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Powers, duties and liabilities of company directors: A comparative study of the law and practice in the UK and Saudi Arabia

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Abstract

Due to the globalisation of business and the concept of borderless business activities, these new phenomena need business management to be open and adopt and practice management' skills with the international in mind, and give good consideration to the circumstances of the internationalisation of the business through directors having powers as provided under contract and law. The financial crises in previous years have demonstrated the importance of directors' duties to manage the company's affairs properly; these crises were a result of many cases of fraud and mismanagement. The directors' duties in the UK and the KSA have been codified to enhance the clarity of the law and make it easier for the responsibilities of directors towards the company and others to be understood. It also aims to prevent fraud and mismanagement that causes corporate collapse.

This study investigates and analyses the powers, duties and liabilities of the directors in Saudi Arabia and the UK in order to demonstrate the extent to which these regulation work effectively. This is by a critical evaluation of relevant legislation and case law on the subject matter of the study and demonstrating practical problems, which may result from some legislation. By doing this, the study provides an accurate picture of the directors' powers, duties and liabilities, and provides solutions to practical problems of legislation in the same context.

Declaration

I confirm that this thesis submitted is my own work. It has not been submitted in the same form for another degree elsewhere. All quotations have been recognised and the sources of identification have been acknowledged.

Acknowledgement

All praise be to Allah (the God) first and foremost.

Then I would like to take this opportunity to express my sincere gratitude and thanks to both of my supervisors, Prof. David Milman and Mr. Philip Lawton for their continued guidance and constant help to overcome obstacles during my PhD research. I must express my thanks and gratitude to the Government of the Kingdom of Saudi Arabia for giving me this opportunity to study a PhD degree in the United Kingdom. Finally, I must thank my parents, who prayed for me and supported me as best they could during my PhD journey.

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Chapter One: Introduction

1.1 Preamble

With the growth of global economic activity and the emergence of flagship projects requiring huge capital expenditure the company emerged as an effective legal form to attract and structure capital investments as a going concern. Companies have numerous and varied relationships which enhance their positions and display their prominent impact on their surroundings. Thus, they affect countries' economies since those countries also depend upon them to establish their giant development projects.

The owners of the majority of companies in modern times authorise a board of directors to perform management functions and to conduct its affairs given the need for specialisation and experience, which the majority of owners may not possess. Directors have overall responsibility for managing the revenue and cost elements of a company’s income statement, which is known as profit and loss (P & L) responsibility. A director normally oversees most or all of the firm’s marketing and sales functions as well as the day- to- day operations of the business. Frequently, the director is responsible for effective planning, delegating, staffing, and decision making to attain desirable profit making results for an organisation.[1] In some cases, the director of a business is known by a different title or designation. The majority of corporate directors hold the titles of chief executive officer (CEO) or president, depending on the company, individuals with the title managing director, regional vice president, country director, product director, branch director, or segment director may also have general management responsibilities; and whereas the director acts as the company’s legal representative and the individual having powers as provided under contract and law, and is held accountable in cases of exceeding such authority. Therefore an urgent need exists to underline the directors’ liability for breach of obligations and exceeding their authority. Holding the director fairly accountable is considered the greatest motive for him to ensure due care in their actions and decisions which determine the fate and future of the company.

[1] Sayles, L. (1979). Leadership. New York: McGraw- Hill, Inc.p.6.

Since the beginning of the Asian financial crisis in 1997 the world has been looking seriously at corporate governance, although the first appearance of the term “corporate governance” was apparently in 1976 in Federal Register.[2] Among many problems that emerged during the crisis operations and transactions of employees and companies obtaining huge amounts of short-term debt at the same time as they are keen to not know the members and hide these debts through innovative accounting methods and systems, most of the loans also were made without checking profitability and returns.[3] The events of the so-called Enron scandal[4] and the ensuing string of corporate misstatements,[5] the latest of which was the UK economic crisis that served as a warning to many cases of fraud and mismanagement.[6] These have clearly demonstrated the importance of corporate governance even in countries that were considered financial markets "close to perfection". Griffin[7] mentions that Angel Gurrı´a indicated in the 2008 statement of Organization for Economic Cooperation and Development (OECD), what he considered the causes of the global financial crisis. The banks acted rationally in given their position and the opportunities in the global market when they responded to investor demand to

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[2] Federal Register: 41 Fed. Reg. 52977 Dec. 3, 1976.

[3] Tejvan Pettinger, (2017) Asian Financial Crisis 1997, EconomicsHelp, 12 November 2017, available at: https://www.economicshelp.org/blog/glossary/financial-crisis-asia-1997/ accessed on 31 July 2018.

[4] Enron is a US energy company that its executives used the accounting loopholes to look more profitable and to hide billions of dollars in debt from failed projects and deals. By 2001, Enron had used hundreds of private-purpose entities to hide its debts. The income is calculated as the present value of net future cash flows. It was often difficult to estimate the viability of these contracts. The income from projects is also recorded, although they may not have received the money, thus increasing financial profits on the books. This means that in the following years, profits cannot be included, so new and additional income must be included from new projects to appease the investors. This contributed to creating a culture of obsession with short-term profits, with ignoring the quality of profits and cash flow, and recording accounting results as soon as possible to keep up the company's stock price. If the project returns are less than the expected, instead of bearing the loss, the company transfers the asset to a company outside the books, thus, the loss is not reported. This type of accounting enabled Enron to write off unprofitable activities without harming profits. This led to the concealment of losses and made the company look more profitable than it actually was. Despite the fact that many of its affiliates were losing money. See Dharan, Bala G.; William R. Bufkins (July 2008). "Red Flags in Enron's Reporting of Revenues and Key Financial Measures" . Social Science Research Network: 112; Healy, Paul, M., and Krishna G. Palepu. 2003. "The Fall of Enron." *Journal of Economic Perspectives*, 17 (2): 3-26. DOI: 10.1257/089533003765888840; McLean, Bethany; Peter Elkind. *Enron: The Smartest Guys in the Room*. 39–42. ISBN 1-59184-008-2.

[5] "Andersen guilty in Enron case". BBC News. 15 June 2002 available at:<http://news.bbc.co.uk/1/hi/business/2047122.stm> accessed on 31 July 2018.

[6] Arden, M. 'Regulating the Conduct of Directors' (2010) 10(1) J Corp L Stud 1, 1-2.

[7] Griffin, P. (2013). Gendering Global Finance: Crisis, Masculinity, and Responsibility. *Men and Masculinities*, *16*(1), 9–34. 10.

expand mortgage lending, accordingly, the global financial system would collapse due to faltering investor confidence. The financial world is governed by assumptions concerning the necessity of capital liquidity, so the only solution that lies in the performance improvements that main market actors must make, by making informed decisions, is not only to protect themselves but also to improve how markets function. In this regard, Campbell[8] asserts that the main causes of the 2008 US financial crisis were a series of institutional failures in how to manage the financial services industry. This can be summed up in three reasons. First, the mortgage markets. Second, the financial services industry, since the amount of money that companies could borrow to leverage their investments increased. As a result of that, the total debt of the US financial sector increased from 22% to 117% of GDP between 1981 and 2008. The institutional reforms in banking regulation, such as adjustable-rate subprime mortgages, with no legal limit on the interest charged, created incentives for lenders to get more credit available to borrowers, even for the borrowers with poor credit history records. Third, the absence of institutional complementarities, which institutions must compensate for each other's shortcomings rather than reinforce each other's incentives.

Following the sound principles of corporate governance leads to the creation of the necessary precautions against mismanagement, while promoting transparency in economic and the fight against fraud and corruption. The directors' responsibility is to ensure that effective corporate governance is applied in all relevant matters by establishing a compliance policy that governs the company's compliance with all applicable laws, including the establishment of effective compliance risk management policies and procedures and the obligation to prepare periodic reports regarding the compliance.[9]

Companies, whether they are public or private[10], that enjoy enduring success have core values and core purpose that remain fixed while their business

[8] Campbell, John. (2011). Campbell, John L. 2011. "The U.S. Financial Crisis: Lessons for Theories of Institutional Complementarity." Socio-Economic Review 9:211-234. 217-228.

[9] See OECD. (2004). OECD Principle of Corporate Governance. OECD. The UK Corporate Governance Code 2018, the main principles of the code.

[10] Most companies in KSA are private. Unfortunately, there are no official detailed statistics.

strategies and practices endlessly adapt to a changing world.[11] Therefore, to enjoy the prosperity, and to continue the progress, the companies need proper tools for managements, with well- designed management powers, duties and responsibilities, and that requires first to have a better understanding of the concept of the corporate governance and its related practices. According to Owen[12] that corporate governance is the rules and systems by which the power is practiced and controlled in corporations. Corporate governance focuses on internal and external corporate structures as well, in order to monitor the actions of the management.[13] Companies' accountability can be established through the corporate governance mechanism, and it also regulates the distribution of the responsibilities between the different participants including: directors, managers and shareholders claim.[14] The mechanisms of the corporate governance comprise: decisions and policies with the corporation and its agents, being designed for monitoring the actions.[15]

In view of increasing interest in the concept of corporate governance, many international institutions have taken care of it, especially OECD, which aims to assist countries to develop legal frameworks for the application of corporate governance through the OECD principles of corporate governance.[16]

As the globalisation of business introduced the concept of borderless business activities, these new phenomena need business management to be open and adopt management skills with the international dimension in mind, and give good consideration to the circumstances of the globalisation of business. One of the most prominent perspectives on current global business activities is Saudi Arabia's Vision 2030[17] that aims to increase the contribution of the private sector to the gross domestic product (GDP) and to attract foreign investment to

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[11] Collins, C., & Porras, J., I. (1996). Building Your Company's Vision. Harvard Business Review. September- October 1996, 74(5), 65.

[12] Owen, John., The Failure of HIH Insurance, Canberra: Commonwealth of Australia, (2003), ISBN 0975067826 (volume 3).

[13] Sifuna, A., P. (2012). "Disclosure or Abstain": The prohibition of Insider Trading on Trial". Journal of International Banking Law and Regulation, 27 (20).

[14] OECD. (2004). OECD Principle of Corporate Governance. OECD.

[15] Tricker, A. (2009). Essentials for Board Directors: An A-Z Guide, Bloomberg Press, New York.

[16] OECD. (2004). OECD Principle of Corporate Governance. OECD.

[17] See Saudi Arabia' vision 2030, available at http://vision2030.gov.sa/en access date 16/July/2018.

Saudi Arabia, which means wider economic openness to the world. Several large Saudi projects[18] will also serve as a centre for international communication in the economic, cultural, legal and other fields that have undoubtedly brought and will bring in many foreign companies. Therefore, Saudi Arabian Companies Law 2015 (SACL 2015) has been issued to provide a legal environment for incubators and incentives for the initiative and investment, in order to enhance the value of companies and develop their activities and contribute to Saudi economy. The SACL 2015 provides the appropriate legal framework for fair and sound corporate governance practices, institutionalising corporate business concepts, supporting the growth and sustainability of economic entities, improving the performance of enterprises and integrity of business transactions through the application of fair standards for transparency and disclosure, the role of shareholder meetings and boards of directors in corporate strategies and responsibilities for corporate activities. The SACL 2015 also recognises the concept of a holding company and a single company and recognises the interests of stakeholders. It is necessary for foreign companies and Saudi Arabia also to understand Saudi law and Islamic law; it is perhaps the best way to understand the law is to compare it with the laws of other countries such as the law of the UK, which is considered as a global economic centre.

In light of the foregoing, underlining the directors' powers and authorities and demonstrating practical problems which may result from some laws, as well as finding and presenting solutions, all play an important role in achieving stability for companies, with effects extending to the overall economic activity.

1.2 The significance of this study

The significance of this study lies in the importance of the sustainability of commercial companies in modern times, whether through job creation or community service by providing products or services in a stable manner; 62% of CEOs considered that corporate sustainability is essential to being

[18] For example *NEOM*, The Saudi *Aramco* listing in the capital (stock) markets, *Red Sea* project, The Saudi–Egypt Causeway that links Asia with Africa with a causeway and bridge, *Silicon Valley* in Saudi Arabia and others.

competitive,[19] thus supporting the country's gross domestic product (GDP). Also, many global companies have already taken steps in sustainability to create long-term value and enhance the company's longevity by taking into account the company's operation in an ecological, social and economic environment. These global companies have pledged to commit to sustainability, through transparency and addressing material issues.[20] The majority of companies are currently managed by non-owners due to the need for specialisation and experience that may not be owned by the majority of owners. The directors of companies must exercise the freedom to perform their duties as they deem fit for the success of the company, but this management of the company subjects to a number of controls and balances, both those contained in the legislation or the constitution of the company. The importance of these controls and balances is to prevent directors from abuse their position and hold them liable in the event of failure to comply with their duties. The successive global financial crises have shown the urgent need for corporate governance for corporate sustainability, by following the sound principles of corporate governance and promoting transparency and combating fraud and corruption.

In 2016, when the Crown Prince of the Kingdom of Saudi Arabia announced Saudi Arabia's Vision 2030, which aims to increase the private sector's contribution to GDP and attract foreign investment to the Kingdom of Saudi Arabia, which means wider economic openness to the world. Many large Saudi projects will serve as a centre for international communications in the economic, industrial, educational and other fields that have undoubtedly brought in many foreign companies. In March 2017, foreign capital in the Saudi market reached 651.6 billion Saudi riyals ($174 billion).[21] The UK companies operating in Saudi Arabia up to the first quarter of 2018 have been estimated at 46 UK

[19] See Knut Haanaes, Why all businesses should embrace Sustainability, International Institute for Management Development, (2016) available at <https://www.imd.org/contentassets/44380898a141424abb873f8774127bc4/tc082-16-print.pdf> accessed on 26 May 2020.
[20] Ibid.
[21] See 7707 foreign companies with investments of 652 billion riyals in the Saudi market. 24/3/2017 available at:<https://www.al-madina.com/article/515454/> accessed on 16 August 2018.

companies,[22] and 10 UK companies have been awarded a work permit direct investment in Saudi Arabia.[23] During the visit of the Crown Prince of Saudi Arabia, Prince Mohammed bin Salman to the United Kingdom in 2018 London witnessed signed agreements between Saudi institutions and companies and British companies to increase trade exchange to rise to 65 billion pounds in the coming period.[24]

One of the most attractive factors for foreign investment is the provision of an appropriate legal environment for investment that provides legal frameworks in a stable and fair manner, which will positively affect GDP. This is what happened recently in the Kingdom of Saudi Arabia through the enactment of SACL 2015 and other corporate governance laws that seek to adapt to global trade and attract more foreign investment into Saudi market. However, the company directors may in some cases, encounter conflicts under laws and practical reality, undermining their powers; in which case, many problems surface in actual reality. The conflict of laws or lack of explicit legal provisions may be one of these causes. Therefore, there are certain problems in – holding company directors liable – for acts which some may see as part of directors' powers, while others may find them beyond their powers.

This study will investigate the powers, duties and liabilities of the directors of companies in both Saudi and UK law; so as to make sure that the management practices of commercial companies meet the international standards, and if not, then the study will suggest the proper mechanism for doing so.

1.3 The aims and objectives of this study

As mentioned above, company directors may in some cases, encounter conflicts under laws and practical reality, particularly in relation to their powers.

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[22] See Country Companies on Ministry of Commerce and Investment available at:<https://mci.gov.sa/en/attache/britain/Pages/Country-Companies.aspx> accessed on 16 August 2018.

[23] See Saudi investment authority awards licenses to 10 UK firms. 09 March 2018 available at:<http://www.arabnews.com/node/1262596/business-economy> accessed on 16 August 2018.

[24] See U.K., Saudi Arabia Target 65 Billion Pounds of Mutual Investment. 7/3/2018 available at:<https://www.bloomberg.com/news/articles/2018-03-07/u-k-saudi-arabia-target-65-billion-pounds-of-mutual-investment> accessed on 16 August 2018.

Based on the above, the aims of this study is to investigate the powers and liabilities of the directors of commercial companies in both of Saudi and UK laws; so as to make sure that the management practices of commercial companies under Saudi laws meet the international standards, and if not, then the study will suggest the proper mechanism for doing so. It can be said that the objective of this study are:

> *To highlight and analyse company directors' powers, duties and liabilities through a critical evaluation of the legal regulation of these matters in Saudi Arabia and UK legislation, and clarifying the differences between these legal systems.*

1.4 Research questions

The study seeks to investigate the powers, duties and liabilities of the company directors in Saudi Arabia and compare them with the laws in the UK to ensure that the management practices of commercial companies under Saudi laws meet the international standards. This study will attempt to answer the main question, ***To what extent does the regulation of directors' powers, duties and liabilities work effectively?***

The study will focus on a critical evaluation of relevant legislation on the subject matter of the study.

1.5 Methodology

To answer the research question, this study will apply doctrinal, comparative and critical analytical methods of the relevant laws and literature. Doctrinal analysis is considered one of the most important legal research methodologies. This method usually deals with clarifying the history of laws, how the law was before and the law is now and how the law evolved, because strong doctrinal analysis to determine what is the law, is often a necessary introduction to research in other legal matters. Doctrinal analysis concentrates on traditional legal sources, such as cases and legislation.[25]

Comparative study means examining the differences and similarities between the laws of a variety of countries in different systems in the world, such as common law, civil law, Islamic law and other legal systems. The importance of comparative law has increased tremendously in the present age because of the economic globalisation. Its importance is that it helps to promote mutual understanding and dispel both prejudice and misinterpretation in this world. It also provides a platform for legal intellectual exchange and helps to broaden the horizons of legislators worldwide. Comparative law may also provide an overview of legal transplantation from another legal system, which will be dealt with in detail in this study.[26] This study will compare the relevant legislation in Saudi Arabia and the like on the UK side and other international organisations' law, and highlight the similarities and differences in what needs to be clarified, taking into account the circumstances, cultures and religions of each legislation. It is worth mentioning that the aim of the comparative study is not to search for the best legal system, but the purpose is to know more deeply the various legal systems and thus develop what we have. Montesquieu[27] believed that the laws must be adapted to each nation as it suits them.

The study will rely on collecting information on primary and secondary sources. The primary sources will include legislation and cases law in the UK and Saudi Arabia. Islamic law can be addressed in relation to legislation in Saudi Arabia, where the legal system in Saudi Arabia derives its provisions from provisions of Islamic law.[28] Therefore, with regard to Islamic law, the study will be

[25] Dixon, M. (2014). A doctrinal approach to property law scholarship. Who cares and Why?. Property Law Review, 3 160-165. available at <https://www.repository.cam.ac.uk/handle/1810/246249> accessed on 26 May 2020.
[26] See legal transplantation on 1.6.
[27] Charles de Secondat, Baron de Montesquieu, *The spirit of laws*, translated by Thomas Nugent, revised by J. V. Prichard, (1914) Based on a public domain edition by G. Bell & Sons, Ltd., London, 57. available at: <https://socialpolicy.ucc.ie/Montesquieu_constitution.pdf> accessed 30 July 2018.
[28] The Basic Law of Governance of the kingdom of Saudi Arabia 1992, art 7.

concerned with the provisions of the Qur'an[29] and Sunnah[30] and their interpretations and the sayings of the most prominent scholars of Islamic jurisprudence as it is relevant. In the event that there is more than one opinion of the scholars, the approach adopted in the thesis is to rely on the views of the senior scholars. In the case where the views are conflicting, the view that is based on the explicit evidence is adopted. Then, after that, we adopt the view that most scholars are agreed upon. The secondary sources will include the critical analysis of journal articles, books and other academic publications.

This study will depend on the UK side on the sources in English. As for the Saudi side and the Islamic law, the sources of the English language will be relied on, if any, and, if not, Arabic sources will be relied on.

1.6 Legal transplantation

Due to economic globalization, the importance of comparative law has increased significantly. Comparative law helps to promote understanding between countries and dispel both prejudice and misinterpretation. It is believed that it is impossible to understand a national law without use of comparative law.[31] Therefore, law scholars may benefit from other sciences in the application of comparative law or the reproduction of laws, for example, political science, economics, history, and religions may provide ideas on how to develop and apply comparative or cloned legal rules from another country and on the possibility of applying a law to different cultures.[32] This is because the law is more than just a set of written rules; the law is a social practice within a legal society that constitutes the actual meaning of the rules, institutions and the way in which society operates. The aim of comparative law is to do a systematic study of foreign laws in order to derive models that would help formulate and

[29] In the Islamic faith, the Quran is the verbally revealed by the God (Allah) to the prophet Muhammad (peace be upon him) through the angel Gabriel (Jibril), which is the last of the holy books.
[30] In the Islamic faith, Sunnah is the second primary sources of Islamic faith and law, which is based on all transmitted record of the teachings, deeds and sayings, silent permissions (or disapprovals) of prophet Muhammad.
[31] Mousourakis, George. Legal transplants and legal development: A jurisprudential and comparative law approach. (2013) Acta Juridica Hungarica, 54.3. 220.
[32] Mousourakis, (n 31) 220.

implement legislative policies of the countries.[33] It is believed that comparative law can provide those involved in law reform with a clearer perspective as to whether it is reasonable to fit into other systems and to what extent.[34] It also provides a platform for legal intellectual exchange and helps to broaden the horizons of legislators worldwide. Comparative law may also provide an overview of legal transplantation from another legal system.

Learning from other countries can be valuable, for example, when a country suffers from an economic or other problem, the benefit of a successful experience in another country may be considered. It is therefore frequently suggested that countries benefit from legal transplants. It is often assumed that legal transplantation can help legislators to choose the best ideas from anywhere in the world, especially when there is an urgent need for political and economic reform through legal transplantation to reshape broad areas of laws, which is necessary for economic and political reform.[35] Legal transplantation is common because most systems, if not all, have been able to integrate ideas from around the world, which is important for implementing successful legal models from other countries in order to stimulate development.[36] Watson believed that most changes in most legal systems are the result of legal borrowing, from the 17th century BC at the time of Hammurabi to modern transitions of European law to Eastern Europe.[37] Unprogressive countries rely heavily on external advice in lawmaking because of the lack of independent governance or a weakness sign.[38] Legal transplantation also save time and resources for international coordination in the legal field, particularly with regard to countries dealing with each other, such as the European Union and the Gulf Cooperation Council countries, to adopt the standard rules as part of domestic

[33] Ibid, 223-224, 227.
[34] Ibid, 230-231.
[35] Engelbrekt A, 'Legal and Economic Discourses on Legal Transplants: Lost in Translation.' (2015) Scandinavian Studies in Law, ISSN 0085-5944, Vol. 60, p. 111-140, 114-116; Mousourakis, (n 31) 227; Siems, Mathias. Malicious legal transplants. Legal Studies, 2018, 38.1. 103-104.
[36] Siems, (n 35) 113-114.
[37] Watson, A. (1974). *Legal transplants: An approach to comparative law* ([Virginia legal studies]). Charlottesville: University Press of Virginia. 95-96.
[38] Schauer, Frederick, et al. The politics and incentives of legal transplantation. (2000) Center for International Development at Harvard University. 3-4. Available at: < https://ideas.repec.org/p/cid/wpfacu/44a.html> accessed on 15 August 2018.

laws or within specific areas of law such as commercial law, transportation law, intellectual property law, the International Civil Aviation Organisation (ICAO) and the Comite Maritime International (CMI).[39] Harmony in laws enables countries accession to international organisations such as the World Trade Organisation and the European Union, which happened with the Baltic states and Eastern European countries to design their legal models on the lines of German models.[40] However, there are those who doubt the success of legal transplantation.

The concept of legal transplantation is used to denote the phenomenon of borrowing legal rules and institutions from a legal system and transferring them to another system.[41] It is claimed that the concept of legal transplantation first appeared in 1970 during the famous Watson controversy about its legitimacy and validity, but the fact that the concept of legal transplantation to describe the transfer of rules between countries was used earlier by Walton in 1927.[42] There are many concepts that are used to describe legal transplantation for example transfer, exports, influence, borrowing, importation and reception. Each term represents an attempt to visualise the legal transplantation.[43] There are also attempts to regulate this difference in nomenclature, for example, Ajani[44] divides the terminology contained in the legal transplantation into general terms and narrower concepts. General terms such as borrowing or influence refer to legal change processes. While narrower concepts such as legal transplants, or reception refer to transplantation.

It can be said that the debate over the legality and validity of legal transplantation revolves around three views. The first view is that the law can be transplanted without knowledge or concern in the context of the legal rules of the donor country, by taking a historical perspective of the enormous

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[39] Engelbrekt (n 35) 114-116 ; Schauer (n 38) 13-14; Mousourakis, (n 31) 219-223.
[40] Schauer (n 38) 13-14.
[41] Engelbrekt (n 35) 112; Watson, A. (1993). *Legal transplants: An approach to comparative law* (2nd ed.). Athens, Ga. ; London: University of Georgia Press. 21.
[42] Kviatek, B. (2015). *Explaining Legal Transplants: Transplantation of EU Law into Central Eastern Europe* [Groningen]: University of Groningen. 50.
[43] De Roo, A., Örücü, E., Jagtenberg, R., Transfrontier Mobility of Law, Kluwer Law International; 1 edition (1995) ISBN-9789041101709, 5.
[44] Ajani G, (1995) 'By Chance and Prestige: Legal Transplants in Russia and Eastern Europe.' 43(1) Am J Comp L 93. 93.

influence of Roman law on existing civil laws in Europe and elsewhere. Watson believed that the law is self-contained and develops independently of the social context and it develops through legal borrowing which is the main way for the legal development.[45] Therefore, Watson believed the theory that the law as a result of the needs of a particular society is incorrect. This is because historically, laws have not met the needs and aspirations of societies, although societies have maintained the laws for long periods of time. Societies also seem tolerant of unsuitable laws, and when the law change, it does so independently of the social context.[46] Kahn-Freund[47] agreed with Watson's view that economic, social and religious factors are no longer an obstacle to legal transplantation due to globalisation. While political factors are becoming increasingly important for legal transplantation, Watson[48] also called for the use of comparative studies to find similarities between different legal systems and to establish relationships between these legal systems. This corresponds to Walton's view[49] of the possibility of full legal transplantation in unprogressive countries that want to be near the level of progressive countries.

Contrary to the first view, Legrand believed in the impossibility of legal transplantation, as Legrand challenged the possibility of applying the legal transplantation.[50] Legrand also criticised comparative studies for the wrong focus on the similarities between laws rather than differences, with no benefit from focusing on similarities in practice and impracticality in understanding the laws.[51] The possibility of finding similarities between laws is minimal because the interpretation of legal rules is influenced by the cultural context at that time and place, which makes them different in practice, even if the legal rules appear to be written in the same form, thus it is impossible to establish relations

[45] Watson (n 37) 88.
[46] Watson, A. (2001). Society And Legal Change (2nd ed.) foreword by Paul Finkelman, Temple University Press, Philadelphia. 98-99.
[47] Kahn-Freund OO, (1974) 'On Uses and Misuses of Comparative Law.' 37(1) Mod L Rev 1. 8-11.
[48] Watson (n 37) 5-9.
[49] Walton, F. (1927) The Historical School Of Jurisprudence And Transplantations Of Law, Journal of Comparative Legislation and International Law Vol. 9, No. 4. 189-192.
[50] Legrand P, (1997) 'The Impossibility of Legal Transplants.' 4(2) Maastricht J Eur & Comp L 111. 113-114.
[51] Legrand P, (2003) "The Same and the Different" in Pierre Legrand and Roderick Munday (eds), *Comparative Legal Studies: Traditions and Transitions* (Cambridge University Press) 277-278.

between the various laws.[52] This is consistent with what Montesquieu believed as having little chance that the legal rules of a country will be suitable for another country.[53] It also emphasises that the law must be seen as an expression of people's convictions in the same way that languages and customs gradually grow as a historical process.[54] Legrand's view, the impossibility of legal transplantation, is based on the impossibility of separating legal transplantation from the social and cultural context; and the legal rules also change once they are transplanted from a legal system to another.[55]

There is a third opinion, which lies between the two previous camps. It believes that there is a possibility of legal transplantation, but the social and cultural context must be considered during the process of legal transplantation. Örücü[56] believes that transferred legal rules must introduce into the recipient system so as to suit the social culture and the needs of the recipient country. Kahn-Freund agreed that the consideration of the social and cultural context is critical to the development and transplantation of the law. Kahn-Freund believed that not all legal rules can be transferred; there are degrees of transferability, so the degree to which any legal rule can be transplanted depends on the extent of its integration into the cultural context. Therefore, he believed the legal transplantation can be rejected and cannot be placed in the recipient country without suitable diagnosis and care.[57] On this aspect, Örücü[58] emphasises that the fine-tuning the laws transferred by the appropriate authorities of the recipient country is the key to success the legal transplantation. Therefore, according to this view, legal transplantation often fails due to the lack of proper application or not fine tuning the laws transferred or the inadequacy of laws and resulting non-integration into the cultural context of the recipient country.

Since this comparative study deals with the duties and liabilities of the company's director in the UK and Saudi Arabian law. It may provide a platform

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[52] Legrand (n 50) 277-278.
[53] Montesquieu (n 27) 57.
[54] Kviatek (n 42) 50-51.
[55] Legrand (n 51) 277-278.
[56] Örücü E, (2002) “Law as Transposition” International and Comparative Law Quarterly, 2002, Vol.51(2), pp.205-22, 207.
[57] Kahn-Freund (n 47) 6-17.
[58] Örücü (n 56) 7.

for legal intellectual exchange and help to broaden the horizons of legislators in Saudi Arabian, the UK or elsewhere, which may help the idea of legal transplantation from another legal system according to the cultural context of the recipient country.

Chapter Two: Legal principles with respect to company directors and board of directors

2.1 Legal principles with respect to company directors

2.1.1 Who is a director?

The company director is considered as the main human actor of the company, which is the natural legal person able to do the legal acts of the company towards others, whereas, without the directors, companies cannot achieve the desired purposes. Believing in the importance of a director, the UK legislator addresses the definition of a director in the Companies Act 2006 (CA 2006). The CA 2006 provides that the director is any legal person who holds the position of director by any name called.[1] The CA 2006 also stipulates that there must be a minimum number of natural persons as directors of the company[2], whereas before the CA 2006 it was not required to appoint a natural person as a director. However, after the Small Business, Enterprise and Employment Act 2015 goes into force, non-natural legal entities will not be able to act as company directors, s 87 states that the directors of all companies must be only natural persons.[3]This formulation of the definition of the director does not seem to be precisely defined for the director, and this may be due to the fact that the UK legislator wants this definition to include all those who practice the actual functions of the director and participate in decision-making, whether this legal person is appointed and registered as a director in accordance with the required procedures "*de jure*" or not "*de facto*". This flexibility in definition fits with the commercial nature of companies. This flexibility also includes a wider range of responsibility, including all those who exercise the role of director and who have not formally registered or shown themselves as directors for any reason.

Accordingly, this definition includes shadow directors, *de jure* directors and *de facto* directors. Despite this flexibility and comprehensiveness in the definition of the director, the legislator provides the definition of shadow directors, stating

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[1] CA 2006 s 250.
[2] CA 2006 s 155.
[3] Small Business, Enterprise and Employment Act 2015 s 87.

that the shadow director is a legal person that the company directors are accustomed to acting in accordance with his/her directives and instructions.[4] This custom of following the directions and instructions of the shadow director must be instinctive and company directors must be without the use of their independent judgment in making decisions.[5] Although the shadow director definition includes all legal persons, whether they are a natural person or not, there are exceptions to this definition. The first is the person will not be considered a shadow director of a company if s/he advises as a professional capacity, without exceeding the scope of professional advice in their respective fields, and the company directors act in accordance with this advice and instructions. The second exception is that the parent company will not be considered a shadow director of its subsidiary companies if any subsidiary company acts in accordance with the instructions and instructions of the parent company for the purposes of directors' duties, transactions requiring members' approval or contracts with sole member who is also a director. In *Smithton v Naggar*,[6] the Court of Appeal held that the holding company director was not a *de facto* or shadow director of its subsidiary.

The *de facto* director is close in concept to the shadow director. Some legal persons serve as official directors "*de jure*", although they are not appointed. Courts apply the legal duties of the directors to these persons, even if they are not formally appointed, and they are treated as *de jure* directors. The English Court of Appeal, therefore, held that the distinction between a shadow director and a *de facto* director actually is not always clear.[7] However, Millett J in *Re Hydrodan (Corby) Ltd*[8] made a distinction between *de facto* directors and shadow directors. Millett J believed that *de facto* director acts as a person claiming to act as a director despite s/he has not been appointed or validly appointed, and the company hold out her/him as a director. Otherwise, a shadow director does not pretend or claim to be a director, but rather rules out themselves and hide behind others who claim to be directors, whether they are

[4] CA 2006 s 251.
[5]See *Lord (Liquidator of Rosshill Properties Ltd) v Sinai Securities Ltd* [2004] EWHC 1764 (Ch); *Re Hydrodan (Corby) Ltd* [1994] B.C.C. 161.
[6] [2014] B.C.C. 482.
[7] See Millett J in *Re Kaytech International Plc*. [1999] B.C.C. 390.
[8]*Re Hydrodan (Corby) Ltd* [1994] B.C.C. 161.

de facto directors or *de jure* directors, and that the company does not hold out the shadow director as a director; and these directors follow the directions and instructions of the shadow director instinctively without using their independent judgment in making decisions. Morritt L.J in *Secretary of State for Trade and Industry v Deverell,*[9] believed that the board's exercise of independent judgment does not preclude a person's liability for being a shadow director. However, Timothy Lloyd QC in *Re Richborough Furniture Ltd*[10] had a different view of what Millett J said in that a person is liable as a de facto director. Timothy Lloyd QC believed that the court must have clear evidence that s/he is the sole person directing the affairs of the company, and if there are other directors, it is necessary to prove that the person "*de facto*" acted on an equal footing with others in directing the affairs of the company. Concerning equality principles, Lewison J argued, in order to impose fiduciary obligations, there must be a direct relation of trust and confidence between the shadow director and the company.[11] In *Popely v Popely,*[12] Hacon QC (sitting in the High Court) mentions the principles relevant to *de facto* director. They are:

> *"[s/he must] be part of the corporate governing structure of the company.... [and] assumed a role in the company which imposed on him the fiduciary duties of a director.... [which] assessed objectively by reference to all the relevant evidence. Merely being involved in the management of the company or exercising a degree of influence over its decision making is not in itself enough. An act will qualify as an act done in the capacity of a de facto director if the corporate governance of the company requires that an act of that nature can be done only by someone having the capacity of a de jure director. If the individual enjoyed some other capacity in which he could properly have done the act, it will not have been done as a de facto director. It is possible for an individual to be simultaneously a de facto director and a shadow director of a company. The capacity in which he acts in relation to the company will depend on the nature of the act.*

[9] *Secretary of State for Trade and Industry v Deverell* [2001] Ch. 340.
[10] [1996] B.C.C. 155.
[11] *Ultraframe (UK) Ltd v Gary Fielding* [2005] EWHC 1638 (Ch) at 1286.
[12] [2019] EWHC 1507 (Ch) at 88.

[But] an act cannot be simultaneously carried out both in the capacity of a shadow director and a de facto director".

In examining the scope and nature of the general duties of company directors, some practical problems arise. In s 170(5) of the Act the extent to which general duties apply to shadow directors is explained by stating that the general duties apply to the extent applicable to corresponding common law rules or equitable principles. This formulation may have been contested by the Grand Committee in the House of Lords, since the comprehensive application of the duties may not be appropriate.[13] The Committee proposed to amend the phrase to "to the extent it is reasonable, just and equitable for any such general duty to apply".[14] The aim is to grant courts discretion in deciding whether or not to apply the duties to shadow directors in a proportionate manner.[15] Although the government refused to change the wording of the law, the government acknowledged that it was important not to place shadow directors in a worse position than directors, where directors might be relieved from liability in some circumstances, other than shadow directors.[16] Accordingly, it does not prevent courts from considering the application of duties on a case by case basis or from relying on existing case law.[17] After the Small Business, Enterprise and Employment Act 2015 came into force, s 170(5) of the Act has been amended to read as "*(5) The general duties apply to a shadow director of a company where and to the extent that they are capable of so applying.*"[18]

The problem for shadow directors is that they cannot meet two duties, duty to avoid conflicts of interest and duty not to accept benefits from third parties. The reason for this lies in their not claiming or acting as directors of the company.[19] In *Instant Access Properties v Rosser*,[20] Rosser was alleged to have violated the duty not to accept benefits from third parties and the duty to avoid conflicts

[13] Baroness Neville-Rolfe, Hansard, Grand Committee, Column GC338(19 January 2015).
[14] Ibid, Column GC337-338.
[15] Ibid, Column GC338.
[16] Ibid.
[17] The Explanatory Notes for Small Business, Enterprise and Employment Act 2015, s 89.
[18] Small Business, Enterprise and Employment Act 2015 s 89.
[19] *Re Hydrodan (Corby) Ltd* [1994] B.C.C. 161; Hansard, Grand Committee, Column GC339 (19 January 2015).
[20] *Instant Access Properties v Rosser*, [2018] EWHC 756 (Ch).

of interest. Rosser denied breaching duty not to accept benefits from third parties, and with regard to the duty to avoid conflicts of interest said he disclosed the dispute to the board and the shareholders. These differences in duties between directors and shadow directors were to be taken into consideration by the legislature when drafting the law. On the other hand, there are those who look at the positive aspect of the harshness of the law on shadow directors as the consequences will be good for promoting loyalty and care from those who are involved in guiding companies.[21]

In the SACL 2015, there is no explicit definition of a director, despite the importance of its definition, as if the Saudi legislator believes that the word "director" is clear, without the need to clarify it by definition. Instead of defining what a director is, the Saudi legislator clarifies what a director shall undertake and what shall not undertake of actions.[22] As if Saudi legislator believes that defining the director by their work and actions better than establishing a definition. Unlike the UK legislator, the Saudi legislator does not address the shadow director issue. The legislator repeatedly stipulated that the company shall be managed by one or more appointed directors and the company shall be bound by any acts performed by the appointed directors, which may mean it is implied that in KSA there is non-recognition of shadow directors and de facto directors in the face of commitments purported to be undertaken by the company towards a third party.[23] The simple truth here is that the position is unclear in Saudi Arabian law.

By examining Saudi Arabian Commercial Court cases, a single case implicitly recognised *de facto* directors. In the suit before the Commercial Court,[24] the company claimed for compensation for the company's losses against its director. The director defended this claim by asserting that he was a fictitious director, as he was appointed only to complete the administrative procedures required to register the company, and days after the completion of the administrative procedures to register the company, a brother of one of the

[21] S Witney, Duties owed by shadow directors: closing in on the puppet masters?, [2016] J.B.L. 321.
[22] SACL 2015 arts 31 and 32.
[23] SACL 2015 arts 23, 68 and 164.
[24] The Saudi Arabian Commercial Court judgments, 1289/Q (2016).

shareholders was appointed as a director by the shareholders' decision, but his name was not officially registered as the company director in the company's register with the Ministry of Commerce. Also, the new director had an office in the company in the name of the general director's office, he was meeting employees and clients in it, also he has the power to issuing orders and signing documents belong to the company. As for the defendant (fictitious director), he was divested of his powers and his work became more like the work of the secretary. Accordingly, the court ruled that the claim rejected and that the compensation claim should arise against the actual director who was appointed by the shareholders' decision.

2.1.2 Appointment of directors

A company, as a legal person, is not able to do legal acts that fall within the scope of its purpose except by the agency of a natural person who is a director. The CA 2006 and SACL 2015 define the provisions on corporate governance in terms of the number of directors, the methods of appointment and specific terms in directors.

The appointment of company directors is subject to several requirements, such as a specific required age of the directors and minimum numbers of directors. The UK laws identify the legal age for occupying the position of company director as stated in the CA 2006 that, a director must be attained sixteen years old for the appointment to be valid;[25] and the Secretary of State has the power to enact a provision for exceptions from the minimum age requirement.[26] Whereas the SACL 2015 does not state the minimum legal age for occupying the position of director, although there is a decision to determine the age of majority by the age of eighteen years by the Shura Council - the kingdom of Saudi Arabia.[27] The CA 2006 also identifies the director of a company as a person who occupies the position of director, by whatever name called as long as the required minimum number of the natural person directors is met[28], while before the CA 2006, a company was eligible to be appointed as a director of

[25] CA 2006 s 157.
[26] CA 2006 s 158.
[27] The Shura Council decree (114) in 1955.
[28] CA 2006 ss250 and 155.

another company without any required minimum number of the natural person directors. However, after the Small Business, Enterprise and Employment Act 2015 goes into force, non-natural legal entities will not be able to act as company directors, as s 87 states that the directors of all companies must be only natural persons, with some powers for the Secretary of State to exclude cases in which non-natural legal entities may be appointed as a director of a company.

The reason for prohibiting the use corporate directors as a director is to encourage transparency, which reflects the common concerns among the G-20 and OECD regarding disclosure of company ownership and control.[29] It is recognised that companies can only act through their directors, which is the case for corporate directors, where they have to follow the instructions of their boards which may be the boards of these companies are companies 'commercial entities'.[30]This restriction is coming for the undesirable chain of command because in this chain the directors of the company can be hidden and exploited this in matters other than illegal.[31]It is also in case a corporate director is a shadow director or *de facto* director, there will be an obstacle to prove it.[32] Therefore, those who control a corporate director are relatively isolated from the consequences of decisions taken with regard to the company they manage.[33]

However, abuse by some does not mean harming other companies that legitimately benefit from existing flexibility, so it is required at least one natural person as a director in the CA 2006, if necessary to hold the company accountable or take direct responsibility.[34]While, the SACL 2015 allows any legal person to be a director of a company, even if such the legal person is not

[29]G20/OECD, ‘Principles of Corporate Governance’ (2015) I/A.
[30] Report of the Company Law Committee (June 1962), Cm.1749, The Report of the Patton Committee on Company Law Amendment in Northern Ireland (para 17).
[31]Jason Ellis, The Continued Appointment of Corporate Directors: An Examination of the Effect of S.87of the Small Business, Enterprise and Employment Act 2015, (2016), 37 Company Law. 203, 204.
[32]*Re Hydrodan (Corby) Ltd* [1994] B.C.C. 161.
[33]*Secretary of State v Hall* [2006] EWHC 1995 (Ch); [2009] B.C.C. 190; Report of the Company Law Committee (June 1962), Cm.1749, The Report of the Patton Committee on Company Law Amendment in Northern Ireland (para 17).
[34] White Paper "Company Law Reform" (March 2005), Cm.6456, para.3.3.

a natural person such as a holding company, managing its subsidiaries or taking part in the management of other companies in which, it holds shares.[35]

Companies might be administered by more than one director because of its need or in accordance with its memorandum of association. Although the CA 2006 expressly states that the number of directors must not be less than one director in a private company and two directors in a public company[36], it must comply with the minimum number of directors that is prescribed in the company's articles and if a company has fewer than prescribed, the directors cannot act unless there is a provision in its articles addresses this situation.[37] While in the SACL 2015 and SACGR 2019, a specific number of directors is not addressed, except to require the number of members of the board of directors is specified so that not less than three and not more than eleven members and the law mandates the administration of a joint stock company to its board of directors.[38]

In this context, it is worth address the diversity of the composition of boards, as pressure is mounting on the boards to have a policy of diversity in the boards and gender balance in senior management and its relation to the strategy of the company and how to implement it.[39] The SACL 2015[40] and related laws do not provide for any promotion of the diversity of the composition of boards. Rather, SACL 2015 only requires that a board member shall have the required experience and competence. However, Saudi Arabia's Vision 2030[41] aims to increase women's participation in the workforce from 22% to 30% in 2030. The indicators of the first half of 2020 showed through the report issued by the Saudi Arabian General Authority for Statistics that empowering Saudi women and increasing the share of their participation in the labour market has increased

[35] SACL 2015 art 183(a).
[36] CA 2006 s 154.
[37] See *Re Alma Spinning Co, Bottomleum Co* (1880) 16 ChD 681; *Re Scottish Petroleum Co,* (1883) 23 ChD 413.
[38] SACL 2015 art 86(1).
[39] The UK Corporate Governance Code 2018, Principle J prevision 23 p.9.
[40] SACL 2015 art 70.
[41] See Saudi Arabia' vision 2030, available at http://vision2030.gov.sa/en access date 4/December/2020.

from 25.9% Q1/2020 to 31.4% in Q2/2020.[42] However, the debate about the advantages and disadvantages of diversity cannot be underestimated. Of diversity advantages, enhancing the independence and creativity and stimulates the board on the diversity of different perspectives; the presence of personalities from different backgrounds and ethnic experiences means finding different solutions to problems in a company and making decisions at a high level of quality.[43] The diversity is also a professional incentive which is an incentive for employees to do their best for career advancement regardless of race or gender and the like.[44] The benefit of diversity is about public relations and social responsibility in terms of understanding the needs of society and enhancing the company's reputation in the view of the public, the media and the government is clear.[45]

By contrast, diversity has potential disadvantages. One of these shortcomings is conflict, lack of cooperation and inadequate communication. The problem may be the possibility of a lack of communication between senior executives and minority outside directors.[46] Diversity may also result in a preference for directors with insufficient experience or qualifications only for increasing the diversity in the board.[47]

The CA 2006 does not explicitly specify who is responsible for appointing company's directors although it stipulates that it must be included in the registration application that, a statement of the company's proposed officers which contain the person who is to be the first director of the company.[48] The appointment of directors is usually in accordance with the provisions of the articles of the company. In case of the absence of the provisions of the directors'

[42] See Labor market statistics Q2 2020 by the Saudi Arabian General Authority for Statistics at <https://www.stats.gov.sa/sites/default/files/LM_2Q2020%20%28Press%20release_EN%20%29.pdf> [accessed on 4 December 2020].
[43] Ferreira, D. (2011). Board Diversity. In Corporate Governance: A Synthesis of Theory, Research, and Practice (pp. 225-242). John Wiley and Sons, p. 227; Rao, K. & Tilt, C. J Bus Ethics (2016) 138: 327. p.337 available at <https://doi.org/10.1007/s10551-015-2613-5> Accessed on 16 November 2018;Erhardt, N., Werbel, J., & Shrader, C. (2003). Board of Director Diversity and Firm Financial Performance. *Corporate Governance: An International Review*, 11(2), 102-111.
[44] Ferreira (n 43) p. 227.
[45] Ferreira (n 43) p. 228; Rao & Tilt (n 43) p.338-339.
[46] Ibid.
[47] Ibid.
[48] CA 2006 s9(4)(c) and s12(1)(a).

appointment, the appointment shall be made by the members of the company who have an inherent power to appoint directors by an ordinary resolution or by a decision of the directors.[49] In all cases of the appointment a person as a director of a company, it is required a desire of the person in order to be valid appointment.[50] The SACL 2015 differentiates between the types of companies in the appointment of directors and specifies the shareholders as the responsible for appointing directors in companies in general, whether such an appointment is stipulated in the articles of association or in a separate contract. In the joint stock company, a board of directors, that is appointed by the constituent general meeting for the first board of directors and then by the regular general assembly, is responsible for the administration of the company[51] and appoint the Chief Executive Officer of the Company.[52] It also must call the regular general meeting to convene when the number of directors' falls below the minimum prescribed to achieve the quorum by electing the required minimum number.[53]

It can be said that the appointment of directors can occur in **<u>two</u>** ways, the first directors and the subsequent directors' appointments. The model articles for public companies 2008 state that the first directors' appointment, which usually the appointment of first directors be in accordance with the provisions of the company articles; and in the case of the provisions absence of the directors' appointment, the appointment shall be made by the company members who have an inherent power to appoint directors by an ordinary resolution or by a

[49] The Companies (Model Articles) Regulations 2008 (SI 2008/3229) reg 20.
[50] The Companies (Model Articles) Regulations 2008 (SI 2008/3229) reg 17 (the phrase "who is willing" is a condition in order to be the appointment valid.); In *Re CEM Connections Ltd,* [2000] BCC 917the official receiver sought the disqualification of a director. The director contended that the application should be dismissed on the basis that she had not been appointed as a director. The official receiver submitted that the director had signed form 288 recording her consent. However, the application in respect of the director and seeking the disqualification was dismissed, on the grounds that the director had not been validly appointed as a director of the company. Whilst the signing of form 288 was prima facie evidence that a person had consented to act as a director, there was strong evidence in the instant case that the director had not been aware of the true nature of any of the forms she had signed.
[51] SACL 2015 arts 25, 63, 86, 75 and 164(1).
[52] SACGR 2019 art 25(3).
[53] SACL 2015 art 70(2).

decision of the directors. This director must retire from office at the first annual general meeting unless they are reappointed by the members[54].

The subsequent directors’ appointment can be made after the appointment of the company's first directors, as the company, by the members or directors, might need to appoint other directors either a supplement the quorum stipulated in the CA 2006 or in the company's articles, or fill a vacancy due to a director's resignation from office. The 2008 model articles grant the members the powers to appoint a person as a director by an ordinary resolution.[55] It is worth noting that the appointment motion of two or more directors, at a general meeting of a public company, must not be made by a single resolution unless this resolution has first been agreed to by the meeting without any vote being given against it.[56] The model articles of 2008 also empower directors to appoint a person as a director in the company[57]. This power may be exercised to complete the minimum quorum of the company, provided for in the CA 2006 and in the company's articles, so that the directors can act to administration the company after the quorum is achieved. The model articles for public companies 2008 state that a director who is appointed by the directors must retire from office at the first annual general meeting unless they are reappointed by the members[58].

2.1.3 Removal of directors

As the appointment of the director has methods, the removal of the director has also methods and provisions defined by the CA 2006 and the SACL 2015 and other relevant laws. In UK laws, the removal of directors has ways whether by a resolution of the members, resignation or under the constitution and articles of the company.

The company's members have significant legal authorities. The CA 2006 grants the company's members the power to remove a director from office at any time by issuing an ordinary resolution for this purpose, regardless of the existence

[54] The Companies (Model Articles) Regulations 2008 (SI 2008/3229) reg 20 and 21(1).
[55] The Companies (Model Articles) Regulations 2008 (SI 2008/3229) reg 20(a).
[56] CA 2006 s 160(1).
[57] The Companies (Model Articles) Regulations 2008 (SI 2008/3229) reg 20(b).
[58] The Companies (Model Articles) Regulations 2008 (SI 2008/3229) reg 21(1).

of any terms in the contractual agreement between the director and the company.[59] However, this resolution must be at a meeting of the company, in accordance with the required procedures.[60] The director may also protest against the removal resolution and hear it at the meeting.[61] Removal of the directors from their office at any time regardless of the existence of any terms in the contractual agreement between the directors and the company does not mean that they are deprived of their rights, the provisions of their contracts with the company are applied including compensations for dismissal during the period of validity of their contracts.[62]

In this regard, it should be noted that the power of the members to remove directors from their position by ordinary decision does not mean the derogating of any power that may exist apart from the CA 2006.[63] In *Bushell v Faith*,[64] there were 3 members and each member owned 100 shares. In the articles of association, each share shall be equal to one vote. But, in the case of a vote on the dismissal of a director, the director shall have 3 votes for each share. Two of the members decided to remove the third member from the position of a director and they thought that they had 200 votes against 100. But the reality was they had 200 votes against 300 votes. The members objected to the fact that the weighted votes infringed s184 of the Companies Act 1948 and appealed to abolish it. Since there is nothing in the Companies Act and common law to prevent some shares from being given special voting rights, the court affirmed that the provision in the articles of association was not contrary to s184 and was therefore not void. Thus, the director cannot be removed save by a special resolution or an extraordinary resolution or in any agreement between the company and the director. The two members' appeal was dismissed. The judgment in *Bushell v Faith*[65] has been criticised as it is contrary to the spirit of s184 of the Companies Act 1948. Also, the judgment promotes the idea of “a mockery of the law” and it nullifies the existence of the legal provisions to

[59] CA 2006 s 168.
[60] CA 2006 ss 169, 228, 303 and 338.
[61] CA 2006 s 169.
[62] CA 2006 s 168.
[63] CA 2006 s 168(5)(b).
[64] [1970] A.C. 1099.
[65] [1970] A.C. 1099.

remove directors.[66] In addition, the validity of weighted voting clauses in the UK indicates legal provisions can be manipulated, thereby losing their practical worth. [67]

Directors may also wish to terminate their appointment by resignation for any reason.[68] This resignation must be in accordance with the required procedures in the articles of association of the company and the terms of the contractual agreement between the director and the company. Otherwise, the company shall have the right to refuse the resignation. The resignation may not necessarily mean the termination of the relationship between the director and the company; directors may then be liable for their resignation in accordance with wrongful trading provisions.[69] Directors who have resigned are also still subject to the duty set out in s 175 duty to avoid conflicts of interest, with respect to the exploitation of any property, information or opportunity of which they became aware during the time they occupied the director position; and the duty under s176 duty not to accept benefits from third parties, in respect of matters completed or omitted by them prior to their ceased from serving as director.[70]

The company's constitution may also provide for some cases where a director must be removed from the office. The Model Articles 2008[71] specify some cases that lead to the termination of the directors' appointment automatically. Of these cases the existence of a bankruptcy order against the directors or making any composition with their creditors in general, also if a director is physically or mentally unable to act as a director and may remain so for more than three months on the written report by a medical practitioner, or suffers from a mental disorder, a court makes an order prohibiting, in whole or in part, that person

[66] Cassim, R. (2019). The Device of Weighted Votes in Blocking the Removal of Directors from Office under the South African Companies Act 71 of 2008. 63(2), 281-302.
[67] Griffin, S., Hirst, Michael, & Walton, Peter. (2006). *Company law: Fundamental principles* (4th ed.). Harlow: Pearson Longman, 288.
[68]The Companies (Model Articles) Regulations 2008 (SI 2008/3229) private companies reg 18(f), public companies reg 22(f).
[69] Insolvency Act 1986 s 214.
[70] CA 2006 s 170(2).
[71] The Companies (Model Articles) Regulations 2008 (SI 2008/3229) reg 18 of privet companies and reg 22 of public companies.

from exercising any powers or rights in person. Companies also have the full right to add other reasons in their articles to terminate directors' appointment.

In SACL 2015 the removal of directors from their position has ways and circumstances. This removal depends largely on the form of the company and the circumstances of the director. In General Partnerships, the removal of a director depends on **two** main things which are first, is the director a partner in the company or not? Secondly, has the director been appointed in the General Partnerships' articles of association or in a separate contract? In the case that the director is a partner in the company there are two cases. (1) If the director has been appointed in the articles of association, then in this case s/he has immunity against the termination except by a decision issued by the competent judicial authority at the request of the majority of partners.[72] The removal of a director other than this manner (the judicial authority) shall entail the dissolution of the general partnership unless the general partnership's articles of association provides otherwise.[73] (2) While if the director is a partner and s/he has been appointed in a separate contract, then in this case s/he may be terminated by an ordinary resolution from the partners.[74] Finally, with respect to General Partnerships, if the director is not a partner, s/he may have office terminated by a resolution from the partners, whether the director has been appointed in the articles of association or in a separate contract.[75]

Similarly, in the resignation of a director, the managing partner appointed in the articles of association must not resign unless for a cogent reason, otherwise s/he shall be liable for the compensation and her/his resignation shall result in the dissolution of the General Partnership unless the articles of association provides otherwise.[76] A non-partner director appointed in the articles of association or a director appointed by a separate contract, whether a partner or non-partner, may resign provided that the resignation occurs on the right time and the director notifies the partners before the resignation takes effect at a

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[72] SACL 2015 arts 33 and 34; the term 'partners' is used in the official translation of SACL 2015 rather than the terms 'members or shareholders'.
[73] SACL 2015 art 33(1).
[74] SACL 2015 art 33(2).
[75] SACL 2015 art 33(2).
[76] SACL 2015 art 34(1).

reasonable period, otherwise the director shall be responsible for a compensation.[77]

In a limited liability company, the shareholders have full freedom to remove a director, whether the director is appointed in the company's articles of association or in a separate contract, without prejudice to their right to compensation due to removal.[78] The SACGR 2019 stipulates that the ordinary general assembly may dismiss all or any of the board members of directors at all time. The ordinary general assembly also, upon the recommendation of the board of directors, may terminate the membership of absent members of the board of directors from attending three consecutive meetings without a legitimate excuse.[79]

2.1.4 Directors' disqualification

Many companies follow the approach of separation between ownership and control that is the basis of the agency's theory, which takes into account the difference that may arise between directors and shareholders in the management of the company. This separation is due to the creation of limited liability companies. This created significant difficulties in respect of how companies with limited liability status could be effectively controlled. Recognition of this limiting liability has prevented the courts from looking to the members for reparation more than the extent of their shareholding when the company is caused damage to individuals or the environment. Therefore, there are many restrictions on an investor's ability to deal with bad practices within companies. One of the aims of this separation of ownership and control is for companies to look beyond shareholders to broader stakeholders, as companies avoid actions that could put employees or the public at risk, delay payment of creditors, or embrace risky ventures just to increase revenue.[80] However, this theory is not enough to curb the drivers of human behaviour that may affect directors' decisions. In order to ensure that directors comply with their duties

[77] SACL 2015 art 34(2)(3).
[78] SACL 2015 art 165(1).
[79] SACGR 2019 art 19(a).
[80] Alsharqawi, A., (2019) Separation of Ownership and Control in Corporate Governance, Journal of Law, Policy and Globalization, Vol.84, 65-72, DOI: 10.7176/JLPG.

towards the company, to maintain the integrity of businesses environment and to protect stakeholders from those who misuse limited liability, the Company Directors Disqualification Act 1986 was enacted to disqualify a person for a specified period from being a company director.

It was the former position that disqualification of directors could only be by the courts, but in the Insolvency Act 2000 an administrative equivalent was added to the order of judicial disqualification, the so-called disqualification undertaking, and was voluntary without the need for judicial proceedings.[81] This administrative equivalent has the same effect as the court order, once it is accepted by the Secretary of State and can only be amended by order of the court. The benefit of this administrative equivalent is not to incur trial costs on the directors disqualified.[82]

It should be noted that the directors' disqualification proceedings are considered as a civil process, but the violation of the order of disqualification is the commission of a criminal offence and can be fined and sent to prison for up to two years, and extend the period of disqualification and impose personal liability for any debts incurred by the company during that period.[83] It has been agreed that the entry of a director into illegal transactions is a sufficient reason for disqualification as a director on the basis of unfitness.[84] In view of the Company Directors Disqualification Act 1986, the disqualification of directors can be classified as disqualification due to misconduct and unfitness.

Misconduct includes conviction a person of an indictable offence in respect of the company or a continuing default with respect to the provisions of the companies' legislation requiring any return, account or documents that must be provided to the registrar of companies.[85] The discovery of the commission of fraudulent trading during the liquidation of the company and participation in wrongful trading or the fact that a person exercises as a director and has an

[81] Insolvency Act 2000, s 6.
[82] Company Directors Disqualification Act 1986 and Failed Companies: A Guide to Director Disqualification, November 2017, p.4.
[83] Company Directors Disqualification Act 1986, ss 13, 14 and 15.
[84] See *Re Looe Fish Ltd*. [1993] BCLC 1160.
[85] Company Directors Disqualification Act 1986, ss 2 and 3.

undischarged bankruptcy of all this within the misconduct.[86] In all previous cases, misconduct is considered regardless of whether the company was within or outside the UK.

As for disqualification due to unfitness, based on a satisfactory application that the conduct of a person as a director of a company is unfit to be concerned in the management of a company; or appeared to the Secretary of State for the public interest based on a report inspectors disqualify a person from being a director.[87]The legislator grants the court the discretion to determine whether the director is unfitness, taking into account, among other things, a violation of fiduciary or other duties of directors; or mismanagement of the company in non-compliance with the provisions of the Companies Act to maintain the accounting records and records of directors, secretaries and members, or failure to achieve the annual return and other matters contained in the Companies Act.[88]

In view of the reasons for the disqualification of directors mentioned above, it is clear that they are closely linked to the application of the general duties of directors as required without prejudice to them. This is because the breach of the duties mentioned in the CA 2006, is considered to be either misconduct such as breaching the duty not to accept benefits from third parties; or unfitness such as breaching the duty to exercise reasonable care, skill and diligence.[89]

It is worth addressing the matter of the impact of conduct in the event that it occurs outside the United Kingdom on directors' disqualification. The UK laws are clear in the application of the disqualification of directors in the event of what would be considered misconduct, regardless of whether the company was within or outside the UK. This may be for protecting the UK labour market by allowing the Secretary of State to seek to prevent them from managing companies.[90] On the contrary, if a person is convicted of misconduct within the United Kingdom, is there an external influence in a country where there are no similar regulations to be disqualified. As is well known, because of the principle

[86] Company Directors Disqualification Act 1986, ss 4, 10 and 11.
[87] Company Directors Disqualification Act 1986, ss 6 and 8.
[88] Company Directors Disqualification Act 1986, s 9, and Schedule 1.
[89] CA 2006, ss 171-177.
[90] CA 2006, s 1184; Small Business, Enterprise and Employment Act 2015, s 104 (5A).

of sovereignty there can be no obligation not to exercise a person in a country where these regulations are not applied. However, the Supreme Court in *Bilta (UK) Ltd (In Liquidation) v Nazir,*[91] unanimously held that section 213 of the Insolvency Act 1986 on fraudulent trading has an extraterritorial effect because the effect of winding up of a company could not be regional but extended all over the world.

In Saudi Arabia, there is no explicit law for the disqualification of directors, but there are some regulations not to nominate for the position of the board of directors any person who has been convicted of an offence against honesty.[92] There are also rules to form the boards of directors of the joint stock companies, in that they consist of persons who meet the conditions of expertise and adequacy of the honesty, in addition to not being a state employee, not being convicted of a crime, not being insolvent or bankrupt, not acting in a manner otherwise in financial markets, commercial business rules, not being a member of more than five listed companies, having scientific and practical experience, committed to the provisions of the laws, regulations and instructions, have sufficient time to work and having independent judgment and non-conflict of interest.[93] The Saudi Arabian legislator should enact a law that is similar to the UK Company Directors Disqualification Act 1986 to protect companies and the Saudi Arabian market, provided that its provisions do not contradict the provisions of Islamic law[94] and human rights principles. For further details see para 7.3.2 (Tenth point at p. 229).

2.2 Legal principles with respect to the board of directors

2.2.1 Board structure

The board of directors is considered as the most important part of a company in terms of coordinating interactions within the company's boundaries, organising relations, enforcing internal regulations, developing strategies for

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[91] [2015] UKSC 23.
[92] SACGR 2019 art 65(2).
[93] Decree of the Saudi Ministry of Commerce and Investment, No 24233, 24/04/2016.
[94] Sharia (Islamic law) does not prohibit this, provided that the procedures are fair and for the purpose of achieving the public interest(benefit), not just for the punishment or harm to the person (director). It is left to the judge's discretion.

the company, delegating responsibilities and monitoring implementation. The board is also responsible for overseeing the company's procedures and appointing directors. The board of director or the supervisory board in two-tier board acts on behalf of the shareholders in the monitoring capacity. All in order to solve the problem of collective action in accordance with corporate governance regulations.

The Council Regulation on the Statute for a European Company (SE) recognises that the board can be constituted from one of two forms; one-tier or two-tier board.[95] The one-tier board consists of independent executive and non-executive directors working collectively.[96] The board of directors (one-tier board), which manages the company, is appointed at the shareholder meeting, and then the board selects some of its members to work in the monitoring process. Shareholders also have ultimate power over the composition of the management control committee and the selection of its members.[97] The one-tier board is considered as the traditional model of the board of directors and is most common in most global economies,[98] as is often the case in UK, US, and Saudi companies.[99] It has two main functions. The first, it is considered as the executive body of the company, and it is obliged to ensure that the company's business conforms to the Companies Act and the related laws; as well as the implementation of working methods on behalf of shareholders. The second, the one-tier board working as a major institutional tool by which shareholders are supposed to be able to hold directors responsible for their actions as a business director.[100] Therefore, this board is often described as combining the responsibilities between monitoring and consultation.[101] These include a

[95] The Council Regulation on the Statute for a European Company (SE) 2157/2001 Art.38.
[96] Glau, T. (2009). Lessons from Germany: Improving on the U.S. Model for Corporate Governance. *International Law and Management review*, 5, at 237.
[97] Ghezzi, F., and Malberti, C. (2008). The Two-Tier Model and the One-Tier Model of Corporate Governance in the Italian Reform of Corporate Law. *European Company and Financial Law Review, 5*(1), at 16-17.
[98] Glau,T (n 96) 237.
[99] SACL 2015 art 68(1); SACGR 2019 art 17 and 22.
[100] Kevin Keasey, Steve Thompson and Michael Wright, *Corporate governance: accountability, enterprise and international comparisons,* John Wiley & Sons, 2005, p.104; Paul Davies and Klaus Hopt "Boards in Europe–Accountability and convergence. The American Journal of Comparative Law, Vol. 61, No. 2 (2013), pp. 301-375.
[101] Francois Belot, Edith Ginglinger, Myron B. Slovin and Marie E. Sushka,"Freedom of Choice between Unitary and Two-Tier Boards: An Empirical Analysis" October 1, 2013, Journal of Financial Economics (JFE), 112(3), 364.

number of responsibilities identified by Boland in six general responsibilities. These responsibilities are in appointing and supervising directors, providing guidance for the company, establishing policies based on governance, controlling the company and the relationship with executives, commitment to the credit obligation and supervision.[102]

As for the two-tier board, the advisory and supervisory responsibilities are divided between two boards, supervision and management boards.[103] The supervisory board shall be appointed directly at the shareholders' meeting.[104] The total number of board members ranges from 3 to 21 members.[105] Then this supervisory board appoints the directors of management board and it also has the right to remove the members of the management board at any time.[106] Nevertheless, the supervisory board cannot participate directly in the management of the company, except in some cases where the management board is required an approval by the supervisory board for a decision.[107] Therefore, this model can be considered based on the principle of separation of ownership and control,[108] which gives shareholders limited powers represented in the appointment and removal of members of the supervisory board.[109] The management board consists of executive directors, who determine the company's purposes, implement the necessary measures, supervising the company's operations in managing the business jointly, managing the manpower, coordinating the tasks, maintaining the books of accounts and so on.[110] The supervisory board consists of non-executive directors and employees; and the board has a supervisory role to review management decisions and annual reports, overseeing the appointment, removal and monitoring of directors on the management board. This board can

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[102] Boland, M., & Hofstrand, D. (2009). The role of the board of directors. *Iowa State University, File C5-71*, *2013*.
[103] Francois Belot, Edith Ginglinger, Myron B. Slovin and Marie E. Sushka, (n 101) 364
[104] Ghezzi, F., and Malberti, C (n 97) 13.
[105] Section 95 AktG, section 7 MitbestG, sections 4 para. 1, 9 Montan-MitbestG; Section 96 para. 2 sent. 1, para. 3 AktG, section 7 para.
[106] Ghezzi, F., and Malberti, C (n 97) 16-17.
[107] Glau,T (n 96) 237.
[108] Ghezzi, F., and Malberti, C (n 97) 9.
[109] Ibid, 20-21.
[110] Jungmann, Carsten, *The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems - Evidence from the UK and Germany,* European Company and Financial Law Review, Vol. 3, No. 4, 426 - 474, 437 (2006).

be also considered as a representative of shareholders, stakeholders and other parties,[111] which achieves a balance between all interests in the company.[112] The two-tier board may be a temporary solution in Saudi Arabia to the problem of directors or board of directors not complying with their duties and Corporate Governance best practice. This is because the two-tier board is a useful mechanism in delegating the business to qualified directors. It also could be a temporary solution that maintaining the interest of creditors in certain circumstances; where this board achieves greater transparency because of the balance of power between management and monitoring and enhanced response to stakeholders. This thesis argues that reforming the substantive law is much better through reforming the directors' duties by imposing a duty to take into account the interests of creditors in certain circumstances and clarifying the liabilities that may be deterring to those who may think to breach the duties.

The one-tier board is characterised by being simpler than the two-tier board and it also provides a faster and more efficient decision-making process[113] and a higher flow of information, which contains a larger number of meetings and committees, which in turn brings a wide range of information. This board also has permanent contact with the company's executives which can promote relationships and better understanding of business. Furthermore, non-executive directors participate in the decision-making process and are not limited to subsequent monitoring of decisions.[114] In the one-tier board the management and supervision are carried out by one administrative body, and therefore its board has broad discretionary powers to delegate authority. It may also grant directors who are non-members of the board significant power.[115]

However, in the 1990s, the one-tier board was criticised for the collapse of a number of companies due to mismanagement, which was a result of the weak role played by non-executive directors, which later proved that many non-

[111] section 7 para. 2 MitbestG, section 6 para. 3 Montan-MitbestG; section 100 para. 2 sent. 2 AktG; sections 394, 395 AktG.
[112] Sections 100 para. 1 sent. 1, 119 para. 1 No. 1 AktG.
[113] Francois Belot, Edith Ginglinger, Myron B. Slovin and Marie E. Sushka, (n 101) 364.
[114] Jungmann, Carsten (n16) 16, 60-64.
[115] Paul Davies and Klaus Hopt (n 100) 25.

executive hiring decisions were made by executives.[116] This means that a personal relationship may play a role in effective appointment and control, which casts doubt on the independence of the board and thus the failure to monitor the executives and act on an equal footing with them.[117] By contrast, boards with a large number of independent members have enjoyed greater freedom and better performance.[118] Therefore, the UK Corporate Governance Code 2018 is consistent with the Cadbury report that the board of directors must consist of a number of executive and non-executive directors and at least 50% of the board are independent non-executive directors, so as to prevent control of the decision-making process. The Corporate Governance Code 2018 also grants non-executive directors a broader prime role to appoint and remove executive directors.[119] However, the one-tier board is criticised because having independent members is not enough for being neutral because of the personal relationship between the members of the board.[120] The one-tier is also criticised for having to take the decision and monitor it at the same time.[121]

The two-tier board is alleged that it is a useful mechanism in delegating the business to qualified directors.[122] It also achieves greater transparency because of the balance of power between management and monitoring and enhanced response to stakeholders, thus attracting a higher level of foreign investors.[123] It also has the advantage of avoiding conflict of interest within the board with regard to judicial proceedings, as the supervisory board represents

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[116] Mahmoud Ezzamel and Robert Watson, *Wearing two hats: the conflicting control and management roles of non-executive directors*, Corporate governance, 1997, 54-79; Kevin Keasey, Steve Thompson and Michael Wright, eds (n 100) p.10.
[117] Mahmoud Ezzamel and Robert Watson (n 116) 54-79; Grit Tungler, *Anglo-American Board of Directors and the German Supervisory Board - Marionettes in a Puppet Theatre of Corporate Governance or Efficient Controlling Devices*, 12 Bond L. Rev. at 264 (2000).
[118] Mahmoud Ezzamel and Robert Watson (n 116) 54-79; Kevin Keasey, Steve Thompson and Michael Wright, eds (n 100) p.10.
[119] The UK Corporate Governance Code 2018, Principle (G), Provisions (11) and (13).
[120] Grit Tungler (n 117) 264.
[121] Block, David and Gerstner, Anne-Marie, "One-Tier vs. Two-Tier Board Structure: A Comparison Between the United States and Germany" (2016). *Comparative Corporate Governance and Financial Regulation.* Paper 1. p20 available at <http://scholarship.law.upenn.edu/fisch_2016/1> accessed on 13 January 2019.
[122] Clara Graziano and Annalisa Luporini, "Ownership concentration, monitoring, and optimal board structure." Economics Bulletin 32.4, 2012, 3333.
[123] Francois Belot, Edith Ginglinger, Myron B. Slovin and Marie E. Sushka (n 101) 364; Aste, L. (1999). Reforming French Corporate Governance: A Return to the Two-tiered Board? *George Washington Journal of International Law and Economics, 32*(1), at 32; Glau,T (n 96) 237, 238 and 246.

the company's claims against the management board, which provides the possibility of instituting proceedings against the management.[124] However, this allegation cannot be proven in practice, because the supervisory board has strong motives to avoid instituting proceedings against the management board because it proves by instituting proceedings that it has violated its duties.[125] As in *ARAG/Garmenbeck*,[126] the supervisory board decided not to instituting proceedings, and it could not rely on the rule of protecting business judgment. Therefore, a higher level of judicial inspection was applied to the supervisory board.

However, the two-tier board is criticised for excessive formalities with regard to reporting the supervisory board and the division between the managers and monitors. The separation between the supervisory board and the management may lead to a lack of information necessary to improve the performance of the company. It also increases the company's financial and time costs for the meetings between the supervisory and management boards.[127] Despite the importance and the advantages of independence in the supervisory board from the management board, it can be argued that it is not involved in the executive procedures and lacks the commercial knowledge from inside the company, which lead to a lack of information necessary for the practice of effective supervision; it is difficult to understand and assess the effectiveness objectively in the management procedures if the considerations are not taken into consideration and economic alternatives from the inside.[128] Although some supervisory boards have taken the option of appointing former members of the management board to ensure familiarity with the necessary information, they

[124] S.90 of the German Stock Corporation Act 2010.
[125] Hans C. Hirt, *"The enforcement of directors' duties in Britain and Germany : a comparative study with particular reference to large companies"*Peter Lang AG, Euroean Academic Publisher, 2004, p.262; [125] *ARAG/Garmenbeck*, German Supreme Court (BGH), (1997), II ZR 175/95, In: NJW. 1997, 1926.
[126] *ARAG/Garmenbeck*, German Supreme Court (BGH), (1997), II ZR 175/95, In: NJW. 1997, 1926.
[127] Aste, L (n 123) 36; Hopt, K., and Leyens, P. (2004). Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy. *European Company and Financial Law Review, 1*(2), at 147; Glau,T (n 96) 240.
[128] Roberts, John; McNulty, Terry; Stiles, Philip, *Beyond Agency Conceptions of the Work of the Non-Executive Director: Creating Accountability in the Boardroom*, British Journal of Management, Vol. 16, S5- S26, S14 & S16 (2005); Zattoni, Cuomo, 21 Brit. J. Mgmt., 63, 65 f. (2010).

have fallen into the dilemma of personal relationships with the board, which may significantly affect independence and effective monitoring.[129]

It remains to be said that with the adoption of laws for duties on directors to protect the interest of stakeholders and with greater monitoring and recognition of the growing importance of the one-tier boards through the delegation of many powers, for example the audit committee, which consists of independent directors, it can be said that the one-tier boards become more similar to two-tier boards.[130]

2.2.2 Directors' meeting and decision-making

The directors of the company are appointed to work collectively so that everyone participates in decision-making, but they may delegate any of their powers to anyone to perform it.[131] However, in premium listed companies there must be a formal determination either in a schedule or in the annual financial report that may be delegated to others and the matters within the competence of the board.[132] In the Saudi law, delegation of powers of the board is stipulated in general, the board may delegate its powers to one of its members or third parties and the chairman of the board by a written decision to delegate some of her/his powers to other members of the board or to others in carrying out the works or specific work.[133]

To achieve collective action so that everyone can participate in decision-making, directors have the all the rights to participate in management, attend and vote at the board meeting and express their views freely and take into account their decisions at the board meetings.[134] In general, the decisions must be taken at the meeting in companies that have more than one director. All decisions must be taken either by a majority at the meeting or by unanimity so that all eligible directors agree "signed" on the decision, even if it is not at the

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129 Block, David (n 121) 33.
130 Ibid, 39, 50-51.
131 The model articles of association in SI 2008/3229, art 5 of public and privet companies.
132 The UK Corporate Governance Code 2018, para A.1.1.
133 SACL 2015 arts 75 and 82.
134 See Romer LJ in *Re H R Harmer Ltd* [1959] 1 WLR 62; Jessel MR in *Pulbrook v Richmond Consolidated Mining Co* [1878] 9 ChD 610.

meeting. The unanimous decisions shall be formalised in a written decision signed by all directors or indicated to the unanimity in the decision. [135] Directors in public companies may make fit rules for decision making, in a manner that does not conflict with the company's articles.[136] The SACL 2015 stipulates that decisions are taken by the majority, while unanimous decisions are not addressed. However, in urgent matters, the board may adopt resolutions and present them to its members individually, unless a member requests in writing that the board be convened to deliberate on such resolutions, in which case they shall be presented before the board at the first following meeting.[137]

In order for the meetings' decisions to be valid, the rules and regulations relating to the board meeting must be applied. The meeting must be notified so that any director may call to the directors meeting, either by giving notice or by the company secretary in any way.[138] In addition, the quorum for directors' meetings is one of the main reasons for being the meeting decisions valid. The model articles of association in SI 2008/3229 stipulates that the quorum is the presence of two qualified directors unless the directors decide otherwise.[139] In the absence of sufficient directors to form a quorum, the directors in office may appoint a sufficient number of directors to reach the quorum or may call a general meeting for it.[140] Accordingly, any decision taken at a meeting that has not been quorate is considered null and void.[141] In the Saudi law, the quorum for valid board decisions is the presence of half of the board members provided that is not less than 3 directors. In the absence of sufficient directors, directors must call the regular general assembly to convene within sixty days to make up the necessary number of directors.[142]

[135] The model articles of association in SI 2008/3229, arts 7 and 8 of public and privet companies.
[136] The model articles of association in SI 2008/3229, arts 19 of public companies.
[137] SACL 2015 arts 83 and 84.
[138] The model articles of association in SI 2008/3229, art 8 of public and art 9 of privet companies.
[139] The model articles of association in SI 2008/3229, art 10 of public and art 11 of privet companies.
[140] The model articles of association in SI 2008/3229, art 11 of public and privet companies.
[141] See *Re Greymouth Point Elizabeth Railway and Coal Co Ltd*, [1904] 1 Ch 32.
[142] SACL 2015 arts 70 and 83; SACGR 2019 art 32.

The meeting of the board is headed by a chairman appointed by the directors and they have the right to remove him/her at any time.[143] The chairman of a premium listed company must be an independent non-executive director.[144] It cannot be one person who combines the position of Chief Executive Officer and chairman of the board, as is also the case in Saudi law, but the Saudi law state that the CEO is prohibited to be appointed as chairman, during the first year following the end of his/her service.[145]

Studies assume that directors are equally involved in directing, controlling and monitoring the company activities. In fact, directors are not equally involved in making decisions that affect the company's policy, and there is a wide variation in the extent to which the decision-making power is for each director.[146] Perhaps this is due to pre-decision-making influencing factors such as the CEO's power, time constraints, and reputational concerns that make directors hesitant to communicate their position and opinion openly.[147] Also, some directors have more control over decisions than others as members of the board committees and the board chairman, which is affecting the participation on an equal footing in the company decisions with other directors.[148]

[143] The model articles of association in SI 2008/3229, art 12 of public and privet companies.
[144] The UK Corporate Governance Code 2018, A.2.1, A.3.1.
[145] SACGR 2019 arts 24 and 28.
[146] Kim, Seoyoung, Directors' Decision-Making Involvement on Corporate Boards (March 10, 2015). Available at SSRN: https://ssrn.com/abstract=1528596 or http://dx.doi.org/10.2139/ssrn.1528596 35-36.
[147] Malenko, Nadya. (2014). Communication and Decision-Making in Corporate Boards. Review of Financial Studies. 27. 1486-1532. 10.2139/ssrn.1712431. 13-15.
[148] Ibid, 24-26.

Chapter Three: The powers and duties of company directors in UK law

3.1 Introduction

One of the most fundamental aspects of CA 2006 is codifying the general duties of the company's directors for the first time. Before the enactment of this law, the duties of directors were not codified in a written law but rather left their interpretation and application to the provisions of common law and equitable principles.[1] The reason for this delayed codification may be to obtain a clear and comprehensive picture of the duties of the directors. The codification evolution was long in gestation as the idea was rejected in the 1920s because it was impossible to apply. Until the 1990s the idea of codification was considered again to be only partially possible and then it was suggested that the codification be so comprehensively that it addresses the most frequently used and most influential duties depending on common law and equitable principles.[2] Perhaps the reason for considering codification again was that company's directors, especially in small companies, who did not have a permanent legal consultant, were struggling to understand and apply the provisions of common law and equitable principles to their duties towards the company, because these principles and provisions are wide and complex. The stakeholders also faced difficulties in their estimation the scope of directors' responsibilities.[3] Therefore, the purposes of codifying the duties of directors was to enhance the clarity of the law and make it easier for the responsibilities of directors towards others to be identified without the need for a legal consultant to interpret these duties. It also aims to prevent fraud and mismanagement that cause corporate collapse.[4] Interestingly, there is no independent mention of the fiduciary duty in the general statutory duties, but

[1] Marjan Marandi Parkinson, Directors' duty to exercise independent judgment: the path to s.173 of CA 2006 and beyond, Comp. Law. 2017, 38(9), 272; Arden (n 6) chapter 1, 1-2.
[2] Company Law Amendment Committee (1925–26) (Cmd 2657), 20; Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties, Law Commission Consultation Paper No 153, Scottish Law Commission Discussion Paper No 105, part 14.8.
[3] Parkinson (n 1) 1; Arden (n 6) chapter 1, 1-2.
[4] Ibid.

the duties, exception of section 174, are enforceable in the same way as the fiduciary duty owed to a company by its directors.[5]

However, there is a criticism of the codification of the general duties, which is not self-contained. These duties need recourse to the provisions of common law and equitable principles to be fully understood. This opposes the claim that the purpose of codifying the general duties is to facilitate understanding and awareness of the directors' duties. Because recourse to common law and equitable principles requires the assistance of a legal consultant to interpret these duties one might wonder whether codification was worthwhile.

This chapter deals with the laws of the United Kingdom in relation to the duties of the company director, in order to compare them with the laws of Saudi Arabia in another chapter, and highlighting the legal problems in enforcement these duties on the ground through the mechanism of exercising the discretion of directors.

3.2 The directors' powers

Although most discussions in this study will be about the directors' duties, it is worthwhile to dwell briefly on the directors' powers. It is also worth distinguishing between power and duty. Power is the ability that the law confers to do something.[6] The duty is the obligation to do something or not to do something[7] and a duty may restrict exercising powers.[8] Under the Model Articles 2008, directors are granted broad managerial powers that for the most part, the law does not see the need to itemise them.[9] Yet as for duties, they need to be itemised, because they give rise to obligations and may raise liabilities, so the liabilities are the result of a breach of duty.[10]

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[5] CA 2006, ss 171-177.

[6] Wesley Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, Yale University Press (Walter Wheeler Cook ed., 1920), as posted (2019) on, <https://thomasalspaugh.org/pub/fnd/hohfeld.html#Hohfeld1913-sflc> accessed on 6 June 2020.

[7] Ibid.

[8] See (3.3.1 duty to act within powers).

[9] The Companies (Model Articles) Regulations 2008 (SI 2008/3229) reg 3.

[10] CA 2006 s 178.

As already mentioned, the directors' powers are wide and most of them do not need to be itemised, but that in order not to confuse powers with duties, it is worth mentioning some examples of the directors' powers. Power to declare a dividend. S416 of the CA 2006 provides that the directors' report, in non-small companies, must state the amount (if any) that the directors recommend should be paid by way of dividend. This power must be exercised only on the distributions are made only out of profits available for the purpose. These profits are a company's profits available for distribution are the company's accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital.[11] The power to litigate deserve mention. The power to litigate can be considered as one of the general managerial powers assigned to the directors by the Model Articles 2008. This power also is supported by the court judgment in *John Shaw and Sons (Salford) Ltd v Shaw*,[12] three directors held a board meeting and decided to sue other directors for their debt to the company. A shareholders' meeting decided that the claim against the other directors should be discontinued and the Court of Appeal must strike out the claim on the ground that the directors' decision, to sue the other, had been invalidated by the members. The court held that the members had no power to overrule the directors. One of the powers is the power to appoint additional directors, see (para 2.1.2 Appointment of directors) for further details. Power to make provisions for employees regarding the cessation or transfer of the company' business, see (para 3.3.2 Duty to promote the success of the company) for further details. Mayson, & others[13] provide a number of the directors' powers, for example, power to forfeit shares.[14] Power to refuse to register a transfer of shares. For private companies, the directors have the power to refuse to register a transfer. While for public companies, the directors can refuse only in relation to partly paid shares.[15] Power to circulate

[11] CA 2006, s 830.
[12] [1935] 2 KB 113.
[13] French, D., Mayson, Stephen W., & Ryan, Christopher. (2019). *Mayson, French & Ryan on company law*. (Thirty-sixth edition, 2019-2020 edition / Derek French. ed.). Oxford, United Kingdom: Oxford University Press. 483.
[14] CA 2006, s 659(2)(c); the Companies (Model Articles) Regulations 2008 (SI 2008/3229) regs 58-61.
[15] The Companies (Model Articles) Regulations 2008 (SI 2008/3229) private companies reg 26(5), public companies, reg 63(5).

information to shareholders.[16] Power to borrow and give security.[17] These are all examples of powers, many of which derive their force from the Model Articles. Some powers are explicitly derived from statute: such as the power conferred by s. 247 of the Companies Act 2006 to make provision for former employees, thereby reversing *Parke v Daily News Ltd*[18].

3.3 The directors' duties

3.3.1 Duty to act within powers

As we noted above, directors of companies have broad responsibilities for the management of the business of the company. These powers are not absolute but are subject to restrictions limiting them by either a company's constitution, the purposes so conferred or provisions of the CA 2006. Therefore, the CA 2006, explicitly stipulates that the directors of companies must act within their powers, in accordance with the company's constitution and for the purposes so conferred.[19] Directors are fiduciaries, therefore. A fiduciary is expected to be very loyal to the person who owes their duties (the company) so that there is no conflict of duties between the fiduciary and the company, and the fiduciary must not benefit from its position as a fiduciary or exercise their powers for personal benefit.

Although s 17 stipulates that the company's constitution is the company's articles and any resolutions and agreements, the CA 2006 does not leave the meaning of the resolutions and agreements as a general meaning which encompasses all possibilities to prevent the possibility of conflict in understanding the meaning. Instead, it defines what resolutions and agreements affect a company's constitution. S 29 defines effective resolutions and agreements as ones that are agreed by all the members of a company or all the members of a class of shareholders or resolutions or agreements that

[16] CA 2006, s 311.
[17] See *Rolled Steel Products (Holdings) Ltd v British Steel Corporation,* [1986] Ch 246.
[18] [1962] Ch 927.
[19] CA 2006, ss 17(a) and 171.

effectively bind all members of a class of shareholders even though they are not agreed to by all those members.[20]

Members and shareholders often have different views to directors on what is in the best interests of the company. This difference in views usually because of the responsibility that rests with directors and the defining the concept of the company's success, for example, the company's success may be for shareholders is to make profits only, while in the perspective of directors it means to achieve the company's objectives and take the responsibility towards both the shareholders as a whole and the stakeholders. The direction of members and shareholders may collide with whether directors act in the company's best interests. Therefore, the power to manage the business of the company, as a duty of directors, is based on the principle of division of power between directors and members. In *Howard Smith Ltd v Ampol Petroleum Ltd*[21], the judge recognised the principle of division of power between directors and members. Millers Company decided to allot shares for its urgent need for capital. Two of the company's members announced their dissatisfaction and would reject any offer of the shares. Howard Company made a bid to Millers to allot 4.5 million ordinary shares at a higher price than Ampol. Millers' directors took a majority decision to allot and issue shares immediately. The allotment and issuance of shares by Millers' directors were contrary to the wishes of the company members. Regardless of the directors' objective and the ultimate judgment, the principle of division of power between directors and members was considered in this case. Lord Wilberforce said, directors might make decisions against the majority of shareholders' wishes, and the shareholders cannot control the directors in the exercise of these powers during their stay in office. According to this principle, the company's constitution is the source of authority to directors of the management of the company and often the appointment of other directors and taking decisions on matters not assigned for management. This principle does not confer on members and shareholders the power to interfere in the matters which have been assigned to directors' control

[20] CA 2006, ss 17 and 29.
[21] [1974] A.C. 821.

or to direct directors to the mechanism of exercising the powers assigned to them.

Once the management power is granted to directors to manage the company, the shareholders and members cannot interfere with decisions made by directors, even if these decisions are against the wishes of most shareholders, except in limited cases. One of these is with the existence of a special resolution, art 4 of the Model Articles 2008, which authorises shareholders to direct directors by special resolution to take a specified action or to refrain from taking a specified action. However, this is related to a subsequent resolution and does not invalidate anything which has been done by directors before the passing of the resolution.[22] Furthermore, if directors of the company believe that a particular course of action is not in the best interests of the company, they may refuse to pursue this course of action even if the entire membership wishes it to be pursued. This can only be countered if the members ratify to pursue it which means relieving the directors from liabilities for breach of duties.[23] Other than that, members may not interfere in the management of the company or direct directors, and members only have the right to remove any directors from their office by an ordinary resolution at a meeting.[24]

The duty to act within directors' powers requires directors of a company to act in accordance with a company's constitution as aforementioned and for the purposes so conferred. The provisions of the Companies Act and the company's constitution are the real source of authority to directors of the freedom to exercise the general powers in order to manage the company as a going concern in accordance with the purposes for which they are conferred to promote the success of the company.[25] The exercise of power for purposes other than the purposes of the company, described as improper or collateral, is an exercise that can be revoked. This species of exercise is punishable not because of a mistake but for abuse of powers as it is an illegal act of legal

[22] The Companies (Model Articles) Regulations 2008 (SI 2008/3229) reg 4.
[23] CA 2006, s 239.
[24] CA 2006, s 168.
[25] CA 2006, ss 171 and 172; the Companies (Model Articles) Regulations 2008 (SI 2008/3229) reg 3.

authority to exceed the powers granted. In *Fairford Water Ski Club v Cohoon*,[26] a director was liable for breach of duty to act within powers. One of the main allegations was the payment of an annual management charge. The company asserted that its directors had no power to pay the annual management charge that it had never agreed to. The result was that the transaction was voidable and the director was accountable to the company for any profit he had made. In *Eclairs Group Ltd v JKX Oil & Gas Plc*[27], directors did what they thought was beneficial to promote the success of the company, but their action was considered as outside the ambit of their powers. Directors took a majority decision to impose restrictions on shareholders' rights (limiting voting rights of shareholders). Although this power was derived from the Company's Articles of Association, the power used was an improper purpose, which was intended to affect the forthcoming shareholders' meeting. Consequently, the decision was rescinded because of the improper purpose. This is because the authority they had used had been granted for a specific purpose that did not include restricting voting rights to shareholders. Consequently, the decision was rescinded for violating their duties to act within their powers for improper purpose. However, the proper purpose rule is not concerned with exceeding the powers granted but with acting within the power conferred by exercising for an improper reason. Each company has restricted purposes for the use of directors' power so the use of the power outside its purposes is similar to the use of the power for an improper purpose. Langford[28] comments on this judgment that the judgment in this way leads to a test that takes into account the self-motivation of directors but is ultimately an objective test. This test assesses the directors' conduct against what the court determines as proper purposes by which a specific power can be exercised, and thus places a limit on the directors' acts. Worthington[29] also comments on this case by saying, this case provides expose for improper purposes, but it does not give rise to certainty. In the end, none of the main questions on improper purposes was identified. These questions are.

[26] [2020] EWHC 290 (Comm).
[27] [2015] UKSC 71.
[28] Rosemary Langford, The Proper Purpose Rule as a Constraint on Directors' Autonomy – Eclairs Group Limited v JKX Oil & Gas Plc, Modern Law Review, Vol. 80, No. 1, pp. 110-120, (2017), 118.
[29] Worthington, S. (2016). Directors' Duties and Improper Purposes. The Cambridge Law Journal, 75(2), 213-216.

"*(1) how to draw the line between acceptable and unacceptable balances of proper and improper purposes. (2) What consequences should follow a finding of improper purposes? This was not considered by the Supreme Court. The decisions made for improper purposes are voidable (3) Assuming the directors decided one way only because of an improper purpose, but they would have decided precisely the same way had that improper purpose not been present, should their decision then be allowed to stand?"*

However, the concept of the proper purpose may be undefined in the company's constitution or the interpretation of this concept may be disputed. Also, setting limits in advance of the scope of the exercise of power by directors is impossible. This is because the limits of the scope of directors' powers, which directors are precluded from exceeding, cannot be enumerated in advance since the different situations cannot be anticipated.

Therefore, determining the meaning of the proper purpose is controversial. The proper purpose is related to, inter alia, the activity of the company, the shareholders' objective, the intent of directors, and the motive behind the decision and consideration of the best interests of the company and others. The appointment of directors is based primarily on confidence and trust in their good faith and in their work involving discretionary decision-making. Section 172 of CA 2006 determines the meaning of the purpose in general and directs discretionary decision-making by stating that directors must act in good faith in a way that enhances the success of the company for the benefit of its members as a whole. Other than the direct benefit of its members, the purpose of the company may also include the likely consequences of short and long term decisions to achieving the objectives set by the company, including financial and strategic objectives of the company. Taking into account the interests of all stakeholders such as employees, suppliers, customers and society as a whole by positive consideration of the impact of the company's operations on the community and the environment, fostering the company's business relationships with others and maintaining the company's reputation are considered as purposes of the company.[30] The protection of the interests of

[30] CA 2006, ss 171 and 172.

creditors likewise is a purpose of the company, in the event the company has entered into insolvent liquidation or the director was aware of or ought to have concluded that there is no reasonable prospect that the company would avoid engaging in the insolvent liquidation before the company's winding up commencement.[31] In the case of multiple purposes, the court can determine the primary purpose of the substantial one in view of the weightiest purpose that directors feel is stronger and consideration for the reasons for decision-making by directors and which purpose has been relevant to it. The proper purpose is influenced by the influence of decisions on dishonest considerations or personal interests. If a decision is influenced by different considerations, some of which are proper and others improper, it is considered the direct significant influence.[32]

It is considered that the power of the allotment of shares as one of the powers of the directors of the company but is not an absolute power. Under s 549 of CA 2006, directors of a company are prevented from exercising any authority to allot shares or to grant rights to subscribe to shares of the company. However, the exception is over such matters as the allotment of shares in pursuance of the share scheme of employees and the granting of the right to subscribe for the allotted shares or to convert any security into the shares so allotted. Directors may exercise the power to allot shares of a private company when it has only one class of shares except when prohibited from doing so by the company's articles.[33]

Directors may exercise the power to allot shares in the event of authorisation from the company to allot shares if they are authorised to do so by the company's articles or by resolution of the company.[34] Authorisation that might be granted for a particular exercise could be conditional or unconditional. However, such authorisation must state the maximum amount of shares to be

[31] CA 2006, s 172; Insolvency Act 1986, ss 213 and 214.
[32]A Seretakis, 'Hostile Takeovers and Defensive Mechanisms in the United Kingdom and the United States: A Case against the United States Regime' (2013) 8(2) Ohio St Entrepren Bus LJ 245, 260-262; Andrew Keay *Directors' Duties* (3rd edition, LexisNexis, Bristol 2016), 97-120; Inferred from the judgment in *Eclairs Group Ltd v JKX Oil & Gas Plc* [2015] UKSC 71.
[33] CA 2006, ss 549 and 550.
[34] S 551(9) of CA 2006 states that the resolutions affecting a company's constitution mentioned in s 17, s 29 apply to the resolution under this section.

allotted under it and the date on which it will expire not later than 5 years from the date of authorisation provided in the company's articles at the date of its incorporation. The date and duration of the resolution shall not preclude the ability to renew, amend or revoke the resolution again by a resolution of the company for a further period not exceeding 5 years with the same conditions of issuing the resolution as the stipulation on the maximum amount of shares that may be allotted and the date on which the renewed authorisation will expire.[35] Directors may exercise the power to allot shares even after the expiry of the authorisation if the allotment of shares has been allotted in pursuance of an offer or an agreement of the company made before the expiry of the authorisation or the authorisation allows the company to make an offer or an agreement after the expiry of the authorisation. The allotment of shares may be made in accordance with the requirements imposed under s 793 of CA 2006, where a company may notify any person whom it is believed is interested in the company's shares, currently or during the three years preceding the date on the issued notice, or to confirm a fact or provide information. The information required in the notification must be provided within a reasonable time as specified in the notification. In addition, the law under s 561 of CA 2006 requires that an offer must be made to every person who holds ordinary shares in the company and that it be allotted to him/her on the same favourable terms at least; or the expiration of the period in which the offer may be accepted, or the company has received a notice of acceptance or refusal with respect to the offer made.[36]

In all cases, directors are obliged to exercise the power of allotment of shares in accordance with the conferred purpose to promote the success of the company for the benefit of its members as a whole. Directors are not authorised to exercise their power to allot shares for their own interests or to maintain their positions. The allotment of shares with the intention of retaining the majority of shareholders who dilute the power is considered not to be part of the directors' fiduciary function. The preference of one shareholder or group of shareholders over the rest by exercising a fiduciary power to allot shares for any purpose is

[35] CA 2006, s 551.
[36] CA 2006, s 561 and 793.

improper. The allotment of shares is often used to raise the company's capital to enhance the company's success and not to prevent the takeover of the company by a person acting legally.[37] The rule of proper purpose is a principle in which justice governs the exercise of the powers of the fiduciary in respects which are not necessarily determined by the instrument of the company's articles, but by understanding the context of business.[38] In *Howard Smith Ltd v Ampol Petroleum Ltd*[39], Millers Company decided to allot shares for its urgent need for capital. Two of the company's members (Ampol and Bulkships Companies) own 55% of the shares. Ampol Company had offered to buy all the shares that Millers Company intended to allot. Millers' directors rejected Ampol's bid for being too low. Ampol and Bulkships then announced their dissatisfaction and would reject any offer of the shares. Howard Company made a bid to Millers to allot 4.5 million ordinary shares at a higher price than Ampol. Millers' directors took a majority decision to allot and issue shares immediately. By this allotment and issuance of shares, Ampol and Bulkships were reduced their percentage of the company from 55% to 36.6%. Howard was in a position to make an effective takeover offer. Ampol challenged the validity of the issuance of shares to Howard and sought an order in the Supreme Court for the rectification of the share register by removing Howard as a member of Millers in respect of the allotted shares. Millers' directors alleged that the reason for the issuance of shares was to obtain capital, while Ampol claimed that the objective of directors was to reduce the voting power owned by Ampol and Bulkships. The judge, after considering the circumstances of the case, held that the allotment of shares was invalid because the directors had exercised their powers for an improper purpose to allot shares. Therefore, the judge ordered the share register to be rectified.

3.3.2 Duty to promote the success of the company

The duty when exercising managerial powers to promote the success of the company contained in s 172 is one of the most important duties of directors in

[37] CA 2006, ss 171 and 172; The Explanatory Notes to the CA 2006, part 323; Keay (n 32) 96-101.
[38] See *Eclairs Group Ltd v JKX Oil & Gas Plc* [2015] UKSC 71.
[39] [1974] A.C. 821.

the CA 2006. It caused a sizable debate when this duty was discussed in Parliament because there were doubts over how this section was to be interpreted or applied, even if this duty appears to be clear in relation to the obligation to act in good faith in the interest of the company. This duty is the core of the fiduciary duty owed by directors but there are other aspects in s 172. The duty to act in good faith to promote the success of the company is somewhat different, as there are some new concepts such as 'the success of the company'. This new concept includes an explicit statement on the interests of non-shareholders.[40]

The Company Law Review Steering Group has made the duty to promote the success of the company part of a strategy to deliver what it called the enlightened shareholder value principle (ESV). Directors should be more comprehensive when performing their duties and making decisions by taking into account all the company's relationships. This compelled listed companies to prepare and publish an operational and financial review (OFR) and disclose a range of qualitative and forward-looking information which is not commonly observed in regular financial statements, for instance, the company's policy regarding non-shareholders such as employees, social and environmental issues related to the company's business and other issues. This disclosure enabled the government to know corporate stakeholders better.[41] The (OFR) was valid until the Strategic Report and Directors' Report have been published in the last quarter of 2013, which repealed the (OFR). The Strategic Report and Directors' Report obliges all listed and unlisted companies, except for small companies, to prepare the strategy report as a part of the annual report for each financial year of the company to inform company's members and help them to assess the performance of directors to promote the success of the company.

[40] Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge 2014) 82-86; Andrew Keay, 'Good Faith and Directors' Duty to Promote the Success of their Company' (2011) 32(5) Company Lawyer 138; Elaine Lynch, 'Section 172: A Ground-breaking Reform of Directors' Duties, or the 'Emperor's New Clothes'?' (2012) (33)7 Company Lawyer 196; R Goddard, 'Directors' Duties' (2008) 12(3) Edinburgh L Rev 468, 471-472.
[41] Lynch (n 40) 197-198.

The information contained in the annual report and the strategic report is of the interest to shareholders and stakeholders.[42]

Based on the above, directors need to consider the objective of the company and know the priority in the performance of their function according to the enlightened shareholder value principle in the interpretation of the duties of directors to act in the interest of the company during managing the company. This means directors must act in the interest of shareholders and take into account other broader interests – the so-called interests of stakeholders. In this context, Lord Goldsmith explained that the government's intention is that the objective of the company should be determined by looking at the company's constitution, the shareholders' resolutions and everything else related in order to reach the judgment.[43]

The shareholder primacy theory holds that the company exists only for the profit of its shareholders. This approach was prevalent in the UK prior to the CA 2006[44] and is based on the fact that the shareholders are the owners of the company and the directors are the shareholders' agents. Thus, this theory enhances economic efficiency as it stimulates shareholder profits. Shareholders of an unlisted company are at risk because they are unable to dispose of their shares easily and quickly when they are dissatisfied with how the company is managed. In contrast, the employees, creditors and others, who deal with the company, are able to protect themselves in accordance with the terms of contracts concluded with the company. The shareholder primacy theory affected companies' transactions with non-shareholders as they were reluctant to make financial investments in the companies. This effect has led to adopting a pluralist approach.[45]

[42] The CA 2006 (Strategic Report and Directors' Report) Regulations 2013.

[43] DTI, 'CA 2006: Duties of Company directors, Ministerial Statements' (June 2007) Lord Goldsmith, Lords Grand Committee (6 February 2006) column 256, available at: http://www.berr.gov.uk/files/file40139.pdf accessed 4 March 2018.

[44] In the former Companies Act 1985, there were no provisions requiring directors to consider the interests of any person other than the shareholders, which affected the companies' transaction with the non-shareholders where they were reluctant to make financial investments in the companies.

[45] Keay (n 40) 68-92; Lynch (n 40) 197-198.

The pluralist approach considers the company as a social entity that takes responsibility for all stakeholders such as employees, creditors, suppliers and society as a whole, and does not function only in the interests of shareholders. The difficulty with the pluralist approach is that the risk of accountability to directors. Moreover, directors must consider the interests of all stakeholders on an equal footing, which will slow the decision-making process. The decisions will also be weak due to the nature of the conflicting interests of stakeholders. Therefore, a compromise was found between these approaches in the form ESV theory. This works on a broader and longer-term approach by adhering to the need to build long-term relationships and trust with employees, suppliers, customers and others to ensure long-term success.[46]

The ESV theory seeks to raise awareness among companies so that a company can be managed in a well-balanced manner in consideration of the interests of shareholders while strengthening relations with stakeholders. This means that directors are committed to achieving the success of the company for the benefit of shareholders by taking into account all relevant considerations for the purpose of the success of the company. This requires taking a balanced and appropriate view for the company in the short and long term and stresses the need to maintain effective and continuous relationships with stakeholders. The impact of the company's operations on the community and the environment should be considered while retaining the benefits of shareholders as an ultimate objective of the company. Accordingly, the ESV theory is about how directors manage the company. This gives directors a broader discretion to override shareholders' interests provided they act in such a way that they believe it will enhance the company's success for the benefit of the members as a whole.[47]

It is noted that the ESV theory is reflected in s 172 of CA 2006, which includes one of the duties that is owed by directors and it can be considered as the loyalty duty. The duty to promote the success of the company is the fundamental duty of directors and any other duties given in the CA 2006 are applications of this duty such as the duty to avoid conflicts. S 172 is based on

[46] Keay (n 40) 68-69.
[47] Ibid, 70-82.

the established rule that directors must act in good faith in the interest of the company in order to promote its success and achievement of its objectives. As Lord Denning stated in *Scottish Co-op Wholesale Society v Meyer*[48] in the context of competing with the company's textile business, 'the duty of the three directors to the textile company was to do their best to promote its business and to act with complete good faith towards it'.

There is a question about whether s172 is it based on common law or is it an entirely new duty. It can be said that the exact equivalent of s172 was absent in common law. But this duty is related to the duty of loyalty to act in good faith for the interests of the company.[49] In *Re Smith and Fawcett Ltd*,[50] Lord Greene said that "*They must exercise their discretion bona fide in what they consider - not what a court may consider - is in the interests of the company*". In the same manner, s172(1) imposes on directors the duty to act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole. Also, subsection (3) provides that this duty is subject to any enactment or rule of law requiring directors to consider the creditors' interests in certain circumstances. Prior to the enactment of this duty, common law imposed on directors a duty towards the creditors in financial distress times.[51] Therefore, I can be said that this duty is a codification of the common law.

Lord Denning's views are consistent with s 172(1) of CA 2006, which states that the acts of directors are to be in good faith. It is not easy to define good faith exactly because of the different contexts in which it arises. Sealy believes that the term good faith is ambiguous and has two meanings, a subjective meaning and an objective meaning. The subjective application is honest human

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[48] [1959] AC 324; Keay (n 40) 91-93.
[49] Andrew R Keay, 'The Duty to Promote the Success of the Company: Is it Fit for Purpose?' (University of Leeds School of Law, Centre for Business Law and Practice Working Paper, 2010) 4 <http://www.law.leeds.ac.uk/assets/files/research/events/directors-duties/keay-the-duty-to-promote-the-success.pdf> accessed 4 March 2018.
[50] [1942] Ch. 304.
[51] *Gwyer v London Wharf (Limehouse) Ltd*, [2002] EWHC 2748 (Ch).

behaviour with best intentions. The second describes the status of the activity as good faith in the sense of ‘genuine’, and has objective application.[52]

However, the meaning of good faith is seldom specified despite its widespread use. This is either because it is assumed that everyone knows what it means or because its widespread use has created an unclear and inconsistent understanding of what it means. Good faith is often linked to ethical standards, where it is called an ethical legal principle. This requires the interests of others to be taken into consideration. Generally, when the term ‘good faith’ is used in law it includes honesty and propriety. In other places, the expression good faith includes equity, fulfilment of obligations, fair disclosure, loyalty and the requirement not to violate the rules of corporate law.[53] On this, Nowicki argues that there is no generally accepted and well-defined definition of good faith in the context of directors' responsibilities. She is supported by Summers who supports the impossibility of applying a specific definition. Nowicki sees that the problem lies in the fact that ‘importing a definition of good faith into the context of director conduct from other areas of law is not ideal, because most definitions of good faith are context-specific’. [54] She ultimately defines good faith[55] as something that is ‘in the best interests of the shareholders’. This indicates that Nowicki's definition is in line with the shareholder primacy theory unless she means that the ultimate purpose is in the interests of shareholders but taking into account all relevant considerations for stakeholders.

Courts have been able to apply the concept of good faith to broad circumstances by granting judges a measure of discretion. The result of this has been that courts have adopted a method of interpretation of 'good faith' by contrast, such as the absence of malice and lack of intent to harm. They also often explain what ‘bad faith’ is in the case at hand rather than getting involved

[52] LL Sealy, ‘Bona Fides and Proper Purposes in Corporate Decisions’ (1989) 15(3 and 4) Monash U L Rev 265, 269.
[53] FK Juenger, ‘Listening to Law Professors Talk About Good Faith: Some Afterthoughts’ (1994-1995) 69(5) Tul L Rev 1253, 1253-1254.
[54] Elizabeth Nowicki, ‘Not in Good Faith’ (2007) 60(2) SMU L Rev 441, 454; RS Summers, ‘Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code’ (1968) 54(2) Va L Rev 195, 200-201.
[55] Ibid, 454.

in the interpretation of good faith. For example, in *Re Walt Disney Co Derivative Litigation*[56], the judge ruled that:

> *I am of the opinion that the concept of intentional dereliction of duty, a conscious disregard for one's responsibilities, is an appropriate (although not the only) standard for determining whether fiduciaries have acted in good faith. Deliberate indifference and inaction in the face of a duty to act is, in my mind, conduct that is clearly disloyal to the corporation. It is the epitome of faithless conduct.*

In *Davies v Ford,*[57] the court interpreted "good faith" by contrast, which was the absence of good faith by acting in a manner other than the interests of the company, as the directors had diverted the company's business to their own company. Bad faith is not just about a bad decision and neglect but involves a conscious act of wrong because of fraud or a dishonest purpose. Therefore, proving bad faith is a daunting task.[58] In *Starling v The Climbing Gym Ltd*,[59] the court held that the director participating in a similar business to that of the company but elsewhere some 200 miles away from the company's business is still a breach of duty to the company by failing to act in good faith or in the best interests of the company, which has created a conflict of interest between the director and the company.

The duty to promote the success of the company, as already mentioned, is somewhat different. The term ‘company success’; there has been some controversy about the interpretation of its ambiguous meaning. In spite of the absence of a definition of the term ‘success of the company’ in s 172, it is determined that the success of the company must be for the benefit of its members as a whole. It can be said that ‘success’ means achieving the objectives set by the company, including financial and strategic objectives in the short and long term and so on. There is also another view that the interpretation of directors of the company for success is a meaningful explanation and cannot be challenged, provided that the acts of the directors

[56] 906 A.2d 27 (2006).
[57] [2020] EWHC 686 (Ch).
[58] Juenger (n 53) 1253-1254; Nowicki (n 54) 457.
[59] [2020] EWHC 1833 (Ch).

are in good faith. Although some concern has been expressed that directors might make business decisions on such matters as broad strategies and that we cannot review these decisions in courts, this can be countered by the argument that directors must always act in good faith and without negligence in making decisions or they will be liable for breach of duty to exercise reasonable care, skill and care in accordance with s 174 of CA 2006.[60]

Lord Goldsmith considered the success of commercial companies according to whether it created a long-term increase in its value. The company's constitution and resolutions may determine the appropriate success of the company by setting out what the members collectively want the company to achieve. These objectives can either be clarified at the time of the establishment of the company and in the company memorandum or subsequently approved by shareholder resolutions. He also stated that most investors in companies often consider money as the objective with a long-term increase in value. For some companies, such as charities and community interest companies, success means achieving the objectives for which the company was established.[61]

Many directors believe that giving immediate returns to shareholders is a priority regardless of the long term value of such a course of action. This is the reason why the Company Law Review Steering Group considered it necessary to encourage long-term work through the drafting of a new law in 2006 in which directors' duties were to work for the ultimate objective of achieving benefit to shareholders by building a successful business that takes into account all stakeholders and the impact of reputation on the business. [62] It is therefore imperative for directors to examine the company's objectives and to know what could be considered success for the members as a whole. They can do this by looking at the company's constitution, the shareholders' decisions and everything else that is related. The determination of the success of the company must be consistent with its constitution because this consistency is the core of the first duty in s 171 that directors of a company must act in accordance with

[60] Keay (n 49) 15-16; The Explanatory Notes to the CA 2006, part 327.
[61] DTI, Lord Goldsmith (n 43) column 255, 256, 258.
[62] DTI, Lord Goldsmith (n 43) column 125, 255; L Cerioni, 'The Success of the Company in S. 172(1) of the UK CA 2006: Towards an Enlightened Directors Primacy' (2008) 4(1) Original L Rev 8, 9-10.

the company's constitution. The ability of companies to succeed depends on their relationships with their business partners, customers and other stakeholders. However, first and foremost the focus must be on the fact that ultimate success is always measured in terms of the benefits to members.[63] In *Fairford Water Ski Club v Cohoon*,[64] the directors were liable for breach of duty to promote the success of the company. The claim related to the transfer of a plot, situated by a lake, from the company to a director (Craig). The company considered this as a 'substantial property transaction' for Companies Act purposes and thus was invalid because it did not have members' approval, which breaches the duties stipulated in ss171 and 172 of the CA 2006. The judge upheld the company's claim and considered that the transfer was a breach of duty to promote the success of the company, as it was made at a significant undervalue. The directors were accountable to the company for equitable compensation for the loss.

There has been some discussion on the reason for the legislator's use of the word 'members' rather than 'shareholders'. The explanation is that the legislation applies to limited liability companies and companies that are limited to stocks. According to Keay,[65] courts have assumed that the term 'members as a whole' includes current and future shareholders and the company's goal to make a profit. This logic can be applied if the long-term approach is adopted to include future and current shareholders. In the case of adopting a short-term approach, it is difficult for courts to evaluate directors' decisions because some of the decisions may be more beneficial to the current shareholder than the future shareholder. However, s 260(C) and s 994(2) of CA 2006 refute this view, stating that the term member includes every person who is a member or not a member but owns shares in the company. In other words, a member is a shareholder whose name appears on the register of members, as sometimes shares are transferred but by error the registration never occurs.

S 172 of CA 2006 lists the factors that directors must consider when executing their duty to promote the success of the company. It is noteworthy that this does

[63] CA 2006, ss 17, 29, 171 and 172; DTI, Lord Goldsmith (n 43) column 125, 255, 256, 258.
[64] [2020] EWHC 290 (Comm).
[65] Keay (n 40) 110.

not impose a new duty on directors other than to the company. The general directors' duties are owed by company directors to the company as stated in s 170 of CA 2006. Keay[66] argues that this list of factors does not offer anything new. It can be said that there was nothing to prevent directors, before the CA 2006, from considering the likely consequences of any decision in the long term and the interests of others as well as shareholders as long as directors acted in good faith for the interests of the company as a whole. However, directors are now, after the enactment of this duty, obligated to consider these factors.

The idea of shares, in general, is in essence partly about 'rights to future income'. This means that usually there can be no benefit to shareholders without the continued flow of profits in the future. Unless the investment objective is a capital asset that may increase in value, which is usually linked to the company's strategic decisions. In turn, to maintain the company's ability to sustain its business and profits over time, the company's strategic decisions and the possible long-term consequences of these strategic decisions must be considered. These consequences must be considered in economic terms in accordance with accounting measures. This means considering the flow of financial resources in a timely manner to meet the entitlement of stakeholders, which ultimately depends on the company's revenue and business viability. Indeed, shareholders' interests are unlikely to be enhanced if the company's employees or customers feel resentful.[67]

The omission of the short-term implication in s 172 of CA 2006 has been considered to indicate the importance of the long-term and its preference over the short-term. However, most directors consider the short-term and believe that giving shareholders immediate returns is a priority. The legislator also felt it was necessary to encourage long-term business to continue the company's business. This is allowed by common law provisions in view of long-term issues in decision-making.[68] The Organization for Economic Cooperation and Development (OECD) has confirmed that considering the interests of

[66] Keay (n 60) 17-19.
[67] Cerioni (n 62) 11-12.
[68] Lord Goldsmith (n 43) column, 125, 255, 258.

stakeholders is a high ethical standard that is certainly in the company's long-term interest, making it more credible and trustworthy.[69]

Incorporating the interests of the company's employees is among the factors that directors must consider in making their decisions to promote the success of the company. OECD Principles of Corporate Governance state that mechanisms to enhance the performance of employee participation should be allowed in the context of corporate governance such as the representation of staff on boards and in governance processes and the mechanisms of sharing of profits, pension commitments and others related to performance enhancement. In this regard, the two-tier board can be considered as a representative of the company's employees, which achieves a balance between all stakeholder interests in the company. This board achieves greater transparency because of the balance of power between management and monitoring and enhanced response to stakeholders (employees).[70] This incorporating implies its importance as the employee is the human capital of the company and is of value to the company and not just a tool that manages the company's financial assets. Directors have power to, therefore, make provisions for employees regarding the cessation or transfer of the company' business under s 247 even if this is a breach of the public duty to promote the success of the company.[71] Section 172 of the Companies Act 2006 requires directors to have regard to the employee interest, a requirement that can be traced back to 1980.

The powers of the company's directors include making provision for the benefit of anyone employed by the company or its subsidiaries. Payments to employees are permitted provided that there is sufficient reason for them related to promoting the success of the company, such as contributing to the development of the company's business which benefits members later because of the efforts made by the employees to make profits. This is because it may

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[69] G20/OECD, ‘Principles of Corporate Governance’ (2015) <https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf> accessed 8 February 2018; Annotations to the OECD Principles of Corporate Governance (2004) <http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf> accessed 7 February 2018.

[70] See (2.2.1 Board structure).

[71] G20/OECD (n 69); CA 2006, s 247.

be a good reason to retain qualified staff or enhance the morale as this will lead to benefits for members over the long-term.[72] Directors may take into account certain issues that affect employees, such as by taking into consideration their views on any matter related to the company's operations or health and safety issues in the company and so forth. Directors, therefore, have complete discretion in assessing the interests of staff.[73]

The company should invest and establish a good working environment by giving employees common sense through good strategic communication and inspiring leadership. This will lead to employees treating the company not only as a source of income but as the right organization through which to develop their professional potential. All of these strategies aim to achieve the company's objectives and to indicate to employees that they are an essential part of achieving the desired objectives by building a long-term mutually beneficial relationship.[74] The other side of this, as Cerioni[75] states, is that employees may be dissatisfied when they see their interests being neglected. Their dissatisfaction will generate poor relations and negatively affect the organization because of the interconnection of their work and the final product provided by the company.

The court rejected the disgruntled shareholders' claim about directors in *Hampson v Price's Patent Candle Co*.[76] The shareholders here claimed that the directors exceeded their granted powers. Directors made a gratuity to the employees who had displayed good character throughout the year, for their efforts to help the company make profits more than has been declared during previous sixteen years. It was argued that the amounts paid, which were in the form of one week's extra pay to each employee in the company who have displayed good character throughout the year, were outside the ambit of the directors' powers. The reason for the court's rejection of the claim was that the meaning of management for the company's affairs is managing the company in the best possible way. Directors know how to administer the company's

[72] Inferred from the judgment in *Hampson v Price's Patent Candle Co* (1876) 45 LJ Ch 437.
[73] G20/OECD (n 69).
[74] Ibid.
[75] Cerioni (n 62) 12.
[76] (1876) 45 LJ Ch 437.

business for the best, and they should be allowed to decide whether the action is beneficial to the company or not. Furthermore, the amount paid was not great and the conduct was appropriate for the company's affairs as payment to employees was likely to motivate them to work more seriously in the future for the benefit of the company.

However, the above-mentioned ‘in the interests of the company's employees’ does not mean giving employees full immunity, nor does it omit consideration of the ultimate objective of the company, which is usually the benefit of the members as a whole. In a ministerial statement, Margaret Hodge MP,[77] in contrast to the government view, stated that the ESV approach is beneficial both to the owners of businesses and society. The company's interests and its employees' interests will not always be identical, for example, it will sometimes be necessary for the company to lay off employees.

This also applies to suppliers and customers in terms of strengthening the company's relationships with them for long-term gains. Relationships have been described as ‘intangible assets’ and ‘relational assets’ are a fundamental element of the company's organisational wealth. This means the company's ability to create long-term value is by relying, inter alia, on customers and suppliers. Economic studies have confirmed that customer loyalty to the brand reduces marketing costs and stabilises the volume of production and sales, thus increasing the operating profit.[78] OECD Principles of Corporate Governance[79] are consistent with the provisions of s 172 of CA 2006, which urge stakeholders to be dealt with fairly whilst considering all their interests.

It is necessary to take into account the impact of the company's operations on society and the environment in order to promote good relations with society. A business that has public support or at least does not appear hostile to the public can be involved in community planning and problem-solving. This may give it the opportunity to present its own side when an opportunity arises through a

[77] DTI, ‘CA 2006: Duties of Company Directors, Ministerial Statements (by Margaret Hodge)’ (DTI, June 2007). Margaret Hodge, Commons Report, 17 October 2006, column 789, available at: <http://www.berr.gov.uk/files/file40139.pdf> (accessed 7 Feb 2018).
[78] Cerioni (n 62) 13-14.
[79] G20/OECD (n 69).

donation to resolve an issue or to refrain from some actions that affect society. In actual fact, the existence of a business which has negative impacts on society and the environment, or that creates public hostility, is subject to constant threat even if it is profitable for a period of time. This is because a negative reputation tends to spread widely and rapidly, which provides a perfectly competitive environment for any competitors. Arguably, the determination of the negative impact of the company's operations on reality is not determined in a legal text but it is left to directors' discretion and business context. Perhaps the reason for inclusion in s 172 is to encourage companies to take care of the environment through compliance with ecosystem and health measures and encourage companies to disclose policies on business ethics and the environment. It can further be the company's' expenses for the benefit of society and the environment does not conflict with the success of the company and it is not considered as an exceeded power granted by directors in the courts' view.[80]

The final factor states that directors must have regard for the need to act fairly towards the company's members. This means not showing a preference for one shareholder or group of shareholders over the rest, especially if some of the shareholders are weaker than others who have not been involved in the appointment of directors.[81] ICSA Guidance on Directors' General Duties stipulates that directors need to ensure that private shareholders are not disadvantaged by the structure of corporate transactions or share issues, or by a lack of information, and that it is important to find a useful system to achieve equality between shareholders.[82]

It is noted that the mentioned factors endeavour to achieve objectives, the most prominent of which is to build the company's reputation for high standards of business conduct and maintain it, which made the legislator provide it as one of the factors to be considered. It is necessary that the company consider the factors in s 172 and other factors that help maintain the company's reputation to promote the success of the company for the benefit of the members as a

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[80] Cerioni (n 62) 14-15; G20/OECD (n 69); Keay (n 40) 123-126.
[81] CA 2006, s 172(1)(f).
[82] ICSA 'Guidance on Directors' General Duties' (June 2015) 2.2.1(6).

whole since the factors stipulated are not exhaustive but highlight areas of importance that reflect responsible business behaviour.[83] Corporate social responsibility (CSR) can be considered as a way to build a company's reputation and maintain it. The importance of reputation stems from the importance of trust in business operations because of the reliance on credit for daily operations. Therefore, OECD Principles of Corporate Governance found that many companies have found it useful to develop codes of conduct for their operations based on professional standards.[84]

It can be said that these factors may cause some conflict in how directors take into account these factors among themselves and also they with the benefit of members as a whole. However, the answer to that is simply that in the event of a conflict between the factors themselves, directors, based on their own discretion, choose among the factors the action that would promote the success of the company for the benefit of members as a whole, even if that action has a negative impact on one or more of these factors. Taking these factors into consideration does not mean that traditional considerations, such as the profitability, financial implications on shareholders, etc, should be neglected as these are a priority and of crucial importance to promote the success of the company for the benefit of the members as a whole. In having regard to these factors, the duty to exercise reasonable care, skill and diligence will apply.[85] In *Martin Shepherd v Michael Roy Williamson, Phoenix Contracts (Leicester) Limited*,[86] the judgment was that the director had been balancing the adverse consequences of his conduct with regard to its relationship with its important customer and the possibility of harming the company's employees if the contract had not been obtained. The director was also concerned about the company's reputation as a whole because of the Office of Fair Trading (OFT) investigation in collusive practices in the construction industry. It was among those practices giving and taking of covers by submitting a higher bid than competitors for a contract with the knowledge that it would not succeed. The

[83] Explanatory Notes to the CA 2006, part 326; ICSA (n 82) 2.2.2; Lord Goldsmith (n 43) 9 May 2006, column 846.
[84] Cerioni (n 62) 15; G20/OECD (n 69); Keay (n 40) 126.
[85] Explanatory Notes to the CA 2006, part 328; ICSA (n 82) 2.2.2 and 2.2.4.
[86] [2010] EWHC 2375 (Ch).

aim was to enable the parties to make special arrangements about who would undertake construction projects and how they would share the price. Therefore, the director of the company decided to inform the hotel (an important customer of the company) to frustrating any covering in which the company may have participated as the company was involved in covering, but its intention for the participation in covering was only for not being removed from a client's tender list by the contractor. The covering was bid-rigged by some construction contractors. The director who informed the hotel explained that he was very concerned about the OFT investigation. The director denied bad faith or any motive other than the desire to defeat the covering in which the company may be involved, while the shareholder considered that the director acted to harm the company.

It is important when dealing with the duty to promote the success of the company to indicate that directors may need to consider various factors in certain circumstances. S 172(3) of CA 2006 provides that directors must consider or act in the interests of creditors of the company in certain circumstances. The term 'certain circumstances' is not defined, but subjecting this section to any enactment or rule of law requiring directors to consider or act in the interests of creditors of the company has removed the ambiguity by applying the provisions of the Insolvency Act 1986,[87] which interprets the meaning into the insolvency of the company or the company being at risk of insolvency. In this case, directors are required to take a balanced view to promote the success of the company and the risks which creditors may be exposed to because they have not received their receivables when the insolvency occurs.

Under ss 214 and 246ZB of the Insolvency Act 1986, the court may, at the request of the liquidator or the administrator[88], declare that the director is liable if there is a failure to take into account the interests of creditors in the event the company has entered into insolvent liquidation or the director was aware of or ought to have concluded that there was no reasonable prospect that the

[87] Insolvency Act 1986, ss 213 and 214.
[88] Insolvency Act 1986, s 246ZB.

company would avoid engaging in the insolvent liquidation before the company's winding up commencement. The conclusions and steps which directors ought to reach and take are those that would be known or ascertained or are done by reasonably diligent directors who have the common experience that is fairly expected from directors or from anyone doing the same functions as that of directors in respect of the company. In *Toone v Ross*,[89] a payment of unlawful distributions to employees and shareholders was made by the directors at a time when the company had been insolvent. The applicants, the joint liquidators, applied for an order that the directors of the company were liable to repay certain payments made by the company. The applicants argued that the payments were unlawful distributions to the shareholders and made at a time when the company was insolvent and the respondents should have taken into account the interests of the company's creditors, not just the shareholders. The court agreed. Therefore, the respondents were liable to account for the loss.

In this regard, it should be noted that there are measures in the Corporate Insolvency and Governance Act 2020, which puts in place measures to amend insolvency and company law to meet the challenges caused by the impact of coronavirus (COVID-19). One of these measures, there will be a temporary suspension only for eligible companies, originally from 1 March 2020 until 30 September 2020, of s 214 of the Insolvency Act 1986. Therefore, the court assumes that directors are not liable for any worsening of the company financial position or its creditors because of breaching the UK's wrongful trading provisions that occur during the mentioned period. [90] This amnesty does not cover other forms of directorial liability. On 26 November 2020, the Corporate Insolvency and Governance Act 2020 (Coronavirus) (Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations 2020 came into force. The Regulations have extended the wrongful trading liability suspension to begin with 26th November 2020 until 30th April 2021.

[89] [2019] EWHC 2855 (Ch).

[90] The Corporate Insolvency and Governance Act 2020, s.12 Suspension of liability for wrongful trading: Great Britain.

The Insolvency Act 1986 determines the exact time for entry into force of the interests of creditors. It provides that the company's directors must comply with the interests of creditors at the commencement of the actual insolvency, so-called insolvent liquidation, when the company has insufficient assets to repay its debts, other liabilities and the expenses of the winding up.[91] However, the duty to take into account the interests of creditors may arise in circumstances where the company has not actually been insolvent. But to what extent should the company be close to the insolvency? The defendants in *BTI 2014 LLC v Sequana SA*[92] argued that it must be very close to insolvency so that there is a real risk of insolvency rather than remote. It is, therefore, possible to say that there are **<u>four</u>** possible answers to the question of when the time for entry into force of the duty to take into account the interests of creditors takes effect. First, it may be when the company is actually insolvent, either on the basis of cash flow or balance sheet. Second, it may arise when the company is on the verge of insolvency or approaching insolvency. Third, it may arise when the company is insolvent or it is likely to be insolvent; in other words, it means that a company is of dubious solvency. Fourth, it may arise when there is a real risk of insolvency, unlike a remote risk of insolvency. In other words, such as the company in a parlous financial situation or financial difficulties. This may be an appropriate description of a company's situation in certain cases, but it is so vague that it cannot be considered as a useful test of the important step of commitment the duty of the interests of creditors.

Despite these possible answers, there is no decision in any English authority that clearly relies on the assumption that the duty of the interests of creditors arises from anything less than the actual insolvency. There is also a problem with the formulation of the second category (on the verge of insolvency) because it proposes a temporal test, it is proposed that the actual insolvency will be within a very short time. This may describe many situations in which the duty is considered, but it does not cover the situation that the company may be able to repay its debts when they are due for some time or a future period of time. Nevertheless, the likely insolvency may occur which prejudice creditors.

[91] Insolvency Act 1986, s 214.
[92] [2019] EWCA Civ 112.

Therefore, it is difficult to determine the exact moment at when a company becomes insolvent, the insolvency may suddenly occur. Directors may not know and are not expected to know that the company is actually insolvent until some time after it occurred.[93] Therefore, the definition of Insolvency Act 1986, to the inability to pay debts, excludes the reasonable suffering financial difficulties faced by companies. If it appears during the winding up of the company that any business of the company has breached s 214 of the Insolvency Act 1986 and s 172(3) of CA 2006, or any business has been carried on with intent to defraud the creditors of the company, the liquidator must claim against the directors and prove that the directors knew (at the time) the financial distress of the company and did not take every possible step to minimise the potential losses to the company's creditors. The obligation of the liquidator to prove breach by the director is evidence that the acquittal of directors is consistent with the rules of common law, in which the proof lies upon the one who affirms, not the one who denies.[94] Commenting on *BTI 2014 LLC v Sequana SA*,[95] Graham[96] says that, it is unfortunate that the company directors that pay a dividend in order to place this amount out of the reach of its creditors so as to bring s.423 of the Insolvency Act 1986 into play, is treated on the basis that they act according to their duties to the company if the company is not insolvent. Also, that the standard for the duty to take into account the interests of creditors under s.172 of the CA 2006 is very low and it constitutes a gap in the law which, if not resolved by the courts, must be addressed by Parliament.

The applied test of the duty to act in the interest of the company or creditors in the case of insolvency is an objective test. In cases where there is evidence of actual consideration of the best interests of the company, the considered test is subjective rather than objective, which is if a director honestly believes that his/her act or omission is in the interest of the company, it is a state of his/her mind. In *Wessely and Peter Hughes-Holland v Richard White*,[97] The liquidators applied for an equitable compensation from the managing director for a breach

[93] Ibid.
[94] Insolvency Act 1986, ss 123, 213 and 214.
[95] [2019] EWCA Civ 112.
[96] Peter Graham, A note on the decisions in *BTI 2014 LLC v Sequana SA and BAT Industries Plc (BAT) v Sequana SA* (Case Comment), Comp. Law. 2017, 38(4), 116-119.
[97] [2018] EWHC 1499 (Ch).

of duties 171 and 172 in entering into the two deeds of release, since the director did not act mainly for the benefit of the creditors. The company ceased trading because of its financial situation on 10 May 2010 and it was put into a voluntary liquidation of creditors in 2011. On behalf of the company, the director executed a deed of release on 14 May and 20 May 2010 whereby the employer and the company were released from the future performance under the contracts. The employer was relieved of any liability of any payment obligations. The director received advice from insolvency practitioners that the novation was a means of avoiding termination of the existing contracts. The director also provided evidence that he had considered the novation would enhance the interests of employers, employees and creditors, and that this is the best way in these difficult circumstances. As the director gave evidence that he considered that all interests of employers, employees and creditors pointed in the same direction, his entry into the deeds of release was not in breach of duties under ss. 171 and 172. Because the conduct of the respondent (the director) must be judged at the time the act was committed and in that situation’s context and circumstances, and also because he genuinely considered he was acting in accordance with the advice of trusted professionals, and the insolvency consultants knew the plan of novation, therefore, his act was not considered to be in breach of the duties.

3.3.3 Duty to exercise independent judgment

The exercise of judgment independently by directors is a fundamental part of their fiduciary duties and powers. As being in a fiduciary position, directors are responsible both for all their performed actions and also the actions that should have been performed.[98] Directors are required to exercise their powers freely and independently of anyone else's control, but their exercise the judgement independently must comply with the duty in s172 of the CA 2006 to act in good faith and to promote the success of the company for the benefit of its members as a whole.[99] Therefore, the allegation of receiving instructions from others or

[98] See *Re City Equitable Fire Insurance Co* [1925] Ch. 407.
[99] CA 2006, ss 172 and 173.

allegation subjecting their powers to the will of others will not be a good defence for directors to evade any breach of a fiduciary duty.[100] This is entirely consistent with the legal principle known as "*Delegatus non potest delegare*".

In *Re City Equitable Fire Insurance Co*,[101] Bevan, who was the chairman of the company and a senior partner in *Ellis & Co,* influenced other directors in *Re City Equitable Fire Insurance Co* by directing them verbally, which was a cause of the company's losses. It started when *Re City Equitable Fire Insurance Co* granted *Ellis & Co* a loan of £30,000. Later the increases of the loan reached to £200,000. Although the estimate of the security value after the company's liquidation was under £31,000. The increase in the loan, despite the fact that the security was not adequate, would not have been for *Ellis & Co*. without Bevan's influence, with no evidence that directors were conscious or should have been conscious that there was not adequate cover for the loan, which caused the company to lose £1,200,000 in the end.

However, the directors' obligation to act independently does not mean that directors make their decision away from consulting any other person. The independent judgment requirement does not prevent directors from consulting or working with others, in some cases, non-consultation may be a breach of the duty to act with reasonable care. It is inconceivable for directors to do everything by themselves. This is because of the overlap and speed of business processes, balancing between the interests of the company and the interests of the stakeholders in the event of conflicts and what could be interpreted as fraudulent trading or wrongful; or even to exploit the opportunities and not to be missed under the pretext of hesitation or lack of knowledge of the associated risks. For these reasons, consultants are an appropriate solution to provide guidance and advice to directors to help solve challenges and exploit opportunities to the fullest. However, in Government response: Insolvency and Corporate Governance,[102] some respondents noted that the problem with the use of professional advice is that directors go for the advice they want, so

[100] Inferred from the judgment in *Re City Equitable Fire Insurance Co* [1925] Ch. 407.
[101] [1925] Ch. 407.
[102] See Insolvency and Corporate Governance, Government Response, 26 August 2018 (DBEIS), 8-9.

counsellors are likely to fail to exercise independence and their advice is to be as desired by the client. Yet the ultimate directors' judgment must be their own and they will bear the consequences of their actions.[103] The independent judgment is not infringed if directors act in accordance with any restrictions on the future exercise of their discretion under an agreement entered into by the company or in a way authorised by the company's constitution.[104] Shareholders are authorised, by special resolution, to direct directors to take a specified action or to refrain from taking a specified action. This authorisation is related to a subsequent resolution and does not invalidate anything, which has been done by directors before the passing of the resolution.[105] Furthermore, if directors of the company believe that a particular course of action is not in the best interests of the company, they may refuse to pursue this course of action even if the members wish it to be pursued. This can only be countered if the members ratify to pursue it which means relieving the directors from liabilities for breach of duties.[106]

Section 173 of CA 2006 does not impose a mechanism on directors to exercise independent judgment. It is left to directors to act freely. This may be because of the complexity and the difference of decision-making processes from a company to another.[107] The law imposes directors' exercise to be under the CA 2006 and the company's constitution, which enables directors to have discretion over the decision making without the need to return to the wishes or the approval of shareholders, based on the principle of division of power between directors and members aforementioned in 3.2 Duty to act within powers. The directors must use care in making decisions and they should be aware of instances in which the benefit of the business judgment rule is unavailable. In *re Tyson Food, Inc. (Tyson I),*[108] the directors failed to exercise independent business judgment by approving self-interested transactions. This meant that the business judgment rule did not apply to protect the directors.

[103] CA 2006, s 789; DTI, Lord Goldsmith (n 43) column 282; ICSA ‘Guidance on Directors' General Duties’ (June 2015) 2.3.3.
[104] CA 2006, s 173; The Explanatory Notes to the CA 2006, para 334.
[105] The Companies (Model Articles) Regulations 2008 (SI 2008/3229) reg 4.
[106] CA 2006, s 239.
[107] Marjan Marandi Parkinson, Directors' duty to exercise independent judgment: the path to s.173 of CA 2006 and beyond, Comp. Law. 2017, 38(9), 271-277.
[108] 919 A.2d 563 (2007).

Therefore, the directors must take reasonable measures to avoid self-interested transactions and to act in the best interests of the company in good faith.

There is debate over the position of nominee directors and the external influence on them. The CA 2006 does not define the concept of the nominee directors, the reason may be that "nominee director" is not a clear term because, in the view of the law, all registered directors owe the same duties, with regardless what they are called.[109] However, the term "nominee director" in companies cannot be overlooked, which means directors are nominated by shareholders or stakeholders of a company to represent their particular interests. The right to appoint a nominee director could be provided under the company's constitution, the appointor's influence or because of other reasons.

There is nothing wrong in appointing the nominee directors as long as they remain free to exercise their best judgment in the interests of the company they serves. Nominee directors' position can be difficult when the company's interests are not consistent with the interests of the appointor. In this position, there are two approaches that govern actions of the nominated director. The approach in English law is that the nominee director does not act in the appointor's interest except when the interests of the appointor and the company are compatible, otherwise it is a breach of the duty to exercise independent judgment.[110] This approach has been criticised as causing uncertainty in the law and lacked guidance with respect to the interests of non-shareholders. It also does not touch the reality of commercial companies which means it is not applicable, because the commercial reality imposes on the nominee directors to maintain loyalty to their nominators.[111] It is also contended that s 173 of CA 2006 authorises the restriction of the directors' future exercise of the

[109] Transparency & trust: enhancing the transparency of uk company ownership and increasing trust in uk business, Government response April 2014, 47, available at: <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/304297/bis-14-672-transparency-and-trust-consultation-response.pdf> accessed 23 April 2018.
[110] See Lord Denning in *Boulting and Another v Association of Cinematograph, Television and Allied Technicians* [1963] 2 Q.B. 606.
[111] Mohammad Rizal Salim and Teh Tai Yong, Market freedom or shareholders' protection? A comparative analysis of the duties of nominee directors (2008), International Journal of Law and Management, 50(4), 169-172.

discretionary power in accordance with an agreement which is believed to be in the interest of the company or the company's constitution allows it.[112] It is important to note that in terms of binding the company to the terms of a contract the case law made it clear as does s173 (2)(a) of CA 2006 that as long the directors/nominee directors bona fide thought the contract was in the interest of the company when they entered into it then it is valid even if it restricts the exercise of their discretion.[113] S 175 of CA 2006 expressly states that the duty to avoid conflicts of interest is not applied in the event that the directors so authorise. Thus, it is permissible to act in the interest of the nominators if it is authorised by directors in a private company unless this invalidates the company's constitution. While in a public company, its constitution must provide for this authorisation. [114] The other approach belongs to an Australian court that is completely contrary to the English approach by recognising that the directors' consideration is in the interests of their nominators and that the directors must have a reasonable belief that their action is in the interest of both the company and the nominators together. [115] The company's constitution may determine the company's interests, which may include the nominee directors who act in the appointors' interests.[116] This approach has been criticised by the fact that the directors' consideration to the interests of the nominators and the preference of nominators' interests over the interests of the company is contrary to the avoidance of actual or potential conflict. It also violates the duty not to disclose company information or misuse the information without the company's consent.[117] S 170(1) of CA 2006 explicitly states that directors owe their duties to the company, not to something else. Finally, the work of the nominee directors is considered to be related to two irreconcilable duties.[118]

The persons assigned to subsidiaries are considered to be the most prominent categories of the nominee directors by holding companies. *In Charterbridge*

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[112] CA 2006, s 173.
[113] See *Thorby v Goldberg* [1964] 112 CLR 597 and *Fulham LBC v Cabra Estates Ltd* [1992] BCC 863.
[114] CA 2006, s 175.
[115] Inferred from the judgment in *Re Broadcasting Station 2GB Pty Ltd* [1964-1965] NSWR 1648 and *Levin v Clark* [1962] NSWR 686.
[116] Inferred from the judgment in *Levin v Clark* [1962] NSWR 686.
[117] Rizal Salim and Yong (n 111), 173-174.
[118] See *Hilton v Barker Booth and Eastwood (A Firm)* [2005] UKHL 8.

Corporation Ltd v. Lloyds Bank Ltd,[119] Pennycuick J held that each company was a separate legal entity, the directors of the company were not entitled to sacrifice its interests for the other companies' interests within a corporate group. The court in this case considered all the circumstances, including that the company's memorandum expressly allowed the company to consider the interests of another company. The court held that taking into account the interests of the other company was one of the purposes expressed and would be contrary if some restrictions were put in place to do so. While some case law state that nominee directors must act in the interest of the company itself and not in the interest of the company group.[120] This is due to the fact that the company's creditors may only look at the company in repaying their debts without the parent company as in the rest of the stakeholders.[121] In general, wholly owned subsidiaries are consistent with the parent company. The parent company often appoints the directors of the subsidiary and removes them and it is considered the main source of finance. Its directors are often the directors of the parent company, with whom they communicate the parent company's policy and direction.[122] In such a company it often seems that the interests of the subsidiary are consistent with the interests of the parent company. However, in cases where there may be a difference of interests, such as that the subsidiary has significant creditors and the like with regard to taking into account the interests of the stakeholders. Therefore, the nominee directors are obliged to take into account the interests of the company itself, away from the parent company.[123]

In this regard, a question arises about the liability of the parent company for the debts of its subsidiary. In the circumstances in which the parent company exercises administrative functions in the subsidiary and becomes a party to wrongful trading, it is fully responsible for the debts.[124] This confusion may be due to the fact that the reason for the establishment of subsidiary companies is

[119] [1970] 1 Ch 62.
[120] See *Walker v. Wimborne*, (1976) 137 CLR 1.
[121] Redmond P, 'Nominee Directors.' (1987) 10(2) UNSWLJ 194, 212.
[122] See Walton J in *Burmah v Hedges and Butler* [1979] 1 WLR 160.
[123] Rizal Salim and Yong (n 111), 172-173.
[124] Insolvency Act 1986, s 214.

often the avoidance by the parent company from potential liability and transfer the liability to another legal person (subsidiary companies).

Because the parent company often controls the subsidiary by appointing and removing the subsidiary's directors and so on; and the directors of the subsidiary are often the directors of the parent company, with whom they communicate the parent company's policy and direction,[125] the English Court of Appeal held that the distinction between a shadow director and a de-facto director actually is not always clear.[126] This is because the influence of the person may be hidden at times but be clear at other times.[127] The holding company scenario is the most prominent example that underlines this problem in terms of determining their status. Holding company usually does not deviate from two things, either to be only a shareholder in the other company without interfering in its administration or having the decision to administer the subsidiary. In the second case, it is claimed that the holding company is considered as a shadow director of the subsidiary.[128] However, the CA 2006 explicitly states that a body corporate is not considered as a shadow director of any of its subsidiary companies, by reason of the subsidiary's directors habitually acting in accordance with the directions and instructions of the parent company, for the purposes of general duties of directors.[129]

A related issue in this area is raised in the literature on an interlocking directorate. This means that the same person is a director of two or more companies at the same time.[130] Some researchers have realised that interlocking directorates have a positive effect on both society and the interlocking companies themselves. It benefits the society through an efficient and stable supply of consumer products. It also benefits the companies by reducing uncertainty in the market by being able to know which business companies can cooperate with and know the most vulnerable competitors. It

[125] See Walton J in *Burmah v Hedges and Butler* [1979] 1 WLR 160.
[126] See Millett J in *Re Kaytech International Plc*. [1999] B.C.C. 390.
[127] Locke N, 'Shadow Directors: Lessons from Abroad.' (2002) 14(3) S Afr Mercantile LJ 420, 422 and 428.
[128] Locke (n93), 429.
[129] CA 2006, s 251(3).
[130] Johnson P and Apps RR, 'Interlocking Directorates among the UK's Largest Companies.' (1979) 24(2) Antitrust Bull 357, 375-385.

also benefits parties to predict the future market status.[131] However, there are some concerns that interlocking directorate can increase the influence of these companies by acting as a group to reduce competition, thereby harming the consumer. It is also considered as a cause of the spread of bad information in the market, leading to negative effects.[132] This concern began in the late nineteenth century in the United States of America on the impact of interlocking directorate on competition, which led to this concern to the enact s 8 of the Clayton Antitrust Act of 1914 which prohibits interlocking directorate between competing companies.[133] The situation in the United Kingdom, like the United States, is that the interlocking directorate is no longer consistent with directors' duties.[134]

This duty requires directors to exercise their powers independently, without subjecting their powers to others' will, whether by delegation or otherwise.[135] This is entirely consistent with the legal principle known as "*Delegatus non potest delegare*". This principle means that when a person has a power or a power to make a decision, they must exercise the power personally and must not delegate it to others unless the original source of authority authorises expressly them to delegate it to another person. As expressly provided in the CA 2006, directors derive their power from the company's constitution.[136] Therefore, the duty to exercise independent judgment does not confer directors the power to delegate, nor does preclude directors from exercising the delegation power granted by the company's constitution.[137] But directors must decide independently whether to follow the action suggested by that a delegated person.[138]

[131] Fischer EN, 'Serving More than One Master: A Social Network Analysis of Section 8 of the Clayton Act.' (2015) 41(1) J Corp L 313, 321.
[132] Ibid, 323.
[133] Johnson P and Apps RR(n 130), 375-385.
[134] CA 2006, s175; *CJC Media (Scotland) Ltd v Sinclair* [2019] CSOH 8; *Shepherds Investments Ltd v Walters* [2006] EWHC 836 (Ch).
[135] The Explanatory Notes to the CA 2006, part 333.
[136] CA 2006, s172.
[137] The Explanatory Notes to the CA 2006, part 335.
[138] ICSA 'Guidance on Directors' General Duties' (June 2015) 2.3.3.

In *Re Leeds Banking Company v Howard's*,[139] Howard was a shareholder who had been offered some of the reserved shares, he had accepted conditionally. The board of directors did not explicitly assent to conditional acceptance. The board of directors decided that the remaining undistributed shares should be allotted. The manager afterwards wrote to Howard that the accepted shares had been allotted to him. There was ambiguity in whether (Howard's shares) were considered of "the remaining undistributed shares" or not. The judgment, in this case, stated that no decision had been made with respect to those shares and there was no acceptance by the board of directors of Mr. Howard's terms. It also appears that through the deed of settlement under which the company was established, the power to allot these shares was delegated only to the board of directors, and the board had no power to delegate the allotment of shares to the manager and two private directors, and that the rule "*delegatus non potest delegare*" applies. Therefore, in respect of Howard's shares, Mr. Howard's name must be removed from the shares list.

3.3.4 Duty to exercise reasonable care, skills, and diligence

In order to ascertain the performance of managerial powers by company directors and their care of duties, several things must be considered, including the consideration of the nature and manner of the company's business, in accordance with the circumstances surrounding it with what is not inconsistent with the company's constitution and the provisions of the director's contract appointment.[140] Judicial decisions must also be considered to determine the standard of competence required of the company's directors in the field of skill, care and diligence.

It can be recognised that the standard of (care, skills, and diligence) in the English common law was developed in two phases, the first is pre-1986 and the second it began from 1986. Each phase is characterised by a standard to determine (care, skills, and diligence). The pre-1986 standard of care and skills was a subjective standard where directors are not required in the performance of their duties skill more than what is reasonably expected from someone who

[139] (1865-66) L.R. 1 Ch. App. 561.
[140] See *Re City Equitable Fire Insurance Company, Limited* [1925] Ch. 407.

has the same of knowledge and experience.[141] Therefore, directors are discharged from their legal company's duties if they act honestly for the company benefit and they did their best as much as they could[142]. Neville J, in *Re Brazilian Rubber Plantation and Estates*,[143] held that directors might manage a rubber company in total ignorance with regard to rubber, without taking responsibility for the mistakes that may result from this ignorance. While if the directors familiar with rubber products, the company must be given the advantage of knowing when doing business. Directors must take reasonable care that an ordinary man is expected to take under the same circumstances.

Since the Insolvency Act 1986 was enacted, it can be considered as the beginning of the adoption phase of the objective and subjective care standard together based on what is reasonably expected from someone professional in their position and considering the knowledge, skill and experience that they actually have. The judgment in *Norman & Anor v Theodore Goddard & Ors,*[144] and *Re D'Jan of London Ltd*,[145] confirmed what is stated in s 214(4) of the Insolvency Act 1986. This judicial precedent adds an additional standard of care for what is stated in *Re City Equitable Fire Insurance Company, Limited*.[146] The standard of care expected from directors in *Norman & Anor v Theodore Goddard & Ors*,[147] and *Re D'Jan of London Ltd*,[148] is, having the common experience that is fairly expected from a director or from anyone doing the same functions as that of directors in respect of the company and considering the knowledge, skill and experience that they actually have. In turn, s 174 of Companies Act does not differ from what is stated in the Insolvency Act 1986, *Norman & Anor v Theodore Goddard & Ors*,[149] and *Re D'Jan of London Ltd*,[150] in determining the standard of care expected from directors. In *Re D'Jan of*

[141] Ibid.
[142] Cassidy J, 'Directors' Duty of Care in Australia - A Reform Model.' (2008) 16(1) Asia Pac L Rev 19.
[143] [1911] 1 Ch. 425.
[144] [1992] B.C.C. 14.
[145] [1993] B.C.C. 646.
[146] [1925] Ch. 407.
[147] [1992] B.C.C. 14.
[148] [1993] B.C.C. 646.
[149] [1992] B.C.C. 14.
[150] [1993] B.C.C. 646.

London Ltd,[151] Mr D'Jan signed a change to the insurance policy that, the insurance broker had filled out, without reading it. The insurance form contained a mistake; the answer "No" was to a question that was supposed to be "Yes" with regard whether he or any director or partner went into liquidation; he was. This mistake was enough for the insurance company to shirk responsibility. As result of this, the insurance company refused responsibility for a fire at the company's premises, which destroyed £174,000 of stock. Signing forms without reading them can be done by a busy director. Directors often do not read every document that they need to sign, but this does not mean they were not negligent. The form was very simple and asked questions that the director was the best person to answer. Mr D'Jan did not appear reasonable care and diligence when he signed the form as stated in s 214(4) of the Insolvency Act 1986. Therefore, Mr D'Jan was liable to compensate the company, based on the provisions of the Insolvency Act 1986 and subject to the provisions of s 727[152] of the Companies Act 1985. In *Manolete Partners v Ellis,*[153] the wrongful trading claim against a director failed due to his exercising reasonable care. Whereas, the director responded that there was no point in the company history when it could reasonably be argued that the director ought to have concluded there was no reasonable prospect that the company would avoid going into insolvent liquidation. The director also relied on Hurst & Co’s Addendum “Independent Accountants Report” stated that the company would not be trading from an insolvent position. The judge upheld the director's defence and considered the director exercised reasonable care.

The situation in the exercise of diligence is the same in the standard of care and skills. The exercise of diligence was in two phases as well in the English common law, the first is pre-1986 and the second it began from 1986. In *Re City Equitable Fire Insurance Company, Limited*,[154] Romer J adopted with regard to the directors’ diligence that directors' duties are of an intermittent nature and must be carried out at the board of directors’ meetings. Directors are not obliged to attend all board meetings but in accordance with

[151] Ibid.
[152] S 727 replaced by CA 2006 s. 1157.
[153] [2020] EWHC 1674 (Ch).
[154] [1925] Ch. 407.

circumstances that they are reasonably able to attend. In *Re Cardiff Savings Bank*,[155] the Marquis of Bute who was described in the bank documents issued as president, at the age of six months after the death of his father in 1848. In 1869 Marquis of Bute attended the first meeting of the trustees and managers of the bank after 21 years of his appointment as a president of the bank. It was not considered the omission of attending meetings of the bank as neglect or omit duties.

The required approach has evolved with regard to the standard of diligence expected of directors by the issuance of the Insolvency Act 1986 and addressing the wrongful trading[156] provisions in terms of what directors are responsible to the creditors of the company. Introducing the provisions of the Company Directors Disqualification Act 1986[157] as well, allowed the courts to make an order to disqualify unfit directors of companies in the management of a company. This means an increase in rigour, and repeal of old standards. In *Baker v Secretary of State for Trade and Industry*,[158] the Secretary of State for Trade and Industry took action to disqualify directors against ten directors for not ensuring that the company had sufficient systems to control and monitor the activities of small employees, especially individual traders whose unauthorised transactions led to the collapse of Barings Bank. The case went against three for trial. One of the three directors, "Mr Baker", was dismissed as the manager of the main commercial banking branch. The judge concluded that the Secretary of State for Trade and Industry had proved that "Mr Baker" was incompetent under s 6 of Company Directors Disqualification Act 1986.

In practice, it is not expected that directors do everything by themselves. In the event that directors decide to rely on the work of others by delegating some tasks and responsibilities to others in accordance with the known legal principle aforementioned "*Delegatus non potest delegare*". However, directors, based on the judgment in *Baker v Secretary of State for Trade and Industry*,[159] must take adequate measures to ensure that the person who is delegated is proper

[155] [1892] 2 Ch. 100.
[156] Insolvency Act 1986, s 214.
[157] Company Directors Disqualification Act 1986, ss 1 and 6.
[158] [2001] BCC 273.
[159] Ibid.

to carry out the tasks and responsibilities. Nor are the directors absolved from the duty of supervising the functions of the person delegated.

3.3.5 Duty to avoid conflicts of interest and to declare the interest in a proposed transaction or arrangement

The duty to avoid conflicts of interest is one of the directors' fiduciary duties, which is associated with the trust entrusted to them to exercise managerial powers properly. S 175 of the CA 2006 stipulates that directors must avoid a circumstance, which have or can have a direct or indirect personal interest in conflict explicitly with the company's interests or is likely to conflict with the interests of the company, including a conflict of interest and duty and a conflict of duties. The provisions of this section also provide examples of the circumstances to which the duty applies. This involves exploiting the position of directors in a company by misuse of property, information and opportunities for the personal interest of the directors.[160] The director's resignation does not resolve the conflict of interest, as the directors remain liable for the duty to avoid conflicts of interest. Therefore, directors must not take advantage of any property, information or opportunities that they realised when they were acting as a director.[161] In *Aberdeen Railway Co v Blaikie Brothers*,[162] Aberdeen Railway Co. needed a number of iron chairs, and Blaikie Brothers was contracted to supply them. Blaikie was the director and the chairman of Aberdeen Railway Co. and also a managing partner in Blaikie Brothers. After handing over two-thirds of the iron chairs, Aberdeen Railway Co. refused to accept any more chairs. Blaikie Brothers sought to implement the contract or obtain compensation for breach of contract. Aberdeen Railway Co. succeeded in making the Blaikie's self-dealing contract voidable. In *Davies v Ford,*[163] the directors breached their duties by diverting its business to their own company. The directors defended themselves by arguing that that the company had been close to insolvency and it had been unable to take up the business opportunities exploited by themselves for their own benefit. So, the company's situation could

[160] CA 2006. s 175.
[161] CA 2006, s 170(2); See *Shepherds Investments Ltd v Walters*, [2006] EWHC 836 (Ch).
[162] (1854) 1 Macq 461.
[163] [2020] EWHC 686 (Ch).

not reasonably be regarded as likely to give rise to a conflict of interest. The argument was rejected. First, the express term in s175(2) of CA 2006, stating that the "This applies in particular to the exploitation...opportunity (and it is immaterial whether the company could take advantage of...opportunity)". Second, directors of an insolvent company have a duty to act in the interests of creditors. It follows that the only situations that can reasonably be regarded as likely to give rise to a conflict of interest are where the directors act in a manner conflicting with the interests of the creditors, and not that of the shareholders. Therefore, the directors were accountable to the company for equitable compensation for the loss.

Directors must refrain from working for a competitive company at the same time as holding office. Under the CA 2006, this conduct is no longer consistent with directors' duties.[164] In *Shepherds Investments Ltd v Walters*,[165] Mr Walters and Mr Hindle, who are the former directors of the claimant investment companies, breached their fiduciary duties and breached their obligation of loyalty by the steps they took before their resignation from the company in encouraging the establishment of a competing company and violated the terms of employment contract. Directors were obligated to the contract of employment in the service of the employer in good faith and fidelity for the best in the company's interest. They also not to participate directly or indirectly in any business rival for a period of six months from the end of their employment. In *CJC Media (Scotland) Ltd v Sinclair*,[166] the director established a rival company for the previous company after the resignation and appropriating a contract that was a mature business opportunity belonging to the previous company. The defender took active steps to solicit the contract, which he had the duty to avoid a conflict with the previous company (the pursuer) in relation to that contract and he had known that the company (the pursuer) was continuing to seek to obtain the opportunity. This was considered as the breach of his fiduciary duties following his resignation. The court refused to grant him the relief because he had not acted reasonably.

[164] CA 2006, s175; ICSA 'Guidance on Directors' General Duties' (June 2015) 2.5.2; Inferred from the judgment in *Shepherds Investments Ltd v Walters* [2006] EWHC 836 (Ch).
[165] [2006] EWHC 836 (Ch).
[166] [2019] CSOH 8.

It has also been accounting him for profits, for the related contracts that the defender benefited from were due to breach of fiduciary duty.

Despite the rigour of s 175 of the CA 2006 in avoiding conflicts of interest, there are exceptions to this duty. The self-dealing transactions are excluded from conflicts of interest arising from transactions or arrangements with the Company in accordance with the disclosure procedures required in ss 177 and 182 of the CA 2006. A director must disclose the nature of such interest in full, clear and accurate to the other directors if s/he is directly or indirectly interested in a proposed transaction or arrangement with the company, and there is a reasonable conflict of interests.[167] This disclosure must be before the company enters into the transaction or arrangement.[168] This disclosure may be made by written or general notices to other directors or at a meeting of the directors.[169] The director is also obliged to make a new disclosure if the previous disclosure is inaccurate, incompleteness or s/he realises after the disclosure that the facts have changed.[170] In *Gwembe Valley Development Company Limited and Anor v Thomas Koshy and Ors*,[171] Mr. Koshy, who worked for GVDC, was liable to account for any profits because he did not deliberately disclose the direct benefit of lending GVDC from Lasco which Mr Koshy owns two-thirds of this company. It is also excluded from this duty if it is authorised by the directors of private companies, with nothing to prevent in the company's constitution. In public companies, there must be a provision in the company's constitution that empowers the directors to authorise the matter.[172] In *Angela Burns v The Financial Conduct Authority*,[173] because of the lack of prior disclosure of conflicts of interest through misuse of the fiduciary position to gain personal benefit, as she failed to disclose a conflict of interest in that she was simultaneously seeking a non-executive position and consulting work. She also omitted important details from her job history when applying to positions. Burns (an investment expert) was sentenced a penalty of £154,800 and made a

[167] CA 2006, s 177(1)(6).
[168] CA 2006, s 177(4).
[169] CA 2006, ss 177(2), 184 and 185.
[170] CA 2006, s 177(3); The Explanatory Notes to the CA 2006, part 351.
[171] [2003] EWCA Civ 1048.
[172] CA 2006, ss 175, 175 and 182.
[173] [2014] UKUT 0509 (TCC) and [2017] EWCA Civ 2140.

prohibition order pursuant to the Financial Services and Markets Act 2000, because of the lack of integrity in a controlled function and the lack of fitness and propriety. In *Fairford Water Ski Club v Cohoon*,[174] the directors were liable for various breaches of duties under the CA 2006. One of the main allegations was the payment of annual management charge by the company to a director (Craig), which the company said it had never agreed to. The directors failed to declare the nature of their interest in the management agreement, and because they had not disclosed the amount of fee payable under the agreement, as they must declare the 'nature and extent' of any interest they had in a transaction or arrangement with the company. Therefore, a director was accountable to the company for any profit he had made.

3.3.6 Duty not to accept benefits from third parties

In the context of the conduct of integrity and propriety, s 176 states that directors must not accept a benefit from a party other than the company or its associated companies or their representative, because of their doing or their abstention from doing anything related to their work.[175] This duty applies to current directors and resigned directors in respect of matters done or omitted before they ceased to be a director.[176] For protecting directors from unexpected things and linking the law to reality, it is excluded from the application of this duty if it is unreasonable to consider the acceptance of benefit leads to a conflict of interests and duties.[177] It is also excluded the benefits offered by the person to a director and the services of this director are provided to the company by that such person.[178] Lord Goldsmith[179] gave an example of that, the operating companies that provide management services to companies, whether the director is an employee of this operating company or its owner.

[174] [2020] EWHC 290 (Comm).
[175] CA 2006, s 176.
[176] CA 2006, s 170(3).
[177] CA 2006, s 170(4).
[178] CA 2006, s 176(3).
[179] Hansard, (9 February 2006) v 678, Lord Goldsmith, column GC330, available at: https://publications.parliament.uk/pa/ld200506/ldhansrd/vo060209/text/60209-36.htm accessed 29 June 2018.

This duty at first glance might be thought to overlap with the duty to avoid conflicts of interest. However, after consideration and scrutiny, the duty not to accept benefits from third parties is more specific than the previous duty (Duty to avoid conflicts of interest). The former duty obligates to avoid conflict of interests and duties. While this duty prohibits the acceptance of any benefit from an external party that reasonably leads to conflicts of interest, acceptance of benefits by a party may be considered a criminal offence and a breach of a directors' duty.[180] Therefore, it is important to clarify, inter alia, the extent of the benefits and what the legal consideration to this benefit is a bribe or a secret commission and what is the difference between them. Some benefits are easy to distinguish, such as financial rewards or high financial value gifts. However, giving or receiving corporate hospitality is problematic about its legality extent. Giving or receiving corporate hospitality can be considered as a conflict of interest in the event that the hospitality is provided by a person or company and the director is involved with them in negotiations on a new contract.[181]

The common law in *Industries and General Mortgage Co Ltd v Lewis*,[182] confirmed that these benefits are considered bribes bribery means the payment of a secret commission, as well as because it induces employees to act positively towards the payer and negatively towards principals. While in *Attorney-General for Hong Kong v Reid and Others Respondents*,[183] a distinction was made between bribery and a secret commission. Lord Templeman believed there is a difference between bribery and secret commission and the secret commission could also be considered a bribe in some cases. He defines the secret commission as a benefit received by a fiduciary because of trust or knowledge acquired by the fiduciary position, while bribery is a benefit given to a fiduciary for the betrayal of trust. In *Gwembe Valley Development Company Limited and Anor v Thomas Koshy and Ors*,[184] Mr Koshy's acts were considered a part of a dishonest breach of trust of a director. Mr Koshy was a reason to make GVDC enter into the process of

[180] See *Attorney-General for Hong Kong v Reid and Others Respondents* [1994] 1 A.C. 324
[181] ICSA 'Guidance on Directors' General Duties' (June 2015) 2.6.3.
[182] [1949] 2 All E.R. 573.
[183] [1994] 1 A.C. 324.
[184] [2003] EWCA Civ 1048.

obtaining a loan from Lasco which Mr Koshy owns two-thirds of this company. In *Medsted Associates Ltd v Canaccord Genuity Wealth (International) Ltd*,[185] the court held that a major element of the agents' fiduciary duty is that they must not receive or agree to receive a secret commission from a third party. This was having found that a broker had lost commission from an investment institution as a result of it breaching a non-circumvention clause in a trading agreement by dealing directly with clients. The court ought not to assist the fiduciary in profiting from its own breach of fiduciary duty. In order to apply the bribery law and secret committees, there must be a trust and confidence relationship between the recipient of the benefit and the director who places the recipient in a conflict position between her/his interest and duty. In *Prince Eze v Conway*,[186] the judge held that relationship between the recipient and the buyer was not one which engaged the law of bribery and secret commissions. Although the relationship between the two parties was a fiduciary relationship, the agent not owed fiduciary duties. In *FHR European Ventures LLP v Cedar Capital Partners LLC*,[187] the Supreme Court took the opportunity to lay to rest the opposing two lines of authority by holding that a fiduciary who receives a bribe or commission in his capacity as a fiduciary holds the proceeds on a constructive trust for his principal. In other words, the principal (the company) will have proprietary rights in the bribe/secret profit.

By reference to the Fraud Act 2006 and Bribery Act 2010, there are differences between the secret commission and bribery. The components of bribery, payer, recipient and benefits which linked to the position of the fiduciary to do something in the interest of the payer.[188] The components of the secret commission are the fiduciary, benefits which linked to the position of the fiduciary and acting for the interest of fiduciaries themselves.[189] In a simplified manner, the secret commission can be such as an employee working in a juice shop which daily takes 50 cartons of fruit to squeeze them then sold them as juice. The employee purchases two additional cartons from his/her own account

[185] [2019] EWCA Civ 83.
[186] [2019] EWCA Civ 88.
[187] [2014] UKSC 45, [2015] AC 250.
[188] Bribery Act 2010 ss 2, 3 and 4.
[189] Fraud Act 2006, s 4.

and sells them to his/her account using the employer's premises and facilities, without disclosing this interest to the employer. In this case, "the abuse of position" is applied from Fraud Act 2006, and it is considered as "the offence of fraud by false representation".[190] To differentiate it from bribery, in the previous example the employee is supposed to advise the employer about the fruit quality. This advice, regardless of suppliers, is supposed to be based on the product's advantages, prices and value for money. The employee then recommends that the fruit be purchased from a particular supplier not for an advantage except that the supplier has provided or promised to provide a benefit to the employee to induce the principal to purchase from this supplier.

[190] Fraud Act 2006, ss 2 and 4.

Chapter Four: The powers and duties of company directors in Saudi Arabian law and Islamic law

4.1 Introduction

The legislator gives broad powers to the company directors to achieve the company's purposes and promote its sustainability. The directors of companies must maintain independence to perform their powers and duties as they deem fit for the success of the company, but this management of the company is subject to a number of controls and balances, both those contained in the legislation or the constitution of the company. The importance of these balances in preventing directors from abuse of position, and the liability in the event of failure to comply with the duties will be discussed below.

This chapter deals with the laws of Saudi Arabia and Islamic law in relation to the duties arising on the exercise of powers of the company director, in order to compare them with the laws of the United Kingdom, and highlighting the legal problems in enforcement of these duties on the ground through the mechanism of exercising the discretion of directors.

It is noteworthy to mention the sources of the directors' duties, before addressing these duties. During ruling on the disputes related to directors' duties in Saudi Arabia, it is imperative to refer to the provisions stipulated in the SACL 2015 and other legislation related to the directors' function. The law is the primary source for the directors' duties. Accordingly, it is imperative that the judges, when a dispute is presented to them in this matter, seek to find an answer in the legal provisions.[1]

In the event that the judges do not find any relevant legislative provisions or do not find an answer in the legislative provisions of the presented dispute, they will resort to another source, which is the provisions of Islamic law. Islamic law is considered as the general law in Saudi Arabia, which regulates all legal ties of any nature and subject to all persons. Therefore, if there were no legal

[1] Dr Muhammad Hassan Al-Jabr, Saudi Commercial Law, Riyadh, (2000), ISBN 99-331-440-5, p. 23.

provisions answer and solve the presented dispute, then it is necessary to refer to the provisions of Islamic law to search for the required answer. However, it should be noted that it is not resorted to the provisions of Islamic law unless the legislative provisions are silent or unclear. However, there is a question when the provisions of Islamic law conflict with commercial legislation. Whereas, Islamic law is considered in this case as Civil Law, it has been agreed in the event of a conflict between the provisions of the Civil Law and the provisions of the Commercial Law, the commercial law provision should prevail over the civil law provision if provisions were in the same degree.[2]

One of the sources for directors’ duties is the company's articles of association. The company's constitution is usually that which regulates the company's management and the powers of directors and imposes restrictions on the powers of directors. As in the contract of appointment of the director, it may stipulate the directors’ powers and impose some restrictions on them. The company purpose determined in the articles of association of the company is considered one of the sources of the directors’ duties. The company purpose is the real project that the shareholders have targeted to achieve, and directors must commit to act to achieve the purpose determined in the company’s articles of association, accordingly, the directors' powers are restricted to this purpose. General assembly decisions may grant permission to the directors to breach some duties, such as a conflict of the personal interests with the interests of the company or competition and the like, it may also restrict some of the powers of the director, as an attachment to the resolution to appoint the director.

Finally, another of the sources for the directors’ duties is commercial custom, which means the set of unwritten rules that with regard to a specific matter in a particular way with a belief in binding it and the necessity to follow its provisions. In the event of a conflict between legislative provisions and commercial customs, the legislative provisions should prevail over the commercial customs.[3]

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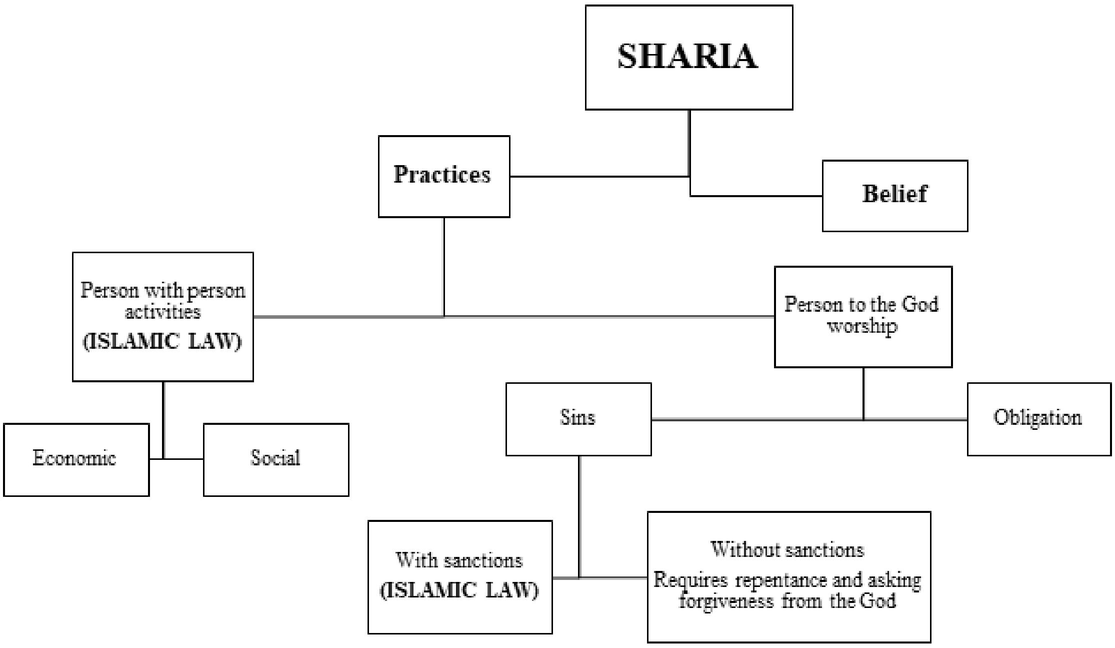
[2] Muhsin Shafiq, Commercial Law, *Dar Al-Nahdhat Al-Arabia*, Cairo, (1997) para 21.
[3] Ibid.

In this regard, it is worth noting that the difference between the term Sharia and Islamic law, as it is well known that Sharia includes all Islamic provisions, and it includes beliefs and practices. Not all of these provisions may fall within the concept of Islamic law. Practices in Islamic law are divided into a person to the God worship or a person with another person activity. A person to the God worship is divided into two parts, obligation or sins. As for sins, they are two parts, which sin with sanctions (this fall or that sin without sanctions, which requires repentance and asking forgiveness from the God. As for a person with another person activities, it is divided into two parts: economic and social, and they are all fall within the concept of Islamic law. Therefore, it can be said that Islamic law is what the judiciary can deal according to the provisions of Sharia (see figure below).



Islamic law does not prohibit in the management of companies any organisational legislation or administrative regulation intended to protect the interests of the company and in order to continue to achieve the desired purpose, provided that this legislation does not conflict with the provisions of Sharia. The basis for managing companies and what the director is permitted to do is due to the custom of traders. The director in Islamic law is an agent of the shareholders, as the company's management is based on agency theory.

Therefore, the company's director is required to have the honesty, integrity, experience and knowledge.[4]

The approach followed in this chapter is to combine the Saudi Arabian law and Islamic law because Islamic law in relation to Saudi law is like the common law to the UK law. Many legal provisions in Saudi Arabian law are explained by the provisions of Islamic law.

4.2 Duty to act within powers to achieve the purposes of the company

Directors of companies have broad responsibilities for the management of the business of the company. These powers are not absolute but are subject to restrictions limiting them in either a company’s constitution, the purposes so conferred or provisions of the SACL 2015. Therefore, the SACL 2015, explicitly stipulates that the directors of companies must act within their powers, in accordance with the company's constitution and for the purposes so conferred.[5] Directors are fiduciaries, therefore, a fiduciary is expected to be very loyal to the company so that there is no conflict of duties between the fiduciary and the company, and the fiduciary must not benefit from their position as a fiduciary or exercise their powers for personal benefit.

In the SACL 2015, the powers of the directors are absolute unless the company's articles of association restrict these powers, and if the company's articles of association do not determine that, the powers are within the scope of the duties stipulated in the SACL 2015 and which consistent with the purposes of the company. Articles 29 and 75 of the SACL 2015 stipulate that the directors undertake all regular management actions that fall within the purpose of the company, and represent the same before courts and arbitral tribunals and any third party unless the company's articles of association explicitly stipulate the restriction of their power. Saudi law grants broad powers to directors to exercise management of the company. Article 22 of Saudi Arabian Corporate Governance Regulations 2019 (SACGR 2019) also affirmed that the company's directors have the broadest powers in the management of

[4] Kamal Ibn Al-Humam, Fateh Al-Qadeer, Dar AlKutub AlElmiah, Beirut, (2003), part 5 p 9.
[5] SACL 2015, Arts 29, 30 and 75; SACGR 2019, Art 21.

the company to achieve its purposes. Therefore, the phrase "*all management actions and the acts that fall within the purpose of the company*"[6] stipulated in the SACL 2015 interprets the extent of the directors' powers in the company's management. In this regard, Al-Rasheed[7] says that the position of director (the acts assigned to be done) is not determined on the basis of an agency or delegation, but rather that it is determined on the basis derived from the nature of the company and its business. But the power of the director is not completely absolute, there are some restrictions, for example, adherence to the purpose of the company so the director cannot do business that it is inconsistent with what is stated in the company's articles of association, otherwise, the director is considered exceeding her/his powers and is being held liable. Also, the director is restricted by the principle of specialisation; it is not possible to override the powers of others that determined in the company's articles of association or what has been approved in the general assembly meetings or even what violates the SACL 2015, such as when the director exceeds the power of the board of directors unless it was delegated by the board of directors. The SACL 2015 restricts the power of the director in several businesses, which are, donations, guaranteeing the company to others, resorting to arbitration, reconciliation regarding the rights of the company, selling or mortgaging real property unless such sale falls within the scope of the company’s purposes, and selling or mortgaging the company’s place of business, except with the consent of the shareholders or an explicit provision in the company's articles of association.[8]

Perhaps the intention of this is that the Saudi legislature seeks to protect the company and the shareholders and others due to the seriousness of the power granted to a director in this regard, so the legislator stipulated the necessity of authorising these acts with controls and conditions for their exercise by the company's articles of association or the general assembly meetings of shareholders; for example, the directors of the company can be granted the

6 SACL 2015, Art 29.
7 Abdulaziz Al-Rasheed, (2010), The liability of the chairman and members of the board of directors of the joint-stock company. Master Dissertation. Department of Commercial and Arbitration Law, College of Law, Al-Khalijia University, Bahrain. P51.
8 SACL 2015, Art 30.

power to absolve the company's debtors of their obligations with specific controls in the company's articles of association, such as showing the maximum value of the debt that is waived, the period that must be exhausted before the release, the total debts that may be waived during the same financial year and so forth from the controls.[9] The Saudi legislator allows the board of directors to sell or mortgage the company's assets, the company's business place, or release the company’s debtors of their liabilities, and contract loans for any periods of time.[10] Whereas in the former Saudi Arabian Companies Law 1965, the board of directors may not contract loans with a term of more than three years or sell or mortgage the company's estates, sell or mortgage the company's business place, or release the company’s debtors of their liabilities unless expressly stipulated in the company's articles of association.[11]

As for the duty to undertake the purposes of the company, every company is established to implement a specific purpose that stated in the company's articles of association that the shareholders aim to achieve through the company. There are some duties that are explicitly stipulated in the SACL 2015 that relate to the company's business and its financial life, and which some consider different duties for directors. However, after scrutiny, it can be said that these duties are within the scope of the duty to undertake the purposes of the company. Among these duties, is the duty to register the company in the Commercial Register and to publish its Articles of Association and bylaws and any amendment on it.[12] The duty to prepare the company's annual financial statements and a report on its operations and financial position.[13] There is a duty to protect the statutory reserves of the company, as the SACL 2015, obliges to set aside 10% of each year of net profits to form a reserve called the statutory reserve of the company until the company’s total reserve reaches 30% of the company's paid-up capital.[14] Finally, there is a duty to report the company's losses in the event that the losses total 50% of its capital, the company’s directors must record this incident in the commercial register and

[9] Al-Jabr (n 1) 335-336.
[10] SACL 2015, Art 75.
[11] The former Saudi Arabian Companies Law 1965, Art 73.
[12] SACL 2015, Arts 13 and 22.
[13] SACL 2015, Art 175.
[14] SACL 2015, Art 129.

invite the shareholders to a general assembly meetings to consider whether the company shall continue to exist or to be dissolved and if the company's directors neglect to invite the shareholders or the shareholders fail to pass a resolution in order for the company continue to exist or to be dissolved, the company shall be deemed dissolved by the virtue of the law.[15]

Islamic law is consistent with Saudi Arabian law that the director may act in the company's business in the interest that leads to its success. The directors have all power if they are granted by shareholders, and this principle is limited by what the people in the same field are accustomed to in terms of trade and company requirements.[16] However, Islamic law restricts the directors in their acts to what the Sharia permits. If the directors have acted in respect of something that is forbidden by Sharia (such as dealing with usury or fraud in transactions and similar forbidden transactions) their acts are invalid, and they are liable for their acts.[17]

4.3 Duty to exercise reasonable care

In order to ascertain the performance of the company directors and their care of duties, several things must be considered, including the consideration of the nature and manner of the company's business, in accordance with the circumstances surrounding it with what is not inconsistent with the company's articles of association and the provisions of the director's contract of appointment. The provisions of Islamic law must also be considered to determine the level of care required by the director.[18]

In general, the level of care in Islamic law has two standards in accordance with the meaning of performing care. First, the commitment to caring for the usual person. The second is the commitment to achieve the desired purpose. What is meant by performing the usual person care is that the person does the care of the usual person in the same circumstances and position to try to reach the

[15] SACL 2015, Art 181.
[16] Ibn Rushd Al-Qurtubi, Bidayat Al-Mujtahid Wa Nihayat *Al-Muqtasid, Maktabat Al-Kulyat* Al-Azhryah, Cairo, (1986), part 2 p 280.
[17] Aladdin al-Kasani, Badayea Al-Sanaiya fi Tartib Al-Sharia, Second Edition, *Dar AlKutub AlElmiah*, Beirut, (1986), part 6 p 68-72.
[18] The Basic Law of Governance of the kingdom of Saudi Arabia 1992, art 7.

desired purpose and s/he does not have to achieve this purpose. The care here is subjective and objective standard and it is agreed upon by appointment contract, custom or determined by law, and the typical example of the duty to do the usual person care is the care of a doctor, as s/he does not commit to healing the patient, but rather s/he is obliged to do care that matches the scientific principles in the medical field.[19] As for the commitment to achieve the desired purpose, it is the subject of the person doing a work that leads to achieving a specific result, such as the commitment of the contractor to establish a specific building, and the commitment of the tenant to return the leased property after the end of the lease. In this type of commitment, the result (the desired purpose) is intended, and the effort and care that the person exerts to achieve are only a means to achieve the commitment (the result/the desired purpose) and effort and care are not the subject of the commitment, therefore, if the result (the desired purpose) is not achieved, the liability is held.[20]

Islamic jurisprudence has clearly distinguished between these two types of the commitment of care. In the commitment to do the usual person's care, there is no liability that if a director does reasonable care, without neglect or exceed the usual norm. In the event that the achievement of the result is stipulated as a condition in directors' acts, the condition is invalid and the directors are not liable if they fail to achieve the desired purpose if they did the reasonable care.[21]

The Saudi legislature adopted the director commitment in a manner that is consistent with Islamic law and exerted the care of the usual person's care (objective-subjective standard).[22] However, the subjective standard at least has to be not less than the objective standard. If the director proves that s/he is doing this care on a personal level, s/he remains liable if the care is less than the substantive level, then s/he must provide reasonable care as those who are in the same position. The directors must be obligated to perform their duties and commitment to the limits of their power determined in the law or the articles

[19] Al-Alfy, Muhammed Jabr, Health Insurance and Use of Health Cards, Journal of the Islamic Fiqh Academy, Thirteenth Issue, (2001) 3/482.
[20] Ibid.
[21] Al-Baghdadi, Ghiath Al-Din, *Majmae Al-Dhamanat*, *Dar AlKutub AlElmiah*, Beirut, (1971) part 2 p 47.
[22] SACGR 2019, Art 21.

of association of the company or under the appointment contract,[23] and to refrain from any activity that harms the company and the purpose that the company is established to achieve.[24] Fahmy[25] confirms that directors must carry out the business and exercise the powers that they have granted, they must make every effort to improve the company's management and monitor the progress of its business and achieve the purposes for which the company is established, and their commitment in this regard is a commitment to exercise reasonable care not to achieve the result (desired purpose), and therefore if the directors carry out their duties carefully, there is no liability, even if the company's conditions worsen. In the judgment declared by the Commercial Court,[26] the respondents (two directors) were liable to pay compensation to the shareholders for the damages incurred by the company due to their negligence in the company's management. Where the respondents committed financial violations such as paying incentives and bonuses for the company employees including themselves despite not achieving profits in the activity of the company, but the source of these incentives and bonus was from the sale of assets in the company. It has been also proven that there were differences and inconsistencies in the company's accounts and budget and that there are deficiencies in the company's internal monitoring process. Accordingly, the court ruled the directors liable for negligence in the company's management.

4.4 Duty to maintain confidentiality

The SACL 2015 states that directors may not disclose the secret information related to the company that they acted for, and they also may not exploit what has come to their knowledge by reason of their position, to achieve an interest for themselves or their relatives or third parties.[27] This assertion from the Saudi Arabian legislature to obligate directors to maintain secrets is in accordance

[23] Dr. Abdul-Razzaq Al-Sanhouri, Explaining the Civil Law, *Dar Al-Nahdhat Al-Arabia*, Alexandria (2004), Part 1, p. 428.
[24] Muhyi-Al-Din Al Nawawi, *Almjmw'a Shrha AlMhdhb*, *Dar AlKutub AlElmiah*, Beirut, (2016) part 15 p 123.
[25] Mahmoud Mohamed Fahmy, The liability of the members of a board of directors of a company whether in their personal capacity or as representatives of others, *Majalet Misr Al-Mueasira*, (1985) 401 p. 6.
[26] The Saudi Arabian Commercial Court, Q/3/847 (2016); 291 (2019).
[27] SACL 2015, Art 74.

with Islamic law and most other legislation. Islamic law urges honesty, including maintaining the business secrets, as it is one of the requirements for fulfilling the obligations that the director has signed with the company to take into account its interests as like as take into account the interests of herself/himself and her/his family.[28] Islamic law also urges the importance of maintaining secrets and considered that disclosing secrets is a betrayal of trust.[29]

However, the Saudi Arabian legislature does not specify the meaning of secrets as stated in the SACL 2015. Some tend to exclude facts and information known to people, so it is not considered as secret.[30] However, there is another opinion, which is that the known facts and information of the people remain a secret because its confirmation from the director is confirmation of its correctness. This opinion is what the French court[31] adopted that revealing the secrets is not permissible, even if it focuses on facts or information that has become known to people because revealing the information by a director or an employee leads to confirm its correctness. Koman and Abdul-Hamid[32] argue that what is meant by company secrets is every specific fact or information or a specific number that is not subject to publication or declaration, and no one but the concerned person (director) knows about it, thus the facts and general information or previously published in any legal way are not considered as secrets.

Jubran[33] says that the nature of the obligation to maintain secrets is not absolute but rather relative, so the scope of the directors' duty to not divulging company secrets outside the General Assembly meeting is determined and then the directors may discuss these secrets during this meeting. Therefore, the directors are prohibited from discussing the secrets with the shareholders outside the scope of the general assembly meetings. Also, it is not considered

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[28] The Noble Qur'an, *Surah Al-Ma'idah ayat* 1, *Surah Al-Isra ayat* 34, *Surah Al-Mu'minun ayat* 8.

[29] The Noble Qur'an, *Surah Al-Anfal ayat* 27.

[30] Abdul-Qadir, The duty of confidentiality in the framework of commercial companies, Vinnak, Majallat al-Qānūn wa-al-Mujtamʻ 2014 Issue 3, pp.48-79, 51 DOI: 10.12816/0010004.

[31] See [crime., 19 decembre 1986, I. p. 347] as cited in Feninekh, Abdul-Qadir., The duty of confidentiality in the framework of commercial companies, Vinnak, Majallat al-Qānūn wa-al-Mujtamʻ 2014 Issue 3, pp.48-79, 51 DOI: 10.12816/0010004.

[32] Koman, Muhammad. Abdul-Hamid, Reza, corporate crime in Saudi Arbia law., *Dar Al-Nahdhat Al-Arabia*., Cairo, (1996) P. 153.

[33] Sadiq Jubran, The board of directors of the Saudi joint-stock company., First edition, Al-Halabi Publications, Beirut, 2006, pp. 287-290.

a secret that the information required by the laws to place it at the disposal of shareholders in order to inform them of the information about the company before a period of the general assembly meeting or that information permitted by the laws to be published. However, the duty not to divulge secrets is limited to what the directors have known information about the company because of their positions only, which is without their positions in the company, they would not have known this information.[34]

Finally, article 74 of SACL 2015 stipulates the penalty for breach of this duty, as it provides two penalties that must be applied together, namely the dismissal of the director from the company's management and the compensation for the damages incurred by the company due to the disclosure of the secret information.

Confidentiality in Islamic law is based on the concept of trust, and maintaining trust is an obligation.[35] Almighty said in the Noble Quran[36] "O you who have believed, do not betray Allah and the Messenger, nor betray your trusts while you know".[37] Also, this is the principle of the Prophet Muhammad (peace be upon him), in all his acts in the works that need to maintain confidentiality.[38] This is the principle of the companions of the Prophet (PBUH).[39] Therefore, divulging business secrets is a breach of trust, and its consequences are grave, it is cheating and fraud. Rather, it is a sign of hypocrisy and bad morals. The Prophet Muhammad (PBUH) said that "The hypocrite signs are three if they talk, they lie, if they promise, they renege if they are trusted, they betray".[40]

The basic principle is that all secrets in Islamic law must be maintained, whether small or large, but the liability of divulging the secrets is emphasised in two things. First, that when divulging secrets leads to damage.[41] Secondly, the

[34] SACL 2015, Art 74.
[35] Al-Raghib al-Isfahani, Al-Mufradat fi Gharib al-Quran, *Dar Al-Qalam*, Beirut, (2009), 25.
[36] The Noble Qur'an, *Surah Al-Anfal ayat* 27.
[37] See Sahih International at http://corpus.quran.com/translation.jsp?chapter=8&verse=27 [accessed 13 April 2020].
[38] Muhammad Al-Bukhari, Sahih al-Bukhari, First edition, Dar Touq Al-Najat, Damascus, (2002), 2948.
[39] Ibid, 2318.
[40] Muhammad Ibn Al-Arabi, Aridah al-Ahwadhi bi-Sharh Sahih al-Tirmidhi, Dar Al-Fikr, Beirut, (1995), part 5 p 308.
[41] The Noble Qur'an, *Surah Al-baqarah ayat* 282.

secret shall not be about something is prohibited in Sharia, such as a crime or a violation that must be disclosed.[42]

4.5 Duty to avoid conflicts of interest and to declare any personal interest

The duty to avoid conflicts of interest when exercising managerial powers is one of the directors' fiduciary duties, which is associated with the trust entrusted to them. The SACL 2015 stipulates that the director may not have a direct or indirect interest in the transactions and contracts that are concluded for the company's account except with prior permission from the ordinary general assembly, renewed annually.[43] The SACL 2015 seeks to ensure that directors act in the company's best interest in the first place, and to prevent them from using their power and position to obtain financial benefits that conflict with the interests of the company. This indirectly includes the relatives of the directors and those connected to them. Therefore, it is emphasized in the same law that directors may not use company information to achieve an interest for them, a relative, or others.[44]

The SACL 2015 also obliges directors to declare any interest they have, directly or indirectly, in the transactions and contracts that are concluded for the company. The directors must inform the board of directors of this interest, and this declaration shall be recorded in the minutes of the board of directors meeting. The concerned director may not participate in voting for the resolution to be adopted in this respect, whether it is in the board of directors or the shareholders' meetings.[45] In the event the director fails to declare her/his interest, the company or any interested party may claim before the competent judicial authorities to avoidance the contract and oblige the director to return any profit or benefit that has been gained thereto from it.[46] In the former Saudi Arabian Companies Law 1965, a transaction that is performed through a public tender process is excluded from that if the director provides the best offer, then

[42] The Noble Qur'an, *Surah Al-mujadilah ayat* 9.
[43] SACL 2015, Arts 31 and 71.
[44] SACL 2015, Art 74.
[45] SACL 2015, Art 71(1).
[46] SACL 2015, Art 71(2).

s/he does not need to obtain permission from the ordinary general assembly.[47] This exception was highly criticised, as the prohibition that the legislature wanted it, did not necessarily relate to purely financial budgets, rather, for ethical considerations. In addition, the presence of the director in her/his position gives them an advantage in providing the best offer, due to the availability of confidential information. Therefore, there is no equality and justice, and there is a restriction of freedom of competition, which may lead to future competitors being reluctant to enter into tenders for this company, which may harm the company's future interests.[48]

Islamic law is consistent with Saudi Arabian law to legalise the acts of the directors that lead to the success of the company within the limits of the power granted by shareholders and prevent wrongful acts. Since Islamic law considers the management of the company as an agency of the shareholders of the director, so Islamic law is strict in purchasing agents for their principals a commodity that the agents or their relatives own.[49] Therefore, Islamic law scholars differed regarding whether the agents can purchase for their principal a commodity that the agents or their relatives own.

Some Islamic law scholars have emphasised that the agents cannot purchase from themselves for their principal, even if the principal has authorised them to do so, because the rights to buy and sell will belong to one person.[50] As for buying from relatives, it is permissible to buy from them if it is bought at the same value or less if the principal has authorised the agent.[51] While some Islamic law scholars argue that the agents cannot purchase from themselves for their principal, unless if the principal has authorised them to do so.[52]

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[47] The former Saudi Arabian Companies Law 1965, Art 69.
[48] Jubran (n 33) 276.
[49] Dr Abdulaziz Al-Khayyat, Companies in Islamic Law, Fourth Edition, Resalah Foundation, Beirut, (1994), 247-248.
[50] Al-Khatib Al-Shirbiny, *Mughni al-Muhtaj ila Ma'rifatil Ma'ani alfadh al-Minhaj*, *Dar AlKutub AlElmiah*, Beirut, (1994), part 2 p224-225.
[51] Hafiz Aurangzeb, *Al-Fatawa al-Hindiyya*, *Dar AlKutub AlElmiah*, Beirut, (2000), part 3 p 589.
[52] Mansour El-Bahouty, Kashaf Al-Qina'a ean Matn Al-Eqna'a, *Dar AlKutub AlElmiah*, Beirut, (2001), part 3 p 473.

4.6 Duty not to participate in any business competitive with that of the company.

The SACL 2015 stipulates that the director may not participate in any business that would compete with the company, or compete with the company in any of the branch activities that it carries out. The commitment to non-competition, in general, has got great attention from many studies, given the problems and legal difficulties it raises, the most important of which is that this commitment represents a restriction of the freedoms of work and contracting. The legal jurisprudence has sought to reconcile this obligation with the freedoms of work and contracting, by proposing criteria by which the scope of the obligation to be non-competitive can be determined.[53]

Therefore, the prohibition against non-competition is not always permanent, as a company's director may avoid this ban by obtaining authorisation to compete the company by following the procedures stipulated in SACGR 2019. The director must inform the board of directors of the competitive business that s/he has or wishes to do and prove this declaration shall be recorded in the minutes of the board of directors meeting. The concerned director may not participate in voting for the resolution to be adopted in this respect, whether it is in the board of directors or the shareholders' meetings.[54] Marqis notes that the duty not to participate in any business competitive with that of the company is an obligation to refrain from an act (non-competition). This duty is always considered as a commitment to achieve a result, and it is not sufficient to exert an effort or a certain level of care in order to achieve this.[55]

The phrase "participate in any business competitive with that of the company" as stated in Article 72 of the SACL 2015 is general, as it includes all types of competition, so includes trading in one of the types of company activity, by establishing a company or a sole proprietorship or the ownership of a controlling percentage of shares or stakes in a company or any other entity engages in

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[53] Reda El-Sayed Abdel-Hamid., Trade Law, *Dar Al-Nahdhat Al-Arabia*, Cairo, 2001, Part 1 p. 217.
[54] SACL 2015, Art 72; SACGR 2019, Art 46.
[55] Marqis, Suleiman., Explaining the Civil Law, Second edition, Law and Economy, Cairo, 1992, Part 4, p. 71.

business activities that are similar to the activities of the company or its group. Also included in these businesses competitive is accepting membership in the board of directors of a company, an entity that competing with the company or its group or managing the affairs of a company or any other entity competing with the company or its subsidiaries, regardless of the form and size of this company or the entity competing, except for managing the affairs of the subsidiary companies. Also included in the concept of business competition, the director acting as an overt or covert commercial agent for another company or entity competing with the company or its group.[56] Because the competition of the company leads intentionally or unintentionally to exploit the information and secrets of the company stated in Article 74 of the SACL 2015 that it is not permissible to use what has come to their knowledge by reason of their position to achieve an interest for themselves or their relatives or others.

The SACL 2015 also indicated that the penalty resulting from the breach of the duty not to participate in any business competitive with that of the company is reasonable compensation for the damages incurred by the company as a result of the breach of this duty.[57] In the former Saudi Arabian Companies Law 1965,[58] the penalty for breaching the duty not to participate in any business competitive with that of the company was reasonable compensation or considering the operations performed by the director for her/his own account conducted for the company. The choice would be for the company to choose between the two. It should be noted that SACGR 2019 stipulate that in the event that the general assembly rejects to grant or renew the authorisation granted to the director to compete with the company, the director must present her/his resignation within a period specified by the general assembly, otherwise the director is deemed terminated by the force of law unless s/he decides to withdraw from the competition of the company.[59] In the judgment declared by the Commercial Court,[60] the respondent (a director) is obligated to return the property (building), which is the subject of the company's competition, the activity of the company

[56] SACGR 2019, Art 47.
[57] SACL 2015, Arts 72 and 74.
[58] SACL 2015, Art 70.
[59] SACGR 2019, Art 48.
[60] The Saudi Arabian Commercial Court, 10/TG/1/7 (2013); 213/TG/2/1 (2014).

is to buy or rent buildings and re-rent them as residential units. The company claimed to the director that after the expiry of the company lease contract for the building (the subject of the dispute), the director rented the building for his own account, and the rent was not renewed for the company's account. The company considered that as competing with the company's activity. Whereas, the former Saudi Arabian Companies Law 1965 stipulated that the penalty for the competition with the company is the choice between equity compensation or considering the operations done for the company account, which the plaintiff chose the second option. Accordingly, the court judged that.

However, the problem with the duty not to participate in any business competitive with that of the company is that it does not specify the range of time or place. The director may practice activity for the same type of company activity in another city, so is this participate considered as competition or not. Because the director may participate in any business competitive in another city, and after the development of her/his business, s/he resigns and competes with the company in the same place and time. In addition, the Saudi Arabian legislature does not stipulate that the time limit in non-competition be specified after the directors leave their position in the company. While the Saudi Arabian Labor Law 2005 stipulates that if the nature of the work allows an employee (director) to get to know the clients of the employer, the employer may stipulate in the appointment contract that the employee (director) must not compete with the company after the end of the contract. The validity of this condition must be written and determined in terms of time, place and type of work, and the duration of the ban on competition must not exceed two years from the end of the relationship between the two parties.[61] It should also be noted that the duty not to participate in any business competitive with that of the company is not subject to some professions even if it is formed in the form of a professional company such as lawyers, engineers, accountants, doctors, and other professions.[62]

[61] The Saudi Arabian Labor Law 2005 Art 83.
[62] Samira Al-Qalyoubi, Explaining Commercial Law, *Dar Al-Nahdhat Al-Arabia*, Cairo, (2013), Part 1 p. 555.

A question is also raised about the validity of the authorisation from the general assembly. If the company is sold and the members of the general assembly become different, does the former authorisation from the former shareholders become valid or need to issue another authorisation? Originally, the rights, responsibilities and liabilities arising from the agreements concluded by the company are transferred from the seller to the buyer.[63] Saudi Arabian laws do not provide explicit prevision for the transfer of these rights and liabilities from the seller to the buyer, except that the principles of law in general and Islamic law agree on that. Unless otherwise specified in the contract of sale.

The question also arises whether the directors' commitment not to compete with the company is a personal commitment that s/he undertakes alone or extends to other people as members of her/his family. Al-Qalyoubi[64] holds in this matter that the directors' commitment not to compete with the company is a personal commitment that s/he shoulders only without her/his family. However, assuming this leads to evading the duty not to compete indirectly. In Saudi Arabian law, this is not explicitly stated. In practice, it is left to the judge's discretion when there is a dispute about this matter and looking into the circumstances of the case; because the principle in Islamic law is a person is not bound by any obligation unless s/he obliges herself/himself to do so.[65]

In Islamic law, the agent's acts must be in accordance with the condition of the principal and the power granted, the agent shall never betray, nor does the agent acts for her/his own fortune. The agent, while performing the agency, is bound by the provisions of the Sharia that do not harm the principal. The prophet Muhammed (PBUH) said, "There should be neither harming nor reciprocating harm".[66]

[63] Al-Qalyoubi (n 62) 302-304.
[64] Ibid, 331.
[65] Sharia jurisprudence principle "*Al'asl Bara'at Althimah*" which means each person's liability is innocent until proven otherwise.
[66] El-Bahouty, (n 52) part 3 p 473.

4.7 Duty not to accept benefits from third parties

In the context of the conduct of integrity and propriety, SACGR 2019 states that directors must not accept a benefit, in particular gifts from another party who has business dealings with the company. It is excluded from the application of this duty if it is unreasonable to consider the acceptance of benefit (gifts) leads to a conflict of interests and duties.[67] The acceptance of benefits (gifts) by a director from a party may be considered a criminal offence and a breach of the duty. There is no explicit provision from the Saudi Arabian legislature linking the acceptance of gifts, by the director, to the crime of bribery, except elsewhere in another law, where the legislature linked the state employee's acceptance of gifts to bribery.[68] Otherwise, the acceptance of gifts from the director is subject to the discretionary authority of the judge, which depends on the provisions of Islamic law.

In Islamic law, the basic principle of accepting gifts by workers is prevention and prohibition.[69] So, in all that the workers benefit from in-kind or cash property, the facilities or any services that granted to them for their work other from other than the employer is not permissible.[70] However, if the gift is caused by doing something, it is part of the meaning of bribery, and it must be rejected. The rule of that is what Ibn-Taymiyyah[71] said if the person is removed from that position and s/he will be still given that gifts, so the position is not the reason for the gifts, then it is permissible to accept it as the gifts that are from family and friends; and if otherwise, the reason for the gift is her/his position, it is part of the meaning of bribery. Al-Shirbiny[72] said, in the context of mentioning the reasons for the inadmissibility of gifts, one of them is the gift to the workers, as

[67] SACGR 2019, Art 49.
[68] The Saudi Arabian Civil Service Law 1976, art 12.
[69] Ibn Qayyim al-Jawziyya, *I'laam ul Muwaqqi'een 'an Rabb il 'Aalameen*, *Dar AlKutub AlElmiah*, Beirut, (1991) part 3 p 114.
[70] Ibn Hajar Al-Asqalani, *Fath al-Bari fi Sharh Sahih Al-Bukhari*, *Dar Al-Salam*, Cairo, (2001), part 13 p 167.
[71] Ibn-Taymiyyah, *Majmu al-Fatwa al-Kubra*, King Fahd Printing Center, Medina, (2004), part 6 p 157.
[72] Al-Khatib Al-Shirbiny, *Mughni al-Muhtaj ila Ma'rifatil Ma'ani alfadh al-Minhaj*, *Dar AlKutub AlElmiah*, Beirut, (1994), part 3 p 558.

it is forbidden for them to accept the gift from those who do not usually gift it before they were in the position.

However, the director may accept gifts in Islamic law provided that the company (the employer) authorises the director to accept the gifts after the gift is disclosed and its amount. This is based on the saying of the prophet Muhammad,[73] "whoever we have employed on work, must s/he bring what was given a little or much, and what we give him/her from that, s/he takes". This is express in the fact that it is permissible for the workers or employees to accept gifts because of their work if they are permitted from their employer (the company). Ibn Hajar[74] said regarding what is prohibited from workers 'gifts, this is prohibited if the employer (the company) does not authorise it. Because it is forbidden only to cut off the causes of dishonesty and prevent the causes of the corruption of jobs and business. Therefore, the directors often are safe from being accused of dishonesty and corruption if the employer knows and authorises the gifts.

SACGR 2019 stipulate that accepting gifts that are forbidden are those gifts that may lead to a conflict of interest. As for what the worker or employee benefits from all kinds of gifts, if the custom is tolerance to accept it, then it does not enter into what is prohibited from the gifts of workers and employees.[75] This is fully consistent with Islamic law as mentioned above where is prevented the acceptance of gifts only to prevent dishonesty, corruption and harm.

As for the hospitality offered to directors, some scholars of Islamic law stated that what is increased on the familiar usual hospitality due to the position is attached to the gifts of employees and workers that is prevented to be accepted.[76] Some Islamic law scholars set a condition for accepting gifts by workers, after disclosing them and obtaining permission. This condition is that the worker (director) must reward the person who gifted her/him with the same

[73] Muslim ibn Al-Hajjaj, *Sahih Muslim*, *Dar AlKutub AlElmiah*, Beirut, (2006), par 3415.
[74] Ibn Hajar (n 70) 167.
[75] SACGR 2019, art 49.
[76] Ibn-Taymiyyah (n 71) part 4 p 174-175.

value of the gift because if s/he does so, the worker (director) will void the effect of the gift and remove its power.[77]

4.8 Duty to act in the interests of the company and consider the interests of the stakeholders.

The SACL 2015 and the Corporate Governance Regulations 2019 implicitly state for the duty to act for the interests of the company in more than one place by imposing duties on directors to avoid conflicts of personal interests with the interests of the company as well as imposing penalties on directors in the event of acting against the interests of the company.[78]

SACGR 2019 also provide that the company director must take into account the interests of stakeholders when managing the company.[79] The OECD has confirmed that considering the interests of stakeholders is a high ethical standard that is certainly in the company's long-term interest, making it more credible and trustworthy.[80] Taking into account the interests of the company's employees is also among the interests that directors must take into account when managing the company.[81] OECD Principles of Corporate Governance state that mechanisms to enhance the performance of employee participation should be allowed in the context of corporate governance such as the representation of staff on boards and in governance processes and the mechanisms of sharing of profits, pension commitments and others related to performance enhancement. This incorporating implies its importance as the employee is the human capital of the company and is of value to the company and not just a tool that manages the company's financial assets. The powers of the director include setting development and incentive programmes for the employees of the company, listening to their opinions and discussing them in decisions affecting them functionally or health and safety issues in the

[77] Al-Shafi'i, Muhammad., *Al-Umm*, *Dar Al-Maarifah*, Beirut, (1990), part 2 p 63.
[78] SACL 2015 arts 31, 72, 74 and 211; SACGR 2019, arts 21, 43, 49 and 86.
[79] SACGR 2019, arts 83 and 86.
[80] G20/OECD, 'Principles of Corporate Governance' (2015) <https://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf> accessed 30 January 2020; Annotations to the OECD Principles of Corporate Governance (2004) <http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf> accessed 30 January 2020.
[81] SACGR 2019, arts 83(4) and 84.

company.[82] Employees may also be granted shares in the company or a percentage of the profits made by the company and other matters that benefit the employees.[83] This may be a good reason to retain qualified employees or boost morale as this will result in long-term company benefits.

The director must also take into account the interests of suppliers and customers in terms of strengthening the company's relationships, which is important for achieving long-term gains.[84] Economic studies have confirmed that customer loyalty to the brand reduces marketing costs and stabilises the volume of production and sales, thereby increasing operating profits.[85] Directors should take into account the social contribution of the company, whether these social initiatives are provided to employees of the company in particular or to society in general.[86] This is by directors establishing social programs and determining the necessary methods for proposing social initiatives by the company in the field of social work.[87] Perhaps the purpose is to promote good relations with society. The company can participate in community planning and problem solving. This enhances the company's long-term reputation and creates loyalty and satisfaction from society (the consumers).

Finally, corporate governance stipulates that managers must consider the need to act with integrity towards shareholders, and protect their rights to ensure equality and fairness among them.[88] This means not favouring one shareholder or group of shareholders over the rest, especially if some shareholders are weaker than others.

4.9 Duty to be a liquidator upon the dissolution of the company

One of the duties of the director stipulated in the SACL 2015 is to be a liquidator for the company.[89] This is upon the dissolution of the company, the directors

[82] G20/OECD (n 80).
[83] SACGR 2019, art 85(2).
[84] SACGR 2019, art 83(3).
[85] Cerioni (n 62) chapter 3, 13-14.
[86] SACGR 2019, art 83(5).
[87] SACGR 2019, arts 87 and 88.
[88] SACGR 2019, art 4.
[89] SACL 2015 art 203.

will automatically be in the liquidator's role until a liquidator is appointed for the company. In this case, the directors take the provisions of the liquidators and their duties and the mechanism of work in the event that there is more than one director, so it is like there is more than a liquidator.[90] Article 206 of the SACL 2015 stipulates that if there are two or more liquidators, they must act jointly and their actions shall be valid only if made jointly unless the appointment resolution or the authority that appointed them authorizes them to act individually. Whereas in UK law, a director cannot become a liquidator but rather the official receiver can become the company liquidator during any vacancy and continues in office until another person becomes liquidator.[91] In addition, UK law requires liquidators to be only independent and qualified insolvency practitioners. Therefore, directors could not be liquidators of their own company, as this would create a conflict of interest.[92]

However, the problem in the event that the resolution to appoint the director does not contain any provision to work as a liquidator in the event of the dissolution of the company. Perhaps the Saudi Arabian legislature intends this to continue to carry out the company's business until a liquidator is appointed, where in many cases the shareholders do not agree on the appointment of a liquidator, and the director will carry out the liquidator's work until a liquidator is appointed, either by the shareholders (voluntarily) or through the judiciary (Involuntary). Since it is one of the duties of the director to be a liquidator in the event of the company's termination and dissolution, it should be mentioned briefly what are the powers and duties of the liquidator.

The SACL 2015 indicates that the liquidator's powers are determined by the company's articles of association or the resolution to appoint the liquidator, and all their acts are valid and binding on the company as long as it is within the powers granted to them.[93] If the liquidator's powers are not determined, the SACL 2015 stipulates that the liquidator may conduct all business required for liquidation.[94] Among the most important of these conducting business is the

[90] SACL 2015 art 206.
[91] Insolvency Act 1986, s 136(2)(3).
[92] See *Re Ipcon Fashions Ltd*, [1989] 5 BCC 733.
[93] SACL 2015 art 205(3).
[94] SACL 2015 art 207(1).

representation of the company before the judicial authorities and third party,[95] converting the company’s assets into cash, including the sale of movables and immovable property whether by auction or by any appropriate method ensures obtaining the highest price.[96] The liquidator may not sell the company’s property in one lot nor offer it as a contribution in another company unless authorized to do that by the party that has appointed them.[97] The liquidators also may not commence new operations unless they are necessary to perform pending tasks.[98]

The SACL 2015 also provides that one of the duties of the liquidator is to pay off the company's debts if duly payable and to set aside the necessary sums for future payment they are undue or contested and then distribute among the shareholders any surplus.[99] However, the SACL 2015 does not state the duty to refund the company's debts from others, which were expressly stipulated in the former Companies Law 1965,[100] even though this duty is within the concept of conduct all business required for liquidation.

The liquidators must also publish the resolution issued for their appointment and the restrictions imposed on their powers by the methods prescribed in the company's articles of association.[101] The liquidators, within three months of commencing their work as a liquidator, must make an inventory of all the company's assets and liabilities. At the end of every financial year, the liquidators must prepare financial statements and a report on the liquidation operations.[102]

Just as the duty to avoid conflicts of interest is one of the duties of directors, it is one of the duties of the liquidator. Article 211 of the SACL 2015 stipulates that the liquidator may not use the company's funds, assets or rights against third parties in a manner conflicts with the interests of the company. However,

[95] Ibid.
[96] Ibid.
[97] SACL 2015 art 207(2).
[98] SACL 2015 art 207(3).
[99] SACL 2015 art 208(1)(3).
[100] The former Saudi Arabian Companies Law 1965, arts 222 and 223.
[101] SACL 2015 art 205(3).
[102] SACL 2015 art 209(1)(3).

the Saudi legislature does not address the matter of the liquidators selling the company's assets to themselves or to any member of their family. The Islamic law states that the agent is not permitted to sell the principal's money to herself/himself because it is not valid that s/he is the seller and buyer at the same time unless the principal has authorised.[103] Also, Islamic law permits the agent to sell to a member of her/his family, provided that the sale is more than the value offered so that s/he is the highest price unless the principal authorises the sale otherwise.[104]

Article 212 of the SACL 2015 states that the liquidator may not divulge the secrets of the company that has come to their knowledge by reason of their position, to other than the concerned authorities. The penalty for breach of this duty is made civil and criminal, imprisonment for a period not exceeding one year as maximum and penalised for not more than one million Saudi Riyals[105] or by either of these two penalties.

The SACL 2015 also provides that the liquidators must take into account the need to act with integrity towards creditors, and protect their rights in a manner that ensure equality and fairness among them. This means not favouring one creditor or group of creditors over the rest.[106]

Finally, Article 79 of the SACL 2015 states that the liquidator, after obtaining the approval of the ordinary general assembly, must institute a liability action against the company directors for wrongful acts that cause prejudice to the shareholders. However, the problem with this duty is that when the directors become the liquidators, it is unreasonable to expect that a suit will be brought against themselves! Basically, the liquidator’s function is to examine the directors’ work before dissolution the company, and if the liquidator was the director, then the purpose of the liquidator's function is negated.

By examining this duty, and inferring the reason for enacting this duty on the director, it may be, as previously mentioned, that the Saudi Arabian legislator

[103] Al-Shirbiny (n 72) part 2 p224-225.
[104] Hafiz Aurangzeb, *Al-Fatawa al-Hindiyya*, *Dar AlKutub AlElmiah*, Beirut, (2000), part 3 p 589.
[105] 1 USD = 3.75 Saudi Riyals, Fixed exchange rate.
[106] SACL 2015 art 211(E).

intended this to continue to carry out the company's business until a liquidator is appointed, where in many cases the shareholders do not agree on the appointment of a liquidator, and the director will carry out the liquidator's work until a liquidator is appointed, either by the shareholders (voluntarily) or through the judiciary (Involuntary). However, the administrative procedures for approving the director to be as a liquidator and the company's representative before the third party take much time to be approved their acts as a legal representative of the company. Therefore, the purpose of automatically appointing directors as a liquidator is not fulfilled in order to conduct the company's business until the appointment of the liquidator.

Since the SACL 2015 does not determine a cut-off point before the company’s winding up for the directors’ duty to act in the interest of the creditors to be triggered, consequently, the directors will act in the interest of the company (shareholders) until the winding up of the company, and then the director may operate as ae liquidator if a liquidator is not appointed. This may create a state of uncertainty, such as if the directors knew that there was no reasonable prospect that the company would avoid going into insolvent liquidation, so they are caught between two options, of either acting in the interest of the company (shareholders) or acting in the interest of the creditors as considered they will be liquidators. Acting as a director means maintaining the company's assets; while acting as a liquidator means converting the company's assets into cash money. In the event that the directors knew that there was no reasonable prospect that the company would avoid going into dissolution or insolvent liquidation, and the price of the company's assets is high, will the director act as a liquidator and sell these assets at the best price, which will be in the interest of the shareholders and creditors after the liquidation, or the directors must wait for the company to be dissolved and be liquidated and then sell assets at the current price, which may decrease.

4.10 The evaluation of the Saudi Arabian law with respect to the directors' duties.

In this chapter, it has been dealt with the discussion of each issue in a detailed manner in its context; it will be briefly touched on the most important issues about the directors' duties in Saudi Arabian law. Contrary to the former position in the UK (prior to CA 2006), directors' duties in the former Saudi Arabian Companies Law 1965 were codified. One of the general reasons for codifying the duties of directors is to enhance the clarity of the law and make it easier for the responsibilities of directors towards others to be understood without the need for a legal consultant to interpret these duties. However, the general duties of directors in Saudi Arabian law are still not self-contained. These duties need recourse to the provisions of Islamic law to interpret them or to complete that which is non-stipulated. For example, in the need to resort to the provisions of Islamic law, in the interpretation and determination of the duty to exercise reasonable care, which was discussed in detail in para 4.3.

Just as understanding the provisions of Islamic law is not so easy; the director needs sufficient knowledge and background to understand the Islamic law provisions. As the company directors must perform their duties as they see fit to achieve the company's purpose, but understanding these unclear or non stipulated duties will be a task that is very difficult especially for the directors who do not have a legal background or even a sufficient background on Islamic law.

The directors' duties are presented in a scattered and not explicit manner in many articles of the SACL 2015. Some of these duties are stated in the form of duties, while others are stated in the form of prohibitions against the director, while others are stated in the form of penalties if a director breached some prohibitions. The duties also are not fully stated in the SACL 2015, as some of these duties are stated in the SACGR 2019. The duties mentioned in the SACL 2015 are scattered, some are stated in the companies section in general, some of the duties are stated in the section of the limited liability companies, and some duties are stated in the context of the joint-stock companies. Whoever sees this chaos in presenting the directors' duties will assume that the legislature, during dealing with one of the forms of companies, stated some duties for only the directors of this company regardless of the position of the provision (article) in the SACL 2015, which gives the impression that this duty is limited to only the directors of this company form or the legislature does not give the same interest and great importance in managing these companies.

The SACL 2015 does not impose any duty on the directors to take into account the interests of creditors before the commencement of the winding up of the company. According to the provision of the SACL 2015, the director acts in the interests of the shareholders until the winding up of the company and then the function of the liquidator will be applied, who must take into account the need to act with integrity towards the creditors, and protect their rights to ensure equality and fairness among them. Failure to stipulate this duty in the corporate law may lead to a lack of trust between creditors and companies, especially in regard to large, long-term debt, or may lead to the need to provide extensive guarantees to creditors by companies. Even if Islamic law maintains the rights of creditors, it would be worthy of the Saudi legislature to state a cut-off point, through which the directors must take into account the interests of creditors, rather than the interests of shareholders, and impose personal liability on the directors in the event that this duty is breached.

In the absence of the duty to take into account the interest of creditors, which the Saudi legislature should have stipulated, the Saudi legislature stated in detail some overlapping duties, such as differentiation and stipulating the duty not to participate in any business competitive with that of the company and the duty to avoid conflict of interests. The duty not to participate in any business competitive with that of the company is included implicitly in the duty to avoid conflicts of interest. Despite the stipulation of the duty not to participate in any business competitive, the Saudi legislature does not determine the scope of time or place for competition. The SACL 2015 also does not stipulate that the period for non-competition be determined after the directors left their position in the company.

Finally, as mentioned previously, one of the duties of the director stipulated in the SACL 2015 is to be a liquidator for the company where the circumstances require. This is upon the dissolution of the company, the directors will automatically be in the liquidator’s rule until a liquidator is appointed for the company. This may create a state of uncertainty, such as if the directors knew that there was no reasonable prospect that the company would avoid going into insolvent liquidation, so they are between two options, either acting in the interests of the company (shareholders) or acting in the interest of the creditors as considered they will be liquidators. Further, the administrative procedures for approving the director to be as a liquidator and the company's representative before the third party take much time to be approved their acts as a legal representative of the company. Therefore, the purpose of automatically appointing directors as a liquidator is not fulfilled in order to conduct the company's business until the appointment of the liquidator.

4.11 The comparison of directors’ duties in the UK and Saudi legislation.

As has been mentioned, the process of comparative study means examining the differences and similarities between the laws of different countries in different systems in the world. The importance of comparative law is that it helps to promote mutual understanding and dispel prejudice and misinterpretation in this world. It also provides a platform for legal intellectual exchange and helps to broaden the horizons of legislators worldwide. This study, in the previous chapters, has highlighted the directors’ duties in the UK and Saudi legislation. In this section, the study will compare the relevant legislation in Saudi Arabia and the like on the UK side, and highlight the similarities and differences in what needs to be clarified. It is worth mentioning that the aim of the comparative study is not to search for the best legal system, but the main purpose is to know more deeply the existing legal systems and thus develop what we have.

One of the similarities between the UK and Saudi Arabian law is the codification of the directors’ duties, and that these duties are not self-contained despite codification. On the Saudi side, it is based on the provisions of Islamic law, and on the UK side, it is based on the provisions of common law for its interpretation.

In general, the Saudi and UK legislators are consistent with framing the general duties of directors, the duty to act within powers granted, the duty to exercise reasonable care, the duty to avoid conflicts of interest and to declare any personal interest and duty not to accept benefits from third parties. They are also implicitly consistent on duty to achieve the company's purposes, which the UK legislature has expressed duty to promote the success of the company. Although the mechanism of the interpretation of some of these duties differs between UK law and Saudi law, depending on the interpretation of common law or interpretation of Islamic law. For example, the interpretation of the term "success" was based on common law on the UK side on several things to determine the meaning of "the company's success", such as achieving the objectives set by the company, the interpretation of directors of the company for success is a meaningful explanation and cannot be challenged, creating a long-term increase in the company's value, and what the constitution determines as a success of the company,[107] and the interpretation of achieving the purposes depends on the level of care required that interpreted by the provisions of Islamic law. Therefore, the directors in both countries need to be aware of the provisions of common law on the UK side, or the provisions of Islamic law on the Saudi side, or the need for a legal consultant to explain this.

As for the differences between the two sets of legislation, the UK legislature has stated all the duties in a separate chapter of the Act, called general duties of directors, and limited them between sections 171-177. The UK legislature has also clarified that the scope of these duties which are imposed on the current directors and the former directors of the company (a person who ceases to be a director), and the UK legislature has explained that the interpretation and the application of these duties are in the same way as under common law rules or equitable principles.[108] While the Saudi legislator has presented the duties in a scattered and non explicit manner in many articles. Some of these duties are stated in the form of duties, while others are stated in the form of prohibitions against the director, while others are stated in the form of penalties if a director made some prohibitions. The duties also are not fully stated in the SACL 2015, as some of these duties are stated in the SACGR 2019. The Saudi Arabian legislature also does not clarify the scope of the application of duties if

[107] See (3.3.2 Duty to promote the success of the company) for further information.
[108] CA 2006, s 170.

it is to the current director only or the current director and former director; this is left to the judge's discretionary authority, which will rely on the provisions of Islamic law.

In respect of the duty to exercise reasonable care, the UK legislature clarified the meaning of care is that "the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company",[109] while the Saudi legislature does not explain this and left its interpretation to the Islamic law provision and the judge's discretionary authority. The UK legislature, when it stated the duty to avoid conflicts, made it clear that this includes the exploitation of the information, as also state that the director may breach the duty if permission to do so is obtained (including competition). While the Saudi legislature when state duty to avoid conflicts does not elaborate on that rather than that stipulating other duties that are included in this duty, such as the duty not to participate in any business competitive with that of the company and the duty to maintain confidentiality.

In the duty not to accept benefits from a third party, the UK legislator stipulated the duty in greater clarity, including the cause of benefit and what is considered a breach of the duty and what is not considered a breach of the duty,[110] which is fully consistent with the provisions of Islamic law. The Saudi legislature stipulates in general that it is not permissible to accept benefits from a third party unless it is not likely to lead to a conflict of interests.

One of the fundamental differences between the duties of the director in Saudi and UK legislation is that the UK legislature requires the director to consider and act in the interest of creditors in certain circumstances,[111] while the Saudi legislature does not stipulate this duty to directors and makes the duties all concentrated on the interest of the company and the shareholders. Although the provisions of Islamic law maintain the rights of creditors, this duty should have been included in the SACL 2015. The failure of the Saudi Arabian

[109] CA 2006, s 174.
[110] CA 2006, s 176.
[111] CA 2006, s 172(3).

legislator to stipulate this duty is one of the legal gaps in the SACL 2015. This indicates a degree of weakness in the Saudi Arabian legislation. This weakness must be recognised in order to promote the future legal reform in Saudi Arabia. One of the reasons for this weakness may be entirely relying on the provisions of Islamic law, and the familiarity of Saudi Arabian people with Islamic law provisions. However, the expansion of the commercial business in Saudi Arabia, the development of these forms of business and the entry of foreign investors, found that understanding the provisions of Islamic law is not an easy matter for everyone. In addition, one of the duties stipulated in SACL 2015 that does not feature in the UK Companies Act is the duty to be a liquidator upon the dissolution of the company.

Given the directors' duties in Saudi law it is clear that there is a great lack of clarification of the duties through the SACL 2015. These duties can only be clarified by making use of the provisions of Islamic law, as stipulating them in the form of legal provisions gives it more strength and makes it easier to be understood by the company directors. Also, many of the duties, as it has been mentioned, are stipulated in the Saudi Arabian Corporate Governance Regulation, but this regulation applies only to listed joint-stock companies and some of them are purely guiding articles (i.e non-compulsory). However, these duties stipulated in the Corporate Governance Regulation ultimately are in full conformity with the provisions of Islamic law, which means that the articles have the power to bind.

Chapter Five: The liability of company directors in UK law

As already mentioned,[1] a duty is the obligation to do something or not to do something. The duties give rise to obligations and may raise liabilities, so it can be said that the liabilities are the result of a breach of duty. This chapter deals with the laws of the United Kingdom in relation to the liabilities of the company director, which may be a result of a breach of duty, in order to compare them with the laws of Saudi Arabia in another chapter.

5.1 Business Judgment Rule and Judicial Intervention

Because not all decisions made by directors have good consequences for the company, its shareholders, stakeholders and other parties, therefore the imposition of duties on directors and hold them to the liabilities for breaching these duties a mechanism to guide them in the way they should exercise their powers to reduce the risk of their decisions. However, courts have often refrained to hold directors liable for undesirable consequences.[2] This is because the courts are not willing to replace the directors' judgment by their own judgment.[3] This attitude led to the establishment of the business judgment rule in the USA.[4] This rule protects the directors from frivolous lawsuits about the way they conduct the company’s business by assuming that management is acting in the interests of the company. This rule states that if the acts of the director can be classified as a business judgment decision, then the director is presumed not to be liable for what has or has not been done. Therefore, it is worth analysing and investigating this rule to know if the legislation in the UK recognizes this rule or not; as this has a great impact on holding the directors liable for their decisions or not and the consequences of these decisions. Although this rule has not been officially recognized by legislation in the UK, but this rule has been recognized in a number of cases, such as in *Birdi v Specsavers Optical Group Ltd*,[5] where the court held that the director's act was

[1] See (3.2 The directors' powers).
[2] J Parkinson, Corporate Power and Responsibility (Oxford: OUP 1993), p 94.
[3] See *Hampson v Price’s Patent Candle Co* (1876) 45 LJ Ch 437; *Circle Petroleum (Qld) Pty Ltd v Greenslade* [1998] 16 ACLC 1577.
[4] Through cases law in Delaware in the US, for example, see *Cede and Co v Technicolor Inc* 634 A 2d 245 (1993); *Re Caremark International* (698 A 2d 959 (1996).
[5] [2015] EWHC 2870 (Ch).

in the interests of the company and there was no evidence of the existence of the motive of malice or improper motive and considered his act "*that was a matter for his commercial judgment, which the Court will not second-guess*". Also in *Howard Smith Ltd v Ampol Petroleum Ltd*,[6] it is stated that the courts "*will respect their* "directors" *judgment as to matters of management*" in the event of exist bona fide. However, there has been no clear explanation of what could be considered as business judgment, although the definition of business judgment is important because the classification of a matter as a business judgment provides immunity to directors from liability for such decisions.

In England, the determination of business judgment is not clear, since the courts do not use the term "*business judgment*" to indicate when the director's judgment will be respected.[7] Instead, the courts use other terms such as "*commercial judgment*" or "*commercial decision*".[8] The court stated in *Merchantbridge & Co Ltd v Safron General Partner 1 Ltd*,[9] "*They* "the directors" *made a business judgment... This was a commercial decision*".

The courts respect directors' exercise of discretion in the management of the company, which is expressed that directors' judgments or decisions. "Judgments or decisions" in this context means the ability to make a decision based on experience and responsibility.[10] This is completely consistent with what was stated in *Re Brian D Pierson (Contractors) Ltd*,[11] Hazel Williamson QC said that "*I must therefore give proper respect to Mr Pierson's* "the director" *evidence as to how his industry operates, and his judgement based on experience*". In *McKee v O'Reilly*,[12] the court considered that the expenditure on the refurbishment of the company's office premises was sensible in terms of commercial, so Sir Donald Rattee said that it "seems to me to have been a

[6] [1974] A.C. 821.
[7] S Cairns, Changing the Culture of Financial Regulation: A Corporate Governance Approach PhD thesis, (2014) University of Liverpool 147.
[8] *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch) at [754].
[9] [2011] EWHC 1524 (Comm).
[10] Oxford and Cambridge dictionaries at: <https://en.oxforddictionaries.com/definition/judgement>; <https://dictionary.cambridge.org/dictionary/english/judgment?q=Judgment> accessed on 12 June 2019.
[11] [1999] B.C.C. 26.
[12] [2003] EWHC 2008 (Ch).

matter of judgment". In *Singer v Beckett*,[13] Mr Justice Park said when the director decided not to pursue a broker for outstanding debts, it "*as a matter of business judgment*".

The "judgment or decisions" may also mean that the final decision or a number of decisions leading to the final decision to do something. Decision-making is therefore not an isolated event; it consists of a series of processes that make the final decision.[14]

Decision-making is part of a series of processes leading to a final decision.[15] Directors should carefully consider all aspects related to the final judgment, such as taking advice, due diligence and then making the decision. Accordingly, is it possible to say that the court may evaluate one aspect of the series of judgments leading to a final decision or are they all protected from scrutiny? This leads to the search for a mechanism through which courts can review the directors' acts or their decisions, which would evaluate the exercise of directors' discretion while ensuring that it does not impede the management of the company effectively.

The judicial approach, in a review of directors' decisions, is based on the view that courts should not substitute decisions for directors' decisions and that directors' decisions should be generally immune from judicial review[16] unless there is no reasonable director could have made, which known *Wednesbury* standard.[17] Judicial intervention occurs in derivative suits or legal proceedings provided by the board of directors on behalf of the company against directors. However, the courts will not review the decisions of directors taken in good faith. With regard to the duty to act for proper purposes and the duty to enhance the success of the company, the court may intervene and repeal the authority

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[13] [2007] 2 B.C.L.C. 287.

[14] Pettigrew, A. 'Studying Strategic Choice and Strategic Change. A Comment on Mintzberg and Waters: 'Does Decision get in the way?'' Organization Studies, January 1990, Vol.11(1), pp.6-11 cited in Keay, A., & Loughrey, J. (2019). The concept of business judgment. Legal Studies, 39(1), 43-44.

[15] Ibid.

[16] See *Howard Smith Ltd. Appellant v Ampol Petroleum Ltd*. and Others Respondents [1974] 2 W.L.R. 689.

[17] P. Davies and S. Worthington (eds), *Gower and Davies: Principles of Modern Company Law,* 9th edn (London: Sweet & Maxwell, 2012), para.16-76; Mortimore, S. (2013). *Company directors: Duties, liabilities, and remedies* (2nd ed.). Oxford: Oxford University Press, 259-262.

decision if it reaches an unreasonable conclusion that no reasonable authority can be made such that.[18] Section 172 has been interpreted as the courts refraining from reviewing on an objective basis if the directors' decision was in the interest of the company in their own opinion.[19] Problematic in the current *Wednesbury* standard is that it is very low because it is accountable only directors who act in bad faith or grossly negligent, so the role of s 172 is closer to being educational because s 172 leaves the explanation of what promotes the success of the company to the directors.[20]

However, the courts cannot be prevented from interfering in the review of the board's decision-making process by adopting a research review when reviewing and evaluating whether directors have breached s 172 through heightened review.[21] This approach has been adopted by the courts to intervene appropriately in other areas of corporate law,[22] which can be used in relation to the decision-making process of directors in cases of breach of duties through the use of heightened review. The adoption of this type of review does not mean that judges are more experienced than directors in understanding risks but this does not preclude examination of the quality and the integrity of the decision-making process. This is the essence of the difference between the *Wednesbury* standard and heightened review. In heightened review, the courts do not scrutinise the decision or its results, but only review the decision-making process on objective and reasonable grounds for the matter to be examined, for example, having the required experience and the allocation of sufficient time and resources to consider matters before the decision is taken,[23] adequate monitoring and supervision, discussion with shareholders about the matter and the like, which is consistent with the nature of the company and the type of

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[18] See Lord Greene M.R. in *Associated Provincial Picture Houses Ltd v Wednesbury Corp* [1948] 1 K.B. 223.

[19] Keay (n 40) chapter 3, 140.

[20] J Loughrey, (2013). *Directors' Duties and Shareholder Litigation in the Wake of the Financial Crisis* (ed). Cheltenham: Edward Elgar Publishing, 93.

[21] Lim, E. (2018). Judicial Intervention in Directors' Decision-Making Process: Section 172 of the Companies Act, Journal of Business Law, (2), 169-170.

[22] See Kershaw, David. (2012). *Company law in context: Text and materials* (2nd ed.). Oxford: Oxford University Press. 614–617; Lim (n 21) 171.

[23] See Sir Nicolas Browne-Wilkinson V.-C at 189 in *Byng v London Life Association Ltd* [1990] Ch. 170.

matter.[24] This review by the courts has current benefit in maintaining rights and holding directors accountable if they are considered by the courts. As well as a future benefit through which the behaviour of directors in the decision-making process of the board is improved through the collection and examination of information carefully, and increase their participation with the shareholders through discussion with them before making any decision.[25]

The argument that the court's review of the decision comes too late after the outcome is clarified, which does not consider the time circumstances at the time of the decision-making, is refuted because the hindsight bias has a clear impact on the decision outcome, not on scrutiny the decision-making process.[26] The argument that courts cannot evaluate experts' evidence to prove that the decision-making process is flawed, is refuted because courts have the ability to evaluate expert testimony, a common practice.[27]

In *Roberts v Frohlich*,[28] the court scrutinised the decision-making process of the directors. The court found that the directors breached their fiduciary duty by not taking into account the interest of the company or its creditors by continuing the project for the subsequent development of the industrial and commercial units instead of suspending the performance despite the futility of the project. During the decision-making process, directors did not take into account the advice received about the risks of continuing the project and its futility, the required amount for the contractor exceeded that provided by the bank for the development facility and directors were unable to obtain funding from an agreed source in the past. Mackie and others[29] comment on this case that, the directors' views of the company's prospects were perhaps overly optimistic and

[24] See House of Commons Treasury Committee, Banking Crisis: Reforming Corporate Governance and Pay in the City Ninth Report of Session 2008–09 (12 May 2009) (London: Stationery Office, 2009) (the Banking Crisis Report), paras 78–79.
[25] T. Payne et al., "Corporate Board Attributes, Team Effectiveness and Financial Performance" (2009) 46 Journal of Management Studies 46; M.A. Eisenberg, (1999). Corporate Law and Social Norms. Columbia Law Review, 99, 1253.
[26] Eisenberg (n 25). 945, 961.
[27] F. Gevurtz, "The Business Judgment Rule: Meaningless Verbiage or Misguided Notion" (1993) 67 S. Cal. L. Rev. 287, 305–312.
[28] [2012] B.C.L.C. 407.
[29] Mackie, F, Davies, R and Townsley, A., Directors' liability: the case of directorial responsibility following Roberts v Frohlich., June 2011, Insurance and Reinsurance Review, Edwards Angell Palmer & Dodge, 10. at <https://www.lexology.com/r.ashx?l=9AXSDHE> accessed on 5 December 2020.

not entirely realistic. It was clear the loan conditions could not be met, and with no alternative avenue for funding, the decision to authorise further development was irrational and based on "*wilful blindness... a deliberate decision not to enquire or consider lest an unpalatable truth be exposed*". At this point, the judge held "the only honest thing to do was to stop the development".

According to the Leeds Project on Business Judgment and The Courts,[30] after analysing a number of law cases, the results show that directors' decisions are not protected from judicial scrutiny or review, and directors are not immune from liability. The law assesses directors' decisions through the process-based classification of the directors' behaviour in context. Where the judges got involved in a systematic review of the directors' business judgment, which includes the matter of substantive decision, and a review of judgment processes. Imposing liability is more likely when the process goes wrong. This means, for example, in the event of the absence of a process. The irrational processes in the directors' acts, such as recklessness, blind optimism, and refusal to accept reality also support the imposition of liability.

Directors have a tendency to assume greater project risk more than others do because the nature of the business world is based on a great deal of trust, speculation and risk.[31] Most business judgment cases are related to risk decisions.[32] Perhaps the reason is that the difference between the acceptable risks to which a businessman is exposed and the unacceptable risks is not always clear.[33] The essence of directors' business judgment involves evaluating the trade-off between risk and return. Taking on more risk often means achieving higher returns. However, all parties must be aware of this risk before entering into the transaction, with the possibility that the return could be different than expected.[34]

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[30] Project of Business Judgment and the Courts. This inter-disciplinary project between the School of Law, Leeds, and the Management School, Liverpool, available at <https://essl.leeds.ac.uk/dir-record/research-projects/268/business-judgment-and-the-courts> accessed on [15 June 2020].
[31] *Overend & Gurney Co v Gibb (Thomas Jones)* (1871-72) L.R. 5 H.L. 480 at 495.
[32] See *ASIC v Rich* [2009] NSWSC 1229.
[33] See *Facia Footwear Ltd (In Administration) v Hinchliffe* 1997 WL 1102751.
[34] See Chandler, Chancellor In *Re CITIGROUP INC. Shareholder Derivative Litigation* 964 A.2d 106 (2009) available at: https://h2o.law.harvard.edu/collages/4274 [accessed June 2019].

The question is whether all decisions of directors are considered business judgment. The Australian Corporations Act 2001 defines business judgment as a decision was taken on the conduct of a company's business operations.[35] While in the United States it is any business decision taken in good faith and rational.[36] Eisenberg[37] argues that every business decision is unique, thus, it cannot be determined. However, the English courts' approach is different from that, some decisions were classified as business judgments. The courts recognized that business judgments involve transactions with third parties. Thus, English courts use the term "commercial judgment"[38]. However, business judgments have been applied to a wide range of other decisions in England, such as the decision to lay off employees to reduce costs for the interest of the company.[39] The Australian Companies and Securities Law Review Committee believes that business judgments are applied to decisions relating to the company's goals and budget, raising or changing capital, and to obtaining or providing credit.[40] However, this does not mean that the business judgement rule has been adopted in the UK, but the variants have been adopted in Malaysia, Australia and South Africa. The directors will be protected in Australia, when they have acted in good faith in a matter in which they have no conflict of interest, have been properly informed and acted rationally in the company's interest. In South Africa the directors will be also protected when they have acted in good faith in the interest of the company, avoided a conflict of interest, took reasonable steps to be informed and made a reasonable business decision.[41]

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[35] Australian Corporations Act 2001, s.180(3).

[36] See *Re Caremark Intern. Inc. Deriv. Lit.* 698 A.2d 959 (1996) available at: https://law.justia.com/cases/delaware/court-of-chancery/1996/13670-3.html [accessed June 2019].

[37] M.A. Eisenberg, "The Duty of Care of Corporate Directors and Officers" (1990) 51 U. Pitt. L. Rev. 964.

[38] *Cobden Investments Ltd v RWM Langport Ltd* [2008] EWHC 2810 (Ch) at [754].

[39] *F&C Alternative Investments (Holdings) Ltd v Barthelemy* [2011] EWHC 1731 (Ch).

[40] Company Directors and Officers: Indemnification, Relief and Insurance Report No 10 (1990), para 81.

[41] Milman, D. (2013). *Governance of distressed firms* (Corporations, globalisation and the law series). Cheltenham, UK; Northampton, MA: Edward Elgar Pub. 124-132.

5.2 Directors' liability

5.2.1 Breach of fiduciary duty

It has already been mentioned in this research that the term "director" includes all those who hold the position of director by any name called.[42] The benefit of this is that all those covered by this definition will be personally liable for the acts and decisions of the company in case of breach of duties. This may be a good reason to prevent using corporate directors from being a company director so that there is no chain of command in management, which may lead to evasion from the consequences of decisions taken.[43] The fiduciary duty is owed by all directors, even if not formally appointed, for the interest of the company except in the case of insolvency, the duty is in the interest of the creditors.[44] However, the director-elect as the director of the company who has not yet taken up the position does not owe the fiduciary duty as well as the director of the holding company for its subsidiaries if it has an independent board.[45]

The fiduciary obligation arose as a legal principle in English equity rules.[46] The term "fiduciary" applies to a large number of persons in legally recognised commercial relations, such as that between a director and a company, which in turn gives authority over the interests of others, which may be vulnerable to misuse. To protect the vulnerable party, the law imposes a fiduciary duty on the party that has the power.[47]

The term "fiduciary obligation" is due to a relationship of trust and confidence. Millett LJ[48] held that a fiduciary is a person who has undertaken to act for or on behalf of another person in a particular matter in a relationship of trust and confidence. The fiduciary duty is characterised as a single-minded loyalty obligation. Thus, a fiduciary must act in good faith and not make a profit by their

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[42] CA 2006 s 250.
[43] Jason (n 31) chapter 2; *Secretary of State v Hall* [2006] EWHC 1995 (Ch); *Re Hydrodan (Corby) Ltd* [1994] B.C.C. 161.
[44] CA 2006 ss 170 and 172; See *DPC Estates Pty Ltd v Grey* (1974) 1 NSWLR 444.
[45] See *Lindgren v L and P Estates Ltd* [1968] Ch 572.
[46] See Lord Herschell in *Bray v Ford* [1896] A.C. 44 HL at 51.
[47] See J. Velasco, "Fiduciary duties and fiduciary outs" (2013) 21 George Mason Law Review 157, 159-161.
[48] See *Bristol and West Building Society v Mothew* [1998] Ch 1 at 18.

trust and not put themselves in a situation where their duty to their principal may conflict with their own interest and they must act for the interest of the principal/company, not for their personal interest, unless expressly stated otherwise.[49] The fiduciary duty seeks to strengthen loyalty and trust and also to prevent dishonesty.[50]

In this context, it is worth mentioning the extent to which the fiduciary obligation can be modified in a fiduciary's contract with the principal. The opponents argue that the modification of fiduciary duties may render them useless as an organisational mechanism created to create a balance of power in a relationship of mutual trust and confidence, where the fiduciary has the power and the control on the interests of the company. This is to prevent the occurrence of disloyal behaviour.[51] The other view, as it is known that freedom of trade must be respected so that traders can manage their trade in the manner they deem appropriate, because of the relationship between the two parties to the trade is subject to legal agreements between them, when an agreement is negotiated with informed consent, it can modify the level of trust and confidence in the relationship between the parties.[52] Therefore, not all self-interested behaviour is non-loyalty.

The breach of the fiduciary obligation involves several cases in that the fiduciary is considered a breach of the fiduciary duty. Therefore, Millett LJ[53] determines fiduciary duties as the duty to act in good faith, the duty of non-profit, the duty to avoid conflicts of interest, the duty not to act for personal benefit or by a third party without informed consent. Of cases of breach of fiduciary duty, breach of duty to act in the interest of the company and for the proper purpose. In general, directors are required to act in what they consider to be in the interest of the company as a whole. If the motives of directors are intact, they will usually be immune from the liability in respect of acting in the interest of the company.

[49] Lord Herschell, *Bray v Ford* [1896] A.C. 44 HL at 57.
[50] Hudson, A., *Equity and Trusts* 9th Edition (Routledge: London, 2017) Ch 14, 621.
[51] Atkins, Matthew, What is the purpose of the ongoing use of fiduciary duties in English business law, with particular reference to breaches of duty in relation to bribery, secret profits, conflicts of interest and unconscionability?, PhD thesis, (2018), Lancaster University, 114-115.
[52] See *Kelly v Cooper* [1993] AC 205.
[53] See *Bristol and West Building Society v Mothew* [1998] Ch 1 at 18.

Nevertheless, when acting for the improper purpose or the purpose was not conferred, the courts will intervene.[54]

It has been mentioned in (*3.3 Duty to promote the success of the company*) that it is not easy to define good faith exactly because of the different contexts in which it arises,[55] notwithstanding its widespread use. This is either because it is assumed that everyone knows what it means or because its widespread use has created an unclear and inconsistent understanding of what it means.[56] On this, Nowicki[57] says that the problem lies in the fact that 'importing a definition of good faith into the context of director conduct from other areas of law is not ideal, because most definitions of good faith are context-specific'. However, courts have adopted a method of interpretation of 'good faith' by contrast, such as the absence of malice and lack of intent to harm. They also often explain what 'bad faith' is in the case at hand rather than getting involved in the interpretation of good faith.[58] The act in good faith in the interest of the company includes disclosure as part of this duty as in *British Midland Tool v Midland International Tooling*,[59] the directors of the company have started to establish a competitive business for their company in which they work. The court held this to be a breach of the fiduciary duty. It also held that the duty to act in the interest of the company includes the duty to inform the company of any actual or threatened activity that may harm the interests of the company. In *Item Software (UK) Ltd v Fassih*,[60] the court held that the director was obliged to disclose as part of acting in the interest of the company, which it was described as a duty of loyalty. The director could not fulfil his duty of loyalty unless he informed the company of his plans to obtain a contract for himself. Also in *Allnutt v Nags Head Reading Ltd*,[61] a director was removed due to his participation with a local competitor company, which the directors considered it as a conflict of interest and a breach of his duties as a director. The director

[54] See Peterson J in *Piercy v S. Mills & Co. Ltd* [1920] 1 Ch 77; Buckley J in *Hogg v Cramphorn* [1967] Ch. 254.
[55] Sealy (n 52) chapter 3.
[56] Juenger (n 53) chapter 3.
[57] Nowicki (n 54) chapter 3.
[58] See *Re Walt Disney Co Derivative Litigation* 906 A.2d 27 (2006).
[59] [2003] EWHC 466 (Ch).
[60] [2004] EWCA Civ 1244.
[61] [2019] EWHC 2810 (Ch).

brought a suit in court alleging unfair dismissal and age discrimination. Those claims were rejected, then he issued the present claim, in the Chancery Division, for unfair prejudice under s 994 of the CA 2006, he sought the remaining shareholders purchase his shares at a price to be fixed by the court and compensation for the loss of his office. The director argued that there was no actual conflict and that it was implicitly approved. However, at the trial, the judge found that he was and is still involved in the strategy, investment and marketing of the other company. The judge, therefore, concluded that the director's participation in the competing company was clearly conflicted with his duties as a director of the company. This conflict was not at any time agreed by his fellow directors or shareholders. Therefore, his claim was rejected accordingly. The court also decided that it cannot be said that he acted honestly and reasonably to the extent that a breach of his duty ought to be excused. He made no real effort to remedy his conduct through disclosure.

Determining the meaning of the proper purpose is controversial. The concept of the proper purpose may be undefined in the company's constitution or the interpretation of this concept may be disputed. The proper purpose is related to, inter alia, the activity of the company, the shareholders' objective, the intent of directors, the motive behind the decision and consideration of the best interests of the company and others.[62] In the considering of the duty to take into account the best interests of the company stipulated in s 172 of the CA 2006, an issue arises not only whether the director acts honestly or not, but whether the action taken is within the purpose conferred and in the interest of the company. In *Howard Smith Ltd v Ampol Petroleum Ltd*,[63] the court held that directors abused their fiduciary duty in allotment of shares for a purpose unrelated to management or other appropriate considerations.

Jonathan Parker J in *Regentcrest Ltd v Cohen*,[64] says that the duty that is imposed is a subjective duty, and not in the court's own consideration (objectively), so the challenge of the act or omission is in the interests of the company or not, depends on the mental state of the director, whether the

[62] CA 2006, ss 171 and 172; for the further see (3.3.1 Duty to act within powers).
[63] [1974] A.C. 821.
[64] [2001] 1 B.C.L.C. 80 at 105b.

director honestly believed that his act or omission was in the interest of the company. Thus, the director's task is to persuade the court that s/he honestly believed it was in the best interests of the company. The court will not replace the directors' judgment by its own judgment, but the appropriateness of the director's acts will be raised by the courts.[65]

There is a slight overlap between the duty to act in the interest of the company and the duty of care. However, failure to take appropriate steps to consider the interests of the company and its creditors may amount to disloyalty and thus breach of duty to act in good faith for the interests of the company. While if directors act in good faith for the interest of the company and for proper purposes they will not be liable for breach of the fiduciary duty but may be liable for breach of duty of care.[66] There is also an overlap between the duty to act in the company's interest and the duty to avoid conflicts of interest. Avoiding conflicts of interest and profits is, in fact, promotion of the duty to act in the interest of the company. In a study on the limits of the fiduciary duty of directors, Lim[67] finds that the duty to avoid unauthorised profits subsumes into the duty to avoid conflicts of interest in general, whether directors get self-interest or not. He suggests that the courts interpret the term "reasonably be regarded as likely" in section 175 by **three** things: that the company has considered the opportunity on an informed basis, the opportunity was within the scope of the company's activity, and the opportunity was a mature business opportunity.[68]

5.2.2 Breach of duty owed to creditors

5.2.2.1 Wrongful Trading

The beginning of the use of the term wrongful trading is due to the Report of the Insolvency Law Review Committee, Insolvency Law and Practice known as the Cork Report, where it states that the fraudulent trading provision had very

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[65] This topic has been addressed in detail in (Business Judgment Rule and Judicial Intervention). See para 5.1 above.
[66] See Leslie Kosmin Q.C. in *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2002] EWHC 2748 (Ch) at 83.
[67] Lim, E; "Directors' fiduciary duties: a new analytical framework." (2013) 129 LQR 242-244.
[68] Gibbs, D; "The absolute limit of directors' fiduciary liability for conflicts of interest: the director's perspective" (2015) 36 Comp. Law. 231.

inadequacies in dealing with irresponsible trading, such as applying the burden of criminal proof to civil proceedings.[69] Cork Report was concerned that unsecured creditors were not adequately protected and felt that compensation should be available to those who suffered a loss due to unreasonable behaviour or fraudulent acts.[70] The fraudulent trading provision failed to rein in directors who incurred losses when their companies faced financial difficulties.[71] Therefore, the Cork Report recommended that a new provision be enacted to provide civil proceedings for unreasonable trading, where only the application of the burden of civil proof, which strips directors of the benefits of limited liability when they see the insolvency is coming and do nothing to stop it or preserve the interests of the creditors.[72]

Section 214 of Insolvency Act 1986 can be described as a provision that aims to control the company's activities by requiring directors to take some action to stop their companies from becoming insolvent,[73] and directors must participate in stricter monitoring of the company's interests. All of these to prevent directors from placing all trade risks on creditors. It does not understand that this provision is to punish the directors to the insolvency of their companies but to address the situation that directors can do better towards the company to protect the interests of creditors effectively. [74] Lewison J[75] says that

> *"... there was no reasonable prospect that the company would avoid an insolvent liquidation? .... it depends on rational expectations of what the future might hold. But directors are not clairvoyant and the fact that they fail to see what eventually comes to pass does not mean that they are guilty of wrongful trading"*.

[69] Insolvency Law Review Committee, Insolvency Law and Practice (Cork Report), Cmnd 8558, HMSO (1982) at para 1776-1780.
[70] Cork Report at 1777.
[71] Ibid, at 1776-1778.
[72] Ibid, at 1777.
[73] Yeung, K, 'Private enforcement of competition law' in McCrudden C (ed), Regulation and Deregulation, Policy and Practice in the Utilities and Financial Services Industries Oxford University Press, (1999) p 40.
[74] See Vinelott J in *Re Purpoint Ltd* [1991] BCLC 491 at 499; *Re Hawkes Hill Publishing Co Ltd (In Liquidation)* [2007] B.C.C. 937 at 41.
[75] *Re Hawkes Hill Publishing Co Ltd (In Liquidation)* [2007] B.C.C. 937 at 950(41).

Liquidators and also administrators may take action against directors when they involved in so-called wrongful trading. This action is taken in order to obtain some contribution from directors towards the payment made to creditors who have not recovered what they were owed to by the company.[76] This action begins in accordance with s 214 of Insolvency Act 1986 if the company's assets are insufficient to pay its debts, and its directors knew or should know that there is no reasonable possibility that the company will avoid entering into insolvent liquidation.[77]

It was originally allowed only for to liquidators to start proceedings, unlike some other jurisdictions allowing other parties to start proceedings. For example, in Ireland, the receiver, the examiner, the creditor, the shareholder and the liquidator can initiate proceedings.[78] The Cork Report supported the view to grant administrators and administrative receivers and the liquidators the authority to take proceedings.[79] However, the administrator's role is limited to recommending that the company be moved from the administration to dissolution if s/he believes that the company does not have sufficient assets to distribute to its creditors.[80] The downside to not allowing administrators to initiate proceedings the fact that the only way to promote creditor interests is to push for liquidation rather than administration. While if the administrator can take proceedings, the company can be placed in administration and the company may still be able to be rescued.[81] After the Small Business, Enterprise and Employment Act 2015 came into force, it also allowed administrators to bring a claim for wrongful trading.[82]

It should be noted that s 214 does not specify the conduct and activities that constitute wrongful trading. This implies the inclusion of all activities involving

[76] Insolvency Act 1986, s 214.
[77] See the principles identified in *Grant v Ralls* [2016] EWHC 243 (Ch), [2016] Bus. L.R. 555, [2016] 2 WLUK 319, with regard to s.214, in particular, the principle that It must be proven that the insolvent liquidation was inevitable.
[78] Irish Companies Act 1963, s 297A.
[79] Cork Report at 1792.
[80] Insolvency Act 1986 Schedule B1, para 84.
[81] Keay, A. (2007). *Company directors' responsibilities to creditors*. London: Routledge-Cavendish, 82.
[82] Small Business, Enterprise and Employment Act 2015, s 117.

the conduct of directors in their management of the company. Griffin[83] believes the type of behaviour included in s 214 involves paying munificent dividends, selling off company assets undervalued, paying excessive remuneration and incurring obligations that the company cannot meet. Sealy[84] says that the formulation of the provision is very broad, the liability includes incompetence, ignorance and indifference. Section 214 of Insolvency Act 1986 also does not provide guidance to liquidators on how to act before the start of proceedings. However, Park J[85] was irritated by the lack of communication of the liquidators' solicitors with the directors for a long time and the commencement of procedures by the liquidators before the limitation period elapses. Because the liquidator is the plaintiff, the burden of proof is thrown on him/her first and then comes the director's defence. The liquidator must prove **four** things to claim for the personal directors' liability in wrongful trading. First, the company must have entered into an insolvent liquidation, which means the company at the time of winding up was its debts and liabilities exceeding its assets.[86] The considered insolvency here is the insolvency in the balance sheet, not with regard to cash flow.[87] Second, to claim for the directors' liability in wrongful trading, the respondent must be a director.[88] The wrongful trading claim applies only to the director, unlike some jurisdictions, the liability is imposed on every officer in the company in general.[89] This is what the Cork Report recommended that to hold any person the liability of wrongful trading if s/he is a party to the execution of the company's wrongful activities.[90] Thirdly, the liquidator must prove that the director at a time prior to the commencement of winding up was aware or ought to have concluded that there was no reasonable possibility of avoiding the company's entry into the insolvent liquidation.[91] Thus, the considered test here

[83] Griffin, S. (1999). *Personal liability and disqualification of company directors*. Oxford; Portland, Or.: Hart Pub, 64.
[84] Len Sealy, *Personal liability of directors and officers for debts of insolvent corporations: a jurisdictional perspective (England*) as mentioned in Ziegel, J., & Cantlie, Susan I. (1994). *Current developments in international and comparative corporate insolvency law*. Oxford : New York: Clarendon Press ; Oxford University Press, 491.
[85] *Re Continental Assurance Co of London plc* [2007] 2 BCLC 287
[86] Insolvency Act 1986, s 214(2)(6)(9).
[87] Keay, A, *McPherson's Law of Company Liquidation*, 2001, London: Sweet and Maxwell, 84–91.
[88] Insolvency Act 1986, s 214.
[89] Irish Companies Act 1963, s 297.
[90] Cork Report at 1787.
[91] Insolvency Act 1986, s 214.

is both the objective and subjective tests together. The lack of qualities or experience of a director would not be a protection from liability because ignorance is not an excuse.[92] Courts will also take several considerations and factors as to whether there is a reasonable prospect or not to avoid insolvent liquidation such as creditors pressure, withdrawal of support from banks, loss of contracts, inability to obtain new contracts.[93] Fourthly, the liquidator must establish that the director knew or ought to know at a specific time that there was no reasonable prospect of avoiding the company's entry into the insolvent liquidation.[94] Oditah[95] says that the term "reasonable prospect" is ambiguous. In many cases, it is difficult to look into the future of the company and determine whether liquidation is the fate of the company. In this case, if directors continue trading, they will be liable. In *Re Continental Assurance Co of London plc*,[96] Park J said that:

> *“closed their eyes to the reality of the company’s position, and carried on trading long after it should have been obvious to them that the company was insolvent and that there was no way out for it. In those cases the directors had been irresponsible, and had not made any genuine attempt to grapple with the company’s real position”.*

The most difficult thing facing the liquidator is to prove and determine a specific time for the director's knowledge the fate of the company is going to the insolvent liquidation.[97] In *Manolete Partners v Ellis,*[98] the wrongful trading claim was for the increase in the deficiency of the (company) BFS’ assets against unsecured claims in the period January 2015 to February 2016. It is contended that if BFS (the company) had been liquidated in January 2015 the net deficiency would have been much less than in the liquidation as happened.

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[92] See *Re Brian D Pierson (Contractors) Ltd* [1999] BCC 26 at 55.
[93] See *Re DKG Contractors Ltd* [1990] BCC 903; Griffin (n 83) 66.
[94] See the principles identified in *Grant v Ralls* [2016] EWHC 243 (Ch), [2016] Bus. L.R. 555, [2016] 2 WLUK 319, with regard to s.214, in particular, the principle that "a court should not approach the question of whether a director ought to have concluded that a company had no reasonable prospect of avoiding liquidation with the benefit of hindsight".
[95] F Oditah, “Wrongful Trading” [1990] LMCLQ 205 at 208.
[96] *Re Continental Assurance Co of London plc* [2007] 2 BCLC 287.
[97] See Hazel Williamson QC in *Re Brian D Pierson (Contractors) Ltd* [1999] BCC 26 at 49, 50; See *Grant v Ralls* [2016] EWHC 243 (Ch) (n 94).
[98] [2020] EWHC 1674 (Ch).

Manolete alleged that the director (Mr Ellis) on 16 December 2014 knew or ought to have known that there was no reasonable prospect that BFS would avoid going into insolvent liquidation and should have initiated an orderly winding up. Mr Ellis (a director) submitted that all these claims were without substance. He made, among others, the following points. Mr Ellis' functions in BFS were limited to that of a non-executive director; thus, there is no point in the history of BFS when it can reasonably be said that Mr Ellis ought so to have concluded there was no reasonable prospect that BFS would avoid going into insolvent liquidation. Hurst & Co's Addendum "Independent Accountants Report" stated that BFS would not be trading from an insolvent position because "*although the projections record a negative balance sheet position until the year ended 31 March 2018, cash-flow projections forecast that BFS will be able to meet its liabilities as they fall due*". The judge held that the director (Mr Ellis) did not know that there was no reasonable prospect of BFS avoiding insolvent liquidation. Accordingly, the wrongful trading claim fails.

Directors must maintain the company's financial position and be cautious. However, excessive caution, may not benefit the creditors, such as an immediate cessation, which may be considered as a breach of duties towards the company and shareholders.[99] Section 214 of Insolvency Act 1986 provides that a director is not liable for wrongful trading when the court is satisfied that the director has taken every step to minimise the potential loss to the company's creditors, after s/he knew that there is no reasonable prospect that the company would avoid going into insolvent liquidation.[100] In this context Park[101] J said that The directors are in trouble to make a difficult decision when the company is suffering financially, when they decide to close down or enter into liquidation or instead continue trading in the hope of improvement. If they decide to continue trading and things are going to reverse what is planned and expected and the company eventually ended up liquidating, they may find themselves liable for wrongful trading; and if they decide to close immediately they may be under pressure from shareholders and risk of criticism. In *Re Brian D Pierson*

[99] CA 2006 ss 172 and 174.
[100] Insolvency Act 1986, s 214(2)(3).
[101] See *Re Continental Assurance Co of London plc* [2007] 2 BCLC 287 at 281.

(Contractors) Ltd,[102] Hazel Williamson QC said that every step is mentioned in s 214 are the steps taken by directors in order to preserve assets or claims for the creditors' benefit, even if they fail to achieve this. In this regard, Sealy[103] suggests that guidelines should be established on what directors should do in these cases. Because the words "every step" is ambiguous, because it is likely to be strict, the defence is almost impossible because no conduct can be accepted that is less than the best. But Goode[104] believes that "every step" is interpreted by s 214 and is meant by every step taken by a reasonably diligent person.

Directors' asking for professional advice may also be included in the meaning of every step. Courts consider directors who seek professional advice and if the advice is not heard, directors are likely to have large difficulty defending.[105] However, it should be noted, that directors following professional advice, it does not absolve them entirely of liability, they must exercise independent judgment.[106] Business termination may be one of the right steps directors can take, although it may reduce or stop the financial flow on the company which may be considered detrimental to shareholders and creditors. However, if directors decide to terminate trading, it would be better to move the company to some formal insolvency proceedings such as administration or liquidation.[107] One of the best choices for directors is to place the company in administration to avoid wrongful trading liability. The administration process is characterised as allowing the assessment of the company's status without any attack and litigation, as all legal proceedings against the company will be suspended.[108] The problem with the placing company in the formal insolvency proceedings, whether it is administration or liquidation, is that the directors' fear of personal

[102] [1999] B.C.C. 26.
[103] Sealy (n 84) 492.
[104] Goode, R. (2011). Principles of Corporate Insolvency Law (4th ed.). London: Sweet & Maxwell, 471.
[105] *Re Bath Glass Ltd* (1988) 4 B.C.C. 130; *Re Continental Assurance Co of London plc* [2007] 2 BCLC 287; In *Grant v Ralls* [2016] EWHC 243 (Ch), the liquidator asserted that the directors had failed to get professional advice.
[106] CA 2006 s173.
[107] Insolvency Act 1986 Schedule B1, para 3 and 84.
[108] Insolvency Act 1986 ss 10 and 11; Schedule B1, para 42 and 43.

liability may hasten the company's end so that the company may not be ended or even in need of rescue, and the company may be able to continue.[109]

Directors may resort to many things, which cannot be enumerated, that may be considered as steps aimed at reducing loss such as contacting creditors to inform them of the company's situation.[110] The resignation may also be the last resort directors for extricating themselves from liability for wrongful trading, especially when they cannot find any response to their advice and recommendations on the preservation of the interests of creditors if they believe that the company is going to insolvent liquidation.[111]

The commentator van Zwieten[112] argues that paying some creditors while not paying others, or paying some creditors and acquiring some new creditors, during the period before the commencement of the insolvent liquidation does not impose personal liability against directors. This is because imposing liability on trading after directors know or ought to know that there is no reasonable prospect to avoid insolvent liquidation would not enable trading, because trading will require the payment of certain liabilities and the incurring of others. However, there are some cases in which directors can be personally liable with respect to the payment of certain creditors before others. The first is when directors incur the company a new debt for the purpose of repaying an old debt in circumstances they know they will not be able to repay the new debt when it is due. The second is when directors use the company's assets to pay some creditors over others in order to obtain some indirect benefits for themselves. Commenting on moratorium in the Corporate Insolvency and Governance Act 2020, Parry and Gwaza[113] say, "*directors can be held liable for wrongful trading*

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[109] Keay (n 81) 117.
[110] See *Brooks v Armstrong* [2015] EWHC 2289 (Ch) at 56.
[111] See Chadwick J, in *Secretary of State for Trade and Industry v Taylor* [1997] 1 WLR 407 at 412 *"...would have been prudent to resign his directorship once he appreciated that his recommendations would not be accepted. By continuing to be a director he exposed himself to potential liability under section 214 of the Insolvency Act 1986"* and at 414 *"If a director finds that he is unable to do what he knows ought to be done, then the only proper course is for him to resign"*.
[112] van Zwieten, Kristin, Disciplining the directors of insolvent companies: an essay in honour of Gabriel Moss QC (December 20, 2019). Insolvency Intelligence (2020) 33(1) 2-10, 1-5.
[113] Parry, R. and Gwaza, S., 2019. Is the balance of power in UK insolvencies shifting? *Nottingham Insolvency and Business Law e-Journal*, 7. ISSN 2053-1648 p20.

in the case where the company which obtains the moratorium has passed the point of no return during the tenure of this moratorium".

It should be noted that the Corporate Insolvency and Governance Act 2020, which puts in place measures to amend insolvency and company law to meet the challenges caused by the impact of coronavirus (COVID-19). One of these measures, there is a temporary suspension, retrospectively from 1 March 2020 until 30 September 2020, of the UK's wrongful trading provisions. However, this suspension is only for eligible companies.[114] On 26 November 2020, the Corporate Insolvency and Governance Act 2020 (Coronavirus) (Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations 2020 came into force. These Regulations have extended the wrongful trading liability suspension to begin on 26th November 2020 and to continue until 30th April 2021. These Regulations (like the 2020 Act itself) do not protect against other forms of liability incurred during the COVID “amnesty” period.

5.2.2.2 Fraudulent trading

The criminalisation of the business of the company for the purpose of defrauding creditors began after the Greene Committee on Company Law Reform in 1926 recommended that, a new provision should be included, namely that if it appears, in the course of the winding up of a company, any business of the company had been done with the intent of defrauding the creditors of the company, the court should, on the application of the liquidator or any creditor or contributory, declare that the directors are liable and shall be subject to unlimited personal liability.[115] In 1928, s 75 of Companies Act 1928 was enacted, but there was leniency in which directors could be protected with limited liability. After the enactment of Companies Act 1929 s 275 criminal and civil liability and criminal and civil proceedings were imposed. The official receiver, liquidator, creditors and contributories may also initiate proceedings. The group of respondents was then expanded to include all parties to fraudulent

[114] The Corporate Insolvency and Governance Act 2020, s.12 Suspension of liability for wrongful trading: Great Britain.
[115] Report of the Company Law Amendment Committee, Cmnd 2697, HMSO, London, 1926 at 61.

trading by enacting s 332 of the Companies Act 1948. Despite this, still there were inadequacies in dealing with irresponsible trading, such as the burden of criminal proof applied to civil proceedings, and applicants were required to prove dishonesty and real moral blame from the respondents.[116] The Cork Report, therefore, recommended amending this provision and applying criminal liability only to fraudulent trading.[117] The UK legislator took this proposal and enacted s 213 of the Insolvency Act 1986; which aimed to compensate those who have lost due to the actions of the persons involved in fraudulent trading.

The conduct that constitutes fraudulent trading is the existence of the intention of defrauding creditors or the existence of a fraudulent purpose.[118] Section 213 of Insolvency Act 1986 does not interpret the meaning of these conducts, it leaves its interpretation to the courts. The fraudulent trading provision is broad enough to cover any business activity of the company that has been done and not only the activities of the company and what is within its purpose; it also covers all creditors and anyone else.[119] Trading when there is no possibility of funds being present at the time of debt payment also constitutes fraudulent trading.[120] Trading with the intent of fraud or the purpose of fraud can constitute fraudulent trading even if there is no loss;[121] proof of loss is only for claiming contribution.[122]

Proving fraudulent intent is a daunting task. This is due to the fact that the interpretation of the meaning of fraud stated in s 213 is difficult, and lies difficult to interpret because it has different meanings in different contexts.[123] In order for a person to be liable for fraud, s/he must prove her/his involvement in dishonesty,[124] which is involving real moral blame.[125] Laddie J[126] agreed, saying

[116] The Cork Report at 1776-1780.
[117] Ibid, at 1777.
[118] Insolvency Act 1986, s 213.
[119] Insolvency Act 1986, s 213(1).
[120] See *Re Pantiles Investments Ltd (In Liquidation)*, [2019] EWHC 1298 (Ch); *Regina v Arthur Frank Chard Waite* [2003] EWCA Crim 1560 at 5.
[121] See *Regina v Grantham* [1984] Q.B. 675 at 683.
[122] See *Re Pantiles Investments Ltd (In Liquidation)*, [2019] EWHC 1298 (Ch); *Morphitis v Bernasconi & Ors* [2003] B.C.C. 540 at 53.
[123] J.H. Farrar, 'Fraudulent Trading' [1980] JBL 336, 339.
[124] *R. v Cox (Peter Nevill)* (1982) 75 Cr. App. R. 291.
[125] *Re Patrick and Lyon Ltd* [1933] Ch. 786 at 790.
[126] *Bernasconi v Nicholas Bennett & Co* [2000] B.C.C. 921at 924.

that dishonesty was a decisive element in any actions under s 213. Also, he added said that acting dishonestly is the factor that distinguishes fraudulent trading from wrongful trading.

In this regard, it is worth noting the court's consideration of the respondent's mental state. The court generally applies a subjective test to determine the respondent's state of mind and the intention of fraud at the time of the alleged fraudulent trading;[127] if it is proved that the respondent was aware of the fraud - at the time of fraudulent trading - it means that the respondent was acting with dishonesty.[128] However, in specific circumstances, the courts may consider objective factors and apply objective test, whether the court is able to deduce the respondent's state of mind through his/her actions and the circumstances surrounding the alleged fraudulent trading.[129] In *Re William C Leitch Bros Ltd*,[130] Maugham J considered that the state of mind could be deduced to determine the intent of fraud by applying the objective test by saying that if a company continues to (do) business and incur debt while directors know that there is no reasonable prospect of repayment of debt, this is generally an appropriate conclusion that the company is engaged in fraudulent activity. The Court of Appeal's view,[131] on whether or not an objective test can be applied, was consistent with Maugham's view that in order to prove fraudulent trading, it must be established that there was a risk in which no one had the right to risk, which would cause detriment or prejudice to another.[132] However, the Australian High Court opposed this and held that the intent of the respondent must be proven to his/her benefit or protection at the expense of creditors in order to hold him/her liable for fraudulent trading.[133]

It is worth noting that s 213 stipulates that fraudulent trading procedures may only be initiated when the company is being brought in liquidation, it may be the reason for this is that the company before being in liquidation it may have hope in life and be solvent; it may be premature to initiate fraudulent trading

[127] *Morris v Bank of India* [2003] B.C.C. 735.
[128] *Morris v State Bank of India* [2004] B.C.C. 404.
[129] See *Re Pantiles Investments Ltd (In Liquidation)*, [2019] EWHC 1298 (Ch).
[130] [1932] 2 Ch. 71 at 77.
[131] *R. v Sinclair (William Vernor Squire)* [1968] 1 W.L.R. 1246 at 1247-1248.
[132] See *Regina v Grantham* [1984] Q.B. 675 at 683.
[133] *Hardie v Hanson* [1960] 105 CLR 451 at 461-462.

procedures.[134] In order to impose personal liability on the person who engaged in fraudulent trading, the liquidator must prove three elements; first, the company's liquidation business was done with the intention of defrauding creditors or for any other fraudulent purpose; second, the respondent's involvement in the execution of the business;[135] third, knowledge of the fraudulent activity. It is not required for knowledge of fraudulent activity to know all details of fraud or how it is committed, it is enough just knowing that the company intends to conduct fraudulent action.[136]

As for those involved in fraudulent trading, as already mentioned, by enacting s 332 of Companies Act 1948, the respondents' group was extended to cover all parties involved in fraudulent trading; then enacting s 213 of Insolvency Act 1986 to confirm this, whether they are current or former directors, officers or others from within or outside the company provided that there is an intention to defraud creditors; unlike wrongful trading, which applies only to directors,[137] as in *Re Daystreet15 Ltd (In Liquidation)*,[138] commenced proceedings against seven respondents were engaged in fraudulent trading. The first and second Respondents were the directors of the Company. The third to seventh respondents are companies. But Keay argues, by inferring what is stated in *Morris v Banque Arabe Internationale d'Investissement SA*,[139] that those who execute the orders will not be liable and that the liability lies with those who organise the business, mostly directors and senior managers.[140] However, each case must be assessed based on the facts and circumstances surrounding it. The court in *Re Maidstone Building Provisions,*[141] held that the company secretary was not liable for failing to inform the directors that the company was insolvent and that trading should be cessation. While in *R v Waite (Arthur Frank),*[142] the company secretary was convicted on counts of fraudulent trading. As the liability lies with persons within the company, it also includes

[134] R. Williams, 'Fraudulent Trading' (1986) 4 Company & Securities Law Journal 14, 17.
[135] Insolvency Act 1986, s 213.
[136] *Morris v Bank of India* [2004] 2 B.C.L.C. 236 at 243.
[137] Insolvency Act 1986, s 214.
[138] [2020] EWHC 1140 (Ch).
[139] [2002] B.C.C. 407.
[140] Keay (n 81) 34.
[141] [1971] 1 W.L.R. 1085.
[142] [2003] EWCA Crim 1560.

persons outside the company,[143] for example, in *Bank of India v Morris,[144]* the bank was held liable for fraudulent trading because it facilitated the company part of its liquidation operations. In *Re Gerald Cooper Chemicals Ltd,[145]* the creditor was liable, where he knew that his debt was paid as a result of fraud committed.

Finally, while individual creditors were able to initiate fraudulent trading procedures under s 332 of Companies Act 1948, but this was not valid anymore. The court can no longer compensate a particular creditor for losses incurred as a result of fraudulent trading. Rather, applications are made through liquidators under s 213, and applications are collective where the liquidator seeks to compensate the creditor's general body.[146] Keay[147] argues it has become more equitable than before, as a single creditor was able to take his/her dues directly after fraudulent trading application, but this could lead to the respondent being in a destitute situation that is unable to pay other creditors. This is with respect to the private right to fraudulent trading. As for the public right, the Secretary of State for Trade and Industry, under s 124A of Insolvency Act 1986, may wind up a company that engages in fraudulent activities that affecting consumers for the public interest; and the initiation of the directors' disqualification order procedures in accordance with s 10 of Company Directors Disqualification Act 1986 for breach of s 213 of Insolvency Act 1986.

5.2.3 Liability for negligence to the company and third party

Unlike other duties, the duty to exercise reasonable care, skill and diligence is not a fiduciary duty in terms of enforceability in the same way of any other fiduciary duty owed to a company by its directors. Therefore, the breach of the duty to exercise reasonable care, skill and diligence could be attributed to negligence.[148] It can be said that the concept of care in common law has been developed through passing stages. The beginning of its development was

[143] Insolvency Act 1986, s 213(2).
[144] [2005] EWCA Civ 693.
[145] [1978] Ch. 262.
[146] *Morphitis v Bernasconi and Others* [2003] Ch. 552.
[147] Keay (n 81) 33.
[148] CA 2006, s 178(2).

largely in 1932 in *Donoghue v Stevenson,*[149] the duty of care was applied despite the absence of relationship or prior interaction and was not constrained by privity of contract. The neighbour principle was adopted and intended as explained by Lord Atkin[150]:

> *"There must be and is, some general conception of relations giving rise to a duty of care... The rule that you are to love your neighbour becomes in law you must not injure your neighbour; and the lawyer's question: Who is my neighbour? ... You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour. Who, then, in law, is my neighbour? ... persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions that are called in question".*

Because of the difficulty of applying the neighbour principle to some cases, it has been adopted *Anns test*, where there is an adequate relationship of proximity or neighbourhood between the plaintiff and the respondent and the negligence of the respondent is likely to cause harm to the plaintiff.[151] A frequent criticism of the *Anns test*[152] led to the emergence of the so-called *three-stage test*, based upon Lord Oliver's summary in *Caparo Industries plc v Dickman,*[153] The harm which occurred is a reasonably foreseeable result of the defendant's conduct; there is an adequate relationship of proximity or neighbourhood between the plaintiff and the respondent; It is fair and reasonable to impose liability.

Prior to 1986 negligence was not clearly defined with regard to the relationship between the director and the company.[154] There were several concepts such as negligence as a state of mind as opposed to deliberate action, there is no

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[149] *Donoghue v Stevenson* [1932] AC 562.
[150] Ibid.
[151] *Anns v Merton London Borough Council* [1978] AC 728.
[152] Steele, Jenny (2007). Tort Law: Text, Cases, & Materials: Text, Cases, and Materials (Paperback). Oxford University Press. ISBN 978-0-19-924885-8. p. 146.
[153] *Caparo Industries plc v Dickman* [1990] 2 AC 605 at 632-633.
[154] *Re B. Johnson & Co. (Builders) Ltd*, [1195] 1 Ch 634, 635.

desire or for a certain result, which is more like carelessness.[155] Another example Supreme Court of New York stated in *Bayer et al. v. Beran et al.*[156] that:

> *"…it is only in a most unusual and extraordinary case that directors are held liable for negligence in the absence of fraud, or improper motive, or personal interest".*

Hence, negligence was linked to fraud, improper motivation or personal interest. At that stage, there was a lack of clarity in the concept of neglect, although the link between them is misfeasance. After the 1986 legislation, negligence in this context was intended to breach the duty to exercise reasonable care, skills, and diligence. Negligence is defined as a breach of the duty of care by the failure of the director to exercising reasonably expected from someone professional in their position and considering the knowledge, skill and experience that they actually have.[157] In *Williams v Natural Life Health Foods*,[158] Lord Steyn said:

> *"The touchstone of liability is not the state of mind of the defendant. An objective test means that the primary focus must be on things said or done by the defendant or on his behalf in dealings with the plaintiff. Obviously, the impact of what a defendant says or does must be judged in the light of the relevant contextual scene. Subject to this qualification the primary focus must be on exchanges (in which term I include statements and conduct) which cross the line between the defendant and the plaintiff".*

It should be noted that breach of duty of care may result from gross negligence, ordinary neglect or even inactivity. Therefore, Baron Rolfe J believed in *Wilson v Brett,*[159] there is no difference between negligence and gross negligence. However, after the enactment of s214 of Insolvency Act 1986 and s174 of CA

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[155] Walton, C., Cooper, Roger, Wood, Simon E, Percy, R. A., & Charlesworth, J. (2006). Charlesworth & Percy on negligence (11th ed., The common law library). London: Sweet & Maxwell.
[156] 49 N.Y.S.2d 2 (Sup. Ct. 1944).
[157] Insolvency Act 1986, s 214(4).
[158] [1998] 1 W.L.R. 830.
[159] [1843] 152 E.R. 737 at 115.

2006, directors have become liable for negligence, regardless of such distinction; the subjective and objective tests were applied together to determine the level of care required. Therefore, it is difficult to identify all cases that lead to liability for negligence, but instead, the courts have been given the discretion to determine negligence through the facts and circumstances surrounding the nature and functioning of the company. It should be noted that, in some cases, the director may be held liable for negligence despite the existence of fraud and the company goes into insolvency, in *Contex Drouzhba Ltd v Wiseman*,[160] a director of a company was personally liable in the tort of deceit in making an implied representation that the company was able to pay for goods to be supplied and in this time he knew the company was insolvent and unable to pay. Because the director signed a document in his personal capacity containing assuring a creditor as to the company solvency, ss.213 and 214 of the Insolvency Act 1986 cannot affect the case.

Claims of misfeasance against directors by liquidators may also be arisen in accordance with s 212 of the Insolvency Act 1986, which often includes a claim that the director has misapplied or retained any money or other property of the company, or been guilty of any misfeasance or breach of any duty in relation to the company.

5.3 The consequences of breach of the duties

5.3.1 Return of property and Account of profits

The company director may be ordered to return the company property to the company in case of taking its property by breach of duties while s/he shall hold the property in trust for the company.[161] Account of profit claims is often involved in breaching the duties stated in ss 175-177, duty to avoid conflicts of interest, duty not to accept benefits from third parties and duty to declare interest in proposed transaction or arrangement. When a company director has benefited from an unauthorised profit by breaching the duties, this profit is confiscated to the company.[162] This is to deter the directors and not to

[160] [2008] BCC 301.
[161] *JJ Harrison (Properties) Ltd v Harrison* [2002] 1 B.C.L.C. 162 at 27, 30.
[162] *Murad v Al-Saraj* [2005] EWCA Civ 959.

compensate the company for the loss, as the company compensation may be greater than the profit realised by the director.[163]

The liability to account for profits is a personal liability of the defaulting fiduciary. The directors are liable for the account of profits regardless of whether the company has suffered or lost.[164] This is an aspect of the fiduciary obligations of the account as part of its oversight of the trust asset.[165] Also, when it is proved that there is a transfer of property or payment to a director, the evidence lies on the director to prove that the transfer the payment was proper.[166] The fiduciary is treated as if the unauthorised profit is given to his/her company and as a consequence of the breach of duty, the director is liable to account for the highest value of assets in the intervention period in the case of the fluctuates of the asset value.[167] In *Fairford Water Ski Club v Cohoon*,[168] a director was accountable to the company for the profit he had made. The directors failed to declare the nature of their interest in the management agreement that they must have declared the interest they had in a transaction or arrangement with the company.

However, the director is not liable to account for profits that are not related to the breach of duties.[169] A fiduciary is liable to account for profits made by themselves or through a company and s/he has a fundamental interest and not for profits made by third parties.[170] In addition, the profits made jointly by other persons are not subject to confiscation unless the other person is aware of the breach of duty and may be liable.[171]

In this regard, it is worth considering the issue of diverting business opportunities into the director's own business. Can the court assess the profit proportion related to the diverted opportunity and confiscating exactly what has

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[163] *United Pan Europe Communications NV v Deutsche Bank AG* [2000] 2 B.C.L.C. 461 at 74.
[164] *Towers v Premier Waste Management Ltd* [2012] 1 B.C.L.C. 67 at 51.
[165] *Re D'Jan of London Ltd* [1994] 1 B.C.L.C. 561.
[166] *Re Snelling House Ltd (In Liquidation)* [2012] EWHC 440 (Ch) at 40.
[167] *Cook v Deeks* [1916] 1 A.C. 554; *Regal (Hastings) Ltd v Gulliver* [1967] 2 A.C. 134; *Target Holdings Ltd v Redferns* [1996] A.C. 421.
[168] [2020] EWHC 290 (Comm).
[169] *Murad v Al-Saraj* [2005] EWCA Civ 959 at 77, 79 and 85.
[170] *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch) at 1550-1576; *Cook v Deeks* [1916] 1 A.C. 554.
[171] *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch).

been obtained or is there another opinion? Lewison J in *Ultraframe UK Ltd v Fielding,*[172] holds that the profits for which an account is ordered must be linked to a reasonable relationship with the breach of the duty; and it is important to determine what was obtained exactly, for example, order an account limited in time; or limited to profits derived from particular assets or customers. In *Warman International Ltd v Dwyer*,[173] the High Court of Australia held in the case of a director who diverted part of the company's business to his own company, that the account of profit should be limited to the first two years of operations.

5.3.2 Equitable compensation

Return of property and confiscation of profits from a director who breached duties may not be sufficient to redress the damage suffered by the company due to the director's breach of his/her fiduciary duty. Therefore, the court may award equitable compensation for any loss not compensated by the account of profit.[174] Equitable compensation is therefore awarded in order to redress the loss caused by a breach of duty which can be realised later.[175] In *Fairford Water Ski Club v Cohoon*,[176] the return of property was not possible because of the limitation period, but the directors were accountable to the company for equitable compensation for the loss. The claim related to the transfer of a plot by the lake from the company to a director. The plot transfer was made at a significant undervalue. The judge considered that was a breach of duty to promote the success of the company. The House of Lords explained in *Target Holdings Ltd v Redferns*,[177] that it does not apply the principles of the common law to causation and quantification, the fundamental principle in common law is two principles for compensation. The act of wrongful defendant must cause the damage complained of; the plaintiff must be placed in the same position and, if s/he does not make the mistake, s/he is entitled to compensation.

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[172] [2005] EWHC 1638 (Ch) at 1588.
[173] [1995] 182 CLR 544.
[174] *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 B.C.L.C. 131 at 142.
[175] *Target Holdings Ltd v Redferns* [1996] A.C. 421.
[176] [2020] EWHC 290 (Comm).
[177] *Target Holdings Ltd v Redferns* [1996] A.C. 421.

While Lord Browne-Wilkinson[178] argued that liability and redress are based on the breach of duties and the causation between breach of duty and damage (loss). It is also not all breach of duty cases that entail compensation, for example, unauthorised profitable investment is not awarded compensation, even if there is a breach of duty to act within powers or breach of duty that is done with the consent of the beneficiaries. Lord Browne-Wilkinson's opinion has been criticised that compensation is binding due to breach of contract and not only the existence of damage (loss). Where the contracting party has a primary obligation to implement its contract and a secondary obligation to pay compensation on the case of not complying with the contract.[179]

5.3.3 Rescission of a transaction

The transaction of a company that has occurred due to a breach of fiduciary duty is voidable in accordance with the option of the company and may be rescinded.[180] The rescission of a transaction involves each party returning to the other what was transferred in the transaction. Nor can the plaintiff be granted restitution from the defendant without being able to give a counter-restitution to the defendant.[181] Also, upon rescission of the contract of sale of property made by a director, the director must return all the profits that s/he made through the transaction; the declining value of the property does not constitute an obstacle to rescission the transaction.[182] In *Fairford Water Ski Club v Cohoon*,[183] the transaction was voidable because of the company's assertion that its directors had no power to pay the annual management charge that it had never agreed to. However, in some circumstances where the transaction cannot be rescission, such as the resale of the property to another party.[184] It is also, the transaction was made with someone who is non-fraudster

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[178] Ibid.
[179] See Millett, P.J. (1998). Equity's place in the law of commerce. *Law Quarterly Review*, 114, 214-227.
[180] *Bamford v Bamford* [1970] Ch. 212.
[181] See Lord Blackburn in *Erlanger v New Sombrero Phosphate Co* [1878] 3 App. Cas. 1218 at 1278.
[182] See *Armstrong v Jackson* [1917] 2 K.B. 822.
[183] [2020] EWHC 290 (Comm).
[184] See *Bentinck v Fenn* (1887) 12 App. Cas. 652.

(has good faith), the rescission may not be possible depending on the circumstances surrounding the transaction.[185]

In this regard, it should be noted that a personal claim can be made against third parties when the director breached his/her fiduciary duty. This is in **two** categories. First, if the third party dishonestly assisted a director to breach the fiduciary duty, the third party may be personally liable to pay compensation to the company.[186] In order to impose this personal liability must be proved three elements, namely, the director breach of the fiduciary duty;[187] the defendant assisted the director to breach the duty;[188] the defendant acted in bad faith.[189] The second category, if the third party receives property as a result of the director's breach of his/her fiduciary duty, the third party may be liable for the payment of compensation to the company.[190] In order to impose this personal liability three elements must be proved. First, there was a disposal of the assets of the company by breach of fiduciary duty.[191] Second, there was a beneficial receipt from the defendant of assets that are traceable as assets of the company.[192] Third, it must be shown the defendant's knowledge that the assets are a result of a breach of the fiduciary duty.[193]

5.3.4 Injunctive relief

The injunction in English law is an important remedy. It is a court order that compels a party to do or refrain from ordering or freezing funds or assets. The aim is to direct the conduct of another party to curb damage.[194] The court has broad powers to grant an injunction against the directors guilty of actual or threatening breach of duty.[195] However, it must be established that there are no

[185] See *Logicrose Ltd v Southend United Football Club Ltd* [1988] 1 W.L.R. 1256.
[186] See *Barlow Clowes International Ltd (In Liquidation) v Eurotrust International Ltd* [2006] 1 W.L.R. 1476.
[187] See *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 A.C. 378, 384, 385.
[188] See Morritt LJ in *Brown v Bennett* [1999] 1 B.C.L.C. 649, 659.
[189] See See *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 A.C. 378, 389.
[190] See *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 (Ch) at 1486.
[191] See Hoffmann LJ in *El-Ajou v Dollar Land Holdings Plc* [1994] 2 All E.R. 685, 700.
[192] See *Brown v Bennett* [1999] 1 B.C.L.C. 649, 655.
[193] See *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 A.C. 378.
[194] See the Supreme Court of the United States in *Nken v. Holder*, 556 U.S. 418, 418 (U.S. 2009).
[195] See *Hedgehog Golf Co Ltd v Hauser* [2011] EWHC 689 (Ch).

other remedies other than the injunction to remedy the damage.[196] An injunction may prevent the directors from conducting any acts such as curbing the directors from continuing a business that contains a breach of duty or prohibits the exploitation of information. This injunction may operate permanently, or temporarily for a specified period.[197] The injunctions may be granted after the court is satisfied that there is a real risk of harm in the absence of the injunctions.[198]

5.3.5 Receivership

A receivership is one of the possible remedies in English law for breach of duty. The High Court may by order to appoint a receiver in cases in which it appears to be fair to do so.[199] The receivership is used to solvent companies as a temporary measure to protect the company or to preserve the interests of the stakeholders in the subject matter of the dispute. However, the court will remain very careful in using this remedy "receivership" with respect to the solvent companies. This is because appointing a receiver for a solvent company means damaging the company's reputation. An injunction is often used because it is less harmful to solvent companies.[200]

It should be noted that receivership has an impact on the directors' powers and duties, as it places directors in a subordinate position. The point of a secured creditor appointing a receiver is not for that receiver to receive directions from the directors, but instead to give directions. The receiver may remove the directors at any time and appoint someone to take over their duties. The receiver may also perform those duties. Therefore, it can be said that the receiver takes the place of the directors and be responsible instead of the directors for the management of the company's affairs even when the receiver

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[196] Practical Law Dispute Resolution, Prohibitory injunctions, Thomson Reuters, 2018, London available at https://uk.practicallaw.thomsonreuters.com/2-211-3117?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1 [accessed on Sep 2019].
[197] See *Hedgehog Golf Co Ltd v Hauser* [2011] EWHC 689 (Ch); *Take v BSM Marketing* [2006] EWHC 1085 (QB).
[198] Mortimore (n 17) 438.
[199] Senior Courts Act 1981, s 37; the Civil Procedure Rules, rule 69.
[200] Kayode Akintola and David Milman (2020) The rise, fall and potential for a rebirth of receivership in UK corporate law, Journal of Corporate Law Studies, 20:1, 99-119, DOI: 10.1080/14735970.2019.1631551.

allows the directors to run the business under his/her leadership.[201] Lord Halsbury[202] expressed the view that the court *"practically removes the conduct and guidance of the undertaking from the directors appointed by the company and places it in the hands of a manager and receiver".*

5.3.6 Criminal sanctions

Of the consequences of a director breaching fiduciary duty or duty of care is that the director may be criminally liable for acts that have been occurred during the company's operations. The criminal liability of directors arises from the criminal liability of the company. The criminal liability of the directors can also be established directly without prosecuting the company. The examples of directors' personal criminal liability as a result of a directors' breach of fiduciary duty or a duty of care are many, among them, the directors' criminal liability under the Bribery Act 2010, which includes three categories of offences; Offences of bribing another person or relating to being bribed or bribery of foreign public officials.[203] The offence of false accounting can lead to the personal liability of the director if s/he aims dishonestly to gain for herself/himself or others or cause loss to others, or destroy, defaces, conceals or falsifies any account or any record or document presented or required for any accounting purpose. It is also misinformation in the provision of information or counterfeiting is a reason for personal criminal liability.[204] In addition, if the company commits fraud through its acts, the director may be criminally liable if the fraud is committed with his/her consent or connivance with another.[205] Under the Health and Safety at Work Act 1974 and the Corporate Manslaughter and Corporate Homicide Act 2007, a director may be liable for a wide range of offences, including the criminal liability of directors for deaths or accidents occurring during the operations of the company when the director is consent or connivance with another or negligent in relation to the criminal act.[206]

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[201] *Meigh v Wickenden*, [1942] 2 K.B. 160.
[202] *Moss Steamship Co Ltd v Whinney*, [1912] A.C. 254.
[203] Bribery Act 2010 s 14.
[204] Theft Act 1968 s 17.
[205] Fraud Act 2006 s 12.
[206] The Health and Safety at Work etc. Act 1974 s 37; the Corporate Manslaughter and Corporate Homicide Act 2007 s 19.

5.3.7 Disqualification

One of the consequences of the directors' breach of the duties is disqualifying him/her for a specified period from being a company director. The entry of a director into illegal transactions is a sufficient reason for disqualification as a director on the basis of unfitness. In view of the Company Directors Disqualification Act 1986, the disqualification of directors can be classified as disqualification due to misconduct and unfitness.[207]

The misconduct in question includes conviction a person of an indictable offence in respect of the company or a continuing default with respect to the provisions of the companies' legislation or commission of fraudulent trading during the liquidation of the company and participation in wrongful trading.[208] As for disqualification due to unfitness includes the conduct of a person as a director of a company is unfit to be concerned in the management of a company or a breach of fiduciary or other duties of directors or mismanagement of the company in non-compliance with the provisions of the Companies Act.[209] This is because the breach of the duties mentioned in the CA 2006, is considered to be either misconduct such as breaching the duty not to accept benefits from third parties; or unfitness such as breaching the duty to exercise reasonable care, skill and diligence.[210] In *Re Noble Vintners Ltd*,[211] the Secretary of State applied for a compensation order against a disqualified director under s 15A and s 15B of the Company Directors Disqualification Act 1986. The director was subject to a disqualification order under s 6 of the Company Directors Disqualification Act 1986 for the maximum 15 years. That order was established on his misappropriation of more than £559,000 from an insolvent company. The instant application was the first time the secretary of state had brought a case under the compensation regime introduced by s 15A and s 15B of the Company Directors Disqualification Act 1986. The commentator van Zwieten[212] says this case can rightfully be described as a "radical" change and it is the first case to

[207] See *Re Looe Fish Ltd*. [1993] BCLC 1160.
[208] Company Directors Disqualification Act 1986, ss 2, 3, 4, 10 and 11.
[209] Company Directors Disqualification Act 1986, ss 6, 8, 9, and Schedule 1.
[210] CA 2006, ss 171-177.
[211] [2019] EWHC 2806 (Ch).
[212] van Zwieten, (n 112) 10-13.

interpret the new provisions. One of the effects of the change is that there is now a straightforward way to recover compensation in relation to losses caused to unsecured creditors by directors who self-interestedly perform a "mini-liquidation" in the lead up to the insolvency proceedings commencement. The new CDDA regime provides new complexity in every case where directors are at risk of personal liability under the Insolvency Act 1986 and the CA 2006. The compensation can now be obtained under the CDDA, the Insolvency Act 1986 and the CA 2006, the compensation can now be ordered for a select group of creditors, alternatively in favour of the class.

5.4 Elimination and limitation of liability

5.4.1 Relief from liability by the ratification of directors' acts

Directors owe fiduciary duty to the company. Fiduciary obligations are imposed on directors to act with care and skill, avoid self-dealing and exercise the absolute good faith and fairness in the management of the company's affairs in the interests of the company.[213] Fiduciary duties for directors have been developed more stringent providing guidelines for the enforcement of these duties. However, this legislation also recognises that directors are subject to business judgment mistake and negligence, which allowing members to relieve directors from liability arising from breach of duties by ratification.[214]

Under s 239 of the CA 2006, the company may ratify the acts of the directors by the company members, for the conduct of the director, amounting to negligence, default, breach of duty or breach of trust with respect to the company.[215] This ratification makes the directors more safe from the company's actions or derivative suits. Therefore, directors do not need to certify if they act according to the powers conferred. The ratification also includes the former and current directors and shadow director.[216] In order to ratify directors' conduct,

[213] CA 2006, ss 171-177.
[214] CA 2006, s 239.
[215] CA 2006, s 239 (1)(2).
[216] CA 2006 s 239 (5).

there are three ways. Either by written resolution or by a resolution passed at a meeting or by unanimous assent.

Ratification through a resolution, if it is written, is required that the member is eligible to vote so that the director is not a member or any other member connected to the director.[217] Where the resolution is passed at a meeting, it shall be required to obtain the necessary majority vote regardless of the votes in favour of the resolution by the director if s/he is a member or any other member connected[218] to the director.[219] It is also possible to ratify the acts of the directors by a resolution taken unanimously by the company members if they authorise or ratify the behaviour of the director.[220]

However, for directors to be safe from company actions or derivative actions, the members must fully understand all related circumstances and disclosure is clear and explicit; the court will also have the discretion to assess the circumstances surrounding the consent and ratification of the members.[221] There are some cases where the conduct of directors cannot be ratified, given the state of the company, which differentiates between a solvent company and an insolvent company. The director acts in the solvent company in the interest of the members, while in the insolvent company (or near insolvency), the acts of the director is in the interest of creditors,[222] and members do not have the ratification authority.[223] The absence of honesty and good faith is also an obstacle to the ratification of the conduct because the ratification may endanger the company's solvency or cause a loss to creditors.[224]

[217] CA 2006 s 239 (3).

[218] Sections 252, 253 and 254 of the CA 2006 provide in detail the persons connected with a director.

[219] CA 2006 s 239 (4).

[220] CA 2006 s 239 (6)(a).

[221] See *Instant Access Properties Ltd (In Liquidation) v Rosser* [2018] EWHC 756 (Ch); *Re RAC Motoring Services Ltd* [2000] 1 B.C.L.C. 307; *Knight v Frost* [1999] 1 B.C.L.C 364.

[222] See *Davies v Ford* [2020] EWHC 686 (Ch) at 282.

[223] See *Liquidator of West Mercia Safetywear Ltd v Dodd* [1988] B.C.L.C. 250; CA 2006 s 172(3).

[224] See *Franbar Holdings Ltd v Patel* [2008] EWHC 1534 (Ch); *Bowthorpe Holdings Ltd v Hills* [2002] EWHC 2331 (Ch).

5.4.2 Relief from liability by the court

If a director is found not to have complied with the fiduciary duty or the duty of care, and the company has not ratified the breach, he or she may be excused. This is in the case where a claim is brought against a director for negligence, default, breach of duty or breach of trust, the court has discretion in granting relieve from liability.[225] However, in order for a director to be relieved of liability by the court, three things must be proven. First, the director acted honestly. Second, the director acted reasonably. Third, the director, having regard to all the circumstances of the case, ought fairly to be excused; with these three requirements, the court may relieve the director from liability in whole or in part and on conditions it deems proper. [226]

In practice, the court requires a strong persuasion for relieving the director from the liability, who has obtained a personal benefit through breach of duty.[227] Therefore, the act of the director honestly is subject to the subjective test; unlike the director's reasonable act which is subject to the objective test. In this regard Buckley J. said in *Re Duomatic Ltd,*[228] whether a director acted reasonably or not that,

> "*he* 'the director' *was acting in the way in which a man of affairs dealing with his own affairs with reasonable care and circumspection could reasonably be expected to act in such a case*".

Strangely enough, the director can be proved to have acted reasonably and is relieved from liability for negligence, if it was not gross, "breaching the duty to exercise reasonable care."[229] However, this has limits, it cannot be said that a director acted reasonably, who did not pay attention to all the affairs of the company.[230] However, there are cases in which the director cannot be relieved from liability; the relief does not apply to the director under the liability of s 214

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[225] CA 2006 s 1157 (1).
[226] Ibid.
[227] *Re System Building Services Group Ltd (In Liquidation)*, [2020] EWHC 54 (Ch); *Re In a Flap Envelope Co Ltd* [2004] 1 B.C.L.C. 64 at 64.
[228] [1969] 2 Ch. 365 at 377.
[229] See *Re D'Jan of London Ltd* [1994] 1 B.C.L.C. 561.
[230] See *Lexi Holdings Plc (In Administration) v Luqman* [2007] EWHC 2652 (Ch).

of the Insolvency Act 1986, known as wrongful trading.[231] As well as that stated in s 216 and 217 of the Insolvency Act 1986, known as the restriction on the re-use of the name of the company.[232] In *Guinness plc v Saunders*,[233] a director was not relieved from liability to the company which was paying directors' remuneration wrongly, even if the director acted honestly and reasonably, but he exceeded the powers, as the board of directors had the power to pay award remuneration only according to the company's articles. Also, in *Re System Building Services Group Ltd (In Liquidation)*,[234] the sole director was also the sole shareholder. While still a director, he purchased from the company, acting by its liquidator, a property at a price what he knew to be a substantial undervalue without regard to the interests of the creditors as a whole. The director had acted entirely out of self-interest and failed to have regard to the interests of the creditors as a whole. His application for relief from liability under s.1157 of the CA 2006 was refused as his act was unreasonable.

It is also if any director who believes that s/he has a reason that a claim will be or might be brought against him/her in respect of negligence, default, breach of duty or breach of trust, s/he may apply to the court for relief.[235]

Often, trying to get relief would be unsuccessful. For example, the court may find that there is no reasonableness,[236] or that the relief will make the director enjoy a benefit at the expense of creditors.[237]

5.4.3 Insurance against directors' liabilities

Insurance may be a good way that directors can rely on to protect themselves from personal liability. It can also be the only means available to relieve themselves of liability when the members of the company are unwilling to ratify the acts of the directors and the court is not convinced that they should be exempted from liability as a result of negligence, default, breach of duty or

[231] See *Re Produce Marketing Consortium Ltd (In Liquidation)*, [1989] 1 W.L.R. 745.
[232] See *First Independent Factors and Finance Ltd v Mountford* [2008] EWHC 835 (Ch).
[233] [1990] 2 A.C. 663.
[234] [2020] EWHC 54 (Ch).
[235] CA 2006 s 1157(2).
[236] See *Re Westlowe Storage & Distribution Ltd (In Liquidation)* [2000] 2 B.C.L.C. 590.
[237] See *Liquidator of Marini Ltd v Dickenson* [2004] B.C.C. 172.

breach of trust.[238] Companies usually purchase insurance for the benefit of directors to attract them and retain them in their positions, because managing a daily business may be surrounded by risk.[239] Therefore, the purpose of insurance is to indemnity for liability incurred by individuals as a result of being in the position of director regardless of the type of director.[240] Under the CA 2006, a company may insure against the liability of the directors associated with negligence, default, breach of duty or breach of trust with respect to the company.[241] Directors may also decide to purchase and maintain insurance at the company's expense for any relevant director in respect of any related damage.[242]

Directors' liability insurance is often called "D&O", which is liability insurance payable to company directors as indemnification for losses or defence costs if the insured suffers such losses as a result of legal proceedings against wrongful acts.[243] The first marketing of this type of insurance for directors was in the 1930s by Lloyd's to protect directors from liability from shareholder claims.[244] D&O insurance is a product subject to price fluctuations, diversity in terms and conditions, scope and size of coverage which is always there is a maximum amount of liability insurance coverage and duration of coverage. The insurance contract, therefore, relies on these terms and trade circumstances, which is negotiable.[245] However, in general, intentional illegal, fraudulent and criminal acts, wrongful profits, and wrongful trading are not covered by the insurance policy. The consequences of financial problems that the insured had previously aware before commencement coverage or breach of duty for personal benefit

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238 CA 2006 s 233.
239 Stadermann F, Banis C. (2008). From 'Severability Clause' to 'Innocent Directors Clause' in Dutch D&O Policies. British Insurance Law Association. 19-20 available at <http://www.ph8.nl/upload/catalog/289/410245/5/From%20'Severability%20Clause'%20to%20'Innocent%20Directors%20Clause'.pdf> [accessed October 2019].
240 CA 2006 s 232(2)(A).
241 CA 2006 ss 232(2)(A), 233.
242 The model articles of association in SI 2008/3229, art 86 of public and art 53 of private companies.
243 Sprayregen JHM, Friedland JP, Ghasemi M. (2005). Directors & Officers Insurance. Thirty-first Annual Southeastern Bankruptcy Law Institute, Atlanta, Georgia. Authors are affiliated with Kirkland & Ellis LLP, 1-2 available at < http://www.sbli-inc.org/archive/2005/documents/395189.pdf > [accessed October 2019].
244 Roberta Romano, "What Went Wrong With Directors' and Officers' Liability Insurance?", 14 Del. J. Corp. L. (1989) 1, 4.
245 Mortimore (n 17) 483, 578-579.

are often excluded from insurance coverage.[246] Therefore, the insured must disclose material facts before contracting.

5.4.4 Indemnification against directors' liabilities

An indemnity clause is a contractual provision that gives benefits to the contracting parties, allowing parties to manage the risks associated with the contract. Because the indemnity enables one party to be protected against liability arising from the actions of the other party, by paying one party the losses incurred by the other.[247] Indemnity is used in a wide variety of contexts and there is no general rule as to when the indemnity will be made, depending on the circumstances of the contract.

Nothing in the past has prevented the indemnity of directors' liabilities at all. In *Re Brazilian Rubber Plantations & Estates Ltd,*[248] it was stated in the company's articles of association that the company could not sue the director for any loss or damage that could be caused by the execution of duties relating to the company unless there was dishonesty. Also in *Re City Equitable Fire Insurance Co Ltd,*[249] the director was not liable for negligence for the same reason, the company's articles of association contain that the company could not sue the director for any loss or damage. However, the indemnity provisions were subsequently voided by statute. Section 232 of the CA 2006 now stipulates that any provision by which the company provides an indemnity for the company director against any liability incurred by him/her in respect of negligence, default, breach of duty or breach of trust in relation to the company shall be considered void.[250] Perhaps the reason for the invalidation of the indemnity provisions is that it prevents the liquidator from suing the director for negligence.[251]

However, there are two exceptions to the invalidation of the indemnity provision, namely qualifying pension scheme indemnity provision and qualifying third

[246] See *Re Produce Marketing Consortium (In Liquidation) Ltd*, [1989] B.C.L.C. 520.
[247] CA 2006 ss 232(2), 234(2).
[248] [1911] 1 Ch. 425.
[249] [1925] Ch. 407.
[250] CA 2006 s 232(2).
[251] See Neville J in *Re Brazilian Rubber Plantations & Estates Ltd,* [1911] 1 Ch. 425.

party indemnity provision.[252] This requires that the indemnity be against the liability incurred by the director to a person other than the company or an associated company in respect of negligence, default, breach of duty or breach of trust in relation to the company.[253] The indemnity also must not be against any liability incurred by the director for the payment of a fine imposed in criminal proceedings or a sum payable to a regulatory authority for non-compliance with any requirement of a regulatory nature.[254] The indemnity also must not be against any liability incurred by the director in defending criminal proceedings in which s/he is convicted.[255] The qualifying third party indemnity provision has more requirement which is the indemnity must not be against any liability incurred by the director in a civil proceeding brought by the company or an associated company, in which it has been judged against the director.[256]

5.5 The evaluation of the UK law with respect to the directors' duties and liabilities

One of the most fundamental aspects of CA 2006 is codifying the general duties of the company's directors. Prior to the enactment of this law, the duties of directors were not codified in a written law but rather left their interpretation and application to the provisions of common law.[257] The reason for considering codification again was that those company's directors, especially in small companies, who do not have a permanent legal consultant, were struggling to understand and apply the provisions of common law and equitable principles to their duties towards the company, because these principles and provisions are wide and complex.[258] The stakeholders also faced difficulties in estimation the scope of directors' responsibilities. Therefore, the purposes of codifying the duties of directors was to enhance the clarity of the law and make it easier for

[252] CA 2006 ss 234, 345.
[253] CA 2006 ss 232(2), 234(2).
[254] CA 2006 ss 234(3)(a), 235(3)(a).
[255] CA 2006 ss 234(3)(b), 235(3)(b).
[256] CA 2006 ss 234(3)(b)(ii).
[257] Parkinson (n 1) chapter 1.
[258] Ibid.

the responsibilities of directors towards others without the need for a legal consultant to interpret these duties.[259]

However, the general duties after the codification are still not self-contained. These duties need recourse to common law provisions and equitable principles. This contradicts the claim that the purpose of codifying general duties is to facilitate understanding and awareness of the directors' duties. Because recourse to common law and equitable principles requires the assistance of a legal consultant to interpret these duties. For example in the need to resort to common law provisions, the interpretation of the meaning of the term ‘company success'. Can it be interpreted by achieving the objectives set by the company, or directors' interpretation of directors is a meaningful explanation and cannot be challenged, provided that they act in good faith? This needs recourse to the provisions of common law, which has been discussed in Chapter Three.[260]

Leaving the factors listed in s 172 of CA 2006 to the discretion of the directors may be an excuse for directors to breach their duties towards the members under the pretext of acts in the interest of the stakeholders and to maintain the company's reputation. One of the ambiguous things is not to determine the minimum amount of declaration interest in the case of receiving a benefit from a third party, especially in matters where courtesy such as luxury hospitality by a third party. In other words, there is no de minimis rule on such a personal benefit that must be declared, and the benefit can be non-financial such as an honorary position or degree.

Finally, in wrongful trading, liquidators and administrators are only allowed to initiate proceedings, unlike in some other jurisdictions that allow other parties to initiate proceedings. Other parties should be enabled to initiate such proceedings as the Secretary of State, through the court after proving that at least a creditor has been harmed by wrongful trading. This empowerment for other parties will help to deter directors from engaging in wrongful trading. However, s 212 of the Insolvency Act 1986 addresses this problem, as it authorised the court, on the application of the official receiver or the liquidator,

[259] Parkinson (n 1) chapter 1; Arden (n 6) chapter 1.
[260] Keay (n 60) chapter 3, 15-16.

or of any creditor or contributory, to examine the claim that the director has misapplied or retained any money or other property of the company, or been guilty of any misfeasance or breach of any duty in relation to the company. In practice liquidators prefer to go down this misfeasance route rather than using wrongful trading, as it is difficult to win a wrongful trading case.

Chapter Six: The liability of company directors in Saudi Arabian law and Islamic law.

6.1 Directors' liability

The legislation in Saudi Arabia imposes general duties on directors, to guide them in the way that they should function to reduce the risks of their decisions, which may have unwanted consequences for the company, shareholders, stakeholders and other parties. The legislation also seeks to prevent the directors from using the position for their personal interests or for any other considerations that are not in the company's interests or are not within the purposes of the company. Accordingly, these broad powers of directors do not leave them free from liability in the event of non-compliance with the duties stipulated. This directors' liability may be civil or criminal, according to the wrongful act committed.

6.1.1 The civil liability

Civil liability, in general, is a result of a breach of the obligation required by the directors. This liability is instituted because of breaching the provisions that are stipulated in the company's articles of association, the general assembly's decisions or the SACL 2015. It can be also because of mismanagement of the company's affair, the abuse of the granted power or as a result of negligence in the oversight of the company's business.[1]

The civil liability of directors also has distinct characteristics, which is that the directors are jointly liable. Although the joint liability in commercial matters is presumed, the legislature has explicitly stipulated it for directors in order to enhance the protection of third party.[2] The imposition of joint liability also enhances the activation of the monitoring of the directors and members of the board of directors on the company's business affairs. If a wrongful act is proven that has arisen the civil liability and the compensation, the aggrieved (affected) party has the right to sue to any director and claim compensation from her/him

[1] SACL 2015, art 78.
[2] SACL 2015, arts 12, 13, 78 and 165.

or from all members of the board of directors jointly.[3] The damage that results from a unanimous resolution made by all directors is considered as a joint mistake, and therefore, the joint liability is against the directors regarding the compensation for the damage resulted from this unanimous resolution. The principle is that the joint liability should be equal between the directors, but the court may determine the percentage of each directors' liability from the compensation according to the severity of the wrongful act s/he committed.[4]

A characteristic of civil liability is that it may be an individual or joint liability. The SACL 2015 states that the liability of directors and members of the board of directors may be imposed on one director, without the rest.[5] A wrongful act that is made by a director that caused damage to the company, shareholders or third party, which the rest of the directors are not related to this wrongful act, for example, divulging company secrets, therefore, the liability will be individual on the perpetrator of the wrongful act and not for other directors. The wrongful act may be made jointly, such as the resolution taken by the directors unanimously or by the majority. In summary, the directors are liable individually or jointly for the damage that results from mismanagement of the company's affairs. The SACL 2015 states that directors shall be jointly liable for damages to the company, the shareholders, or third parties, arising from their maladministration of the affairs of the company, or their breach of the provisions of the SACL 2015 or of the articles of association of the company. Joint liability shall be assumed by all directors if the wrongful act arises from a resolution adopted unanimously. With respect to resolutions adopted by majority vote, dissenting directors shall not be liable if they have expressly recorded their objection in the minutes of the meeting. Absence from the meeting during which such resolution is adopted shall not constitute cause for release from liability, unless it is established that the absentee was not aware of the resolution, or, on becoming aware of it, was unable to object to it.[6]

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[3] Hayaa Al-Muribidh, The liability of company board members within the framework of corporate governance in Saudi Arabian law, *Dar Alfikr wAlqanun*, Mansoura, (2016), 180-181.
[4] Fahmy (n 25) chapter 4, 25.
[5] SACL 2015, arts 12, 13, 24, 31, 32, 71, 72, 73, 74, 211, 212 and 213.
[6] SACL 2015, art 78(1).

In Islamic law, as has been mentioned above, the director is considered as an agent. Therefore, directors should be honest and trustworthy. In the event of a claim of the negligence against an agent, the burden of proof shall be on the principal. In general, Islamic law is consistent with Saudi Arabian law, the agents may face civil liability if they neglect or violate the limits of their granted powers.[7]

6.1.1.1 The nature of civil liability of directors

The purpose of civil liability is to compensate the aggrieved (affected) party for the damage that s/he sustained as a result of the directors' breach of an obligation. The basis of liability in law is making a wrongful act, and it means deviation in conduct that is a breach of legal obligation.[8] The nature of the civil liability of the directors differs according to the difference of those who prove this liability in facing them, and then the legal basis on which the relationship linking the directors with those who have been proven liable (affected) differs. The civil liability is either a contractual basis or tortious (default) basis. The liability with a contractual basis lies with the directors in the face of the company, because the relationship of the directors to the company is caused by the appointment contract. The liability with a contractual basis arises because of exceeding the powers granted in the appointment contract, in the law or the company's articles of association, or because of acts tainted by lack of goodwill;[9] or not to exercise reasonable care, which has already been mentioned in duty to exercise reasonable care.

As for the liability with a tortious (default) basis, which is so-called an obligation not to hurt others, this liability arises from a wrongful act that is due to acts that involve bad faith or fraud or those acts arising from a breach of the general duties or a breach the prevision of the company's articles of association.[10] It may also be due to negligence or abuse of power so that the wrongful act does

[7] Al-Humam (n 4) chapter 4 part 8 p 126.
[8] Marqis, (n 55) chapter 4, 107.
[9] Tiemah Al-Shamrii, the board of directors of the joint stock company, Kuwait Foundation for the Advancement of Sciences, Kuwait, (1995), 145.
[10] Fahad Al-Khudair, civil liability of the members of the board of directors of the joint-stock company, First edition, Law and Economy, Riyadh, (2012), 93-94.

not reach the degree of criminal liability. The liability hold does not require that the damage be deliberate. This liability is often faced with shareholders and the third party.[11]

In general, civil liability arises under <u>three</u> conditions, and the liability is excluded by the absence of any of these conditions. These three conditions are focused on the wrongful act, the damage and the causal relationship between them. First, the wrongful act, which is a condition for the establishment of civil liability, whether this wrongful act is due to the director's breach of her/his duties stipulated in the appointment contract, the company's articles of association or the law. Whether the wrongful act is by doing something which is considered as a breach of duties or omission doing something that must be done. Therefore, the director's concealment of the fact of the company's financial position by submitting misleading reports is considered a wrongful act because it is against the law and may be considered as criminal liability.[12]

In this regard, a question arises as to what kind of wrongful act arises civil liability, is it a grave wrongful act (*culpa lata*) or any wrongful act regardless of its gravity (*culpa levis*). The Saudi Arabian legislature does not specify the wrongful act whereby the civil liability of directors arises. There are those who argue that the wrongful act that gives rise to the civil liability is the grave wrongful act (*culpa lata*).[13] While there are those who argue that the gravity of the wrongful act has no effect on the emergence of civil liability against directors, so all wrongful acts, whether grave (*culpa lata*) or not (*culpa levis*) establish the civil liability.[14]

In all cases, it is considered an impediment the civil liability claim is that the absence of the existence of the wrongful act from the director. In the judgment declared by the Saudi Arabian commercial court,[15] a civil liability claim instituted

[11] Abdul-Wadud Yahya, the general theory of law, Institute of Public Administration, Riyadh, (1986), 156.
[12] See SACL 2015, art 211(a); Zaki Mahmoud Jamal Al-Din, Civil Liability Problems, Cairo University Press, Cairo, (1998), 527.
[13] Fahd Al-Habbini, the responsibility of the members of the board of directors of the joint stock company for their decisions, the National Library of Kuwait, Kuwait, (2012) 201-202.
[14] Al-Muribidh (n 3) 185.
[15] The Saudi Arabian Commercial Court, 940/TG/7 (2007).

by one of the shareholders against the company's board of directors was rejected. The shareholder claimed to abolish the resolutions of the ordinary general assembly and compensate him for the damage that he had suffered because he was not invited by the board of directors to attend the general assembly. The respondent defended that the failure to invite the shareholder is due to his lack of proof of his ownership of shares in the company at the time of the general assembly meeting, even though this condition is publicized and published. Therefore, the court held that the respondent performed his duty in accordance with the law and there is no negligence in the performance of the duty, and since the claim for compensation is required from the shareholder to prove the wrongful act, which was no proof before the court, therefore, the liability claim was rejected.

The second condition is the occurrence of damage. It is not sufficient to prove the wrongful act committed by the director to establish civil liability. Rather, this wrongful act must lead to damage to the company, shareholders or the third party. The burden of proving the damage rests with the aggrieved (affected) party. The damage is of two types, material damage, which is the violation of the financial interest of the aggrieved (affected) party, and it is required that it be actual, that is, the damage is firmly certain even in the future, and that merely alleging the possibility of the damage is not sufficient for the liability to be arisen.[16] The second type of damage is moral harm, and it violates non-financial interests, such as the violation of reputation and dignity.[17]

The occurrence of damage results in the necessity of compensation from the one who caused it. The compensation for material damage is not problematic, whether for legal or Islamic law scholars.[18] As for the compensation for moral damage is subject to dispute among Islamic law scholars, about the possibility of the judge's discretionary power to assess the compensation for moral damage and its denial because of the difficulty or impossibility of assessing the

[16] Amr El-Feky, The Legal Encyclopedia of Civil Responsibility, *Dar Al-Kutub Al-Qanuniah*, Egypt (2002), 43-44.
[17] Al-Muribidh (n 3) 189.
[18] Hassan Akoush, Contractual and default liability in the civil law, Second Edition, *Dar Al-Fikr Al-Hadith*, Beirut, (1997), 245.

moral damage.[19] As for the laws, most Arab legislatures have adopted the compensation for moral harm, although there is a dispute over the details of the kinds of moral damage that are compensated for.[20] For example, it is stated in *Malik v BCCI*,[21] about the moral damage that the House of Lords considered that it is wrong in the event of a wrongful dismissal that the award of compensation does not include compensation for the manner of the dismissal, for the injured feelings, or for the loss that the employee may suffer from the fact that the dismissal itself makes it more difficult to obtain a new job. Nor did any Lord say that it is not permissible for an employee to recover the financial loss for the damages caused to her/his employment prospects caused by a breach of contract. Or, in the event of breach of contract cases, compensation can never be awarded for loss of reputation. In addition, the House of Lords in *Spring v Guardian Assurance Plc*,[22] held that a former employee could recover damages for the financial losses incurred as a result of the negligence of the employer in preparing a reference that affected her/his reputation. Lord Steyn said that proving stigma compensation is difficult, but these difficulties do not change the legal principles that allow to claims for financial losses arising from a breach of contract for consideration.

The third condition is the causal relationship between the wrongful act and the damage. There must be a direct relationship between the wrongful act made by the director and the damage to the company, the shareholder or the third party. This is a condition for the emergence of civil liability against the directors. This relationship does not exist if the damage is due to an external cause that the director has no control over, such as force majeure or the wrongful act is from a third party provided that the director does not have a relationship with them based on the delegacy and the like.[23] In the judgment declared by the Saudi Arabian Commercial Court,[24] the court rejected the claim of civil liability and

[19] Wahbah Al-Zuhaili, the theory of liability in Islamic jurisprudence, Second edition, Dar Al-Fikr, Jordan, (1998), 23.
[20] Abdul-Razzaq Al-Sanhouri, Civil Law Explanation, Second Edition, Dar Ehya Al-Turath Al-Earabi, Beirut, (1997), part 1, page 866.
[21] [1997] UKHL 23.
[22] [1995] 2 AC 296
[23] Redha Wahdan, Disputes attributable to damages in the compensation claim, the Journal of Justice, v 54 (2012), 150-184, 172.
[24] The Saudi Arabian Commercial Court, 29/TG/1 (1991).

compensation, as there was no causal relationship between the acts of the directors and the damage. It has been proven that the damage claimed for compensation was due to the wrongful act of the aggrieved (affected) party and the wrongful act of the third party, and the director has no related to this wrongful act.

However, the causal relationship between the wrongful act and the damage in practice has several problems regarding the multiplicity of causes and the sequence of results. The problem is that there may be multiple causes and that the damage did not happen based on one cause, but the combination of all these causes caused the damage, and if one of these causes did not exist, the damage would have not happened. Will be the liability, in this case, be based on all causes or on some causes? This is based on two theories, which are the theory of equivalent or equal causes and effective cause theory.[25] The theory of equivalence of causes is based on the premise that each factor is involved in causing the damage so that without each factor the damage would not have been, and that every factor would be an equal legal cause to the other causes. However, this theory has been criticized as extending the concept of causation significantly.[26] The second theory is the effective cause theory, and this theory differentiates between secondary and productive causes. If there are multiple causes, the productive (fundamental) cause is considered to be the cause of the damage and establishing for the liability.[27]

With respect to the problems of the sequence of results, it is contrary to the aforementioned theories, which are the theory of equivalent or equal causes and effective cause theory. This theory assumes that one cause had caused several damage sequentially from each other. It has been agreed that the liability of the one who made the wrongful act is limited to the direct damages resulting from the wrongful act itself, while the liability for the indirect damage to the wrongful act does not arise. This is because the sequential results are

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[25] Abdel-Rashid Maamoun, The causal relationship in civil liability, First Edition, *Dar Al-Nahdhat Al-Arabia*, Cairo, (1998), 10.
[26] Maamoun (n 25) 10.
[27] Anwar Sultan, Sources of Commitment, *Dar Al-Thaqafata*, Jordan, (2010), 379.

not related to the wrongful act with a sufficient causal relationship.[28] The determination of these direct damages or not and the possibility of avoiding sequence damages or not depends on the circumstances of the incident and the judge's discretion.

In the event that these three conditions are all met (wrongful act, damage and the causal relationship), civil liability arises against the directors.

6.1.1.2 The directors' liability in the face of the company.

The SACL 2015 stipulates in more than one article the directors' liability to compensate the company for all damages incurred as a result of mismanagement of the company's affairs.[29] Although the company has the right to dismiss the director in the event of a breach of duties, the dismissal does not relieve directors of the liability in the face of the company.[30] The company has the right to hold directors accountable against decisions and conduct that are harmful to it, such as gross negligence in management, wasting its money, or damaging its commercial reputation, and breaching the provisions of the company's articles of association or the SACL 2015 and the relevant legislation.[31] The principle is to institute the liability action by a decision of the general assembly and appoint a representative to pursue the case on behalf of the company. If a judgment is passed on the insolvency of the company, the institution of this action shall rest with the receiver, and upon the dissolution of the company, the liquidator shall pursue the case after obtaining the approval of the ordinary general assembly.[32] However, due to the possibility that the general assembly or its representatives may not play their role in instituting the liability action, the Saudi Arabian legislature has recognised the need to preserve the rights of shareholders and the third party. The SACL 2015 stipulates that a shareholder shall have the right to institute a liability claim against the directors and the board of directors on behalf of the company,

[28] Maamoun (n 25) 15; Marqis, Suleiman., Reasons for exemption from civil liability, Huquq Al-Qahirah, Cairo (1996), 240.
[29] See for example, SACL 2015, arts 12,13, 24,31, 32, 71, 72, 73 and 74.
[30] SACL 2015, arts 74 and 100(3).
[31] SACL 2015, art 74.
[32] SACL 2015, art 79.

except that this prosecution has conditions, which is that the shareholder had suffered personal damages and that the company's right to institute the prosecution is still valid and that s/he shall notify the company of her/his intention to do so.[33]

6.1.1.3 The directors' liability in the face of the shareholder.

The wrongful act of the directors may result in damage to one or some shareholders without affecting the rest, such as if directors or the board of directors refused to hand over one of the shareholders her/his share of the profits or prevent her/him from the right to look at the necessary information, so the shareholder who was aggrieved (affected) in this case will have to claim directors or the members of the board to compensate her/him for the damage.[34] This prosecution in such a scenario is called the shareholder's personal claim, which aims to the reparation of the damages that shareholder incurred without the company.[35]

This is close to the reflective loss principle in the UK law, which is the loss of individual shareholders that are inseparable from the company's general loss. Lord Bingham in *Johnson v Gore Wood & Co*,[36] summarised the reflective loss in three propositions:

> *"(1) Where a company suffers loss caused by a breach of duty owed to it, only the company may sue in respect of that loss. No action lies at the suit of a shareholder suing in that capacity and no other to make good a diminution in the value of the shareholder's shareholding where that merely reflects the loss suffered by the company... (2) Where a company suffers loss but has no cause of action to sue to recover that loss, the shareholder in the company may sue in respect of it...(3) Where a company suffers loss caused by a breach of duty to it, and a shareholder suffers a loss separate and distinct from that suffered by the company caused by breach of a duty independently owed to the shareholder, each*

[33] SACL 2015, art 80.
[34] SACL 2015, art 78.
[35] Al-Jabr (n 1) chapter 4, 342.
[36] [2002] 2 AC 1.

may sue to recover the loss caused to it by breach of the duty owed to it but neither may recover loss caused to the other by breach of the duty owed to that other".

In *Sevilleja v Marex Financial Ltd*,[37] the court held that the reflective loss principle did not bar the appellant creditor, who was not also a shareholder, from bringing claims against the respondent owner of the companies who had acted in breach of duty by stripping the companies' assets, causing the creditor to suffer loss. Regarding the problem of possible double recovery against the defendant in respect of the loss suffered by the creditor and the loss suffered by the companies there is a mechanism available to the extent that the creditor sues the defendant and obtains a recovery from him for the judgment sum, the defendant can be subrogated to the creditor's rights against the companies or allowed a right of reimbursement in respect of them. Generally, the Supreme Court took a restrictive view of the reflective loss rule.

6.1.1.4 The directors' liability in the face of the third party.

Directors' wrongful acts may result in damage to a third party, such as signing forged instruments without verification of their authenticity or acting exceeding the granted power of the director or the board of directors that the stakeholder knows that this is exceeding the director granted power; therefore, the liability claim shall be only in the face of the director.[38] The third party acting in good faith may institute the liability action in the face of the company itself because the company shall be bound by all the acts performed by its directors and its board of directors.[39] In the judgment declared by the Saudi Arabian commercial court[40] that it is for the plaintiff to claim on behalf of the company for compensation for the damage caused due to the wrongful act of its director, and the company has the right to institute the liability action in face of the director for the compensation due to negligence and default in his function.

[37] [2020] UKSC 31.
[38] SACL 2015, art 77.
[39] Ibid.
[40] The Saudi Arabian Commercial Court, 11/TG/4 (1988).

In Islamic law, the third party that has dealt with the agent (director) may institute civil liability proceedings against the agent; and the agent is not entitled to exempt of the liability on the pretext that s/he is an agent of the principal (company).[41] The third party has the option to institute the prosecution against the agent or the principal directly if the transaction was within the powers granted to the agent. Then the relationship will be direct between the third party and the principal in order to preserve the rights of the third party; this is by making the option for the third party to raise the liability action in the face of the principal or the agent or all of them as a joint liability.[42] This is in the case that the third party had known about the agency contract between the agent and the principal when the transaction was done with the agent. In the event that the third party did not know about this relationship between the agent and the principal during the transaction, the third party has nothing but to raise the liability in the face of the agent.[43]

It should be noted that, in the context of a civil liability claim, it might be difficult to estimate some of the directors' acts and know whether they constitute mismanagement or not. Not all decisions made by directors have good consequences for the company, as it is well known that the function of the director is based on commercial risk. The Saudi Arabian courts will respect directors' exercise of discretion in the management of the company, which is known as Business Judgment Rule. The directors' decision-making is part of a series of processes leading to a final decision, which is not an isolated event. The directors should carefully consider all aspects related to the final judgment, such as taking advice, due diligence and then making the decision. Accordingly, the court will take into account whether reasonable care was exercised and all aspects related to the final decision. If the decision is taken in a reasonable manner, the directors cannot be held liable for any damage as a result of this decision.[44]

[41] Muhammad ibn Abidin, Radd Al-Muhtar ala Al-Durr Al-Mukhtar, Second edition, Dar Al-Fikr, Beirut, (1992), part 1 p 224.
[42] Al-Sanhouri (n 23) chapter 4, part 1, p. 232.
[43] Mansour El-Bahouty, Sharah Muntaha Al-iradaat, First edition, Resalah Foundation, Beirut, (2001), part 2 p 308.
[44] See Al-Jabr (n 1) chapter 4, 340.

6.1.2 Criminal liability

The civil liability against directors may be insufficient to deter directors from some wrongful practices. The Saudi Arabian legislature has adopted criminal liability against some of the directors 'acts, and it has emphasised the punishment against them, because civil penalties may not prevent the director from committing a wrongful act, and may not fit the gravity of the act. Accordingly, the Saudi legislature is seeking to protect the companies, shareholders, and the third party from wrongful conducts that may be made by directors to fulfil personal interests due to dishonesty and abuse the position, the legislature imposed criminal liability against some of the directors 'acts that take place while performing their duties.[45] The SACL 2015 stipulates the criminalisation of many wrongful practices by directors, which would violate the integrity, trust, protecting companies, shareholders and third party, and imposing the appropriate penalties against these practices.[46] The directors' criminal liability derives from one of two things, either through the criminal acts that criminal law has criminalised against members of society or through the provisions on criminal liability in the SACL 2015 and relevant legislation.

It is known that the natural person is the one who commits acts that constitute an offence punishable by the laws, and is subject to criminal liability, but the criminal liability is unlike civil liability, it does not extend to other directors who did not contribute to the commission of the criminal act.[47] As for the legal person is like a natural person, acquiring rights and has obligations. However, the dispute is on whether the legal person (companies) would face criminal liability or no. Some jurisdictions[48] have adopted the criminal liability against the legal person (companies), that equated a natural and legal person with criminal liability, but it replaced the prison sentence with a fine penalty in the event of a judgment of criminal liability against the legal person (companies). The SACL 2015 adopted the criminal liability of a legal person, since if the prosecution

[45] Ali Al-Waeli, Governance of Saudi Joint Stock Companies and its Role in Reducing Financial Crime, Master dissertation, (2010), Prince Nayef Arab University for Security Sciences-Department of Criminal Justice, Riyadh, 33.
[46] SACL 2015, arts 211, 212, 213, 214, 2015 and 216.
[47] Samiha Al-Qaliubi, Commercial Companies, Dar Al-Nahda Al-Arabia, Cairo, (2008), 999.
[48] For example SACL 2015.

cannot be instituted against the offender who committed one of the violations stated in the SACL 2015; the public prosecution may institute a case against the company to adjudge the company with the fine stipulated for such violation.[49] While some jurisdictions do not adopt criminal liability against the legal person as is the case in the Egyptian Criminal Law, the Egyptian legislature has not adopted criminal liability against companies.[50] Perhaps the justification for this is that legal persons are not criminally liable for the criminal misdeeds of their representatives. The legal person also cannot commit an offence for lack of criminal will. In addition, it is inconceivable to apply the sentence of imprisonment for a legal person.[51]

In general, criminal liability arises under two conditions, and the liability is excluded by the absence of any of these conditions. The first condition, which is a material condition which is performing the criminal act or omission doing the obligation, and all of these are criminalized with a criminal penalty by law.[52] The second condition is a moral condition and it relates to the psychological and motivating aspect of the perpetrator of the offence, which is the presence of the criminal intent to commit the criminal act, for example, divulging the company secrets with the intent to obtain personal interests, or intentionally divulging the company secrets with the will of the perpetrator and not through an external force such as the company emails hacked or company database hacked.[53]

The SACL 2015 identifies a number of acts that give rise to criminal liability and imposed criminal penalties against their perpetrators. It is possible to

[49] SACL 2015, art 217.
[50] See the Egyptian Criminal Law 1937 amended 2003, there is no provision in the Egyptian Criminal Law that establishes criminal liability for the legal person, as the legislature limits criminal liability to the natural person.
[51] Rana Al-Eutur, Criminal liability for the legal person, Damascus Journal of Economic and Legal Sciences, v 2, (2006), 341-424, 343.
[52] Abdelrahman Al-Rashoud, Criminal Liability for Distributing fictitious profits in Joint Stock Companies in Saudi Arabia, Master dissertation, (2014), Prince Nayef Arab University for Security Sciences-Department of Criminal Justice, Riyadh, 61.
[53] Muhammad Swailem, Corporate Governance in Arab and Comparative regulation, *Dar Al-Nahdhat Al-Arabia*, Cairo, (2010), 406-410.

summarize these acts in which the director may make as a result of occupying the position.[54]

The offence of making false statements or omitting including some data deliberately in the company's financial statements or in the reports of the general meeting. The SACL 2015 stipulates that this act is criminalized where it is stated without prejudice to any more severe penalty stipulated for in any other law, liable by imprisonment for a period not exceeding five years and a fine not exceeding five million Saudi Arabian Riyals[55] or by either of these two penalties.[56] Any director, official, auditor, or liquidator who knowingly includes false information in the financial statements or in the reports prepared by him for the shareholders or the general meeting; or who omits essential facts from such statements or reports with the intention of concealing the financial position of the company from the shareholders or third parties.[57] Whoever willfully inserts in the articles of association, bylaws, or other of the company's documents or in the incorporation license application form or in the documents attached to the incorporation application form, false information contradicting with the provisions of the SACL 2015; and whoever knowingly signs or distributes such documents.[58] This is also can be considered as a breach of the principle of disclosure and transparency contained in the corporate governance regulations.[59]

The offence of divulging company secrets should be noted. As formerly mentioned, it is the duty of the director to maintain confidentiality. What is meant by this is that the company secrets that the directors have information about because of their positions only, which without their positions in the company they would not have known this information.[60] Included in the scope of the commitment of the director not to divulge the secrets of the company outside the general assembly meeting. As for the information that the laws require placing at the disposal of shareholders in order to inform them of the information

[54] See SACL 2015, arts 211, 212 and 213.
[55] 1 USD = 3.75 Saudi Riyals, Fixed exchange rate.
[56] SACL 2015, arts 211 and 212.
[57] SACL 2015, arts 211(a).
[58] SACL 2015, arts 212(f).
[59] SACGR 2019, art 89.
[60] SACL 2015, art 74.

about the company before a period of the general assembly meeting or that information permitted by the laws to be published, it does not fall within the meaning of this duty, are not considered in the meaning of this duty.[61] Although the breach of the duty to maintain confidentiality arises the civil liability,[62] the legislature has doubled the liability for the breach of the duty to maintain confidentiality by joining criminal liability to the civil liability against every employee (including the director) who divulges to non-concerned authorities the secrets of the company that have come to her/his knowledge in the course of duties.[63]

The Saudi legislature also combined the civil and criminal liability in the offence of knowingly misusing the company's funds and misusing the powers granted against the company's interests. The civil and criminal liability will arise against any director, official or board member who knowingly misuses the company's funds or misuses her/his powers or votes of such power in a manner that conflicts with the company's interest for personal interests or in favour of a company or person; or benefit from a project or deal in which s/he has a direct or indirect interest.[64]

The offence of not calling the general assembly meeting when the losses of the company amount to half of the paid-up capital or if fails to publish such information in accordance with such losses.[65] In addition, the Saudi legislature considered that the director misuses the company for purposes other than that for which the company was designated, is an offence that arises the criminal liability.[66] It is noted that the Saudi legislature stipulates the moral condition for criminal liability, which is the existence of criminal intent, knowledge of the incident and motive for committing the criminal act with the phrases "with the intention", "knowingly misuses" and the phrase "deliberately" or mentioning the motive, whether it is personal interests, favouritism or other motives.[67] Finally,

[61] Ibid.
[62] Ibid.
[63] SACL 2015, art 212(b).
[64] SACL 2015, art 211(b)(c).
[65] SACL 2015, art 211(d).
[66] SACL 2015, art 211(i).
[67] SACL 2015, arts 211 and 212(c)(d)(f).

the director may be criminally liable, according to other laws that may relate to the position of director,

6.2 The consequences of breach of the duties

6.2.1 Return of property and account of profits

The company directors may be ordered to return the company property to the company in case of taking its property by breach of duties while they shall hold the property in trust for the company.[68] Account of profit claims is often involved in breaching some of the directors' duties, duty to avoid conflicts of interest and to declare any personal interest,[69] duty not to participate in any business competitive with that of the company[70] and duty not to accept benefits from third party.[71] If a company director had benefited from an unauthorised profit by breaching these duties, this profit is confiscated to the company. This is to deter the directors from exercising these wrongful acts and should be note that profits confiscated and return the company property are not to compensate the company for the loss, as the company compensation may be greater than the profit realised by the director.[72]

Consequently, the court may, at the request of the affected party (the company), rule to return the property and account of profits as a result of the directors breach of their duties. In the judgment declared by the Commercial Court,[73] the respondent (a director) is obligated to return the property (building), which is the subject of the company's competition, the activity of the company is to buy or rent buildings and re-rent them as residential units. The company claimed to the director that after the expiry of the company lease contract for the building (the subject of the dispute), the director rented the building for his own account, and the rent was not renewed for the company's account. The company considered that as competing with the company's activity. Therefore,

[68] SACL 2015, arts 24, 31, 71 and 72.
[69] SACL 2015, arts 31 and 71.
[70] SACL 2015, arts 31 and 72.
[71] Sharia "Islamic" jurisprudence principle "*Al'asl Bara'at Althimah*" which means each person's liability is innocent until proven otherwise; The Saudi Arabian Corporate Governance 2019, art 49.
[72] SACL 2015, art 218.
[73] The Saudi Arabian Commercial Court, 10/TG/1/7 (2013); 213/TG/2/1 (2014).

the court held that the operations done by the director were for the company account. However, logically, the directors are not liable to account for profits that are not related to the breach of the duties. The directors are liable to account for profits made by themselves or through a company and they have an interest.[74] In addition, the profits made jointly by other persons are not subject to confiscation unless the other person is aware of the breach of duty and may be liable.[75]

In Islamic law, the general rule is that every act of an agent (director) that has exceeded the granted powers or with negligence, the agent is liable for that conduct. Whether by compensation or other remedies. The compensation in Islamic law is either in-kind or monetary. In-kind compensation is the restoration of the situation as it was before the damage, if possible.[76]

6.2.2 Equitable compensation

Return of property and confiscation of profits from a director who breached the prescribed duties may not be sufficient to redress the damage suffered by the company due to the director's breach of his/her fiduciary duty. Therefore, the court may award equitable compensation for any loss not compensated by the account of profit.[77]

The Saudi Arabian legislature does not specify a specific mechanism to compensate for the damage but rather left that to the judge's discretionary power to consider the circumstances of the case and the provisions of the Islamic law. Here a question arises as to the amount of compensation due to the affected party. In general, the amount and the type of compensation in the civil liability cases against directors according to the damage to the affected party. The general rule in assessing compensation is that if the compensation is stated by the legislature, the judges are obligated to compensation as in the manner of the legal provisions. If there is a legal provision that determines the amount of compensation for the damage, the judges are obliged by this legal

[74] SACL 2015, art 71(2).
[75] SACL 2015, art 74.
[76] El-Bahouty (n 43) part 2 p 306.
[77] SACL 2015, art 218.

provision, and they do not have discretionary authority to determine the compensation.[78] Since the Saudi Arabian legislature does not specify the amount of compensation for the damage caused due to the wrongful acts of the directors, the judges have discretion in assessing the appropriate compensation.

However, the judge's discretionary power to fix the compensation, as Al-Sanhouri[79] and Wahdan[80] argue, is restricted by some of the principles that have been agreed upon judicially in accordance with the provisions of Islamic law, and among these principles we should note the following. First, the compensation is to the extent of the damage, according to the opinion of those with experience in that. Second, the judge does not have to award compensation for more than what the claimant (the affected party) claim, even if the claim compensation is less than the damage that in the discretion of the judge and the experts. Third, the compensation is related to the damage itself not to the gravity of the wrongful acts. For the wrongful act that is not grave (*culpa levis*), which leads to grave damage, the compensation must be estimated on the damage, not estimated on the wrongful acts caused; and the grave wrongful act (*culpa lata*) that causes minor damage the compensation would be for the amount of damage regardless of the grave wrongful act. In addition, the financial position of the director should not be taken into account in the amount of compensation, so the compensation is not increased if the director is affluent or insured on their liability. Fourth, the affected person may not obtain more than one sum of compensation for one damage, so no matter how many perpetrators made the wrongful act, the compensation is for the damage.

The damage, whether or not it occurred, is of <u>three</u> types. First, the damage has already occurred. Second, the damage that its causes have occurred, but its effects have not yet occurred, and it will happen in the future certainly. Third, the potential damage, which its causes have occurred, but its effects are not

[78] Redha Wahdan, The practical problems in the compensation claim before the Saudi Arabian judiciary, the Journal of Justice, v 46 (2010), 75-88, 78.
[79] Al-Sanhouri (n 20) chapter 4, part 2, p. 971.
[80] Wahdan (n 78) 80-81.

certain to happen in the future.[81] Saudi Arabian law has adopted the same approach as Islamic law. The compensation is estimated on the damages that have already occurred or the damages that are certain to happen in the future. As for the potential damage that is not certain to happen in the future, it will not be compensated because the consideration is in the occurrence of the damage, not in the expected damage.[82]

As already mentioned, the compensation is in the event of occurrence a wrongful act, the damage and the causal relationship between them.[83] The compensation for moral damage is subject to disagreement among Islamic scholars, about the possibility of the judge’s discretionary power to assess compensation for moral damage, and its denial because of the difficulty or impossibility of assessing the moral damage.[84]

In the judgment declared by the Commercial Court,[85] the respondents (two directors) were liable to pay compensation to the shareholders for the damages incurred by the company due to their negligence in the company's management. Where the respondents committed financial violations such as paying incentives and bonus for the company employees including themselves despite not achieving profits in the activity of the company, but the source of these incentives and bonus was from the sale of the company's assets. It had been also proven that there were differences and inconsistencies in the company's accounts and budget and that there are deficiencies in the company's internal monitoring process. Accordingly, the court ruled the directors liable for negligence in the company's management and they are liable to pay compensation to the company. This is supported by the judgment declared by the Commercial Court,[86] against the defendant (the director) to compensate the plaintiffs (shareholders) for the loss resulting from negligence in the company's management. Where a large number of goods were lost in relation to the size of the company and the short period of its operation, the

[81] Jamal Al-Din Atwa, Contractual Liability in Islamic Jurisprudence: A Comparative Study, published doctoral thesis, Al-Azhar University, Cairo, (1979), 380.
[82] Wahdan (n 78) 82.
[83] Jamal Al-Din (n 12) 527.
[84] Al-Zuhaili (n 19) 23.
[85] The Saudi Arabian Commercial Court, Q/3/847 (2016); 291 (2019).
[86] The Saudi Arabian Commercial Court, 83/2 (2014).

court held that it usually does not lose such a number (percentage) of the goods, except in the case of negligence.

In Islamic law, as previously mentioned, if civil liability is established against an agent, then the agent is obligated to pay in-kind compensation, which is to restore the situation as it was before the damage, if possible. If it is not possible, in-kind compensation, then monetary compensation is another remedy that is resorted to in this case.[87]

6.2.3 Rescission of a transaction

The transaction of a company that has occurred due to a breach of duty to declare any personal interest, violating the grant of loans or violating the provisions of debt instruments or financing instruments is voidable in accordance with the options of the company and may be rescinded.[88] The rescission of a transaction involves each party returning to the other what was transferred in the transaction. Also, upon rescission of the contract of sale of property or any transactions made by a director, the director must return all the profits that they made through the transaction.[89] However, in some circumstances where the transaction cannot be rescission, such as the resale of the property to another party. It is also the case where the transaction was made with someone who is non-fraudster (has good faith), rescission may not be possible depending on the circumstances surrounding the transaction.[90]

In the judgment declared by the Saudi Arabian commercial court,[91] the director of the company sold part of the company' shares to herself, provided that the value of the shares be paid from future profits. It is evident that selling in this way is nothing more than being in a non-interests of the company and the shareholders, but rather is in consideration of the interests of the buyer (the director), and by claiming the shareholders to revoke this transaction (selling the shares), then the court ruled to nullify the sale, as it is exceeded the granted

[87] El-Bahouty (n 43) part 2 p 306-307.
[88] SACL 2015, arts 71, 73(1) and 124.
[89] SACL 2015, art 71(2).
[90] SACL 2015, arts 29 and 77.
[91] The Saudi Arabian Commercial Court, 3708/Q (2016).

power of the director and in breach of the duty to act in the interests of the company. Also, in the judgment declared by the Saudi Arabian commercial court,[92] the board of directors set aside a yearly sum to support the defaulters of the tenants, and as this violates art 30 of the SACL 2015 (Donations). This is considered by the court as exceeding the power of the board of directors and mismanagement of the company's affairs, and therefore the court annulled the support decision and obligated the board of directors to compensate for what was paid.

In this regard, it should be noted that a personal claim could be made against third parties when the directors breached their duties. This is if the third party dishonestly assisted a director to breach their duties, the third party may be personally liable to pay compensation to the company. Or if the third party knows that such directorial acts are not within the limits of the board's competence, the third party may be liable for compensation to the company.[93]

In Islamic law, if the agent acts in a manner that does not benefit the principal, then this act is considered non-binding for the principal; some Islamic law scholars argue that the wrongful act is void even if it is authorised later by the principal. While some scholars believe that, the act is void unless it is authorised later by the principal.[94]

6.2.4 Removal of directors

In SACL 2015, the removal of directors from their position has also ways and circumstances. This removal depends largely on the type of company and the circumstances of a director. In general partnerships, the removal of a director depends on two main things which are that the director is a shareholder in the company or not, and the appointment of the director is in the general partnerships' articles of association or in a separate service contract. If a director is a shareholder and appointed in the articles of association, s/he has immunity against the termination except by a decision issued by the competent judicial authority at the request of the majority of shareholders. The removal of

[92] The Saudi Arabian Commercial Court, 5855/Q (2017).
[93] SACL 2015, arts 74 and 77.
[94] El-Bahouty (n 43) part 2 p 306.

a director in such manner shall entail the dissolution of the general partnership unless the general partnership's articles of association provides otherwise.[95] While if the director is a shareholder appointed in a separate contract, s/he may be terminated by a resolution from the shareholders.[96] Finally, with respect to general partnerships, if a director is not a shareholder, s/he may be terminated by a resolution from the shareholders, whether the director is appointed in the articles of association or in a separate contract.[97]

In a limited liability company, the shareholders have full freedom to remove a director, whether the director is appointed in the company's articles of association or in a separate contract, without prejudice to their right to compensation due to removal.[98] SACGR 2019 stipulate that the ordinary general assembly may dismiss all or any of the board members of directors at any time. The ordinary general assembly also, upon the recommendation of the board of directors, may terminate the membership of absent members of the board of directors from attending three consecutive meetings without a legitimate excuse.[99]

The removal of the directors from their office at any time without a reasonable reason does not mean that the provisions of their contracts with the company, including compensation for dismissal, are not applied during the period of validity of their contracts. However, the dismissal due to the directors breaching their duties, whether, by the general assembly, the board of directors or the judicial authority exempt the company from the compensation of the dismissed director,[100] rather, civil or criminal liability may arise against the director because of that breach of duties.[101]

In the judgment declared by the Saudi Arabian commercial court,[102] the shareholders wanted to dismiss the director due to many violations, including

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[95] SACL 2015 art 33(1).
[96] SACL 2015 art 33(2).
[97] Ibid.
[98] SACL 2015 art 165(1).
[99] SACGR 2019 art 19(a).
[100] SACL 2015, arts 74, 81(4), 100 and 165(1).
[101] Further details in (6.1.1 the civil liability) and (6.1.2 the criminal liability).
[102] The Saudi Arabian Commercial Court, 6251/Q (2017).

not exercising reasonable care, the director's personal interests having conflicted with the interests of the company and a number of administrative violations. Whereas, the articles of association of the company stipulated that the dismissal of the director is by unanimous consent of the shareholders, which has not happened, as the director owns 1% of the company and naturally refuses to dismiss himself. Accordingly, the shareholders turned to the other option, which is to dismiss the director through the judicial authority. With the court having examined the aforementioned violations, the court ruled to dismiss the director without consideration to the rights stipulated in the appointment contract.

It should be noted that claiming the dismissal of the directors in a manner that exempts the company from applying the provisions of the directors' contracts with the company, including expulsion compensation during the period of the validity of their contracts, is not an easy matter. By examining the judicial judgments that were published between[103] the years 2012-2016,[104] all judicial rulings regarding claiming to the director dismissal, in a manner that exempts the company from applying the provisions of the directors' contracts with the company, were rejected because there are not sufficient reasons that exempt the company from applying the provisions of directors' contracts with the company.

In Islamic law, a question arose as to whether the agent exceeded the powers granted or acted in a wrongful manner to the principal, so would the agency contract remain or be abolished? Islamic law scholars have two opinions. The first opinion, if the agent exceeded the powers granted or acted in a wrongful manner to the principal, then the agency contract is not invalidated, and if the agent is paid for their work, the principal is obligated to pay so. This is because the agency contract is authorising to act in accordance with the powers granted, and if the agents exceed it or act in a wrongful manner, they are liable for their

[103] After 2017, it has not published any new judicial judgments. Perhaps the reason for this is the new organisation of commercial courts as self-standing courts since October 2017. Where the administrative and commercial courts were in the past before 2017 merged into one court. It may take some time to publish judicial judgments.
[104] For example, see the Saudi Arabian Commercial Court judgments, 6755/Q (2015); 788/Q (2016).

acts; therefore, the wrongful act or exceeding the powers does not affect their position as agents.[105] The second opinion, if the agent exceeded the powers granted or acted in a wrongful manner to the principal, the agency contract is automatically abolished unless the principal authorised the agent to continue, therefore the implications for that are that the agent does not deserve the pay for subsequent work and the subsequent acts of the agent are invalid.[106]

6.2.5 Receivership

A receivership in Saudi Arabian law is placing the disputed money in the hands of a person appointed by agreement of all concerned parties, or failing that the judge shall make the appointment of a receiver if no agreement is reached.[107] The judge may order placement under receivership if the party having an interest in the movable or immovable property presents reasonable cause that imminent danger is feared if the property remains in the hands of its possessor.[108] Receivership shall end by agreement of all the parties concerned or by a court judgment. The receiver shall then return the property under his custody to the person chosen by the concerned parties or appointed by the judge.[109] However, it must be established that there are no other remedies other than the receivership to remedy the damage. Because appointing a receiver for a company means destroying the company's reputation in the Saudi Arabian market and the unwillingness of traders to deal with it for fear of the company's unknown future.

6.2.6 Criminal sanctions

The potential imposition of civil liability against directors may be insufficient to deter directors from some wrongful practices. The Saudi Arabian legislature has adopted criminal liability against some of the directors ’acts; as the director may be criminally liable for acts that have been occurred during the company's

[105] Ali al-Mardawi, Al-Einsaf fi Ma'rifat Al-Rajih min Al-Khilafi, First Edition, Sunna Al-Muhammadiyyah Press, Tunis, (1956), part 5 p 369.
[106] El-Bahouty (n 43) part 2 p 312.
[107] The Saudi Arabian Law of Civil Procedures 2013, art 212.
[108] The Saudi Arabian Law of Civil Procedures 2013, art 211.
[109] The Saudi Arabian Law of Civil Procedures 2013, art 217.

operations. The criminal liability against the director can be established directly without prosecuting the company.

As it has been mentioned, SACL 2015 stipulates the criminalisation of many wrongful practices by directors, which would violate the integrity, trust, protecting companies, shareholders and the third party, and imposing the appropriate penalties for these practices.[110] The directors' criminal liability derives from one of two things, either through the criminal acts that criminal law has criminalised against members of society or through the provisions on criminal liability in the SACL 2015 and relevant legislation. The SACL 2015 stipulates a number of acts that give rise to criminal liability and impose criminal penalties on their perpetrators. These acts in which the director perhaps make as a result of occupying the position are.[111]

The offence of making false statements or omitting including some data deliberately in the company's financial statements or in the reports of the general meeting is to be noted. The SACL 2015 stipulates that this act is criminalized where it is stated without prejudice to any more severe penalty stipulated for in any other law, liable by imprisonment for a period not exceeding five years and a fine not exceeding five million Saudi Arabian Riyals[112] or by either of these two penalties,[113] against any director, official, auditor, or liquidator who knowingly includes false information in the financial statements or in the reports prepared by him for the shareholders or the general meeting; or who omits essential facts from such statements or reports with the intention of concealing the financial position of the company from the shareholders or third parties.[114] The penalties will also be against whoever willfully inserts in the articles of association, bylaws, or other company's documents or in the incorporation license application form or in the documents attached to the incorporation application form, false information contradicting with the

[110] SACL 2015, arts 211, 212, 213, 214, 2015 and 216.
[111] SACL 2015, arts 211, 212 and 213.
[112] 1 USD = 3.75 Saudi Riyals, Fixed exchange rate.
[113] SACL 2015, arts 211 and 212.
[114] SACL 2015, arts 211(a).

provisions of the SACL 2015; and whoever knowingly signs or distributes such documents.[115]

One of the offences is the offence of divulging company secrets. The SACL 2015 stipulates that this act is criminalized where it is stated without prejudice to any more severe penalty stipulated for in any other law, liable by imprisonment for a period not exceeding a year and a fine not exceeding one million Saudi Arabian riyals or by either of these two penalties.[116]

The SACL 2015 also stipulates the criminalisation of knowingly misusing the company's funds and misusing the powers granted against the company's interests. This act is criminalized where it is stated without prejudice to any more severe penalty stipulated for in any other law, liable by imprisonment for a period not exceeding five years and a fine not exceeding five million Saudi Arabian riyals or by either of these two penalties.[117]

In addition, the offence of not calling the general assembly meeting when the losses of the company amount to half of the paid-up capital or if fails to publish such information in accordance with such losses, is liable by imprisonment for a period not exceeding five years and a fine not exceeding five million Saudi Arabian riyals or by either of these two penalties.[118] Finally, the Saudi legislature considered that the director who misuses the company for purposes other than that for which it was designated, is an offence that arises the criminal liability, is liable by imprisonment for a period not exceeding five years and a fine not exceeding five million Saudi Arabian riyals or by either of these two penalties.[119]

In addition, the director may be criminally liable, according to other laws that may relate to the position of director, such as those offences contained in Anti-Forgery Law 2013, which stipulates that the penalty for forgery be by imprisonment for a period not exceeding ten years and a fine not exceeding

[115] SACL 2015, arts 212(f).
[116] SACL 2015, art 212(b).
[117] SACL 2015, arts 211(b)(c).
[118] SACL 2015, art 211(d).
[119] SACL 2015, art 211(i).

one million Saudi Arabian riyals.[120] Also, the bribery penalty stipulated in the Saudi Arabian Anti-Bribery Law 1992 is imprisonment for a period not exceeding ten years and a fine not exceeding one million Saudi Arabian riyals or by either of these two penalties.[121] In addition, if the company commits fraud through its acts, the director may be criminally liable if the fraud is committed with his/her consent or connivance with another. If the fraud is committed by committing one of the offences stipulated in the Saudi Arabian Anti-Cyber Crime Law 2007, the penalty is imprisonment for a period not exceeding three years and a fine not exceeding two million Saudi Arabian riyals or by either of these two penalties.[122] As for if the fraud is committed by committing one of the offences stipulated in the Saudi Arabian Anti-Money Laundering Law 2012, the penalty is imprisonment for a period not exceeding fifteen years and a fine not exceeding seven million Saudi Arabian riyals or by either of these two penalties.[123] As for the legal person (the entity - the company), the penalty is a fine not exceeding fifty million Saudi Arabian riyals.[124]

Finally, the directors may be liable for a wide range of offences, including the criminal liability of directors for offences stipulated in Electronic Transactions Law 2007, Anti-Trafficking in Persons Law 2009, Environmental Law 2001, Law of Chemicals Import and Management 2006, Electronic Transactions Law 2007, Anti-Trafficking in Persons Law 2009, Environmental Law 2001, Law of Chemicals Import and Management 2006 and other relevant laws.[125]

Islamic law recognises criminal punishment, establishing criminal punishment for the benefit of the community against those found to be criminally liable.[126] One of the criminal penalties recognised in Islamic law is imprisonment.[127] The punishment for imprisonment is stipulated in the Noble Qur'an,[128] and the

[120] The Saudi Arabian Anti-Forgery Law 2013, arts 3, 4, 6, 8, 10, 11 and 13.
[121] The Saudi Arabian Anti-Bribery Law 1992, arts 1, 9, 10 and 11.
[122] The Saudi Arabian Anti-Cyber Crime Law 2007, art 4.
[123] The Saudi Arabian Anti-Money Laundering Law 2012, arts 2, 3 and 27.
[124] The Saudi Arabian Anti-Money Laundering Law 2012, art 31.
[125] See the Saudi Arabian Criminal Procedure Law 2013, art 112.
[126] Abdel-Qader Odeh, Islamic Criminal Legislation, 14th Edition, Al-Resalah Foundation, Beirut, (2001), Part 1, p. 609.
[127] Ibn Qayyim al-Jawziyya, Al-Turuq Al-Hukmiah fi Al-Siyasah Al-Shareiah, International Islamic Fiqh Academy, Jeddah, (2008), p 101.
[128] The Noble Qur'an, *Surah Al-Nisaa ayat* 15.

Prophet Muhammad (PBUH) ordered the imprisonment of a person in some cases,[129] as well as the companions after him.[130] The Prophet Muhammad (PBUH) also ordered the punishment of a fine in some cases.[131]

6.3 Elimination and limitation of liability

6.3.1 Relief from liability by the ratification of directors' acts

Directors owe general duties to the company. These duties are imposed on directors to act to achieve the purposes of the company, avoid conflicts of interest and not to participate in any business competitive with that of the company and exercise the absolute good faith and fairness in the management of the company's affairs in the interests of the company.[132] However, this legislation also recognises that directors are subject to business judgment mistake, which allowing only the general assembly or the shareholders to relieve directors from liability arising from breach of some of the duties by ratification; without granting the court any power to relieve directors from their liability.[133] This is in contrast to the CA 2006 s.1157, which also grants the courts the discretion in granting relief to directors from their liability if they prove three things. They acted honestly, reasonably and having regard to all the circumstances of the case they ought fairly to be excused. Therefore, the court may relieve the director from liability in whole or in part and on conditions it deems proper.

Under the Saudi Arabian Companies Act 2015, the company may ratify the acts of the directors by the company shareholders or the general assembly, for some of the conduct of the director, amounting to undertaking any acts beyond the scope the purposes of the company or participate in any business that conflicts with the interest of the company. This ratification makes the directors more safe from the company's actions or derivative suits. Therefore, directors do not need

[129] Sulayman Al-Azdi, Sunan Abu Dawood, Al-Maktabah Al-Eisriah, Beirut, (2000), 3629. (Known as Sunan Abu Dawood).
[130] Abu Bakr bin Abi Shaybah, The Book Classified in Hadiths and Athar, 1st Edition, Al-Rushd Library, Riyadh, (1988), part 1, p. 132.
[131] Sunan Abu Dawood (n 129) 1719.
[132] SACL 2015, arts 29, 31, 71, 72, 74 and 75.
[133] SACL 2015, arts 30, 31, 71 and 72.

to certify if they act according to the powers conferred.[134] The Saudi Arabian Companies Act 2015, does not specify who would include in ratification, whether are the current and former directors or only the current directors. However, considering the aim of the ratification, which is making the directors more protected from the company's actions or derivative suits; it can be said that the ratification includes the former and current directors.

In order to ratify directors' conduct, there are three ways. Either by the consent of the shareholders or by the ordinary general assembly or by virtue of an express provision in the articles of association of the company.[135] In the case of a director who declares to the board of directors any direct or indirect interest that s/he may have in the transactions or contracts concluded for the company. Such declaration must be recorded in the minutes of the board meeting, and this director shall not participate in voting for the resolution to be adopted in this respect in the board of directors and the shareholders' meetings. The chairman of the board of directors shall inform the ordinary general assembly upon convening, of the transactions and contracts in which any director has a direct or indirect interest. Such notification shall be accompanied by a special report from the company's external auditor.[136]

Regarding the ratification of the directors 'acts due to a breach of the provisions of the company's articles of association, or because of the director's default or negligence, or because of mismanagement of the company's affairs, the Saudi Arabian legislature prevents from certifying these acts. In the context of liability against director because of breaching the provisions of the company's articles of association or due to director's default or negligence or mismanagement of the affairs of the company; articles 78(2) and 165(3) of the SACL 2015, states that the ordinary general assembly's and the shareholders' ratification and their consent a to discharge the directors from their liability shall not preclude the institution of a liability suit.

[134] Ibid.
[135] Ibid.
[136] SACL 2015, art 71(1).

6.3.2 Indemnification against directors' liabilities

An indemnity clause is a contractual provision that gives benefits to the contracting parties, allowing parties to manage the risks associated with the contract. Because the indemnity enables one party to be protected against liability, by paying one party the losses incurred by the other.[137] Indemnity is used in a wide variety of contexts and there is no general rule as to when the indemnity will be made, depending on the circumstances of the contract.

The Saudi legislature stipulates in the SACL 2015[138] and the former Saudi Arabian Companies Law 1965,[139] that any provision, whether in the company's articles of association or in the appointment contract of the director or any subsequent agreement according to which the company provides an indemnity for the company directors against any liability incurred by them in respect of default, negligence, a breach of the provisions of the company's articles of association, or because of mismanagement of the company's affairs, or breach of trust in relation to the company shall be considered non-existent (void).

Islamic law is consistent with Saudi Arabian law to prevent the indemnity of liabilities. If the agents (directors) are provided with an indemnity against any liability incurred by themselves in respect of their wrongful acts in relation to the principal (the company) this shall be considered void.[140]

6.3.3 Insurance against directors' liabilities

Insurance may be a good way that the company directors can rely on to protect themselves from personal liability. It can also be the only means available to relieve themselves of liability when the shareholders of the company and the general assembly are unwilling to ratify the acts of the directors that breached the duties. Companies usually purchase insurance for the benefit of directors to attract them and retain them in their positions, because managing a daily business may be surrounded by risk. Therefore, the purpose of insurance is to

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[137] SACL 2015, arts 32, 78(1) and 165(2).
[138] Ibid.
[139] The former Saudi Arabian Companies Law 1965, arts 32, 76 and 168.
[140] Ibn Abidin (n 41) part 1 p 300.

indemnity for liability incurred by individuals as a result of being in the position of director.[141] The insurance can also cover the court, tribunal and legal fees and other costs the company or the directors personally may incur as a result of such a suit.

The SACL 2015 does not contain any provision regarding the directors' liability insurance, whether by permitting or prohibiting. Perhaps this is due to the fact that the idea of insurance on the liability of directors is considered somewhat new in the Saudi Arabian market. Directors' liability insurance is often called Directors and Officers liability insurance "D&O", which is liability insurance payable to company directors as indemnification for losses or defence costs if the insured suffers such losses as a result of legal proceedings against wrongful acts.[142] D&O insurance is a product subject to price fluctuations, diversity in terms and conditions, scope and size of coverage which is always there is a maximum amount of liability insurance coverage and duration of coverage. The insurance contract, therefore, relies on these terms and trade circumstances, which is negotiable. However, in general, intentional illegal, fraudulent and criminal acts and the acquisition of wrongful profits are not covered by the insurance policy. The consequences of financial problems that the insured had previously aware of before commencement coverage or breach of duty for personal benefit are often excluded from insurance coverage. Therefore, the insured must disclose material facts before contracting.[143]

6.4 Evaluation of the Saudi Arabian law with respect to the directors' liability.

The legislation imposes liabilities against the directors to reduce the unwanted consequences of their decisions for the company, shareholders, and third party, and it seeks to prevent the directors from using the position for their personal

[141] Stadermann F, Banis C. (2008). From 'Severability Clause' to 'Innocent Directors Clause' in Dutch D&O Policies. British Insurance Law Association. 19-20 available at <http://www.ph8.nl/upload/catalog/289/410245/5/From%20'Severability%20Clause'%20to%20'Innocent%20Directors%20Clause'.pdf> [accessed 14 April 2020].
[142] Sprayregen JHM, Friedland JP, Ghasemi M. (2005). Directors & Officers Insurance. Thirty-first Annual Southeastern Bankruptcy Law Institute, Atlanta, Georgia. Authors are affiliated with Kirkland & Ellis LLP, 1-2 available at < http://www.sbli-inc.org/archive/2005/documents/395189.pdf > [accessed 17 April 2020].
[143] See the insurance policy of UIB-Saudi and HISCOX.

interests or for any other considerations that are not in the company's interest or are not within the purposes of the company. However, the problem is despite the fact that the legislature emphasis the liability of directors through civil and criminal liability, but that the law should be clearer regarding the duties of the directors, which is the basis of liability and not to leave it to the provisions of Islamic law, or scattered in SACL 2015 and the Corporate Governance Regulations.

As for the liability towards the company's creditors, the provisions of Islamic law impose liability against the directors regarding the debts of the company's creditors in the event of negligence, default or fraud. Undoubtedly, the Saudi Arabian law and judiciary are based on the provisions of Islamic law, and accordingly, the directors will be liable in relation to the debts of the company's creditors in the event of negligence, default or fraud. It is worth that the legislature to state the duty to take into account the interests of the creditors of the company at a specific point of the company's life, so the directors to be aware of it.

Finally, as mentioned previously, one of the duties of the director stipulated in the SACL 2015 is to be a liquidator for the company. This is upon the dissolution of the company, the directors will automatically be in the liquidator’s rule until a liquidator is appointed for the company. Article 79 of the SACL 2015 states that the liquidator, after obtaining the approval of the ordinary general assembly, must institute a liability action against the company directors for wrongful acts that cause prejudice to the shareholders. However, the problem with this duty is that when the directors become the liquidators, it is unreasonable that a suit to be brought against themselves. Basically, the liquidator’s function is to examine the director's work before dissolution the company, and if the liquidator was the director, then the purpose of the liquidator's function is negated.

6.5 The comparison of directors’ liabilities in the UK and Saudi legislation.

As has been mentioned, the comparative study means examining the differences and similarities between the laws of different countries in different systems in the world. The importance of comparative law is that it helps to mutual understanding and dispel prejudice and misinterpretation in this world. It also provides a platform for legal intellectual exchange and helps to broaden the horizons of legislators worldwide. This study, in the previous chapters, has highlighted the directors' liabilities in the UK and Saudi Arabian legislation. In this section, the study will compare the relevant legislation in Saudi Arabia and the like on the UK side, and highlight the similarities and differences in what needs to be clarified. It is worth mentioning that the aim of the comparative study is not to search for the best legal system, but the purpose is to know more deeply the existing legal systems and thus develop what we have.

One of the similarities between the UK and Saudi Arabian law is that the directors may face civil and criminal liability as a result of a breach of the duties imposed on them, whether by legislation, the company's articles of association or the appointment contract. In general, the Saudi Arabian and UK legislators are consistent with that it is of the consequences of the breach of the duties return of property and account of profits, equitable compensation, rescission of a transaction, receivership, removal of directors and criminal sanctions. They are also consistent, in general, on the directors may be relieved from liability by ratifying their acts, or by insurance against their liabilities. The Saudi Arabian and the UK legislature also correspond to prevent the indemnity of directors' liabilities at all.

As for the differences between the two sets of legislation, we note the following. The UK legislature has explicitly stipulated civil liability for wrongful trading and criminal liability fraudulent trading in order to protect the company's creditors. While the Saudi Arabian legislature does not address the protection of creditors by any legal provisions but rather left it to the provisions of Islamic law in protecting creditors.

In the consequences of the breach of the duties, the UK legislator stipulates more broadly than the Saudi Arabian legislator on the consequences of the breach of the duties, as it the UK legislator stipulates on directors disqualification. Of the consequences of the director's breach of the duties in the UK law is disqualifying a person for a specified period from being a company director. In view of the Company Directors Disqualification Act 1986, the disqualification of directors can be classified as disqualification due to misconduct and unfitness. In Saudi Arabia, there is no law for the disqualification of directors, but there are some regulations not to nominate for the position of the board of directors any person who has been convicted of an offence against honesty.[144] There are also rules to form the boards of directors of the joint stock companies, in that they consist of persons who meet the conditions of expertise and adequacy of the honesty, in addition to not being a state employee, not being convicted of a crime, not being insolvent or bankrupt, not acting in a manner otherwise in financial markets, commercial business rules, not being a member of more than five listed companies, having scientific and practical experience, committed to the provisions of the laws, regulations and instructions, have sufficient time to work and having independent judgment and non-conflict of interest.[145] It is worth the Saudi Arabian legislature to protect the Saudi Arabian market by enacting a law that is similar to the UK Company Directors Disqualification Act 1986 to protect companies and the Saudi market.

With regard to exempting directors from liability by ratifying their acts, the UK and Saudi Arabian legislators are consistent that the directors may be relieved from liability by ratifying their acts by the shareholders, in general. However, the UK legislator is broader in the exemption, which enacts another way to exempt directors from their liability by exempting through the court, which is not stipulated by the Saudi Arabian legislator. However, in order for a director to be relieved of liability by the UK court, three things must be proven. First, the director acted honestly. Second, the director acted reasonably. Third, the director having regard to all the circumstances of the case s/he ought fairly to be excused; so, the court requires a strong persuasion for relieving the director from the liability. In practice, proving these three things from the director may be sufficient not to be liable.

[144] SACGR 2019 art 65(2).
[145] Decree of the Saudi Ministry of Commerce and Investment, No 24233, 24/04/2016.

Chapter Seven: Conclusion

7.1 Introduction

Modern companies need directors having flexible powers and clearly defined duties as provided under contract and law. Recent financial scandals have demonstrated the importance of directors' duties to ensure they manage the company's affairs properly; these crises were a result of many cases of fraud and mismanagement. Studies[1] have proven that companies that enjoy enduring success have core values and a core purpose that remain fixed while their business strategies and practices endlessly adapt to a changing world. The directors' duties in the UK and the KSA have been codified to enhance the clarity of the law and make it easier for the responsibilities of directors towards the company and others to be understood without the need for a legal consultant. It also aims to prevent fraud and mismanagement that causes corporate collapse.

Returning to our research question this thesis sought to investigate and analyse the powers, duties and liabilities of the directors through a critical evaluation of the legal regulation of these matters in Saudi Arabia and UK legislation, and clarifying the similarities and differences between these bodies of legislation. This thesis also sought to find and provide solutions to perceived problems in the same context.

7.2 Summary of findings

7.2.1 Summary

The main actor in the subject of this thesis is the company's director, who is the one who has been clarified in the CA 2006 as any legal person who holds the position of director by any name called. This includes shadow directors, *de jure* directors and *de facto* directors. In the SACL 2015, there is no explicit definition of a director. The SACL 2015 only recognises *de jure* directors and it does not provide expressly for shadow directors nor *de facto* directors but recently the

[1] See Collins (n 11) chapter 1.

Commercial Courts with a single case that implicitly recognises *de facto* directors.[2]

With regard to the interaction between powers, duties and liabilities; a power is the ability that the law confers on a person to do something. The duty is the obligation to do something or ought not to do something and a duty may restrict the exercising of powers. Directors are granted broad managerial powers that for the most part, the law does not see the need to itemise them. Yet as for duties, they need to be itemised, because they give rise to obligations and may raise liabilities, so the liabilities are the result of a breach of duty. Of the directors' powers are, power to declare a dividend, power to litigate, power to appoint additional directors, power to make provisions for employees regarding the cessation or transfer of the company' business, power to forfeit shares, power to refuse to register a transfer of shares, power to circulate information to shareholders and power to borrow and give security. [3]

7.2.1.1 On the UK side

In UK law, the directors' duties can be summarized in the following way. First, duty to act within powers in accordance with the company's constitution and for the purposes so conferred.[4] Second, there is a duty to promote the success of the company for the benefit of shareholders by taking into account all relevant considerations for the purpose of the success of the company.[5] Third, there is a duty to act in the interests of the company's creditors in defined circumstances. This duty arises at the commencement of the actual insolvency, so-called insolvent liquidation, when the company has insufficient assets to repay its debts, other liabilities and the expenses of the winding up.[6] Fourth, we note the duty to exercise independent judgment. Directors are responsible both for all their performed acts and for the actions that should have been performed. Therefore, the allegation of receiving instructions from others or allegation subjecting their powers to the will of others will not be a good defence for

[2] See (2.1.1 who is a director?).
[3] See (3.2 The directors' powers).
[4] See (3.3.1 Duty to act within powers).
[5] See (3.3.2 Duty to promote the success of the company).
[6] Ibid.

directors to evade any breach of fiduciary duty.[7] Fifth, directors must consider the nature and manner of the company's business, in accordance with the circumstances surrounding it with what is not inconsistent with the company's constitution and the provisions of the directors' contract appointment. The care standard that is adoption is the objective and subjective care standard together.[8] Sixth, directors must avoid a circumstance, which has or can have a direct or indirect personal interest in conflict explicitly with the company's interests or is likely to conflict with the interests of the company.[9] Seventh, directors must not accept a benefit from a party other than the company or its associated companies or their representative, because of their position.[10]

Regarding the directors' liabilities in UK law, the directors' liabilities arise for several reasons. (1) Breach of fiduciary duty. (2) Breach of the duty to exercise reasonable care, which is so-called liability for negligence. (3) Breach of duty owed to creditors and this includes wrongful trading and fraudulent trading.[11]

The consequences of breach of the duties can be summarized in the following. First, the director may be ordered to return the company property to the company.[12] Second, the court may award equitable compensation for any loss not compensated by the account of profit.[13] Third, the transaction of a company that has occurred due to a breach of fiduciary duty is voidable in accordance with the options of the company and may be rescinded.[14] Fourth, the court may order that compels a director to do or refrain from ordering or freezing funds or assets.[15] Fifth, the High Court may by order to appoint a receiver in cases in which it appears to be fair to do so.[16] Sixth, the directors may be criminally liable for acts that have been occurred during the company's operations.[17] Seventh,

[7] See (3.3.3 Duty to exercise independent judgment).
[8] See (3.3.4 Duty to exercise reasonable care, skills, and diligence).
[9] See (3.3.5 Duty to avoid conflicts of interest and to declare the interest in a proposed transaction or arrangement).
[10] See (3.3.6 Duty not to accept benefits from third parties).
[11] See (5.2 Directors' liability).
[12] See (5.3.1 Return of property and Account of profits).
[13] See (5.3.2 Equitable compensation).
[14] See (5.3.3 Rescission of a transaction).
[15] See (5.3.4 Injunctive relief).
[16] See (5.3.5 Receivership).
[17] See (5.3.6 Criminal sanctions).

directors may be disqualified for a specified period from being a company director due to misconduct and unfitness.[18]

With respect to the mitigation of the directors' liabilities in UK law, it can be summarized that. First, the company may ratify the acts of the directors by the company members, for the conduct of the director, amounting to negligence, default, breach of duty or breach of trust with respect to the company.[19] Second, the court has discretion in granting relief from liability in the case where a claim is brought against a director for negligence, default, breach of duty or breach of trust.[20] Third, insurance may be the only means available to relieve themselves of liability when the members of the company are unwilling to ratify the acts of the directors and the court is not convinced that they should be exempted from liability as a result of negligence, default, breach of duty or breach of trust.[21]

7.2.1.2 On the Saudi Arabian side

In Saudi Arabian law, the directors' duties can be summarized in the following. First, there is a duty to act within powers in accordance with the company's constitution and for the purposes so conferred.[22] Second, directors must exercise reasonable care during managing the company's business affairs. The care standard that is adoption is the objective and subjective care standard together.[23] Third, directors may not disclose secret information related to the company that they acted for. The duty not to divulge secrets is limited to what the directors have known information about the company because of their positions.[24] Fourth, there is a duty to avoid conflicts of interest. The director may not have a direct or indirect interest in the transactions and contracts that are concluded for the company's account except with prior permission from the ordinary general assembly. The directors are also obliged to declare any interest they have in the transactions and contracts that are concluded for the

[18] See (5.3.7 Disqualification).
[19] See (5.4.1 Relief from liability by the ratification of directors' acts).
[20] See (5.4.2 Relief from liability by the court).
[21] See (5.4.3 Insurance against directors' liabilities).
[22] See (4.2 Duty to act within powers to achieve the purposes of the company).
[23] See (4.3 Duty to exercise reasonable care).
[24] See (4.4 Duty to maintain confidentiality).

company.[25] Fifth, directors may not participate in any business that would compete with the company, or compete with the company in any of the branch activities that it carries out.[26] Sixth, directors must not accept a benefit in particular benefits from another party who has business dealings with the company.[27] Seventh, there is a duty to act in the interests of the company is implicitly stated in more than one place.[28] Eighth, there is a duty to take into account the interests of the company's employees, suppliers and customers in terms of strengthening the company's relationships, social contribution of the company.[29] Ninth, we have a duty to be a liquidator for the company upon the dissolution of the company, the directors will automatically be in the liquidator's role until a liquidator is appointed for the company.[30]

Regarding the directors' liabilities in Saudi Arabian law, the directors' liabilities arise for several reasons. (1) Breaching the provisions of the company's articles of association, the general assembly's decisions or the SACL 2015. (2) Mismanagement of the company's affair, the abuse of the granted power. (3) The negligent oversight of the company's business.[31]

The consequences of breach of the duties can be summarized in the following. First, the director may be ordered to return the company property to the company.[32] Second, the court may award equitable compensation for any loss not compensated by the account of profit.[33] Third, the transaction of a company that has occurred due to a breach of duty to declare any personal interest, violating the grant of loans or violating the provisions of debt instruments or financing instruments is voidable in accordance with the options of the company and may be rescinded.[34] Fourth, a director dismissal due to breaching duties with exempt the company from the compensation of the dismissed director.[35]

[25] See (4.5 Duty to avoid conflicts of interest and to declare any personal interest).
[26] See (4.6 Duty not to participate in any business competitive with that of the company).
[27] See (4.7 Duty not to accept benefits from third parties).
[28] See (4.8 Duty to act in the interests of the company and consider the interests of the stakeholders).
[29] Ibid.
[30] See (4.9 Duty to be a liquidator upon the dissolution of the company).
[31] See (6.1 Directors' liability).
[32] See (6.2.1 Return of property and Account of profits).
[33] See (6.2.2 Equitable compensation).
[34] See (6.2.3 Rescission of a transaction).
[35] See (6.2.4 Removal of directors).

Fifth, the judge may order the placement of the company under receivership.[36] Sixth, the directors may be criminally liable for acts that have been occurred during the company's operations.[37]

With respect to the mitigation of the directors' liabilities in Saudi Arabian law, it can be summarized that, first, the company may relieve directors from liability arising from breach of some of the duties by ratification, amounting to undertaking any acts beyond the scope the purposes of the company or participate in any business that conflicts with the interest of the company.[38] Second, the SACL 2015 does not contain any provision regarding the directors' liability insurance, whether by permitting or prohibiting. But insurance may be a good way that the company directors can rely on to protect themselves from personal liability.[39]

7.2.2 The differences and similarities the UK and Saudi legislation

The process of comparative study means examining the differences and similarities between the laws of selected countries with different legal systems in the world. It helps to promote mutual understanding and dispel prejudice and misinterpretation in this world. It also provides a platform for legal intellectual exchange. This section highlights the similarities and differences in the directors' duties and liabilities in the UK and Saudi legislation. (See the schedule below).

Duties	UK	SA
Duty to act within powers	Stated	Stated
Duty to promote the success of the company	Stated	Implicit
Duty to exercise independent judgment	Stated	Not stated
Duty to exercise reasonable care	Stated	Stated
Duty to avoid conflicts of interest	Stated	Stated
Duty to declare any personal interest	Stated	Stated
Duty not to accept benefits from third parties	Stated	Stated

[36] See (6.2.5 Receivership).
[37] See (6.2.6 Criminal sanctions).
[38] See (6.3.1 Relief from liability by the ratification of directors' acts).
[39] See (6.3.3 Insurance against directors' liabilities).

Duty to maintain confidentiality	-	Stated
Duty not to participate in any business competitive with that of the company	-	Stated
Duty to take into account the impact of the company's operations on the environment	Stated	Not stated
Duty to take into account the social contribution of the company	Stated	Stated
Duty to take into account the interest of stockholders	Stated	Stated
Duty to take into account the interest of creditors	Stated	Not stated
Duty to be a liquidator upon the dissolution of the company	Not applicable	Stated
The consequences of breach of the duties	**UK**	**SA**
Return of property and Account of profits	Stated	Stated
Equitable compensation	Stated	Stated
Rescission of a transaction	Stated	Stated
Injunctive relief	Stated	Not applicable
Criminal sanctions	Stated	Stated
Disqualification	Stated	Not applicable
Removal of directors	Stated	Stated
Receivership	Stated	Stated
Elimination and limitation of liability	**UK**	**SA**
Ratification by the company members	Stated	Stated
Ratification by the court	Stated	Not applicable
Insurance	Stated	Stated
Indemnification	Prohibited	Prohibited

Schedule (1)

7.2.2.1 The similarities with respect to the duties of the directors

First, the Saudi Arabian and UK legislators both are consistent with the view that the codification of the directors' duties is the best way forward. This is because the codification of the directors' duties enhances the clarity of the law and make it easier for the responsibilities of directors towards others to be identified without the need for a legal consultant to interpret these duties.[40]

Second, notwithstanding what was said above, the directors’ duties in the Saudi Arabian and UK legislation both are not fully self-contained despite codification. On the Saudi Arabian side, it is based on the provisions of Islamic law, and on the UK side, it is based on the provisions of common law for its interpretation. Therefore, directors in both jurisdictions need to be aware of the provisions of common law on the UK side, or the provisions of Islamic law on the Saudi side, or the need for a legal consultant.

Third, the Saudi Arabian and UK legislators are consistent with the general duties of directors, duty to act within powers granted, duty to exercise reasonable care, duty to avoid conflicts of interest and to declare any personal interest, duty to take into account the social contribution of the company, duty to take into account the interest of stockholders and duty not to accept benefits from third parties. They also implicitly correspond on duty to achieve the company’s purposes, which the UK legislature has expressed as a duty to promote the success of the company.

7.2.2.2 The similarities with respect to the liability of the directors

First, the UK and Saudi Arabian courts will respect directors' exercise of discretion in the management of the company. Nevertheless, the courts will take into account whether reasonable care was exercised and all aspects related to the final decision. If the decision is taken in a reasonable manner, the directors cannot be held liable for any damage as a result of this decision. Second, the UK is consistent with Saudi Arabian law on that the company's directors may face civil and criminal liability as a result of a breach of the duties. Third, the Saudi Arabian and UK legislators correspond with the approach that the consequences of the breach of the duties may involve the return of property and account of profits, equitable compensation, rescission of a transaction, receivership, removal of directors and criminal sanctions. Fourth, the Saudi Arabian and UK legislators correspond, in general, on the point that directors

[40] See 3.1 Introduction of chapter three.

may be relieved from liability by ratifying their acts by the shareholders, or by insurance against their liabilities. Fifth, the Saudi Arabian and the UK legislature both prevent the indemnity of directors' liabilities at all.

7.2.2.3 The differences with respect to the duties of the directors

First, the mechanism of the interpretation of some of the duties differs between UK law and Saudi law, depending on the interpretation of common law or interpretation of Islamic law. For example, the interpretation of the term "success" was based on common law on the UK side on several things to determine the meaning of "the company's success", such as achieving the objectives set by the company, the interpretation of directors of the company for success is a meaningful explanation and cannot be challenged, creating a long-term increase in the company's value, and what the constitution determines as the success of the company, and the interpretation of achieving the purposes depends on the level of care required that interpreted by the provisions of Islamic law, whether is the care for the usual person(objective-subjective standard) or the commitment to achieve the desired purpose.

Second, the UK legislature has stated these duties in a single chapter in the Act, called general duties of directors, and limited them between sections 171-177. While the Saudi legislator has presented the duties in a scattered and non explicit manner in many articles in the legislation. Some of these duties are stated in the form of duties, while others are stated in the form of prohibitions against the director, and others are stated in the form of penalties if a director made some prohibitions. The duties also are not fully stated in the SACL 2015, as some of these duties are stated in the SACGR 2019.

Third, the UK legislature has clarified that the scope of the duties is both on the current director and the former director of the company (a person who ceases to be a director) depending on when the breach of duty occurred. In contrast, the Saudi Arabian legislature does not clarify whether the scope of the application of duties i is to apply to the current director only, or the current director and former director; this is left to the judge's discretionary authority, which will rely on the provisions of Islamic law.

Fourth, in duty to exercise reasonable care, the UK legislature clarified the meaning of care is that "the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company", while the Saudi legislature does not explain this and left its interpretation to the Islamic law provision and the judge's discretionary authority, whether is the care for the usual person(objective-subjective standard) or the commitment to achieve the desired purpose. Therefore, it can be said that the codification of this duty in the SACL 2015 from Islamic law needs more clarification in SA company law. It might be clarified as recommended and suggested in para 7.3.2 below (Eighth).

Fifth, in the duty to avoid conflicts of interest, the UK legislature explains what includes in this duty and what does not apply to it or not infringed it. While the Saudi Arabian legislature does not elaborate on it, rather it stipulates other duties that are included in this duty, such as a duty not to participate in any business competitive with that of the company and duty to maintain confidentiality. As has been said above in the duty to exercise reasonable care, the codification of this duty in the SACL 2015 from Islamic law can be described as incomplete.

Sixth, in duty not to accept benefits from a third party, the UK legislator stipulated the duty in greater clarity, including the cause of benefit and what is considered a breach of the duty and what is not considered a breach of the duty,[41] which is fully consistent with the provisions of Islamic law. The Saudi Arabian legislature stipulates briefly that it is not permissible to accept benefits from a third party unless it is not likely to lead to a conflict of interests.

Seventh, the UK legislature imposes on directors a duty to act in the interest of creditors in the event that the company has entered into insolvent liquidation or the director was aware of or ought to have concluded that there was no reasonable prospect that the company would avoid engaging in the insolvent liquidation before the company's winding up commencement. While the Saudi Arabian legislature does not stipulate this duty to directors and make the duties

[41] See CA 2006, s 176.

all concentrated on the interest of the company and the shareholders. Therefore, this duty has not been codified in the SACL 2015 from the Islamic law provisions, which maintain the rights of creditors.

Eighth, the UK legislature imposes on directors a duty to exercise independent judgment, while the Saudi Arabian legislature does not stipulate this duty to directors although not recognised the shadow director and *de facto* directors in the face of the third party.

Ninth, the UK legislature imposes on directors a duty to take into account the impact of the company's operations on the environment, while the Saudi Arabian legislature does not impose this duty on directors, nor even on the companies.

Tenth, the Saudi Arabian legislature imposes on directors a duty to assume the role of a liquidator upon the dissolution of the company, while the UK legislature does not impose this type of duty on directors; rather the UK law requires liquidators to be only independent and qualified insolvency practitioners. Therefore, directors could not be liquidators of their own company, as this would create a conflict of interest.

7.2.2.3 The differences with respect to the liability of the directors

First, the UK legislature has explicitly stipulated civil liability for wrongful trading and criminal liability for fraudulent trading in order to protect the company’s creditors. While the Saudi Arabian legislature does not address the protection of creditors by any legal provisions but rather left it to the provisions of Islamic law and the judge's discretion in protecting creditors.

Second, in the consequences of the breach of the duties, the UK law is disqualifying a person for a specified period from being a company director. In view of the Company Directors Disqualification Act 1986, the disqualification of directors can be classified as disqualification due to misconduct and unfitness. In Saudi Arabia, there is no law for the disqualification of directors, but there are some regulations not to nominate for the position of the board of directors any person who has been convicted of an offence against honesty. There are also rules to form the boards of directors of the joint stock companies, in that they consist of persons who meet the conditions of expertise and adequacy of the honesty, in addition to not being a state employee, not being convicted of a crime and not being insolvent or bankrupt.

Third, the UK legislator enables the court to compel the director to do or refrain from ordering or freezing funds or assets, which is so-called the injunctive relief. While the Saudi Arabian legislature does not adopt this type of legal remedy.

Fourth, the UK legislator adopts a broader position in the directors' exemption from liability. The UK courts have discretion in granting relief from liability in the case where a claim is brought against a director for negligence, default, breach of duty or breach of trust. While this discretionary judicial pardon is not adopted by the Saudi Arabian legislator.

Fifth, the Saudi Arabian legislation differs from the UK legislation in the directors' exemption from their liabilities by ratifying their acts by the shareholders. in the Saudi Arabian legislation the directors' exemption is limited to liability arising from breach of some duties, amounting to undertaking any acts beyond the scope the purposes of the company or participate in any business that conflicts with the interest of the company; and it prevents to ratify the directors 'acts due to a breach of the provisions of the company's articles of association, or because of the directors' default or negligence, or because of mismanagement of the company's affairs. In the UK legislation allows the company members to ratify the director's acts, for the conduct of the director, amounting to negligence, default, breach of duty or breach of trust with respect to the company as long as the company is solvent.

These differences between Saudi and UK law, and the legal drafting problems and the legal gap in Saudi Arabian law, indicates a degree of weakness in the Saudi Arabian legislation. This weakness must be recognised in order to promote the future legal reform in Saudi Arabia. One of the reasons for this weakness may be entirely relying on the provisions of Islamic law, and the familiarity of Saudi Arabian people whit Islamic law provisions. However, the expansion of the commercial business in Saudi Arabia, the development of these forms of business and the entry of foreign investors, found that understanding the provisions of Islamic law is not an easy matter for everyone.

The codification of Islamic law provisions and the enactment of laws in detail has been the subject of controversy for **three** reasons. First, codifying Islamic law provisions restricts the judge's discretionary power and is a subject of a long dispute among Islamic law scholars. Second, there were concerns that enacting laws in detail might lead to the introduction of what is conflicts with Islamic law provisions. Third, enacting laws in detail may lead to the disruption of commercial life if the laws are not continuously updated. Given the directors' duties in the CA 2006, there is nothing to conflicts with Islamic law provisions, nor does it restrict the judge's discretion. It is worthy for the Saudi Arabian legislature to benefit from the UK experience in order to amend SACL 2015 in accordance with the recommendations and suggestions that I presented in this thesis.[42]

7.2.3 Problems in the legal drafting of the duties of the directors in Saudi Arabian law

Although the Saudi Arabian Companies Law was recently issued in 2015, there are many problems in the legal drafting of the duties of the director in the SACL 2015 that the Saudi Arabian legislator does not address at the enactment of the law. These formulation problems can be summed up as follows. First, the duties are scattered with some in the SACL 2015, some in Corporate Governance Regulations 2019 and some in Islamic law. Second, these duties are stated within in the SACL 2015, different contexts of companies forms, some stated in the companies section generally, which means include all companies forms, but some of the duties are stated only in the section of the limited liability companies and some of the duties are stated only in the context of the joint-stock companies, and the legislator does not state whether these duties for all companies forms or not. But initially, this gives the impression that such a duty that stated in a specific company form is limited to only the directors of this form of the company. However, after examining the rest of the articles and

[42] See (7.3 recommendations and suggestions, 7.3.2 On the Saudi Arabian side).

considering the penalties stated in articles 211 and 212 of the SACL 2015, it becomes clear that these duties are for all forms of companies. In detail, these legal drafting problems are.

First, the duty to act within powers to achieve the purposes of the company. This particular duty is stated in the SACL 2015 when dealing only with the provisions of the general partnerships and the joint-stock companies without the rest of the companies' forms, despite the fact that the legislator imposes in art 212 of the SACL 2015 a criminal penalty on all directors in all companies' forms when directors breach this duty.[43]

Second, the duty to maintain confidentiality. This duty is stated in the SACL 2015 when dealing only with the provisions of the joint-stock companies without the rest of the companies, even though the legislator imposes in art 212 a criminal penalty on all directors in all companies' forms when directors breach this duty.[44]

Third, the duty to avoid conflicts of interest. This duty is stated in the SACL 2015 when dealing only with the provisions of the joint-stock companies without the rest of the companies, even though the legislator imposes in art 211 a criminal penalty on all directors in all companies' forms when directors breach this duty. This duty is not expressly stipulated by the legislator, but rather implicitly and has been inferred from the concept of more than one article in the SACL 2015.[45]

Fourth, the duty to declare any personal interest. This duty is stated in the SACL 2015 when dealing only with the provisions of the joint-stock companies without the rest of the companies forms such as general partnerships and limited liability company, even though the legislator imposes in art 211 a criminal penalty on all directors in all forms of companies when directors breach this duty.[46]

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[43] See (4.2 Duty to act within powers to achieve the purposes of the company) and (5.3.5 Criminal sanctions).
[44] See (4.4 Duty to maintain confidentiality).
[45] See (4.5 Duty to avoid conflicts of interest and to declare any personal interest).
[46] Ibid.

Fifth, the duty not to participate in any business competitive with that of the company. This duty is stated in the SACL 2015 when dealing only with the provisions of the joint-stock companies without the rest of the companies forms, even though the legislator imposes in art 211 a criminal penalty on all directors in all forms of companies when directors breach this duty.[47]

Sixth, duty to act in the interests of the company. This duty is stated in the SACL 2015 when dealing only with the provisions of the general partnerships and the joint-stock companies without the rest of the companies, even though the legislator state in art 211 a criminal penalty on all directors in all forms of Saudi Arabian companies when directors breach this duty. This duty is not expressly stipulated by the legislator, but rather implicitly and has been inferred from the concept of more than one article in the SACL 2015.[48]

7.2.4 A legal gap in the directors' duties in SACL 2015

Besides problems in the legal drafting of the duties of the director in SACL 2015, there are also legal gaps in the scope of directors' duties in SACL 2015. These legal gaps lie in that the Saudi Arabian legislator does not state any definition of a director and does not address the shadow director issue, rather it does implicitly recognize the shadow directors and de facto directors. The Saudi Arabian legislator does not also state some of the duties in the SACL 2015 despite the imposition of penalties for breaching these duties and these duties are recognised by the Islamic law provisions and the corporate governance regulations 2019. The problematic in the Corporate Governance Regulations 2019 is that the scope of the application of the Corporate Governance Regulations is only to the listed joint stock company. In addition, some of the duties stated in the Corporate Governance Regulations 2019 are not mandatory to companies but rather a reference of being guiding, although the provisions of Islamic law impose these duties. These legal gaps are.

First, the duty to exercise reasonable care. This duty is not stated by the Saudi Arabian legislator in the SACL 2015 as a duty as such, but the legislator

[47] See (4.6 Duty not to participate in any business competitive with that of the company).
[48] See (4.8 Duty to act in the interests of the company and consider the interests of the stakeholders).

includes it in the form of penalties for negligence in article 213 on all directors in all forms of Saudi Arabian companies, and the Islamic law imposes the duty of care on directors. The Saudi legislator states duty to exercise reasonable care explicitly only in the Corporate Governance Regulations. Therefore, it can be said that this duty is inferred from the concept of article 213 of the SACL 2015, the Islamic law provision and the Corporate Governance Regulations 2019.[49]

Second, the duty not to accept benefits from third parties. This duty is not stated by the Saudi Arabian legislator in the SACL 2015, although the Islamic law provisions, which the Saudi Arabian judiciary is based upon it, prevents directors from accepting benefits from the third party and the Islamic law provisions address in detail the types of benefits and the ruling on accepting them. The Saudi Arabian legislator provides duty not to accept benefits from third parties explicitly only in the Corporate Governance Regulations.[50]

Third, the duty to take into account the interests of the stakeholders. This duty is not stated by the Saudi Arabian legislator in the SACL 2015, despite the Islamic law provisions, which the Saudi Arabian judiciary apply, and impose a duty to take into account the interests of the stakeholders. The Saudi Arabian legislator provides duty to take into account the interests of the stakeholders explicitly only in the Corporate Governance Regulations.[51]

Fourth, the duty to be a liquidator upon the dissolution of the company. This duty is stated by the Saudi Arabian legislator in the SACL 2015, but the lacuna is that the Saudi Arabian legislator does not clarify the mechanisms of the directors' conduct during the period close to the preceding the company dissolution and being a liquidator, just as the legislator does not indicate a mechanism that how the liquidator will hold herself/himself accountable when s/he was a director. Because it is unreasonable to expect that a suit will be brought against themselves. Basically, the liquidator’s function is to examine the directors’ work before dissolution of the company, and if the liquidator was

[49] See (4.3 Duty to exercise reasonable care).
[50] See (4.7 Duty not to accept benefits from third parties).
[51] See (4.8 Duty to act in the interests of the company and consider the interests of the stakeholders).

the director, then the purpose of the liquidator's function is negated. This may create a state of uncertainty, such as if the directors knew that there was no reasonable prospect that the company would avoid going into insolvent liquidation, so they are between two options, either acting in the interest of the company (shareholders) or acting in the interest of the creditors as considered they will be liquidators. Acting as a director means maintaining the company's assets; while acting as a liquidator means converting the company's assets into cash money. In the event that the directors knew that there was no reasonable prospect that the company would avoid going into dissolution or insolvent liquidation, and the price of the company's assets is high, will the director act as a liquidator and sell these assets at the best price, which will be in the interest of the shareholders and creditors after the liquidation, or the directors must wait for the company to be dissolution and be liquidated and then sell assets at the current price, which may decrease. Also, the legislator does not address the directors' interests when they act as liquidators in the event of insolvency and the impact of this on the creditors' interest when the directors themselves are shareholders or creditors.[52]

Fifth, the duty to take into account the interests of creditors in certain circumstances. Unfortunately, the Saudi Arabian legislator does not impose any duty on the directors to protect the company's creditors by taking into account the interests of creditors in certain circumstances. Rather, the legislator makes the entire focus of the directors' duties to act in the interest of shareholders. Despite this, the Saudi Arabian judiciary, based on the provisions of Islamic law, may hold the director the liability for the failure to protect the creditors. Failure to stipulate this duty in the corporate law may lead to a lack of trust between creditors and companies, especially in large long-term debt situations, or may lead to the need to provide extensive guarantees to creditors by companies. Even if Islamic law maintains the rights of creditors, it would be worthy of the Saudi legislature to state a cut-off point, through which the directors must take into account the interests of creditors, rather than the interests of shareholders,

[52] See (4.9 Duty to be a liquidator upon the dissolution of the company).

and impose personal liability on the directors in the event that this duty is breached.

Sixth, the duty to take into account the impact of the company's operations on the environment while retaining the shareholders' benefit as the ultimate objective of the company "shareholder wealth maximization is prioritized". It is necessary for the Saudi Arabian legislator to enact a duty to consider the impact of the company's operations on the environment in order to encourage the companies to take care of the environment through compliance with ecosystem and health measures and encourage companies to disclose policies on business ethics and the environment.

Seventh, determining the scope of the duty not to participate in any business competitive with that of the company requires clarification. As already mentioned, there are problems in the legal drafting of this duty; as well, there is a legal gap in this obligation. In this duty, the Saudi Arabian legislature does not determine the scope of time or place for competition. The Saudi SACL 2015 also does not stipulate that the period for non-competition be determined after the directors left their position in the company.

7.3 Recommendations and suggestions

This thesis sought to investigate and analyse the powers, duties and liabilities of the directors through a critical evaluation of the legal regulation of these matters in Saudi Arabia and UK legislation, and clarifying the similarities and differences between these legislations. This thesis also seeks to provide recommendations and suggestion to try, as much as possible, to reach the best legislation in the same context to be clear and sufficient for better practice in the companies' affairs management.

7.3.1 On the UK side

With regard to UK law. First, the duty to avoid conflicts of interest in s 175 of CA 2006, the legislator states, "*This duty is not infringed if the situation cannot reasonably be regarded as likely to give rise to a conflict of interest*". Lim[53]

[53] Lim, E; (n 67) chapter 5, 242-244.

suggests that the interpretation of the term "*reasonably be regarded as likely*" should be tested by three things: that the company has considered the opportunity on an informed basis, the opportunity was within the scope of the company's activity, and the opportunity was a mature business opportunity. Therefore, it is worth the UK legislator to consider adopting this or similar interpretation in the UK Company Law in order to be clear to the company's directors and legal advisors.

Second, with regard to wrongful trading that is stated in s 214 of Insolvency Act 1986, the legislator states, "*The court shall not make a declaration...with respect to any person if it is satisfied that after the condition...was first satisfied in relation to him that person took every step with a view to minimising the potential loss to the company's creditors*". Sealy[54] suggests that guidelines should be established on what directors should do in these cases. Because the words "*every step*" is ambiguous and, because it is likely to be strict, then any defence is almost impossible because no conduct can be accepted less than the best.

Third, in the duty not to accept benefits from third parties there is ambiguity in determining the minimum amount of declaration interest in the case of receiving a benefit from a third party. It is worthwhile for the UK legislature to give guidance to determine the minimum amount that must be disclosed, especially in matters where courtesy such as luxury hospitality by a third party.

7.3.2 On the Saudi Arabian side

With regard to the reform Saudi Arabian law, first, the Saudi Arabian legislator should bridge the aforementioned legal gap identified in para 7.2.4 above in the directors' duties in the SACL 2015.

Second, the Saudi Arabian legislator should solve the legal drafting problems in framing the directors' duties in the articles that are mentioned above in para 7.2.3 so as to be more explicit and clearer.

[54] Sealy (n 84) chapter 5, 492.

Third, it is worthy for the Saudi Arabian legislator to define who is a director of the company, and to recognize the idea of a shadow director and a *de facto* director. The provisions of Islamic law dealt with provisions close to a *de facto* director which the so-called (Mutatafil/Tufili)[55] "interloper".

Fourth, the Saudi Arabian legislator in the Companies Law should determine the scope of duty not to participate in any business competitive with that of the company by establishing a company or working in a company that is in the same business field as the previous company, which will lead, whether intentionally or not, to exploiting the information that has reached them because of their position. The legislator also should stipulate the period for direct non-competition for six months from the end of their employment, with a commitment to duty to maintain confidentiality and not exploit what has come to their knowledge because of their position.

Fifth, the Saudi Arabian legislator should impose a duty to take into account the interests of creditors in certain circumstances; it imposes personal liability on the directors in the event that this duty is breached. This is to protect creditors and to enhance confidence and trust between creditors and borrowing companies.

Sixth, the Saudi Arabian legislator should impose duty to take into account the impact of the company's operations on the environment while retaining the shareholders benefits as the ultimate objective of the company. This is to encourage the companies to take care of the environment through compliance with ecosystem and health measures and encourage companies to disclose policies on business ethics and the environment.

Seventh, the Saudi Arabian legislator should abolish the duty to be a liquidator upon the dissolution of the company that is stated in the SACL 2015. This duty may create a state of uncertainty in the mechanisms regulating the directors' conduct during the period close to the preceding the company dissolution and

[55] A person who becomes involved in a situation where they are not wanted or are considered not to belong such as sell what s/he not own.

being a liquidator. It is also unreasonable for a liquidator (director) to hold herself/himself accountable when s/he was a director.

Eighth, the Saudi Arabian legislator should place all directors' duties in the Companies Law in a chapter entitled General Duties of Directors, provided that the duties are for directors in all forms of companies, to be drafted as follows.

Duty to act within powers to achieve the purposes of the company

(1) A director shall enjoy full powers in the management of the company to achieve its purposes and represent the same before courts and arbitral tribunals and any third party unless the company's articles of association restrict her/his power in this respect.

(2) A director shall not undertake any of the following acts beyond the scope the company purposes, except with the consent of the shareholders or by virtue of an express provision in the company's articles of association.

(a) Donations, except for small and regular amounts.

(b) A company guarantee to a third party.

(c) Resorting to arbitration

(d) Reconciliation regarding the company's rights

(e) Selling or mortgaging the company's real property unless such sale falls within the scope of the company's purposes.

(f) Selling or mortgaging the company's place of business.

Duty to act in the interests of the company

(1) A director must act in a way that serves the interest of the company, develop it, and maximise its value, and in doing so have regard (amongst other matters) to,

(a) The company's long-term interest,

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

(c) Strengthening the company's business relationships with suppliers, customers and others,

(d) The social contribution of the company,

(e) The impact of the company's operations on the environment

(f) Enhancing the company's long-term reputation, and

(g) The need to act with integrity towards shareholders and protect their rights to ensure equality and fairness among them.

(2) In the event that the company has entered into insolvent liquidation or the director was aware of or ought to have concluded that there was no reasonable prospect that the company would avoid engaging in the insolvent liquidation before the company's winding up commencement, the director must act in the interests of creditors of the company.

Duty to exercise reasonable care

This means the care that would be exercised by a reasonably diligent person with—

(a) The general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and

(b) The general knowledge, skill and experience that the director has.

Duty to maintain confidentiality

(1) A director may not disclose the secret information related to the company for any purposes.

(2) The secrets mean all the company's information that directors have known it because of their positions.

(3) This duty is not infringed if-

(a) A director discloses the company secrets inside the general meetings to discuss these secrets during this meeting.

(b) The secrets are the information required by the laws to place it at the disposal of shareholders in order to inform them of the information about the company before a period of the general assembly meeting or that information permitted by the laws to be published.

Duty to avoid conflicts of interest

(1) A director must avoid a situation in which has or may have, a direct or indirect interest that conflicts, or may conflict, with the interests of the company or compete with the company.

(2) This applies to -

(a) The exploitation of information that has come to their knowledge by reason of their position to achieve an interest for themselves or their relatives or third parties.

(b) Conclude an agreement for their own benefit with the company.

(c) Participate in any business that would compete with the company or compete with the company in any of the branch activities that it carries out.

(3) This duty is not infringed-

(a) If the situation cannot reasonably be regarded as likely to give rise to a conflict of interest or compete with the company; or

(b) If the matter has prior permission from the ordinary general assembly, renewed annually.

Duty to declare any personal interest

(1) If a director of a company is in any way, directly or indirectly, interested in a transaction, contract or participate in any business that would compete with the company, or compete with the company in any of the branch activities that it carries out, s/he must declare the nature and extent of that interest to the other directors.

(2)The declaration may be made in any manner considered from the company.

(3) The declaration must be accurate and complete, and if not, a further declaration must be made.

(4) The permission may be given to conditions-

(a) A director must notify the board of directors any direct or indirect interest that he may have in the transactions or contracts concluded for the company.

(b) Such notification must be recorded in the minutes of the board meeting.

(c) The conflicted director shall abstain from voting on the related decision in the board meeting and general assemblies' meeting.

(d) The chairman of the board informing the ordinary general assembly, once convened, of the transactions and contracts in which any director has an interest and the competing businesses that the member of the board is engaged in.

(e) Such permission must be renewed annually.

Duty not to accept benefits from third parties

(1) A director of a company must not accept a benefit from a third party conferred by reason of his/her being a director"

(2) A "third party" means a person other than the company, an associated body corporate or a person acting on behalf of the company or an associated body corporate.

(3) This duty is not infringed if the acceptance of the benefit cannot reasonably be regarded as likely to give rise to a conflict of interest.

(4) A director may accept a benefit that may lead to a conflict of interest if the company authorises it after his/her disclosure.

Ninth, Although the two-tier board is often criticised for excessive formalities with regard to reporting to the supervisory board and the division between the managers and monitors, which may lead to a lack of information necessary to improve the performance of the company. It also increases the company's financial and time costs for the meetings between the supervisory and management boards. The two-tier board may be the ultimate solution in Saudi Arabia to the problem of directors or board of directors not complying with their duties and Corporate Governance. This is because the two-tier board is a useful mechanism in delegating the business to qualified directors. It also achieves greater transparency because of the balance of power between management and monitoring and enhanced response to stakeholders.[56] This thesis argues that reforming the substantive law is much better through reforming the

[56] See (2.2.1 Board structure).

directors' duties and clarifying the liabilities that may be deterring to those who may think to breach the duties. The Ministry of Commerce should also tighten monitoring over the companies' management and ensure they comply with the provisions of the law and corporate governance. Theoretically, introducing a two-tier board structure is radical and may be a long-term solution.

Tenth, the Saudi Arabian legislator should enact a law that is similar to the UK Company Directors Disqualification Act 1986 to protect companies and the Saudi Arabian market, provided that its provisions do not contradict the provisions of Islamic law and human rights principles. The UK Company Directors Disqualification Act 1986 can be used by Saudi Arabian legislator as legal transplantation, with some modifications needed. In the proposed Saudi Arabian law, the reason for disqualification a director should be as in the UK Act on the basis of misconduct and unfitness. Misconduct can be expanded to include a person's conviction of any criminal offence during the past 5-7 years, being insolvent or bankrupt, contravention of the provisions of the financial markets and commercial business rules, non-compliance with the provisions of the laws, regulations and continuing default and negligence and the like. As for disqualification due to unfitness, the person's conduct is unfit for the concern of the company's management or the person's physical or mental health is unfit for the company's concern or for the public interest. The directors' disqualification also in the proposed law could be effected in two ways, either by the court or through the Minister of Commerce so-called administrative equivalent, which is voluntary without the need for judicial proceedings, with some privileges given to the Minister of Commerce, such as reducing the disqualification period. It is also possible to cooperate between countries, Saudi Arabian and the UK and others in exchanging information about people disqualified from being a company director in order to protect the markets.

7.4 Research contribution

Returning to the research question which is "*To what extent does the regulation of directors' powers, duties and liabilities work effectively?*",, this thesis answered it by discussing the definition of the company director and the shadow director and other basic legal principles with respect to the directors in chapter

2. Next, the study investigated and analysed the directors' powers and duties through a critical evaluation of the legal regulation of these matters in chapter 3 and 4. Then, the study investigated and analysed the directors' liabilities through a critical evaluation in chapter 5 and 6. This thesis also has been able to highlight the legal problems with respect to the duties of directors in Saudi Arabian law. This study highlighted and discussed the issues in legal drafting in para 7.2.3 and legal gaps with respect to the directors' duties and liabilities in para 7.2.4 and provided some recommendations and suggestion in para 7.3 that the study hopes to make legislation regarding the directors' duties and liabilities more efficient and effective. In short, for the regulation to be "effective" means achieving the purpose of the codification of the duties of directors, which is enhancing the clarity of the law and to make it easier for the responsibilities of directors towards the company and others to be identified without the need for a legal consultant to interpret these duties. Given the issues in legal drafting in identified in para 7.2.3 and legal gaps with respect to the directors' duties and liabilities noted in para 7.2.4 above, it can be said that the SACL 2015 does not work as effectively as expected with respect to the directors' powers, duties and liabilities. The change that has been introduced and related to the directors' powers, duties and liabilities is that increase of the civil and criminal procedures as fines and imprisonment against directors. The SACL 2015 was supposed to introduce the directors' duties more clearly than it is now and codifies what is stated in the Islamic law provisions, but the SACL 2015 did not make any changes regarding this type of claims. Therefore, it can be said that the codification of duties in SACL 2015 is incomplete. The study hopes to make the new legislation regarding the directors' duties and liabilities more efficient and effective by the provided recommendations and suggestion.

The researcher believes that this study makes a significant contribution to knowledge. This contribution can be highlighted by the following. First, during this study, this thesis found that SACL 2015 suffers from a lack of studies that dealt with the duties and responsibilities of company directors in a critical analytical manner. Also, as far as is known, there are no studies that deal with **all** of the directors' duties, the consequences of the breach of duties and the provisions of exemption from liabilities under Saudi Arabian legislation as is done in this study.

Second, this thesis provided a comparative critical analytical study of the powers and liabilities of the company's directors in the legislation in Saudi Arabia and the United Kingdom and clarifies the similarities and differences between these legislation.

Third, this study can be considered one of the first studies that include the entire spectrum of directors’ duties in Saudi Arabia under the SACL 2015, Corporate Governance Regulations 2019 and Islamic law provision, where this study gathered all the duties that many researchers overlooked. This is perhaps due to the lack of clarity and scatters the duties.

Fourth, this thesis can also be considered the first study[57] that combines the analysis of the powers, duties and liabilities of the company's directors in Saudi Arabian law and compares them with the UK law.

Fifth, the thesis endeavours to broaden the understanding of the subject of the study to company directors, judges, academics, legal advisers and lawyers.

Sixth, through evaluation and taking advantage of the legislation in the UK, this thesis has been able to highlight the legal problems with respect to the duties of directors in Saudi Arabian law. This study highlighted and discussed the issues in legal drafting and legal gaps with respect to the directors’ duties and liabilities and provided some recommendations and suggestion that the study hopes to make legislation regarding the directors’ duties and liabilities more efficient and effective.

[57] According to the database in British library <https://ethos.bl.uk> and Saudi digital library <https://sdl.edu.sa> [20 July 2020].

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