Ltd].[55] Indeed, directors may have discretionary power to dismiss a managing director. However, this power must be exercised *bona fide* in the interests of the company and not for some ulterior purpose such as appropriation of the managing director's shares [Hindle v. John Cotton Ltd.][56]. It is also held in a number of cases[57] that if this power (removal) is exercised in breach of his contract of service, the company will be liable to pay damages. In Algeria however, the president may be removed by the conseil d'administration at any time without notice or dismissal or assigning reasons. Such removal cannot give rise to any action for damages on his part or to any indemnity whatever, any stipulation in the statutes (articles of association) to the contrary shall be of no affect[58]. Lastly, article 84 of table A provides that a managing director shall not retire by rotation, but shall cease to be managing director if he ceases to be a director for any other reason. Although the Articles may provide otherwise, but cannot preserve a managing director in office when he has become disqualified from being a director or has been removed from office under the provisions of the Companies Act 1985.

Section 2: Scope of Delegation of Powers

Like any other power of management, the directors' authority to delegate depends on the articles adopted by a company. In other words, the right of delegation of powers conferred on the board of directors by the articles of association is subject to express permission in the articles, or by a general meeting[59]. Thus the rule is that if under the Memorandum and Articles of association the board of directors is allowed to delegate all or any of its powers, the board may delegate any of its powers vested in it by the Memorandum and Articles of association. However, an interesting question in the law of corporations is to what extent a board of directors may entrust their powers to an executive committee or agent?

As noted earlier, under British law, the directors may delegate any of their powers to any committee consisting of one or more directors or to any managing director or any director holding any other executive office such of their powers as they consider desirable to be exercised by him. Any such delegation may be made subject to any conditions the directors may impose, and either collaterally with or to the exclusion of their own powers and may be revoked or altered[60]. It follows therefore, that the validity of delegation of directors' powers depends upon the true construction of the articles of association or the service agreement made in pursuance of the articles[61]. Indeed, this agreement may be designed and worded so as to enable the directors to deprive the managing director of his wide powers of management while letting him retain his title and remuneration[62]. This is the case in Holdsworth (Harold) and Co. (Wakefield) Ltd. v. Caddies in which Caddies was appointed as a managing director of the company for a period of five years by an agreement which provided that he should be 'appointed a managing director of the company and as such managing director he shall perform the duties and exercise the powers in relation to the business of the company and the businesses of its exiting subsidiary companies at the date hereof which from time to time be assigned to or vested in him by the board of directors of the company.' After Caddies had acted for some time as managing director of both the appellant company and its subsidiary, differences having arisen between Caddies and the board of directors, the latter resolved, while the five year period was still running, that he should confine his attention to one particular subsidiary company only. Caddies claimed that this deprived him of the powers of managing director of the parent company and was a repudiation of his agreement and he brought an action of £25 000 damages for breach of contract by the company but his action was dismissed on the grounds that no breach had occurred and the resolution limiting his attention to a subsidiary was consistent with the agreement concluded between him and the company. The decision in the above case shows clearly the governing character of the articles as well as determining the real position of managing director and his legal relation *vis a vis* the board of directors.

Although it is well recognised that directors should be permitted to delegate their powers and functions so as to facilitate their managerial task, it is argued that some directors powers are delegable and some others are non-delegable. However, in practice this categorisation seems to be rather difficult and vague since the clear line between the two types of powers is usually uneasy to draw. As Delforge put it: This confusion "probably due to the vagueness of the terms "ministerial" and "discretionary", and their application in the business world[64]. For example, in the United States the distinction tends to be made on the basis of identification and determination of the nature of matters or the functions that purported to be delegated by the directors. The general tendency there, in respect of ministerial or routine matters, is that the board of directors should be given a free hand in choosing delegates or subordinates to exercise them, and in determining the extent of such delegation on the grounds that these matters belong to the management of the ordinary commercial matters, and the performance of these matters by persons other than the board of directors cannot harm the company. Indeed, its confinement in the board of directors may lead to unnecessary delays that may have negative effects on the company's business development. Further, it was held that the designation of certain officers to exercise a particular ministerial or routine act or function does not prevent the board of directors from authorising another person to perform the same act[65]. On the face of it, it is believed that discretionary powers that require to some extent an exercise of judgment and discretion or involve the exercise of executive functions such as deciding the "policy" of the corporation or generally overseeing its affairs, are classified as non-delegable powers on the basis of its sensitivity and its importance to the company's business as a whole. For example, in Ames v. Goldfield Mines Co.[66], the court expressed strongly against the the delegation of the discretionary powers, although in one previous case (Jones v. Williams)[67] it was held that "the directors have the power, without statutory authority, to delegate to officers, agents or executive committees the power to transact, not only the ordinary and routine business, but business requiring the highest degree of judgment and discretion". However, it can be argued that the determination of the validity of a particular delegation by the board using the discretionary-ministerial test adopted in U.S.A. seems to be ineffective since the line between the routine or ordinary matters and discretionary ones is difficult to understand as their interpretation differs from one case to another. One clear instance is the case of Re Lone Star Shipbuilding Co.[68] where it was held that the power to file a voluntary petition in bankruptcy by a certain time (delegated by the board to two directors) was held to be merely ministerial[69]. Although it is quite obvious that these kind of acts have a great impact on the continuity and existence of the company's business. In Britain, however, as previously mentioned, the validity of delegation depends upon the construction of the articles of association. Hence no ministerial-discretionary controversy would arise[70]. The Cartmell's case (Re County Palatine Loan and Discount Co.)[71] appears to be the only case in Britain that attempted to distinguish between ministerial or routine matters and discretionary ones. This can be deduced easily from the words of Mellish L.J. who said:

> "It appears to me that a mere power to appoint a general manager would not authorise the directors to transfer to him the power to purchase shares; because that power is by the articles expressly given to the directors themselves; whilst the only duties which they could delegate to the general manager are those which belong to the management of the ordinary commercial business of such a company".

For a clear understanding of the delegation of powers issue, it would be necessary to examine and highlight three hypothesis; assumptions in connection with the directors' right to delegate their powers. Firstly, the rule is that if the articles provide that the board may delegate "all its powers" or "any of its powers" the board may do so as the validity of delegation is subject to express permission in the articles of association. In other words, where, under the articles the board of directors is empowered to delegate all its powers, it would be *intra vires* the directors to delegate a power though specifically vested in them. For example, in Re Taurine Company,[72] although an article of the company provided "A transfer of a registered share, except a fully paid up share, shall not be made without the the approval of the board, who shall have an absolute discretion as to accepting or rejecting the transfer..." nevertheless, the power to approve the transfers was held to have been properly delegated to a one-director - Committee appointed by the board. Secondly, if the articles of association provide that certain powers are specifically vested in the board of directors and must be exercised by them; The general belief seems to be that directors cannot delegate that particular power or function. This is the judgment in Howard's Case[73] where it was held that the allotment of shares made by the manager and two directors was invalid, on the basis that the delegation by the directors was unwarranted, as they had no authority to perform such an act, since under the deed[74], the power to allot shares was expressly vested in them[75]. Moreover it is submitted that certain powers may expressly be reserved to the board as a whole, e.g. borrowing money on behalf of the company, incurring capital expenditure beyond a defined limit, and other matters and functions of special importance[76], such as the power to declare dividends, to make calls, to adopt or amend or repeal the corporate enactments, to issue or float debentures or other securities, to appoint, remove, or fix the renumeration of the executive committee members and other officers. All these should only be exercised by the board of directors and not delegated to others. This is because as Goel[77] pointed out such matters "often involve the conflict of interests between the operating management and the shareholders that they require the prudent, wise and unbiased decision of the whole board".

Lastly, having shown that directors are often empowered by their companies to delegate their managerial powers and duties to other persons as they think fit, another important question which still remains to be examined is whether the directors can divest themselves or be divested otherwise of their own powers and escape all responsibility for the proper discharge of matters so delegated? Although, in usual practice the managing director is appointed on the terms that he will perform the duties and exercise the powers which, from time to time, may be assigned to or vested in him by the board of directors and that he will in all respects obey and conform to the orders and instructions given by the board from time to time[78]. Nevertheless, the board may, if so empowered by the company's articles, delegate to the managing director its powers of management or some of them to the exclusion of its own powers. This may clearly be seen in article 72 of Table A Companies Act 1985 which reads thus:

"...They may also delegate to any managing director or any director holding any other executive office such of their powers as they consider desirable to be exercised by him. Any such delegation may be made subject to any conditions the directors may impose, and either collaterally with or to the exclusion of their own powers and may be revoked or altered."

Pursuant to article 72 (79) Professor Gower suggested that:

> "There seems to be no reason why a delegation to a managing director under an Article worded like Table A, art 109 (now 72) should not be so expressed as to deprive the board of the right to interference. The wording of the article, with its express reference to a delegation 'to the exclusion of their own powers', appears to imply that the directors may effectively divest themselves of their own powers in favour of the managing director."[80]

According to Professor Gower the board may delegate to the managing director exclusive powers without reserving the right of supervision or revocation and therefore disable itself of the right to interfere with his exercise of such powers or to vary them during the subsistence of the service agreement.[81] Another suggestion was made by Palmer[82], which stated that the board does retain the right to interfere in so far as it has, as a matter of construction of its own powers to delegate, the right to revoke at any time. Some judicial support for Gower's point of view can be found in Re Bulawayo Market and Officers Co. Ltd[83], in which one of the company's articles empowered the directors to delegate to a manager "to the exclusion, or in substitution for" their own powers, and Warrington, J. submitted that such a provision "enabled the directors to divest themselves of all powers and responsibilities in the management of the company..."[84]

It appears, therefore, that a company's regulations may entitle the board to relinquish all of its managerial powers and functions. However, Gower's suggestion was criticised by Goel[85]. He argues that it appears "inconsistent with what is ordinarily implied by the term 'delegation' because as a rule, the delegated powers are always subject to resumption by the delegating authority."

Although it is true that some limitations imposed upon the directors power to delegate their duties and functions may result sometimes in unnecessary delays and could deprive the company of a number of transactions, it can be justified on the basis of preventing any abuses of the company's powers or misusing its assets by the delegates. Furthermore the permission of the board of directors to divest themselves of their powers completely seems to be exaggeration and would contravene the statutory requirement that the board manage or supervise management of the company's affairs as it is the competent and the appropriate body to act. Indeed, it will lead to the creation of sterilised boards. This is the view adopted in the United States where the board of directors is regarded as "the exclusive executive representative of the corporation[86]", and therefore cannot abdicate all their authority and responsibility by delegating their duties and functions to the exclusion of their own powers. This is based on the fact that although by delegation the exercise of a power or function may shift to the delegate concerned, the overriding control and the ultimate supervision and responsibility must rest upon the board itself by retaining the power to supervise, review and interfere.[87]

Section 3: Delegates Acts and the Protection of Third Parties

Before leaving the subject of delegation of director's powers, it is necessary to throw some light on the legal effects that may flow from from the exercise of these delegated powers. Some concern the company and whether it is bound by the acts of its director or directors[88], and others concern the third party who deals with this delegated director or directors. One of the important questions concerning the delegation rule is that whether the person seeking to rely upon it need have any actual knowledge of the existence of the power of delegation?[89] The answer to this question involves a clear distinction between two different situations, namely, where there is an express delegation in the articles of association and where there is no provision permitting a delegation of the board's authority or they expressly preclude its being conferred. Regarding the first assumption, the established rule in company law provides that where the articles of association contain a power of delegation and some person purports to exercise such delegated authority on behalf of the company, that a proper delegation can be assumed by a person dealing *bona fide* with the company if the act in question could be said to be ordinarily within the powers of that person who purports to act as the company's agent.[90] This rule is of course, only a special application of the rule in Royal British Bank v. Turquand[91] which establishes in effect that a person dealing with the company is not put upon notice as to its indoor management[92]. In addition, the general rule of agency provides that a principal is liable for all the acts of his agent within the agent's apparent authority, i.e the authority usually possessed by agents of that class or the authority which the principal has 'held out' the agent as having. For example, where a managing director is appointed under provisions in the articles of association of the company and unless the party dealing with him has been put upon inquiry by the circumstances, the third party is entitled to assume that he (managing director) has power to act on behalf of the company and to enter into a particular transaction in dispute. Similar views, can be noticed in a few early cases[93] where it was held that a person dealing with one director might assume under the rule in Turquand's Case that the board had delegated to him the powers which he pretended to possess without being required to prove whether the board had actually held out the director as having those powers[94]. However, later cases[95] have shown that the rule in Turquand's case does apply in this situation.[96] Thus a mere power of delegation cannot be construed so as to bar a company from denying that it has been used. As Sarget L.J in Houghton & Co v. Nothard Lowe and Wills Ltd. said[97]:

> "I know of no case in which an ordinary director, acting without authority in fact, has been held capable of binding a company by a contract with a third party, merely on the ground that the third party assumed that the director had been given authority by the board to make the contract".[98]

Furthermore, it is argued that unless before entering into the transaction the third party was aware of the articles enabling the board to delegate its powers, he cannot say that he relied on the power of delegation at all[99]. This is the view in Rama Case, in which the facts may be summarised very briefly as follows:

By the articles of association of the defendant company the board of directors had power (except as regards borrowing and making calls) to delegate its authority to a committee consisting of one or more of its members. Without the authority of the board, one of the directors purported on behalf of the company to enter into an agreement with an agent of the plaintiff company. Under the agreement the parties were to subscribe to a fund for the financing of a telephone directory holder to be manufactured by a third company. The plaintiff company had no knowledge at the time it purported to enter into the agreement of the defendant company's articles of association or the power of delegation therein contained. Slade, J after a full discussion of the authorities, dismissed the action brought by the plaintiff company for enforcement of the agreement and decided that actual knowledge of the power of delegation was necessary. He argued that the failure on the part of the plaintiff company to consult the defendant company's articles of association, under which power to conclude the contract in dispute could have been conferred on the director, precluded it from invoking the protection of the doctrine of estoppel, and expressed the rule

> "The doctrine of constructive notice of a company's registered documents, such as its memorandum of association, its articles of association, its special resolutions, etc. does not operate against a company, but only in its favour. Put it in the converse way, the doctrine of constructive notice operates against the person who has failed to inquire, but does not operate in his favour. There is no positive doctrine of constructive notice; it is a purely negative one".[100]

However, this view was criticised on the basis that it is not practicable and may stand as a stumbling block in the way of business life. This led the learned editors of Palmer's Company Law[101] to postulate an alternative view that a director's authority to bind the company must depend not on the doctrine of estoppel, but rather on the wider principle expressed in the *maxim Ominia praesumuntur rite ac solemniter esse acta*, i.e. all necessary formalites and procedures are presumed to have been properly carried out.

It is quite clear that in the case of a managing director little doubt may arise regarding the validity of his delegated powers to act on behalf of the company since his position entitles him to commit the company to almost anything that relates to its commercial activities.[102] This is surely due to his key position in the company and his usual investment with most powers of the company. This situation, however, differs where a director who purports to represent the company is an ordinary director i.e., (not being appointed as managing director). In the latter case more convincing evidence will be necessary to support the assumption that the board delegated the power in question to the director in addition to his ordinary powers.[103] This is because an ordinary director as such has no authority over the management of the company's affairs.[104]

In respect of the second assumption, if there is no power under the articles to delegate the board's power to an individual director, then third parties, being deemed to have notice of the fact, cannot hold the company to the contract. However, if under the terms of the articles it was legally possible that the director concerned might have had such authority conferred upon him, and the other party relied upon this, then the latter may be able to hold the company liable under the rule in Turquand's Case[105]. This view was expressed in Kreditbank Cassel v. Schenkers Ltd.[106] in which Atkin L.J said that:

> "If you are dealing with a director in a matter in which normally a director would have power to act for the company, you are not obliged to inquire whether or not the formalities required by the articles have been compiled with before he exercised that power. Those are matters of internal management which an outsider is not obliged to investigate."

For the pusposes of this rule it is submitted that it is quite irrelevant whether or not the party purporting to contract with the company even had sight of the articles.[107] This is because the company is bound not by virtue of an estoppel, but instead by the exercise of an agency power[108]. However, apart from two cases[109], it has been generally held that were the articles do not contain a power to delegate, a company will not be bound by a transaction entered into by an individual director. This is so even where the board has led the outsider to believe that it has a power to delegate and that it has exercised it[110].

Finally, it is clearly established that where a director has been empowered to enter into a particular transaction on behalf of the company or where the company has held him out to a third party as having such authority the company will unquestionably be bound by his acts. However, as Rice[111] suggests, business relations could not function on these two principles alone. He submits that "whether or not a director enjoys actual power, the company will be bound by any act of his that falls within the usual authority [112] of his position".[113]

This view seems to be logical and practically important since its application will facilitate business transactions, particularly for thirds parties dealing with the company as they are not required to check the company's constitution whenever they are interested in a contract with the company. Indeed, this view has received judicial support in Freeman's Case[114] which established the principle that where acts purporting to be done in the name of the company lie within the usual authority of the particular agent performing them, the company is bound without any necessity for the contracting party ever to have studied the company's memorandum and articles.[115]

In the light of the above discussion, it appears that delegation of directors' powers and duties became a necessity in the modern corporate management and probably no company could function or cope with business life without providing for such delegtion in its constitution. As a result of this, modern commercial companies in different legal systems often include a provision in their article of association empowering the board of directors to delegate some of its functions to other subordinate bodies or individuals to assist them in running the day-to-day company's affairs. However, as seen earlier, British directors have no inherent power to delegate as their

American counterparts do. Their power of delegation depends primarily upon an authorisation of the shareholders. This appears to be inconsistent with the status accorded to the board of directors as a primary organ of the company. Thus, it is suggested[116] that the board should be regarded as possessing inherent powers of delegation although the investment of such a power in the board must not result in a total abdication or relinquishment of its office in favour of others.

Notes:

1- County Palatine Loan and Discount Co.,Re Cartmell's Case (1874) 9 Ch.App. 691

2- Re Scottish Loan and Finance Co. Ltd. (1934) 44 S. R (N.S.W) 461; in the United States, however, even in the absence of any express statutory or corporate provision authorising directors to delegate, they are empowered to delegate not only routine or ministerial functions but also discretionary ones provided that they do not abdicate their office.

3- The position of "managing director" does not exist in Algeria today. It is the president who is "Président du conseil d'administration", empowered to act on the company's behalf in all commercial matters. Article 634 of the Commercial Code 1975 provides that "The board of directors elect from its members a president who is, on penalty of the nominations nullity a physical person. It determines his remuneration".

4- Such a power is conferred by Table A, article 72 and 84. Article 84 allows the director to appoint a managing director (and other executive directors) on such terms as they determine. Article 72 allows directors to delegate to such persons such of their powers and on such conditions as they consider desirable. For the Algerian position see article 634 of the Commercial Code 1975, cited above.

5- Pennington, R.R., Company Law, 5th edition, 1985, at p. 653; also see Table A, article 71

6- Goel, R. K., "Delegation of Directors Powers and Duties - A Comparative Analysis", (1969) 18, I.C.L.Q at p. 152

7- Dickson. M.S., Comment "The Executive Committee in Corporate Organization - Scope of Powers" (1943), 42

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8- Gower, L.C.B., Gower's Principles of Modern Company Law, 4th edition, (1979), p.153; Schmitthoff, C.M., Palmer's Company Law, vol 1, The Treatise, 24th edition, 1987, p. 955

8(a)- In U.S.A directors are regarded as possessors of inherent powers of delegation and not merely delegates, and the existence of their power of delegation does not depend upon an authorisation of the shareholders. See Goel, supra, note 6, pp. 155-157

9- See chapter Two, section three, supra

10- De Bussche v. Alt (1878) 8 Ch.D. 310

11- Re Leeds Banking Company (Howard's Case) [1866] L.R.1 Ch.App. 561

12- Ibid at p. 563 (emphasis added)

13- Trebilcock,M.J., "Liability of Directors for Negligence", (1969) M.L.R 499 at p. 507

14- Goel, R.K., supra, note 6, pp. 155; for an agents authority to delegate ordinary matters see Bussche v. A.L.T (1878) 8 Ch.D. 286; Calico Printers' Association v. Barclays Bank [1931] 145 L.T. 51

15- Re Imperial Land Company of Marseilles, (Harris Case) (1872) L.R. 7 Ch.App. 587. Where such a committee was able to exercise the boards power allotment.

16- Re Fireproof Doors Ltd. [1916] 2 Ch. 142

17- (1883) 25 Ch.118

18- Article 43 provides that "The board may from time to time delegate to any such local or other committee, managing director, manager, agent or representative, all or any of the powers, authorities, and discretions of the board."

19- at p. 132

20- Read, A., The Company Directors:His Functions, Powers and Duties, 4th edition, London, 1971, p.44

21- Huth v. Clark (1890) 25 Q.B.D.391; Gordon, Dadds & Co. v Morris, [1945] 2 All E.R. 616

22- Manton v. Brighton Corporation, [1951] 2 K.B.393 [1951] 2 All E.R. 101

23- Ibid

24- See Copeman, G., The Role of the Managing Director, 1959, at p.46; in Shirlaw v. Southern (1926) ltd., and Federated Foundries Ltd., [1939} 2 All E.R.113, 117, Green M.R. described a managing director as "a director to whom the board, being empowered to do so by the articles of association, delegates its powers of management, or some of them."

25- Gower, L.C.B., supra note 8, p. 19

26- Barc and Bowden (editors), Tolley's Company Law, 2nd edition,1987, at p.289

27- Pennington, R.R., Directors Personal Liability, 1986, at p.12

28- See Boschoeck Proprietary Co. v. Fuke [1906] 1 Ch.148. at p. 159; in Re Anderson v. James Sutherland (Peterhead) Ltd. "...Unless the board are authorised by the articles to make such an appointment and are empowered to delegate their powers as directors to one or some of their numbers, they would require to conduct the business of the company themselves..." Per Lord Stevenson (1941), S.C. 203, p. 208

29- [1914] 2 K.B.770

30- Article 84 of Table A, allow the directors to appoint a managing director (and other executive directors) on such terms as they determine, and by article 72, to delegate to such persons such of their powers and on such conditions as they think fit.Boyle and Birds company Law, 1987, 568

31- Thomas Logan Ltd. v. Davies [1911] 104 L.T 914

31(a)- Bull, G., (ed), The Directors' Handbook 2nd edition, 1977, at p.33

32- Powell-Smith, V., The Law and Practice Relating to Company Directors, 1969, p. 107

33- Barc and Bowden (editors), Tolley's Company Law, supra, note 26, p.289; see also Palmer's Company Law, supra, note 8, p.915

34- Boyle, A.J., et al, Boyle and Birds Company Law, 24th edition, 1987, p. 568

35- [1900] 2 Ch.349

36- (1831) 3 B & ALd.125; Schmitthoff, C.M., supra, note 8, at p.916

37- (1883) 23 Ch.D. 654

38- [1908] 1 Ch.84

39- [1933] S.C.458

40- [1941] S.C.203, at p.208

41-The view that a director may be an employee of the company is supported by a number of cases, such as Lee v. Lee's Farming Ltd.[1961]A.C 12 and Boulting v. Assn. of Cinematograph, Television and Allied Technicians [1963] 2 Q.B. 606. It is also submitted that "...in modern practice a managing director, in the great majority of cases combines the position of director and of employee and that,...,the validity of his appointment and the scope of his duties have to be gathered from the provisions of the articles and the terms of his contract with the company." See Schmitthoff, C.M., supra, note 8, p. 917

42- Freeman Lockyer v. Buckhurst Park Properties (Mangal) Ltd., [1964] 2 Q.B. 480

43- Willet, "Conflict Between Modern Managerial Practices and Company Law" (1966) 5 Mel. U.L.R. 481 at p. 486

44- George Whitechurch Ltd. v. Cavanagh [1902] A.C. 117

45- Pennington, R.R., Company Law, supra, note 5, p.143

46- Article 637(2) of the Commercial Code provides " Subject to the powers expressly given by law to the shareholders meetings as well as the powers specially reserved by law to the board of directors, and within the limits of the corporate purpose, the president shall be vested with the broadest powers to act in any circumstance in the name of the company".

47-Mahrez, A., Droit Commercial en Algerie, vol.2 (Société commerciales) 2nd ed, 1980, p. 292

48- Article 637(3) of the commercial code provides "In dealings with third parties, the company shall be bound even by acts of the president of the board of directors that are not within the scope of the company purpose, unless the company proves that the third party knew that the act was outside the company purpose or that under the circumstances it could not have been ignorant of this; however, mere publication of the articles is not sufficient to constitute such proof".

49- See the judgement of Court de Cassation of March 9th 1970, Rev. Trim Droit Com. 1971, p. 719; also see the judgement of Court de Cassation of March 11th 1975 in Dalloz, Surrey, October 1975, p. 90, where it was held that the company was responsible for the president's acts even if it repudiates responsibilty on the ground that his appointment was void because he didn't obtain his qualification shares.

50- art 624 (1)

51- art 624 (2)

52- art 624(3)

53- art 624(6)

54- Le Gall, J., French Company Law, 1974, p. 136

55- [1955] S.C. 27

56- [1919] 56 S.L.R. 625 (H.L)

57- e.g Nelson v. James Nelson Sons [1914] 2 K.B. 770; Schindler v. Raincoat Co. Ltd. [1960] W.L.R 1038; [1960] 2 All E.R. 239

58- Article 535(2) of the Commercial Code 1975 "The board of directors may dismiss him at any time. Any stipulation to the contrary is considered void." "Le conseil d'administration peut le revoquer a tout moment. Toute disposition contraira est reputée non écrite."

59- Merchantile Bank of India Ltd. V. Chartered Bank of India, Australia, and China and Strause & Co., [1937] 1 ALL E.R. 231;

60- Article 72, table A, CA 1985

61- Goel, R.K., supra, note 6, p.161

62- Ibid at p. 162

63- [1955] 1 W.L.R.352; [1955] S.L.T.133

64- Delforge, R., "Non-Delegable Powers of Board of Directors", (1950), 34, Marq. Law Rev. 48 at p. 50

65- Keenan v. Zemaitis (1925) F. 2d 572. See Goel supra, note 6 at p.157 n.33

66- (1915) 227 Fed. 292, 302

67- (1897) 139, Mo, 1, 39 S.W.486, 490; (1950) 34 Marq. Law Rev., p. 50 note 12

68- (1925) 6F 2d 192 (2d Cir)

69-See Goel, supra, note 6, p. 157, note 31

70-Ibid, p. 161

71- (1874) L.R 9 Ch.App. 691

72- (1884) 25 Ch.D. 118; see also Re Imperial Land Company of Marseilles, (Harris Case) (1872) L.R. 7 Ch.App. 587, James LJ at p. 591

73-(1866) 1 Ch.App 561

74- The deed of settlement then fulfilled the same purposes as the present memorandum and the articles of association

75- Ibid, Kindersley V.C at p.563 where it was held that "a mere power to appoint a general manager (conferred on the directors under the articles) would not authorise the directors to transfer to him (the general manager) the power to purchase shares (from any shareholder, on behalf of the company, out of funds) where that power is by the articles expressly given to the directors themselves" see Goel, supra, note 6, p. 163

76- Read, supra, note 20, at p. 45

77- Goel, supra, note 6, p.176

78- Gower, supra, note 8, p. 155

79- previously article 109 of the Table A, Companies Act 1948

80- Gower, L.C.B., The Principles of Modern Company Law, 2nd ed. 1957, p. 131

81- Ibid at p. 464, note 8

82- Schmitthoff, C.M.,& Carry, T.P.E., Palmer's Company Law, 20th ed., 1959, p. 548

83- [1907] 2 Ch.458

84- Ibid at p. 464

85- Goel, R.K., supra, note 6, p. 168

86- Pollitz v. Wabash R.R CO (1912) 207 N.Y. 113, 124

87- See Goel, supra, note 6, p. 176

88- it is argued that "Where functions are delegated they are removed from board control, just as members' powers in general meeting are removed by delegation in the articles to the directors. Until the authority to act is revoked, the appointing authority will be bound by the acts of the delegate and so will the company". See Mitchell, Philip L.R., Directors' Duties and Insider Dealing, 1982, at p. 18

89- see chapter Two, section two, supra

90- Mahoney v East Holyford Mining Co (1875) L.R. 7 H.L 869

91- (1856) 6E & B 327

92- see chapter Two, supra

93- Smith v. Hull Glass Co. (1852) 11 CB 897; Totterdell v. Fareham Blue Brick and Tile Co. Ltd. (1866) LR 1 CP 674

94- Pennington,R.R., supra, note 5, p. 147

95- Houghton & Co. v. Northard Lowe and Wills Ltd. [1927] 1 K.B. 247; Kreditbank Cassel GmbH v. Schenkers Ltd. [1927] 1 K.B. 826; Rama Corpn Ltd. v. Proved Tin and General Investments Ltd. (1952) 2 Q.B. 147, 1952 1 All E.R. 554

96- Pennington,R.R., supra, note 5 at p. 147. The author submits that "The reason for the exclusion of the Turquand rule, however is purely practical one that if it did apply each director would be invested with apparent authority to enter into transactions on the company's behalf without consulting his fellow directors, and this would be destructive of the system of collective management by the board on which our company law is based."

97- [1927] 1 K.B.247 at p. 267

98- See also Atkin L J in Kreditbank Cassel GmbH v. Schenkers Ltd. supra note 95, at p. 844, and Selsser L J in British Thomson-Houston v. Federated European Company Bank Ltd. 1932 2 K.B.176 at p. 183. A limitation of the right to make such an assumption is expressed by Buckley on the Companies Act, 10 Ed, p. 75, as follows "And the principle does not apply to the case where an agent of the company has done something beyond any authority which was given to him or which he was held out as having."

99- Houghton & Co. v. Northard Lowe and Wills Ltd. supra note 95; Kreditbank Cassel GmbH v. Schenkers Ltd. supra note 95; Rama Corpn Ltd. v. Proved Tin and General Investment Ltd. supra note 95

100- Rama Case [1952] 2 K.B.147, 149

101- Schmitthoff, C.M and Curry T.P.E., Palmer's Company Law, 20th edition, 1959, at pp. 247-250; see also Rice, D.G., "Powers of Director to Bind the Company", (1959) J.B.L. 322 at p. 233-234

102- Rice, D. G., "Ostensible Authority of Company Directors", (1965) JBL, note 21, at p. 322

103- Houghton & Co. v. Northard Lowe and Wills Ltd. [1927] 1 K.B. 246 at p. 267

104- Rice, D.G.,supra, note 15, at p.p 322-323; also Freeman's case seems to confirm this view. i.e that an ordinary director as such cannot bind the company in an executive matter except when the authority has been delegated to him under the company's constitution

105- Read, A, supra, note 20, at p. 49; it is also submitted in two cases (Freeman & Lockyer (A Firm) v. Park Properties (Mangal) Ltd [1964] 2 Q.B.480 at 505-506 Per Diplock L.J. Hely-Hutchinson v. Brayhead Ltd. [1968] 1 Q.B. 549) that where a director has expressly or impliedly held out by the board as having power to act on the company's behalf, it is not necessary that the company articles should contain a power of delegation

106- [1927] 1 K.B. 826 of p. 844

107- Biggerstaff v. Rowatt's Wharf Ltd [1896] 2 Ch.93

108- Rice, D.G., supra, note 101, at p.337

109- Freeman's case; Hely-Hutchinson v. Brayhead Ltd. ,supra note, 105

110- Pennington, R.R., supra, note 5, p.147

111- Rice, D.G., supra, note 101, at p. 336

112- The author argues that the usual authority of a director is deemed as a matter of practice (ibid 339)

113- This rule however is subject to obvious limitation that the person so dealing must have no actual or constructive notice that the professing agent of the company has not authority in fact.

114- See also <u>Panorama Developments (Guildford) Ltd</u> v. <u>Fidelis Furnishing Fabrics Ltd.</u> [1971] 2 Q.B 711

115- Except in so far as they expressly prohibit the agent in question from acting in the way he did; see also Rice supra, note 102 at p. 324

116- Goel, R.K., supra, note 6, at p.175

Chapter Four

Directors' Duties At Common Law

The company directorship is not a mere honorarium or a simple sinecure as it is sometimes treated. It is attached to a body of obligations, duties and responsibilities. Indeed it can be described as a coin with two sides. One side is rights, powers and discretion which are vested in directors. The other is the liabilities, duties and responsibilities that face directors when their duties appear to be breached or neglected, or when their powers are abused.

Having discussed the vesting of wide powers in the board of directors, it would be necessary to highlight the legal means of controlling the directors in the exercise of these extensive powers. In order to prevent directors from abusing their managerial powers, a body of rules are imposed on them by common law designed to ensure certain minimum standards of behaviour from directors. The breach of these rules renders the directors legally liable. In Company law directors' duties means "The obligations and the standards of conduct and performance imposed on directors mainly by Common law developed through cases",[1] but in recent times augmented by Statutory Prescriptions.

As previously noted[2], a company director can to some extent be regarded as a trustee and as an agent. This analogy is relevant because both have a fiduciary duty to those for whom they act which requires them to act in an honest and disinterested fashion. Furthermore, the case law on the duties of directors has been developed by applying to the special circumstances of company directors, as "officers" of their company, by borrowing the same standards as *mutatis mutandis* apply to agents and to trustees.[3]

The directors' duties are wide and diversified. The law does not impose an all-embracing code of conduct on directors. Therefore, some duties are laid down by statute (statutory duties) i.e. restrictions and prohibitions which are imposed on directors by the Company Act 1985 and other legislation, but many are found only in common law. Moreover, a director may also have some specific duties to the company by virtue of his contract of employment or where he is acting as a professional adviser [4]. However, the established rule is that a director owes two types of duty to a company, a fiduciary duty and a duty of skill and care.[4(a)]

Section 1: <u>Fiduciary Duties</u>

Director's fiduciary duties are described as "The body of duties invented and elaborated by the court of chancery in the eighteenth and nineteenth centuries to ensure that persons who had assets or exercise functions in a representative capacity for the benefit of other people act in good faith and conscientiously protect the interests of those they represent[5]. Before exploring the fiduciary duties owed by the directors to their companies in detail, it would be very useful to mention briefly the general principles from which these duties are derived.

a - The duties of good faith are owed by each director individually.

b - The fiduciary duties are owed to the company and to the company alone[6]. Clearly, no such duties are owed by the directors to the individual members as such, or to a person who has not become a member, such as a potential purchaser of shares in it (company). [7]

c - The fiduciary duties are imposed on directors by virtue of the nature of the work they perform. For this reason, that the same duties (although less rigorous depending on the particular circumstances of the case) apply to any officials (other than directors in the usual sense) of the company who are authorised to act on its behalf, particularly to those in a managerial capacity.[8]

As a result of the fiduciary relationship between a director and his company, a number of duties and obligations are imposed on him. Although in practice, these duties tend to blend together, it would be convenient to categorise them into three important groups as follows:

Firstly, the directors must act *bona fide*, that is, in what they believe to be the best interests of the company.

Secondly, they must exercise their powers for the particular purpose for which they were conferred and not for some extraneous purpose[9]. Thirdly, the directors must not, without the consent of the company, place themselves in a position in which there is a conflict between their duties and their personal interests[10].

1.1.- Duty to act *bona fide*

One of the established rules in company law is that directors when acting as a board have a duty to use their powers and act in good faith in what they consider to be the best interests of the company, which means the shareholders as a whole[11]. This is the view of Lord Green M.R. in Re Smith & Fawcett Ltd[12]. He stated that "Directors must exercise their discretion *bona fide* in what they consider is in the interests of the company, and not for any collateral purpose". Accordingly, directors cannot justify the exercise of their powers for the benefit of themselves or only some of the shareholders. Further, what is the interest of the company is subject to the judgement of the directors which is applied as the (subjective opinion) of the board of directors, and the court will not interfere with a decision which the directors honestly believed to be the right one. For example, in relation to the payment of dividends, the question whether there are profits available is left to the subjective judgement of the board of directors based on *bona fide* appraisals of valuations, stock-takes, depreciation provisions, etc.[13]. The courts will interfere only if no reasonable director could possibly have concluded that a particular course of action was in the interests of the company[14], i.e. the courts interfere only if there is evidence of bad faith on the part of the directors, or if their decision is one which no reasonable board could have reached. In addition, it is submitted that a director acting honestly but not in the interests of the company, is in breach of duty. In Re W & M Roith Ltd[15]. A director (of two companies) who was in poor health entered into a service contract with one of the companies providing for a generous widow's pension (pension for life) in the event of his death. The court held that he was not acting *bona fide* in the interests of the company and therefore the contract (transaction) was not binding on the company.

1.2.- Duty to Act for a Proper Purpose

In addition to acting in good faith, directors are under duty to exercise the powers vested in them by the company's memorandum or articles of association for the purpose for which the powers were conferred. However, a subsidiary purpose, albeit improper, will not invalidate the exercise of the power, as long as the main purpose for which the power has been exercised is a proper one[16]. For example, some incidental benefit obtained by a director will not invalidate the exercise of the power unless his self interest was the substantial purpose for the exercise of the power[17]. The use of directors' powers for other purposes constitutes a breach of duty, and renders the directors liable to compensate the company for any loss suffered. Besides, their decision will be voidable by the company. The impropriety of the purpose may arise because of illegality or contravention to public policy[18] or in cases where it is not that contemplated by the articles conferring it[19]. The rule that they must not exercise their powers for an improper purpose applies of the exercise by the directors of any of their powers, this includes, making calls on shares[20], ordering the forfeiture of shares[21], refusing to register transfers[22] or expelling a member[23]. However, the problem that arises more frequently concerns the exercise of the directors' powers to allot shares [24]. The director's powers to issue shares has been considered by the court in a number of cases. In Piercy v. S. Mills & Co. Ltd.[25], Patterson J submitted that:

> "Directors are not entitled to use their power of issuing shares mainly for the purpose of maintaining their control or the control of themselves and their friends over the affairs of the company, or mainly for the purpose of defeating the wishes of the existing majority of shareholders".

The same issue was raised again in Hogg v. Cramphorn Ltd[26] where the directors issued shares with special voting rights to the trustees of a scheme set up for the benefit of the company's employees, in order to forestall a takeover. It was held by Buckley J that although the directors had acted in good faith they had breached their duty to the company by making improper use of their power to issue shares. In reaching this decision, Buckley J was influenced by the directors taking into account the staff's interests - Thus he said "I am satisfied that Mr. Baxter's offer, when it became known to the company's staff, had an unsettling effect on them. I am also satisfied that the directors and the trustees of the trust deed genuinely considered that to give the staff through the trustees a sizeable, though indirect, voice in the affairs of the company would benefit both the staff and the company. I am sure that Colonel Cramphorn and also probably his fellow directors firmly believed that to keep the management on the company's affairs in the hands of the existing board would be more advantageous to the shareholders, the company's staff and its customers than if it were committed to a board selected by Mr. Baxter".[27] Yet, supposing that the decision in Hogg v. Cramphorn Ltd.is the right one, and by adopting it, the directors may not allot shares to defeat an attempt to gain control of the company. This is so even if they believe that is the best interest of the company. However, this leads us to a view which is inconsistent with the established rule in Re Smith & Fawcett Ltd.[28], expressed by Lord Green M.R.: "They (the directors) must exercise their discretion *bona fide* in what they consider - not what a court may consider - is in the interests of the company, and not for any collateral purpose". Therefore, it is quite clear that the directors' right to exercise their powers and consider the company's interest are restricted. A clear example for this is the director's power to issue shares. In exercising this power, directors cannot in any circumstance issue shares in order to maintain their own control. Surprisingly, this is so even if they believe that is in the best interest of the company - this according to Hogg v. Cramphorn.[29]

This view which is adopted by U.K. courts, however, is criticised as too rigid. In addition, to its contradiction, to the rule in Re Smith & Fawcett Ltd. As a result of this, a number of commonwealth authorities[30], (particularly Australian), seem to be unconvinced by the U.K courts' view. Hence, they rejected the breadth of the principle in Hogg v. Cramphorn Ltd [34]. For example, in Teck Corpn v. Millar[31]. The supreme court of British Columbia permitted an allottment to defeat a takeover, despite the fact that the allotment was made against the wishes of the existing majority shareholder and deprived that shareholder of control of the company. This decision was regarded as a departure from the prevailing British view (Hogg v. Cramphorn Ltd); Bamford v. Bamford[32] which holds that the share issue power is properly to be exercised for limited purposes only[33]. Similarly, the High Court in Australia, in Harlowe's Nominees Pty v. Woodside (Lake Entrance) Oil Co.[34] permitted an allotment of shares which was made in order to secure the financial support of a large oil company although the consequence of the allotment was to block a would-be takeover by an existing shareholder. However, despite the rejection of Hogg v. Gramphorn by Berger J in the Teck Case[35], he admitted that this rejection might cause more abuses by directors of their powers or weaken the protection of shareholders. He, consequently, proposed to resolve this problem by introducing a "reasonable grounds" factor into the Smith & Fawcett test:

> "I think the court should apply the general rule in this way: the directors must act in good faith. Then there must be reasonable ground for their belief. If they say that they believe that there will be substantial damage to the company's interests, then there must be reasonable grounds for that belief. If there are not, that will justify a finding that the directors were actuated by an improper purpose."

Finally it is necessary to note that the power to issue shares is not confined solely for the purpose of raising capital. Indeed, it can be used for other purposes as well.[36] For example, for maintaining the minimum necessary membership[37] or fostering desirable business relations.[38] Clearly, as Birds put it, the use of such a power, if given to directors, is primarily a matter for them to decide, a matter of management.[39]

1.3.- Duty to avoid a conflict of interest and duty

By virtue of the fiduciary relationship which a director has with his company, he is under obligation to avoid placing himself in a position where there is an actual or potential conflict between his own personal interest and his duty to the company. This general principle applies to all persons who are subject to fiduciary duties. Furthermore, it is not confined to contracts directly with directors but it includes those in which they are in any way interested.[40] In Aberdeen Rly Co. v. Blaikie Brothers[41] Lord Cranworth L.C stated that: "no-one having such 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 interest of those whom he is bound to protect."

However, this view seems to be very wide indeed. Thus, it has been suggested that it is too broad a principle to be strictly applicable in all situations,[42] and its application without any exception would be unworkable.

Following the general principle cited above, Directors must avoid any act or transaction that may give rise to a conflict between their duty and their interest. Yet the source of conflict may be ascertained to a number of acts performed by the directors during their directorship term (mandate). This includes contract with the company, competition with the company, using corporate property, information or opportunity... However, we will confine the discussion to contracts with directors as creating the most reason for conflict.

1.4.- Contracts of Directors With their Company

As previously noted[43], the legal position of a company director *vis a vis* his company, is that of an agent who may not himself contract with his principal, or a trustee who is not allowed to let the position arise where his interest and that of the trust may conflict. Yet, at Common law, and in the absence of a liberating provision in the articles, a director could not safely contract with his company unless a general meeting, after full disclosure, approved the contract[44]. Nowadays, most modern company articles of association relax a director from the general prohibition (that he may not contract with his company) by permitting directors to contract with their companies.[45] However, this permission is subject to a number of provisions contained in section 317 of the Companies Act 1985 and to be found also in article 627 of the Algerian Commercial Code 1975.

Under section 317 (CA 1985), any director of the company who is in any way, whether directly or indirectly[46], interested in a contract or proposed contract with the company is under a statutory duty to declare his interest at a meeting of the board (and not to a committee of the board)[47] at which the contract, transaction or arrangement is first considered, or if his interest does not arise until after that time, at the first board meeting after his interest does arise. The meaning of the term 'contract' under section 317(5) is extended to include any transaction or arrangement (whether or not constituting a contract) made or entered into on or after 22 December 1980 (section 317(5) CA 1985). The other safeguard to the company, imposed as a condition of permitting directors to be interested in its contracts is a rule (table A article 94) which prohibits a director from voting at a board meeting on any matter in which he has an interest, with certain exception. The same safeguard is provided by the Algerian legislature. Article 627(6) of the commercial code 1975 provides "interested directors may not participate in a vote, and their shares are not taken into account in the calculation of the quorum and the majority."48 Furthermore, it is submitted that a mere declaration of the directors interest is not enough to validate the contract (ie, disclosure must not simply be of the directors interest). Therefore, the nature of that interest must be specified as well. In Imperial Mercantile Credit Association v. Coleman [49]Lord Cairns pointed out " a director...must show that he has in letter and in spirit, complied with the provisions of the clause...A man declares his interest, not when he states that he has an interest but when he states what his interest is". Similarly, in Gray v. New Augarita Procupine Mines Ltd.[50], Lord Radcliffe stated:

> "there is no precise formula that will determine the extent of detail that is called for when a director declares his interest or the nature of his interest...If it is material to their (the directors) judgement that they should know not merely that he has an interest, but what it is and

how far it goes, then he must see to it that they are informed".

Section 317 of the Companies Act 1985 applies with equal force to shadow directors, i.e., "certain persons in accordance with whose directions or instructions the directors are accustomed to act" [51]. However, since a shadow director may have no right to attend board meetings he must declare his interest by notice in writing to the directors[52]. This notice must either be a specific notice given before the date of the directors' meeting at which, if he had been a director, he would have been required to make a declaration in accordance with section 317(2), or a general notice under section 317(3). According to section 382(3) such a specific notice is to be minuted as if the declaration had been made at the meeting in question and a general notice is to be minuted as if the declaration had been made at the next directors' meeting after the notice is given. In the event of the director failing to disclose his interest in a contract with his company in accordance with section 317 (CA 1985), the contract is *prima facie* voidable by the company[53]; and the director must account to it for any secret profit he has made out of the contract[54]. In addition, section 317(7) provides that a director who fails to make proper disclosure of his interest is liable to a fine.

1.5.- The position in Algerian law

With the exclusion of the prohibited transactions and acts (conventions prohibées)[55], all transactions between commercial companies and their directors and shareholders are subject to precise regulations. Indeed, the possible conflict that may occur between the personal interests of the directors and the interest of the company led the Algerian legislature to subject some agreements (conventions) to a prior authorisation of the general meeting[56]. Similar regulations exist in all modern legal systems; although the precise form naturally differs from one country to another[57]. From the regulations, the commercial code appears to distinguish between three categories of conventions, namely, conventions subject to prior authorisation by the general meeting, normal conventions and prohibited conventions (conventions interdites).

Like British law, Algerian law permits company directors to enter into agreements and transactions with their companies provided that they comply with the formalities and conditions set out by law. In fact apart from the normal conventions relating to the operations of the company with its clients[58] (i.e., those in the ordinary course of business) any agreement between the company and one of its directors must be submitted, on penalty of nullity, to prior authorisation by a general meeting, following a report by the auditors (commissaire aux comptes)[59]. This applies to any agreement in which a director is directly or indirectly interested or in which he deals with the company through an intermediary or nominee[60]. In other words, article 627(1) applies to three types of conventions:

1- Conventions entered into directly between the company and a director acting personally.

2- Conventions in which a director has an indirect interest, entered by a third person on his own account.

3- Conventions between the company and a director entered by an intermediary, notably - a parent- a friend - figurehead, in which a director will benefit[61].

Furthermore, agreements between a company and another enterprise shall also be subject to a prior authorisation if one of the directors of the company is a manager, administrator or director of the enterprise, whether he is a shareholder or not. A director who finds one of these cited cases applicable to himself is obliged to make a declaration to this effect to the board of directors[62]. Since article 627(2) does not require a particular form of declaration, a verbal declaration will suffice. The content of the declaration is also not determined by article 627(2). Consequently, it would be sufficient for a director to indicate the nature of the contract into which he intends to enter with the company or to mention the existence of a personal interest in the enterprise contracting with the company. This declaration is required in all circumstances, whether a director is acting directly or through an intermediary .[63]

Unlike French law[64], power to give the prior authorisation in Algerian law is reserved exclusively to the general meeting. However since commercial transactions require speed and flexibility and according to article 627(6) the director who is interested in the contract with the company cannot take part in the vote, and his shares shall not be taken into account in determining the quorum and the majority. Therefore, it is impractical to convene a general meeting every time one director is interested in a contract with the company; a prior authorization by the conseil d'administration (board of directors) followed by the ratification of the general meeting seems to be sufficient. Indeed, The requirement of a prior authorization by the general meeting may appear to be an excessivety elaborate procedure especially when balancing the financial and other costs of such a meeting which are in many cases infrequent.[65]

The authorisation required by the legislature in article 627(1) must be prior, and follow from a general meetings deliberations.[66] It must be given without fraud.[67] The sanction is the nullity of the transaction or agreement.[68] A nullified action is prescribed for three years counting from the date of the agreement.[69] However, failure to obtain an authorization does not nullify the agreement except when it has damaging effects on the company. This can be seen in article 629(1) which provides that "without prejudice to the liability (responsibility) of the interested director, the agreement cited in article 627, paragraphs 2,3,4 and 5, and concluded without prior authorization of a general meeting, may be annulled if they had had damaging effects on the company". Furthermore, even in this case, the nullity may be cured by a vote of a general shareholders' meeting after an auditors report which describes the circumstances causing the failure to follow the correct authorisation procedure.[70]

Finally, it is worthy of note that the agreements approved by the shareholders' meeting, as well as those which it does not approve, shall be effective with respect to third parties, unless they are annulled by fraud.[71] However, even in the absence of fraud, the administrator (administrateur) or general manager (directeur général) concerned, and possibly other members of the administrative board, may be held liable for the consequences of a disapproved agreement where such consequences are detrimental to the company.[72]

Section 2: <u>Common Law Duties of Care, Diligence and Skill:</u>

In addition to the fiduciary duties of loyalty and good faith imposed on company directors, the common law further provides an additional body of obligations under which a director is required to show proper skill, diligence and care in the performance of his duties. These duties are described to be less onerous, more broadly formulated than the fiduciary duties. They are owed to the company and not to individual members[73].

The leading case on the nature and extent of the duty of skill and care is Re City Equitable Fire Insurance Co. Ltd.[74]. In which Romer J, after reviewing the early authorities formulated three basic principles which are still regarded as expressing the law on duties of care and skill.

2.1.- Degree of skill:

Since a director is not an expert, he need only display skills he actually possesses."A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience."[75] It follows from this, that the test of skill required by a director is a subjective one, since he is not expected merely by virtue of his office to possess any particular skills. The exercise of his duties must be judged by the way he applies any skills which he actually has[76]. On the other hand, any objective test of skill may be imposed. For example, if a director who is employed by a company in a professional capacity, he must attain the standard of a reasonably competent member of that profession, and also if a director is employed under a service contract. It will in any event imply a requirement to display an objective level of skill in the performance of his duties[77]. Moreover, in the case of an insolvent company, a director faces liability for wrongful trading, if he fails to display both the general knowledge, skill and experience that he actually has and also that which might reasonably be expected of someone carrying out his function within the company.[78]

2.2.- Attention to Company Business and attendance of board meetings;

"A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings...He is not, however bound to attend all such meetings, though he ought to attend whenever in the circumstances, he is reasonably able to do so".[79] This dictum is clearly more relevant to the circumstances of a non-executive director from whom nothing more is expected than attendance at meetings. In Re Cardiff Savings Bank; the Marquis of Bute's Case,[80] the Marquis of Bute became president of a company by succeeding his father (he had been appointed to this post when he was only six months old) he attended one board meeting in 38 years. As a result of this he failed to prevent the active director conducting the company's business improperly. Nevertheless, Stirling, J held that he was not liable for losses resulted from irregularities which had occurred during his absence. Stirling, J said "Neglect or omission to attend meetings is not, in my opinion, the same thing as neglect or omission of a duty which ought to be performed of those meetings". However, this view seems to be unlikely to be adopted in future judgements.[81] On the face of it, executive directors are required by their service contracts to devote their full attention to the business of the company. In the Ssouth African case of Fisheries Development Corps of SA Ltd. v. Jurgensen,[82] Margo, J. suggested that the old rules as formulated by Romer, J. are relevant only to non-executive directors and new rules must be formulated for executive directors.

2.3.- Reliance on other executives (officials):

"In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly."[83] As previously noted in chapter three, company's business cannot be carried out in an efficient manner unless its directors are permitted to be assisted by other persons (officials & executives) who posses more skill and experience. Furthermore, the fact that directors as such are not required to possess any particular accomplishment[84] shows clearly their necessity of relying on expert officials. The directors are not required when relying on other officials, to supervise those to whom tasks have been delegated. Further, they are not responsible vicariously for their wrongful acts since they are (officials) the agents and servants of the company, not of the directors[85]. In Dovey v. Cory[86], the director of a banking company agreed to certain irregularities in reliance on the advice of the chairman and general manager. The House of Lords held that was not liable in negligence for breach of his duty of care because it was reasonable for him to rely on these officers. Lord Halsbury L C said:

> "I cannot think that it can be expected of a director that he should be watching either the inferior officers of the bank or verifying the calculation of the auditors himself. The business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to details of management."

Having said that, directors are still under duty to exercise a reasonable amount of care. In other words, they are not entitled to accept blindly all documents placed before them[87].

However, it appears that the judgements of the Re City Equitable and other old cases can no longer be regarded as safe guides to the standard of care and skill required.[87(a)] This is because the commercial climate under which they were formulated differs from the current commercial practice. Consequently, a new formulation updating the rules regulating the duty of care and skill should be presented in a way that reflects the true position and real role of a modern company director.

After this brief discussion of the three propositions expressed by Romer J in Re City Equitable Fire Insurance, it would be important to throw some light on the current situation regarding the duties cited above.

2.4.- Standards of Care and Skill

The law at present requires all company directors to display some degree of care and skill when discharging their duties. However, to understand the two duties, it is necessary to highlight two important points. The first one concerns a definitionary problem. In one attempt to draw a line between the duty of care and skill[88], it is submitted that care refers to any duties concerning factors that might be employed by the layman in dealing with issues that he is called upon to consider as a director (in his capacity as a director). Conversely, duties of skill relate to specific areas of expertise and specialty. This distinction appears to have a practical importance. This is so because the standard applicable to directors when limiting (deciding the degree) of their liability differs from one duty (care) to another (skill).

The second important and most controversial question facing courts over the years is that: How much of care and skill can be expected of them? Clearly, what is the standard of care and skill expected from a company director? Although the judgement of Romer J., in Re City Equitable Fire Insurance[89] lays down that, in discharging his duties, a director must act honestly, and must also exercise "some degree of care, skill and diligence".

However, as to what particular degree he submits that the authorities do not give any clear answer. Furthermore, despite the fact that business administration has become a specialised task, there are not yet any signs that the courts are attributing to directors the standards of any profession[90]. Currently, British law does not provide an objective standard of skill and care that can be applicable to all company directors[91]. Instead, there is a general principle whose application in each case calls for a personal assessment of the individual director[92]. This shows clearly the personal character of the duty of care and skill under British Company Law. The absence of a professional standard as Professor Pennington argues is that "because directors do not form an homogeneous category and they require different degrees of skill and application to do their work efficiently, depending on the size of the company they serve, the complexity of its operations, the form of its management structure and the relative importance to the company of the transactions in respect of which negligence is alleged"[93]. This view seems to be logical and reasonable. Indeed, the fact the British legislature does not require any qualification for the post of company director means that skill and qualification may differ from one director to another. Thus, any attempt to establish an objective standard applicable to all directors appears to be a very difficult task if not impossible. In addition, many boards of management (especially large companies) include outside directors (non-executive directors). This category of directors do not devote all their time and energies to one company only. Therefore, it can be said that it is quite difficult and unrealistic to frame a standard (professional standard) which is precise enough to be effective and flexible enough to comprehend many different directors in many different situations[94]. Furthermore, the law cannot really measure business efficiency, and courts are always reluctant to be involved in the investigation of the internal management of the company[95] or intervene with the director's business judgement[96] (particularly after the event). This is known in America as "the business judgement rule" which means that it is not the function of the court to intervene in the matters regarding the business judgement of the company[97]. As Professor Ballantine[98] pointed out:

> "The [USA] courts will not in general undertake to review the expediency of contracts of other business transactions authorised by the directors. A large discretion is lodged in them. Questions of value and policy are for their business judgement, although their errors may be so gross as to show their unfitness to manage corporate affairs. But it is presupposed in this business judgement rule that reasonable diligence and care have been exercised."

The lightness of the duties of care, diligence and skill may be noticed in a number of British cases. For example, in <u>Re Forest of Dean Co</u>.[99], Jessel M.R. said:

> "...(Directors are) to use reasonable diligence having regard to their position, though probably an

> ordinary director, who only attends at the board occasionally, cannot be expected to devote as much time and attention to the business as the sole managing partner of an ordinary partnership, but they are bound to use their fair and reasonable diligence in the management of their company's affairs, and to act honestly."

It is also submitted that a director cannot be expected to display skill that he does not possess. Thus, in Re Brazilian Rubber Plantations & Estates Ltd.[100], Neville J said:

> "(A director) is, I think, not bound to bring any special qualifications to his office. He may undertake the management of a rubber company in complete ignorance of everything connected with rubber, without incurring responsibility for the mistakes which may result from such ignorance."

It was also pointed out in the Government White Paper "The Conduct of Company Directors"[101] that a director is only required to exercise that degree of skill which may reasonable be expected of a person of his knowledge and experience. The same provision can be found in the Companies Bill 1978 (Cl. 45 (1)).[102]. It is clear from this that the standard of skill is a subjective one. However, this view may be criticised on the grounds that it makes the directors' duties of care and skill very low and may exonerate incompetent directors on the basis that he can do no better[103] Indeed, this may be used as an excuse by directors to escape from liability for their negligence. As a result of this it is suggested that this low standard applicable to directors' duties of care and skill must be increased. It is argued[104] that the main reason for that is that the reported cases on this question were all decided before the existence of 'professional' company directors. In addition, a director of a modern company may be an employee of the company with a service contract, in this case he will subject to greater standard. Furthermore, the unreported case of Dorchester Finance Co. Ltd. v. Stebbing (22 July 1977) noted in(1980) 1 Co. Law 38) recognises the need for a higher standard besides it can be noticed that certain provision of the Insolvency Act 1986 such as (Section 214 regarding wrongful trading) seem to require higher standards of a director.

From the discussion above, it can be said that both objective standard and subjective standard are unable to provide a convincing solution to frame the extent of directors' duties of skill and care, although as Mr MacKenzie noted "Both formulae have their advantages and many drawbacks"[105]. Indeed the application of subjective standard may lead to strange consequences, such as the protection of incompetent directors at the expense of other directors which constitutes a breach to the established rule that the board of directors should be seen to act uniformly in the benefit of the company. In addition, this may discourage the well qualified directors from accepting directorships, and this, consequently result in creating incompetent Companies Boards. Similarly, the objective standard is not free from disadvantages. The reason is that the impracticality of applying the same standard to different types of directors with different tasks to do e.g. it is not fair to judge an outside director (non-executive director) by the same standard as a full time director (executive director) since the former is not expected to have the same amount of knowledge and experience of the company's affairs as the latter.

The third view suggests the combination of the two opposing theories stated above. This is by setting out a number of different objective standards. The application of each depending on the particular role the director is occupying in the company. For example, separate standards for expert directors, executive directors (with no speciality) and non-executive directors (with no specialty). Therefore, every director will subject to one objective standard within the area of his specialty or competence. In other circumstances the normal lax rules would be applied[106]. The last view is that of Professor Pennington. He submits that:

> "The most the courts can do in seeking to establish objective criteria is to require a minimum degree of specialised competence from directors whose recognised qualifications or experience in the company's area of business make it reasonable to expect them to exhibit a certain level of professional or practical skill. This is a less exacting criterion that the standard of performance expected of a professionally qualified practitioner, namely the level attainable by the average competent practitioner in his field.[107].

This view seems to be more balanced and more acceptable in practice.

Notes:

1- Gullick J.M, Ranking and Spicer's company law, 13th edition, 1987, at p. 215

2- See chapter two, section one ,supra.

3- Gullick, J.M., supra, note 1 , at p. 215

4- Wright, D., Rights and Duties of Directors, 1987, at p.33

4(a)- Riley, C. A. in "Directors Duties and the Interests of Creditors" (1989) Co.lawy p.87 argues from commonwealth decisions that in the circumstances of insolvency there is the possibility that the United Kingdom Courts might recognise that directors owe a duty to the wider community and to the creditors in particular. Mr Riley emphasises the uncertainty underlying his argument and that the availability of Insolvency Act 1986 s.214 would make unlikely the development of such a common law duty.

5- Pennington, R.R., Directors' Personal Liability, 1987, at p.36

6- This principle is regarded as established by the the decision in Percival v.Wright [1925] 2 Ch. 421; T.L.R. 697.

7- Gower, L.C.B.,The Principles of Modern Company Law, 4th ed.,1979, at p.573

8- Ibid, at p.574

9- Ibid, at p.576

10- Ibid, at pp.575-76

11- See Greenhalgh v. Arderne Cinemas,Ltd., [1925] 1 Ch.286 at p.291 where Lord Evershed M.R. said "The company as a whole does not mean the company as a commercial entity, distinct from the corporators. It means the corporators as a general body". French law contains no statutory definition of the phrase *"interests of the company"* similarly the courts have not established a clear cut definition. For example, while the Paris *Court D'appel* in <u>société Fruehauf corp</u> v. <u>Massardy et autres</u> (Paris, 22.5.68, D. 1969, 147) (has) stated that the interests of the company are the interests of the "enterprise", the *Court de Cassation*, however, has adopted a more restrictive view, confining it to the interests of the shareholders. See Dobson, J.M., "Lifting The Veil in Four Countries: The Law of Argentina, England, France and the United States", (1986)35 <u>I.C.L.Q</u>. 839 at p.855

12- [1942] 1 All E.R. 542; [1942] Ch. 304

13- <u>Re Kingston Cotton Mill</u> (No. 2) [1896] 1 Ch. 331; see also Mitchell philip L.R., <u>Directors' duties and Insider Dealing,</u> 1982, p. 27

14- <u>Thompson</u> v. <u>J. Barke & Co. (Caterers) Ltd</u>., 1975 S.L.T. at p. 67.

15- [1967] 1 W.L.R. 432

16- Northy & Leigh, <u>Introduction to company law</u>, 4th ed., 1987, p. 195

17- <u>Ngurli Ltd</u> v. <u>McCann</u> (1953) 27 ALJ 349, 90 CLR 425; <u>Mills</u> v. <u>Mills</u> (1938) 60 CLR 150 at p. 164

18- <u>Pharmaceutical Society</u> v. <u>Dickson</u> [1968] 3 W.L.R. 286; Gower, L.C.B., <u>The Principles of Modern Company Law</u>, 3rd Edition, 1969, at p.524

19- Ibid. p. 524

20- <u>Golloway</u> v. <u>Hallé Concerts Society</u> [1915] 2 Ch. 233; <u>Alexander</u> v. <u>Automatic Telephone Co</u>. [1900] 2 Ch. 56

21- <u>Re Agriculturist Cattle Insurance Co., Stanhope's Case</u> (1866) 1 Ch.App. 161

22- <u>Re Smith & Fawcett Ltd</u> [1942] Ch.304

23- <u>Gaiman</u> v. <u>National Association for Mental Health</u>, [1971] Ch 317, [1970] 2 ALL E.R.362; See also Prentice,D.D, "Expulsion of members from a Company", (1970) 33 M.L.R at p. 700

24- The power to allot shares is now restricted by the the Companies Act 1985, section 80(1) which provides that the power to allot shares shall not be exercised by the directors unless they are authorised to do so by the company in general meeting or by the articles .

25- [1920] 1 Ch. 77, 84; See also Fraser v. Whalley (1864) 2 H. & M. 10; Punt v. Symons & Co. [1903] 2 Ch. 506

26- [1967] Ch. 254

27- Ibid, at p.265

28- [1942] Ch.304 at p. 306

29- However in Teck Corporation v. Millar [1973] 33 D.L.R.(3^d) 288 at p.317. Mr.Justice Berger rejected Buckley J's position in hogg v. Cramphorn that directors are not entitled to exercise their share issuing powers to frustrate a take-over bid even though they believe themselves to be acting in the company's best interests. He expressly held that "Directors are entitled to consider the reputation, experience and policies of anyone seeking to take over the company. If they decide, on reasonable grounds, a take over will cause a substantial damage to the company's interests, they are entitled to use their powers to protect the company".

30- Teck Corporation v. Millar (1972) 33 D.L.R (3^d) 288; see also Harlowe's Nominees PTy v. Woodside (Lake Enterance) Oil Co. Ltd. (1968)121 CLR .483

31- The Teck Case was approved by the Privy Council in Howard Smith Ltd v. Ampol Petroleum Ltd [1974] A.C. 821; See Birds,J., "Proper Purpose As A Head of Directors' Duties", (1974)37 M.L.R. 580

32- [1969] 1 ALL E.R. 969

33- Slutsky, B.V., "Canadian Rejection of the Hogg v.

Gramphorn "Improper Purpose" Principle - A Step Forward? (1974) M.L.R p. 457

34- (1968) 121 CLR (483)

35- (1973) 33 DLR (3d) 288

36- Pennington, R.R., Directors Personal Liability, 1986, at pp.71-72

37- Punt v. Symons & Co. Ltd. [1903] 2 Ch 506 at p. 515

38- Harlowe's Nominees Pty. Co. Ltd. v. Woodside (Lake Enterance) Oil co. Ltd (1968) 42 A.J.L.R.123

39- Birds,J., supra, note 31, at pp.583-83

40- Gower, L.C.B., supra, note 7, at 584.

41- (1854) 1 Macq.(H.L.) 461 at pp. 471-2 (HL Sc); (1854) 23 L.T. (O.S.) 315, HL

42- See Phipps v. Boardman [1967] 2 AC 46 at p. 124, "But it is applicable, like so many equitable principles which may affect a conscience, however innocent, to such a diversity of different cases that the observations of Judges and even in your Lordships' House in cases where this great principle is being applied must be regarded as applicable only to the particular facts of the particular case in question and not regarded as a new and slightly different formulation of the legal principle so well settled." Per Lord Upjohn

43- See chapter two, section one, supra

44- Transvaal lands Co. v. New Belgium (Transvaal) land and Development Co. [1914] 2 Ch. 488

45- Article 85 of Table A provides: "Subject to the provisions of the Act, and provided that he has disclosed to the directors the nature and extent of any material interest of his, a director notwithstanding his office

(a) may be a party to, or otherwise interested in, any transaction or arrangement with the company or in which the company is otherwise interested"; see also Article

627 (2) of the Algerian Commercial Code 1975.

46- For example, when a director holds shares in another company; being a partner in a firm where the other company or firm is a party to the contract with the directors company

47- Guinness PLC v. Saunders & Anor (1987) 3 BCC 271; The Independent, July 21, 1987. However, in the House of lords 1990 reported in BCC at p.205 the court held that under the articles only the board had authority to grant special payment to a director serving on a committee and as the board had not done so the contract in question could not excist. These powers could not be delegated to chief-executive, nor could any assemption of authority inconsistent with the articles be implied. nevertheless this would appear to leave the court decision at first instance a valid statement of the disclosure obligation.

48- Article 627(6) " Le ou les administrateurs interessés ne peuvent pas prendre part ou vote et leurs actions ne sont pas prise en compte pour le calcul du quorum at la majorité."

49- (1873) LR 6 H.L, 189

50- (1952) 3 DLR 1, P, PC

51- except professional advisers 741(2) of the Companies Act 1985

52- Barc, S. & Bowen (Editors), Tolley's Company law, 2nd Edition 1988, at p. 452

53- See Hely-Hutchinson v. Brayhead Ltd. [1968] 1 Q.B 549 (C.A.) where Lord Denning M.R. stated: "...Non-disclosure does not render the contract void or a nullity. It renders the contract voidable at the instance of the company and makes the director accountable for any secret profit which he had made ".

54- Aberdeen Rly Co. V. Blackie Brothers (1854) 1 Macq. 461

(HL (SC)); Imperial Mercantile Credit Association v. Coleman (1873) L.R. 6 H.L 189

55- Article 627(5) provides "On penalty of nullity, it is forbidden for the directors of a company to contract, under any form whatsoever, loans on behalf of the company, or agree to overdrafts on the current account in connection with the making of loans, so that their engagements towards third parties may be secured or guaranteed in this connection"; see also articles 77, 410, 42 of the Algerian Civil Code 1975.

56- Zerguine, R., Les Conventions entre les sociétés at leurs dirigeants on droit positif Algerien, (1979) Rev. alg.soc.jur.eco. pol., at p. 199

57- Ibid

58- Article 627(3) " The preceeding terms are not applicable to the normal conventions relating to the operations of a company with its clients. The auditors present to the general meeting a special report on the agreements authorised by the board".

59- This report is necessary (article 627(1)), and special (article 680). Failure to submit this report results in the nullity of the deliberations of the general meeting (article 680). However, the sanction of the insufficience of the report is the nullity of the resolution which approved the agreement (convention).

60- Article 627(1) "Toute conventions entre une société et l'un des ces administrateurs, soit directement, soit par personne interposé, doit être soumise, a peine du nullité a l'autorisation prealable de l'assemblée générale aprés rapport du commissaire aux comptes".

61- Zerguine, R., supra, note 56, at p. 206

62- Article 627 (2) "Il en est de même pour les conventions entre une société et une autre entreprise, si l'un des administrateurs de la société et propriétaire associé ou non, gerant, administrateur ou directeur de l'entreprise. L'administrateur qui se trouve dans l'un des cas ainsi prévu, est tenu d'en faire la declaration ou conseil d'administration".

63- Zerguine, R., supra, note 56, at p. 217

64- Article 101 of the French Commercial Code 1966 provides "Toute conventions intervenant entre une société et l'un de ces administrateurs généraux doit être soumise a <u>l'autorisation prealable du conseil d'administration"</u>.

65- Zerguine, R., supra, note 56, at p. 216 "L'exigence de l'organisation prealable de l'assemblé générale pour chaque convention peut se révéler génante d'autant plus que les réunions de cette organe ne sont pas frequentes".

66- Article 627 (1) of the Algerian Commercial code 1975

67- Article 627 (4) of the Algerian Commercial Code 1975

68- Article 627 (1) of the Algerian Commmercial Code 1975

69- Article 629 (2) of the Algerian Commercial Code 1975

70- Article 629 (3) "La nullité peut être converte par un vote de l'assemblée générale intervenant sur rapport special des commissaire aux comptes exposant les circonstances en raison desquelles la procedure d'autorisation n'a pas été suivie. Les dispositions de l'article 627 alinéa 6, sont applicables".

71- Article 628 (1) "Les conventions autorisées par l'assemblée, comme celles qu'elle n'autorise pas, produisent leur effet á l'égard des tiérs, sauf lorsqu'elles sont annullées dans le cas de fraude".

72- Article 628 (2) "Même en l'absence de fraude, les consequences, préjudiciables a la société, des conventions non autorisées, peuvent être mise a la charge de l'administrateur ou du directeur général intéressé et, éventuellement, des autres membres du conseil d'administration".

73-. MacKenzie, A.L., "A company Director's Obligations of Care and Skill", (1982) J.B.L. 460

74- [1925] Ch.407

75- Ibid, at p. 428

76- Wright D., supra, note 4, at p. 43

77- Cf. Lister v. Romford Ice and Cold Storage Co. Ltd. (1957) A.C. 555;

78- Insolvency Act 1986, section 214

79- [1925] Ch.402 at p.429

80- [1892] 2 Ch.100

81- For example, in Dorchester Co Ltd v. Stebbing (Unreported) July 1977, (1980) 1 Co. Law 38. It was held that the two inactive directors, who had acted *bona fide* throughout, could not escape liability on the grounds that their failure to participate in the company's activities contributed to the fraud of the third director. Foster J held that "it was unreasonable for directors not to attend board meetings or show any active interest in the company's affairs".

82- [1980] (4) SA 156 at 165

83- Re City Equitable Fire Insurance Co ltd, [1925] Ch.407 at p. 428

84- See Chapter One, Section Three, supra; see also Gower, supra, note 7, at p.605

85- Gower, .L.C.B., supra, note 7, at p.605

86- [1901] A.C. 477; see also Huckerby v. Elliott [1970]1 ALL E.R. 189

87- See Fisheries Development Corpn of SA Ltd v. Jorgensen 1980 (4) SA 156 at 166 "Obviously, a director exercising reasonable care would not accept information and advice blindly. He would accept it, and he would be entitled to rely on it, but he would give it due consideration and exercise his own judgment in the light thereof".

87(a)- Mackenzie, A.L., supra, note 73, at p. 474

88- Ibid, at p.461

89- [1925] Ch.407 at pp. 427 - 428

90- Mayson & French, A practical approach to company law, 1987, 3rd ed., at p.333; see also Mitchell Philp, L.R., Directors' duties and insider Dealing, 1982, at p.40

91- The objective standard view was supported by the Lawrence Committee on Company Law Reform in Ontario reporting in 1967 (at p.53) suggested this provision: "Every director of a company shall exercise the powers and discharge the duties of his office honestly, in good faith and in the best interest of the company, and in connection therewith shall exercise that degree of care, diligence and skill which a reasonably prudent director would exercise in comparable circumstances."

92- Pennington, R.R., supra, note 5, at p. 83

93- Ibid, at p.83-84

94- Gullick, J.M., supra, note 1, at p. 223; There is a well known passage in Re City Equitable Fire Insurance Co, [1925] 1 Ch.407, 426 " It is indeed impossible to describe the duty of directors in general terms, whether by way of analogy or otherwise. The position of a director of a company carrying on a small retail business is very different from that of a director of a railway company. The duties of a bank director may differ widely from those of an insurance director, and the duties of a director of one insurance company may differ from those of a director of another."

95- Farrar, J.H., Company Law, 1985 at p.318

96- Gower, L.C.B., supra, note 7, at p. 603

97- Feuer, M., Personal Liability of corporate officers and directors, 2nd Edition, 1974 , at p. 32

98- Ballantine on Corporations, Rev. Edition, 1946, p.156

99- (1878) 10 Ch.D.450; 40 L.T 287; (1878)2 A.t.k. 40 at p.405

100- [1911] 1 Ch.425; 27 T.L.R. 109

101- Cmnd 7037 (1977), para 4

102- Cl.45 (1), Comapnies Bill 1978 "In the exercise of the powers and the discharge of the duties of his office in circumstances of any discreption, a director of a company owes a duty to the company to exercise such care and diligence as could reasonably be expected of a reasonably prudent person in circumstances of that discreption and to exercise such skill as may reasonably be expected of a person of his knowledge and experience."

103- Mitchell, Philip.L R, supra , note 90, at p. 40

104- Boyle, A.L., et all, Boyle & Birds Company Law, 1987, p. 621

105- MacKenzie, supra, note 73, at p.469

106- Ibid, at p.470

107- Pennington, supra, note 36, at 84

Chapter Five

Liability of Company Directors

Section 1: Separate legal personality of a company and its effects on Directors liability

Both British law and Algerian law expressly recognise the separate legal entity of the company. Under Algerian law both civil and commercial companies, if properly and validly formed enjoy a separate legal identity (la personalité morale) and full legal capacity. In other words, an Algerian company is deemed by the fact of its constitution, to be a juristic person. Such juristic personality is, however, effective as regards third parties only upon completion of the formalities of publication required by law.[1] This is provided by article 417(1) of the Civil Code 1975: "Par le fait de sa constitution, la société est considerée comme personne morale. Toutefois, cette personalité morale n'est opposable aux tiers qu'aprés l'accomplissement des formalités de publicité prescrites par la loi."

Moreover, the law provides in article 444 (of the civil code) that the juristic personality persists in so far as is necessary, for and up to the end of the liquidation. "...mais la personalité de la société subsiste pour les besoins et jusqu'a la fin de la liquidation". This is again confirmed by article 766 of the commercial code (1975)[2]. In fact, once the company acquired its juristic personality (personalité morale) it becomes an independent separate body distinct from its founders. Indeed, it will be similar to any other individual person in a number of aspects. The authority for this is article 50 of the Civil Code 1975 (modified 1986) which provides that "A juristic person enjoys, within the limits established by law, all rights, with the exception of those rights which are inherent in the nature of a natural person."[3] In this respect Dr. Mahrez[4] submits that there are limitations imposed upon juristic personality (la personalité morale) of the company. One derived from its nature and formation, the other is by virtue of its purpose. Regarding the first one, it is clear that there are some rights which are confined to natural persons only and cannot be enjoyed by an artificial person such as a company.[5] Examples for this are: Familial rights that follows from marriage, divorce or rights that result from (kinship of affinity) such as rights of inheritance and aliment etc. The second limitation results from the fact that companies are limited to (restricted to) the purpose for which they are formed for. In other words, a company is empowered only to the extent necessary to enable it to carry out its objects or purposes; unlike the natural person who is entitled to acquire any rights and assume any obligations. Nevertheless, apart from these two restrictions, the company is very akin to a natural person. It has **a**) its own name[6] that distinguishes it from other legal persons and under which it can sue and be sued; **b**) its own patrimonium (property), assets and liabilities (un patrimoine propre) distinct from those of its members. They are to be used exclusively for its own purposes. In addition, its creditors cannot obtain satisfaction from the assets of its members, since the liability of the latter is limited to the capital invested by them; **c**) legal capacity (la capacité juridique) within the limits fixed by its constitution or established by law; **d**) its own domicile (siége social) which is the place where its direction is centralised.[7] In addition, it has the right to sue and a representative to express its will.[8]

Similarly, under British law a company is treated as a person quite distinct from the individuals who are its members.[9] It can own property, have rights and duties and incur liabilities. Indeed, the two prime advantages of a incorporation are the creation of a separate legal entity and the limited liability. As Professor Gower[10] noted "It is from this fundamental attribute of separate personality that most of the particular advantages of incorporation spring". It is the main characteristic that distinguishes a registered company from a partnership, which is defined by the Partnership Act 1890 as "the relationship which subsists between persons carrying on a business in common with a view of profit". Unlike a registered company it has no legal existence but is merely the association of two or more persons carrying on business together. The property of the firm belongs to the partners and the firm's debts are the debts of the partners.[11] On the other hand, the registered company holds property and enters into contractual relations with outsiders. Thus, it is the company which will primarily be liable to such activities and not the members or directors.

Section 13(3) of the Companies Act 1985 expressly recognises the separate legal identity of the company. It provides that: "From the date of incorporation mentioned in the certificate, the subscribers of the memorandum, together with such other persons as may from time to time become members of the company shall be a body corporate by the name contained in the memorandum."

This fundamental principle of company law of 'separate legal personality of a company was established by the House of Lords in the leading case of Salomon v. Salomon & Co. Ltd.[12] where it was decided that however large the proportion of shares and debentures owned by one man, the Company's acts were not his acts nor were its liabilities his liabilities; and it is not otherwise even if he has sole control of the affairs of the company as its governing directors[13]. In the words of Lord Macnaghten:[14]

> "The company is at law a different person altogether from the subscribers to the memorandum; and, though it may be that after incorporation the business is precisely the same as it was before, and the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for

> them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act."

A support for this rule can be found in a number of cases.[15]For example, in Booth v. Helliwell[16], Shearman J said[17]:"A company must be regarded as a separate entity from any one of its shareholders, no matter how many shares he may hold." Similarly, in Macaura v. Northern Assurance Company Ltd.[18], it was held that the largest shareholder had no insurable interest in the property of the company. Lord Wrenbury said:[19] "My Lord, this appeal may be disposed of by saying that the corporator even if he holds all the shares is not the corporation, and that neither he nor any creditor of the company has any property legal or equitable in the assets of the corporation." Again in Tunstall v. Steigmann[20] the same view was confirmed. Ormerod L.J. said:[21]

> "It was decided in Salomon v. Salomon Co that a company and the individual or individuals forming a company were separate legal entities, however complete the control might be by one or more of those individuals over the company. That is the whole principle of the formation of limited liability companies and it would be contrary to the scheme of the Companies Acts to depart from that principle".

It appears that Scots Law also adopts the same view and the principle of separate personality applies equally to companies incorporated in Scotland.[22] Indeed, it is submitted that the principle stated in the Salomon's case was forcefully stated in the earlier Scots case of Thomson v. Incorporation of Candlemakers of Edinburgh (1855) 17 D. 765 [23] Furthermore L.P. Inglis in Muir et al v. City of Glasgow Bank[24]; stated that a:

> " Corporation being a separate person has its own estate and its own liabilities and the corporators are not liable for the corporation but only to the corporation within the limit of the obligations they have undertaken to subscribe to the corporate funds. "*Si quid Universitati debetur, singulis non debetur; nec quod Universitas debet singuli debent.*"

From the line of cases cited above it is quite clear that the principle of separate personality became a real phenomenon and a fully recognisable principle in British Company law.[25] This is so despite a strong criticism from some writers[26] .

One of the geatest advantages of the principle of separate entity of a company is that its members (shareholders) are not as such liable for its debts. In other words, a shareholder in a company incorporated with limited liability is liable only for the amount, not already paid, of the capital represented by the shares in his name. He is also under no further liability in the case of fully paid shares.Consequently, the assets of the company are the only source upon which the creditors can depend for payment of their debts. The same rules apply to directors. Hence they incur no personal liability for the debts of the company. This is because the protection provided by the veil of incorporation includes both shareholders and directors alike although this rule does subject to exceptions as regards the directors.[27] This veil of incorporation is described as "a barrier interposed between the company as a legal person, on the one hand, and its shareholders and its directors and managers on the other."[28] However, despite the advantages of the principle the courts began to be faced with situations where the concept of corporate personality was being used as a curtain (mask) to hide the real facts. This includes the use of corporate form to commit fraud, avoid personal civil of criminal liability or evade contractual or other legal obligations. One good illustration for the latter case is to be found in Jones v. Lipman [29]. Lipman had entered into a contract to sell his house to Jones. He sought to escape his obligation by saying that he had sold the house to a company called Alamed Ltd. (in which it was revealed that he and a clerk of his solicitors were the directors and only shareholders). He considered himself to be in breach of contract and offered damages. But Jones refused to accept this and sought specific performance. Russel J,[30] in granting a decree of specific performance, described the company as "The creature of the first defendant, a device and a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity". The same view was recognised by the House of Lords in the Scottish case of Woolfson v. Strathclyde Regional Council[31], where it was laid down that the veil of incorporation could be lifted but only where special circumstances indicate that the corporation is a mere façade concealing true facts. Indeed, the abuses of corporate personality and the injustice that may result from the rigid application of Salomon rule have convinced the courts to review the principle in order to find some ways to prevent this negative effect.[32] This has led to the creation of a procedure known as lifting or "piercing" the corporate veil[33] by which the legal personality of the company is disregarded. This enables the creditors to get at the human persons behind the company, against whom they sought some remedy for some wrongdoing.[34] Where the veil is lifted, the law either renders other persons, usually members or directors, jointly liable with the company for its debts or to identify them with a company as a single person.[35]

Various courts and commentators list different factors that will justify piercing the corporate veil.[36] That is to ignore or set aside the separate legal personality. These may be categorised into three classes.[37] Firstly, case where the veil has been lifted by Act of Parliament (Statutory cases),[38] secondly, cases under the Trading With the Enemy Act where the veil has been lifted by the courts in carrying out the intention of the Act (Trading with the Enemy Cases) [39], thirdly, cases where the courts have lifted the veil at common law and without statutory authority (common law cases). However, the decided cases do not provide a general principle under which the courts permit the veil to be lifted. In fact some of these cases are difficult to reconcile with others where the courts have refused to lift the veil.[40] In Algerian law article 224 of the commercial code seems to be the only article that mentions the lifting of the corporate veil. This is by holding those who control the company responsible for the company's debts when the company goes bankrupt. It provides as follows:

" En cas de réglement judiciaire ou de faillite d'une personne morale, peut être déclaré personnellement en réglement judiciaire ou faillite tout dirigeant de droit ou de fait, apparent ou occulte rémunéré ou nom, qui a:

- Sous <u>le couvert</u> de la personne morale <u>masquant</u> ses agissements, fait des actes de commerce dans un intérêt personnel, ou dispose des biens sociaux comme des siens propres;

- ou poursuivi abusivement, dans sont intérêt personnel, une exploitation déficitaire qui ne pouvait conduire qu'a la cessation des paiement de la personne morale."

In the light of the above discussion, it seems that the piercing of the corporate veil is a necessary legal procedure and a sufficient weapon in the hands of the courts. It is also the only effective device before the courts to reach the wrongdoers that hide behind the corporate curtain. Indeed, as Palmer put it:

> "The ability to chose between the application of the rule in <u>Salomons</u> case and the jurisdiction to

> pierce the veil of corporateness gives the courts a considerable degree of discretion and enables them to do justice and to decide individual cases in accordance with equitable considerations."[41]

Finally, it can be said that once the veil is pierced, directors will personally face the third party seeking remedy against their action.

Section 2: Directors' Personal Liability

2.1.- General Immunity

As previously noted[42] directors duties are owed to the company and to the company alone. In other words, they owe no duties to the shareholders[43] and are not personally liable for the company's debts or other obligations to its creditors or other persons with whom they deal on its behalf. This is so even if the directors acts cause the company to incur a legal liability.[44] This general immunity of directors from liability to the company's shareholders, creditors, persons with whom the company contracts and to third persons is legally justified by the fact that directors act as agents of the company, which is a distinct legal person from themselves and from shareholders and creditors.[45] Indeed, by consulting case law it can be noticed that Company directors have benefitted from this general principle of immunity in a number of cases. For example, it was held in Wilson v. Lord Bury[46] and in Multinational Gas and Petrochemical Services Ltd.[47] that directors are not liable at common law or in equity for debts which they incur on the company's behalf at a time when they know that their company is insolvent and cannot pay the new debts incurred by them. Similarly, they are not liable to the company's creditors or persons with whom it has contracted, if they manage the company's affairs negligently and therefore make it incapable of fulfilling its contracts or paying its debts.[48] However, despite this general immunity, directors may be held liable either alone or concurrently with their company wherever there is ground for liability.

This section deals with the two ways in which directors' acts create a liability in the company: Firstly, where directors are treated as the company's agents and act for the company. Secondly, where directors acts are treated as the company's acts, and finally discusses who is the alter ego of the company.

2.2.- Directors acting for the company (Agents)

It has long been established that directors are, in the eyes of the law, agents of the company for which they act.[49] Indeed, the relationship of the company and its directors in many respects is regulated by the general principles of the law of agency and vicarious liabilty. For example, when a director acts on behalf of the company as its agent with authority[50] such as concluding a contract or entering an agreement or transaction, he will not be personally liable for these agreements and contracts, but the liability will be attributed to his company alone which is his principal. Furthermore, even if a director acts without authority he is still only liable in the same way as any other agent. Indeed, it was held, that directors who have duly acted on behalf of the company are not liable to the contracting party even if the company could not, at the time the contract was made, fulfil it.[51] The authority for this established principle can be clearly noticed in a number of cases where the British courts applied the agency rules to the relationship between the company and its directors. As early as 1866 in Ferguson v. Wilson[52] Cairns L J. tried to clarify the position of directors and their relationship with their company by saying:[53]

"What is the position of a director of a public company? They are merely agents of a company. The company itself cannot act in its own person, for it has no person; it can only act through directors, and the case is, as regards those directors merely the ordinary case of principal and agent. Whenever an agent is liable those directors would be liable; where the liability would attach to the principal, and the principal only, the liability is the liability of the company". As to the general principle that a master is liable for every such wrong of his servant or agent as is committed in the course of his service, and for the masters benefit. Lord Selbourne in Houldsworth v. City of Glasgow Bank and liquidators[54] stated that "It is a principle, not of the law of torts, or of fraud or deceit, but of the law of agency equally applicable whether the agency is for a corporation (in a matter within the scope of the corporate powers) or for an individual".[55] The same view was expressed by Lord Hatherly[56] who believes that a corporation is bound by the wrongful act of its agent "no less than an individual", and that the result of such misrepresentation must take effect in the same manner against a corporation as it would against an individual. Again in Citizens' Life Assurance Company Ltd. v. Brown[57] Lord Lindley in his statement regarding the principle that governs a corporate liability. He said:[58]

> "If it is once granted that corporations are for civil purposes to be regarded as persons, i.e., as principals acting by agents and servants, it is difficult to see why the ordinary doctrines of agency and of a master and servant are not to be applied to corporations as well a to ordinary individuals."

However, the insuficence of these principles (doctrine of agency) in certain situations to provide a clear answer on how to impose liability on a company led the courts to search for alternative principles that may solve this problem. This consequently paved the way to the development of the organic theory.

2.3.- Directors acting as the company

Despite the fact that the application of the law of agency to the relationship between a company and its directors played an important role in preventing the company from escaping liability both in civil and criminal law by exposing the company to liability whenever justice so requires.[59] There are some situations where agency principles could not provide an adequate solution or help the courts impose liability on a company particularly where personal fault alone was an ingredient in that liability.[60] In other words there are some circumstances where personal fault is a requirement for liability. However, according to the general rule, the company is fictional person, it has no mind or body or other physical attributes and therefore cannot be held liable for any delict / tort that prerequisites actual fault on the part of the wrongdoer or any crime that requires proof of *mens rea* or any act requiring evidence or, for example, intent.[61] But since the strict application of the principle in some cases may lead companies to escape liability. It was necessary to find some exceptions to the principle whereby the company itself may be held responsible. The leading case in this respect is Lennard's Carrying C. v. Asiatic Petroleum Co. Ltd.[62], where a company which was the owner of the ship that caused damage was seeking the protection provided by section 502 of the Merchant Shipping Act 1894, under which the owner of the British ship will not be liable to make good claims for "any loss or damage happening without his actual faults or privity". To take advantage of this section, the company submitted that the fire loss of a cargo of benzine happened without its personal fault or privity. In fact, the loss was caused by the default of Lennard, the managing director of the company. The House of Lords in this case was faced by a new situation where the application of agency rules (doctrine of agency) cannot do justice. As a result of this, in order to impose liability on the company, the House of Lords had to find some justifying arguments. This is by finding a device of identifying certain categories of person (officer) with the company or, in other words, of treating them as the human embodiment of the company in order that their acts or omissions can be attached to the company, and consequently holding the company liable. The judgement of the House of Lords was delivered by Viscount Haldane who said:[63]

> "My Lords a corporation is an abstraction. It has no mind of its own any more that it has a body of its own; its active and directing will must consequently be sought in the person of somebody who for some purposes may be called an agent, but who is really the directing mind and will of the corporation, the very ego and centre of the personality of the corporation. That person may be under the direction of the shareholders in general meeting; that person may be the board of directors itself, or it may be, and in some companies it is so, that that person has an authority co-ordinate with the board of directors given to him under the articles of association...It must be upon the true construction of that section in such a case as the present that the fault or privity is the fault of somebody who is not merely a servant or agent for whom the company is liable upon the footing *respondeat superior*, but somebody for whom the company is liable because his action is the action of the company itself".

This judgement seems to have received a great support.

This is reflected in a number of cases in different areas of law [64], although its formulation has tended to differ depending on the branch of law in which it was employed.[65] The example for Merchant Shipping Law is H.M.S Truculent. The Admirality v. The Divina[66] where Willmer, J applied the same principle so as to impose liability on the Admiralty for a fault committed by a commanding officer of a submarine. Likewise, the above principle appeared in law of Landlord and Tenant. In H.L Bolton (Engineering) Co. Ltd. V.T.J Graham & Sons Ltd.[67], in applying the principle Denning L.J expressed his dictum by likening the company to a human body.[68] According to his view there are some persons who constitute the company's brain and therefore he suggests that the company would be liable for their acts because their acts are those of the company itself. On the other hand, he described the other category of persons as merely the hands which hold the tools, and the company's liability for their acts could be only upon the footing *respondeat superior.*

As stated earlier the adoption of the organic theory was not confined to delict or tort but extended to include criminal acts as well. This is reflected in the introduction of a general principle whereby (under which) the company would be personally liable for the acts of certain officers. This principle is clearly shown in three different cases. The first one is Director of Public Prosecution v. Kent & Sussex Contractor Ltd.[69] where the company and the transport manager were prosecuted for a contravention of the Defence (General) Regulations, 1939 in that **(1)** 'They with intent to deceive, made use...of a document which was false in a material particular'; and **(2)** 'they made a statement which they knew to be false in a material particular'. The local justices dismissed the information, on the basis that a body corporate could not in law be guilty of the offenses charged. However, this decision was reversed by a Divisional Court. Macnaghten J said:"It is true that a corporation can only have knowledge and form an intention through its human agents, but circumstances may be such that the knowledge and intention of the agent must be imputed to the body corporate"[70]. In the same year this decision was approved by the Court of Criminal Appeal in the case of R.V.I.C.R Haulage Ltd.[71] where the appellant Company was charged, along with its managing director and nine other persons with common law conspiracy to defraud. The Court held that the Company could be convicted despite the fact that *mens rea* was an essential element of the offence.[72] In the third case, Moore v. Bresler Ltd [73] a company was prosecuted, for contravening section 35(2) of The Finance (No.2) Act 1940, which provides: "If, with intent to deceive, any person for the purposes of this Act...makes use of...any document which is false in a material particular, he shall be liable to a penalty of £500." The Company was convicted despite the fact that the acts were not those of its directors but merely of its secretary and a branch manager.

In Scotland, however, the first case where corporate criminal liability for common law crimes was considered is Dean v John Menzies (Holdings) Ltd [74] in which a limited company that operates a chain of bookshops in Scotland was charged with the common law offense of " shamelessly indecent conduct" in that they were alleged to have sold or exposed for sale various indecent and obscene magazines. The High court held that a company could not commit a crime of shameless indecency.[75] This is because ,according to Lord Maxwell, there was no clear single fiction recognised by Scots law for these purposes.[76] In addition, Lord Stott said:[77]

> "It is I think self-evident that there are certain crimes and offences which cannot be committed by a corporate body. Murder is such a crime , not only, as the Advocate-Depute conceded, because a company cannot be imprisoned but because it is incapable of having that wicked intent or recklessness of mind necessary to constitute the crime of murder .Other examples which come to mind are reset and perjury. In my opinion the offence of conducting oneself in a shamelessly indecent manner falls into the same category."

The very recent case is that of Purcell Meats (Scotland) Ltd. v. McLeod [78] which is the first case in a Scottish Common Law prosecution where it is decided that the actions and knowledge of "individuals of the necessary status" can be ascertained to a company.[79] Here, the company was charged with attempted fraud arising from an incident in which the premium certification stamps from nine carcases of beef were obliterated and an Intervention

Board for Agricultural Produce Exemption Stamp applied instead. As a result of this the company was exempted from the repayment of the beef premium clawback amounting to £411. At first instance, the sheriff repelled the pleas to the competency and relevancy of this amended complaint. In its appeal to the High Court against the decision the company produced two arguments. The first one is that the complaint was incompetent as a limited Company was incapable of forming the requisite *mens rea* for the offence, and the second argument is that it was lacking in specification in that the person or persons through whom or by whom the limited company had acted(operated) were not identified and that it was not possible to impute the mental state of a natural person to the company if the identity of that person was unknown, and accordingly the action should be dismissed. In delivering the judgement of the Court [80], The Lord Justice Clerk quoted the dictum of Lord Reid in the case of Tesco Supermarkets Ltd. v. Nattras[81] which his Lordship apparently accepted in its entirety. He concluded that the charge was sufficient in competency and specification. That is to say that it is competent to charge a limited company with the common law crime of attempted fraud, even though the crime has a prerequisite of *mens rea*.[82] However it is worthy of note that although the general principle of imputing directors' acts to the company is normally applied in cases involving delict or tort and crime, there are limits to its application.[83] For example, it has been held that a company cannot be indicted for an offence of violence[84] or for conspiracy with a director who is its only responsible officer.[85] Furthermore, there are some offences which cannot be committed by companies[86] such as bigamy, perjury, rape or murder .

2.4.- The alter ego of the Company

Although as seen above the alter ego doctrine (organic theory) has been applied to both delict/tort and criminal law. This is by treating certain persons as the company itself and their acts are the company's acts and their will, the company's will. However, it remained unclear as to exactly whose acts and intentions could be attributed to the company.[87] In other words, at what point in the company hierarchy will individuals cease to be treated as servants or agents and start to be treated as the company itself? The question seems to be tied in with the issue of delegation of managerial powers within the company[88] and how the level of the officer or employee in the corporate hierarchy affects liability of the company[89] In fact the answer for this question can be derived from different statements and authorities in a number of cases. For example, in J.C Houghton & Co. v. Nothard, Lowe and Wills Ltd [90] in an attempt to clarify the category of persons whose acts may be imputed to the company. Viscount Dunedin said[91] "The knowledge of the company can only be the knowledge of persons who are entitled to represent the company. It may be assumed that the knowledge of directors is in ordinary circumstances that of the company". However, this view seems to be rather general and broad. Thus in H.L. Bolton (Engineering) Co. Ltd V. T.J. Graham and Sons Ltd.[92], Lord Denning went further trying to be more specific. This is by drawing a line between the acts of those directors and mangers who control what the company actually does and the acts of mere servants who simply carry out orders from above. His Lordship said:[93] "Others are directors and managers who represent the directing mind and will of the company, and control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such".

Similarly, Judge Chapman, in R.V. Stanley Haulage Ltd.[94] decided that a corporation could be held liable where the authority held by the officer in question was managerial, and where his decisions over the relevant aspect of corporate affairs could be made without further reference to any superior. Again in Magna Plant Ltd v. Mitchell [95] it was pointed out by Lord Parker _C.J. That a corporation could only be held liable for the knowledge and "acts of the responsible officers forming the brain, or in the case of an individual, a person to whom delegation in the true sense of delegation of management has been passed."[96] This view was adopted again in Tesco Supermarket Ltd._v. Nattrass.[97] In the light of the above cases Dr. Leigh suggested that there are two circumstances in which criminal liability may be imposed." It may be imposed in respect of actions commanded by the board of directors as the brain, or by a responsibilé officer enjoyng managerial functions"[98] In Canada the doctrine of identification seems to be wider and extends beyond directors to include high managerial persons who have been given autonomous responsibility and an extensive authority over a particular area of corporate activity.[99] In a recent case, R.V. Spot Supermarket Inc[100] It was held that the acts of a Company Supervisor and auditors were the acts of the corporation. In delivering his judgement Lamer, J.A said[101] "One must not lose sight of the fact that the board of directors had delegated to the company auditors complete latitude to decide on all accounting questions with the company supervisor."

On the other hand, the position in Britain as Mr. Fien [102] put it is slightly more conservative than in Canada. This can be clearly noticed in the recent leading case Tesco Supermarkets Ltd. v. Nattrass[103] where the House of Lords held that a branch manager, one of a several hundred, was not sufficiently superior to be the *alter ego* of the company. This is because the persons or delegates who could be identified with the company as Viscount Dilhorne noted, must have control and management, with full discretionary powers, of some sections of the company's business.

Finally, it is worthy of note that even in the circumstances where directors acts and mind are treated as the acts and mind of the company. They are not the company as such. Consequently, it can be said that the principle of separate personality remains the norm and indeed one of the strongest rules in modern Company law.

Notes

1- Article 549(1) of the Commercial Code 1975 provides that "A company does not have a juristic personality until its enrollment in the register of commerce".

2- Article 766 of the Commercial Code 1975 provides: "La personalité morale de la société subsist pour les besoins de la liquidation, jusqu'a la cloture de celle-ci."

3- Article 50(1) of the Civil Code 1975 (modified 1986) "La personne morale jouit, dans les limites determinees par la loi, de tout les droits, a l'exclusion de ce qui sont propres a la personne physique".

4- Mahrez, A., Droit Commercial en Algerie (Sociétés Commerciales), 2nd edition, 1980, at p.68.

5- Similar view was expressed by Pickering, M.A., "The company as a separate legal entity", (1968), 31 M.L.R.481 at p. 509. He noted that the company as an artificial person differs from a natural person in two main respects. Firstly," the extent or range of the capacity with which it may be endowed is very much more restricted that that of an individual. Secondly, its ultimate motivation is not that of one person but of an association of persons, who usually act by majority rule, and who customarily delegate the exercise of their powers of control over many of the company's affairs to others."

6- Article 593 of the Algerian Commercial code 1975 provides : "La société par action est désignée par une dénomination sociale qui doit être précédé au suivi par de la mention de la forme de la société et du montant du capital social."

7- Article 547 of the Algerian Commercial code provides

"The domicile of the company is at the firm's headquarters. Companies which operate in Algeria are subject to Algerian law".

8- Article 50 of the Civil Code 1975 (modified 1986)

9- See Pennington, R,R., Company law, 5th edition 1985, p.46; See for example section 13(2) of the Companies Act 1948 which provides: "From the date of incorporation mentioned in the certificate of incorporation, the subscribers of the memorandum, together with such other persons as may from time to time become members of the company, shall be a body corporate by the name contained in the memorandum, capable forthwith of exercising all the functions of an incorporated company, and having perpetual succession and a common seal, but with such liability on the part of the members to contribute to the assets of the company in the event of its being wound up as is mentioned in this Act."

10- Gower, L.C.B., Principles of Modern Company Law, 4th Edition, 1979, p. 100.

11- Unlike English partnership, Scottish Partnership is " a legal person distinct from the partners of whom it is composed." (Partnership Act 1890 section 4(2) i.e It has a separate legal existence and is not merely the association of two or more persons. The property of the firm belongs to the firm and the firm's debts are the debts of the firm, although each partner may ultimately be made personally liable for the firm's debts; See also Hemphill,P.C., "The Personality of the Partnership in Scotland", (1984), Jur.Rev, 208

12- [1897] A.C.22

13- See Silvertown, A.H., "Piercing the Corporate Veil", (1989) 133, S.J. 346.

14- [1897] A.C.22 at p.51

15- Some of these cases existed before Salomon's case such as Farrar v. Farrar Ltd [1888] 40 Ch.D. 395; North-West Transportation Co. v. Beatty [1887] 12 App.CAS. 589. For more details see Schmitthoff, C.M., Palmer's Company Law, 24th edition, 1987, p.202.

16- [1914] 3 K.B. 252; also see Lee v. Lees Air Farming Ltd. [1961] A.C. 12

17- [1914]3 K.B. 252 at p. 254

18- [1925] A.C. 619

19- At p.633

20- [1962] 2 All E.R. 417

21- Ibid, at p. 420

22- see Ruthven, E.K.B., "Lifting the Veil of Incorporation in Scotland" (1969) Jur.Rev, 1 at p.2

23- Ibid

24- (1878) 6 R. 392 at p. 401

25- See Samuels. A.,"Lifting the Veil" (1964) J.B.L.107. Her noted "Ever since Salomon v. Salomon [1897] A.C.22 the separate legal identity of a company from its members has stood as a fundamental principle of our law".

26- Kahn, F., "Some Reflections on Company Law Reform", (1944), 7 M.L.R.54 at p. 55 in which the decision in Salomon v.Salomon & Co. Ltd. was described as "calamitous decision" See also Wedderburn, "Company Law Reform" (1965) Fabian Tract. 363, at p.2

27- See Powell-Smith,V., The Law and Practice Relating to Company Directors., 1969, p.143

28- Hunter, M., "The Civil Liability of Company Directors in United Kingdom" (1981) 9 int.Bus Lawy, at p.231.

29- [1962] 1 W.L.R 832; see also Gilford Motor Company v. Horne [1933] Ch. 935

30- Ibid, at p. 836

31- 1978 S.C (H.L) 90; 1977 S.C 84; 1978 S.L.T 159

32- In this respect an American author submits that "on the one hand we wish to encourage development of our economy by allowing persons to invest their money in business enterprise without the risk of unlimited personal liability. On the other hand, we do not wish to allow the corporate entity to be used 'to defeat public convenience to justify wrong, protect fraud, or defend crime"; see Prentice R.A., Law of Business Organisations and Securities Regulation, 1987, p.179.

33- This is known in Germany as "Breaching of the wall of the corporation

34- Hunter. M., supra, note 28, p.231

35- Gullick. J.M, Ranking and Spicer's Company Law 13th edition, 1987, p.5

36- See for example, Dobson, J.M., " 'Lifting the Veil' in Four Countries. The Law of Argentina, England, France and the United States" (1986) 35 I.C.L.Q. p.839

37- See Ruthven E.K.B, "Lifting the Veil of Incorporation in Scotland", (1969), Jur Rev. p.5

38- See the Companies Act 1985, section 24 (membership); section 349(4) (failure to use the correct company name); The Insolvency Act 1986, section 213 (Fraudulent trading) section 214 (Wrongful Trading)

39- Daimeler Company Ltd V. Continental Tyre and Rubber Company (GB) Ltd [1961] 2 A.C. 307

40- See Barc and Bowen (editors), Tolley's Company Law, 1987, p. 571

41- Schmitthoff, C.M., (editor), Palmer's Company Law, vol 1, The treatise, 24th edition, 1987, p.215

42- See chapter 4 supra

43- Percival v. Wright [1902] 2 Ch.421.

44- Pennington, R.R., Directors Personal Liability, 1986, p. 148

45- Ibid, at p.149

46- [1880] 5 Q.B.D. 518

47- [1983] BCLC 461 at p. 487 per Dillon, L.J; [1983] Ch.258

48- Ibid, see also Clark v. Urquart (1930) A.C. 28 where it was held that directors are not liable to the lender for the insufficiency of the assets of the company to repay the loan which caused by the directors negligent mismanagement. per Lord Sumner at p.53 of the report.

49- See chapter Two, supra; However, they are subject to section 35 of the Companies Act 1985 now amended by Companies Act 1989.

50- Actual authority may be expressed or implied. See Chapter Two, supra

51- Elkington & Co. V. Hürter [1892] 2 Ch.452

52- [1866] 2 Ch. 77

53- at p. 89

54- (1880) 5 A.C. 317

55- At p. 326

56- At p.331

57- [1904] A.C. 423;see also Mousell Brothers Ltd v. London and Nort-western Railway Company (1917] 2 K.B. 836 which has been long been regarded as the leading case on vicarious responsibility. see Gordon, The Criminal Law of Scotland, 2nd ed., 1978, at p. 301 et seq

58- At p. 426

59- Gower L.C.B., Principles of Modern Company Law, 4th edition 1979, at p. 205.

60- Leigh, L.H., "The Criminal Liability of Corporations in English Law", 1969. p.97; see also Leigh, L.H., "The Alter Ego of a Company", (1965) 28 M.L.R 584

61- Pickering, M.A., "The Company as a Separate Legal Identitẏ" (1968) 31 M.L.R 481 at p.503

62- [1915] A.C.705; see also Houghton and Co v. Nothard, Lowe and Wills [1928] A.C. 1 at p. 14 where Lord Dunedin submitted that a company is not...a being who has eyes and ears".

63- [1915] A.C.705 at p. 713

64- For example, Merchant Shipping, Landlord and Tenant, Tort Criminal Law

65- Leigh, L.H., The Criminal Liability of Corporations in English Law, (1969), p. 100

66- [1951] 2 All E.R. 968; see also other cases where the organic theory was applied such as, Royal Exchange Assurance Co. v. Kingsley Navigation Company [1923] A.C. 235; Robin Hood Mills Ltd. v. Paterson Steamships United [1937] 3 DLR 1

67- [1957] 1 Q.B. 159; also regarding the application of the principle see the Lady Gwendolen Case (1965) 2 All E.R. 283 where it was indicated by Wilmer and Winn L.JJ. that the person whose fault is to be taken as that of the corporation need not be a director .In the words of Winn LJ: (P.302) "Wherever the fault either occurs in a function or sphere of action which the owner has retained for himself or is that of a manager independent of the owner to whom the owner has surrendered all relevant powers of control, it is "actual fault of" the owner within the meaning of the section."

68- [1957] 1 Q.B. 159 at p. 172 "A company may in many ways be likened to a human body. It has a brain and nerve center which controls what it does. It also has hands which hold the tools and act in accordance with directions from the center. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company, and control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such. So you will find that in cases where the law requires personal fault as a condition of liability in tort, the fault of the manager will be the personal fault of the company.... So also in the criminal law, in cases where the law requires a guilty mind as a condition of a criminal offence, the guilty mind of the directors or the managers will reder the company itself guilty."

69- [1944] K.B. 146

70- At p.156

71- [1944] K.B. 146

72- Stable. J said at p. 559 " Where in any particular case there is evidence to go to a jury that the criminal act of an agent including his state of mind, intention, knowledge or belief is the act of the company and... whether the jury are satisfied that it has been proved, must depend on the nature of the charge, the relative position of the officer or agent and the other relevant facts and circumstances of the case".

73- [1944] 2 All E.R. 515

74- 1981 S.L.T. 50; See also Stuart, S.L., "The Case of the Shameless Company (Dean v. John Menzies (Holdings) Ltd.) High Court of Justiciary, 3/10/80", (1981)26 J.L.S. 176 and 222

75- Unlike the majority of the court (Lord Stott and Lord Maxwell) the dissenting Judge (Lord Cameron) held that it could be committed by a company.

76- 1981 S.L.T. 50 at p.64

77- Ibid, at p.59

78- 1987. S.L.T 528

79- Whyte, D., "Corporate Criminal Liability", (1987) S.L.T. 348 at p. 349

80- which is composed of Lord Justice-Clerk and Lords

Robertson and MacDonald

81- [1972] A.C.153 at p.170 "[A corporation] must act through living persons, though not always one or the same person. Then the person who acts is not speaking or acting for the company. He is acting as the company and his mind which directs his acts is the mind of the company. There is no question of the company being vicariously liable. He is not acting as a servant, representative, agent or delegate. He is an embodiment of the company or one could say, he hears and speaks through the persona of the company, within his appropriate sphere, and his mind is the mind of the company. If it is a guilty mind then that guilt is the guilt of the company. It must be a question of law whether, once the facts have been ascertained, a person in doing particular things is to be regarded as the company or merely as the compay's servant or agent. In that case any liability of the company can only be a statutory or vicarious liability."

82- 1987,S.L.T. at pp. 529- 530

83- See Leigh, L.H., supra, note 60, pp.57- 64

84- R v. Cory Bros & Co Ltd [1927]1 K.B. 810

85- R v. McDonnell [1966]1 Q.B.233

86- See remarks of Stable J in Rex v. I.C.R Houlage Ltd [1944] K.B. 551 at p. 554; See also Notes, "Criminal Liability of Corporations", (1914) 14 Col .Law .Rev. 241 at pp.242-243; Winn, "The Criminal Responsibility of Corporations", (1927/1929)3 C.L.J., 398; Welsh, R.S.,The Criminal Liability Of Corporations" (1946) 62 L.Q.R. 345 at pp. 362-365

87- Leigh, L.H., "The Alter Ego of A Company "(1965)28 M.L.R. 584; Williams, G., Textbook of Criminal Law, 1978, at p. 947; Wells, C., "Manslaughter and Corporate Crime", (1989)139 N.L.J. 931

88- see Chapter 3, supra

89- Fien, Cy.M., "Liability of a Corporation for Acts of Corporate Officials in the Tax Field, and Liability of Corporate Officials for Acts of a Corporation", (1982) Corporate Management Tax Conference, 177 at p.182

90- [1928] A.C. 1, see also Fantan v. Denville [1932] 2 K.B.309,329 where Green L.J said: "A general manager of the business is deemed to be the *alter ego* of the company, and it would be responsible for his personal negligence."

91- Ibid at p. 14

92- [1957] 1 Q.B. 159

93- At p. 172

94- [1964] Crim. L.R. 221, see also John Henshall (Queries) Ltd v. Harvey, [1965] 2 Q.B 233

95- [1966] Crim. L.R. 395

96- see Leigh, L.H. "By Whom a Company Permit?" (1966) 29 M.L.R 568 at p. 569

97- [1972] A.C.153 at p.171 in which Lord Reid said:" Normally the board of directors, the managing director and perhaps other superior officers of a company carry out the functions of management and speak and act as the company. Their subordinates do not. They carry out orders from above and it can make no difference that they are given some measure of discretion. But the board of directors may delegate some part of their functions of management giving to their delegate full discretion to act independently of instructions from them. I see no difficulty in holding that they have thereby put such a delegate in their place so that within the scope of the delegation he can act as the company."

98- Leigh, L.H., supra, note 96, at p. 570

99- Fien, Cy.M, supra, note 89, at p. 183

100- (1979), 50 C C C (2d) 239 (Que. C.A); see also R.V Waterloo Mercury Sales Ltd. (1974), 18 C C C (2d) 248, where a company was convicted of fraud arising from the activities of its used cars sales manager in turning back odometers, although he was neither an officer nor a director

101- 1979, 50 C C C (2d) 239 at p. 252

102- Fien, Cy.M, supra, note 79 , at p 184

103- [1972] A.C. 153

Chapter Six

Grounds of Liability of Company Directors

Section 1: Personal Liability of Directors on Contracts

Since a company is an artificial person its contracts are made on its behalf by its agents. As seen earlier, the principal agents of the company are its directors to whom wide powers of management are delegated, including the power to make contracts. The general rule in company law is that a director owes no fiduciary or contractual duty to third parties, dealing with his company[1]. Subject to the provisions of section 213 of the Insolvency Act 1986 (previously section 332 of 1948; section 630 of the Companies Act 1985 Act) he is never liable for the payment of the company's debts even if it is insolvent nor is he liable for breach by the company of contracts made by the company even though he has been instrumental in the company's entering into the contract concerned. Moreover, directors are not liable if the company cannot or fails to perform a contract due to some other default, such as negligence, on their part[2]. However, there are certain circumstances in which a director becomes personally liable on a company contract[3]. This is by accepting personal liability either expressly or impliedly.[4] The liability is express where a director contracts with a third party so as to make himself rather than his company liable. This liability arises by a voluntary act of the director such as guaranteeing the company's overdraft or accepting goods for use in the company's business on his own name.[5] On the other hand, the implied liability will arise when a director signs a contract in his own name without mentioning the name of the company or mentioning the name without the word 'Limited' or its abbreviation[6]. Clearly, if the director enters a contract with a third party without disclosing that he is acting as an agent for his company, the agency rule of the undisclosed principle will apply and therefore the director will be held personally liable on the contract. Thus a director should make it clear to the other party that the contract will be entered into by the company, and not by the director personally. Furthermore, a director may become personally liable even in the case where he has expressly contracted as an agent. This is provided by section 349 of the Companies Act 1985: "Every company shall have its name mentioned in legible characters...in all bills of exchange, promissory notes, endorsements, cheques and orders for money or goods purporting to be signed by or on behalf of the company... (3)(a) if an officer of the company or any person on its behalf...issues or authorises of any business letter of the company...(4) signs or authorises to be signed on behalf of the company any bill of exchange promissory note endorsement, cheque or order for money or goods in which the company's name is not mentioned as required by subsection (1), he is liable to a fine, and he is further personally liable to the holder of the bill of exchange, (etc.)...for the amount of it (unless it is duly paid by the company)".

This section shows clearly that the intention of the legislation is to provide a sufficient protection for third parties dealing with the company. This is by emphasising on the use of the real name of the company and especially of the word "Limited"[7]. The reason is that to make third parties realise that they are dealing with limited companies. Any breach of this enactment involves heavy penalties and may impose personal liability on the directors. In fact, directors have been held liable under this provision 349 (Formerly section 108 CA 1948) in a number of case. For example, Atkins & Co. v .Wardle[8]. The directors were held personally liable on the bill as a result of a misdescription of the company in a bill of exchange as the "Salt Water Baths Co. Ltd" instead of its true name "The South Shields Salt Water Baths Co. Ltd. In addition, directors were held personally liable only because they omitted the connecting ampersand, by writing "L.R. Agencies Ltd." instead of "L. & R. Agencies Ltd."[9] This really shows the strictness of the legislature with the use of the name.

Similarly, when a director acts without authority or in excess of his authority, he will be held personally liable to the other party to the contract for the loss suffered by the latter (third party) as a result of entering into the contract. This is so even though he expressly contracted in the company's name or on its behalf. However, in this situation the director is not liable as a party to the contract, but for breach of warranty of authority[10]. This is the same rule applicable in the law of agency under which the agent can only bind his principal when he acts within his authority. But when he exceeds his authority his principal is not bound, and the agent will be held personally liable for breach of his warranty of authority. There are a number of circumstances in which a director may be held liable for breach of warranty of authority. For example, if he concludes a contract beyond the company's powers or *ultra vires*, and the implied warranty of authority given to the other party by the director embodies a promise that the contract is within the company's lawful powers[11]. He may also be liable if the contract entered is beyond his powers although it is within the company powers and made in its name. But simply because e.g the power in question is reserved by the company's memorandum or articles of of association to its shareholders in general meeting. Likewise he will be held liable for breach of warranty of authority if he contracts without delegated authority by the board of directors to act on its behalf.[12]

Section 2: Personal Liability of Directors in Delicts/Torts

A company, like any other employer, is liable for Delicts committed by its servants in the course of their employment.[13] Thus, the general rule is that directors as such are not liable for delicts or civil wrongs of their company or its servants or agents. This is on the principle that whoever commits a wrong is liable for it himself[14]. For example, if a director himself commits a delict/tort in the course of the performance of his duties for the company he will be held personally liable for it jointly and severally with the company. He may also be liable to the company for breach of duty. However, the commission of the delict/tort by the company does not make the director automatically liable for that tort simply by reason of their being the directors of the company. English Authority in tort can usefully be cited to clarify this area. In Rainham Chemicals Works Ltd. V Bellevedece Fish Guano Company[15] in which a company was held responsible for damages resulting from an explosion and fire at the company's premises where it stored explosive and inflammable goods. In that case an attempt to make two joint managing directors also responsible failed, although the storage must have been known to them. It was argued that the company was under their control and they were responsible for the work done by the employees of the company. However, Lord Buckmaster said that the directors would not be liable unless they expressly directed the tortuous acts. In British Thomson Houston Co. v. Sterling Accessories, Limited[16] a company and its directors were sued for infringement of a patent. It was held that the directors of a company cannot be liable for an infringement of patent by the company merely by reason of their position as directors even though they were the sole directors and shareholders of the infringing company. In the words of Tomlin J[17] "...It must be established that either [the defendant] himself is the tortfeasor or that he is the employer or principle of the tortfeasor in relation to the act complained of, or at any rate the person on whose instructions the tort has been committed". This means that directors may be held personally liable for torts committed by the company. Indeed, if a director has expressly authorised the tort, or directed its commission by his company, he will be just as liable as the company for the consequences of this tort.[18] In addition he cannot escape liability by showing that he didn't know the acts so authorised were tortious or didn't care whether the acts were tortious or not[19]. In a recent case Evans (C) & Sons Ltd. V. Spritebrand Ltd[20] Slade LJ referred to a Canadian case Mentmore Manufacturing v. National Merchandising Manufacturing Co. Inc.[21] which was also about patent infringement in which Le Dain J[22] said the following principle: "I do not think we should go so far as to hold that the director or officer must know or have reason to know that the acts which he directs or procures constitute infringement".

In short, it can be said that a director cannot be held personally liable for his company's tort such as trespasses, patent infringement, negligence, nuisance and defamation, merely because he is a director[23] but it must be shown that he participated in or ordered the tortious acts. However, the treatment of a director as a participator or instructor of the tort committed is a question of fact to be decided on the circumstances of each case. As L J Slade put it[24] "In every case where it is sought to make a director liable for his company's torts it is necessary to examine with care what part he played personally in regard to the act or acts complained of". Likewise, directors are not liable for the fraud of their co-directors unless they have expressly or impliedly authorised it[25]

Section 3: Statutory Liabilities of Company Directors

In addition to their general management responsibilities, company directors are also subject to certain liabilities imposed upon them by the acts.[26] Indeed there are a number of statutory provisions which the directors have to comply with and directors who have been or are in default shall be personally liable for breaches of the Companies Acts provisions to persons other than the company. There are altogether 202 criminal offences created by the Companies Act 1985 for contravention of its provision, some of which have now been re-enacted in the Insolvency Act 1986. All of these offences are punishable by a fine and 37 of them are also punishable by imprisonment with or without the option of a fine [27].In addition part X of the Companies Act 1985 as amended by Companies Act 1989 provides a group of sections enforcing fair dealing by directors. These invalidate certain transactions which could be used by directors for improper purposes to confer personal benefits upon themselves. Other transactions are only permitted on compliance with approval of the general meeting. Examples are section 320 of the Companies Act 1985 which provides that subject to certain exceptions, a company shall not enter into an arrangement whereby a director of the company or its holding company or a person connected with such a director is to acquire one or more non-cash assets of the requisite value from the company; or the company is to acquire one or more such non-cash assets from such a director or a person so connected; unless the arrangement is first approved by a resolution of the company in general meeting. Similarly, according to section 319 a company may not include in a director's service contract or any other agreement a term by which the director will be employed by the company or any of its subsidiaries, whether as a director or in any other capacity, for a period exceeding 5 years which cannot be terminated for any reason whatsoever by the company giving notice, unless the term is first approved by a general meeting by ordinary resolution or such other resolution of a general meeting as the articles provide. This section intends to highlight, although briefly, certain circumstances where this statutory liability arises.

3.1.- Liability for (misrepresentation) Mis-statement

A frequently occurring instance of a director's liability for fraud or misrepresentation is in relation to the contents of a public company's prospectus[28] which is defined by section 744 of the Companies Act 1985 as " Any prospectus, notice, circular, advertisement, or other invitation offering to the public for subscription or purchase any shares or debentures of a company". Under Section 67 of the Companies Act 1985 the director of the company will be personally liable on a mis-statement in a prospectus to any person who subscribes for shares and debentures on the faith of the prospectus and who has suffered loss and damage. In other words, the directors liability will arise either when there is a false statement in the prospectus or there has been a wilful non-disclosure of material information. In such case the directors are liable to compensate any person who relied on the untrue statement in the prospectus when subscribing for any shares or debentures. The persons liable to pay the compensation are defined by section 67 (2) as follows:

(a) every person who is a director of the company at the time of the issue of the prospectus,

(b) every person who authorised himself to be named and is named, in the prospectus as a director or as having agreed to become a director (either immediately or after an interval of time),

(c) every person being a promoter of the company and

(d) every person who has authorised the issue of the prospectus.

The plaintiff need only prove a mis-statement or omission and loss as a result to establish liability[29]. Once the liability is established the persons mentioned above are liable to compensate him unless they can prove one of the defences provided by section 68 CA 1985. Thus a director will not be liable under Section 67 if he can prove that the prospectus was issued without his knowledge or consent and that on becoming aware of its issue he gave reasonable public notice that it was issued without his knowledge or consent. Likewise, a director will not be liable after the prospectus is issued and before any allotment or sale if, on becoming aware of any false statement, he withdraws his consent and gives reasonable public notice of the withdrawal and the reason for it. Furthermore, section 68(2) adds that a director will not be responsible as regards any false statement if he had reasonable ground to believe the statement was true.[30] Section 68(2)(a), or where the untrue statement was made on the authority of an expert[31] reasonably believed to be competent who had given and not withdrawn his consent before a copy of the prospectus was delivered to the company's registry. Again, no liability to the directors where the statement was a fair representation of a statement made by an official person (e.g Minister or a member of the Government Service of the UK or an oversees Government)[32] or an extract from some public official document. However, failure to prove the above defences gives rise to both Civil and Criminal proceedings against those who are responsible for them.

3.1.1.- Civil liability

It appears that subscribers for shares' rights like any other third parties rights dealing with the company are safeguarded by the law. This may clearly be deduced from a number of remedies provided by the legislature. For example, in respect of subscribers who relied on false statement when subscribing for shares the law provides various civil remedies to enable such persons to recover from the loss they have sustained as a result of their subscription. What is more is that these remedies are cumulative and thus, for example, the rescission of an allotment of shares or debentures by a subscriber to recover his money does not prevent him from pursuing a claim for damages for deceit or negligence or a statutory claim for compensation for false statements in a prospectus[33]. A statutory claim for compensation is provided by sections 150 and 166 of the Financial Servicess Act 1986. Under these sections any subscriber for shares or debentures under a prospectus is entitled to recover compensation from directors who are responsible for issuing it for any financial loss which they suffer as a result of any untrue statement of fact contained in the prospectus. Furthermore, a subscriber if in Scotland may rely on the Law Reform (Miscellaneus Provisions) (Scotland) 1985, or if in England on the Misrepresentation Act 1967 which gives a person who is induced to enter a contract by reason of a negligent misrepresentation, a right to recover damages in addition to his right to rescind the contract.

The Common Law remedy against directors for untrue statements in a prospectus was an action for damage for fraud. It was held in Derry v. Peek[34] that in an action for fraud (deceit) the plaintiff must prove actual fraud. In this case a prospectus was issued by the directors stating that the company, under its special Act, had the right to use steam power instead of horses. The plaintiff subscribed for shares on the faith of this statement. The Board of Trade afterwards refused its consent, and the company was wound up. The plaintiff sued the directors for damages of fraud. It was held that directors were not liable as the statement had been made by them in the honest belief that it was true, and fraud is only proved when it is shown that a false representation has been knowingly, or without caring whether it be true or false. The same judgment was adopted in Akerhielm v. De mare where the subscriber brought an action for fraud on the ground that untrue statement in the prospectus had induced him to subscribe for share. However, his action was failed and the court held that the representor was not liable for fraud because he honestly believed the representation to be true in the sense in which he understood it. The measure of damages for fraud is the difference between the actual value of the shares at the time of allotment and the sum paid for them.[35]

3.1.2.- Criminal Liability

The criminal liability of directors for mis-statement in a prospectus is stated in a number of statutes. Indeed, the offences which arise when inducing persons to subscribe for shares seem to be serious and may be punished by a fine or by long prison sentences. For example, under the Prevention of Fraud (Investments) Act, it is a criminal offence (triable on indictment only) for any person to induce or attempt to induce another person to enter into, or offer to enter into any agreement for acquiring or subscribing for shares by:

(a) using a statement, promise or forecast that he knows to be misleading,

(b) by recklessly making (dishonestly or otherwise) a statement, promise or forecast that is misleading, false or deceptive. Similarly, section 15 of the The Theft Act 1968 make it an offence (triable on indictment only) dishonestly to obtain by deception (whether deliberate or reckless) property belonging to another with the intention of permanently depriving the other of it. Section 19 of the same act (which replaces section 84 of the Larceny Act 1969) provides that an officer of a body corporate or unincorporated association (or a person purporting to act as such) who, with intent to deceive members or creditors about its affairs, publishes or concurs in publishing a written statement or account which to his knowledge is or maybe misleading, false or deceptive in a material particular, is liable to seven years imprisonment. This provision of the Theft Act does not apply to Scotland[36]. In addition, under section 47 of the Financial Services Act 1986 it is an offence for a person either to make a statement, promise of forecast which he knows to be misleading, false or deceptive, or if he dishonestly conceals any material facts, or if he recklessly makes (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive if that statement etc...is for the purpose of inducing another to enter into any investment agreement. The maximum sentence under this provision is seven years imprisonment. The Companies Act 1985 also deals with the issue of criminal liability of directors for false statements in prospectuses. Section 70 (1) provides that any person who authorised the issue of the prospectus with an untrue statement included in it is guilty of an offence and liable to imprisonment (up to two years on conviction on indictment) (CA 1985, Sch. 24) or a fine, or both. However, this section provides two statutory defences that enables the accused to escape conviction, which are:

1- That the fact mis-stated was immaterial

2- That the accused has reasonable ground to believe and, up to the time of the issue of the prospectus, believe that the statement was true.

3.2.- <u>Liability for Fraudulent Trading</u>

As noted previously directors are required to act *bona fide* and show a reasonable standard of care and skill while running the company's business. Otherwise they will be in breach of their managerial duties. In addition, the management of the company in a negligent manner gives rise to directors liability to the company and it's shareholders. This principles apply equally whether the company is solvent or in insolvent liquidation. Indeed they may apply more strongly in the later case by reason of the director's liability to the company's creditors, who may be suffered by his acts. Section 630 of the Companies Act 1985 (previously section 333 of the Companies Act 1948) grants rights of action to the liquidator or any creditor or shareholder, to sue any officer of the company for misfeasance or breach of duty, as well as misapplication of funds or for an account of his dealing with the company's property. Similarly, liability may be imposed by an order of the court under section 213 and section 214 of the Insolvency Act 1986, for the negligent management of a company's affairs by its directors resulting in its insolvency. According to section 213 Insolvency Act if in the course of a winding up a company, it appears to the court that the company's business has been carried on with intent to defraud it's creditors or the creditors of any other person, or for any fraudulent purpose, the court, on the application of the liquidator, may declare that any person who were knowingly parties to the fraudulent trading shall make such contributions to the company's assets as the court thinks proper. This section shows clearly the intention of the legislature in protecting the creditors rights from the abuses and misconduct of company directors.As Professor Gower put it[37]

> "This section (formerly was 332 of the Companies Act 1948) represents a potent weapon in the hands of directors which exercises a restraining influence on over-sanguine directors...It is probably the most serious attempt which has yet been made to protect creditors generally (as opposed to the revenue) from the abuses inherent in the rigid application of the corporate entity concept".

In regard to what constitutes fraudulent trading, the courts have been reluctant to put forward a definition and it is difficult to formulate general principles from the decided cases[38]. However, it appears that the crucial elements of fraudulent trading are that the business of the company has been carried on with intent to defraud creditors...or...for any fraudulent purpose. In the leading case Re William C Leith Bros Ltd[39] where further supplies of goods were ordered for the company by the directors on the advice of the managing director despite the fact that there was no prospect of the company paying for them. In holding the managing director liable Maugham, J said,

> "If a company continues to carry on business and to incur debts at the time where there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payment of those debts, it is, in general, a proper inference that

> the company is carrying on business with intent to defraud".

However, this finding was narrowed in a subsequent case Re Patrick and Lyon Ltd[40] where Maugham, J said that the words "defraud" and "fraudulent purpose" connote "real dishonesty involving, according to current notions of fair trading among commercial men at the present day, real moral blame". The meaning of the phrase 'intent to defraud' in the Companies Act 1985, section 458, and Insolvency Act 1986, section 213 was considered by the Court of Appeal, in R.V. Grantham[41]. The court noted a relevant dictum of Lord Radcliffe in Welham v. DPP[42]

> "Now, I think there are one or two things that can be said with confidence about the meaning of this word 'defraud'. It requires a person as its object: That is, defrauding involves doing something to someone. Although in the nature of things it is almost invariably associated with the obtaining of an advantage for the person who commits the fraud that ultimately determines its meaning."[43]

It is quite clear that to obtain an order making individuals personally liable under section 213 of the Insolvency Act 1986, it might be provided that the director or other person whom it is sought to make liable was guilty of fraud, and not merely of negligent mismanagement. Under section 458 of the Companies Act 1985, fraudulent trading is a criminal offence punishable by fine or imprisonment and may be committed whether the company is subsequently wound up or not. For this reason, the same high standard of proof of fraud is required to obtain an order imposing personal liability on them as is required for a criminal conviction.[44] According to section 213 of the Insolvency Act 1986 applications for orders imposing personal liability on directors who are guilty of fraudulent trading can be made only by the liquidator and in consequence a creditor cannot intervene in order to secure a payment direct to himself, as happened in Re Cyona Distributors[45]. The wording of section 213 of the Insolvency Act 1986 differs from that used in earlier legislation (Section 332 of the Companies Act 1948, and section 630 of the Companies Act 1985). Under the latter (section 332) the application for the same order (imposing personal liability) could be made by a creditor or shareholder of the company, as well as by its liquidator. In contrast, under section 213 of the Insolvency Act 1986, all applications for the above orders must be made by the liquidator.

It has been established in a number of cases that a single transaction can constitute "carrying on business". For example, in Re Gerald Cooper Chemicals Ltd[46] Templeman J said "It does not matter for the purposes of [S.S 458 and 213] that only one creditor was defrauded, and by one transaction, provided that the transaction can properly be described as a fraud on a creditor perpetuated in the course of carrying on business". Indeed in R V Lockwood[47] the defendant was held to have been rightly convicted under section 458 of the Companies Act 1985, on the basis of a simple transaction.

The expression "parties to" in section 213 of the Insolvency Act 1986 involves some positive steps. In other words, it must be proved that individuals whom it sought to make liable took an active part in the management of the company during the period while debts or other liabilities were incurred fraudulently. In Maidstone Buildings Provisions Ltd.[48] it was held that a company secretary, who knew that the company was insolvent but failed to advise the company's directors that the company should cease trading was not included among "parties to the carrying on of the business" with intent to defraud creditors and, therefore cannot be made liable under the section, although he is guilty of negligence in failing to advise the directors, and in such case he could be sued by the company for breach of duty as an officer of the company or for breach of a contract to advise it properly[49] Similarly, a controlling shareholder or shareholders (including a parent company of a group) cannot be personally liable for a company's debts by an order of the court, merely because of their position but it must be shown that they gave instruction or took part in making management decisions which were intended to defraud creditors[50]. On the other hand, it was held in Re Gerald Cooper Chemicals Ltd[51] that a creditor who, knowing of the circumstances, accepted money fraudulently obtained by the company may be liable to repay it even if he took no part in the fraudulent trading itself. In his judgement Templeman J said:[51(a)]

"A creditor is a party to the carrying on of a business with intent to defraud creditors if he accepts money which he knows full well has been procured by the company carrying on business with intent to defraud creditors for the very purpose of making the payment"

The extent of liability of those responsible for fraudulent trading,is subject to the court's discretion. When the directors are declared by the court to be responsible for fraudulent trading, it may change their liability against any securities which they hold against the company[52]. They may also be disqualified from acting in the management of companies for a period not exceeding 15 years[53], and may be made criminally liable as well.[54]

3.3.- Wrongful Trading

In addition to the existing provisions regarding fraudulent trading, the Insolvency Act 1986 introduced the new concept of personal liability for wrongful trading in section 214 [55]. This section was enacted, pursuant to the recommendation of the Review Committee on Insolvency Law and Practice chaired by Sir Kenneth_Cork[56] to eliminate the need to prove fraud under the Fraudulent Trading Provision. This is because of the practical difficulties of establishing the fraud element of fraudulent trading which was an obstacle for a liquidator to succeed in an application for the imposition of a personal liability for fraudulent trading.[57] The situation resulted in exemption for many directors who had carried on the business recklessly. Thus the purpose of this section (214) of the Insolvency Act 1986 is to impose personal liability on the directors of an insolvent company for trading while insolvent but in the absence of fraud.[58] In other words, under section 214 of the Insolvency Act 1986 civil personal liability could arise without proof of fraud or dishonesty and without requiring the full criminal standard of proof. To establish wrongful trading the liquidator of a company must show that the company has gone into an insolvent liquidation (i.e. its assets are insufficient for the payment of its debt and other liabilities and the expenses of the winding up)[59] that the director, prior to the liquidation knew or ought to have concluded that there was no reasonable prospect that the company could avoid going into insolvent liquidation, and that he did not take every step he ought o have taken to minimise the potential loss to the company's creditors[60]. What the director ought to know or have concluded or done depends on (1)- what a reasonable director carrying out similar functions in that type of company would know, conclude or do, and, (2)- the general knowledge, skill and experience of that director[61]. However, in <u>Re Produce Marketing Consortium Ltd</u> [61(a)] Mr Justice Knox said that:

> "The knowledge to be imputed in testing whether or not directors knew or ought to have concluded that there was no reasonable prospect of the company avoiding insolvent liquidation is not limited to the documentary material actually available at the

given time...there is to be included by way of factual information not only what was actually there but what, given reasonable diligence and an appropriate level of general knowledge, skill and experience, was ascertainable".

Applications under 214 may only be made by the liquidator of a company, and only in respect of a person who is or has been a director or shadow director of the company[62] unlike fraudulent trading wrongful trading is not also a criminal offence. In addition, it is worthy of note that wrongful trading provision catches not only the criminal and reckless, but the careless and incompetent[63]. Finally, once wrongful trading was established the court may require the director to make a contribution to the company's assets.[64] The extent of this contribution is a matter for the court's discretion. Furthermore, a person who has been declared liable to make a contribution for the wrongful trading under S. 214 may also, if the court thinks fit, have a disqualified order made against him.[65]

3.4.- Disqualification of Directors;

A disqualification order is defined as an order of the court prohibiting a person, without leave of the court, from acting as a director of a company, or a liquidator or administrator of a company, or a receiver or manager of a company's property or, in any way, whether directly or indirectly, be concerned or take part in the promotion, formation or management of a company, for a specified period beginning with the date of the order.[66] The restriction on taking part in the management of the company is very wide. In particular the words " be concerned in " the management do not mean " take part in" and so include acting as a management consultant advising on financial management and restructuring of a company.[67]

3.4.1. Grounds for disqualification orders

1- Conviction of indictable offence:The court may make a disqualification order against a person who has been convicted of an indictable offence (whether on indictment or summarily) in connection with the promotion, formation, management or liquidation of a company or with the receivership or management of a company's property.(CA 1985, S.296 (1); now CDDA 1986, S.2(1)); The court which convicts the accused has jurisdiction to make the disqualification order, and so also has any court with jurisdiction to wind up the company in relation to which the offence was committed, and if the conviction was by a magistrate' court, any magistrates's court for the same petty sessions area(CA 1985, s.296 (2); now CDDA 1986, S.2 (2)); The maximum duration of the disqualification imposed is 15 years if imposed in consequence of a conviction on indictment and 5 years if imposed by the sheriff court on summary complaint or if in England by a magistrates court (CA 1985, S.295(2); CDDA 1986, S. 2(3)). An application for such a disqualification order may be made by the secretary of state or (if in England by the official receiver), the liquidator or any past or present member or creditor of the company concerned. Such a person must give at least 10 days' notice of his intention to the person against whom the disqualification order is sought and that person may appear on the application and give evidence or call witnesses (CDDA 1986, S.16).

2- Persistent default in filling obligations under the Companies Act: A person may alternatively be disqualified from being a director of or being concerned in the management of a company if he has been persistently in default in complying with the provisions of the Companies Legislation (as defined by section 22(7) of the CDDA 1986) which require returns, accounts or documents to be filled with the registrar of companies or require notice to be given to him (CDDA 1986, S.3(1)). Persistent default for the purpose of disqualification may be conclusively proved by showing that a person has been adjudged guilty of three or more defaults in the previous five years (CDDA 1986, S.3(2) and (3)). A person is adjudged guilty if he has been convicted of any offence consisting in of any contravention of or failure to comply with any provision of the Companies Acts (whether on his own part or on the part of the company)or if a default order is made against him under any of section 244 or 713 of the Companies Act or sections 41 or 171 of the Insolvency Act 1986. (S.3(3) of the CDDA 1986). However, it is not necessary to show three such convictions. For example in Re Artic Engineering Ltd[68] failure to send 35 required returns to the registrar was held to be sufficient evidence for the making of an order. The courts which have jurisdiction to impose a disqualification on this ground are are the courts which may order the company concerned to be wound up, which in the case of a company with a paid up share capital of not more than £120 000 includes the Sheriff court (if in England the county court) in whose district the company's registered office has longest been situate during the preceding six months (CA 1985, S.297(4) and S.512(2); CDDA 1986, S.3(4)) The maximum period of disqualification that can be imposed under this head is 5 years (CA 1985, S.295(2); now CDDA 1986, S.3(5)).

3- Fraudulent trading, Fraud or Breach of Duty revealed in a winding up: If in the course of winding up a company, it appears to the court that a person has been guilty of fraudulent trading (Whether convicted thereof or not) or otherwise been guilty of fraud in relation to the company whilst acting as an officer or liquidator of the company or receiver or manager of its property or has committed a breach of duty in any of these capacities, the court may make a disqualification order (CDDA 1986, S.4(1)) The term "officer" includes a shadow director (S.4(2)). The maximum period for which disqualification may be made is 15 years.

4- The Court has found in the winding up of a company that the person concerned has been guilty of fraudulent trading, or of wrongful trading. That is to say that he has been a director of a company which has gone into liquidation in an insolvent condition, and at some time before its liquidation commenced while he was a director of the company he realised, or ought to have realised, that there was no reasonable prospect that the company would avoid going into an insolvent liquidation, and the court has in consequence of its finding declared that the person concerned shall be liable to make the contribution to the company's assets which the court directs (IA 1985, S.15(1), (2), (6) and (7) and S.16; now CDDA 1986, S.10(1); and IA 1986, S. 214(1) and (2).The court which has jurisdiction to impose a disqualification under this head is the court which has made a winding up order against the company, or if is a voluntary liquidation, which could make a winding up order against it (CA 1985, S. 744 and IA 1985, S. 108 (1); IA 1986, S.251). The maximum period for which a disqualification order may be made is 15 years (CA 1985, S. 295 (2) and IA 1985, S. 108; CDDA 1986, S. 10(2).

5- Summary conviction of an offence consisting in a failure to comply with the provisions of the Companies Act requirements to file returns, accounts or other documents (CDDA 1986, S.5). The maximum period of disqualification under this head is 5 years.

The above five grounds are uncontrversial, they are enforcement/ anti-avoidance provisions reinforcing the Companies Act 1985. But the sixth ground is far reaching imposing duties of "care" or competence on the directors.

6- Unfitness: If the court is satisfied that a person is or has been a director (including a shadow director) of a company which has become insolvent within the past two years, and that his conduct as such makes him unfit to be concerned in the management of a company, it may make a disqualification order against him for at least two years. the application for such an order must be made by the secretary of state (or the official receiver if the company is in compulsory liquidation) if it appears to him to be in the public interest, as the result of information received from a liquidator, administrator, administrative receiver or the official receiver. A company becomes insolvent for this purpose if: (1)- The company goes into liquidation at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding up; (2)- and an administration order is made in relation to the company or (3) an administrative receiver of the company is appointed (CDDA 1986 S.6(2)). Similarly, if the secretary of state receives a report from inspectors under section 437 of the Companies Act or sections 94 or 177 of the Financial Services Act 1986 or obtains information under sections 447 or 448 of the Companies Act or section 105 of the Financial services Act 1986 and as a result forms the opinion that it is expedient in the public interest that a disqualification order be made against any person who is or has been a director or shadow director of any company, he may apply to the high court or court of session for such an order (CDDA 1986, S.8(1)). The court my make a disqualification order against a person if it concludes that his conduct in relation to the company makes him unfit to be concerned in the management of a company (CDDA 1986, S.8(2)).

In deciding whether a person's conduct makes him unfit to be concerned in the management of a company, section 9 of the CDDA 1986 requires the court to have regard to the matters specified in schedule 1 to that Act. These matters are divided into those applicable in all cases, and those applicable where the company has become insolvent.

The first head comprises; (1)- misfeasance or breach of duty to the company, (2)- misapplication of the company's money or property, or any conduct giving rise to account to the company for money and property, (3)- the extent of directors responsibility for the company entering into any transaction liable to be set aside as being at undervalue and with the object of putting assets out of reach of claimants; (4)- the extent of the directors responsibility for the company's failure to keep accounting records and retain them for the prescribed period; maintain the register of directors and secretaries, maintain a register of members and keep it in the prescribed location; make an annual return within the prescribed period; and register charges on the company's assets.

Where the company has become insolvent, the court is required to have regard to:

(1)- The extent of the director's responsibility for the causes of the company's insolvency;

(2)- The extent of the directors responsibility for:

a- any failure by the company to supply any goods or services which have been paid(in whole or in part)

b- The company giving preference or entering into a preferential transaction liable to be set aside as such;

c- Any failure by the company to call a meeting of creditors in accordance with the statutory procedure including the production of a statement of affairs duly verified by affidavit by some or all directors.

(**3**)- Any failure by the director to comply with an obligation relating to a statement of affairs in a winding up.

(**4**)- Any failure to comply with the requirements relating to the first meeting of creditors in a voluntary winding up.

Section 6 of CDDA 1986 is described as one of the most important and controversial provisions of the Disqualification Act.[69] Its main purpose is to deal with what the Cork Committee called "widespread dissatisfaction at the ease with which a person trading through the medium of one or more companies with limited liability can allow such a company to become insolvent, form a new company, and then carry on trading much as before, leaving behind a trial of unpaid creditors, and often repeating the process several times"[70]. In other words, section 6 intends to safeguard the general public against the perils of directors abuse of the privileges of limited liability, and to prevent the "phoenix syndrome" in which an insolvent company transfers its business to a new company under a similar name and management.

Recent years have witnessed a growing body of case law on the principles which ought to govern the disqualification of directors. although the majority of cases were brought under section 300 of the Companies Act 1985, they seem to be appropriate to be used in interpreting section 6 of CDDA 1986 since the two sections are very similar(close). For example, they both refer to directors of insolvent companies being unfit to be concerned in the management of a company. The main difference between the two sections are that: First, s.300 required two successive insolvencies before the director was disqualified whereas s.6 requires one insolvency (although more may be considered).[71] Secondly, the discretion available to the court is different under section 300 from that under section 6. In that under s.300 the court had a discretion as to whether to make a disqualification order whereas s.6 provides that the court "shall make a disqualification order...where it is satisfied" the person unfit. That to say, once unfitness is shown, disqualification is mondatory.[72]

One of the important points dealt with (discussed) in most disqualification cases is the interpretation of s.6(1) and the use of the words "unfit to be concerned in the management of a company" In <u>Re Lo-line Electric Motors Ltd</u>[73], The Vice Chancellor stated that "the primary purpose of the section is not to punish the individual but to protect the public against the future conduct of companies by persons whose past records of insolvent companies have shown them to be a danger to creditors and others" Thus, it is not fundamentally penal. Nevertheless, he did accept that application of the section would involve "a substantial interference with the freedom of the individual." Accordingly, he stated that ordinary commercial misjudgment was by itself not sufficient to show that a director was unfit to be concerned in the management of the company. The vice-Chancellor added, however, that an extreme case of gross negligence could show that a director was unfit. In describing what will be regarded as unfitness Peter Gibson J in Re Bath Glass Ltd[74] said:

> "To reach a finding of unfitness, the court must be satisfied that the director has been guilty of a serious failures, whether deliberately or through incompetence, to perform those duties of directors which are attendant on the privilege of trading through companies with limited liability. Any misconduct of the respondent qua director may be relevant, even if it does not fall within a specific section of the Companies Acts or Insolvency Act."

In interpreting section 6 the decision in Re Bath Glass Ltd, two important points were raised: (1)- As to the matters for judging unfitness listed in Sched 1 of the CDDA, the learned judge was of the view that they are not exhaustive and the court is not confined to looking at those matters. Thus, for example, the court can take account of a failure to comply with a provision of the Companies Act not actually mentioned in the Schedule.[75] (2)- It was held that for evidence of a director's unfitness the court may look not only to his conduct in relation to the insolvent company but also to his conduct in relation to other companies.

Another recent case on disqualification is Re Majestic Recording Studios[76] where it was held that disqualification of director is appropriate though his involvement in the irresponsible conduct of company affairs was peripheral only, if he has shown himself to trade with the benefit of limited liability in that he shirked his duties as director of more than one company by leaving everything to others. In his judgement, Mervyn Davies J. referred to two authorities. The first is in Drincqpier v. Wood[77] where Byrne J said: "It should be understood that a director, consenting to be a director has assumed a position involving duties which cannot be shirked by leaving everything to others". The second is Stanford Services Ltd[78] in which Vinelott. J. said:

> "The public is entitled to be protected, not only against the activities of those guilty of the more obvious breaches of commercial morality, but also against someone who has shown in his conduct of more than one company...a failure to appreciate or observe the duties attendant on the privilege of conducting business with the protection of limited liability"

Similarly, Horman J. in Re Douglas Construction Services Ltd. & Anor[79] described the limited liability as "privilege which must be exercised responsibly and cannot be abused and, if abused, the courts must prevent those who abuse it from so doing in the future".

Another important issue raised in a number of disqualification cases is that whether there is a difference between Crown debts and ordinary trade debts.[80] The decisions show that there is a slight difference of judicial approach to Crown debts. For example, in Re Dawson Print Group Ltd[81] Hoffmann J on the facts of the case, did not draw any distinction between a failure to pay Crown debts and the failure to pay other trading debts. He stated " I cannot accept that failure to pay this [Crown] debts is regarded in the commercial world generally as such a breach of commercial morality that it requires in itself a conclusion that the directors concerned are unfit to be involved in the management of the company". However, in Re Wedgecroft Ltd[82] Harman J regarded the Crown debts as "quasi trust" monies and the failure to pay them as being more morally culpable than failure to pay ordinary trade debts. Again in Re Stanford Services Ltd[83] Vinelott J. treated the failure to pay the Crown debts as more serious than the failure to pay commercial debts. He described the Crown as an involuntary creditor and regareded this as one of the reasons for the preference afforded to Crown debts. Thus, he expressed the view that the directors ought not to use money which is owed to the Crown to finance trading activities. If they did so,

> "the court may draw the inference that the directors were continuing to trade at a time when they ought to have known that the company was unable to meet its current and accruing liabilities...It is, I think misleading (or at least

> unhelpful) to ask whether a failure to pay debts of this character would be generally regarded as a breach of commercial morality. A director who allows such a situation to arise is either in breach of his duty to keep himself properly informed with reasonable accuracy ...or is acting improperly in continuing to trade at the expense and jeopardy of money's which he ought not to use to finance the company's trade."

In Re lo-Line Electric Motors[84], the Vice-Chancellor agreed with Vinelott.J. that Crown debts are different from ordinary trade debts. He added that although the Crown debts were not strictly trust moneys, "the failure to pay them over does not only prejudice the Crown, as creditor, but in the case of PAYE and national insurance may also have a prejudicial effect on the company's employees". He considered that the use of this money which should have been paid to the Crown to finance the trading activities of an insolvent company more culpable than the failure to pay commercial debts.

From the above cases it can be deduced that directors are now more exposed to legal liability than before and the circumstances under which they could be held personally responsible are far greater. Indeed, the scope of disqualification has been widned by the new provisions on company insolvency, introduced by the Insolvency Act 1985 and consolidated in the CDDA 1986. Thus, the threat or actual penalty of disqualification may now operate not only against a dishonest director but includes directors who are irresponsible or incompetent.

Contravention of orders

If a person against whom a disqualification order is made contravenes it, he commits a criminal offence, for which he may be punished, if convicted on indictment, by not more than two years' imprisonment or unlimited fine or both, or if convicted summarily, by not more than six months' imprisonment or a fine not exceeding £1,000 or both (CA 1985, S.295(7) and Sched.24; now CDDA 1986, s.13).

Apart from the disqualification noted above the articles may include any provision for disqualifying a director from office.A typical article is article 81 of the Table A which provides that a director shall be vacated if he ceases to be a director by virtue of section 291 or section 293 of the Companies Act 1985. Section 293 refers to the age limits. section 291 refers to share qualification. A director who is required by the articles to obtain qualifying shares within a given time and who does not (or who sells all the qualifying shares which he is required to hold), vacates office on the expiration of the period allowed. Other grounds included in the articles upon which the director vacates his office include: (1)- if he becomes a bankrupt or makes any arrangement or composition with his creditors generally; (2)- if he suffers from a mental disorder and is either admitted to hospital under the Mental Health Acts or becomes the subject of a court order; (3)- if he is absent from directors' meetings for more than six consecutive months and the board resolves that he should vacate his office.

3.4.2.- Liability For Acting While Disqualified

Section 15 of the Company Directors Disqualification Act 1986 contains a further provision under which a person may be held liable for the company's debts. The personal liability arises if a person acts as a director of a company or takes part in its management while he is undischarged bankrupt or subject to disqualification order.[85] In such a case, he is personally liable to creditors of the company for its debts and other liabilities incurred, while he acts as a director or takes part in its management, unless he acts with leave of the court.[86] The same thing applies to a person who, as a director or involved in the management of a company, acts or is willing to act on instruction given without the leave of the court by a person whom he knows at that time to be an undischarged bankrupt or to be subject to a disqualification order, and he (a person) is presumed to continue to be willing to act on those instructions unless the contrary is proved.[87] Moreover, where a person is personally liable under this section for the relevant debts of the company, he is jointly and severally liable in respect of those debts with the company and any other person who, whether under this section or otherwise, is liable.[88] One of the advantages of section 15 of the Company Directors Disqualification Act is that it enables the individual creditors to recover their debts without the need for action by the liquidator or even for the company in question to be in liquidation.[89]

Section 4: Relief From Liability

Having considered, although briefly, the various kinds of duties and liabilities to which company directors may be subject, it seems appropriate to throw some light on some of the practical measures that are available to relax company directors from the duties imposed upon them by the common law and equity and relieving them from the liability which may arise from their breach of their duties. This section focuses on a number of ways in which directors may be relieved from liability. This includes (1) ratification, (2) relief by the articles (3) relief by the court.

4.1.- Ratification ;

It is generally agreed that ratification, either by ordinary resolution of the general meeting or by the approval of all members having voting rights at a general meeting[90], is one of the means that may "Cure" directors breach of duty and "absolve" the directors from liability[91]. Indeed, in the absence of fraud, the ratification or authorisation validates what would otherwise be an unlawful act or transaction.[92] The most frequently cited case in support of this rule is North-West Transportation Co. Ltd. V. Beatty.[93] The facts of that case may be summerised as follows: The company contracted to purchase a steamship from a vendor who was one of its directors at a reasonable price. At a general meeting the contract was approved, against the wishes of the minority of the shareholders, by reason of the fact that the vendor held one-third of the total votes in favour of the resolution to approve the contract. Nevertheless, it was held that the resolution was valid, and the vendor who was also a shareholder was merely using his voting power to his own advantage, and there was no fraud on the minority of the members since there was no unfairness of impropriety. If the directors use their votes to deprive the company of its property for their own benefit and prevent it from taking any action against them, their resolution to approve the transaction will be invalid. This was the case in Cook V. Deeks[94] where the defendant who were the controlling shareholders and directors of the company had negotiated a contract on behalf of the company, then took it for themselves by passing a resolution in the general meeting that the company had no interest in the contract. It was held that the contract belonged in *equity* to the company. Hence, the directors must account to the company for the benefit gained from it. Furthermore, their ratification was regarded as fraud on the minority and ineffective. Lord Buckmaster said: "If, as their Lordships find on the facts, the contract in question was entered into under such circumstances that the directors could not retain the benefit of it for themselves, then it belonged in equity to the company and ought to have been dealt with as an asset of the company. Even supposing it be not *ultra vires* of a company to make a present to its directors, it appears quite certain that directors holding a majority of votes would not be permitted to make a present to themselves. This would be to allow a majority to oppress the minority". Again in Regal (Hastings) Ltd V. Gulliver[95], the house of Lords in its decision observed that if the directors, who were also controlling shareholders had summoned a general meeting to approve their action they would have been relieved of their duty to account to the company, although it would have been a mere formality since the directors were also the only shareholders. In the words of Lord Russel,[96] "They [directors] could, had they wished, have protected themselves by a resolution (either antecedent or subsequent) of the Regal shareholders in general meeting. In default of such approval, the liability to account must remain". At this stage, it appears that if an act or a transaction can be validly ratified, so that it becomes binding on the company, the directors will be relieved from liability from any breach of duty. However, what may be ratified is still to some extent unclear, since the distinction between ratifiable and unratifiable acts appears to be difficult to draw.[97] Nevertheless, it is established in a number of cases that certain types of directors' acts may be ratified merely by an ordinary resolution of the general meeting. This includes, for example, an allotment of shares for an improper purpose[98], a failure to disclose an interest in a contract to which the company is a party[99], the obtaining of a secret profit not available to the company[100]. And a failure of skill and care; if not fraudulent[101].

Indeed it is suggested that directors must act in a *bona fide* manner in all the circumstances mentioned above. In this respect Professor Gower[102] argues that it is impossible to ratify when directors do not act *bona fide* in the interests of the company. He cites in support of this proposition the case of Attwool v. Merryweather[103] where a shareholder was permitted to bring an action against the directors of a company who had, sold to it a mine for an excessive price. On the other hand, Gower adds that the general meeting can validly ratified the directors' act if they have acted honestly in that they believe to be the best interest of the company although they have acted for an improper purpose. He supported his argument by citing Hogg v. Cramphorn Ltd.[104] which was a case on the improper issue of shares. The directors issued shares with special voting rights to the trustees of a scheme set up for the benefit of the company's employees, in order to forestall a take-over. The court held that although the directors had acted in good faith they had breached their duty to the company by making improper use of their power to issue shares. However, it was also held that the directors' breach of duty could be ratified by the company in general meeting (with the newly issued shares not voting). This decision was approved by the Court of Appeal in Bamford v. Bamford[105] where the directors had allotted shares to create additional votes in order to resist a take-over bid. This breach of duty was held to be ratifiable by the ordinary resolution passed in general meeting. Harman L.J. described this case as a tolerably plain case and stated that it was trite law[106] that directors can, through full and frank disclosure to the general meeting, obtain "absolution and forgiveness of their sins", whether this take the form of procedural irregularities (e.g. lack of quorum, defective appointment) or improper purpose, provided "the acts are not *ultra vires* the company as a whole". His lordship added "If the majority of the general meeting will not forgive and approve, then the directors must pay for it." This judgment, however, was described by Lesser, in his article[107] as "a substantial encroachment on minority protection". In his view, the judgment "would deny the possibility of a minority action in cases of contravention of the articles or "Fraud on the minority" both of which are established 'exceptions' to the rule in Foss v. Harbottle."

In contrast to the above category of acts there are some breaches of directors' duties that cannot be ratified by an ordinary resolution of the general meeting. This includes (a) breach of duty involving infringement of the individual rights of shareholders, such as an improper refusal to register a share transfer [108], or a class of shareholders (e.g cases of fraud on the minority); (b) an act which is *ultra vires* the company[109], (c) acts which are fraudulent or dishonest[110], (d) acts which are performed without following a required procedure such as obtaining a special resolution.

Finally, it is worthy of note that unlike British Company Law, which relies on common law principles, American and other European countries laws provide expressly for the release of directors from liability for fully disclosed breaches of duty by the shareholders passing a resolution by a simple majority vote at a general meeting or in the case of many states in the USA by the board of directors resolving to release individual directors.[111]

4.2.- <u>Relief by the Articles</u>

Prior to the Companies Act 1929, the insertion of a provision in a directors service contract or in the memorandum or articles of association of the company in order to exclude any liability of breach of directors' duties, except that which was wilful and dishonest, was valid and could be relied upon by the directors who were in breach of their fiduciary or statutory duties.[112] A clear example of this situation can be found in <u>Re City Equitable Fire Insurance Co</u>.[113] where one of the company's articles provided that none of the directors, auditors, secretary or other officers of the company should be answerable...for any loss misfortune, or damage which might happen in the execution of their respective offices or trusts or in relation thereto, unless the same should happen by or through their own wilful neglect or default. This type of article was described by the Green Committee[114] as giving "a quite unjustifiable protection to directors". They recommended "the proper course in our view is to prohibit articles and contracts relieving directors and other officers from their liability under the general law for negligence and breach of duty of breach of trust. These recommendations led to the introduction of what is now section 310 of the Companies Act 1985 [115]. Section 310 of the Companies Act 1985 makes void "any provision, whether contained in a company's articles or in any contract with the company or otherwise for exempting any officer of the company or any person (whether an officer or not) employed by the company as auditor from, or indemnifying him against, any liability which by virtue of any rule of law would otherwise attach to him in respect of any negligence, fault, breach of duty or breach of trust of which he may be guilty in relation to the company".

However, the relationship between this section and the articles is not clear. Indeed, the wording of this section renders it very difficult for academics to define the exact scope of section 310 (formerly 205 Companies Act 1948) which gave rise to an extensive academic discussion.[116] The main issue considered was about the effect of section 310 on articles 85 and 94 (formerly 78-84). In other words, are articles 85 and 94 and similar provisions caught by the invalidating terms of section 310 of the Companies Act 1985. In answering this question various views and arguments were expressed. In an attempt to define the extent of section 205 (now 310) it is submitted that the correct construction of the section is more narrow and that some exclusion clauses can be valid.[117] Both Gower and Gore-Brown take the view that, literally interpreted section 205 permits the modification or abrogation of the directors duty by the articles, but not the exclusion of liability which may arise for breach of that duty. Professor Gower[118] puts the point as follows:

> "Notwithstanding this [section 205] waiver clauses have... continued to be inserted in articles and, since they appear in table A, they must be regarded as permissible and, at any rate to some extent, as effective. Presumably that is so because the articles permit a director to place himself in certain situations and to retain the benefits he derives thereby, it can no longer be said that the situations are ones in which there could be a conflict with his duty in the light of permission".

Another statement found in Gore-Brown[119] "It is open to a company, subject to certain limits, to include in its articles provisions which render one or more of the general duties... Inapplicable to its directors. Any such provision must, however, take the form of a reduction or abrogation of the relevant duty, as opposed to an exemption of the directors from liability for breach of the duty".[120] Similar view was expressed by Parkinson[121]. He noted that

"On a strict reading, section 205 does not invalidate provisions which are duty-releasing, but only those which exempt liability for breach of duty. Birds[122] took a different approach. He suggested that articles 78 and 84 are inconsistent with section 205, but valid because of their statutory character. Another view was presented by Gregory.[123] He submits that the literal effect of section 205 is to avoid all forms of exclusion from liability, without making any distinction between exemptions from the scope of the duty and exemptions from consequences of a breach of duty. He reconciles this view with the Table A provisions by holding that there is nothing in them which can be said to authorise directors to commit breaches of duty. This view, however, was criticised by Instone[124] in his article. He argues that if Mr Gregory's submission above was true, no absolution could be effectually obtained by means of a shareholder's resolution. The reason for this was that section 205 applies to "any provision, whether contained in the articles of a company... or otherwise", and the words appear to cover such a resolution. That it can be effectively so obtained is illustrated by Bamford V. Bamford.[125]

However, all the views and arguments mentioned above were expressed in the absence of any judicial guidance[126], due to the lack of any case-law dealing with the issue. Until recently the only reported case on section 310 is Movitex Limited V. Bulfield & others.[127] In that case, the company's articles were similar to but slightly more extensive and went a little further than article 84 of the 1948 Table A. These articles allowed a director to be a party to or otherwise interested in a contract with the company and declare that the transaction shall not be voidable, and the director not accountable for any benefit that he may derive from it, provided that his interest is disclosed to the rest of the board and that in most instances, the director also abstains from voting. In this judgment Vinelott J held that such articles were valid and did not infringe section 205 of 1948 Act (New Section 310). He said[128] that "it would at the very lowest paradoxical to find that section 205 conflicts with articles 78 and 84. The legislature in enacting the 1948 Act must have contemplated that the modifications of the self-dealing rule in articles 78 and 84 do not infringe section 205". Another important point which was raised in connection to duty-releasing articles, was about excludable and non-excludable duties. This is resolved by drawing a distinction between the directors duty which may be released and the duty that may not. It is suggested that while the no-conflict duty may be released by a provision in the articles, the duty to act in good faith, the duty of care and the duty to act for a proper purpose may not.[129] The reason for this distinction may be attributed to the fact that the breach of the latter duty may be harmful to the company, since these non-excludable duties represent the range of obligations imposed upon directors in order to prevent them from damaging the interest of the company.[130]

Finally, it is interesting to note that although the Companies Act 1985 invalidates exoneration and indemnity clauses in articles of association and directors' service contracts, section 310(3) of the Act empowers a company which has such a clause in its articles, or which is party to a contract which contains such a clause, to indemnify a director against costs which he incurs in defending any civil or criminal proceedings brought against him in which judgment is given in his favour or he is acquitted, or against the cost incurred by a director who successfully applies to the court for relief from liability.[131]

4.3.- Relief by the court:

Directors application to the court for relief is another way of releasing directors from their liability. This is provided by section 727 of the Companies Act 1985. Under this section the court has a discretionary jurisdiction to relieve an officer (including a director, manager or secretary (section 744) or an auditor of the company, wholly or partly, from liability which he has incurred by "his negligence, default, breach of duty or breach of trust." This relief can, however, be granted only if it appears to the court that the applicant director "has acted honestly and reasonably, and that having regard to all the circumstances of the case (including those connected with his appointment) he ought fairly to be excused..."[132] The court may give a relief to a director even though the company's shareholders or creditors (if the company is in liquidation) are opposed to such relief if it (the court) considers that the director should be excused.[133] On the other hand, directors cannot be relieved by the court from liability which they incur personally to persons other than the company. Thus, it would seem that directors cannot be relieved in those cases where they incur personal liability to shareholders or creditors of the company, although they may be relieved from liability to the company on the same facts.[134] In Excise Commissioners v. Hedon Alpha Ltd[135], it has been held that the section applies to actions brought by or on behalf of the company against its directors for breach of duty and to penal proceedings for the enforcement of the Companies Acts. In explaining the circumstances in which the section cannot apply, Lord Stephensen said:[136]

> "I would...hold that [s.727]...is inapplicable to any claim by third parties to enforce any liability except a director's liability to his company or his directors duties under the Companies Acts. Wide and general though the opening words of [s.727] are, read in their context they do not allow an officer or auditor of a company to claim relief in "any" legal proceedings which may be brought against him in his capacity as an officer or auditor of a company by the rest of the world".

4.4.- Directors Liability in Algerian Law

Under Algerian Law, like other legal systems that treat a company as an entity separate from its shareholders and directors, directors are not personally liable for the acts performed in the name of the company in the ordinary discharge of their duties, such acts are exclusively imputed to the company. Their liabilities, however, stem from the breach of certain standards of conduct which may make them civilly or criminally liable. In addition to the general principles that govern civil and criminal liability, the Algerian legislator set forth a number of provisions dealing specifically with the responsibility of company directors.[137]

4.4.1- Civil Liability

Article 693(1) of the commercial code 1975 provides that "Directors shall be liable, individually or jointly and severally, as the case may be, to the company or to the third parties, for the violation of the legislative or regulatory provisions applicable to companies, for violations of the provisions of the companies statutes, or for faults committed in their management."[138] It is quite clear from this article that the main basis of civil liability are:

A- violation of the law on companies (Infractions aux dispositions legislative, ou reglementaires applicables aux sociétés par actions); The Commercial Code 1975 regulating companies lays down strict rules, any breach of which results in the liability of directors. Examples of these rules are : The obligation to keep books of account in accordance with the provisions of the commercial code[139], to convene the ordinary annual shareholders meeting and any extraordinary shareholders meeting that may be necessary, and to draw up the agenda for these meetings; to submit correct balance sheets, to distribute dividends; to obtain a necessary authorisation before doing any business with the company.

B- Violation of the statutes of the company (bylaws) (violation des statuts); Non-compliance of the company's articles might result in the civil liability of the company director. Examples for such violations are: Failure to call shareholders meetings as prescribed, making contracts that are prohibited by the company's statutes (statuts); granting of loans when unauthorised, or granting loans without obtaining the security called for in the articles of association.

C- Faulty management (Faute de gestion): As seen earlier, directors are under duty to exercise care and due diligence in their management of the affairs of the company. Furthermore, their position entails the common law fiduciary obligation to manage the company as would a "good family father" (bon pére de famille)[140]. That is to say, in the same way as a diligent and honest person would manage his own affairs. As a result of this, any negligence or mismanagement, even slight, may expose the director to liability. As a matter of fact, the faults that can be committed by directors when running the day to day management of the company are numerous and varied. They include all acts or omissions contrary to the obligation to manage the company in the way described above. For example, negligence or incompetence of the directors in management and in the supervision of the staff, which may cause losses to the company, abuse of their position as directors such as obtaining a loan from the company without following the prescribed procedure, heavy purchases by a company in financial difficulties or buying goods or property at a price completely disproportionate to their value; granting loans to insolvent individuals; concealing the true situation of the company from the shareholders by knowingly presenting an inaccurate financial statement; fiscal frauds that may lead to the payment of heavy penalties which force the company to borrow money in order to make such payments.

Any director who commits the cited violations is liable in damages to the company, its shareholders and third persons for any loss sustained as a result of his acts and omission. As a general rule the directors liability is individual and each director is only personally liable for his own acts and omission. However, since the board of directors is a collegiate body, and acts giving rise to liability may be done by the directors acting together, in which case they are collectively liable.[141] In addition, where several directors are jointly liable as participants in the same acts, the court shall determine the degree of responsibility and the contributive share of each one in reparation for damages.[142] The directors may be sued by anyone who has been prejudiced (damaged) by their acts or omissions: The Company, the shareholders and third parties.

1- Individual Action (Action individuelle)

Any shareholder who has been directly prejudiced by the action of a director of the company may bring a suit for damages because of the loss caused to him[143]. The general foundation of this action is article 124 of the civil code 1975 "Every fault which causes injury to another, imposes an obligation to make reparation upon the person by whom it is committed." Thus, all shareholders in different kinds of companies are entitled to bring that action. Here the shareholder acts on his own behalf and his action is in respect of the damages sustained by him personally which may be different from the damages caused to the company[144] This led some writers to call it a personal action (action personelle)[145] although it may happen that one fault by a director or directors gives rise to both action sociale and action individuelle if it affects both the interests of the company and the individual shareholder at the same time[146]. In all cases, a shareholder cannot be deprived from his individual rights of action whether by a provision in the statutes of a company, a resolution of a general meeting or by subjecting the action to a prior authorisation or any other procedure.[147] In addition to the shareholders' action, third parties, generally creditors, may sue any director for damages suffered by them as a result of directors breach of duty.

According to the general principle of civil liability, it is necessary to prove an error (Faute) made by the directors of the company, damage sustained by a shareholder or third party, and finally a link of causation between the error and damage.

2- Company's Action (Action Sociale)

The fact that a company is a legal person enables it to bring an action against any director or directors who may cause loss to the company. (e.g actions for negligent management, actions for misuse of the company's assets, action for damaging the company's financial reputation or quality of its production). It is submitted that the basis of this action is a contractual one.[148] This is because the board of directors acts as an agent (mandataire) for the company. Therefore, its faults which cause damage to the company constitute a breach of its duties as an agent. Another view argues that this action is based on violation of legal obligations (obligations legalès).[149] However, some writers suggest that the search for the nature of this action has no practical importance since the responsibility is founded on the fault (faute) that must be proved in all circumstances. Mr. Tunc noted "On remarquera que nous passons entiérement sous silence les discussion relatives a la nature contractuelle ou delicutelle de la responsabilité des organes. Ces discussion ne peuve aboutir, parce qu'elles ont trait a un faux probléme.[150]

An action by the company has in principle to be brought in its name by its legal representatives (ie it board of directors). However, in practice it seems impossible for such action to be brought if all or several of the directors are guilty of the breaches of duty complained of, since they are unlikely to initiate an action against themselves.[151] As a result of this, the law permits the shareholders to bring action sociale instead of the company's legal representatives (les représents legaux). This is known as action social exercée "ut singuli".[152] Article 694 of the Commercial Code 1975 provides that "In addition to the action for damages suffered personally, the shareholders may, either individually or as a group bring a corporate action (action social) against the directors. The plaintiff shall have the right to claim compensation for the full injury suffered by the company, to which the damages shall be awarded." It is worthy of note that unlike French law, Algerian law does not impose any condition on shareholders to exercise action sociale "ut singuli". In French Law, however, the requirement is to hold a certain percentage of the issues capital of the company which is at least one-tenth (1/10) of the capital in the case of societé a responsabilité limitée[153], and at least one-twentieth (1/20) in the case of societé par actions[154].

The persons who are authorised (permitted) to act in this action, are those who are still shareholders when the action is brought, in other words, they must be in actual possession of shares at the time the suit is brought "seules sont authorisés a agir les personnes qui ont la qualité d'associés au moment de l'action".[155]

According to the commercial code, no clause in the statutes of a company may validly subject the enforcement of a right of action vested in the company to the prior opinion or authorisation of the general shareholders meeting, and no renunciation of the rights of shareholders to sue in the company's name or their own names is valid.[156] In addition, no decision adopted at a shareholders meeting can terminate or exclude a liability suit brought against the directors for their errors in the performance of their functions.[157]

Finally, a right of action for damages against the directors, whether brought by the company or by a shareholder individually, must be sued upon within three years after the right of action arose or, if the existence of the right of action has been concealed, within three years of the discovery of the relevant facts. However, if the act constitutes a crime, the action shall be barred after ten years.[158]

A number of attempts has been made to draw a line between the two actions cited above. Firstly, it is submitted that the difference between company rights of action (actions sociales) and individual rights of action (actions individuelles) lies in the purpose of the suit and in the nature of damages sought. A suit belongs to the company if the company or all of its members have an interest in it and its purpose is to maintain, reconstitute or augment company assets. An action is personal if not all shareholders have an interest in it or if all have an interest but of different degrees, and if its purpose is to make each interested individual whole for personal damages suffered.[159] The second view attributes the above difference to the nature of the duty of whose breach gave rise to the action. This is to say that the right of action belongs to the company whenever the contractual duties of directors are at stake, on the other hand the action is personal if it is based on a misdemeanour (*délit*) or a technical misdemeanour (*quasi-délit*)[160]. The third view argues that while the action sociale results from a breach of a contractual obligation the individual action arises from breaches which are not contractual.[161]

4.4.2- Criminal Liability

Like French law, the criminal liability of directors under Algerian law is wide and extensive. This may be deduced from the fact that most of the breach of directors duties and defaults regarding most statutory prescriptions concerning the management of the company may make a director civilly as well as criminally liable. This is in addition to certain crimes set forth in the penal code which may be committed by directors in their capacity as such viz., fraud, (escroquerie) and embezzlement (abus de confiance). The most important examples of criminal liability are laid down by article 811 of the commercial code under the title "Violations relating to management and administration of companies". It states as follows "The following shall be subject to imprisonment for one to five years and a fine of AD 2 000 to AD 20 000, or to either of such penalties:

1- The president, the administrators, or the general managers of a company who, in the absence of a book of account balances (inventory of the company's assets and liabilities) or through fraudulent books of account balances, knowingly distribute fictitious dividends to the shareholders;

2- The president, the administrators, or the general managers of a company who, even though no dividends were distributed, knowingly publish or submit to the shareholders inaccurate balance sheet in order to conceal the true financial situation of a company;

3- The president, the administrators, or the general managers of a company who, acting in bad faith, use the company's property (assets) or credit in a manner which they know to be contrary to the interest of the company, for personal ends (gain), or for the benefit of another company or enterprise in which they have a direct or indirect interest;

4- The president, the administrators, or the general managers of a company who, acting in bad faith, use powers which they possess or votes which they dispose, in such capacity in a manner which they know to be contrary to the interests of the company, for personal ends (gains) or for the benefit of another company or enterprise in which they have a direct or indirect interest."

In addition to the above criminal sanctions, article 812 of the commercial code imposes liability on a director (the president or administrator) presiding over a meeting who fails to have the deliberations of the board of directors (conseil d'administration) set down in minutes forming a special record kept at the company's registered office. The penalty is a fine of AD 500 to AD 2 000 [162].

From what have been said it appears that the directors liability has received a great deal of attention from both the British and Algerian legislature. This is reflected in a large number of provisions and regulations dealing with directors and executives, especially in Britain where private sector companies constitute a cornerstone of the British economy. Thus, the proper control of the national economy can only be achieved through the control of its leaders, ie, directors. Indeed, the recent increase in a number of fraud cases, bankruptcies and insider dealings is a clear sign that shows the need to enact more strict rules that can prevent such acts, and to fill up any loophole that may be used by director to escape liability. Although this general increase of directors liabilities may be seen as rendering company's directorship as a risky task which may discourage persons from holding managerial offices in fear of personal liability that may attach to them. The shareholder, creditors and the general public as large, however, will be encouraged to invest their money in companies and commercial projects since they are assured by the law that their rights are safeguarded. Finally, it seems to me that the directors liability will continue to increase as the economy and commercial world continue to develop.

Notes:

1- Ferguson v. Wilson (1966) LR 2 Ch.77

2- Steen, M. & Aldis, M., Tolley's Company Law, 1988, p.346

3- A director may also be held concurrently liable with his company for fulfillment of a contract it has entered into, if, for example he has agreed to guarantee performance of the company's obligations.See Pennington, R.R., Directors' Personal Liability, 1986, p. 180

4- Powell-Smith,V., The Law and Practice Relating to Company Directors, 1969. p.143

5- Mitchell philip, L.R., Directors' Duties and Insider Dealing, 1982, p. 86

6- Powell-Smith, V., supra, note 4, at p. 144. The representation of the final words of a company's name "limited" or "public limited company" by the contractions "Ltd" or "PLC" is treated as equivalent to the full expression of these words (CA 1985, section 27(1) and (4)). Similarly, the contraction "Co" is accepted as equivalent to word "company". See Banque de l'Indochine et de Suez S.A· v. Euroseas Group Finance Co· Ltd. [1981] 3 All E.R.198; [1981] Com. L.R. 77

7- Gower, L.C.B., Principles of Modern Company Law, 4th edition, 1979, p. 117

8- (1889) 5 T.L.R 679, see also Penrose v. Martyre (1858) E.B. & E. 499 where an officer (secretary) were held liable when the word "Ltd." was omitted; see also British Airways Board v. Parish [1979] 2 Lloyd's Rep. 361

9- See also Henden v. Adelman and others [1973] 117 S.J. 631; see also Durham Fancy Goods, Ltd. v. Michael Jackson (Fancy Goods) Ltd., [1968] 2 Q.B.839; [1968] 2 All E.R. 978; see also John Wilkes (Footwear) Ltd. v.

Lee International (Footwear) Ltd. [1985] J.B.L.356

10- Pennington, R.R., Directors Personal Liability, 1986, p.177

11- Ibid, p. 178; see also Weeks v. Propert (1873) LR 8; CP 427; West London Commercial Bank v. Kitson (1883) 12 Q.B.D. 157

12- Pennington, R.R., supra, note 10, at p.178; Cherry and McDougall v. Colonial Bank of Australia (1869) LR 3; PC 24

13- Pennington, R.R., Company Law, 5th edition, 1985. p. 126

14- Schmitthoff, C.M., Palmer's Company Law, Vol 1, The Treatise, 24th edition, 1987, at p.972

15- [1921] 2 A.C. 465

16- [1924] 2 Ch.33

17- Ibid, at p.37

18- [1924] 2 Ch. at pp. 38-40 per Tomlin J

19- See Schmitthoff, C.M., supra, note 14, p.972; see also performing Rights Society v. Ciryl Theatrical Syndicate, [1924] 1 K.B.1, at pp. 13-14

20- [1985] 1 W.L.R 317; [1985] 2 All E.R. 415

21- [1978] 89 D.L.R (3d) 195

22- at p. 204-205

23- See British Thomson Houston Company Limited v. Sterling Accessories Limited [1924] 2 ch 33 at p.39 where Tomlin J said "if the company was really trading independently on its own account, the fact that it was directed by Messrs. Feldman and Partridge would not render them responsible for its tortious acts unless, indeed, they were acts expressly directed by them".

24- Evans (C) Sons Ltd. v. Spritebrand Ltd. [1985] 1 W.L.R 317 at p.329

25- Cargill v. Bower (1878) 10 Ch.D.502

26- Powell-Smith, V., The Law and Practice Relating Company Directors, 1969, p. 150

27- Pennington, R.R., Directors Personal Liability, 1986, p. 105

28- Mitchell philip, L.R., Directors Duty and Insider Dealing, 1982, p.87

29- However, there must be causation between the misstatement/ omission and the loss.

30- However, this defence of honest and treasonable belief as Professor Pennington pointed out will be relied on by a director only if he cannot avoid liability on any other grounds. For more details see Pennington, R.R., supra, note 2 p. 166-167

31- The expression expert under Companies Act 1985 section 62 includes engineer, valuer, accountant and any other person whose profession gives authority to a statement by him

32- Pennington, R.R., supra, note 3, p. 166

33- Pennington, R.R., Company Law, 5th edition 1985, p.302; see also Archer v. Brown [1985] Q.B.401

34- (1889) 14 A.C. 337

35- McConnel v. Wright [1903]1 Ch.546; Davidson v. Tulloch (1860) 3 Macq. 783; 22 D.(HL) 7

36- Morse, G., Charlesworth's Company Law, 13th edition, 1987 at p.168

37- Gower, L.C.B., Principles of Modern Company Law, 4th edition, 1979, p.115-116

38- Wright, D., Rights and Duties of Company Directors, 1987, p.144

39- [1932] 2 Ch.71

40- [1933] 1 Ch.786

41- [1984] Q.B.675

42- [1961] A.C. 103

43- the need to show dishonesty was more recently stressed in <u>R</u>.V <u>Cox and Hedges</u>, [1982] 75 Crim.App.R 291 and <u>Re Augustus Barrnet & Son Ltd</u> [1986] BCLC 170

44- Pennington, R.R., <u>Directors' Personal Liability</u>, 1986, p. 194

45- [1967] Ch.889

46- [1978] Ch.262

47- [1986] Crim. L. R 244

48- [1971] 1 W.L.R. 1085

49- Pennington, R.R., <u>Company Law</u>, 5th edition, 1985, p. 55

50- Ibid.

51- [1978] Ch.262 ;See also Rajak,H.,"Company Directors - The End of An Era", (1989) <u>N.L.J</u>., 1374-1375

51(a)- [1978] Ch.262, at p.268

52- Section 215 (2) of the Insolvency Act 1986

53- SS.4, 10 of the Company Directors Disqualification Act 1986

54- Section 458 of the Companies Act 1985

55- Although the words "wrongful trading" do not appear in the substantative text of the section at all- nor even the word "trading". For the interpretation of this section see Sealy <u>Disqualification and Personal Liability of Directors</u>, (CCH edition, 1986) pp. 14-19

56- The Report of the Review Committee on Insolvency Law and Practice (The Cork Committee), 1982, Cmnd 8558, paras 1758-1760 Ch 44

57- Schmitthoff, C.M., <u>Palmer's Company Law</u>, 24th edition, 1978, p. 1466; The Cork Committee on Insolvency Law and Practice (1982) Cmnd (8558) noted that: "It is the general experience of those concerned with the administration of the affairs of insolvent companies that the difficulty of establishing dishonesty has deterred the issue of proceedings in many cases where a strong case has existed for recovering compensation from the directors or others involved"; see also Fletcher, I.M., "Directors' Responsibility and Wrongful Trading", (1989) 86 L.S.Gaz. 19

58- Schmitthoff,C.M., (editorial), "Wrongful Trading" (1989) J.B.L. p.188 at 189

59- Section 214 (3) of the Insolvency Act 1986

60- Section 214 (2) (3) of the Insolvency Act 1986; See also Rajak, H.,"Wrongful Trading", (1989)139(1) N.L.J. 1458; Section 214 was criticised by the Confederation of British Industry and the Institute of Directors. This is by showing their dissatisfaction with imposing on a director, with the benefit of hindsight, knowledge which he did not at the time possess ('ought to have concluded') and courses of action ('every step') which may not be obvious at the time. See Gullick, J.M. Ranking and Spicer's Company Law, 13th edition 1987, p.320

61- Section 214 (4) of the Insolvency Act 1986

61(a)- [1989]5 BCC 569 (This is believed to be the first case in which section 214 has been examined by the courts). See also Tang Ying Hui,"Directors contribution after firm traded when insolvent"(1989) Friday, April 14th, The Independent, at p.14

62- Whereas in fraudulent trading it is persons who are party to the carrying on of business

63- Ellington, P.R., and Fletcher, I.M, "Responsibilities and Liabilities of Directors and Officers of Insolvent Corporations in the UK", (1988) Inter-Bus-Lawy., 491 at p.493

64- Section 214(1) IA 1986

65- Section 10 of the Company Directors Disqualification Act 1986

66- Companies Directors Disqualification Act 1986, section 1; For a more elaborate account see Leigh, L.H., " Disqualification Orders in Company and Insolvency Law ", (1986)7 Co.Lawy. 179; see also Birds, J., " Disqualification of Directors", (1989)10 Co.Lawy. 21.

67- R v. Campbell, [1984] BCLC.83; see also R v. Austen, (1985) L.S.Gaz. 2499.

68- [1986]1 W.L.R. 686;

69- Schmitthoff, C.M., Palmer's Company Law, Vol 1, The Treatise, 2nd edition, 1987, p.887.

70- The Report of the Review Committee on Insolvency Law and Practice (The Cork Committee), 1982, cmnd 8558, p.1813.

71- Thornton, L., "Company Directors Disqualificattion: defining director", (1989) 86 L.S.Gaz.22.

72- Birds, J., "Disqualification of Directors",(1989) Co.Lawy.22; see also Churchill Hotel (Plymouth) Ltd & Ors, (1988)4 BCC 112.

73- [1988]3 W.L.R.26; (1988)138 (1) N.L.J. 119.

74- [1988] 4 BCC 130 at p.133.

75- Re Bath Glass Ltd, [1988]4 BCC.130 at pp.132-133; see also Birds, J., supra, note 72.

76- [1988]4 BCC 518.

77- [1899]1 Ch.393 at p.409.

78- [1887] BCLC 607 at p.619. See also Ipcon Fashions Ltd., Re [1989]5 BCC. 773

79- [1988] 4 BCC 553 at p.557.

80- Re Stanford Services Ltd [1987] BCLC 607; Re Churchill Hotel (Plymouth) Ltd & Ors, [1988] 4 BCC 112; Re Bath Glass Ltd [1988] 4 BCC 130; Re Lo-Line Electric Motors Ltd [1988]3 W.L.R.26.

81- [1987] 3 BCC 322 at p.325.

82- March 7, 1986, (Unreported)

83- [1987]3 BCC 327 at p.334; see also Churchill Hotel (Plymouth) Ltd & Ors, [1988] 4 BCC. 112.

84- [1988] 3 W.L.R. 26 at p.34; (1988) 138(1) N.L.J. 119; see also Re Ipcon Fashions Ltd, [1989] 5 BCC 773

85- Acting in Contravention of a disqualification order is an offence triable either way (section 13 of CDDA 1986)

86- Section 15(1), (3) and (4) of the Company Directors Disqualification Act 1986

87- Section 15(5) of the Company Directors Disqualification Act 1986

88- Section 15(2) of the Company Directors Disqualification Act 1986

89- Boyle, A.J., *et all*, Boyle and Birds Company Law, 1987, p. 578

90- Re Duomatic Ltd. [1969] 2 Ch.365; Re Gee & Co.(Woolwich) Ltd. [1975] Ch.52

91- Boyle, A.J. & Sykes, R., Gore-Brown on Companies, 44th edition, 1986, vol.2, para 27.21.1; Pennington, R.R., Company Law, 5th edition, 1985 p. 737; Schmitthoff, C.M., Palmer's Company Law, 24th edition, 1987, para 63-25; Mason. H., "Ratification of the Directors Acts: An Anglo-Australian Comparison", (1978) M.L.R. 161

92- Pennington, R.R., supra, note 13, p.737; See also Burke, M.J.,"Shareholders Ratification of Directors Action", (1990) 140 N.L.J.240

93- (1887) 12 A.C.589

94- [1916] 1 A.C. 554

95- [1967] 2 A.C.134

96- Ibid,at p.150

97- Gore-Brown, supra, note 72 para 27.21.1

98- Hogg V. Gramphorn Ltd. [1967] Ch.254; Bamford V. Bamford [1970] Ch.212

99- North-West Transportation Co. v. Beatty, (1887)12

A.C.589

100- Regal (Hastings) Ltd. v. Gulliver, [1967] 2 A.C.134

101- Pavlidas v. Jensen [1956] Ch.565, this is supported by the Multinational Gas & Petrochemical Co. Ltd. case [1983]2 All E.R. 563

102- Gower, L.C.B., Principles of Modern Company Law, 4th edition 1979, p. 619-620

103- (1867) L.R. 5 Eq 464

104- [1967] Ch.252

105- [1970] Ch.212

106- Ibid at p. 237-238

107- Lesser,H., "Organising Resistance to Take-Over Bids. The Legality of Strategic Allotments of shares ", (1969) C.L.J 198 at p.200

108- Re Smith & Fawcett [1942] Ch.304

109- " An *ultra vires* agreement cannot become *intra vires* by means of estoppel, lapse of time, ratification, acquiescence or delay " see York Corpn v. Henrt Leetham & Sons Ltd. [1924] 1 Ch. 557 at 573. Per Russel J

110- Mason v. Harris (1879) 11 Ch.D. 97

111- Pennington, R.R., Directors' Personal Liability, 1986, p. 101

112- Birds. J, "The Permissible Scope of Articles Excluding the Duties of Company Directors", (1976) 39 M.L.R 394 at p. 395; see also Pennington, R.R., supra, note 21, p. 95

113- [1925] Ch.407; see also inter alia, Re Brazilian Rubber Plantations and States Ltd. [1911]1 Ch.425, 440

114- Cmd 2657 (1925-26) paras 46 and 47

115- Formerly Section 205, of the Companies Act 1948 which was first introduced as section 152 in the Companies Act 1929

116- See Gower, L.C.B., supra, note 7, p. 601, 602 Gore-

Brown, supra note 2, para 27.21.3, Baker, (1975) J.B.L 181; Birds (1976) 39 M.L.R. 349 Gregory, (1982) 98 L.Q.R. 314, Sealy, "Directors' Duties and Exempting Articles" (1987) C.L.J, 217

117- Gower, L.C.B., supra, note 12, p.601-602; Gore-Brown, supra, note 2, para 27.21.3

118- at p 601-602

119- para 27.21.3

120- However, this interpretation by Gower and Gore-Brown was described as unacceptable. See Baker, "Disclosure of Directors' Interest in Contracts" (1975), J.B.L. 181 at p.188

121- J.E. Parkinson, "The Modification of Directors' Duties", (1981) J.B.L.335 at p. 339

122- Birds.J.,"The Permissible Scope of Articles Excluding the Duties of Company Directors", (1976) 39 M.L.R 394 at p. 401

123- Gregory. R., "The Scope of the Companies Act 1948 section 205", (1982) L.Q.R 413, at p. 414

124- Instone, R., "The Scope of the Companies Act 1948, S. 205" (1982) 98 L.Q.R 548 at p. 549

125- [1970] Ch. 212, 238. For a reply to this criticism see Gregory.R., "Section 205 of the Companies Act 1948- A Reply", (1983) 99. L.Q.R. 194 at p.195

126- Birds.J., "Excluding the Duties of Directors", (1987) Co. Lawy p. 31

127- [1986] 2 BCC 99, 403, [1988] BCLC 104

128- Ibid, at p.429

129- Parkinson, J.E., "The Modification of Directors' Duties", (1981) J.B.L 335 at p. 343-44; the same conclusion was reached by Vinelott J in Movitex Ltd. V Bulfield [1988] BCLC 104;

130- Boyle, A.J., et al, Boyle and Birds Company Law, 1987, at p. 627

131- See Pennington, R.R., supra, note 3, p. 97; see also Gower, L.C.B., supra, note 7, p. 612

132- See Selangor United Rubber States Ltd. v. Cradock (no.3) [1968]1 W.L.R. 1555, see also Gower, supra note 7, p.611 (Footnote 86)

133- Re Gilt Edged Safety Glass Ltd. [1940] Ch.495; see also Pennington, R.R., supra, note 3, p 99

134- Pennington, R.R., supra, note 3. p. 99

135- [1981] 2 All E.R. 697

136- Ibid, at p. 702

137- Civil liability, articles from 691 to 697, and criminal liability articles from 811 to 813 of the commercial code 1975

138- Article 693(1) "Les administrateurs sont responsables, individuellement ou solidairement, selon le cas, envers la société ou envers les tiers, soit des infractions aux dispositions législatives, ou réglementaires applicables aux société par actions, soit des violations des statuts, soit des fautes commises dans leur gestion".

139- article 9 of the Algerian commercial code 1975

140- see article 432 of the civil code 1975 " L'associé doit s'abstenir de toute activité préjudiciable á la société ou contraire au but pour lequel elle a été formée.

Il doit veiller et pourvoir aux intérêts de la société comme á ses propre intérêts, á moins qu'il ne soit chargé de l'administration moynant rémunération, auquel cas sa diligence ne doit pas être inférieur á celle d'un bon pére de famille".

141- Juglart & Ippolito, Cours de droit Commercial, 4th edition, 1971, vol.2, p.454

142- article 693(2) of the commercial code 1975 "Si plusiers administrateurs ont coopéré aux même faits, le tribunal détermine la part contributive de chacun dans la réparation du dommage"

143- Article 694 of the commercial code 1975 "Outre l'action en reparation du préjudice subi personnellement, les actionnaires peuvent, soit individuellement, soit en se groupant, intenter l'action sociale en résponsabilité contre les administrateurs. Les demandeurs sont habilités a poursuivre la réparation de l'entier préjudice subi par la société, a laquelle, le cas échéant, les dommages intérêts sont alloués"

144- see Omneshaughe, P.V., Le regime de sociétés par actions et leurs administration en droit comparé, 1960 at p. 545, "Les administrateurs peuvent d'autre part subi un préjudice distinct de celui qui résult de l'atteinte portée au patrimoine social"; see also Berdah, J.P, Fonction et responsabilité de dirigeants de sociétés par actions, 1974, p. 144

145- Escarra et Rault, Traité theorique et practique de droit commercial: Les Sociétés Commerciales, 4th edition 1959, p.327

146- see Salah. M., Les Prerogative des associés et des organes sociaux dans le fonctionnement des sociétés a responsabilité limité et des sociétés par action en droit Francais et en droit Algerien, Thesis (Doctorat D'etat) 1984, p. 452; see also Omneshaughe, P.V., supra, note 144, p. 545

147- see article 695 of the Algerian commercial code 1975

148- see Omneshaughe, P.V., supra, note 144, p. 505, "On admet trés généralement que la résponsibilité des administrateurs envers la société est de nature contractuelle."

149- Berdah, J.P., supra., note 144, p. 157

150- Tunc, A., " La responsabilté civile des organes de sociétés et les régles générales de la responsabilité civile en droit Francais", (1967), vol. 15, Travaux de l'Association Henri Capitant pur la culture Juridique, 27 at p. 28; see also Escarra and Rault, supra, note 8, p. 309; Mezeaud et Tunc, Traite Théoretique et practique de la responsabilité civile, délictuelle et contractuelle, 5th edition, 1957, p. 103

151- Le Gall, J., French Company Law, 1974, p. 174

152- Salah .M., supra, note 146 at p.451

153- article 41 of the decree N^{O} 67-236, 1967

154- article 200 of the decree N^{O} 67-236, 1967

155- This rule was established by the French Chambre Commerciale de la Cour de Cassation, January, 26th, 1970, J.C.P. (juris classeur périodique), 1970, II, 16 385; see also Abu Zeid R., "Commercial Companies in Egyptian and Comparative Law, 1989, p. 641 (Arabic text)

156- see article 695(1) of the Algerian commercial code 1975

157- see article 695(2) of the Algerian commercial code 1975

158- article 696 of the Algerian commercial code 1975 provides "L'action en responsabilité contre les administrateurs, tant sociale qu'induviduelle, se prescrit par trois ans á compter de fait dommageable ou s'il a été dissimulé, de sa révélation. Toutefois, lorque le fait est qualifié crime, l'action se prescrit par dix ans."

159- Church, E.M., Business Associations Under French Law, 1960, p. 507; see also Hamel et Lagarde, Traite de droit commercial, 1954, vol. 1 para 663, p. 793, "Un préjudice subi directement par la société donne overture a une action sociale; celle-ci sera exercé *ut universi* ou *ut* *singuli*. Seul un préjudice spécial a un actionnaire ou certains actionnaires est sanctionné par une action individuelle"

160- Church, E.M., supra, note 21, p. 507

161- Berdah, J.P., supra, note 144, p. 172

162- article 812 of the Algerian commercial code 1975, see also article 813 on directors liabilty for violations relating to financial statements.

Conclusion

The management of commercial companies and the protection of their assets constitute one of the most important problems in contemporary company law. The increase in a number of bankruptcies and misappropriation of corporate funds, frauds and scandals witnessed over the last decade show clearly the extent of risk and danger that can face companies when they are managed and directed by incompetent or negligent directors. As a result of this, the issue of directors' powers and responsibilities have recently received constant attention and pressures for reform are increasing. These pressures for change are due to a number of factors such as: The European harmonisation programme embodied in various directives; the general development of economic life, and the techniques relating to the governance and management of companies.

The foregoing discussion has shown that shareholders as such have lost all genuine control over the affairs of their companies. The general tendency in modern company law is to recognise the reality caused by the separation of ownership and control. The net result is that nowadays all managerial powers and privileges are conferred upon the board of directors, while very few powers are retained by the company in general meeting. Moreover, while the articles normally envisage that the collective board is the competent and appropriate body to act they also permit extensive delegation of power to a committee of directors (consisting either of a single director or several directors), or to a managing director. This general vesting of wide powers and discretion in the directors seems to be necessary and expedient for directors to cope with the exigencies of business life and to enable them to carry out their job properly. In addition, it provides the company with sufficient legal status such that third parties dealing with the company will no longer be required to look outside the Acts and Memorandum and Articles of Association to make sure that the directors are competent to enter into a particular transaction. However as we have seen directors powers are not absolute but subject to an array of obligations and restrictions designed to ensure certain minimum standards of behaviour from directors and to prevent them from misusing their privileges or abusing their position. In this respect, the law does not impose an all-embracing code of conduct on directors. Some of their duties are laid down by statute but many are found only in common law. However, it is established that a director owes two types of duty to the company, a 'fiduciary' duty and a duty of skill and care. Firstly, the fiduciary duty requires a director to act honestly in his dealings with or on behalf the company. That is to say that the director must act in good faith in the best interests of the company, and ensure that the powers of a company are used in a *bona fide* manner in the company's interest and not for any collateral purpose. He must not place himself in a position where his duty to the company and his personal interests conflict, nor must he derive any personal profit from his position beyond that which the company pays him, for example, by diverting corporate opportunities to himself. Secondly, a director must exercise whatever skill he possesses and reasonable care and diligence when discharging his duties.

An examination of the case law regarding directors' duties appears to show that while their duties of loyalty are very strict their duties of care, diligence and skill are quite lax. This phenomenon may be explained primarily due to the fact that the company directorship is not yet a recognised profession with its own professional standards. As already indicated the British legislator adopts the attitude that directors need have no special qualification at all for the office of directorship. In other words, anyone can be a director. This is clearly illustrated by a very recent survey published by the Institute of Directors. The survey of 218 members of the institute found nine of 10 had received no preparation for becoming a director other than "experience". Less than a quarter had any professional or management qualifications.[1] This is despite the fact that the effectiveness of any board of directors and the success of any company depends mainly upon the abilities and professional competence of its board of directors. The second reason is that the principles established in the old cases[2] particularly in Re City Equitable Fire Insurance are still regarded as expressing the law on directors' obligation of care and skill even although they were all decided before the existence of "professional" company director. Furthermore, the commercial circumstances under which their judgments were formulated differs greatly from present commercial practice.

The lightness of the obligations of care, diligence and skill may result in exonerating incompetent directors. Indeed, it can be used as a justification to escape from liability in case of negligence by directors. Thus, in order to fill up this loophole it is proposed that the degree of care and skill must be increased, and must be measured by what is reasonably expected of a director in the current business community. Further, they should be made expressly liable for negligence if they have failed to exercise the degree of care and skill which is reasonably required for the proper performance of the functions for which they are appointed. In addition, it is proposed that the director (with exception of worker directors) should be required to possess some professional qualifications or at least attend training courses in management or business administration before he is appointed to a managerial office. This may provide companies' boards with competent directors and may assist the legislature in setting out a fair objective standard applicable to all executive directors' duties of care and skill. Moreover, such training may familiarise directors with the regulations governing the management of companies and make them more aware of their legal obligations and their responsibilities to their company, its shareholders, its employees, to the public at large.

As to the legal liability, directors seem nowadays to be more vulnerable than they have ever been. This is shown by a rapid increase in the number of cases involving the legal liability of directors. Directors can no longer rely for protection on the separate personality of their company as the lifting of the corporate veil has become a more common practice. Accordingly, they are now more exposed to legal liability than before and the circumstances under which they could be held personally liable are far greater. This can clearly be noticed in the increasing number of statutory provisions dealing with the directors personal liabilities embodied in different statutes such as the Companies Act 1985, Insolvency Act 1986, Companies Directors Disqualification Act 1986. Indeed, the Insolvency Act 1986 provisions have increased the risk for those who participate in the management of a company which ultimately goes into insolvent liquidation, by introducing the new concept of personal liability for wrongful trading in section 214 of the Act. Under the latter section, the personal liability could arise without proof of fraud or dishonesty and without requiring the full criminal standard of proof. Similarly, the extent of directors' disqualification has been widened by the new provisions on company insolvency. Particularly by section 6 of the Company Directors Disqualification Act 1986 which is intended to prevent directors from abusing the privilege of limited liability, and protect the general public against the irresponsible behaviour of directors.

The recent failures of companies due the misconduct of directors show that there is a need for legislative reform in this area. It is fair to say that both section 214 of the Insolvency Act 1986 and the Company Disqualification Act 1986 have a wide indirect effect, carrying back an obligation to the very incorporation of the company to ensure that it is initially adequately capitalised, that proper accounting and control systems are set up and that the company's progress can be (and actually is) regularly reviewed. For otherwise the directors will not be able to discharge their obligations under section 214 of the Insolvency Act 1986 to assess the need for preventative measures against insolvency and its consequences for trade creditors and also avoid unfitness under the Company Directors Disqualification Act 1986.

However, whilst academic writers may appreciate this, the average small company director does not. For effective public protection the working director needs education and information to tell him of the need for compliance. Thus, it is recommended that the duties and responsibilities of directors should be spelt out more clearly in future legislation, and that the rules governing them ought to be changed so as to be in accordance with the current commercial practice with a recognition that subsequent action must be supported through education as well as effective enforcement.

Notes

1- Churchill, D., "Directors Lack training for role, says study "(1990) Monday, February 19th, Finacial Times at p.10

2- Re Forest of Dean Co. (1878)10 Ch.D. 450; 40 LT 278; Re Brazilian Rubber plantations & Estates Ltd, [1911]1 Ch.425; 27 T.L.R. 109, see also the Conduct of Company Directors, 1977, Cmnd 7037, para 4; The Companies Bill 1978, (Cl.45(1))

Appendix

Some matters relating to companies according to the British companies Act of 1985 and the Algerian commercial code of 1975.

Definition of a company

Algerian law.

Article 416 of the civil code 1975 provides "The company (société) is a contract between two or more persons whereby they agree to pool assets in common with the object of sharing any profits that might accrue therefrom."

Article 417 of the civil code adds that "These assets may be money, property or services, contributed to the enterprise (societé)."

Like French law, in Algerian law there is a single word which comprises both partnerships and companies. This word is société depends upon the context in which it is used, may refer to a partnership or to a company.

British Law

A company may be described as an association of a number of persons for a common object of mutual profit.

Law governing Companies

Algerian Law

Algerian companies (sociétés) are governed by the commercial code of 1975, and the civil code of 1975 (articles from 416 to 449).

Commercial law governs merchants (commerçants) who are principally engaged in commercial dealings or transactions

(actes de commerce).
The commercial law rests upon and presupposes the civil law, which is applicable whenever the commercial law differs both substantively and procedurally from the civil law; it involves a different judiciary, the commercial courts or special section of the court (chambre de commerce) dealing with commercial matters: It employs different rules of proof; it permits a higher rate of interest to be charged; and it includes the bankruptcy law, which does not apply to persons not engaged in commerce.

British law

Companies in British law are governed by companies Act 1985 and case law.
British law does not recognise the idea of commercial law as a formally separate category. In general no distinction is made between commercial and other transactions, or between the trader and other individuals i.e. behind the acts is a general body of law applying to all companies irrespective of their nature.

Forms of business organisations (Classification)

Algerian Law : The most significant classification of business organisation is the dichotomy between civil companies and commercial companies. This reflects the crucial distinction between the civil law and commercial law. Another fundamental classification is that between sociétés de personnes and sociétés de capitaux.
Article 544 of the commercial code of 1975 provides that

"the commercial character of a firm is determined by its form or by its objects (purpose)". It follows from this that a partnership or a company which has neither a commercial form nor commercial objects is a civil partnership or company.

Article 544(2) - "Stock companies (Sociétés en commandité); limited liability companies (sociétés a responsabilité limiteé); and partnership companies (société en nom collective) are commercial by reason of their form, whatever their purpose may be.

Corporate personality

Algerian law

Commercial sociétés (companies) shall possess legal personality as of the date of their registration in the commercial register.

Persons who acted in the name of a company in the course of its formation before it acquired legal personality shall be liable jointly and severally and without limitation for any acts so undertaken, unless the company, after having property organised and registered, assumes the obligations incurred. Such obligations shall then be deemed to have been incurred by the company ab initio (Article 549 of the Algerian commercial code of 1975).

British law

A company in British law is regarded as a legal entity distinct from its members. Hence, it is capable of enjoying rights and of being subject to duties which are not the same as those enjoyed or born by its members. In other words, it has a legal personality and is often described as an artificial person in contrast with a human being, a natural person.

Formalities of formation

Algerian law

As a general rule commercial société (companies and partnerships) are subject to more complex and stricter rules than civil ones.

After the signature of the statute the following steps must be taken:

1- Registration. The statute of the partnership or company (societé) and, where applicable, the other documents relating to the constitution of the company must be submitted for the purpose of the collection of registration tax.

2- Advertisement in newspaper publishing legal notices, after the constitution of any societé (partnership or company), a notice must be published in a newspaper in which legal announcements are published and in the department where the partnership or company's registered office (siege social) is situated.

3- A contract of formation of a societé must be in writing (article 418 of the civil code 1975).

4- A societé is established by an authentic act, upon penalty of nullity (article 445 of the commercial code 1975).

5- The constitutive acts and acts of modification of commercial societés, on pain of nullity, be published at the national centre of the register of commerce , according to the modalities which are proper to each form of a company (article 548 of the commercial code).

6- A société does not have a corporate personality until its enrollment in the register of commerce. Before the accomplishment of this formalities, persons who have made engagements in the name and for the account of the firm (societé) are jointly and severally responsible without limit for the transactions they have entered into, unless the societé after being regularly constituted and registered assumes the obligations entered into by them in that case, those obligations shall be deemed to have entered in by the societé immediately after it is constituted (article 549 of the commercial code).

7- The dissolution of the firm must be published under the same conditions and time periods as the constitutive act itself (article 550 of the commercial code).

British law

A company is brought into existence by the issue, by registration of companies, of a certificate of incorporation (section 13). The certificate is conclusive evidence that the requirements of the Act as to have been compiled with, and the corporate existence of the company cannot therefore be challenged.

Limited company (S.A.R.L. & L.T.D)

Definition

Algerian law (societés à responsabilités limitées)

Limited companies SARL'S, by virtue of their forms, and regardless of the nature of their operations, treated as commercial companies.

The private company SARL is a mixed or hybrid type of company. It resembles a partnership (societés de personnes) in that the personal element in its membership is important and the shares (parts) held by its members cannot be represented by freely transferable securities (e.g. bearer share certificate). On the other hand, an SARL resembles (société de capitaux) in that all its members are liable to contribute towards its debts and obligations only to the extent of their agreed contribution.

British law

Private limited company (LTD)

Section 1 (3) of the Companies Act, 1985, provides that "a private company is a company that is not a public company". A private company is the one which, by its articles of association, prohibits any invitation to the public to subscribe for its shares or debentures.

Membership

Algerian law

The number of shareholders of limited liability company may not be greater than 20. If the company comes to include more than 20 shareholders, it must be transferred into a stock company (societé en commandité) within a year. Otherwise it is dissolved, unless during that year the number of shareholders has become equal to or less than 20. (Article 590 of the commercial code).

British law

A private company must have at least two members. A company having only one member is not admitted in British company law.

There is no maximum limitation on number of the members in a private company.

Capital and shares

Algerian law

The company capital of an SARL may not be less than AD 30 000. It is divided into shares value of equal nominal value of at least AD 100 . (Article 566 of the commercial code 1975).

The share of the societé (SARL) are nominative, they may not be represented by negotiable instruments. Article 569 of the commercial code.

British law

A private company needs no minimum capital either for registration or the commencement of business.

Management (Directors)

Algerian law

A limited liability company (SARL) is managed by one or more physical persons. Managers may be chosen from among persons who are not shareholders. They are named by shareholders, in the company statutes or by a subsequent act, under the conditions cited in Article 582 (1) - (Article 576 of the commercial code 1975)

In meetings or at the time of written consultations, decisions are adopted by one or more shareholders representing more than half of the firm's capital. (Article 582 of the commercial code).

British law

Section 282 (3) of the Companies Act 1985 provides that "every company shall have at least one director".

The articles of a private company sometimes vests the management in a small number of directors, or in a governing or permanent or life director.

private company has no security of office but can be removed by the general meeting at anytime before the expiration of his period of office. (Section 103 (1) of the companies Ac t 1985).

Stock company (société par action)

Algerian law

"A stock company (société par action) is a firm (société) that is constituted among shareholders who support losses only to the amount of their company assets" (article 592(1) of the commercial code).

A stock company is designated by a company name which must be preceded or followed by mention of the type or firm and the amount of the firms capital.

The name of one or more of the shareholders maybe included in the name. (Article 593 of the commercial code).

Membership

The number of membership in societé par action (stock company) may not be less than nine (9) - Article 592 of the commercial code.

Capital

The capital of a société par action may not be less than AD 300 000 (article 594). The capital must be wholly subscribed.

Management

The management of the company's affairs is entrusted to three main organs, namely;

1- Board of directors (conseil d'administration) article 611 to 640 of the commercial code.

2- General meeting (assemblee general) articles 641 to 655 of the commercial code.

3- Auditors (commissaire aux comptes) articles 678 to 684.

Board of directors

A société par action is administered by a board of directors composed of at least <u>three</u> and at most <u>seven</u> members; however in case of merger; this number of seven may be exceeded up to the total number of directors who have been in their positions for more than six months in the merged companies without being permitted to exceed fourteen - article 611 of the commercial code 1975.

British law

<u>Public company - PLC</u>

Section 1 (3) of the companies Act 1985 provides "a public company is a company limited by shares or limited by guarantee and having a share capital, being a company".

- The memorandum of which states that it is to be a public company, and

- in relation to which the provisions of this Act or the former companies Acts as to the registration or reorganisation of a company as a public have been compiled with on or after 22nd December 1980.

Membership

The minimum number of members in as public company is two. SS 1 (1) and section 24.

Capital

(Public companies): When a memorandum delivered to the registrar of companies under section 10 states that the association to be registered is to be a public company, the amount of the share capital stated in the memorandum to be that with which the company proposes to be registered must not be less than the authorised minimum defined in section (118) Section 118 - "The authorised minimum".
(Definition): In this Act the authorised minimum £50 000, or such other sum as the secretary of state may by order made by statuary instruments specify instead.

Management

Article 70 of table A "Subject to the provisions of the Acts the memorandum and the articles, and to any direction given by special resolution, the business of the company shall be managed by the directors who may exercise all the powers of the company.

Board of directors

The two main organs that govern the company management are;
- Board of directors

- General Meeting

Every company must have a board of directors and the minimum number of directors who must hold office at any time, is two in the case of a public company.

Section 282 (1) public company on or after November 1st 1929 (other than a private company) shall have at least two directors.

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