➢ Questions

1. The members can use CA 2006 s 168 to dismiss a director 'without cause' (ie even if the director is performing perfectly properly and effectively). Why should the members have this right? Are there any disadvantages?

2. In *Russell v Northern Development Corporation Ltd* **[4.34]**, the *company* could not bind itself by contract in a way that made it impossible for the company to alter its capital as permitted by the Act. Presumably a *company* could not bind itself in a way that made exercise of the rights in CA 2006 s 168 impossible. And yet in both these instances the company's rights can only be exercised by the members in general meeting. Given this, do shareholders' agreements and weighted voting rights make a mockery of the Act, or is the appropriate analysis a little more subtle?

Dismissal by the board

Articles often provide that the office of director is to be vacated if all the other members of the board make a written request for the director's resignation, although the Model Articles (both private and public) make no such provision.

Like all powers held by directors, exercise of this power is subject to the directors' duties to act for proper purposes, in good faith to promote the success of the company, and in a way that does not involve unacceptable conflicts of interest (see Chapter 5). But, subject to that limitation, the courts appear loath to allow this power to be further limited unless by explicit agreement: *Dear v Jackson* [2013] EWCA Civ 89.

➢ Question

An early suggestion (since dropped) for Model Articles for Private Companies gave power to the directors to terminate the appointment of one of their number only 'with cause'. Why should the dismissal power of the board of directors be more limited than that of members in general meeting?

(p. 288) Directors acting after their office is vacated

If directors continue to act after their office is vacated, for whatever reason, their acts will generally continue to bind the company: see CA 2006 s 161(1)(c) and s 161 generally. Also see 'Agency and authority in corporate contracting', pp 95ff, on a company's dealings with third parties.

Rights of directors on termination of appointment

Compensation claims for loss of office

Recall that directors have no entitlement to remuneration and generally no claim to any kind of tenure unless specifically provided for by contract. Even then, they cannot specifically enforce their rights to remain in office; they can only claim damages for breach.[12]

If there is a contract between the director and the company, then dismissal from office under CA 2006 s 168 may be a breach of that contract by the company. This will be the case if the contract is for a fixed period which has not expired, or if the director is entitled to a period of notice. Alternatively (or in addition), dismissal of a person from the office of director may breach a second contract between the director and the company if the director can

perform the second contract only by being a director. For example, a contract between the managing director and his company may depend upon the person continuing to be a director of the company.

The company will then be liable in damages,[13] and the damages payments may be large. This is why provision is made to ensure that members can discover the terms of their directors' contracts of service (CA 2006 ss 228–229), and why long-term contracts are subject to approval by the members (s 188).[14] The following case extracts all concern arguments that termination of a directorship was *not* a breach of contract between the company and the director.

A contract that incorporates the provisions of a company's articles is subject to the articles being altered in the usual way, although an alteration cannot have retrospective effect.

[6.03] Swabey v Port Darwin Gold Mining Co (1889) 1 Meg 385 (Court of Appeal)

The articles provided that the directors were to be remunerated at the rate of £200 per annum. In July 1888 the company passed a special resolution altering the articles so that directors were thereafter to receive £5 per month. Swabey, a director, thereupon resigned office and claimed three months' accrued fees at the old rate. Stephen J rejected his claim, but he was successful in the Court of Appeal. **(p. 289)**

> LORD ESHER MR: The articles do not themselves form a contract, but from them you get the terms upon which the directors are serving. It would be absurd to hold that one of the parties to a contract could alter it as to service already performed under it. The company has power to alter the articles, but the directors would be entitled to their salary at the rate originally stated in the articles up to the time the articles were altered.
>
> LORD HALSBURY LC delivered a concurring judgment.
>
> LINDLEY LJ concurred.

It may be a breach of contract for a company to alter its articles or to act, personally or vicariously, upon a power created by altering its articles.

[6.04] Southern Foundries (1926) Ltd v Shirlaw [1940] AC 701 (House of Lords)

In 1933, the respondent was by a written agreement appointed managing director of the appellant company ('Southern') for ten years. In 1936, after Southern had been taken over by Federated Foundries Ltd ('Federated'), Southern altered its articles so as to include, inter alia, a new art 8 which empowered Federated by a written instrument to remove any director of Southern. In 1937 Federated exercised this power and removed the respondent from his directorship. He sued Southern for breach of contract and Federated for wrongly procuring the breach of contract. He was awarded £12,000 damages against both defendants (a substantial sum at the time, hence the appeals), and the award was upheld by the Court of Appeal (Sir Wilfrid Greene MR dissenting), and by the House of Lords (Viscount Maugham and Lord Romer dissenting).

> LORD ATKIN: My Lords, the question in this case is whether the appellant company have broken their contract with the respondent made in December 1933 that he should hold the office of managing director for ten years. The breach alleged is that under the articles adopted by the company, after the agreement, the respondent was removed from the position of director of the company by the Federated Foundries Ltd. There can be no doubt that the office of managing director could only be held by a director, and that upon the holder of the office of managing director ceasing for any cause to be a director the office would be ipso facto vacated. Under the articles in existence at the date of the agreement, by article 89 the office of a director could be vacated on the happening of six various events, bankruptcy, lunacy, etc, including the giving by the director of one month's notice to resign; while by article 105 the company by extraordinary resolution could remove him from his office. I feel no doubt that the true construction of the agreement is that the company agreed to employ the respondent and the respondent agreed to serve the company as

managing director for the period of ten years. It was by the constitution of the company a condition of holding such office that the holder should continue to be a director: and such continuance depended upon the terms of the articles regulating the office of director. It was not disputed, and I take it to be clear law, that the company's articles so regulating the office of director could be altered from time to time: and therefore the continuance in office of the managing director under the agreement depended upon the provisions of the articles from time to time. Thus the contract of employment for the term of ten years was dependent upon the managing director continuing to be a director. This continuance of the directorship was a concurrent condition. The arrangement between the parties appears to me to be exactly described by the words of Cockburn CJ in *Stirling v Maitland*:[15] 'If a party enters into an arrangement which can only take effect by the continuance of an existing state of circumstances'; and in such a state of things the Lord Chief Justice said: 'I look on the law to be that … there is an implied engagement on his part that he shall do nothing of his own motion to put an end to that **(p. 290)** state of circumstances under which alone the arrangement can be operative.' That proposition in my opinion is well-established law. Personally I should not so much base the law on an implied term, as on a positive rule of the law of contract that conduct of either promiser or promisee which can be said to amount to himself 'of his own motion' bringing about the impossibility of performance is in itself a breach. If A promises to marry B and before performance of that contract marries C, A is not sued for breach of an implied contract not to marry anyone else, but for breach of his contract to marry B. I think it follows that if either the company of its own motion removed the respondent from the office of director under article 105, or if the respondent caused his office of director to be vacated by giving one month's notice of resignation under article 89, either of them would have committed a breach of the agreement in question …

The question that remains is whether if the removal by the company would have been a breach by the company, the removal under the altered articles by the Federated Foundries Ltd was a breach by the company. In this matter the Master of the Rolls agreed with the other members of the Court of Appeal; but all the members of this House are not agreed. My Lords, it is obvious that the question is not as simple as in the case just considered of the removal being by the Southern Foundries Ltd; but I venture respectfully to think that the result must be the same. The office of director involves contractual arrangements between the director and the company. If the company removes the director it puts an end to the contract: and indeed the contract relations cannot be determined unless by events stipulated for in the contract, by operation of law, or by the will of the two parties. The altered article 8 which gives power to the Federated Foundries Ltd to remove from office any director of the company is, when analysed, a power to the Federated to terminate a contract between the Southern and its director. It is an act which binds the Southern as against its promisee; and if a wrong to the respondent if done by the Southern it surely must be a wrong to the respondent if done by the Federated who derive their power to do the act from the Southern only. If a landlord gives power to a tenant to discharge the landlord's servants, gardener or gamekeeper, it is the master, the landlord, who is bound by the consequences of that discharge whether rightful, or whether wrongful, and so involving the payment of damages … The action of the Federated was, I think I may say avowedly, taken for the sole purpose of bringing the managing director's agreement to an end. I do not think that it could be said that the Southern committed any breach by adopting the new articles. But when the Federated acted upon the power conferred upon them in the new articles they bound the Southern if they acted in such a way that action by the Southern on the same articles would be a breach. It is not a question of agency but of acting under powers conferred by contract to interfere with a contract between the party granting the power and a third person …

LORD PORTER: The general principle therefore may, I think, be thus stated. A company cannot be precluded from altering its articles thereby giving itself power to act upon the provisions of the altered articles—but so to act may nevertheless be a breach of the contract if it is contrary to a stipulation in a contract validly made before the alteration.

Nor can an injunction be granted to prevent the adoption of the new articles and in that sense they are binding on all and sundry, but for the company to act upon them will none the less render it liable in damages if such action is contrary to the previous engagements of the company. If, therefore, the altered articles had provided for the dismissal without notice of a managing director previously appointed, the dismissal would be intra vires the company but would nevertheless expose the company to an action for

damages if the appointment had been for a term of (say) ten years and he were dismissed in less …

LORD WRIGHT delivered a concurring opinion.

VISCOUNT MAUGHAM and LORD ROMER dissented.

➢ Notes

1. A *managing director* is often both the chief executive officer (CEO) of a company and a director who works full time for the company for a salary. The functions of a managing **(p. 291)** director are not fixed by law, but depend upon the particular terms of the appointment: *Harold Holdsworth & Co (Wakefield) Ltd v Caddies* [1955] 1 WLR 352, HL. As noted earlier, under the articles of most companies, a managing director will automatically lose office on ceasing for any reason to be a director: see, eg, Table A, art 84. In larger companies, there may be more than one managing, or executive, director, but there will only be one CEO. See *Smith v Butler* **[3.14]**, where the powers and authority of managing directors are discussed.

2. The *Shirlaw* case was followed by Diplock J in *Shindler v Northern Raincoat Co Ltd* [1960] 1 WLR 1038, where the managing director had a written service agreement appointing him for ten years. By contrast, in the case next cited, the appointment was an informal one, and the only source from which the terms of the contract could be determined was the articles themselves. There was therefore no breach of contract when the company exercised a power of removal which was expressly contained in the articles.

Reasonable notice rules.

[6.05] Read v Astoria Garage (Streatham) Ltd [1952] Ch 637 (Court of Appeal)

The defendant company's articles included art 68 of Table A of the 1929 Act, which provided that the directors might appoint a managing director for such term and at such remuneration as they might think fit: '… but his appointment shall be subject to determination *ipso facto* if he ceases from any cause to be a director, or if the company in general meeting resolve that his tenure of the office of managing director … be determined'. Read was appointed managing director at a salary of £7 per week by a resolution of the board. Seventeen years later the board, with the approval of the company in general meeting, gave him notice terminating his employment. It was held that he had no claim for wrongful dismissal.

JENKINS LJ: There is no record anywhere of any terms on which the plaintiff was appointed managing director beyond the minute of resolution no 4 which was passed at the first meeting of the directors by which the plaintiff was appointed managing director at a salary of £7 a week from 1 February 1932, and the articles of association of the company. The company's articles adopted Table A, with certain modifications. Amongst the articles of Table A adopted was article no 68. [His Lordship read the article.]

It is argued by Mr Harold Brown for the plaintiff that, notwithstanding the provisions of article 68, there was a contract between the plaintiff and the defendant company in the nature of a contract of general hiring—a plain contract of employment, one of the terms of which was the plaintiff's employment should not be determined by the defendant company except by reasonable notice. The judge came to the conclusion that the terms of the plaintiff's appointment were not such as to entitle him to any notice in the event of the company choosing under article 68 to resolve in general meeting that his tenure of office as managing director be determined, and, in my judgment, the judge was clearly right …

The directors purported by a resolution of the board to appoint him managing director. In my view, it is really clear beyond argument that the directors must be taken to have been making that appointment with reference to the provisions of article 68 of Table A—it was only under that article that they could make the appointment. Accordingly, in my view, the resolution, containing as it did no other special terms beyond the

fixing of the remuneration of £7 a week, and containing nothing whatever amplifying, or inconsistent with, the provisions of article 68, must be taken to have been an appointment of the plaintiff as managing director on the terms of article 68, and accordingly it was an appointment upon terms, inter alia, that it should be subject to termination if the company in general meeting resolved that the plaintiff's tenure of the office of managing director be determined …

(p. 292) We were referred to various authorities on this topic which, in one form or another, has been fairly often before the courts. The first was the well-known case of *Nelson v James Nelson & Sons Ltd*[16] …

It is to be observed that this was a case in which there was an actual agreement with the plaintiff that he should be managing director for a period which was inconsistent with the unfettered exercise by the directors of their power under the articles to revoke the appointment of a managing director; and it seems to me that this is a vital distinction from the present case, in which there is no vestige of any contract beyond the minute of the resolution making the appointment and the article by reference to which, in my view, the appointment was made …

In my view, on the facts of this case, the position was simply that the plaintiff was appointed to be managing director in accordance with article 68 of the 1929 Table A with such tenure of office as was provided for by that article, and had no special right to receive any particular notice of the termination of his employment in the event of the company deciding to determine it and doing so by a resolution in general meeting. Accordingly, in my view, the learned judge came to a right conclusion on the plaintiff's second claim; and in the result the appeal fails on both points, and should be dismissed.

MORRIS LJ concurred.

➢ Notes

1. In *Nelson v James & Sons Ltd* [1914] 2 KB 770, CA, Nelson had been appointed managing director of the company by a written agreement 'for so long as he shall remain a director of the company and retain his qualification and shall efficiently perform the duties of the said office'. The board revoked his appointment. It did not allege any breach of the terms of the agreement but purported to rely upon a provision in the articles authorising them to do so. The company argued that in any agreement entered into by the directors for the appointment of a managing director, a term must be implied giving them the right to revoke such appointment. It was held, however, that no term could be incorporated by implication from the articles into this contract so as to override its express terms, and that Nelson's dismissal was unjustified. He was awarded £15,000 damages.

2. In *Read v Astoria Garage*, the director might have sought to rely on an implied term or an estoppel that required the company to give him reasonable notice of termination, but recall the failure of such arguments in *Baird Textile Holdings Ltd v Marks & Spencer plc* [2001] EWCA Civ 274, after M&S terminated a long-standing arrangement with Baird for the supply of goods.

Complaint that alteration of the articles is invalid as an objectionable exercise of power by the members.

[6.06] Shuttleworth v Cox Bros & Co (Maidenhead) Ltd [1927] 2 KB 9 (Court of Appeal)

The plaintiff had been removed from the position of 'permanent' director, to which he had been appointed by the articles, in the circumstances described by Atkin LJ in his judgment. This followed the discovery of irregularities in the accounts between him and the company. He claimed his dismissal was wrongful. The Court of Appeal, affirming Avory J, upheld the validity of the company's action.

ATKIN LJ: The plaintiff was a director of the defendant company from May 1921, when the company was

incorporated, until 1926. Up to 1924 he was a director on the terms of article 18, which provided **(p. 293)** that he and others should be the first directors of the company, that they should be permanent directors, and that each of them should be entitled to hold office so long as he should live, unless he should become disqualified from any of the causes specified in article 22. At that time article 22 provided that the office of director should be vacated in any of the events specified in the six clauses of the article. In 1924 the company passed an altered article by a special resolution … adding to the six clauses of article 22 a seventh clause: 'If he shall be requested in writing by all the other directors to resign his office.' Some ten or eleven months after article 22 was altered he was requested in writing to resign his office. He claims in this action that the clause added to the article is invalid, and that he still remains a director …

[The] contract that they shall be permanent directors at a salary is contained in the articles only … In these circumstances the proper inference appears to be that there was a contract that the plaintiff should be a permanent director, but a contract … which could be altered by a special resolution of the company in accordance with the provisions of the Companies Act; and inasmuch as the contract contemplated the permanent office being vacated in one of six contingencies, it is not inconsistent with the contract that the article should be altered so as to add a seventh contingency. In other words, it is a contract made upon the terms of an alterable article, and therefore neither of the contracting parties can complain if the article is altered. Consequently I cannot find that there has been any breach of contract in making the alteration.

The only other question is whether the article is upon general principles objectionable as being not honestly made within the powers of the company. Here the limits to the power of the company to alter its articles have to be considered. Certain limits there are, and they have been laid down in several cases, notably by Lindley MR in *Allen v Gold Reefs of West Africa Ltd* **[4.22]**… There in a reasoned and lucid judgment the Master of the Rolls uses the phrase 'bona fide for the benefit of the company'. But neither this court nor any court should consider itself fettered by the form of words, as if it were a phrase in an Act of Parliament which must be accepted and construed as it stands. We must study what its real meaning is by the light of the principles which were being laid down by the Master of the Rolls when he used the phrase … The only question is whether or not the shareholders, in considering whether they shall alter articles, honestly intend to exercise their powers for the benefit of the company. If they do then, subject to one or two reservations which have been explained, the alteration must stand. It is not a matter of law for the court whether or not a particular alteration is for the benefit of the company; nor is it the business of a judge to review the decision of every company in the country on these questions. And even if the question were not for the shareholders themselves, but for some other body, it must be a question of fact. In this case there is a finding of fact by the jury that the alteration was for the benefit of the company; but I do not decide the case on that ground. In my view the question is solely for the shareholders acting in good faith. The circumstances may be such as to lead to one conclusion only, that the majority of the shareholders are acting so oppressively that they cannot be acting in good faith; or, to put it in another way, it may be that their decision must be one which could [not] be taken by persons acting in good faith with a view to the benefit of the company. But these are matters outside and apart from the question, does this or that tribunal consider, in the light of events which have happened, that the alteration was or was not for the benefit of the company? With great respect to a very learned judge I cannot agree with the judgment of Peterson J to the contrary on this point.[17] In my view the passage which has been cited from the judgment of Lord Sterndale MR in *Sidebottom*'s case **[4.23]** makes it clear that in his view the ultimate decision is to be the decision of the majority of the shareholders …

BANKES and SCRUTTON LJJ delivered concurring judgments.

(p. 294) ➢ Question

In what circumstances might it be possible for directors to advance this sort of argument successfully? (See 'Removal of directors', pp 284ff.)

Other payments for loss of office

Any *voluntary or non-contractual* termination payment must be approved by the members (CA 2006 ss 215–222). CA 2006 s 222 specifies the remedies for breach of this requirement subject to limited exceptions. The remedies are: any such payment to the director is held on trust for the company; and any director who authorised such payment is jointly and severally liable to indemnify the company for any loss resulting from the payment. For the avoidance of doubt, these rules do not apply to any bona fide payment by way of damages for breach of contract, or by way of pension in respect of past services, or any payment required to be made by virtue of the terms of the director's contract.

Directors' disqualification

Acting to protect the public interest, the Secretary of State for Business, Innovation and Skills may apply to the courts to have certain individuals disqualified from acting as directors (*Re Sevenoaks Stationers (Retail) Ltd* **[6.08]**).[18] A related but subsidiary goal is to raise the standards of honesty and diligence in corporate management (*Re Barings plc* [1998] BCC 583 at 590; *Re Blackspur Group plc* [1998] 1 WLR 422 at 426, CA).

The courts have wide statutory powers to order that directors of companies that have gone into insolvent liquidation, or people who have committed serious or persistent breaches of company law, shall be banned from being directors of a company or being concerned (directly or indirectly) in their management, except with the leave of the court. The legislation on disqualification orders is consolidated in CDDA 1986.[19] Under this Act, the court may make an order against a person who has:

(i) been convicted of an indictable offence in connection with the formation or management of a company (s 2);
(ii) been persistently in breach of his or her obligations under the Companies Act, for example to file returns (ss 3, 5);
(iii) been guilty of fraud or fraudulent trading revealed in a winding up (s 4);
(iv) been a director of a company that has become insolvent and who is found 'unfit' to be concerned in the management of a company (s 6), or similarly been found 'unfit' after a statutory investigation into the affairs of a company (s 8);
(v) been guilty of fraudulent or wrongful trading as defined in IA 1986 ss 213–214 (s 10);
(vi) been a director of a company that has breached competition law and who is found 'unfit' to be concerned in the management of a company (s 9A).

Of these provisions, CDDA 1986 ss 6 and 8 are of particular interest because of the statutory concept of 'unfitness', which is elaborated in CDDA 1986, Sch 1. These provisions amplify the directors' traditional common law duties of care and skill; indeed, this is a 'growth area' in **(p. 295)** which new standards of conduct are being set and a greater awareness of the responsibilities of directors is being fostered.[20]

The Insolvency Service is charged with the task of enforcing this branch of the law. Whenever a company goes into receivership, administration or insolvent liquidation, a report on the conduct of every director has to be made to the Secretary of State for Business, Innovation and Skills by the insolvency practitioner concerned (see 'Investigating and reporting the affairs of the company', pp 822ff). Disqualifications are currently being made at the rate of about 1,500 per annum. A *disqualification order* may ban the person from being a director or being concerned in the management of a company for up to 15 years in the more serious cases (eg fraudulent trading) and up to five years in other cases (eg persistent failure to file returns with the registrar). The registrar maintains a register of the names of those against whom disqualification orders have been made (CDDA 1986 s 18).

When the Act was introduced, it made no provision for directors to admit that their conduct justified a finding of 'unfitness' and, in effect, plead guilty to the charge brought against them. As a result, every case carried the burden and expense of a contested trial, and the resulting workloads inevitably led to delays.[21] Now disqualification can be imposed without any court hearing at all. CDDA 1986 was amended in 2000 to allow the Secretary of State to accept *disqualification undertakings* from directors that for specified periods they will not do any of the things normally prohibited by a disqualification order. Such undertakings have consequences identical in

all material respects to disqualification orders (see CDDA 1986 ss 1A, 7(2A) and 8(2A)). In the past few years almost all disqualifications are a result of undertakings rather than court orders, and reporting of new cases is now rare.

Note that, despite a disqualification order or undertaking, the court has a discretion to allow the director to act as a director in specific circumstances that make his or her input essential (CDDA 1986 ss 1(1) and 1A(1)): see *Secretary of State for Trade and Industry v Swan (No 2)* **[6.11]**.

An enormous number of disqualification cases used to be heard and reported in this area. Those cited in the following extracts provide an illustration. Two are particularly significant. In the early decision of *Re Sevenoaks Stationers (Retail) Ltd* **[6.08]**, the Court of Appeal laid down guidelines for the exercise of this jurisdiction. And *Re Barings plc (No 5)* **[6.12]** probably remains the best example of the significant role that disqualification cases played in the development of the law on directors' duties of care, skill and diligence.

Human rights issues have arisen. In *Saunders v UK* (see 'Inspections and subsequent fair trials—criminal and civil cases', p 737), the European Court of Human Rights decided it was an infringement of human rights for statements obtained under compulsion (in company investigations) to be used as evidence in criminal prosecutions of the individual in question. Such usage is no longer allowed. Nevertheless, these statements are regularly relied on in disqualification proceedings, and both the European Court of Human Rights and UK courts have ruled that, since the nature of these proceedings is essentially civil and regulatory, not criminal, no violation of human rights is involved: see *DC, HS and AD v UK* [2000] BCLC 710 and *Re Westminster Property Management Ltd* [2000] 2 BCLC 396, CA.

Finally, the court has warned against case preparation practices by the Secretary of State which risk unfairness and oppression of both witnesses and defendant directors: see statement **(p. 296)** of Peter Smith J following the discontinuance of proceedings in *Secretary of State v Fowler* (formerly known as *Home Retail v Farepak*), 21 June 2012.[22]

CDDA 1986 ss 6 and 8 compared.

[6.07] Re JA Chapman and Co Ltd [2003] EWHC 532, [2003] 2 BCLC 206 (Chancery Division)

> PETER SMITH J: The application is made under section 8 CDDA 86 following a report from inspectors following an investigation under section 447 of the Companies Act 1985 [this is still in force]. In the case of an application under section 8 CDDA 86 the Court has a discretionary power of disqualification against a person where it is satisfied that his conduct in relation to the company makes him unfit to be concerned in the management of a company.
>
> This contrasts with the applications that are normally made under section 6 CDDA 86, where the Court is under an obligation to make a disqualification order against a person where such unfitness is satisfied.
>
> There are a number of differences between the two sections. First, as I have said under the power of disqualification under section 8 the Court retains a discretionary power not to disqualify even if the Defendant's conduct is unfit. That must be read in the light of the observations of Lloyd J in *re Atlantic Computers plc* [Ch, 15 June 1998] where he observed that it would be unusual for the Court to use its discretion in this way. Second, under section 8 there is no minimum period of disqualification whereas under section 6 there is a minimum of 2 years. Third there is no limitation period for proceedings under section 8. Fourth, there is no requirement for the company to become insolvent for an application under section 8. Fifth, the application under section 8 must be made by the Secretary of State. The Official Receiver cannot apply and finally, the County Court has no jurisdiction under section 8.
>
> Nevertheless, there are a number of similarities. I have already observed the test is the same as to unfitness. Second, it is established that the disqualification periods (if any) set out under section 6 in *re Sevenoaks Stationers (Retail) Ltd* **[6.08]** are to be applied to the period of disqualification under section 8 see *re Samuel Sherman plc* [1991] 1 WLR 1070.

➢ Note

Although there is a two-year period for proceedings to be brought without leave under s 6 (CDDA 1986 s 7(2)), this is not strictly a limitation period: *Instant Access Properties Ltd* [2011] EWHC 3022 (Ch). There, Floyd J held that 'after the period has expired a defendant director does not acquire an immunity from suit. All that occurs is that the Secretary of State needs to surmount an additional hurdle' [8]. The court therefore embarked on a balancing exercise, eventually concluding that the public interest in bringing the case outside the two-year period (in view of the gravity of the allegations and their prospect of success) outweighed the purported prejudice caused by the delay.

Guidelines for exercise of the jurisdiction.

[6.08] Re Sevenoaks Stationers (Retail) Ltd [1991] Ch 164 (Court of Appeal)

Cruddas, a chartered accountant, was a director of five companies which had become insolvent with a total net deficiency of £600,000. The defaults proved against him in respect of **(p. 297)** one or more of the companies included: failing to keep proper accounting records; failing to ensure that annual returns were filed and that annual accounts were prepared and audited; causing the companies to incur debts when he ought to have known that they were in severe financial difficulties; causing them to trade while insolvent; and failing to pay Crown debts in respect of PAYE and NIC contributions and VAT. The Court of Appeal upheld the judge's finding that he was 'unfit to be concerned in the management of a company' (CDDA 1986 s 6). A disqualification order for five years was imposed.

> DILLON LJ: … [This] appeal has an importance beyond its own facts, since it is the first appeal against a disqualification order which has come to this court …
>
> I would for my part endorse the division of the potential 15 year disqualification period into three brackets, which was put forward by Mr Keenan for the official receiver to Harman J in the present case and has been put forward by Mr Charles for the official receiver in other cases, viz: (i) the top bracket of disqualification for periods over 10 years should be reserved for particularly serious cases. These may include cases where a director who has already had one period of disqualification imposed on him falls to be disqualified yet again. (ii) The minimum bracket of two to five years' disqualification should be applied where, though disqualification is mandatory, the case is, relatively, not very serious. (iii) The middle bracket of disqualification for from six to 10 years should apply for serious cases which do not merit the top bracket.
>
> I will come back to the appropriate bracket and period of disqualification when I have considered the facts and other issues.
>
> [His Lordship discussed the facts, and continued:]
>
> It is beyond dispute that the purpose of s 6 is to protect the public, and in particular potential creditors of companies, from losing money through companies becoming insolvent when the directors of those companies are people unfit to be concerned in the management of a company. The test laid down in s 6—apart from the requirement that the person concerned is or has been a director of a company which has become insolvent—is whether the person's conduct as a director of the company or companies in question 'makes him unfit to be concerned in the management of a company'. These are ordinary words of the English language and they should be simple to apply in most cases. It is important to hold to those words in each case.
>
> The judges of the Chancery Division have, understandably, attempted in certain cases to give guidance to what does or does not make a person unfit to be concerned in the management of a company. Thus in *Re Lo-Line Electric Motors Ltd*,[23] Sir Nicolas Browne-Wilkinson V-C said:

> Ordinary commercial misjudgment is in itself not sufficient to justify disqualification. In the normal case, the conduct complained of must display a lack of commercial probity, although I have no doubt in an extreme case of gross negligence or total incompetence disqualification could be appropriate.

Then he said that the director in question

> has been shown to have behaved in a commercially culpable manner in trading through limited companies when he knew them to be insolvent and in using the unpaid Crown debts to finance such trading.

Such statements may be helpful in identifying particular circumstances in which a person would clearly be unfit.

This is not a case in which it was alleged that Mr Cruddas had, in the colloquial phrase, 'ripped off' the public and pocketed the proceeds. On the contrary, and as the judge found, he had lost a lot of his own money … There was evidence that Mr Cruddas had remortgaged his home to raise **(p. 298)** money to pay creditors of the companies, and he claimed to have lost from £200,000 to £250,000 of his own money.

> I turn next to the question of Crown debts. As to this the judge said:[24]
>
> In the circumstances I am faced with admitted deficiencies of a most serious character, including in particular Crown debts in total of an order of £120,000 which were left outstanding … It is, in my judgment, a badge of commercial immorality to cause moneys which have been taken under force of law from third parties (PAYE deductions, after all, are taken under compulsion of law from wages which are owed to employees; VAT is taken under compulsion of law from members of the public who purchase goods as an addition to the price of the goods) to be not paid over to the Crown.

There have been differing views expressed by Chancery judges about the significance of Crown debts on a disqualification application and the phrase has tended to become something of a ritual incantation. In some earlier cases, Harman J regarded such Crown debts as 'quasi-trust moneys'. That view has not however been followed by other judges, and the official receiver does not seek to resurrect it. A different view was expressed by Hoffmann J in *Re Dawson Print Group Ltd*,[25] where he said, in a passage with which I entirely agree:

> … but the fact is that, no doubt for good reasons, the Exchequer and the Commissioners of Customs and Excise have chosen to appoint traders to be tax collectors on their behalf with the attendant risk. That risk is, to some extent, compensated by the preference which they have on insolvency. There is, as yet, no obligation on traders to keep such moneys in a separate account, as there might be if they were really trust moneys. They are simply a debt owed by the company to the revenue or the Commissioner of Customs and Excise. I cannot accept that failure to pay these debts is regarded in the commercial world generally as such a breach of commercial morality that it requires in itself a conclusion that the directors concerned are unfit to be involved in the management of the company.

The official receiver cannot, in my judgment, automatically treat non-payment of any Crown debt as evidence of unfitness of the directors. It is necessary to look more closely in each case to see what the significance, if any, of the non-payment of the Crown debt is.

Mr Cruddas made a deliberate decision to pay only those creditors who pressed for payment. The obvious

result was that the … companies traded, when in fact insolvent and known to be in difficulties, at the expense of those creditors who, like the Crown, happened not to be pressing for payment. Such conduct on the part of a director can well, in my judgment, be relied on as a ground for saying that he is unfit to be concerned in the management of a company. But what is relevant in the Crown's position is not that the debt was a debt which arose from a compulsory deduction from employees' wages or a compulsory payment of VAT, but that the Crown was not pressing for payment, and the director was taking unfair advantage of that forbearance on the part of the Crown, and, instead of providing adequate working capital, was trading at the Crown's expense while the companies were in jeopardy. It would be equally unfair to trade in that way and in such circumstances at the expense of creditors other than the Crown …

[His Lordship reviewed the various defaults which had been established against the respondent, and fixed a disqualification period of five years.]

BUTLER-SLOSS and STAUGHTON LJJ concurred.

➢ Notes

1. Applications under the CDDA 1986 are normally brought by the Secretary of State for Business, Innovation and Skills or the official receiver against individuals who are or have been **(p. 299)** company directors. The jurisdiction is broader than that, however. In *Asegaai Consultants Ltd* [2012] EWHC 1899 (Ch), a successful application was brought by the company's liquidator against his predecessor liquidator (who had never been a director of any of the companies in question) for disqualification as a director and insolvency practitioner. Newey J held that the liquidator had standing: he did not need a financial interest in a disqualification order being made, since applications are essentially for the protection of the public and not for private advantage; moreover, there was no suspicion that the liquidator had an improper ulterior motive, and the application was fully supported by the company's only legitimate creditor and the Secretary of State.

2. In the same case, Newey J also considered the appropriate way of cumulating relatively minor breaches in order to satisfy the test laid down in s 6:

> Were a serious breach of duty established, the Court could surely take other, less important breaches into account when deciding what, if any, order to make under section 4. A number of relatively minor breaches of duty could also, taken together, be thought serious enough to warrant a disqualification order [24].

Summary of the law and its application.

[6.09] Secretary of State for Trade and Industry v Swan [2005] EWHC 603 (Ch), [2005] BCC 596 (Chancery Division)

The Secretary of State applied for disqualification orders against former directors (S and N) of a parent company and certain other companies within the group. S was both the chairman and chief executive of the parent company and N was a non-executive director. The group had practised 'cheque kiting',[26] which fell within the control of the finance director. As a result of the cheque-kiting practice, an indebtedness statement sent to shareholders showed misleading figures. Other irregularities were alleged. The judge held that it was not established that S had actual knowledge of the cheque kiting, but his failure properly to inquire into the reason for the cheques (for sums completely out of line with the company's normal scale of transaction) before signing them had permitted the group's cheque-kiting policy to continue, and was a serious dereliction of his duty as a director, although only within the lowest of the three categories specified in *Re Sevenoaks Stationers (Retail) Ltd* **[6.08]**. In the circumstances, bearing in mind the purpose of the Act, and that the cheque-kiting policy had not caused any person any loss or played a role in the insolvency of the company, the appropriate period of disqualification was four years. Equally, there was no cogent evidence that N had known of the cheque-kiting policy, but he had failed