FIDUCIARY DUTIES TO SHAREHOLDERS?

In the 2001 CA decision in Peskin v Anderson, Mummery LJ (with whom Latham and Simon Brown LJJ agreed), gave a exegesis as to when if ever a director owed a fid duty to shareholders. That case, and the more recent decision of Nugee J in Sharp v Blank, are both illustrative of the true nature of fiduciary duties in the corporate context. The take away is that there are no general equitable duties owed by directors. They are carefully constrained and confined.

In Peskin, an action was brought by a large number of former members of the RAC against the committee members and the holding company for damages for breach of duty in changing the rules of the Club so as to allow it to distribute its property to its members, each of whom would get £34k. Neuberger summarily dismissed it and the CA upheld his decision.

Mummery began by citing the headnote in Percival v. Wright [1902] 2 Ch 421. That case decided that “The directors of a company are not trustees for individual shareholders, and may purchase their shares without disclosing pending negotiations for the sale of the company’s undertaking.”

The apparently unqualified width of the ruling has, over the course of the last century, been subjected to increasing judicial, academic and professional critical comment; but few would doubt that , as a general rule, it is important for the well being of a company (and of the wider commercial community) that directors are not over-exposed to the risk of multiple legal actions by dissenting minority shareholders. “As in the affairs of society, so in the affairs of companies, rule by litigation is not to be equated with the rule of law.”

It was common ground that the fiduciary duties owed by the directors to the company do not necessarily preclude, in special circumstances, the co-existence of additional duties owed by the directors to the shareholders. In such cases individual shareholders may bring a direct action, as distinct from a derivative action, against the directors for breach of fiduciary duty. That is because it is owed to them personally and not in their capacity as shareholders as such. These are not class rights.

The CA pointed out that the duties exist on two planes. In Stein v. Blake [1998] 1 All ER 724 at 727d and 729g Millett LJ recognised that there may be special circumstances in which a fiduciary duty is owed by a director to a shareholder personally and in which breach of such a duty has caused loss to him directly (e.g. by being induced by a director to part with his shares in the company at an undervalue), as distinct from loss sustained by him by a diminution in the value of his shares (e.g. by reason of the misappropriation by a director of the company's assets), for which he (as distinct from the company) would not have a cause of action against the director personally. Indeed prospectus liability is a good example of the former – a duty owed to shareholders personally, by virtue of the fact that they are representees of statements made by directors and rely on it in becoming shareholders in the first place.

The fiduciary duties owed to the company arise from the legal relationship between the directors and the company directed and controlled by them. The fiduciary duties owed to the shareholders do not arise from that legal relationship. They are dependent on establishing a special factual relationship between the directors and the shareholders in the particular case. Events may take place which bring the directors of the company into direct and close contact with the shareholders in a manner capable of generating fiduciary obligations, such as a duty of disclosure of material facts to the shareholders, or an obligation to use confidential information and valuable commercial and financial opportunities , which have been acquired by the directors in that office, for the benefit of the shareholders, and not to prefer and promote their own interests at the expense of the shareholders.

These duties may arise in special circumstances which replicate the salient features of well established categories of fiduciary relationships. Fiduciary relationships, such as agency, involve duties of trust, confidence and loyalty. Those duties are, in general, attracted by and attached to a person who undertakes, or who, depending on all the circumstances, is treated as having assumed, responsibility to act on behalf of, or for the benefit of, another person. That other person may have entrusted or, depending on all the circumstances, may be treated as having entrusted, the care of his property, affairs, transactions or interests to him. There are, for example, instances of

- the directors of a company making direct approaches to, and dealing with, the shareholders in relation to a specific transaction
- holding themselves out as agents for them in connection with the acquisition or disposal of shares;
- making material representations to them;
- failing to make material disclosure to them of insider information in the context of negotiations for a take-over of the company's business;
- supplying to them specific information and advice on which they have relied.

These events are capable of constituting special circumstances and of generating fiduciary obligations. That is especially in those cases in which the directors, for their own benefit, seek to use their position and special inside knowledge acquired by them to take improper or unfair advantage of the shareholders.

The Court of Appeal conducted a detailed examination of the authorities, especially those fro other common law jurisdictions like NZ (the judgment of the Court of Appeal of New Zealand in Coleman v. Myers [1977] 2 NZLR 225 and of the Court of Appeal of New South Wales in Brunninghausen v. Glavanics [1999] 46 NSWLR 538. These were each cases where fiduciary duties of directors to shareholders were established in the specially strong context of the familial relationships of the directors and shareholders and their relative personal positions of influence in the company concerned.

The English cases can all be explained the same way –

- Allen v. Hyatt (1914) 30 TLR 444 at p. 445 (directors making representations to secure options to purchase shares of shareholders and undertaking to sell shares of shareholders in agency capacity);
- Howard Smith Limited v. Ampol Petroleum Limited [1974] AC 821 at pp.834, 837-838 (directors' use of fiduciary power of allotment of shares for a different purpose than that for which it was granted, and so as to dilute the voting power of the majority shareholding of issued shares); although query whether that is a breach of fiduciary

duty per se, a point which Lord Wilberforce left open. It has now been examined further by the SC in Eclairs Group v JKX Oil and Gas [2016] 3 All ER 641, where at para 16 Lord Sumption explained that the improper purpose rule in company law had its root in the doctrine of fraud on a power, which is a vitiating circumstance even if the directors honestly believe that what they are doing is in the best interests of the company. Indeed, as he said, in Hogg v Cramphorn [1967] Ch 254, the directors' powers to issue shares could not be used in order to see off a hostile takeover bid based on the genuinely and honestly held view that the company was better off under their stewardship. As Sumption said, the company's interest was an additional and not an alternative test for the propriety of a board resolution. Properly analysed, the misuse of a fiduciary power is not of itself a breach of fid duty, since it may well not involve disloyalty (the Mothew touchstone), and shareholders may well have standing to complain in seeking to vitiate a resolution.

That takes me to Sharp v Blank, 2015 Nugee J. In that case the claimants had been shareholders in Lloyds TSB at the time of its takeover of the Halifax Bank of Scotland. They alleged that the directors had breached their fiduciary duties in respect of their representations to them in a circular in which they encouraged the shareholders to approve the transaction. The directors accepted that they owed a duty not to make misleading statements, not to conceal material facts and to give the shareholders sufficient information to enable them to make an informed decision, but they denied a fiduciary duty. The directors applied to strike out the claim on the basis that there was no fiduciary duty, the sufficient information duty was not fiduciary and that the tort claims failed for lack of any properly pleaded basis for causation.

Of interest here is Nugee's exegesis on the fiduciary duties owed by directors

He started by referring to Peskin v Anderson [2001] 1 BCLC 372 at [33] the fiduciary duties owed by directors to the company "arise from the relationship between the directors and the company directed and controlled by them"; it is the fact that they are directors of the company's affairs which by itself gives rise to their fiduciary duties. He reasserted that in general the directors do not, solely by virtue of their office of director, owe fiduciary duties to the shareholders, collectively or individually and referred with approval to the decision of

Handley JA in the New South Wales Court of Appeal in Brunninghausen v Glavanics (1999) 32 ACSR 294 at [40], this is in essence no more than an application of the principle established by Salomon v A Salomon & Co Ltd [1897] AC 22 that a company is distinct from its members. The directors direct and control the affairs and assets of the company; they do not direct or control the affairs or assets of the members.

The rule rests on policy considerations as well as legal orthodoxy – it has also been said to be supported by a number of policy considerations. Handley JA in Brunninghausen referred to the fact that only the company, not its members, can sue for wrongs done to the company (under the rule in Foss v Harbottle (1843) 2 Hare 461), and the principle that where a wrong has been done to a company, individual shareholders are not able to sue for losses which are merely derivative or reflective (as exemplified by Prudential Assurance Co Ltd v Newman Industries Ltd (No 2) [1982] Ch 204 and Stein v Blake [1998] 1 AER 724) – this is of course not a complete explanation as some losses claimed by shareholders go beyond merely reflective loss (as they did in that case). Handley JA also said that if the directors owed fiduciary duties to the shareholders they would be liable to harassing actions by minority shareholders, and exposed to a multiplicity of actions, each shareholder having his own personal claim.

This latter point was also made by Mummery LJ in Peskin v Anderson at [30] where he said that it was important that directors are not over-exposed to the risk of multiple legal actions by dissenting minority shareholders. At first instance in the same case Neuberger J said that to hold that a director owed some sort of general fiduciary duty to shareholders would involve placing an unfair, unrealistic and uncertain burden on a director, and would present him frequently with a position where his duty to shareholders would be in conflict with his undoubted duty to the company: [2000] 2 BCLC 1 at 14.

The idea of a potential conflict between the directors' duty to the company and their supposed duty to shareholders can also be found in the founding decision of Perceval v Wright [1902] 2 Ch 421, often regarded as the origin of this line of authority, where Swinfen Eady J referred to the fact that if directors owed a duty to disclose negotiations to shareholders it would place them in a most invidious position, as premature disclosure of negotiations might well be against the best interests of the company. As Nugee pointed out, that decision has had a chequered history.

10. There are however circumstances where directors have been held to owe particular fiduciary duties to shareholders. The duties that arise in such cases are dependent on establishing a "special factual relationship" between the directors and the shareholders in the particular case: Peskin v Anderson per Mummery LJ at [33]. Examples put before me are as follows:

(1) Allen v Hyatt (1914) 30 TLR 444, a decision of the Privy Council in a Canadian appeal, where it was held that directors who had acquired shares from shareholders in order to sell them to a third party had made themselves agents for the shareholders, and hence were accountable for the profits they had made.

(2) Coleman v Myers [1977] 2 NZLR 225, a decision of the Court of Appeal of New Zealand, where the company was an old established private company in which many of the shareholders, individually or through trusts, were relatives, and two directors (father and son) engineered a takeover, persuading some members of the family to sell, and seeking to compel a reluctant minority. It was held that in the particular circumstances the directors owed fiduciary duties. Woodhouse J said (at 325) that in deciding the standard of conduct required from a director in relation to dealings with a shareholder it was not possible to lay down any general test, but some factors would usually be influential , including: "dependence upon information or advice, the existence of a relationship of confidence, the significance of some particular transaction for the parties and, of course, the extent of any positive action taken by or on behalf of the director or directors to promote it." Cooke J thought it obvious that a fiduciary duty was owed in the particular circumstances of the case, summarising the facts which gave rise to the duty as being (at 330): "the positions of father and son in the company and the family; their high degree of inside knowledge; and the way they went about the take-over and the persuasion of shareholders." Casey J (at 371) referred in particular to the fact that it must have been obvious to the son that other shareholders were reposing trust and confidence in him; and that the father was in everyone's eyes the head of the family group and its associated shareholders: "whom they respected to look after their personal interests in the management of the company."

(3) re Chez Nico (Restaurants) Ltd [1992] BCLC 192, where Sir Nicolas BrowneWilkinson V-C referred to Coleman v Myers and said (at 208): "Like the Court of Appeal in New Zealand, I consider the law to be that in general directors do not owe fiduciary duties to shareholders but owe them to the company; however in certain special circumstances fiduciary duties, carrying with them a duty of disclosure, can arise which place directors in a fiduciary capacity vis- à-vis the shareholders. Coleman v Myers itself shows that where directors are purchasing shares in the company from outside shareholders such duty of disclosure may arise dependent on the circumstances of the case." On the facts of the case he did not in fact have to decide whether such a duty arose or not.
(4) Platt v Platt [1999] 2 BCLC 745, a decision of David Mackie QC, sitting as a Judge of the High Court. He held, following Coleman v Myers and the obiter comments in re Chez Nico, that a fiduciary duty was owed where the oldest of 3 brothers, who was the only director of the company, bought out his younger brothers who held preference shares. The Court of Appeal dismissed an appeal without expressing any views on this particular point.
(5) I was not referred to any other English case where such a fiduciary duty had been held to arise, although there are a number of other cases from overseas. It is not necessary to refer to them in any detail: see Dusik v Newton (1985) 62 BCLR 1 (where the Court of Appeal of British Columbia held that a special relationship existed between a director and the only other shareholder); Brunninghausen (also concerning a company with only two shareholders, where the sole director bought out the other shareholder); Crawley v Short [2009] NSWCA 410 (where one of three shareholders was bought out); and Valastiak v Valastiak [2010] BCCA 71 (misappropriation by director of company property held to be a breach of fiduciary duty to his wife who was the beneficial owner of half the shares). All these cases concerned small closely-held companies.

"I take it therefore to be established law, binding on me, that although a director of a company can owe fiduciary duties to the company's shareholders, he does not do so by the mere fact of being a director, but only where there is on the facts of the particular case a "special relationship" between the director and the shareholders. It seems to me to follow that this special relationship must be something over and above the usual relationship that any director of a company has with its shareholders. It is not enough that the director, as a director, has more knowledge of the company's affairs than the shareholders have: since they direct and

control the company's affairs this will almost inevitably be the case. Nor is it enough that the actions of the directors will have the potential to affect the shareholders – again this will always, or almost always, be the case. On the decided cases the sort of relationship that has given rise to a fiduciary duty has been where there has been some personal relationship or particular dealing or transaction between them."

Nugee J went on to cite Millett LJ's now classic judgment in Bristol & West Building Society v Mothew [1998] Ch 1 at 18A-F, that a fiduciary is someone who has undertaken to act for or on behalf of another in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty: someone who has agreed to act in the interests of another has to put the interests of that other first.

Nugee pointed out that the relationship between directors and shareholders is not in general like that. By agreeing to act as director, he necessarily agrees to act in the interests of the company. But that appointment does not bring him into any direct relationship with the shareholders.

It is true that the interests of the company in general meeting is the same as the company's separate corporate interests, at least while the company is solvent. And here Nugee J could have cited Greenhalgh v Arderne and Dillon LJ's classic judgment in Multinational Gas. But that does not mean that a director has agreed to act for the shareholders either individually or as a class or indeed has any direct relationship with them – his relationship is with the company. So to hold would conflate commercial interests and legal identity.

No - If a director he is to be held to owe fiduciary duties to the individual shareholders, there must be something unusual in the nature of the relationship which gives rise to it. What he meant by that was, as he went on to explain, either a relationship of trust and confidence which might exists where the company is small and closely held such as a family company; or else where there is a specific transaction where the directors stand to gain personally and which gives rise to an obligation of loyalty. All the cases where such duties have been held to exist are such cases.

Conclusions in a wider setting.

- Reinforces Salomon v Salomon, and the separate legal personality.
- Is consistent with Foss v Harbottle and the reflective loss principle.
- Identifies the need for special circs akin to quasi-partnership, outside the strict confines of institutional company law.
- Protects directors from open-ended liability to a potentially enormous class of members.

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