THE DUTIES OF A COMPANY DIRECTOR:

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BY

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A C K N O W L E D G E M E N T S

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Any views and mistakes expressed in this paper are, unless otherwise stated my own.

N j e r u D. A. N

TABLE OF CONTENTS

INTRODUCTION

(i) WHO IS A DIRECTOR ?

The definition section of the Companies Act does a poor job at defining who a director of a company is, if indeed the relevant provision therein may be called a definition. The section provides that a director

> "includes any person occupying the position of director by whatever name called." [1]

While it is submitted that this definition is rather wide and lacks in precision by the very nature of it's width, it operates to include any person whose work, duties and obligations to the company and shareholders is like that of a company director, notwithstanding the fact that such a name as 'Councillors' might have been used.

It is a deeply rooted fact that a company is a distinct legal entity from the members.[2] Common sense however dictates that it is an artificial person and can only act through the agency of a natural person. The distinct legal entity principle is a recent development. Until the end of the 19th century, it was assumed that the general meeting was the company, directors being no more than mere agents of the company, subject to the control of the company in general meeting. Today, this is neither the law nor the fact. The directors and members in general meeting are the primary organs of the company between whom the company's powers are divided. The proposition that it was thought directors were mere agents of the company is well illusrated by the case of ISLE OF WIGHT v TAHOURDIN[3], where it was said,

> "Directors have great powers and the court refuses to interfere with their management of the company's affairs if they keep within their powers, and if a shareholder complains of the conduct of directors... the court says to him, go to a general meeting and if they agree with you, they will pass a resolution obliging the directors to alter their course of action." [4]

This is no longer the position because the directors are the mind and will

of the company, they are the brain, and the members can not rush to a general meeting and pass a resolution "obliging directors to alter their course of action" [5]. They are not

> "servants to obey directions given by shareholders as individuals ...directors are not, I think, bound to comply with the directions even of all the corporators acting as individuals, they are not agents appointed by and bound to serve the shareholders as their principals". [6]

His Lordship then expressed his strong view to the effect that any other construction but that would be disastrous "because it would lead to an interference by a mere majority." [7]

The TAHOURDIN case is not in conflict with this view, that was the law at that time. The present law was enunciated in AUTOMATIC SELF CLEANSING FILTER SYNDICATE COMPANY v CUNNINGHAM [8]. The Company's relevant article provided that, subject to such regulations as might be made by extra-ordinary resolution, the management of the company should be vested in the directors, who might exercise all the powers of the company, which were not by the company's articles or the companies Act expressly required to be exercised by the company in general meeting. The articles empowered the directors to deal with any property of the company as they thought fit. At a general meeting, a resolution was passed by a simple majority of the shareholders for the sale of some of the company's assets, with directions to the directors to carry out the same. The directors' opinion was that the sale of those assets would be prejudicial to the company and did not follow the directions of the shareholders. The issue was whether the directors were bound to comply with the decision of the shareholders. It was held that the articles constituted a contract under which the members had agreed that the business of the company would be directed by the company and the company alone. They could not curtail the same powers they had given without alteration of tha articles of association. Their power is such that the resolutions of the general meeting does not bind them, the

general meeting is not the will and mind of the company, the directors are, and later cases have followed this trend.

In JOHN SHAW & SONS(SAFORD) LTD v PETER SHAW & JOHN SHAW,[9], the powers to manage the company's affairs was vested in the directors. As one of the incidents of management, they decided to commence an action for and on behalf of the company. The general meeting passed a resolution opposing commencement of the action. It was held the resolution by the general meeting was a nullity. Lord Justice Greer was of the opinion that

> "Certain powers may be reserved for the shareholders in general meeting. If powers of management are vested in the directors, they and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested...in the directors is by altering the articles..."[10]

The hierachy, if indeed we may call it that, seems to start from the shareholders, Board of directors and Managing directors at the top. The Board of directors is not allowed to give and take power from a managing director at their whims and fancies.

In ELLIS v BAILEY & CO. (E.A) LTD [11], the Board of directors appointed a managing director whom they later dismissed by a resolution at a meeting they had convened in the absence of that managing director. The dismissal was held to be a nullity.

It is for the purpose of never mistaking the directors' big powers that the companies Act also reinforces the part the directors play in the management of the company. Article 80 Table A provides that "The business of the company shall be managed by the directors...", and this, it is submitted, is in conformity with the law and the decided cases. The arms of the company are the directors, and it follows that a company must have directors if its affairs are to be run at all. The Act provides that

> "Every company, (other than a private Company) registered after the appointed day shall have at least two directors, and every company registered before the appointed day shall have at least one director."[12].

Apart from that one provision, the Act is curiously mute on the appointment of directors. The provvision that

> "The names of the first directors shall be determined in writing by the subscribers of the memorandum of association shall be the first directors."[13]

does not do much in the way of showing one how directors are appointed. Sometimes, such a determination is impossible. In such cases,

> "The signatories to the memorandum of association shall be the the first directors."[13]

Even though the Act is not of much help as concerns the appointment of future directors after the first ones, power to appoint subsequent directors is usually exercised by members in general meeting by ordinary resolution. Appointing them at the general meeting is "One of the rituals of the Annual meeting"[14] Each appointment of a director must be voted on individually except in the case of a Private Company or unless the meeting agrees unanimously to include two or more appointments.[15] Resolutions in contravention of this provision are void.

(ii) ELLIGIBILITY

The Act provides for who is and who is not elligible to be a company director. It provides that

> "No person shall be capable of being appointed a director of a company...if at the time of his appointment he has not attained the age twenty one or he has attained the age of seventy"[16]

This provision is obsolete and ought to be amended. The electoral laws of the land have allowed all persons of eighteen years and above to vote. The traffic Act allows any persons of eighteen years and over to hold driving licences. The provision is, it is submitted, behind times.

Section 188 operates to disqualify

> "Any person who has been declared bankrupt or insolvent by a competent court in Kenya or elsewhere and has not received his discharge"

to become a director of a company.If one has been adjudged bankrupt by such a court and contravenes the provision by taking part in the management of a company,either directly or indirectly,the Section provides that

> "He shall be liable to imprisonment for a term not exceeding two years or to a fine not exceeding ten thousand shillings or to both."

A curious decision was reached in DAWSON v AFRICAN CONSOLIDATED LAND AND TRADING COMPANY[17].An article provided that a director should vacate his office if he became bankrupt.A Mr. Thompson had been appointed director notwithstanding the fact that he was an undischarged bankrupt.It was held that this did not prevent the appointment of a bankrupt to be a director. In his judgement, Lindley M.R said,

> "It was said that the shareholders did not know that he was an undischarged bankrupt and our attention is called to a clause that a director vacates his employment if he becomes bankrupt,but that does not apply...,the shareholders(could) if they chose...appoint Mr. Thompson."[18]

It is submitted that this case was wrongly decided and a dubious authority,if an authority it could ever be.It flaunts the provisions of the Act and devies the business morality that was aimed at by Section 186,business morality which is that if a man can not take care of his own affairs,he is not competent to take care of the affairs of hundreds of men and women.Insofar as the decision contravenes the statute, it is not an authority.It would be futile to have one vacate office as a director and then appoint the same person director.

It follows from the nature of his work,as he will be called upon to keep proper books of accounts,and inter alia to exercise care and skill that insanity will operate to completely disqualify one from being a director of a company.This can hardly be called a peculiarity in company law.Insanity will disqualify whoever stands in a fiduciary relationship to another,and the principles of the law of agency will

will apply.[19]

From the discussion above,it is clear that directors are poweful and influential persons in the management of a company.They are the machinery that make the wheels of a company turn and hence the protection afforded to them both by the Common Law and statute.Their powers however, great as they are, are not absolute.It was imperative to discuss their powers before we turn to the examination of their duties as the two go hand in hand.The duties of a director to the company form the subject matter of this paper.We shall first endeavour to determine whether the Company Director is an agent or trustee,which determination will lead us to deal with his duties in accordance with the finding whether he is an agent or a trustee.

CHAAPTER ONE.

(i) AGENT OR TRUSTEE ?

We have seen that, a company, a creature of law, is an artificial person and can only act through natural persons. Such persons are directors. Of the company and directors, it has been said,

> " The company itself cannot act in its own person for it has no person, it can only act through directors, and the case is, as regards those directors merely the ordinary case of principal and agent."[1]

While his Lordship's view was that mere rules that control agent and principal would apply, it is to be observed from authorities and opinions of company law scholars, past and present, that this is not really the case. It has, for example, been felt that directors are not only agents, but they are in some sense and to some extent trustees or in the position of trustees.[2] This is in conformity with the decision reached in AUTOMATIC SELF CLEANSING FILTER SYNDICATE v CUNNINGHAM[3].

Lord Collins M.R said,

> "No doubt for some purposes directors are agents. For whom are they agents? You have no doubt, in theory and in law, one entity, the Company, which might be a principal, but you have to go behind that when you look at the particular position of directors. It is by consensus of all the individuals in the Company that directors become agents and hold their right as agents."[4]

It may be noted that it is only for some purposes that directors may be considered as agents. One consequently asks oneself, what about for all purposes? The answer is that they have been at times held to be trustees and at some other times to be agents; in fact some emminent company law writers have asserted, tentatively though, that directors are trustees and that their duties can only be explained on this basis. Professor Gower disputes this view and says that such an analogy is

is purely historical.He writes that

> "Prior to 1884,most joint stock companies were incorporated and depended for their validity on a deed of settlement vesting the property of the company in trustees."[5]

Thus in GRIMES v HARRISON[6], the directors of a building society were held liable for breach of trust while the actual trustees escaped liability only because they had acted ministerially relying on the instructions of the directors.The other reason that has tempted courts in the past to regard directors as trustees may be explained by looking at the courts of equity which have always regarded anybody standing in a fiduciary relationship to another as a trustee indiscriminately.Yet, the historical explanation has not been sufficient to deter scholars even today from regarding directors as trustees.Berle for example feels that

> "Managers today function more as princes and ministers than merchants."[7]

The same author is of the opinion that the only way by which this state of affairs could be checked is by setting down rigorous rules they would have to comply with,analogous to those of trustees.Dodd,in his article quotes a Mr. Young:

> "I conceive my trust...to be to see to it that the capital which is put into this concern is safe,"[8]

for fear that like a director,he might be tempted to use his position to exploit those whose capital has been invested in the business.[8]

It is submitted that regarding directors always as trustees of the company would be misconceived in today's commercial world.It is not denied that,

> "In the early cases, a director's role was identified with that of trustees.He was subjected to the same rigorous fiduciary discipline in order to ensure the performance of his office solely in the interest of the corporation...,the trust analogy was not a happy one."[9]

It has never been a happy one because of the obvious differences between a director and a trustee strictly so called.While they deal with the

property of the company or the assets of the same, the Trustee analogy is not far fetched.It is when we turn to the duties of care and skill that the analogy breaks down completely.Broadly speaking, the duties of a trustee of a will or marriage settlement is to be cautious and to avoid any possible risks to the trust fund or property.The director of a company,unlike a trustee, carries on a speculative business in an attempt to earn the company more profits.Furthermore,a trustee is the legal owner of the trust property.In a company , the property belongs to the company and to the company alone.The writer does in no way deny that directors are in some cases, as elaborated above,trustees.But when he is entering into contracts for the company,which we think constitutes a considerable bulk of his duties,he is just an agent for his company, the principal.

In RE CITY EQUITABLE FIRE INSURANCE COMPANY[10], Romer J, at page 426 said,

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

A long line of cases however shows that directors have at times been regarded as trustees and sometimes as agents.As indicated earlier on, modern scholars, for example Berle and Dodd feel that a revival of the trustee analogy would be beneficial to the company.Our intetion at this juncture is to examine when directors may be regarded as trut trustees and when they may be regarded as agents,although on the other hand it has been asserted that directors are in no sense trustees.[11]

When directors have been held to be agents of the company,it is the case more often than not that it is the company as a distinct legal entity that institutes the proceedings and not the shareholders, treating the directors as trustees of the property they have entrusted

in their hands. Lord Selbourne's words in in C.E RAIL Co. v TURNER[12] are notably clear in this respect, and reveal a two-fold character of directors.

> "The directors are the mere trustees or agents of the company ; trustees of the company's money and property, agents in the transactions which they enter into on behalf of the company."

Thus it is the function they perform at a given time that determines whether they are agents or trustees, but any time they deal with the assets of the company which have come into their hands or which are under their control, they are trustees, and any time they enter into transactions on behalf of the company they are agents.

The scope of the paper does not allow us to examine the role of a director as a trustee of a marriage settlement or will, but rather as a trustee of a company's property which puts him in a fiduciary position as a trustee properly so called.

(ii) FIDUCIARY DUTIES.

The word 'fiduciary' has its roots in the latin word 'fiducia', whose translation is trust, 'fides' means faith and 'fideles' means faithful. It is from these latin words the phrase "fiduciary duties" comes from. Whenever fiduciary duties are established, good faith will be in issue.

The fiduciary duties of a director to the company are identical to those of any other fiduciary. The bulk of such duties are extensively elaborated in works of trusts and agency.[13]

For the authority of directors to bind the company, they must act collectively as a board, but the duties of good faith are owed by each individual director, and not by the board collectively. It has long been decided that it is not to the shareholders that the duty is owed but to the company and company alone. In the case of PERCIVAL v WRIGHT[14]

it was held that directors could purchase shares or make any negotiations for the sale of shares or company's assets without first disclosing it to the shareholders.To that extent only, it may be said,subject to their rights (which are not the topic under discussion) the shareholders may be exploited by the Board of directors at Board Meetings through resolutions. This is because, as explained elsewhere in this paper,it is what the directors think are the best interests of the company and not what the court may think were the best interests of the company. I do not feel ready to easily believe that it would not be easy for a bunch of directors to convince the court that what they did was, in their opinions ,in the best interests of the company,hence their totally disregarding the shareholders and consequently,a possibility of their being exploited.

In the introduction to the paper,an attempt was made to indicate that directors are powerful officers of the company,but we have just indicated that as far as fiduciary duties are concerned,just like trustees,the duties are strict. They must at all times act honestly and use reasonable diligence in the discharge of the duties of their office;but

> "Good faith,like fraud refers to the posture of a party engaged in the process of bargaining...,it signifies the truthfulness."[15]

But it has been held that courts will ordinarily be satisfied if it is shown that the directors have behaved like honest businessmen would in similar circumstances.An honest business judgement will not be reviewed. It has been said that :

> "In most cases,compliance with this rule is tested on common sense principles,the court asking itself whether it is proved that the directors have not done what they honestly believed to be right and normally accepting that they have,unless satisfied that they have not behaved as honest men of business might be expected to act."[16]

Whether or not the director has exhibited good faith will therefore depend on the circumstances of each particular case.[17]

(iii)DUTY TO ACT BONA FIDE IN THE INTEREST OF THE COMPANY

Under the present sub-heading,specific problems do arise,and in

in particular,the meaning of 'the interests of the Company.' We shall turn at a later stage to an attempted clarification of the phrase.At this juncture,all we need assert is that the director must exhibit good faith any time he is performing duties that relate to the company.The burden of proving mala fides lies on the proponent. The dictum in RE SMITH FAWCETT LTD[18] by Lord Greer at page 309 clarifies the proposition .His Lordship said that no ground had been shown for saying that the non-compliance by the directors was due to anything else but the interests of the company.It was the duty of those who thought that the directors had acted in bad faith to show it.

If to be a director one has to have a share qualification,the law realistically allows one to take one's own interests into consideration.In such a case,the court only asks itself what motivated the directors to enter into a particular transaction. .If it is shown that

> "The true effect of the whole evidence is that the (directors) truly and reasonably believed at the time that what they did was for the interests of the company,they are not chargeable with dolus malus or breach of trust merely because in promoting the interests of the company they were also promoting their own."[18]

This formulation also presents difficulties because there is no guide as to the extent to which directors may consider their own interests,or even the extent to which he may allow the interests of another company to which he is director influence him.More telling however, is the realisation that, the orthodox test more or less breaks down completely in relation to guarantee companies which are formed for some charitable purpose and not for the interests of the members.Yet courts will insist that whatever is done must be for the interest of the company.Unsatisfactory as it is,nothing positive has been done to make the rule more realistic .

It is also evident that there is the need for courts to make this clear especially in a country like Kenya where the interests of the workers is said to be paramount to other national considerations.It is submitted that for such a change,the whole economic sructure would have to be changed,because our mode of production is capitalistic and the decisions of the courts have invariably been in favour of others other than the workers strictly so called.So while we feel that there is need for some changes,we feel as well that the present economic structure is not conducive to such changes.

(iii)MEANING OF "INTERESTS OF THE COMPANY"

A director is expected to act reasonably in his own judgement and not the court's judgement. "Interests of the company" would therfore seem to be objectively determinable. In a case that never reached the courts[18] an attempt was made to define the phrase. The inspector for the Board of Trade believed it meant that directors must act in the interests of the

> "Shareholders present and future, balancing a long term view against the short-term view of the present members."[19]

When directors are members by virtue of their having shares, their acting in the company's interests does not, preclude a consideration of their own interests .It is a trite observation that there are two elements that appertain to the rule.The one is objective and the other is subjective,objective because it is the interests of the company that will be considered and subjective because they, (the directors) must act bona fide.Our concern here is only with the objective element.That is actually the interests of the shareholders that ought to be paramount is borne out by the Savoy Hotel Controversy and the case of GREENHALGH v ARDENE CINEMAS[20],where the company as a whole was said not to be a purely commercial entity distinct from

its members.It has sometimes been felt that even the members ought to be included in the definition of the company as a whole,but the curt "Such is not the law"[21] by Plowman C.J discourages further discussion.

As argued elsewhere in this paper,the present writer is of the view that the interests of the members of the company ought to be considered.If that is not the law,as indeed it is not,a country that is developing like Kenya ought to consider the changing of the law so as to cater for those interests of the members.There does not seem to be any hope of changing the law in the near future because our mode of production is,as indicated earlier on, purely capitalistic,and those who are in a position to initiate such changes are more often than not,the ones who would not want such changes because they want to protect both themselves and their property.

(v) PROPER PURPOSE

Directors can only exercise the powers for the purposes the same were given.If they exceeded those powers,their acts would be ultra vires and those acts would not bind the company.What they do must at least have been contemplated by the articles.Apart from exceeding their powers,some acts by them may be declared void because of some illegality or because the act itself is contrary to public policy.In PHARMACEUTICAL SOCIETY OF GREAT BRITAIN v v DICKSON & ANOTHER[22], a Society was formed for the purpose of safeguarding and promoting the interests of the members in their exercise of the proffession of pharmacy.The society purported to pass a resolution by a mere majority that new pharmacies would have to be situated in physically distinct premises.On its being challenged

the court held that it was null and void as it amounted to a restraint in trade..

What the court looks at is whether or not the articles contemplated the acts complained of , the legality of the acts in relation to public policy, and the honesty of the directors in the perfomance of the acts. This will determine whether or not the directors used their powers for a proper purpose.It is not far-fetched to say that this principle of proper purpose is also vague and it is upon courts to come out with a more concrete formulation.Much more so is the fact that it is even more uncertain in a country like Kenya.

It is manifestly clear throughout this part of the discussion that the fiduciary duties of directors revolve around the concept of good faith.

CHAPTER TWO

DUTIES OF CARE AND SKILL.

(i)COMMON LAW RULE

It has been stated by Baran P.A that the goals of modern large scale business are high managerial incomes,good profits,a strong competitive position and growth.[1]

> "The big corporation is like the proffessional gambler,who takes care that the odds are in his favour...,it approaches a new development with care and circumspection and does not make a final commitment until the relevant investigations have been carried out."[2]

The company can not,as indicated earlier on,act for itself since it is an artificial entity ,and consequently it is the directors who are,as it were,the gamblers,who approach business with care and circumspection.

It has been stated generally that a director has a common law duty to exercise reasonable skill and diligence in the discharge of his duties,and this is in conformity with the foregoing quotation.Except for the reasonable man's test,[3]courts have been lax to formulate a rule of universal application in this respect. All that is asserted is that the duty is relative and will depend on each particular transaction entered into by a particular director.The laxity has led courts to some obviously inappropriate decisions.

In RE BRAZZILIAN RUBBER PLANTATIONS [4] ,a company had five directors.One of them was absolutely ignorant of business,the second one was seventy five years old and was des cribed as "very deaf".The other three were fairly able businessmen.Acting on false information which they did not even try to verify,they entered into a contract to purchase some rubber plantations.They had been cheated as to the acreage of the plantations and the buildings on the plantations.They were held not to be liable.

The decision is not a good one because the losses that the company incurred could have been evaded if the directors had tried to verify the information that led them to enter into the contract. They were judged on their ignorance which led them to enter into the contract,hence our assertion that this position of affairs could lead into some not very pleasing decisions.In giving judgement, the court stressed that directors would be judged on their knowledge and experience.

In this respect,the most authoritative and pursuading case is RE CITY EQUITABLE FIRE INSURANCE COMPANY.[5] Investigations into a company's affairs in the course of winding up disclosed a shortage in the funds.The shortage was due to the fraud of the managing director for which he was convicted and sentenced.The liquidator sought to make the other directors, all of whom had acted honestly throughout, liable in negligence.This was because if the other directors had inquired into the items that had facilitated the fraud,they would have discovered it quite early.They were held not liable because of a clause absolving the directors from all liability except for wilful default.

This decision does not seem to be in total conformity with the RE BRAZIL CASE, discussed above. From the set of facts, it is hard to get convinced that with similar facts to-day the court would reach the same decision.This is so because of the provisions of The Companies Act,which provides that

> "Any provision whether contained in the articles or in any contact with a company or otherwise,for exempting an officer of the company or any person employed by the company...indemnifying him against any liability which ...would otherwise attach to him in respect of any negligence,default,breach of duty or breach of trust of which he may be guilty in relation tothe company shall be void.[6]

It is submitted that this provision is subject to the provisions

of the same Act which empower a court to absolve such officers under certain circumstances. Such are the provisions of S.402 (1) which are that

> "If in any proceedings for negligence, default, breach of duty or breach of trust against an officer of a company or a person employed by a company as auditor (whether he is o or not an officer of the company) it appears to the court hearing the case that that officer or person is or may be liable in respect of the negligence, default, breach of duty or breach of trust, but that he has acted honestly and reasonably, and that, having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for the negligence, default, breach of duty or breach of trust, that court may relieve him, either wholly or partly, from his liability on such terms as the court may think fit."

This provision then is the only one that could save a director from liability in a situation where there has been a breach. Our opinion is that the court would hasten more to absolve him from liability than find him liable.

In the RE CITY EQUITABLE case, the judgement of Romer J. formulated what standards of care would be expected of a director. He need not exhibit a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. The test to be applied is therefore, as indicated earlier on, both objective and subjective. It would then be absurd and indeed fallacious to expect, for example, a director of an insurance company to exhibit the skill of a doctor. A director is not expected to be a specialist or an expert in the strict sense of the word, unless he has been appointed in view of his specialist qualifications. An ordinary managing director's duties will therefore more often than not be radically different from those of an expert director.

We have deliberately condensed his Lordship's three propositions. From the foregoing, it is clearly conceived that it would be quite futile to formulate a rule that would adequately cover all situations where directors might seem to have breached.

It has sometimes been felt that this rule is not really apt. If for example, a Board of directors was composed of elderly and eccentric gentlemen, who, through their own lack of care lead the company into liquidation, it is appalling that they will escape liability just because by their standards, the act or omission was reasonable. It is accepted that if the misfortune arises out of a director having delegated his functions to an officer he had no reason to suspect of inefficiency, he is absolved from liability. In SHONOWO v ADEBAYO[7], it was said,

> "A director of a company is not expected to fill all the positions of the company...he is entitled to rely on the judgement of responsible assistants"

Yet the maxim "delegatus non potest delegare" applies to them.[8] Since it is settled that a director may entrust some other officer with his work, it can only be concluded that it is the articles that give him that authority to delegate, since the Act is silent on that particular issue. Prima facie, a director is not supposed to delegate.

Secondly, it has been felt that the common law ought to recognise the office of a director as a professional one requiring particular skills and abilities. It has been suggested for instance that there ought to be provisions covering the director's duty of care designed to allow courts to develop standards based on an objective yardstick because

> "As the business world comes to expect higher standards, the law should develop in step. What has handicapped legal development so far has been the failure of the courts to recognise that directing is becoming a proffession with developing standards of expertise."[9]

The common law position may be explained by examining the facts of business life. Some companies do not show any division between management and ownership as is the case in large corporations. In

small companies,directors are in practice more or less partners in the loose sense of the word.It is not realistic to speak of an implied warranty of fitness or skill when referring to such directors because their abilities and shortcomings will often have been known to their associates from the inception of the business. The public at large is not owed any warranty of fitness of directors either.If the public at large wanted to know the duties of directors of a certain company,then the law provides that the public is supposed to have constructive notice of a company's public documents. Such documents can be perused at the Companies registry in Kenya on payment of two shillings and fifty cents at the registrar's office.

The one question that gives some unease is why the duties of care have not been made more stringent than they are .The answer lies in the fact that the care required of a director is commensurate with his responsibility and renumeration.Ofcourse this lack of stringency does not dispense with the duty to give reasonable attention to the affairs of the company.

(ii)UNDER STATUTE.

The Act makes no mention of the standard of skill required of a director in the discharge of his duties.This is left to the courts to determine.The duty of care falling under statute will be more restricted than that demanded under the common law.This is because precision in the standard is not possible due to the rule's obvious subjectivity.We tentatively suggest that the rule could hardly be expected to be above that formulated in the RE CITY FIRE INSURANCE case .If a director relies on advice of a company's official,as indicated elsewhere,he will be fully absolved from liability.[10]At page 486 of the case cited above,Halsbury L.C said:

> "Mr.Corey was deceived by his own officers,...the business of life could not go on if people could not trust those who are put in a position of trust."

The statement is clearly compatible with what was ruled in the ADEBAYO case.

An examination of the cases discussed under the two heads shows some inconsistency where allegations of lack of care have been made against directors. It has for example been observed that the RE BRAZZILIAN case lays down the proposition that if a director is ignorant he is to be judged by that ignorance and not any other standards.

We submit that if there is an area in company law that lacks precision and definite formulation , that area falls under the duties of care of a director of ac company. We may perhaps console ourselves with the fact that some other areas of company law, as yet untouched are not that unclear.

CHAPTER THREE

CONFLICT OF DUTY AND INTEREST

The law of trusts forbids the trustee to act in any way that might bring about a conflict between his duty and his interest. A director is, as we have seen, a trustee for so long as he deals with the company's property or assets, and he is therefore also precluded from any undertaking that might have his duty and his interest conflicting. The Companies Act requires a director to disclose any interest he might have in any contract with a company or firm with which the company of which he is a director is contracting. If a future contract is contemplated, then he is supposed to disclose at the earliest possible moment.[1] He is not even supposed to take part in voting for a contract in which he has an interest.[2]

The Cohen Committee of England was for the relaxation of the rule, but this was subsequently rejected. It is therefore an inflexible rule and it has been observed that

> "A director of a company is precluded from dealing, on behalf of the companywith himself, and from entering into engagements in which he has a personal interest conflicting, or which may possibly conflict with the interests of those whom he is bound by fiduciary duty to protect."[3]

It is to be observed that a conflict of duty and interest in fact is not the test to be applied. If a director simply placed himself in a position that may potentially generate a conflict between duty and interest, he would be held liable. He ought not to place himself in the path of temptation. Furthermore, a director may not use his position so as to make some personal gain without both the assent and knowledge of the company.

(i) SECRET PROFITS MADE WITHOUT RATIFICATION BY MEMBERS: THE REGAL HASTINGS DECISION.

Any kind of secret benefit obtained by a director by virtue of his position renders him accountable to the company for the value of that benefit. The only way by which he may evade liability

is either by disclosure or ratification by the general meeting.If in dealing with a certain company A, it is discovered that a director made some secret profits,he will be liable to account for those profits.If it transpires at the time of discovery of those secret profits that he had also as a matter of fact made other such profits, not in company A, but also in company B,he will be liable for those other profits as well.[4] It then follows that before and after the discovery of the breach, the secret profit he got by virtue of his employment is accountable to the company.

The rule being strict, a director is expected to disgorge any benefits.If it appears likely that by having that secret profit the company might have benefitted,such a likelihood is disregarded. The rationale for this was stated in BRAY v FORD[5]. Lord Herschell said;

> "Human nature being what it is,there is a danger of a person being swayed by interest rather than duty.It has therefore been deemed expedient to lay down this positive rule."[6]

The rule is;

> "An inflexible rule and must be applied inexorably by this court which is not entitled,in my judgement,to receive evidence or suggestion or argument as to whether(the company) did not suffer."[7]

A director is totally forbidden to place hiself,not just where there is a conflict,he is forbidden to place himself in a position where a conflict between his duty and interest might occur. Jones[8] makes it clear that whether or not the company could and actually did benefit from the director's act should not be and is never a point in issue.The director's saving clause in the rule is that ratification by members in general meeting indemnifies him.

The leading case in this branch of directors' duties is REGAL (HASTINGS) LTD v GULLIVER[9],whose facts were as follows:- A private company wished to expand its cinema business by acquiring two other theatres for the purpose of eventually selling all the three as a going concern.The owners insisted on a personal guarantee

from the directors unless the paid up capital in the newly formed subsidiary was above a certain amount.The company was unable to meet this demand and the directors did not want to give a personal guarantee,so a new course of action was devised.The company took up 40% and the directors took up 60% of the paid up capital of the new subsidiary.The directors controlled the majority of the shares in the company, but either ignored or neglected to ratify the arrangement at a general meeting.All the shares of the company and its subsidiary were at a later date sold at a profit.The new controllers caused the company to sue the old directors for the profits made on the sale of the shares in the subsidiary.It was never in dispute that the directors had not acted in good faith.It was never alleged that they had appropriated an opportunity which the company might have taken for its own advantage.Holding the directors liable, the court said that they occupied a fiduciary position to the appellant company and were liable to repay to it the profits they had made on the sale of the shares.

> "Their liability in this respect does not depend upon a breach of duty but upon the proposition that a director must not make a profit out of property acquired by reson of his relationship to the company to which he is director,... What the directors did was so related to the affairs of the company...that what they did resulted in a profit to themselves."[10]

The only observation that might be made here is that,just as the no-conflict rule has established,ratification absolves a director from liability.The construction of the articles may also operate to absolve the director from liability,in other words the construction of the articles might be such that a contemplated action against the directors is legitimised.Disclosure and ratification will however be ineffectual if the directors did not act in good faith.

The rule has been applied by East African courts.In OVERSEAS FINANCE CORPORATION LTD v CHAPMAN[11], the court was at pains to explain that the doctrine was in no way confined to express

trustees.Any one in a fiduciary relationship would be subject to it.

Due to its rigidity,the rule has not found favour with everybody.The dissenting judgement of Lord Upjohn in PHIBBS v BOARDMAN is a point in issue,where he felt that the rule might be departed from in many cases, unless there was a real sensible possibility of conflict. Otherwise, its relaxation is pessimistically not foreseeable in the near future. If the rule was made less strict, then a director who had acted in good faith and thereby not occassioning any loss to the company would escape liability, and that seems to me to be a better position.

(ii)CONTRACTS WITH THE COMPANY.

The common law rule is that all contracts made between a company and one of its directors is voidable at the instance of the company.The question of the fairness of the contract is irrelevant. The rationale for this strictness is that the company has the right to undivided loyalty from the directors and the opinion of each one of them.

It may be observed that even if an interested director does not vote at a meeting where the contract is discussed it goes without saying that those other directors who could have ties of friendship with the interested director would vote in his favour. This would defeat the purpose of the rule.

(iii) STATUTORY REQUIREMENTS.

The Companies Act provides that:

> "it shall be the duty of a director of a company ... interested in a contract or proposed contract with the company to declare the nature of his interest at a meeting of the directors of the company."[13]

Where it is a proposed contract, declaration ought to be made when the issue first comes before the board.[14] S. 200 ss.3, relaxes the rule because ,

> "a generall notice given to the board of directors by a director to the effect that he is a member of a specified company" with which they contemplated a contract "shall be deemed to be sufficient notice."

Under this section, a direct or an indirect possibility of a conflict ought to be disclosed at the earliest possible moment.Failure by a director to disclose renders him liable to a fine not exceeding 2,000/-.

If a company's articles take the form of Table A, then under article 84 clause 2,a director interested in a contract is prohibited from voting at the meeting of the Board at which the contract will be discussed,but as we have indicated elsewhere, this is a provision that is likely to be evaded easily.

CHAPTER FOUR

(i) BREACH & LIABILITY.

An assertion that ought to have gained notoriety by now is that a company can only act through natural persons. Companies enter into contracts in the ordinary way through the agency of their directors. The rules that pertain to principal and agent likewise pertain to them, for so long as they act on behalf of the company. They are therefore not personally liable for contracts purporting to bind a company. The rule has been stated thus:

> "Whenever an agent is liable, those directors would be liable ; where the liability would attach to the principal and the principal only, the liability is the liability of the company."[1]

Like an agent, a director will be personally liable if he fails to disclose that he acts on behalf of his principal the company, or if he enters into a contract, discloses that he acts on behalf of the company but does not have authority. If he does the latter, then he will be liable for all the damages necessarily ocassioned to the other party as a result of reliance on the contract and the implied warranty of authority. If from all the material facts it seems that the person or persons with whom the directors entered into contract ought to have known of the lack of authority, then no action can be maintained against the directors. The measure of damages in an action for the breach of warranty of authority is the actual loss sustained either as a natural and probable consequence of reliance on the contract, or such as both parties ought to have reasonably expected to be the probable consequence of the breach of warranty. The case of ELLIOT v BAX IRONSIDE[2], illustrates the working of the rule.

If a director ought to have suspected an officer of the company of fraud, his failure to investigate into it may amount to connivance in the fraud and dishonesty will be imputed to him. He is further

liable if, because of some fact he ought to have known but did not, loss is occassioned to the company.This is because the trust analogy is again stretched so as to cover such situations, but a director is not under duty to read all the documents of the company. It therefore follows that if he did not know of the fact that occassioned loss, constructive notice will not be imputed to him, and the fraud of his co-directors when he did not know of such a fact does not affect him, as no man is bound to presume a fraud.However, if a director knows of a breach of a co-director, he must take active steps to protect the company's interests.

Other aspects of breaches have been touched at in various parts of this paper,and we deem it unnecessary to repeat them at this stage. All that may be said is that the breaches and liabilities that will attach to a director are similar to those that would attach to agents and trustees.It has been indicated when a director may be a 'trustee' and when he may be an 'agent'.

CHAPTER FIVE

C O N C L U S I O N.

This paper has attempted to touch on the duties of a director of a company, but even after going through it, one is certainly left dissatisfied by a number of things. One can not say that one knows even who a director of a company is. Maurer H.[1] says that a director is just any man called so, and we do not feel equal to attempting a better or even a more appropriate definition. The companies Act has failed to clearly define a director, and we feel that an attempt should be made to amend S. 2 so that speculation among scholars as to who a director is might stop among ~~scholars~~ them. The Act should have made an attempt also to give some guide as to the duties of a director, the excuse given for that is that:

> "Hitherto, most Acts based on the English model have not attempted a codification of these duties, and... their ambit has to be culled from a mass of judge-made law"[2]

but it is submitted that this is not a sufficient excuse for not amending our laws to suit our needs.

Our country has its own needs and needs some positive steps to ensure that the workers of this country are protected from any frustrations. Most of the provisions of the companies Act are essentially from the English Act and do not take into consideration our [illegible] country's needs. If for instance we took the common law duties strictly, there is a possibility that the Africanisation policy of the government would be frustrated because as indicated, we lack managerial talent.

The minimum age of appointment as provided for in the Act is also behind times. The statute imposes the age of twenty one, and that age limit is obsolete and should be changed so that it may be in conformity with at least tha Age of Majority Act.

The last point I feel compelled to touch on is the number of multiple directorships that is every day escalating in this

country .Understandably,this is one of the facets of the so called free-enterprise,or what socialists would call freedom to exploit. A few examples will illustrate.

Trade Winds Limited was incorporated on 24th August 1974.A Mr.Eliud Ndirangu,who at that time had 12 other directorships, was directo Newark Limited was incorporated sometime in 1974.The company has 2 directors and one of them has 28 other directorships.Even more significant is the fact that Karuna Business Agencies Limited,a Private Company has a managing director,one Udi Mareka Gecaga, who had at that time, a total of 49 other directorships.He had 43 directorships in Kenya,3 in Tanzania,2 in Uganda and 1 in the United Kingdom.That was in 1971 and we may reasonably assume that by now those directorships have been increased.Escapists from reality have shown neither concern nor have they found it necessary to come up with any honest explanation as to why this should be so,feeling that:

> "The mere total number of directorships should not be given undue significance."[3]

But this is a reflection of the economic beliefs we cherish.It is not in conformity with the promises of Session paper No. 10 (1965),and it defeats the equality promised in our constitution.The equality so promised becomes meaningless because there possibly can not be equality among Kenyan peoples if economic equality is lacking,and also if others are not given a chance to attain what others in higher economic brackets have.

From the Companies Registry,it is evident that most of the most promising businesses are controlled,not by Africans,but by foreigners,thus rendering the Africanisation policy nearly a mockery.[4] Steps ought to be taken at government levels to ensure the realisation of some of these pre-independence beliefs.

We conclude by asserting that the present role of directors in our countryis nothing but a perpetration of a capitalist and a neo-colonial economy.

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2. Baran P.A ;Monopoly Capital 1st Ed.

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6. Palmer; Palmer's Company Law; (1959) 21st. Ed.

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1. Berle; "For whom are corporate managers trustees?" 45 Harv.L.Rev. 1365.

2. Christian Council of Kenya; "Who controls Industry in Kenya?"

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4. Jones; " Unjust enrichment and the fiduciary duty of loyalty."

FOOTNOTES

1. S.2 C.A

2. SALOMON v SALOMON & CO. LTD (1897) A.C 22.

3. (1883) 25 Ch.D 320.

4. Per Lord Justice Cotton at 330.

5. Supra

6. Per Lord Justice Farwell at 319.

7. At 319,320.

8. (1906) A.C 442.

9. (1935) 2 K.B 113.

10. At 134.

11. (1962) E.A 626.

12. S.177 C.A.

13. Art. 75 Table A.

14. Christian Council of Kenya, "Who controls Industry in Kenya?"

15. S.184 C.A

16. S. 186 C.A

17. (1898) 1 Ch. 6.

18. At 11 and 12.

19. YONGE v TOYNBEE (1910) 1 K.B 215.

FOOTNOTES TO CHAPTER ONE

1.Per Lord Justice Cairns in FERGUSON v WILSON (1886) L.R 2 Ch. at page 89.

2.Palmer,Palmer's Company Law,21st Ed. at pages 524 and 525.

3.(1906) 2 Ch. 34.

4.At pp. 42 and 43.

5.L.C.B Gower,Principles of Modern Company Law,3rd Ed. at page 515.

6.(1859) 26 Beav. 435.

7.BERLE, "For whom Corporate managers are trustees",45 Harv.L.Rev 1365 (1932).He says that in support of Dodd who has in the same volume written,"For Whom are corporate managers trustees?" at page 1145.

8.At page 1154.Mr.Young is reported to have practised law for a long time before becoming a businessman.

9.NOTES, 61 Harv. L. Rev. at page 335.

10.(1925)Ch. 407.

11.Per Justice Vaughan Williams in RE KINGSTON COTTON MILL (1896) 1Ch. 331 at page 345.

12.(1872) 8 Ch.app 149 at page 152.

13."Corporate fiduciary doctrine,"Vol. 74 Yale Law Journal at 342.

14.(1902)2 Ch. 421.

15.SEALEY, "The director as a Trustee," 1967 C.L.J at 87.

16.(1942)Ch. 304. Re Smith & Fawcett Ltd

17.Per Earl of Selbourne inHIRSCHE v SIMMS (1894) A.C 654 at 660

18.Supra.Savoy Hotel Controversy.

19.Supra.

20.(1946) I All E.R 512.

21.PARKE v DAILY NEWS (1962) Ch.927 at 962-963

22.(1968) 3 WLR 286.

FOOTNOTES TO CHAPTER TWO

1.Baran P.A; Monopoly Capital at page 37.

2.Baran P.A ,, ,, ,, ,, 59

3.Palmer,Palmer's Company Law;LAGUNAS NITRATE Co. v LAGUNA'S NITRATE (1899) 2Ch. 392 at page435.

4.(1911) ICh. 425.

5.(1925) ICh. 407.

6.S. 206 C.A

7.(1969) 2 A.L.R Comm. 419.

8.Palmer;Palmer's Company Law at page 523.

9.L.C.B Gower;Final report of the commission of enquiry into the working and administration of the present Company Law of Ghana; Comment No.6 of S.203 page 146.

10.DOVEY v COREY(1901) A.C 477.

FOOTNOTES TO CHAPTER THREE

1.S. 200 ss. 1 & 2 C.A; Art 84 Table A.

2.Art. 84 Table A (2).

3.Judgement of Sir R.Baggalay in N.W TRANSPORTATION Co. v BEATY 12 App. Cas 589, Quoted by Mr. Justice Astbury in TRANSVAAL LANDS Co. v NEW BELGIUM LAND & DEVELOPMENT Co.(1914) 2 Ch.488 at 495.

4.As was the position in BOSTON DEEP SEA FISHING&ICE Co.v ANSELL (1888) 39 Ch. D 339.

5.(1896) A.C 44.

6.At pages 51 & 52.

7.James L.J in PARKER vMCKENNA (1874) L.R 10 Ch.96 at 124 & 125.

8.Jones, Unjust enrichment and the fiduciary's duty of loyalty 84 L.Q.R 472.

9.(1942) 1 All E.R 378.

10.Per Lords Wright & Macmillan at pp.395 & 391 respectively.

11.(1942) 9 E.A.C.A.I

12.(1966) 3 W.L.R. I009.

13.S. 200 ss 1.

14.ss.2 of S. 200.

FOOTNOTES TO CHAPTER FOUR

1.Per Lord Cairns in FERGUSON v WILSON(1886) L.R 2 Ch.App 77 at 89.

2.(1925) 2 K.B 301.

3. Introduction.

Footnotes to the Conclusion

1. Great Enterprise; Directors at work at 195.

2. L.C.B Gower; Final Report of the Commission of enquiry into the working and administration of the present Company law of Ghana, page 145, comment No. 1.

3. All the data was obtained from the companies registry in Nairobi with the permission of the Assistant Registrar of companies. The statement is from "Who controls industry in Kenya ?" at page 144.

4. Block Hotels Limited is in point.